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1 Consumer Credit Law Manual Foreword

Foreword

Foreword

This volume is the collaborative effort of a number of National Consumer Law Center staff attorneys and consumer law experts around the country. Deanne Loonin, Elizabeth Ryan, and Bruce Plenk are principally responsible for writing this volume. Elizabeth Renuart, Robert Hobbs, Willard Ogburn, Katherine Fitzgerald, Margot Saunders, Rita Pereira, and Jonathan Sheldon all assisted. We also want to thank Elinor Reinhardt for her editing.

All of these individuals are also indebted to the much larger number of contributors to other NCLC publications upon which this volume is based. While these individuals are too many to list here, we wish to acknowledge all those who participated in the following NCLC manuals: Fair Debt Collection, Truth in Lending, Unfair and Deceptive Acts and Practices, Fair Credit Reporting Act, Repossessions and Foreclosures, Cost of Credit, Student Loan Law, Credit Discrimination, and Access to Utility Service.

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Consumer Credit Law Manual

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What's New

1 Consumer Credit Law Manual Scope

Scope

HIGHLIGHTS

Release 12 November 2010

Highlights

This release of *Consumer Credit Law Manual* contains updates and revisions to Chapters 1, 2, 3, 4, 5, 6, 8, 9, 10, 12, 13, 15, and 16 to provide the current status of consumer credit law, including recent developments in case and statutory law.

The new 2010 edition of the *Consumer Credit Law Manual Primary Source Pamphlet* includes up-to-date changes to statutes and regulations.

Chapter 1--Truth in Lending. The Truth in Lending Act seeks to guarantee the accurate and meaningful disclosure of the costs of consumer credit. Regulation Z, promulgated by the Federal Reserve Board, implements the TILA. TILA covers "open-end" credit, such as that employed with most credit cards, and "closed-end" end credit, fixed-term credit transactions, such as most mortgages.

For closed-end transactions, the "annual percentage rate" must be disclosed. The coverage of APR disclosure in § 1.05[e][iii] has been expanded to include discussion of variable rate transactions.

New § 1.05[h] covers special disclosures for student loans. Lenders making private student loans are now required to provide special disclosures. There are three sets of required disclosures: (1) application and solicitation; (2) loan approval; and (3) final disclosures. Each is subject to special timing rules and detailed form and content requirements. All disclosures must be made clearly and conspicuously.

Open-end credit regulations are discussed in *§ 1.07*. The coverage notes that the Credit Card Accountability, Responsibility and Disclosure (CARD) Act added a number of substantive protections and new disclosure requirements concerning open-end credit, and that the Board must now revise Regulation Z due to the Credit CARD Act.

Regulation Z sets forth all the items concerning credit costs and terms required to be disclosed in credit and charge card applications and solicitations. The discussion in *§ 1.07[2]*, pertaining to disclosure requirements in credit and charge card applications and solicitations, has been expanded to note that now certain additional disclosures will required to be made in a tabular format. The disclosures required to be made in tabular format will include credit and charge card applications and solicitations, account-opening disclosures, and notice of penalty rate imposition.

Chapter 2--High Rate Home Equity Loan Protections. Chapter 2 has been updated to provide the current status of the law. New case citations include: *Laudani v. Tribeca Lending Corp. (In re Laudani), 401 B.R. 9, 32-33 (Bankr. D. Mass. 2009)* .

Chapter 3--The Consumer Leasing Act and Automobile Leases. Chapter 3 has been updated to provide the current status of the law. New case citations include: *In re Northwest Airlines Corp., 393 B.R. 352 (Bankr. S.D.N.Y. 2008)* ; *Hart v. Autowest Dodge, 147 Cal. App. 4th 1258 (2007)* .

Chapter 4--Unfair and Deceptive Credit Practices. All fifty states have enacted at least one statute with broad applicability to most consumer transactions aimed at preventing consumer deception and abuse in the marketplace. Many of these statutes are patterned after the language found in the Federal Trade Commission Act, which prohibits "unfair or deceptive acts or practices." State UDAP statutes can be used to challenge abusive credit practices. Challenges can also be raised under RICO. Several new case citations have been provided. Of particular note, the United States Supreme Court, in *Boyle v. United States, 129 S. Ct. 2237 (2009)* , loosened the definition of what constitutes an association-in-fact enterprise for purposes of establishing a RICO claim. Under Boyle, an association-in-fact enterprise must have three structural features: (1) a purpose; (2) relationships among those associated with the enterprise; and (3) longevity sufficient to permit these associates to pursue the enterprise's purposes.

Chapter 5--Credit Discrimination. Chapter 5 has been updated to provide the current status of the law. New case citations include: *Robinson v. Schafer, 2008 U.S. Dist. LEXIS 36900* (M.D. Ga. May 6, 2008) ; *Chiang v. Schafer, 2008 U.S. Dist. LEXIS 64654* (D. V.I. Aug. 20, 2008) .

Chapter 6--The Cost of Credit. The oldest of the statutes that limit the cost of credit are so-called "general" usury statutes, which purport to set the maximum rate of interest that can be charged in any "loan" transaction in a given jurisdiction. Numerous federal statutes and regulations preempt state usury laws with respect to some lenders, transactions, and practices that might otherwise lead to illegal overcharges. New § 6.02[13] notes that Congress recently enacted the Military Lending Act. The Act imposes a 36% interest rate cap, bans mandatory arbitration, and imposes other restrictions on consumer credit. This is the first time that Congress has re-imposed a usury cap for certain types of credit since legislation responding to the Great Depression.

A distinct form of overcharge often occurs when credit is retired early by prepayment of the debt. Since the amount of interest due is in part a function of the time the credit is outstanding, shortening the time should reduce the amount of interest the borrower pays. But sometimes the creditor imposes hidden charges. Almost all state consumer credit statutes require the rebate of unearned interest and insurance charges. Section 6.03[1] newly notes that even in the absence of a specific statute or contract provision requiring a rebate, a court may impose such a requirement based on an equitable principle that unearned interest must be deducted upon acceleration and payment of a debt prior to maturity, and lists relevant state statutes.

The Real Estate Settlement Procedures Act (RESPA) seeks to protect consumers from unnecessarily high settlement charges and certain abusive practices that have developed in the residential real estate industry. Section 6.09[1][a] has been updated to note that HUD has released amendments to Regulation X, most of which are effective January 1, 2010. The amendments significantly alter RESPA disclosure requirements. The new rules, among other things, standardize the good faith estimates, limit increases on most fees, unless circumstances change, and revamp settlement statements.

Chapter 8--Fair Debt Collection. The Fair Debt Collection Practices Act restricts debt collectors' collection efforts and choice of venue. It establishes general standards of proscribed conduct, defines and restricts abusive collection acts, and provides specific rights for consumers. Section 8.02[1][f][vi], covering attorneys' ethical duties regarding the FDCPA, has been expanded to include discussion of ABA Model Code of Professional Responsibility DR 7-104(A)(2), which permits a lawyer to advise a self-represented person adverse to the lawyer's client to seek his or her own counsel and to make certain other related statements.

The FDCPA generally prohibits a collector from communicating with any person other than the consumer in connection with the collection of any debt. Section 8.03[2][e][ii], covers situation s in which debt collectors leave voicemail messages for consumers. The leading case on this issue, *Foti v. NCO Fin. Sys., Inc., 424 F. Supp. 2d 643 (S.D.N.Y. 2006)* , held that a debt collector must leave the section 1692e(11) disclosure in a voicemail that the caller is a debt collector, a statement that may not be made to third parties under section 1692c(b), thus prohibiting a debt collector from leaving messages with most third parties.

The FDCPA prohibits a collector from actually or implicitly impersonating an attorney. Section 8.03[4][g] discusses *Rosenau v. Unifund Corp., 539 F.3d 218 (3d Cir. 2008)* , in which the Third Circuit found an FDCPA deception violation where a collection letter indicated it was from the debt buyer's "Legal Department," and the unit sending the letter was not supervised or staffed by any lawyers.

The FDCPA gives consumers the right to obtain verification of a debt from the collector. The discussion in *§ 8.03[6][c][ii]* has been expanded, noting that FTC staff has generally refused requests to provide a definitive position on what information is sufficient to verify a debt under *15 U.S.C. § 1692g*. The section also notes that when the amount of the debt is disputed, the collector must verify the amount, and also that charging a fee for verification violates the FDCPA.

Section 8.05[7], which reviews certain possible barriers to FDCPA suits, has added discussion of *Kelley v. Med-1 Solutions, L.L.C., 548 F.3d 600 (7th Cir. 2008)* . In that case, The Seventh Circuit upheld a Rooker-Feldman defense in a post-Exxon case arising out of attorney fees awarded in connection with medical debt collections actions in small claims court. The Seventh Circuit found that certain of the plaintiff's claims were not independent of the state court judgment for the attorney fees.

Chapter 12--Student Loans and Trade School Abuses. One of the most common forms of consumer loans are student loans, and student loan collections raise numerous special issues. Federal law provides collectors and student loan debtors with many special rights and responsibilities.

The Department of Education issued proposed regulations in August 2009 to implement new Pell Grant program provisions. Under the proposed regulations students will be eligible for a second scheduled award if the student has earned in an award year at least the credit or clock hours of the first academic year of the student's eligible program and if the student is enrolled as at least a half-time student in a program leading to a bachelor's or associate degree or other recognized educational credential. A review of the proposed amendments has been added to the discussion of Pell grants in §12.02[7].

The discussion of wage garnishment in § 12.04[b] has been expanded to note that accounts should not be submitted to garnishment while a borrower is still negotiating repayment, and to review certain aspects of the rehabilitation regulations, which require that borrowers make voluntary reasonable and affordable payments.

New § 12.05[1][c] has been added to cover new in-school deferment provisions for parent PLUS borrowers created in the 2008 Higher Education Opportunity Act.

Unlike federal loans, there is no federal law requiring private student loan creditors or servicers to offer deferments or forbearances. New § 12.05[2][b] has been added to cover private loan deferments and forbearances.

Chapter 13--Foreclosure Defense. Foreclosure procedures are wholly determined by state law, the details of which vary from state to state.

A growing number of states and localities are implementing foreclosure mediation programs to help homeowners avoid foreclosure. The mortgage industry is increasingly willing to modify loans, but, because servicers are insufficiently staffed, mediation is sometimes the only chance a homeowner has for serious negotiation over modifying a loan. State and local mediation programs vary widely in design. New § 13.03[6][d][iii] reviews loan modification and mediation.

New § 13.03[6][d][xi] has been added to cover negotiating an affordable and sustainable loan modification. It includes an analysis of the net present value test. Once the terms of a proposed modification are established, the net present value of the money the investor would receive under the proposed modification is compared to what would be received if no modification were made. If the servicer can expect a greater return from modifying the mortgage, then the servicer should modify and not foreclose on the mortgage.

Several states have enacted legislation that requires mortgage holders to provide identifying information about themselves and their interest in the property when they foreclose. The disclosure requirements can serve as a basis for ascertaining claims related to the standing and real-party-in-interest status of the foreclosing party. A discussion appears in new § 13.04[2][a][v].

Chapter 16--Fair Credit Reporting. The Fair Credit Reporting Act regulates the activities of credit reporting agencies, users of credit reports, and those who furnish information about consumers to reporting agencies. The FCRA is intended to protect consumers from invasion of privacy and the dissemination of false, outdated, or misleading information by placing various obligations on persons who use or disseminate credit information about consumers. Consumer reporting agencies must adopt reasonable procedures to ensure that the information they disseminate is accurate and up-to-date and that it is furnished only to users with certain permissible purposes.

The FCRA establishes minimum standards of accuracy for creditors and other furnishers initially providing information about consumers to consumer reporting agencies. New § 16.05[2][c][i] covers furnisher accuracy and integrity guidelines. The guidelines apply to the accuracy and integrity of information furnishers are to provide to consumer reporting agencies; related regulations require furnishers to establish reasonable policies and procedures for implementing those guidelines. While having a set of policies and procedures is mandatory, compliance with all of the guidelines is not.

A furnisher's policies and procedures regarding accuracy and integrity must be in writing. The regulation requires the policies and procedures to be appropriate to the business's nature and size. Furnishers are required to periodically review and update their policies and procedures for accuracy and integrity as necessary to ensure their continued effectiveness.

2010 Consumer Credit Law Manual Primary Source Pamphlet. The updated and revised 2010 edition of the Primary Source Pamphlet includes up-to-date revisions to consumer credit regulations and statutes. Affected material includes changes to Regulation Z and the Consumer Credit Protection Act.

Index. The index has been comprehensively revised with this release.

Table of Cases. The Table of Cases has been comprehensively revised with this release.

Table of Statutes. The Table of Statutes has been comprehensively revised with this release.

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PART I Consumer Credit
CHAPTER 1 Truth in Lending

1-1 Consumer Credit Law Manual § 1.01

§ 1.01 Introduction

The Truth in Lending Act ("TILA") n1 is a cornerstone of consumer credit legislation. The statute is Congress' effort to guarantee the accurate and meaningful disclosure of the costs of consumer credit and thereby to enable consumers to make informed choices in the credit marketplace. n2

TILA is both consumer protection legislation, recognizing "the right to be informed--to be protected against fraudulent, deceitful, or grossly misleading information, advertising, labeling, or other practices, and to be given the facts he needs to make an informed choice," n3 and legislation designed to protect the "ethical and efficient lender or credit extender," thus "invigorat[ing]" competition. n4

The TILA is codified at *15 U.S.C. section 1601 et seq.* It is technically Title I of the Consumer Credit Protection Act. The TILA is divided into five "parts" (if you are reading the U.S. Code) or "chapters" (if you are reading the pamphlet published by the Federal Reserve Board ("FRB")). n5 Part A n6 contains general definitions, including the method for calculating the finance charge and annual percentage rate. It also outlines the administrative enforcement of the Act, and provides criminal sanctions for willful violations.

The second part n7 of TILA distinguishes "open-end" credit, such as that employed with most credit cards, from closed-end, fixed-term credit transactions, such as most mortgages or automobile loans, and describes the particular disclosures required for each. The chapter also defines the consumer's right of rescission in transactions involving the grant of a security interest in the consumer's home, and provides for the civil liability of creditors who fail to comply with the Act's disclosure provisions. In addition, by amendment, this chapter includes special protections for consumers in high cost mortgages and creates disclosure rules for reverse mortgages, and provides certain lenders with immunity from liability for some violations of the Act.

Together, Parts A and B contain the heart of the TILA. They govern what a consumer must be told when entering a credit transaction. The remaining three TILA chapters deal with separate, although related and important, credit issues. Part C n8 addresses the advertising of credit terms. It forbids the practice of bait-and-switch advertising of credit terms (offering credit terms which are, in fact, not available) and forces a more complete disclosure of credit terms than an advertiser might otherwise give.

TILA Part D, n9 the Fair Credit Billing Act ("FCBA"), which was enacted in 1974 and took effect in 1975, outlines a resolution procedure for credit card billing disputes. Among other provisions, the chapter requires creditors to inform consumers of the dispute procedures when an account is opened, compels creditors to investigate and respond to a consumer's complaints within a set time, and forbids the collection of finance charges on incorrectly billed amounts.

Finally, TILA Part E is the Consumer Leasing Act of 1976, n10 discussed separately in Chapter 3 of this volume, and governing advertising and disclosures for those consumer personal property leases whose terms exceed four months. Because of the four month limitation, the Consumer Leasing Act does not apply to many consumer transactions. The Leasing Act is administered separately through the FRB's Regulation M.

The TILA now also contains several provisions unrelated to disclosures, but which give consumers important substantive rights. The Housing and Community Development Act of 1992 n11 included a provision which outlaws the use of the Rule of 78 in any precomputed consumer credit transaction with a term longer than 61 months signed after September 30, 1993. This provision is now housed in the TILA, having been codified as *15 U.S.C. section 1615*. n12 Similarly, certain substantive terms are prohibited in high cost mortgages. These are codified at *15 U.S.C. section 1639(c)-(j)* and discussed separately in Chapter 2 of this volume.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. §§ 1601 et seq*. The Truth in Lending Act [hereinafter TILA] is reprinted in Vol. 1A *infra*.

(n2)Footnote 2. *See, e.g., Williams v. Chartwell Fin. Servs., Ltd., 204 F.3d 748, 751 (7th Cir. 2000)* ("Congress enacted TILA to ensure that consumers receive accurate information from creditors in a precise and uniform manner that allows them to compare the cost of credit."); *Landreneau v. Fleet Fin. Group, 197 F. Supp. 2d 551 (M.D. La. 2002)* (TILA enacted to promote informed borrowing by requiring disclosures, to protect consumers from hidden and unreasonable charges, and to allow comparison of credit terms). *See, e.g., Frazier v. Washington Mutual, 2006 U.S. Dist. LEXIS 35767* (W.D. Tenn. June 1, 2006) (TIL's meaningful disclosures intended to promote informed use of credit); *Betancourt v. Countrywide Home Loans, 344 F. Supp. 2d 1253 (D. Colo. 2004)* .

(n3)Footnote 3. 109 Cong. Rec. 2029 (1963) (remarks of Sen. Douglas).

(n4)Footnote 4. 109 Cong. Rec. 2029 (1963) (remarks of Sen. Douglas).

(n5)Footnote 5. Note that the sections are numbered differently, too.

(n6)Footnote 6. *15 U.S.C. §§ 1601-1615*.

(n7)Footnote 7. *15 U.S.C. §§ 1631-1648*.

(n8)Footnote 8. *15 U.S.C. §§ 1661-1665b*.

(n9)Footnote 9. *15 U.S.C. §§ 1666-1666j*. The Fair Credit Billing Act is reprinted in Vol. 1A *infra*.

(n10)Footnote 10. *15 U.S.C. §§ 1667-1667e*. The Consumer Leasing Act and Regulation M are reprinted in Vol. 1A *infra*.

(n11)Footnote 11. Pub. L. No. 102-550 § 933, *106 Stat. 3891* (Oct. 28, 1992).

(n12)Footnote 12. For an explanation of the Rule of 78, see *§ 6.03[4][b][i][B] infra*.

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 1 Truth in Lending

1-1 Consumer Credit Law Manual § 1.02

§ 1.02 Sources of Law in Truth in Lending Cases

One of the complications of handling Truth in Lending ("TIL") issues is the number of sources of law. The basic source of TIL law is, of course, the statute itself. n1 As a practical matter, however, the statute will seldom provide quick answers to every day TIL questions. The most important function of the statutory text for the consumer advocate is that it serves as a check on the regulations. n2

The Federal Reserve Board, the agency with broad authority for implementation of TILA, has promulgated a comprehensive set of TIL rules known as Regulation Z. n3 Regulation Z is generally a more thorough statement of TIL law than the statute and reference to it is inescapable in almost any TILA case.

Prior to Simplification, there were several authoritative interpretations of Regulation Z. n4 As part of Simplification, all existing interpretations of Regulation Z were replaced by the Official Staff Commentary on the Regulation. n5 It tracks Regulation Z clause by clause, clarifying the intent of the Regulation, giving examples of its proper application, and, at times, inventing rules where none otherwise exist. When assessing any transaction for compliance with any Regulation Z provision, the corollary Commentary provision should also be reviewed. n6

The importance of case law to TIL is similar to its importance in other fields of law--the courts are the final arbiter of the interpretation of either the TILA or its associated regulations. n7 One difficulty is determining the value of the numerous pre-Simplification cases n8 under the current law. There is no one answer to this problem because the amendment of the TILA and Regulation Z was not uniform. On topics where the underlying statutory and regulatory provisions are substantially the same in current law as they were prior to Simplification, the old cases should still be authoritative.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. §§ 1601 et seq.*

(n2)Footnote 2. Note that for loans made prior to 1982, the pre-Simplification law will generally apply. Simplification refers to the complete revision of TILA begun by Congress in 1978. The revisions were part of the Depository Institutions Deregulation and Monetary Control Act of 1980 which included the Truth in Lending [hereinafter TIL] Simplification and Reform Act at Title V of DIDMCA, *codified at 15 U.S.C. §§ 1601 et seq*. Because there are relatively few loans still outstanding from the pre-Simplification era, that law is increasingly less relevant.

(n3)Footnote 3. Regulation Z is reprinted in Vol. 1A *infra*.

(n4)Footnote 4. *See* note 2 *supra*.

(n5)Footnote 5. The Federal Reserve Board Official Staff Commentary on Regulation Z is reprinted in Vol. 1A *infra*, and in National Consumer Law Center, Truth in Lending, App. C (6th ed. 2007).

(n6)Footnote 6. The Supreme Court has ruled that the Commentary is entitled to a high degree of deference. *See Ford Motor Credit Co. v. Milhollin, 444 U.S. 555, 100 S. Ct. 790, 63 L. Ed. 2d 22 (1980)* .

(n7)Footnote 7. State courts are "bound by the authoritative holdings of federal courts on federal questions when there is no conflict." *See, e.g., Kocsis v. Pierce, 480 N.W.2d 598 (Mich. Ct. App. 1991)* .

(n8)Footnote 8. For a compilation of pre-Simplification cases, see National Consumer Law Center, Truth in Lending Case Summaries (1977, 1980, and 1983).

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PART I Consumer Credit
CHAPTER 1 Truth in Lending

1-1 Consumer Credit Law Manual § 1.03

§ 1.03 Scope of TILA

[1] Definitions of "Credit" and "Creditor."

[a] Definition of "Consumer Credit."

TILA applies to most *consumer credit* transactions. The first condition for TIL coverage, therefore, is that the transaction fall within the TIL definition of "credit." Credit is defined in the Act as the right granted by a creditor to defer payment of debt or to incur debt and defer its payment. n1 The Commentary elucidates this definition, offering a list of transactions not considered "credit." n2

The list includes:

- *Layaway plans,* unless the consumer is contractually obligated to continue making payments. n3
- *Tax liens and tax assessments*. n4
- *Court judgments* n5 *and reaffirmations of debts in bankruptcy*. n6
- *Home improvement progress payment transactions*. n7

It is not always clear when a transaction meets the TILA definition of "credit" and some creditors may try to disguise transactions to avoid TIL coverage. For example, the "cash price" of a product may be hiked, so that a seller can postulate that there is no finance charge. n8 However, in TIL cases, as is true with consumer protection laws generally, courts look to the true nature of the transaction to determine coverage. n9 Therefore, it is important to look for disguised credit transactions that should be subject to TIL.

Secondly, the credit transaction must be "consumer" credit as defined in the Act. Consumer is defined as a "natural person" and, generally, the "consumer" must be the one to whom the credit is extended. n10 Certain non-obligors, though, may have the right to receive TIL disclosures and be entitled to exercise TIL rescission rights in transactions subject to the rescission right. n11 Accommodation parties, while not generally considered consumers, may have some TIL rights in limited circumstances. n12

Generally, except in the context of credit cards, guarantors, endorsers, and sureties, as opposed to cosigners, are not considered "consumers." n13 A fair amount of litigation under Article 3 of the Uniform Commercial Code ("UCC") is devoted to drawing this very distinction, and, for the most part, those cases should be relevant. n14 In the credit card context, coverage of accommodation parties is considerably broader. The definition of "cardholder," which is a subcategory of "consumer," includes any natural person "who has agreed with the card issuer to pay consumer credit obligations arising from the issuance of a credit card to another natural person." n15 A person who is an authorized user without being obligated on the card is not included in the definition, however. n16

Finally, in order to fall within the scope of TILA, the consumer credit must be primarily for personal, family, or household purposes. Litigation on whether a particular transaction meets this requirement is often concerned with the meaning of "primarily." n17

As noted in the Commentary, there is no precise test for determining what constitutes the primary purpose of a credit transaction. n18 The Commentary only points for guidance to its discussion of business purposes. n19

The Commentary gives two simple examples to illustrate the "primary" purposes rule. A business account used occasionally for consumer purposes would be business-purpose credit, n20 while a personal account used occasionally for business purposes would be consumer-purpose credit. There is little doubt that "primary" is not synonymous with "exclusive." n21 At the very least, "primarily" must refer to the use of more than half the proceeds of the transaction. n22

[b] Definition of "Creditor."

The next crucial issue in determining the scope of TILA is the definition of "creditor." For most TIL transactions, n23 a creditor is defined as a person:

> "Who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments (not including a down payment); and
>
> "To whom the obligation is initially payable, either on the fact of the note or contract, or by agreement when there is no note or contract." n24 Both of these prongs of the definition must be met. n25

To meet the test of "regularly" established by Regulation Z, n26 a person must have extended consumer credit more than 25 times in the preceding calendar year. n27 The numerical standard is lower for real-estate secured loans. A person also regularly extends consumer credit if the person extended credit more than five times in the preceding calendar year if each of those transactions was secured by a dwelling. n28 In high cost mortgage transactions, subject to the Home Ownership and Equity Protection Act of 1994 ("HOEP"), the numerical standard is lower still, as is discussed in Chapter 2 of this volume.

The next element of the definition of creditor mandates that the credit which the person extends meet either one of two alternative tests. n29 The credit must be either:

a) Subject to a finance charge, n30 *or*

b) Payable by written agreement in more than four installments. n31

While the vast majority of consumer credit transactions will meet both tests, satisfaction of only one test is sufficient for a person to be considered a creditor. n32

In addition, the obligation must be initially payable, either on the face of the note or contract, or by agreement when there is no note or contract, to the person in order for that person to be considered a creditor. n33 The person to whom the obligation is initially payable is the creditor and even if simultaneously assigned, the person to whom it is assigned is only the assignee. n34 In a section titled "Notice of New Creditor," Congress imposed in 2009 a requirement on assignees to provide notice to homeowners of the transfer of ownership of mortgage loans. n34.1 The new statutory language refers to "the *creditor* that is the new owner or assignee of the debt," clearly evincing a congressional intent to treat assignees as creditors, in at least some limited circumstances. Congress drove this point home by adding the new section to the list of violations in *15 U.S.C. § 1640(a)* for which statutory damages are generally available. n34.2

In addition, persons who merely "arrange" for the extension of credit may no longer be considered creditors. n35 The definition of creditor under the HOEP is broader. n36

[2] Exempt Transactions

The TILA exempts several classes of transactions from its scope, including, but not limited to, credit primarily for business and agricultural purposes, n37 credit to organizations, n38 some credit transactions over $25,000, n39 student loans, n40 public utility credit, n41 and securities or commodities accounts. n42

TIL also includes a mechanism by which a state can request that the FRB exempt any class of credit transactions from TIL's requirements. n43 In 1982, the FRB granted exemptions to the same five states that had been granted exemptions prior to Simplification. n44 None of the state exemptions extends to the civil liability provisions of the TILA. n45 This assures that consumers in exempted states may continue to bring TIL damage actions based on the equivalent state disclosure requirements n46 in either state or federal court, while creditors retain the statutory defenses in the Federal TILA. n47

With respect to preemption, generally, the Federal Act does not affect any state credit disclosure law unless the state law is inconsistent with the federal law, and then only to the extent of the inconsistency. n48

Legal Topics:

For related research and practice materials, see the following legal topics:
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FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1602(e)*; Reg. Z § 226.2(a)(14).

(n2)Footnote 2. Official Staff Commentary § 226.2(a)(14)-1. (Some of these examples include transactions which some courts had held to be credit under pre-Simplification TIL. The Commentary weighed in against these cases, though the statute's definition of credit did not change.)

(n3)Footnote 3. Official Staff Commentary § 226.2(a)(14)-1.

(n4)Footnote 4. Official Staff Commentary § 226.2(a)(14)-1.

(n5)Footnote 5. *Bonfiglio v. Nugent, 986 F.2d 1391 (11th Cir. 1993)* .

(n6)Footnote 6. Official Staff Commentary § 226.2(a)(14)-1.

(n7)Footnote 7. Official Staff Commentary § 226.2(a)(14)-1.

(n8)Footnote 8. Note, though, that if the price is repayable by written agreement in 4 or more installments, it is

subject to TIL irrespective of whether there is a finance charge involved.

(n9)Footnote 9. *Adams v. Plaza Fin. Co., 168 F.3d 932 (7th Cir. 1999)* ; *Edwards v. Your Credit, 148 F.3d 427 (5th Cir. 1998)* ; *Williams v. Chartwell Fin. Servs., Ltd., 204 F.3d 748 (7th Cir. 2000)* . *See generally* National Consumer Law Center, Truth in Lending § 2.5 (6th ed. 2007 and Supp.), for further discussion of disguised credit and credit sales.

(n10)Footnote 10. *Cf. Dorothy Edwards Realtors, Inc. v. McAdams, 525 N.E.2d 1248 (Ind. Ct. App. 1988)* (where bank permitted its borrowers to sell mortgaged property to third party "subject to its encumbrance," and the third party did not become personally liable on the original debt, bank had no duty to give TIL disclosures to third parties). A separate section of TILA, § 1603(a), specifically exempts credit granted to "organizations" from the statute's coverage. *Prifti v. PNC Bank, 2001 U.S. Dist. LEXIS 16387* (E.D. Pa. Oct. 9, 2001) (corporations and organizations cannot be considered consumers regardless of the purposes for which credit was used); *Community Nat'l Bank v. Nemo Dev. Inc., 124 P.3d 521 (Kan. Ct. App. 2005)* (unpublished, not precedential) (TILA does not cover a loan to a corporation).

(n11)Footnote 11. *See § 1.08[3][a] infra.*

(n12)Footnote 12. An "accommodation party" is defined as "one who signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument." *U.C.C. § 3-419(a)* (as revised in 1990). Reg. Z §§ 226.2(a)(11), 226.23(a)(1), (b), 226.17(d); *Soto v. PNC Bank (In re Soto), 221 B.R. 343 (Bankr. E.D. Pa. 1998) . But see Citifinancial, Inc. v. Blosser, 2001 Ohio App. LEXIS 2645* (Ohio Ct. App. June 15, 2001) (if security interest for loan in individual's principal dwelling does not affect individual's ownership interest, then he or she is not entitled to TILA disclosures, right to rescind or to seek damages).

(n13)Footnote 13. Official Staff Commentary § 226.2(a)(11)-1; *Aurora Firefighter's Credit Union v. Harvey, 516 N.E.2d 1028 (Ill. App. Ct. 1987)* .

(n14)Footnote 14. *See, e.g., Aurora Firefighter's Credit Union v. Harvey, 516 N.E.2d 1028 (Ill. App. Ct. 1987)* .

(n15)Footnote 15. *15 U.S.C. § 1602(m)*; Reg. Z § 226.2(a)(8). Note that if there is more than one consumer, disclosures must be made to a consumer who is primarily liable on the account. Reg. Z § 226.5(d).

(n16)Footnote 16. Official Staff Commentary § 226.2(a)(8)-1.

(n17)Footnote 17. *See, e.g., Semar v. Platte Valley Fed. Sav. & Loan Ass'n, 791 F.2d 699 (9th Cir. 1986)* (loan "primarily" for personal purpose if primary purpose is to pay off a second trust deed loan on consumer's home and only 10% of proceeds used for business purposes); *Tower v. Moss, 625 F.2d 1161 (5th Cir. 1980)* (home improvement transaction primarily for consumer purpose although home had been leased for nominal rent).

(n18)Footnote 18. Official Staff Commentary § 226.2(a)(12).

(n19)Footnote 19. Business purpose is discussed in the Official Staff Commentary at § 226.3(a).

(n20)Footnote 20. Official Staff Commentary § 226.3(a)-2.

(n21)Footnote 21. *See, e.g., Palmer v. Statewide Group, 134 F.3d 378 (9th Cir. 1998) , reported in full, 1998 U.S. App. LEXIS 1497* (9th Cir. Feb. 2, 1998) (consumers' use of their home for child care business did not make loan a business loan).

(n22)Footnote 22. *Semar v. Platte Valley Fed. Sav. & Loan Ass'n, 791 F.2d 699 (9th Cir. 1986)* .

(n23)Footnote 23. See Reg. Z § 226.2(a)(17)(ii), (iii) and (iv) for other definitions of creditor for the purposes of discounts, returns, credit card issuers, etc.

(n24)Footnote 24. Reg. Z § 226.2(a)(17)(i). *See also 15 U.S.C. § 1602(f)*; *Moore v. Flagstar Bank, 6 F. Supp. 2d 496 (E.D. Va. 1997)* (broker, though a lender too, at times, was not the entity to which the obligation was initially payable and, therefore, not a "creditor"); *Johnson v. Thomas, 794 N.E.2d 919 (Ill. App. Ct. 2003)* (defendant held to be an assignee, not a creditor, where retail installment contract identified home improvement contractor as the creditor even though contract simultaneously assigned itself to defendant and defendant had informed plaintiff that he was the "partner" of the creditor).

(n25)Footnote 25. *Parker v. Potter, 232 Fed. Appx. 861 (11th Cir. 2007)* (unpublished).

(n26)Footnote 26. Reg. Z § 226.2(a)(17) n.3.

(n27)Footnote 27. Every closed-end credit transaction and every open-end credit outstanding account is counted towards the numerical standards. Official Staff Commentary § 226.2(a)(17)(i)-4. In *Armstrong v. Kittinger, 1994 Ohio App. LEXIS 4465* (Ohio Ct. App. Sept. 21, 1994) , however, the court sidestepped the fact that no evidence was presented as to how many cars the creditor had sold in the year in question (the creditor having testified that he only sold "six or eight"); instead, it let a damage award stand since it was unclear what portion, if any, the jury had allocated to TILA violations. One issue for TILA coverage may be whether a series of transactions constitutes a single open-end account or a series of closed-end credit extensions. *See, e.g., Sticka v. Geller (In re Stratton), 299 B.R. 616 (Bankr. D. Or. 2003)* (promissory note for $20,000 that could be adjusted to cover additional amounts of indebtedness created an open-end credit account; hence, attorney was not creditor because he only extended one open-end credit account, not several closed-end loans).

(n28)Footnote 28. Reg. Z § 226.17(a) n.3. (Note, too, that the broad definition of dwelling, Reg. Z § 226.2(a)(19), includes mobile homes, trailers, condominiums, and cooperatives, as well as traditional houses.) *See, e.g., Redic v. Gary H. Watts Realty Co., 762 F.2d 1181 (4th Cir. 1985)* (consumer only introduced direct evidence that 4 of 12 similar sale/leaseback transactions were disguised loans; defendant presented evidence from remaining homeowner-"grantors" that their transactions were genuine sales, thus numerical threshold to make defendant a creditor not met), *cert. denied, 474 U.S. 920, 106 S. Ct. 249, 88 L. Ed. 2d 257 (1985)* , *modified on other grounds, 862 F.2d 314 (1988)* ; *Clay v. Johnson, 22 F. Supp. 2d 832 (N.D. Ill. 1998)* , *rev'd on other grounds*, *264 F.3d 744 (7th Cir. 2001)* ; *Levites v. Chipman, 30 Mass. App. Ct. 356, 568 N.E.2d 639* , *review denied*, *410 Mass. 1102, 573 N.E.2d 984 (1991)* . *Cf. Garofalo v. Boyer, 2001 Conn. Super. LEXIS 932* (Jan. 24, 2001) (defendant who made only two real estate-secured loans in previous year, and no others in year of this transaction, was not a creditor); *Peterson v. Rothweiler (In re Peterson), 270 B.R. 719 (B.A.P. 8th Cir. 2001)* (borrower established that lender made six real estate-secured loans in current calendar year, but failed to established that properties were "dwellings"); *Thanhauser v. Nemickas, 2001 Conn. Super. LEXIS 3370* (Conn. Super. Ct. Nov. 29, 2001) (dismissing borrowers' TILA claim because they did not allege sufficient facts to establish that mortgage lender extended dwelling-secured credit more than five times in preceding year); *McDonnell v. Von Feldt, 231 Wis. 2d 239, 604 N.W.2d 305 (Ct. App. 1999)* , *review denied*, *233 Wis. 2d 85, 609 N.W.2d 474 (2000)* (borrower identified seven real estate-secured loan transactions, but lender was able to rebut by establishing that two loans were business purpose credit, for one loan he was not originating lender, and two other loans were actually made in different calendar year).

(n29)Footnote 29. *15 U.S.C. § 1602(f)(1)*; Reg. Z § 226.2(a)(17)(i)(A).

(n30)Footnote 30. Official Staff Commentary § 226.2(a)(17)(i)-1; *see § 1.04 infra*.

(n31)Footnote 31. Reg. Z § 226.2(a)(17)(i)(A). *See also 15 U.S.C. § 1602(f)(1)*.

(n32)Footnote 32. *Ferrari v. Howard, 2002 Ohio 3539, 2002 Ohio App. LEXIS 3632* (Ct. App. July 11, 2002) . Note that card issuers may be creditors even without a finance charge or written 4-installment obligations. *15 U.S.C. § 1602(f)*; Reg. Z § 226.2(a)(17)(ii), (iii).

(n33)Footnote 33. *15 U.S.C. § 1602(f)(2)*; Reg. Z § 226.2(a)(17)(i)(B); Official Staff Commentary §

226.2(a)(17)(i)-1. Note that open-end credit card issuers and those who honor credit cards may be creditors for some purposes even without meeting this requirement. *15 U.S.C. § 1602(f)*; Reg. Z § 226.2(a)(17)(ii), (iii). *See Flynn v. People's Mortgage, Inc., 1998 U.S. Dist. LEXIS 18891* (N.D. Ill. Nov. 18, 1998) (mortgage broker was not creditor where credit was not initially payable to broker); *Barlow v. Evans, 992 F. Supp. 1299 (M.D. Ala. 1997)* (agents of pawn shop, who were its President and Secretary, were not creditors where transaction was conducted in shop's name); *Moore v. Flagstar Bank, 6 F. Supp. 2d 496 (E.D. Va. 1997)* (entity whose role was merely the provision of form documents was not a creditor); *Fabricant v. Sears Roebuck & Co., 1999 U.S. Dist. LEXIS 16574* (S.D. Fla. Sept. 30, 1999) (insurance company not creditor; dismissed from suit challenging retailer's inclusion of credit insurance in contracts); *Aiello v. First Alliance Mortgage Co. (In re First Alliance Mortgage Co.), 47 C.B.C.2d 1043, 280 B.R. 246 (Bankr. C.D. Cal. 2002)* (founder and CEO of mortgage company was not creditor, because debt was not payable to him); *Garrett v. Fleet Fin. Inc., 252 Ga. App. 47, 556 S.E.2d 140 (2001)* (closing attorney for mortgage company was not creditor); *Jefferson v. Briner Inc., 2006 U.S. Dist. LEXIS 41423* (E.D. Va. June 21, 2006) (broker is not a creditor); *Porter v. NationsCredit Consumer Discount Co., 2006 U.S. Dist. LEXIS 14925* (E.D. Pa. Mar. 31, 2006) (corporations that were related to the lender were not creditors when the obligation was not payable to them), *reconsideration granted in part, denied in part on other grounds, 2006 U.S. Dist. LEXIS 41947* (E.D. Pa. Jun 22, 2006) ; *Craven v. Litton Loan Servicing, L.P., 2005 U.S. Dist. LEXIS 44546* (W.D. Mich. Sept. 23, 2005) (servicer not creditor because obligation not originally payable to it, but it may be liable as an assignee).

(n34)Footnote 34. Official Staff Commentary § 226.2(a)(17)(i)-2; *Riviere v. Banner Chevrolet, Inc., 184 F.3d 457 (5th Cir. 1999)* (decision after rehearing); *Mayfield v. General Elec. Capital Corp., 1999 U.S. Dist. LEXIS 4048* (S.D.N.Y. Mar. 31, 1999) ; *Noel v. Fleet Fin., Inc., 971 F. Supp. 1102 (E.D. Mich. 1997)* (applying statutory definition to find that two middle-men were creditors where obligations were made initially payable to them, but denying coverage as to one middle-man who acted as broker).

(n35)Footnote 34.1. *15 U.S.C. § 1641(g).*

(n36)Footnote 34.2. *See generally § 1.10[3][a], infra* (discussing availability of statutory damages).

(n37)Footnote 35. Pub. L. No. 97-320, Title VII, § 702(a) (Oct. 15, 1982), *as amended by* Pub. L. No. 97-457 (Jan. 13, 1983).

(n38)Footnote 36. *See § 2.02[3] infra. See Hruby v. Larsen, 2005 U.S. Dist. LEXIS 42285* (D. Minn. June 30, 2005) (lender was liable as creditor under special HOEPA definition where high rate--and disguised--loan involved mortgage broker).

(n39)Footnote 37. *15 U.S.C. § 1603(1)*; Reg. Z § 226.3(a)(1). *But see Citibank (South Dakota), N.A. v. Mincks, 135 S.W.3d 545 (Mo. App. Ct. 2004)* (cardholder entitled to assert TIL protections for a business transaction made using a personal consumer credit card account.) Official Staff Commentary § 226.3(a)-2.

(n40)Footnote 38. *15 U.S.C. § 1603(1)*; Reg. Z § 226.3(a)(2). *See Chase Agri-Credit System v. Jack Spears Drilling Co., 2003 U.S. Dist. LEXIS 21694* (N.D. Tex. Dec. 3, 2003) (when purpose of a loan is to benefit a corporation, the fact the loan is guaranteed by individuals does not alter its business purpose), *aff'd 102 Fed. Appx. 884 (5th Cir. 2004)* .

(n41)Footnote 39. The exception to this exemption includes any extension of credit secured either by real property or by personal property used or expected to be used as the consumer's principal dwelling. Reg. Z § 226.3(b). *See In re Costa, 2008 Bankr. LEXIS 1224* (Bankr. D. Mass. Apr. 22, 2008) (personal loan of $165,000 not covered by TILA, or by Massachusetts disclosure law).

(n42)Footnote 40. Until Oct. 15, 1982, the TILA applied to all student loans; since then, certain types of student loans are exempt, but the exemption is not universal and some student loans remain subject to the Act's requirements. Several courts have questioned whether programs which require service obligations in exchange for tuition assistance

create credit obligations at all. *See, e.g., United States v. Hugelmeyer, 774 F. Supp. 559, 562 n.3 (D. Ariz. 1991)* ; *United States v. Citrin, 972 F.2d 1044 (9th Cir. 1992)* . Advocates representing clients with student loan problems should be aware that they present a wide array of legal (and practical) issues that are discussed in depth in National Consumer Law Center, Student Loan Law (2d ed. 2002).

(n43)Footnote 41. Public utilities have a limited exemption from the application of TIL. *15 U.S.C. § 1603(4)*; Reg. Z § 226.3(c). During the past decade, however, about half the states have deregulated one or more utilities industries to varying degrees. Depending on what is deregulated and how it is done, deregulation could mean that a utility no longer qualifies for this exemption from TIL. *See* National Consumer Law Center, Access to Utility Service §§ 1.2, 1.4 (2d ed. 2001 and Supp.). The Federal Communications Commission [hereinafter FCC] has "detariffed" long-distance telephone service, which means long-distance carriers no longer file their rates with the FCC; thus, credit extended for long-distance service may no longer be subject to the TILA exemption. National Consumer Law Center, Access to Utility Service § 2.8.2 (2003 Supp.).

(n44)Footnote 42. *15 U.S.C. § 1603*; Reg. Z § 226.3.

(n45)Footnote 43. *15 U.S.C. §§ 1633* (Part A), 1666j(b) (Part D); Reg. Z § 226.29.

(n46)Footnote 44. Maine (Parts B, D, and E of the federal TIL statute); Connecticut (Parts B and D); Massachusetts (Parts B and D); Oklahoma (Parts D and E); and Wyoming (Part B). *See* Official Staff Commentary § 226.29(a)-4.

(n47)Footnote 45. Reg. Z § 226.29(b)(1).

(n48)Footnote 46. Reg. Z § 226.29(b)(2).

(n49)Footnote 47. Official Staff Commentary § 226.29(b)-1. *See Ives v. W.T. Grant Co., 522 F. 2d 749 (2d Cir. 1975) . But cf. In re Myers, 175 B.R. 122 (Bankr. D. Mass. 1994)* .

(n50)Footnote 48. *15 U.S.C. §§ 1610(a)(1), 1666j(a)*; Reg. Z § 226.28(a) and Appendix A; Official Staff Commentary § 226.28(a). *See, e.g., Anderson v. Household Fin. Corp., 900 F. Supp. 386 (M.D. Ala. 1995)* ; *Heastie v. Community Bank of Greater Peoria, 690 F. Supp. 716 (N.D. Ill. 1988)* (TILA does not preempt state unfair and deceptive acts and practices [hereinafter UDAP] statute unless state provisions are inconsistent with TILA); *People v. Fulvio, 135 Misc. 2d 93, 514 N.Y.S.2d 594 (Crim. Ct. 1987)* , *rev'd on other grounds*, *136 Misc. 2d 334, 517 N.Y.S.2d 1008 (Crim. Ct. 1987)* (TILA does not exempt *N.Y. Gen. Bus. Law § 518*); *Williams v. First Gov't Mortgage & Investors Corp., 176 F.3d 497 (D.C. Cir. 1999)* (TILA does not preempt state UDAP statute unless UDAP statute directly conflicts with TILA); *Aiello v. First Alliance Mortgage Co. (In re First Alliance Mortgage Co.), 280 B.R. 246 (Bankr. C.D. Cal. 2002)* (same); *Black v. Freedom Fin. Senior Funding Corp., 92 Cal. App. 4th 917, 112 Cal. Rptr. 2d 445 (1st Dist. 2001)* , *review denied*, *2002 Cal. LEXIS 479* (Cal. Jan. 23, 2002) (same). *See Kajitani v. Downey Sav. & Loan Ass'n, 2008 U.S. Dist. LEXIS 42388* (D. Haw. May 22, 2008) (holding state law claims for conduct that also violated TILA were preempted; other claims, such as those for oral representations used for bait and switch, were not preempted); *Matter of People of the State of New York v. Applied Card Sys., Inc., 2008 N.Y. Slip Op 5780 (N.Y. 2008)* (finding claims under state consumer protection law and executive law brought by state attorney general not preempted by TILA *because* claims sought to hold the credit card issuers to disclosure and UDAP rules not contained in TILA); *Monaco v. Bear Stearns Residential Mortg. Corp., 554 F. Supp. 2d 1034 (C.D. Cal. 2008)* (holding consumer claim under state UDAP law not preempted by TILA where consumer was seeking additional remedies because additional penalties are not inconsistent with TILA but rather provide greater protection). *But see Kajitani v. Downey Sav. & Loan Ass'n, 2008 U.S. Dist. LEXIS 42388* (D. Haw. May 22, 2008) (finding claim under state UDAP law preempted under HOLA where basis of claim was attempt to use four-year statute of limitations period under the state law to circumvent the one-year limitations period for damages claims under TILA; allowing consumers to avail themselves of the longer period would alter rules controlling how a federal savings and loan is operated).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 1 Truth in Lending

1-1 Consumer Credit Law Manual § 1.04

§ 1.04 The Finance Charge

[1] Introduction to the Finance Charge

As stated above, TILA was created to guarantee the accurate and meaningful disclosure of the costs of consumer credit. The disclosure of the finance charge is at the heart of this purpose.

An accurately calculated finance charge is particularly critical as it is a necessary precondition to an accurately disclosed annual percentage rate ("APR"). The finance charge is the cost of credit as a dollar amount, and the APR reflects that cost on a yearly percentage rate basis. Together, these two disclosures are designed to provide an accurate price tag for credit. They are the two most important disclosures required under TIL, n1 and, consequently, they must be disclosed more conspicuously than any other. n2

For both creditor and consumer, determining the accurate cost of credit for TIL purposes involves breaking down the components of the total obligation into two basic classifications: the amount financed and the finance charge. The amount financed is comprised of those legitimate components of the obligation which are advanced by the lender directly to the borrower or paid to others on the borrower's behalf; the finance charge is the cost of the credit, as the explanatory phrases on a disclosure statement indicate. n3 *The two categories are mutually exclusive*.

To be accurate, the disclosed finance charge n4 must reflect:

a) The inclusion of all *types* of charges which TIL defines as part of the finance charge for that particular transaction, i.e., proper allocation of charges between the amount financed column and the finance charge; and

b) Proper computation of each component charge of the total finance charge, and proper disclosure of the resulting total charge.

There are important distinctions between the rules used to classify the component parts of the total debt under TIL, and the rules used by the law which regulates the *substance* of that credit transaction, most often state usury law. n5

One important distinction is between finance charges and interest. The finance charge is conceptually comparable to the total interest charge on a credit contract, but they are *not* the same. n6 As it is most commonly used, "interest" refers to the compensation creditors receive for the use of their money, calculated by applying a contractual interest rate to the contractual principal for the amount of time the credit is outstanding. n7 While additional types of fees and charges imposed on a credit transaction may be considered interest for purposes of the substantive regulatory law, in most states, "interest" is defined more narrowly than TIL defines the finance charge.

A second important distinction is between the amount financed and loan principal. The flip side of the differing definitions for interest and finance charge is that state law defines the principal amount of a loan more broadly than TIL defines the amount financed. Under TIL, the finance charge and amount financed are mutually exclusive terms. Charges that meet TIL's definition of a finance charge must be classified as a finance charge even if the consumer financed it as part of the loan. Therefore, it should not be surprising that the amount financed will often be less than the note principal.

Finally, there is a distinction between the APR for TIL purposes and the interest rate on the loan. First, the interest rate may refer to any one of three methods of calculating interest: add-on, discount, or actuarial. However, because the actuarial method is the only economically accurate method of reflecting the cost of installment credit, the APR must be stated in terms of actuarial rate. n8

In addition, the APR translates to a yearly percentage rate the broader measure of the cost of credit that the finance charge reflects in dollars. That is, if the finance charge includes charges which state law does not consider interest, the TIL-defined APR will reflect them, too. Therefore, the APR on a disclosure statement will often be larger than the interest rate on the accompanying note.

In general, for an outline of TIL's finance charge rules, see the following sections of the Act and Regulation Z which define the finance charge:

1) *Reg. Z § 226.4(a)* Reg. Z § 226.4(a): n9 This sets forth the basic, all-inclusive definition.

2) *Reg. Z § 226.4(b)* Reg. Z § 226.4(b): n10 This subsection lists examples of common credit charges which fall within the overall definition.

3) *Reg. Z § 226.4(c)-(e)* Reg. Z § 226.4(c)-(e): n11 While these *categories* of charges may be excluded from the finance charge, most require that in any *individual* case they can be excluded only when certain preconditions are met.

[2] Basic Definition of Finance Charge

The fundamental principles against which any credit-related cost must be measured for a TIL finance charge-fit boil down to four elements, as expressed in Reg. Z section 226.4(a). n12 Thus, the finance charge includes:

[a] Any Charge

Theoretically, any cost beyond what the consumer asked to borrow, payable by the consumer and added at the creditor's behest could be a charge. Particularly in home-secured loans, the creditor may offset the closing costs in part by a credit, often in exchange for a higher interest rate. Some lenders pay a credit to the consumer instead of paying a yield spread premium to a broker. Sometimes, the payment of a credit masks a broker upcharge even though the credit is applied against closing costs generally. The Official Staff Commentary suggests that these payments should not be reflected in (or subtracted from) the finance charge. n13

When the credit is applied generally to closing costs, the credit should be treated as a "deposit" (counted toward the total

of closing costs) and used to reduce the total amount due from the consumer. n14 It should not affect the finance charge because it is not a credit toward a particular fee that meets the finance charge definition, such as an origination fee. Accordingly, a lender should not be allowed to apply a general credit against a specific fee in order to lower the finance charge total. Otherwise, the result would distort the purposes of the Act. The APR would be lower because the creditor applied the credit to a finance charge, lowering the number in the finance charge box on the disclosure. The Official Staff Commentary lends support to this argument because it highlights the importance of tracing a payment to particular activity in order to analyze whether it is in or out of the finance charge. n15 In its discussion of lump sum charges, the Commentary explains that one must look at the uses of the fee. If a portion of a lump sum charge is specifically for a service that is not excludable from the finance charge, that portion of the lump sum should be included in the finance charge. If the charge is for conducting or attending a closing and is primarily for services regarding items excluded from the finance charge, the entire fee is excluded even if some "incidental" finance charge services are performed. The Department of Housing and Urban Development now requires that yield spread premiums and other lender-paid broker compensation be disclosed on the settlement statement in effect as a credit against the borrower's other closing costs, regardless of how the funds are actually applied. n15.1

[b] Payable Directly or Indirectly by the Consumer

The creditor usually takes into consideration its costs of doing business in determining what interest rate or cash price to charge its customers. The Commentary describes these costs as "absorbed by the creditor" and excludes them from the finance charge unless the consumer pays a separate charge to cover some or all of those costs. n16 There should be no question that *financed* closing costs are payable at or before closing. However, a Tennessee federal court in *Terry v. Community Bank of Northern Virginia*, n17 focused on the word "payable," holding that closing costs are "payable" only when the homeowner is required to pay certain points and fees "at or before closing of a loan, not over the course of the loan." n18 A decision from a West Virginia federal court, however, expressly disavows the *Terry* holding. *Short v. Wells Fargo Bank Minnesota, N.A,* n19 relies upon the facts that the closing charges were paid out of the amount loaned and that the HUD-1 Settlement Statement acknowledges that the closing costs are paid by the homeowner. n20 The court distinguished the word "payable" from "paid" in this way: "Congress did not use the term 'paid' in § 1602(aa), instead, it used the term 'payable' which looks to the fact that the consumer bears the cost of those fees at the time of closing, not whether those fess were financed, paid separately or deducted from the loan proceeds." n21

[c] Imposed Directly or Indirectly by the Creditor

This condition can cover a wide variety of charges, and the charge does not have to be retained by the creditor to have been imposed directly or indirectly by the creditor. However, if the charge is not avoidable by the creditor--if it is imposed by a third party for services which the creditor does not require, and the creditor does not retain the charge--then it is not a finance charge. n22

A specific problem that arises in this element of the definition is brokers' fees. Before the 1995 TILA amendments, brokers' fees were in the class of charges which did not have a per se rule as to whether they were considered part of the finance charge. Commencing September 30, 1996, brokers' fees are always to be treated as a finance charge, whether paid directly to the broker or to the lender to be passed on, and whether paid in cash or financed. n23 The only circumstance under which a fee charged by a broker may be excluded from the finance charges is if the creditor itself could exclude it. For example, if the broker charges an application fee to successful and unsuccessful applicants, n24 that fee could be excluded. n25

Sometimes the creditor lists a fee on the HUD-1 Settlement Statement as paid to itself but, after receipt of a rescission letter or the initiation of a lawsuit, later claims that the fee ultimately went to a third party. In other words, the creditor argues it received no compensation even though the disclosures show that it kept the fee. One response is that consumers, regulators, and assignees have to rely upon the legally required documents that list the disbursements. The creditor is responsible for the accuracy of the HUD-1 that substitutes for the itemization of the amount financed for TIL

purposes. The creditor should just list the third party's name if the fee is going to that party. The HUD-1 or itemization of the amount financed should be prima facie evidence of who received which fees and in what amounts from the borrower at closing. n26 Indeed, HUD requires lenders to name the person or firm "ultimately" receiving the payment on the HUD-1. n27

[d] As an Incident to or a Condition of the Extension of Credit

If a charge is imposed because there is a *credit* transaction or as a condition precedent to the extension of credit, then it should be disclosed as part of the finance charge. To meet this requirement, a charge need only be "incident to" a credit extension, and need not be a "condition of credit." In determining whether a charge is "a condition of the extension of credit," a proper question to ask is whether the credit would have been granted if the borrower did not agree to pay it. n28

In 1996, the Board interpreted the "incident to" language of the Act to mean "in connection with" and "part of the cost of credit." n29 At that time, the Board rejected the notion that a fee for a product or feature that the consumer may voluntarily select is per se excluded from the finance charge. n30

In a recent case, the Supreme Court discussed the "incident to" language when deciding whether the Board exceeded its authority by excluding over-limit fees charged by credit card issuers from the finance charge. n31 The Court was unsure whether the phrase requires a substantial or remote connection to the credit transaction. Given this uncertainty, the Court deferred to the Board's characterization of the over-limit fee as a penalty for violating the creditor's agreement, rather than related to the extension of new credit. n32 Nonetheless, the Court recognized that "incident to" means "connection to."

As a final requirement for the inclusion of a charge in the finance charge, the Act and Regulation provide that any charge of a type payable in a comparable cash transaction is not considered a finance charge. n33

Sometimes both cash and credit customers will be required to pay a charge for the same service, but the credit customers will have to pay a higher price than that paid by the cash customers. In those situations, the difference between the two charges is logically considered a finance charge.

[3] Examples of Finance Charges

Following the general definition of finance charge, n34 there is a non-exclusive list of examples. n35 Ordinarily, interest will be the largest component, and often the only component, of the finance charge. n36 The full amount of the contract interest is a finance charge irrespective of how it is calculated: n37 "add-on" or "discount" methods of computing charges for credit are explicitly included in the list of finance charge examples. n38

There are also numerous other examples of finance charges. These charges arise in the context of refinancing if, in calculating the pay-off balance for the prior transaction when refinancing, the creditor fails to rebate any unearned charges, the portion of the pay-off balance which represents the non-rebated charges must be considered as part of the finance charge in the new loan. n39

Other examples of finance charges under TIL include:

1) *Service, transaction, activity and carrying charges;* n40

2) Generally, "*points,*" n41 *loan fees, assumption fees,* n42 *finder's fees* and similar charges are also finance charges; n43

3) *Appraisal, investigation and credit report fees* are also examples of finance charges unless they

fall within one of the specific regulatory exceptions; n44

4) *Credit insurance premiums* are explicitly characterized as part of the finance charge, n45 although they are also the subject of one of the exclusionary rules; n46

5) *Prepaid finance charges*: n47 This can be a confusing area because there is no listing of "prepaid finance charge" in the statutory and regulatory examples. n48 The term prepaid finance charge is simply an umbrella term for "any finance charge paid separately in cash or by check before or at consummation of a transaction, or withheld from the proceeds of the credit at any time." n49

The fundamental rule is that the prepaid finance charge is always *calculated* as a *component* of the finance charge; n50 it is never calculated as a component of the amount financed--even if it does show up listed in the itemization of the amount financed.

Bounce loans--overdraft coverage systematically included in customers' deposit accounts--are transactions with no cash equivalent, similar to a non-purchase money loan. With bounce loans, the consumer is receiving cash, not goods or services. Thus, fees imposed for bounce loans appear to be a finance charge. Nevertheless, Regulation Z and the Commentary arguably do not treat this fee as a finance charge. n51 Rather, they seem to treat fees for overdrafts as comparable to an NSF fee for a returned check (which they assume to be the comparable cash transaction). Although the amount of an overdraft fee is often the same amount as that charged for an NSF fee on a returned check, the transactions are not comparable. Moreover, some bounce loan plans charge per-day fees as well, which clearly are not comparable to one-time NSF fees. n52

[4] TIL's "Exclusionary" Rules: Taking Charges Out of the Finance Charge

After identifying any given charge as meeting the overall definition or even finding it specifically listed as an example, advocates must then check TIL exclusionary rules to see if the charge is subject to one (or more) of them. n53 Note that the majority of the exclusions are authorized only in certain circumstances, rather than as a universal rule. Examples of TIL's exclusions are discussed below.

[a] TIL Exclusions: Application Fees

Application fees may be excluded from the finance charge if they are charged to all applicants for credit, regardless of whether credit is actually extended. n54

[b] TIL Exclusions: Late Charges, Over-the-Limit Fees, and Other Delinquency Charges

Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, n55 or a similar occurrence n56 may be excluded from the finance charge. n57 In fact, one case holds, and Regulation Z suggests, that they must be excluded from the finance charge. n58 But charges imposed for payments which are not actually late or which can be anticipated to be late should be finance charges. In Regulation Z, the Federal Reserve Board excludes over-limit charges from its definition of "finance charge" under the Truth in Lending Act. n59 The Sixth Circuit held that over-limit charges that the creditor imposes after *allowing* the consumer to exceed the original credit limit must be treated as finance charges, notwithstanding Regulation Z. n60 The Supreme Court, however, reversed the Sixth Circuit ruling, holding that the statute is ambiguous regarding whether over-limit fees are incident to the extension of credit under *15 U.S.C. § 1605(a)* and that the Board's regulatory provision uniformly excluding over-limit fees from the finance charge is reasonable and must be followed. n61 Justice Thomas, writing for a unanimous court, wrote that the statute's ambiguity is rooted in the fact that not all charges for open-end credit are part of the finance charge, and that the statute's description of over-limit fees as imposed "in connection with an extension of credit" is not clearly within the scope of the phrase "incident to an extension of credit." The Court went on to say that the Board's view of over-limit fees as a penalty for default, rather than a fee for an extension of credit, is not contrary to the statute, and that it is easy

to apply because it is a bright-line test.

[c] TIL Exclusions: Credit Insurance

The TILA exception for credit insurance has nearly swallowed the rule that credit insurance must be included as part of the finance charge since virtually all creditors do, or intend to, take advantage of the exception.

There are different types of credit insurance and different rules apply. First, premiums or other charges for insurance against interruption of the borrower's income, if written in connection with a credit transaction, must be included in the finance charge unless certain disclosures are made and certain rules are followed. n62 The most common examples of this kind of insurance are credit life insurance, n63 accident and health/disability, n64 and unemployment insurance. n65

Premiums for this insurance may be excluded from the finance charge *only* if the following conditions are met: n66

a) The insurance coverage is not required by the creditor and this fact is disclosed; n67

b) The premium for the initial term of the insurance coverage is disclosed. If the term of the insurance is less than the term of the transaction, the term of insurance must be disclosed, as well; n68 and

c) The consumer signs or initials an affirmative written request for the insurance after receiving the required disclosures. n69

In addition, the rules on the timing and location of insurance disclosures for closed-end transactions must be followed. n70

If, as occasionally happens, a creditor fails to provide the necessary written notice that insurance is not required, the premium is a finance charge. n71 The more common situation, though, is that the voluntariness disclosure is a part of the written disclosures, while oral information or conduct from the creditor obscures, undermines, or flatly contradicts that written notice. These practices not only can be challenged under state deceptive acts and practices statutes where they apply to the transaction, n72 but are also vulnerable to a range of other challenges, including usury and common law tort claims. n73 It is also arguable that there are TIL implications. n74

One of the newer add-on products to credit transactions (particularly car loans) is "GAP" insurance. The risk insured is the "GAP" between the outstanding loan balance and the amount paid out by the property insurer after a covered loss occurs on the collateral. In 1996, the Board revised Regulation Z to provide that GAP insurance is to be treated in the same fashion as credit life and disability insurance. n75 The revised regulation has survived legal challenge from the insurance industry. n76 A growing practice in the GAP insurance industry is being used to decrease the value of this coverage by measuring the "GAP" as the difference between the amount owed and either the insurer's estimation of the vehicle's value or the value in the National Automobile Dealers Association (NADA) guidebook, whichever is greater. Often the NADA amount is greater, and the result is that the insured still owes money. For example, in the previous example, if the insurer's estimation at time of loss is $3000 and the debt balance is $5000, but the NADA value is $4000 ($1000 higher than the insurer's amount), then GAP insurance pays $1000 (the difference between the $5,000 owed and the $4000 valuation) and the insured still owes $1000 (so that car insurer pays $3000, GAP insurer pays $1000 and insured pays $1000).

Fees for debt cancellation coverage are practically per se written in connection with the credit. n77

Another type of insurance is credit property insurance related to loss of or damage to property, or against liability arising out of the ownership or use of property. n78 The premiums or other charges for this type of insurance, if written

in connection with a credit transaction, must be included in the finance charge unless the exclusionary rules are followed. n79

These rules generally apply to credit property insurance "obtained from or through the creditor." n80

The rules for excluding credit property insurance from the finance charge differ somewhat from the rules to exclude credit life, disability, and unemployment. Unlike loss-of-income insurance, creditors are permitted to require that their collateral be insured. n81 To exclude credit property insurance premiums from the finance charge, the creditor need only do two things: give consumers written notice that they may choose to purchase the insurance either through the creditor or from a third party; n82 and disclose the cost if purchased through the creditor. n83 (Here, too, the premium disclosed is for the initial term, and, if less than the loan's term, the term of insurance must be disclosed, as well.) n84 In another contrast to the loss-of-income insurance, there is no requirement for an affirmative written request for property insurance.

The Regulation allows creditors to exclude single interest property insurance premiums from the finance charge under the general exclusionary rules for property insurance, though there is one additional condition: The insurer must waive all rights of subrogation against the consumer. n85 "Single interest insurance" refers only to the types of coverage traditionally included in the term "vendor's single interest insurance" ("VSI"). n86 This kind of insurance protects only the vendor's (that is, the seller's) interest in the property. n87

[d] TIL Exclusions: Real Estate and Residential Mortgage Transaction Charges

Just as there are special disclosure and rescission rules for some transactions secured by the consumer's principal dwelling, n88 there are also special finance charge rules for transactions either secured by real property or involving residential mortgages. n89

The 1995 TIL amendments contain many important changes in this area. In particular, prospectively, the exclusion for document preparation in mortgage loans was slightly expanded, and pre-consummation pest-inspection and flood hazard inspections were added to the statute's list. Closed-end mortgage lenders obtained retroactive immunity for misstatements in the finance charge and consequent misstatements in other affected disclosures when the violation alleged related to one of these charges. Other amendments offered complete or partial retroactive immunity for mishandled fees, and changed the rules prospectively. Additionally, a multi-tiered level of tolerance for error in disclosing the finance charge and related errors was created, operating both retroactively and prospectively. n90

[i] Classes of Real Estate Closing Charges: What's Excludable; What's Not

The following classes of closing costs may be excluded from the finance charge in these transactions, but only when the fees are bona fide and reasonable. n91

[A] Real Property, Title-Related Fees n92

Fees for title examination, abstract of title, title insurance, property survey, or similar purposes may, if bona fide and reasonable, be excluded. n93 Cases involving such fees hold that excessive cost would violate the bona fide and reasonable standard. n94

Where a consumer repeatedly has been refinanced by the same lender, a number of the closing fees may warrant scrutiny under the "bona fide and reasonable" analysis. Fees for full title exams and appraisals may not be reasonable if the previous loan was made only a short time earlier; it also is worth checking to make sure the work was done at all and thus that the fee is bona fide. Additionally, title insurance for subsequent refinancings also should be based on lower reissue rates. n95

[B] Document Fees; Closing Agent/Attorney Fees

This category of fees was among the subjects of the 1995 amendments, both retroactive and prospective, so it will be necessary to check those carefully to determine their impact on the analysis of any case. n96 Prospectively, *15 U.S.C. section 1605(e)(2)* was amended to read that "fees for preparation of loan related documents" in a real estate secured transaction are not part of the finance charge. n97

A document preparation fee could be illegal under state law if the entity preparing the documents was engaged in the unauthorized practice of law. n98 If the lender or other entity charged a fee for preparing or filling in the blanks on legal documents and this activity was part of the entity's business, the lender or entity may be engaged in the unauthorized practice of law. n99

[C] Notary, Appraisal, and Credit Report Fees n100

These fees are also subject to this exclusion. n101 The Commentary allows the cost of verifying or confirming information relating to the excludable item, such as credit reports, to be excluded as well, though those charges, too, must be bona fide and reasonable. n102 Note that these fees, if not eligible for this special exclusion, are included among the listed examples of finance charges. n103 Some fees, such as notary fees, are regulated by state law. n104

[D] Escrow Costs

As the Act itself makes clear, the prototypical costs encompassed by this provision are "escrows for future payments of taxes and insurance." n105 Unfortunately, the current version of Regulation Z muddies that statutory provision, in allowing "amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge." n106 In short, if a charge is not a finance charge when not escrowed, it does not become one by virtue of being escrowed. This provision, thus, does not create any additional exclusions. However, it does invoke the bona fide and reasonable requirement.

[E] Fees for Post-Consummation Services

Fees for such services may be excluded, but only to the extent they are incurred as part of the initial credit-granting decision, for example, checking tax lien status or determining whether the proposed collateral is subject to flood insurance requirements. n107 In contrast, fees which pay for such services during the loan term are finance charges, as they are recurring administrative fees incurred to protect the creditor's security interest. Post-consummation costs, such as monitoring the tax lien status of secured property or checking whether contractually required property insurance has been maintained, are finance charges, irrespective of whether they are collected at closing or later, when performed. n108

[e] TIL Exclusions: Security Interest Charges; Filing and Recording Fees

Some charges imposed in connection with a security interest may be excluded from the finance charge under prescribed conditions in both real-estate secured loans and non-real-estate loans. n109 This exclusion covers taxes and fees which meet the following criteria: n110

a) Are itemized and disclosed;

b) Are prescribed by law;

c) Actually are or will be paid to public officials; n111 and

d) Are for investigating, perfecting, releasing or satisfying a security interest.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingDisclosureContracts LawDebtor & Creditor Relations

FOOTNOTES:

(n1)Footnote 1. *E.g., First Nat'l Bank v. Office of the Comptroller, 956 F.2d 1456 (8th Cir. 1992)* .

(n2)Footnote 2. *15 U.S.C. § 1632(a)*; Reg. Z §§ 226.5(a)(2), 226.17(a)(2). *See § 1.05[2][a] infra*.

(n3)Footnote 3. Reg. Z § 226.18(b) and (d).

(n4)Footnote 4. In closed-end credit, the finance charge is disclosed at consummation. In open-end credit, the finance charge is an after-the-fact dollar amount which appears only on the periodic statements. Reg. Z § 226.7(f).

(n5)Footnote 5. *See* Ch. 6 *infra*.

(n6)Footnote 6. Some states, though, in updating their consumer credit regulatory laws since 1968, adopted TIL definitions and terminology. Only if state law so defines them will there be a direct correlation.

(n7)Footnote 7. *See* Ch. 6, *§§ 6.05- 6.07 infra* . See generally National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges Ch. 4 (3d ed. 2005), for a discussion of the basic concept of interest, and Chapters 6-8 for additional charges which are sometimes considered interest under state law.

(n8)Footnote 8. *See § 1.05[2][e] infra*.

(n9)Footnote 9. *15 U.S.C. § 1605(a)*.

(n10)Footnote 10. *15 U.S.C. § 1605(a)(1)-(5)*.

(n11)Footnote 11. *15 U.S.C. § 1605(c)-(e)*.

(n12)Footnote 12. *15 U.S.C. § 1605(a)*.

(n13)Footnote 13. Official Staff Commentary § 226.4(a)(3)-3.

(n14)Footnote 14. This credit could be listed as a "borrower credit" in the 200 series of the HUD settlement statement, an issue governed by the Real Estate Settlement Procedures Act. *See* Regulation X, 24 C.F.R. 3500.

(n15)Footnote 15. Official Staff Commentary § 226.4(c)(7)-2.

(n16)Footnote 15.1. *73 Fed. Reg. 68,244-68,245, codified at* 24 C.F.R. Pt. 3500, Apps. A, C.

(n17)Footnote 16. Official Staff Commentary § 226.4(a)-2. *See Jennings v. Edwards, 598 F.2d 614 (4th Cir. 1979)* (filing fee absorbed by creditor was not part of finance charge). *But see* State *ex rel.* Brady v. 3- *D Auto World, Inc., 2000 Del. Super. LEXIS 17* (Del. Super. Ct. Jan. 19, 2000) (UDAP enforcement action, in which court granted summary judgment to the state on the issue of whether a "carrying charge" of 20% of the outstanding balance at purchase with 0% financing constituted a hidden finance charge; court used TILA definitions to support its holding). *See, e.g., Bynum v. Equitable Mortg. Group, 2005 U.S. Dist. LEXIS 6363* (D.D.C. Apr. 7, 2005) (flood certification excluded from finance charge even where payment was made directly to lender; court found that lender had advanced fee to contractor and that this payment was a reimbursement).

(n18)Footnote 17. *Terry v. Community Bank of N. Va., 255 F. Supp. 2d 811 (W.D. Tenn. 2003)* .

(n19)Footnote 18. *Terry v. Community Bank of N. Va., 255 F. Supp. 2d at 817* .

(n20)Footnote 19. *401 F. Supp. 2d 549 (S.D. W. Va. 2005)* .

(n21)Footnote 20. The phrase "paid from borrowers funds at settlement" appears on the top of one of the columns on page two. This statement should appear on *all* Settlement Statements when the lender uses the HUD standard form. For a copy of the standard form, see 25 C.F.R. 3500 App. A, *reproduced in* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses Appx. K.2 (4th ed. 2009).

(n22)Footnote 21. *401 F. Supp. 2d 549, 562 (S.D. W. Va. 2005)* .

(n23)Footnote 22. Reg. Z § 226.4(a)(1). *But see Person v. Courtesy Motors, Inc., 2001 U.S. Dist. LEXIS 4556* (W.D. Mich. Apr. 6, 2001) (portion of sales tax charged to the purchaser resulting from the dealership's inflation of the purchase price of the vehicle to offset the amount credited to the purchaser from a non-existent trade-in is a finance charge).

(n24)Footnote 23. *15 U.S.C. § 1605(a)(6)*; Reg. Z § 226.4(a)(3) (Sept. 30, 1996 effective date).

(n25)Footnote 24. *Cf.* Reg. Z § 226.4(c)(1).

(n26)Footnote 25. *61 Fed. Reg. 49,237, 49,238* (Sept. 19, 1996) . For a more extensive discussion of the brokers' fee issues and of the law that was in effect prior to implementation of the 1995 amendments, see National Consumer Law Center, Truth in Lending, § 3.7.4 (6th ed. 2007 and Supp.).

(n27)Footnote 26. However, one court refused to grant the consumer summary judgment when the assignee argued that the fee was simply advanced by the lender on behalf of the consumer. *Bynum v. Equitable Mortgage Group, 2005 U.S. Dist. LEXIS 6363* (D.D.C. Apr. 7, 2005) .

(n28)Footnote 27. 24 C.F.R. § 3500.

(n29)Footnote 28. *First Acadiana Bank v. FDIC, 833 F.2d 548, 550 (5th Cir. 1987)* ; *Yazzie v. Ray Vicker's Special Cars, 12 F. Supp. 2d 1230 (D.N.M. 1998)* (since pawnbroker would not have extended credit if storage fee was not paid at the outset, the fee is a finance charge). The charge, of course, must also meet the other requirements.

(n30)Footnote 29. *61 Fed. Reg. 49237, 49239* (Sept. 19, 1996) .

(n31)Footnote 30. *Id.*

(n32)Footnote 31. *Household Credit Servs. Inc v. Pfennig, 541 U.S. 232, 124 S. Ct. 1741, 158 L. Ed. 2d 450 (2004)* .

(n33)Footnote 32. *Id.* at 1749

(n34)Footnote 33. *15 U.S.C. § 1605(a)*; Reg. Z § 226.4(a). The Commentary gives several examples of credit transaction charges that would not be imposed in cash transactions and, therefore, are considered finance charges. Official Staff Commentary § 226.4(a)-1(ii). The Commentary also gives several examples of credit transaction charges that would also be imposed in comparable cash transactions and, therefore, are not considered finance charges. Official Staff Commentary § 226.4(a)-1(i). *See, e.g., Basile v. H&R Block, Inc. 897 F. Supp. 194 (E.D. Pa. 1995)* (electronic filing fee charged by tax preparation service to taxpayers who participate in its "refund anticipation loan" program, as well as those who do not, is not a finance charge, since the fee is the same in comparable cash transactions); *Ferrari v. Howard, 2002 Ohio App. LEXIS 3632* (Ohio Ct. App. July 11, 2002) (creditor must show that it charges the same documentary service charge to both cash and credit customers in other to take advantage of this exception); *Tripp v. Charlie Falk Auto, 2001 U.S. Dist. LEXIS 14096* (E.D. Va. Aug. 22, 2001) (car dealer processing fee was charged to

both cash and credit customers and was properly excluded from the finance charge). *See also Hook v. Baker, 352 F. Supp. 2d 839 (S.D. Ohio 2004)* (document preparation fee assessed only to customers who finance the transaction is an undisclosed finance charge).

(n35)Footnote 34. *15 U.S.C. § 1605(a)*; Reg. Z § 226.4(a).

(n36)Footnote 35. *15 U.S.C. § 1605(a)(1)-(5)*; Reg. Z § 226.4(b)(1)-(9).

(n37)Footnote 36. *15 U.S.C. § 1605(a)(1)*; Reg. Z § 226.4(b)(1).

(n38)Footnote 37. See generally *§ 6.05 infra* for a detailed explanation of the various methods of calculating interest.

(n39)Footnote 38. Reg. Z § 226.4(b)(1).

(n40)Footnote 39. Reg. Z § 226.20(a); Official Staff Commentary § 226.20(a)-4.

(n41)Footnote 40. *15 U.S.C. § 1605(a)(2)*; Reg. Z § 226.4(b)(2). *See, e.g., Ferran v. Sanchez, 105 N.M. 518, 734 P.2d 758 (1987)* (loan servicing fee part of finance charge); *In re Fryer, 183 B.R. 322 , motion for reconsideration denied, 183 B.R. 654 (Bankr. S.D. Ga. 1995)* (pawn charge at issue).

(n42)Footnote 41. "Points" are a fee imposed frequently by mortgage lenders and occasionally by other creditors. Points are calculated as one percent of loan principal. Thus, two points on a $100,000 mortgage is a fee of $2000. Ostensibly, points compensate lenders for processing a loan and packaging it for resale, and points are therefore sometimes called "origination fees." *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 7.2.2 (4th ed. 2009).

(n43)Footnote 42. Assumption fees are paid by a consumer to assume a credit obligation of another consumer. The Commentary points out that the assumption fee is a finance charge (for the new buyer) only when it is imposed on the new buyer. Official Staff Commentary § 226.4(b)(3)-1. See also Reg. Z § 226.20(b) for a discussion of assumptions.

(n44)Footnote 43. *15 U.S.C. § 1605(a)(3)*; Reg. Z § 226.4(b)(3).

(n45)Footnote 44. *15 U.S.C. § 1605(a)(4)*; Reg. Z § 226.4(b)(4).

(n46)Footnote 45. *15 U.S.C. § 1605(a)(5), (b), (c)*; Reg. Z § 226.4(b)(7), (8).

(n47)Footnote 46. *15 U.S.C. § 1605(b), (c)*; Reg. Z § 226.4(d).

(n48)Footnote 47. *See* Reg. Z § 226.2(a)(23). *See, e.g., April v. Union Mortgage Co., 709 F. Supp. 809, 811 (N.D. Ill. 1989)* (failure to include $1,049 prepaid finance charge as part of finance charge violates TIL even if annual percentage rate [hereinafter APR] correctly disclosed); *Ferran v. Sanchez, 105 N.M. 518, 734 P.2d 758 (1987)* (loan servicing fee was prepaid finance charge). Some states place caps on allowable prepaid finance charges. *See Winn v. Ameriquest, 2006 Conn. Super. LEXIS 1129* (Conn. Super. Ct. Apr. 12, 2006) (discussing Connecticut law limiting the amount of any prepaid finance charges that may be charged in connection with a first mortgage loan to the greater of $2000 or 5% of the original loan amount plus five percent of any additional proceeds received by the borrower in the refinancing).

(n49)Footnote 48. *15 U.S.C. § 1605*; Reg. Z § 226.4(a), (b).

(n50)Footnote 49. Reg. Z § 226.2(a)(23); Official Staff Commentary § 226.2(a)(23)-2.

(n51)Footnote 50. *See* Reg. Z § 226.2(a)(23). *See, e.g., April v. Union Mortgage Co., 709 F. Supp. 809, 811 (N.D.*

Ill. 1989) (failure to include $1049 prepaid finance charge as part of finance charge violates TIL even if APR correctly disclosed); *Ferran v. Sanchez, 105 N.M. 518, 734 P.2d 758 (1987)* (loan servicing fee was prepaid finance charge).

(n52)Footnote 51. Reg. Z § 226.4(b)(2); Official Staff Commentary § 226.4(b)-2.

(n53)Footnote 52. *See* National Consumer Law Center, Truth in Lending, § 2.5.7 (6th ed. 2007), for a fuller discussion of bounce loans. The FRB recently proposed regulating bounce loans under the Truth in Savings Act, not under TILA. *69 Fed. Reg. 31760* (June 7, 2004) . In addition, the federal banking regulators proposed interagency guidelines setting "best practices" for bounce loans. Proposed Interagency Guidance on Overdraft Protection Programs. *69 Fed. Reg. 31858* (June 7, 2004) .

(n54)Footnote 53. See also *§§ 1.05[2][e][ii][A]*, *1.08[3][b]*, *1.09[2][h] infra* , for the impact of the new immunity statute and increased tolerance levels for finance charge and related disclosures.

(n55)Footnote 54. Reg. Z § 226.4(c)(1).

(n56)Footnote 55. *United States v. Citrin, 972 F.2d 1044 (9th Cir. 1992)* .

(n57)Footnote 56. These include charges for reinstatement of credit privileges or for submitting as payment a check that is later returned unpaid. Official Staff Commentary § 226.4(c)(2)-2. *See, e.g.*, Opinion of the Idaho Attorney General, No. 87-11, [1980-1989 Transfer Binder] Consumer Cred. Guide (CCH) P 95,968 (Sept. 23, 1987).

(n58)Footnote 57. Reg. Z § 226.4(c)(2). *See Cappalli v. Nordstrom FSB, 2002 U.S. App. LEXIS 2492* (3d Cir. Feb. 15, 2002) (TILA requires exclusion of late charge from APR or from finance charge).

(n59)Footnote 58. *Cappalli v. Nordstrom FSB, 28 Fed. Appx. 160, 2002 U.S. App. LEXIS 2492 (3d Cir. 2002)* ; Reg. Z § 226.4(c) ("[t]he following charges are not finance charges ... .").

(n60)Footnote 59. Reg. Z § 226.4(c)(2).

(n61)Footnote 60. *Pfennig v. Household Credit Servs., 295 F.3d 522 (6th Cir. 2002)* , *cert. granted*, *123 S. Ct. 2639 (2003)* , *rev'd 124 S. Ct. 1741 (2004)* .

(n62)Footnote 61. *Household Credit Servs. v. Pfennig, 124 S. Ct. 1741 (2004)* .

(n63)Footnote 62. *15 U.S.C. § 1605(b)*; Reg. Z § 226.4(b)(7); Reg. Z § 226.4(d)(1).

(n64)Footnote 63. Credit life insurance is sold on the life of the borrower, with the creditor or the debtor's account as the beneficiary. If the borrower dies, the insurance company will pay off the debt. *See generally § 6.06[2][a] infra*.

(n65)Footnote 64. Accident and health insurance ("A & H" or disability insurance) insures the borrower against the loss of income caused by an illness or accident which prevents the borrower from working. This insurance pays off the debt installments which become due during the period the borrower is out of work. *See generally § 6.06[2][b] infra*.

(n66)Footnote 65. Unemployment insurance insures the borrower against involuntary unemployment. In the event of such unemployment, some or all of the consumer's payments will be made. (The policies may be drafted so that benefits are quite limited.) *See § 6.06[2][c] infra*.

(n67)Footnote 66. *15 U.S.C. § 1605(b)*; Reg. Z § 226.4(d)(1). However, the creditor is always free to include the premium in the finance charge. *See, e.g., Robinson v. Central Loan & Fin. Corp., 609 F.2d 170 (5th Cir. 1980)* . If the creditor chooses to do so, the § 226.4(d) disclosures are not required.

(n68)Footnote 67. *15 U.S.C. § 1605(b)(1)*; Reg. Z § 226.4(d)(1)(i). *See London v. Chase Manhattan Bank USA,*

N.A., 150 F. Supp. 2d 1314 (S.D. Fla. 2001) (disclosure need not exactly track language in the statute; regulatory language, though different from the statute, is a permissible construction; purchase of credit insurance that is "not a factor" in whether the creditor will issue a credit card is sufficient). *But see* Fabricant v. Sears Roebuck, Clearinghouse No. 54,563, Case No. 98-1281-CIV-Moreno (S.D. Fla. Mar. 5, 2002) (disclosure must state that the purchase of credit insurance does not influence, bring about, or contribute to the extension of credit; the issue was whether to follow the wording in the statute or the regulation and the court chose the statute; use of the word "optional" does not meet the statutory standard).

(n69)Footnote 68. *15 U.S.C. § 1605(b)(2)*; Reg. Z § 226.4(d)(1)(ii). The term of the insurance may be less than the loan term in cases, for example, where the loan term exceeds an older borrower's eligibility for the coverage or, for a variety reasons, in cases of long-term loans. When a creditor retains a portion of the credit insurance premium, TIL requires the creditor to disclose that it is receiving such a payment. *15 U.S.C. § 1638(a)(2)(B)*; Reg. Z, *12 C.F.R. § 226.18(c)*; Official Staff Commentary, § 226.18(c)(1)(iii)-2. *See also Guinn v. Hoskins Chevrolet, 836 N.E.2d 681 (Ill. App. 2005)* (TILA commentary requires disclosure of fact that creditor is retaining premium upcharge--additional amount retained by creditor--but does not require disclosure of the amount).

(n70)Footnote 69. *15 U.S.C. § 1605(b)(2)*; Reg. Z § 226.4(d)(1)(iii).

(n71)Footnote 70. Official Staff Commentary § 226.4(d)-1, -2.

(n72)Footnote 71. *See Barnes v. Robert Holliday, DBA, 1990 Conn. Super. LEXIS 392* (Conn. Super. Ct. June 5, 1990) (consumer signed next to credit insurance, but the blank next to that item was not filled in; consumer was unaware of the "payment protection plan" and was never issued insurance; therefore, the $605.74 charge is a finance charge). *See also Bragg v. Bill Heard Chevrolet, Inc., 374 F.3d 1060 (11th Cir. 2004)* , *cert. denied 125 S. Ct. 963 (2005)* (plaintiff's complaint states a claim where creditor failed to include in the finance charge the costs of credit insurance products sold in connection with the credit transaction but for which creditor did not make required disclosures). *But see Clark v. U.S. Bank Nat'l Ass'n, 2004 U.S. Dist. LEXIS 11264* (E.D. Pa. June 18, 2004) (plaintiff did not show a reasonable probability of success regarding claim of TIL violation where paperwork met TIL requirements for exclusion of credit property insurance from finance charge, despite alleged contrary oral representations and the fact that the documentation was filled out prior to closing with the creditor's "usual" insurer).

(n73)Footnote 72. National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.6.4.2 (7th ed. 2008).

(n74)Footnote 73. *See generally* Ch. 6 *infra*.

(n75)Footnote 74. Some courts have specifically held that where a creditor gives collateral information which undermines or contradicts *accurate* TIL disclosures, that renders the disclosures "unclear." *Jenkins v. Landmark Mortgage Corp. of Va., 696 F. Supp. 1089 (W.D. Va. 1988)* (notice of right to rescind at issue). *See also Ralls v. Bank of N.Y. (In re Ralls), 230 B.R. 508 (Bankr. E.D. Pa. 1999)* (information contained in TILA statement was inconsistent with significant terms in other documents evidencing the legal obligation of the borrower; constituted a rescindable violation). That obfuscation, in turn, means the required disclosures are not made in accordance with the mandate that all required disclosures be made "clearly and conspicuously." Further, the current Federal Reserve Board [hereinafter FRB] Commentary codifies the Board's historic position that voluntariness is a factual issue, ascertainable only "by reference to all of the circumstances of a particular transaction." Official Staff Commentary § 226.4(d)-5. *See also* Official Staff Commentary to revised Reg. Z §§ 226.4(b)(7) and 226.4(b)(8)-4, which reiterates the position that required non-credit insurance *also* is a finance charge. *See Brugger v. Elmhurst Kia, 2001 U.S. Dist. LEXIS 10298* (N.D. Ill. July 18, 2001) (car dealer's motion to dismiss on the voluntary issue denied where oral representations contradicted the written disclosures).

(n76)Footnote 75. *61 Fed. Reg. 49,237* (Sept. 19, 1996) . *See also* Official Staff Commentary § 226.4(b)(10); *62*

Fed. Reg. 10,193, 10,196 (Mar. 6, 1997) ; Official Staff Commentary § 226.4(d)(3); *62 Fed. Reg. 10,193* (Mar. 6, 1997) .

(n77)Footnote 76. *American Bankers Ins. Group, Inc. v. Board of Governors of the Fed. Reserve Sys., 3 F. Supp. 2d 37 (D.D.C. 1998)* .

(n78)Footnote 77. OCC Interpretive Letter No. 1028 (May 9, 2005) (the fee is "just an increase in the price of the loan package in exchange for the loan incorporating an additional term or provision that benefits the borrower and reflects the bank's assumption of risk ... ."). A summary of the letter can be found at National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses Appx. C.3 (4th ed. 2009).

(n79)Footnote 78. Credit property insurance is commonly written in loans secured by automobiles, mobile homes, and household goods.

(n80)Footnote 79. *15 U.S.C. § 1605(c)*; Reg. Z §§ 226.4(b)(8), 226.4(d)(2).

(n81)Footnote 80. *15 U.S.C. § 1605(c)*; Reg. Z § 226.4(d)(2)(ii). *See, e.g., In re Moore, 117 B.R. 135 (Bankr. E.D. Pa. 1990)* (property insurance was "purchased through" creditor when it purchased a replacement policy for a new borrower whose pre-existing coverage had lapsed and could not be renewed).

(n82)Footnote 81. *Compare 15 U.S.C. § 1605(b)*; Reg. Z § 226.4(d)(1) (required credit life, disability, or unemployment insurance is a finance charge). Of course, creditors may require property insurance only where they have a security interest in the insured property.

(n83)Footnote 82. *15 U.S.C. § 1605(c)*; Reg. Z § 226.4(d)(2)(i). The creditor, however, may refuse to accept an insurer offered by the consumer, provided it has reasonable cause to do so. Reg. Z § 226.4(d)(2) n.6. *See* Fabricant v. Sears Roebuck, Clearinghouse No. 54,563, Case No. 98-1281-CIV-Moreno (S.D. Fla. Mar. 5, 2002) (where the creditor uses word "optional" to describe insurance, creditor violates requirement to disclose that consumer may purchase property insurance by a provider of consumer's choice), *class cert. granted, 202 F.R.D. 310 (S.D. Fla. 2001)* . *See also Stump v. WMC Mortg. Corp., 2005 U.S. Dist. LEXIS 4304* (E.D. Pa. Mar. 16, 2005) (property insurance premium properly excluded from finance charge with general disclosure that borrower could obtain insurance from anyone acceptable to the creditor).

(n84)Footnote 83. *15 U.S.C. § 1605(c)*; Reg. Z § 226.4(d)(2)(ii).

(n85)Footnote 84. Reg. Z § 226.4(d)(2)(ii).

(n86)Footnote 85. Reg. Z § 226.4(d)(2) n.5; Official Staff Commentary § 226.4(d)-9.

(n87)Footnote 86. Official Staff Commentary § 226.4(d)-10.

(n88)Footnote 87. For additional analysis of credit insurance issues and the finance charge, see National Consumer Law Center, Truth in Lending § 3.9.4 (6th ed. 2007 and Supp.).

(n89)Footnote 88. *See, e.g., §§ 1.07[9]* (on HELC disclosures), *1.08 infra* (on rescission).

(n90)Footnote 89. Thus, they apply to both purchase-money and home equity loans. A residential mortgage transaction is defined as one in which a consensual security interest, including a mortgage or deed of trust, is taken in the consumer's principal dwelling to finance the acquisition or initial construction of that dwelling. Reg. Z § 226.2(a)(24). *See also 15 U.S.C. § 1602(w).*

(n91)Footnote 90. *See §§ 1.05[2][e][ii][A], 1.08[3][b], 1.09[2][h] infra* .

(n92)Footnote 91. The regulation does not define either "bona fide" or "reasonable." At a minimum, bona fide should mean that the fee is both legal and actually incurred in the amount charged. This requirement is likely to continue to apply in evaluating charges under the 1995 amendments, as the legislative history indicates that the immunity and tolerances are to protect good faith judgment errors, not to give lenders room to pad fees. Cong. Rec. S14,567 (Sept. 28, 1995) (statement of Sen. Sarbanes). *See Inge v. Rock Fin. Corp., 281 F.3d 613 (6th Cir. 2002)* (to prove that a document preparation fee is a finance charge, consumer need only allege that fee was not reasonable as it exceeded the actual cost of preparing the documents; specifically rejected a lender's argument that the consumer must allege facts showing the lender's charges differed from those of other local businesses).

(n93)Footnote 92. *15 U.S.C. § 1605(e)(1)*; Reg. Z § 226.4(c)(7)(i).

(n94)Footnote 93. *15 U.S.C. § 1605(e)(1)*; Reg. Z § 226.4(c)(7)(i). *See, e.g., Bell v. Parkway Mortgage, Inc. (In re Bell), 309 B.R. 139 (Bankr. E.D. Pa. 2004) as amended on reconsideration by 314 B.R. 54 (Bankr. E.D. Pa. 2004)* (title insurance endorsement fee of $200 excluded under § 226.4(c)(7)(i), where the charging of the fee was "customary," required by the lender, and the cost was set by the state Department of Insurance). *Guise v. BWM Mortgage, 377 F.3d 795 (7th Cir. 2004)* (title insurance fee would not be bona fide where insurance or endorsements were not received, or if services covered by such fee were not performed); *Murry v. America's Mortg. Banc, Inc., 2004 U.S. Dist. LEXIS 12045* (N.D. Ill. June 25, 2004) (excessive title insurance fee is not bona fide). *Cf. Marquez v. New Century Mortg. Corp., 2004 U.S. Dist. LEXIS 5725* (N.D. Ill. Apr. 2, 2004) (summarily concluding that only the amount of the title fee that makes the charge unreasonable should be included in the finance charge); *Scott v. IndyMac Bank, FSB, 2004 U.S. Dist. LEXIS 1309* (N.D. Ill. Feb. 2, 2004) (bona fide title expenses should be excluded from the finance charge "to the extent reasonable" in order to give meaning to the tolerance); *McMaster v. CIT Group/Consumer Fin., 2006 U.S. Dist. LEXIS 28831* (E.D. Pa. May 11, 2006) (genuine issue of material fact as to whether title fee was bona fide and reasonable when evidence indicated that consumer may have been charged twice for the title exam). *But see Strang v. Wells Fargo Bank, 2005 U.S. Dist. LEXIS 14135* (E.D. Pa. July 13, 2005) (title insurance excluded from finance charge; no bona fide/reasonable analysis). *Madera v. Ameriquest Mortgage Co. (In re Madera), 388 B.R. 586 (E.D. Pa. 2008)* (holding that appropriate standard is that lender knew or should have known that borrowers were eligible for reissue title insurance rate); *Escher v. Decision One Mortg. Co., LLC (In re Escher), 369 B.R. 862 (Bankr. E.D. Pa. 2007)* (charging higher standard fee rather than lower reissue title rate was reasonable and not a finance charge where lender neither knew nor should have known that borrowers had previous insurance policy).

(n95)Footnote 94. *Compare In re Grigsby, 119 B.R. 479 (Bankr. E.D. Pa. 1990)* (fee for title insurance policy was bona fide and reasonable and properly excluded from the finance charge, though not issued until three days after consummation; no evidence was presented that the charge was excessive, "either due to a relationship between [creditor and insurer] or otherwise," or illegal), *vacated on other grounds, 127 B.R. 759 (Bankr. E.D. Pa. 1991)* , *with Mayo v. Key Fin. Servs., Inc., 2 Mass. L. Rep. 269 (Super. Ct. 1994)* (title insurance premium alleged to be in excess of market rate).

(n96)Footnote 95. *Johnson v. The Know Fin. Group, 2004 U.S. Dist. LEXIS 9916* (E.D. Pa. May 26, 2004) (finding a title insurance charge to be unreasonable where the creditor did not abide by published state guidelines for reissue rates); *Johnson v. Banc One Acceptance Corp., 278 F. Supp. 2d 450 (E.D. Pa. 2003)* (same case; describing how court would analyze whether the title insurance charge is unreasonable or not bona fide, but holding that this can not be determined on a motion to dismiss because discovery is needed).

(n97)Footnote 96. *See §§ 1.05[2][e][ii][A], 1.08[3][b], 1.09[2][h] infra* . *See Brannam v. Huntington Mortgage Co., 287 F.3d 601* (6th Cir.) , *cert. denied, 537 U.S. 1048, 123 S. Ct. 635, 154 L. Ed. 2d 522 (2002)* (this exclusion covers not only documents related to the transfer of title but all documents; court construed Reg. Z § 226.4(c)(7)(ii)). A document preparation fee will not be bona fide if it includes amounts for any additional purpose. *Cowles v. Bank West, 687 N.W.2d 603 (Mich. Ct. App. 2004)* (distinguishing facts from *Brannam* on this basis), *appeal granted, 705 N.W.2d 28 (Mich. 2005)* . *Bynum v. Equitable Mortg. Group, 2005 U.S. Dist. LEXIS 6363* (D.D.C. Apr. 7, 2005) (settlement closing fee counts toward finance charge where lender required that loan be closed by lender-approved title insurance

company, and where lender required the fee; evidence came from a disclosure form provided to borrower at closing).

(n98)Footnote 97. Reg. Z § 226.4(c)(7)(ii). Given the legislative history, this provision, as was its earlier incarnation, should be subject to the good faith and reasonable test articulated in Regulation Z's interpretation of section 1605(e). *See Bell v. Parkway Mortgage, Inc. (In re Bell), 309 B.R. 139 (Bankr. E.D. Pa. 2004) as amended on reconsideration by 314 B.R. 54 (Bankr. E.D. Pa. 2004)* (copying fee and recording service fee were not finance charges when imposed by closing agent because there was no evidence that creditor required the fee or retained a portion of it; court also rejected consumer's argument that the copying fee was not a reasonable or bona fide real-estate-related fee under § 226.4(c)(7)).

(n99)Footnote 98. *See, e.g., Lawson v. First Union Mortgage Co., 786 N.E.2d 279 (Ind. Ct. App. 2003)* (reversing trial court's dismissal of a consumer's equitable claim for return of a document preparation fee; court held that while a lender's lay employees did not commit the unauthorized practice of law by preparing mortgage loan documents, the lender could not charge a separate fee for such documents); *Eisel v. Midwest Bankcentre, 2006 Mo. App. LEXIS 1820* (Mo. Ct. App. Nov. 28, 2006) (bank engaged in unauthorized practice of law when it charged a separate document preparation fee for creating deeds of trust and loan documentation; trial court awarded treble damages pursuant to state statute and appellate court transferred case to state supreme court in light of importance of issue).

(n100)Footnote 99. The issue of non-attorneys preparing mortgage documents is a hotly contested one between the legal profession and non-legal entities. Ironically, the Federal Trade Commission and U.S. Department of Justice have weighed in on the side of the lending industry, believing that permitting non-lawyers to prepare mortgage loan documents is consumer-friendly because it supposedly increases competition and reduces the cost of document preparation. Fed. Trade Comm'n & United States Dep't of Justice, Comments on the American Bar Association's Proposed Model Definition of the Practice of Law (Dec. 20, 2002).

(n101)Footnote 100. *15 U.S.C. § 1605(e)(4)-(6)*; Reg. Z § 226.4(c)(7)(iii).

(n102)Footnote 101. *15 U.S.C. § 1605(e)(4)-(6)*; Reg. Z § 226.4(c)(7)(iii).

(n103)Footnote 102. Official Staff Commentary § 226.4(c)(7)-1. *See Riopta v. Amresco Residential Mortgage Corp., 101 F. Supp. 2d 1326 (D. Haw. 1999)* (court found that overcharge on the property appraisal did not exceed the tolerance of $35 for foreclosure cases without any analysis of whether the entire fee or only the overcharge is a finance charge, and because the lender relied upon an oral representation of the cost, which later turned out to be too low).

(n104)Footnote 103. *15 U.S.C. § 1605(a)(4)*; Reg. Z § 226.4(b)(4).

(n105)Footnote 104. *See Oscar v. Bank One, 2006 U.S. Dist. LEXIS 6410* (E.D. Pa. Feb. 17, 2006) (when notary fee limited under state law to $2, remaining $33 of $35 fee counts toward finance charge).

(n106)Footnote 105. *15 U.S.C. § 1605(e)(3)*. Prior to the 1981 revision, Regulation Z also cast this provision in terms of escrow for future payments of "taxes, insurance, and water, sewer and land rents." Reg. Z § 226.4(e)(3) (1980).

(n107)Footnote 106. Reg. Z § 226.4(c)(v).

(n108)Footnote 107. Official Staff Commentary § 226.4(c)(7)-3; *60 Fed. Reg. 16,771, 16,773* (Apr. 3, 1995) (Supplemental Information). The 1995 statutory amendments codified this approach with respect to pest inspection and flood hazard inspection fees. Only if conducted prior to closing are they excluded from the finance charge. *15 U.S.C. § 1605(e)(5), as amended* Sept. 30, 1995.

(n109)Footnote 108. Official Staff Commentary § 226.4(c)(7)-3; *60 Fed. Reg. 16,771, 16,773* (Apr. 3, 1995) (Supplemental Information).

(n110)Footnote 109. *15 U.S.C. § 1605(d)*; Reg. Z § 226.4(e).

(n111)Footnote 110. *15 U.S.C. § 1605(d)*; Reg. Z § 226.4(e).

(n112)Footnote 111. A payment to public officials need not occur simultaneously with a consumer's transaction to be excluded from the finance charge. *See Harper v. Lindsay Chevrolet Oldsmobile, 212 F. Supp. 2d 582 (E.D. Va. 2002)* (amount paid by auto dealer for purchase of temporary plates in advance of consumer's transaction could be excluded from the finance charge). *See also Payton v. New Century Mortgage Corp., 2003 U.S. Dist. LEXIS 18366* (N.D. Ill. Oct. 14, 2003) (excluding from the finance charge only the portion of the government recording fee that actually was paid to record the mortgage and finding that the remaining amount paid by the consumer for this service--the overcharge of $49.50--is a finance charge). *See, e.g., Kai v. Aames Capital Corp., 920 So. 2d 846 (Fla. Dist. Ct. App. 2006)* (when fees were properly itemized and disclosed, public official fees did not violate TILA).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 1 Truth in Lending

1-1 Consumer Credit Law Manual § 1.05

§ 1.05 Closed-End Credit Disclosures

REGULATION Z CHANGES OR ADDITIONS DUE TO FEDERAL RESERVE BOARD AMENDMENTS OF JULY 30, *2008 Fed. Reg. 44,522* (July 30, 2008). The Federal Reserve Board issued a proposed rule on August 26, 2009, that includes substantial changes to Regulation Z's disclosure requirements for closed-end, home-secured credit. When a final rule is issued, the changes will be examined more comprehensively in a future update to this publication.

Regulation Z and related Commentary Section	**Description of Affected or Added Regulation**	**Effective Date**
§ 226.2(a)(6)	Definition of business day for purposes of early disclosures for covered loans.	New transactions for which the creditor receives an application on or after Oct. 1, 2009.
§ 226.16(d), (e)	Advertising rules for open-end credit.	Advertisements occurring on or after Oct. 1, 2009.
§ 226.17(b), (f)	Timing of closed-end disclosures and redisclosure if early disclosures become inaccurate.	New transactions for which the creditor receives an application on or after Oct. 1, 2009.
§ 226.19(a)	Early disclosures for all loans secured by the consumer's principal dwelling, other than home equity lines of credit.	New transactions for which the creditor receives an application on or after Oct. 1, 2009.
§ 226.23, note 48	Definition of "material" disclosures for purposes of rescission.	New transactions for which the creditor receives an application on or after Oct. 1, 2009.
§ 226.24(b), (c), (d), (e), (f), (g), (h), (i)	Advertising rules for closed-end credit.	Advertisements occurring on or after Oct. 1, 2009.
§ 226.32(d)(6), (7)	HOEPA prepayment penalty prohibition.	New transactions for which the creditor receives an application on or after Oct. 1, 2009.

§ 226.34(a)(4)	HOEPA ability to repay standard.	New transactions for which the creditor receives an application on or after Oct. 1, 2009.
§ 226.35 *new*	Higher-priced mortgage loans; prohibited acts or practices.	New transactions for which the creditor receives an application on or after Oct. 1, 2009, except for the escrow rules; escrow rules apply to new transactions for which the creditor receives an application on or after April 1, 2010; for loans secured by manufactured housing, escrow rules apply to new transactions for which the creditor receives an application on or after Oct. 1, 2010.
§ 226.36 *new*	Credit secured by a consumer's principal dwelling; prohibited acts or practices.	New transactions for which the creditor receives an application on or after Oct. 1, 2009, except for the servicer rules which apply to all covered loans serviced on or after Oct. 1, 2009.

[1] Introduction

As discussed above, disclosure of the finance charge is at the heart of TIL. However, this disclosure is by no means the only important TILA disclosure requirement. TILA mandates additional disclosures for both closed-end and open-ended credit. Disclosures required in closed-end credit transactions are discussed in this section. Open-ended credit disclosure requirements are discussed in *§ 1.07 infra*.

"Closed-end" credit transactions are defined by Regulation Z as "consumer credit other than 'open-end credit.' " n2 Closed-end credit usually involves one transaction, such as a mortgage loan to buy a home, or an installment sale of an appliance, or a car loan with a fixed repayment plan as to both number and amount of payments. Open-end plans are often referred to as "revolving credit."

For covered closed-end transactions in which there is a single creditor, that creditor must make the disclosures. n3 In the rare instance in which there are multiple creditors, only one set of disclosures must be given. n4

Disclosures must be made to the consumer who is obligated in the transaction. n5 If more than one consumer is involved, disclosures may be given to any one consumer who has primary liability on the obligation. n6 However, in rescindable home secured transactions, n7 separate disclosures must be given to every consumer who has the right to rescind. n8

[2] Required Closed-End Disclosures

[a] Form of Required Disclosures

The statute n9 and Regulation Z n10 require that disclosures must be made clearly and conspicuously. The Commentary amplifies this standard to require that disclosures be made "in a reasonably understandable form." n11 If a disclosure is capable of more than one plausible interpretation, it is not clear and conspicuous. n12 The standard typically employed by the courts to judge whether a disclosure is "clear and conspicuous" is an objective one. n13 The courts will review disclosures through the eyes of the ordinary consumer. n14 If the ordinary consumer would be confused or misled by the disclosures, they are not clear and conspicuous. n14.1 Several courts hold that whether disclosures meet these

standardsis a question of law to be decided by a judge. n15 Consequently, cases can be won or lost on summary judgment. In late 2003, the Federal Reserve Board proposed a more specific definition of "clear and conspicuous." n16 It intended to make the definition uniform among five regulations over which it has authority: Regulations B (relating to equal credit), E (relating to electronic fund transfers), M (relating to consumer leasing), Z (relating to truth in lending), and DD (relating to truth in savings). However, the Board withdrew its proposed uniform standard in light of industry opposition and consumer concerns. n17 Some disclosures have to be "*more* conspicuous" than the other required disclosures, specifically, the finance charge and the annual percentage rate. n18

The "clear and conspicuous" standard also embraces the notion of legibility. n19 The disclosures must be written n20 but may be handwritten, typed, printed by computer or any combination of these. n21 In addition, the consumer must be given a copy of the written disclosures. n22 "Conspicuousness" is a question of law to be decided by a judge. n23 Consequently, cases can be won or lost on summary judgment.

The 1980 Simplification amendments required the FRB to publish model disclosure forms and clauses upon which creditors may rely. n24 Although use of the forms and clauses is not required, the Act does give some protection to creditors choosing to use them. Creditors using the model forms as printed, if they choose the correct forms, should be immune to attacks for violations of the clear and conspicuous requirements. n25 Those not using the forms or altering them arguably carry a high burden to show they satisfy the requirements.

The FRB has promulgated the following Closed-End Models of Regulation Z:

H-1 Credit Sale Model Form (§ 226.18)

H-2 Loan Model Form (§ 226.18)

H-3 Amount Financed Itemization Model Form (§ 226.18(c))

H-4 Variable-Rate Model Clauses (§ 226.18(f))

H-5 Demand Feature Model Clauses (§ 226.18(i))

H-6 Assumption Policy Model Clause (§ 226.18(q))

H-7 Required Deposit Model Clause (§ 226.18(r))

H-8 Rescission Model Form (General) (§ 226.23)

H-9 Rescission Model Form (Refinancing) (§ 226.23)

The Models are illustrated by examples in six samples:

H-10 Credit Sale Sample

H-11 Installment Loan Sample

H-12 Refinancing Sample

H-13 Mortgage with Demand Feature Sample

H-14 Variable-Rate Mortgage Sample

H-15 Graduated-Payment Mortgage Sample

The Board has proposed sweeping changes to the model forms for closed-end mortgages. n26 More information about these disclosures will be provided in subsequent supplements, after the adoption of final regulations.

The statute's purpose is to require meaningful disclosures to consumers, n26.1 and therefore their adequacy must be assessed at least, in part, by the audience of ordinary laypersons. n27 Violation of the "meaningful" standard does not itself give rise to damages. Rather, the "meaningful" requirement should be used in interpreting whether the specific disclosures made meet statutory requirements. n28 Failure to make certain disclosures in a "meaningful" way leads to damages.

The statute requires that the disclosures must be "segregated from everything else, and shall not contain any information not directly related" to the disclosures required by Regulation Z section 226.18. n29 Contradictions on the TIL disclosure itself may also render the disclosures not clear and conspicuous. n29.1

In some cases, creditors may issue more than one TIL disclosure or there may be, in a mortgage transaction, multiple and conflicting settlement statements. n29.2 In such cases, it may be difficult for consumers or their advocates to determine what the correct disclosures are--a very nearly per se violation of the clear and conspicuous rule. On the other hand, TILA provides for redisclosure when previously provided disclosures become inaccurate. Redisclosure required or permitted by TILA by itself is not a violation of the clear and conspicuous standard. n29.3

The Electronic Signatures in Global and National Commerce Act ("E-Sign"), n30 which became effective October 1, 2000, allows disclosures that are required by federal statutes to be made electronically, as long as certain conditions are met. n31 The legislative history of the Act refers to TIL disclosures as an example of a law affected by this provision. n32 The new statute applies not only to transactions that the consumer initiates electronically, but also to traditional paper transactions. It authorizes creditors to make TIL disclosures electronically in transactions that are otherwise conducted entirely on paper, as long as the new statute's requirements satisfied. For consumer transactions, the key requirement is that the consumer must consent in a very specific way to receive electronic disclosures. n33

Prior to consenting to receive electronic disclosures, the consumer must be given a clear and conspicuous statement of:

- Any right or option to get the disclosure in non-electronic form;
- The right to withdraw consent and the procedures for and consequences of doing so;
- What transactions the consumer's consent applies to;
- The procedures for updating the information needed to contact the consumer electronically;
- How, after consenting to electronic disclosures, to get a paper copy of any disclosures, and whether any fee will be imposed. n34

The consumer must also be given a statement of the hardware and software requirements for access to and retention of electronic records. n35 Most importantly, the consumer must also either give consent electronically to receive electronic disclosures, or must confirm consent electronically. n36 In either case, the consent or confirmation of consent must be done "in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent." n37

The federal E-Sign statute states that it does not affect requirements regarding the content or timing of disclosures. n38 The legislative history shows that Congress considered a requirement that disclosures be clear and conspicuous to be the an example of a "content" requirement that was unaffected by the E-sign statute. n39 In addition, another section of the

statute states the general rule that it does not undermine any statutory or regulatory requirements other than those that require contracts or other records to be written, signed, or in nonelectronic form. n40

The federal statute gives federal agencies, including the FRB, authority to interpret the federal statute, but the interpretation must be consistent with the statute's rules for electronic disclosures and cannot add requirements.

In 2001, the Federal Reserve Board issued an interim rule governing electronic disclosures under TILA. n41 The rule was immediately effective and contained a mandatory compliance date of October 1, 2001. n42 After the comment period expired, however, the Board lifted the mandatory compliance date because the "Board is considering adjustments to the rules to provide additional flexibility." n43 Because the landscape of the interim rule is in doubt, it is unlikely that creditors will engineer their computer software and gear up to engage in electronic credit transactions until some rule becomes final.

The Board structured the new rules by amending certain existing provisions and by adding a new section to Regulation Z entitled "Requirements for electronic communication." n44 This addition contains the basic thrust of the Board's views on how electronic disclosures must be made. Further, the Commentary was revised in parts and new Commentary fleshes out the new Regulation Z section.

[b] Timing of Required Disclosures

The statute requires that closed-end disclosures be made "before the credit is extended." n45 Regulation Z uses the phrase "before consummation," n46 defined as "the time that a consumer becomes contractually obligated on a credit transaction." n47 A copy of the disclosures are not provided before consummation where the creditor gives a copy to the consumer to review before signing the contract, but will not permit the consumer to leave with the copy unless it is signed. Whether or when a consumer becomes "contractually obligated" is an issue of state law; it is not, theoretically, a TIL issue. n48 In 2002, the Board added a discussion in the Commentary regarding the timing rules when the creditor provides the TILA disclosure on the same form as the credit contract. n49 The Board rejected the argument that a creditor can provide a copy of the disclosure within a reasonable time after consummation, and made clear that when the disclosures are combined with the credit contract, the creditor must give the consumer a copy of the unexecuted contract to read and sign. n50

There are two exceptions to the rule that disclosures must be made prior to consummation. These are for some mail or telephone orders n51 and, in a series of sales, the creditor may delay disclosures until the due date of the first payment for the current sale. n52

Transactions which are both "residential mortgage transactions" as defined by TIL n53 and which are also subject to Real Estate Settlement Procedures Act ("RESPA"), n54 are subject to special timing rules. n55 For this category of transactions, good faith estimates of the required disclosures n56 must be made prior to consummation or delivered or mailed within three days after the consumer's written application is received, n57 whichever is earlier. n58 Depending on the terms of the transactions, these loans may also be subject to special timing rules for variable-rate transactions. The Commentary also allows creditors subject to RESPA to completely omit the itemization of the amount financed. n59

In 2008, both the Federal Reserve Board and the Congress decided it was time that borrowers who were refinancing their homes should receive early disclosures of the cost of credit. n60 The current early disclosure requirements apply only to purchase mortgage loans. The statute, signed the same day the final regulations were published in the *Federal Register*, amends TILA to require early disclosures on most extensions of credit secured by a dwelling. The statute and the regulations, in an effort to promote shopping, also limit the fees that a consumer may be charged, by any party, before the early disclosures are received by the consumer, to a credit report fee. n61

The statute generally provides more coverage than the regulations. More loans are covered; redisclosure is required before the closing table. Disclosures must be delivered three business days after application (the current law for residential mortgage transactions), but no less than seven business days before closing. n62 The statute goes into effect on July 30, 2009, n63 two months before the regulations are set to take effect on October 1, 2009. n64

Consumers can, in some circumstances, waive receipt of the early disclosures only in the event of a "bona fide personal emergency." n65 The Board has authority to further define bona fide personal emergency. n66

"Bona fide personal financial emergency" is also required for waiver or modification of rescission rights. n67 The consumer must receive the final disclosures no later than the waiver. n68

As with the existing timing regulations, failure to comply with the timing requirements should give rise to a claim for actual and statutory damages.

With respect to timing of disclosures in variable-rate transactions, creditors are required to provide consumers with extensive information about the variable-rate feature of closed-end adjustable rate mortgages ("ARMs") secured by the consumer's principal dwelling and with a maturity longer than one year when such loan terms are contemplated. n69 These disclosures, which include both an ARM brochure and other detailed information, must be provided to prospective borrowers when an application form is furnished or before the payment of a non-refundable fee, whichever is earlier. n70

[c] Basis of Disclosures

The disclosures must reflect the terms of the legal obligation between the creditor(s) and the consumer(s). n71 As with the definition of consummation, the "legal obligation" is determined by applicable state or other law. n72 The disclosures should reflect the legal obligation in effect at the outset of the transaction. n73

If any information necessary for an accurate disclosure is unknown, the creditor must make the disclosure based on the best information "reasonably available" and must state that the disclosure is an estimate. n74 If the loan note is ambiguous as to the legal obligation regarding, for example, a balloon payment, the consumer could argue that the TIL disclosures do not reflect the legal obligation. This argument is strong when the TIL disclosures list a specific balloon payment amount, the loan note does not but is titled "Balloon Note," and the creditor claims there is no balloon or the balloon payment differs from that disclosed. n75

As with many other disclosure rules, creditors are given considerable flexibility in making estimated disclosures. According to the Commentary, only the particular disclosure for which the exact information is unknown must be labelled as an estimate. n76 It is quite possible, however, that the accuracy of other disclosures will also be affected by the estimated disclosure. In those situations, the creditor has the option of labelling every affected disclosure as an estimate or only labelling the disclosure primarily affected as an estimate. n77

The 1995 amendments included a special rule for estimated disclosures of per diem interest. A creditor is now permitted to disclose per diem interest based on information actually known to the creditor at the time the disclosure documents are prepared. n78

In addition to labelling disclosures as estimates, creditors may also disregard what the Commentary calls "minor variations" n79 and "irregularities." n80

Sometimes in the period after a creditor has made disclosures and before consummation, a "subsequent event" may make those disclosures inaccurate. There are some limited situations in which these subsequent events require new disclosures. Specifically, there are three circumstances where a change in the interim will trigger a redisclosure

requirement. n81

If the annual percentage rate changes by more than 1/8 of 1 percentage point in a "regular transaction" or 1/4 of 1 percentage point in an "irregular transaction," n82 then the creditor must disclose the changed terms prior to consummation. n83 (The APR tolerance is the key issue even if the changed terms exceed other TIL tolerances such as that for the finance charge.) Second, even where any change in the APR is within the permitted tolerance, if the APR or other disclosed terms initially were not based on proper estimates and labelled as such, redisclosure is also required. n84 Finally, new disclosures must also be made prior to consummation if a variable-rate feature is added to the credit terms. n85

Not surprisingly, the issue of solicitations and disclosures matching the legal obligation has arisen in the credit card context. In a recent Third Circuit decision, Rossman v. Fleet Bank National Ass'n, n86 the consumer signed up for a credit card that the TIL disclosures described as a "no-annual-fee Platinum Master Card." Nonetheless, just six months later, the bank imposed an annual fee, payable almost immediately. Along with the disclosure of "no annual fee," the bank had disclosed its right to "change the benefit features associated with [the] card at any time." The court held that TILA only requires disclosure of *current* fees, not all fees that might ever be imposed. But the court went on to evaluate whether the disclosure of "no annual fee" was a clear and conspicuous statement of the terms of the card. The court held that such a disclosure implies that there will be no fee for at least a year. If the creditor imposes an annual fee sooner than a year, the initial disclosure is not a clear and conspicuous statement of the legal obligation.

[d] Determining Which Disclosures Are Required

The TILA and the Regulation require a creditor to disclose a long list of items for each closed-end transaction. n87 Every item must be disclosed "to the extent applicable" n88 or "as applicable." n89 The Commentary attempts to give some meaning to the phrase "as applicable," n90 stating that "any disclosure not relevant to a particular transaction may be eliminated entirely." The Commentary gives two fairly obvious examples. The "total sale price" disclosure may be eliminated in a loan transaction; the "down payment" disclosure may be deleted if there is no down payment. n91

[e] Special Consumer Relief Disclosures

All of the required disclosures are not created equal. Improper disclosure of certain ones give rise to greater liability for the offending creditor than others. Violations of any disclosure requirement give rise to a right to actual damages, attorney fees and costs. n92 But since many disclosure violations are unlikely to give rise to actual damages to the average consumer, those disclosure violations which give rise to special consumer relief take on increased importance.

There is no requirement of actual damages in order to obtain the right to special relief for these violations, n93 although as with any TIL disclosure requirement, actual damages are available where they arise. Those violations which give rise to special consumer relief are listed below.

[i] Amount Financed

The amount financed must be disclosed using that term. n94 In addition, a brief description of the amount financed must be provided. n95 The Regulation suggests using the description "the amount of credit provided to you or on your behalf." n96

Failure to properly disclose the amount financed gives rise to statutory damages and attorney fees, n97 as well as any actual damages. Improper disclosure of the amount financed is also a material violation for purposes of rescission. n98

According to the Regulation, the amount financed for a *loan* is calculated by determining the *principal loan amount* and

a) Adding *other amounts financed by the creditor* but not included in the finance charge, and

b) Subtracting any *prepaid finance charge*. n99

The amount financed for a *credit sale* is calculated by determining the *cash price* and:

a) Subtracting any *down payment*; n100

b) Adding *other amounts financed by the creditor* but not included in the finance charge; n101 and

c) Subtracting any *prepaid finance charge*. n102

Though the formula conveys the concept underlying the amount financed in a given transaction, it may be a somewhat imprecise description. n103 Any financed fee or other charge that is not part of the finance charge and is not paid separately at consummation of the transaction must be included in the amount financed. n104

[ii] Disclosure of the Finance Charge

The finance charge must be disclosed as a dollar amount, the term "finance charge" must be used, and a brief description of the finance charge must be provided. n105 The Regulation suggests using the description "the dollar amount the credit will cost you." n106 In variable-rate transactions, the creditor has the option of modifying the description with a phrase such as "which is subject to change." n107

The finance charge may be disclosed only as a total amount. Its elements need not be itemized in the segregated disclosures (although nothing would prohibit its elements from being disclosed elsewhere). n108

The disclosure of the finance charge (along with the disclosure of the annual percentage rate) must be more conspicuous than any other required disclosure. n109 The only required disclosure which may be, but need not be, more conspicuous than the finance charge is the creditor's identity. n110 Violation of the more conspicuous requirement entitles the consumer to statutory damages, n111 as well as any actual damages.

Failure to properly disclose the amount of the finance charge gives rise to statutory damages, n112 as well as any actual damages. n113 Improper disclosure of the amount of the finance charge is also a material violation for purposes of rescission. n114

[A] 1995 Amendments and Tolerances for Error

A key issue for evaluating an inaccurate finance charge is whether the disclosure must be treated as accurate because it is within the TILA's "tolerance" for error. The 1995 amendments to TILA create a complicated system for determining tolerances for the disclosure of the finance charge for different types of transactions and claims. The finance charge tolerance for a particular claim will depend on the date of the transaction, the type of transaction, the type of relief being sought, and for some real-estate secured loans, whether or not the creditor has initiated foreclosure.

The Regulation provides a general tolerance for the disclosure of the finance charge, which applies to all non-mortgage credit. n115 If the amount financed exceeds $1,000, then the finance charge is considered accurate if it is no more than $10 above or below the exact finance charge. n116 If the amount financed is $1,000 or less, then the finance charge is considered accurate if it is no more than $5 above or below the exact finance charge. The amendments, however, create a complicated series of exceptions, limitations, and exceptions to the exceptions which apply to real estate and dwelling secured loans. n117

For advocates using TIL rescission to defend against home foreclosures, n118 the tolerance is $35 for underdisclosures. n119 The precondition on the exception is that the creditor must have initiated a judicial or nonjudicial foreclosure. n120 Overdisclosures of the finance charge will have an unlimited tolerance. n121

The tolerance for rescission remedies, except after initiation of foreclosure as discussed above, is more complicated. The general rule allows a tolerance for an understatement of $100 or one-half of one percent of the total amount of credit extended, whichever is greater. n122 There is an unlimited tolerance for an overstated finance charge. n123 Note that only the unreasonable portion of a fee under the finance charge analysis is misdisclosed; thus, only the unreasonable portion counts towards the tolerance of one half of one per cent. n124

Closed-end loans secured by real-estate or a dwelling made after September 30, 1995, are subject to a special set of finance charge tolerance rules. n125 For damage remedies, the tolerance in these transactions is $100. n126 There is an unlimited tolerance for overdisclosures. n127

For transactions refinancing the principal balance and accrued unpaid finance charges of a prior residential mortgage transaction, n128 and subsequent refinancings of such a transaction (in both cases whether or not the same creditor is involved), the finance charge tolerance is one percent of the total amount of credit extended, or $100, whichever is greater. n129 However, to qualify for this larger tolerance, the loan must not include any debt consolidation or new advances. Again, overdisclosures in any amount do not give rise to any liability. n130 However, it does not apply to high-rate mortgage transactions as defined by the statute. n131

The tolerances--at least those provided by sections 1605(f) and 1635(i)(2) for transactions entered into after September 30, 1995--are affirmative defenses that must be raised by the creditor, rather than an element of the claim that the consumer must plead. n132

In the 1995 amendments, Congress also created tolerances which apply retroactively to transactions consummated before September 30, 1995, the effective date of the Act. n133 The retroactive tolerance levels apply only to closed-end loans secured by real-estate and dwellings. n134

[iii] Annual Percentage Rate Disclosure

The "annual percentage rate" must be disclosed using that term, and a brief description of the annual percentage rate must also be provided; the Regulation suggests using the description "the cost of your credit as a yearly rate." n135 In variable-rate transactions, the creditor has the option of modifying the description with a phrase such as "which is subject to change." n136 The disclosure of the annual percentage rate (along with the disclosure of the finance charge) must be more conspicuous than any other required disclosure. n137 The only required disclosure which may be, but need not be, more conspicuous than the annual percentage rate is the creditor's identity. n138 Violation of the more conspicuous requirement should entitle the consumer to statutory damages, n139 as well as any actual damages.

The APR for a variable rate transaction is calculated like other APRs, based on the legal obligation as it exists at the time of origination. With a variable rate transaction, however, the question arises as to which interest rate to use in calculating the payment schedule on which the APR is based. The rate at origination will change; from the beginning, the note presumes a change in the rate. This choice is further complicated in notes that set an initial rate artificially low, such that the rate will, without doubt readjust to a higher rate during the note term. Variable rate transactions should be distinguished, however, from notes, such as step-rate mortgages, that provide for a series of defined adjustments in the interest rate. If the interest rate changes are pre-defined and certain at the time of origination (e.g., if the note provides that the rate will increase from 2% to 7% over five years, with one percentage point increases every year), that is a step-rate mortgage, which is not subject to the variable rate transaction disclosure rules. n139.1

The Commentary dispenses with the need for crystal balls by requiring that the APR should be calculated based on the

rate in effect at the loan's inception. n139.2 If this initial rate is not calculated in accordance with the formula defined in the note for subsequent variations in the rate, then the creditor will need to calculate a composite APR. n139.3 The composite APR, in essence, averages out the initial rate and the rate calculated in accordance with formula set out in the note over the life of the loan. But this composite APR, too, reflects the market rate in effect at origination and does not account for any subsequent changes in the index.

The finance charge, total of payments, and payment schedule must also reflect the effect of the combined rates, where the initial stated rate is not the same as the rate that would apply if calculated according to the formula contained in the loan note.

[iv] Disclosure of the Payment Schedule

The creditor must disclose the payment schedule for each transaction, including:

a) The number of payments; n140

b) The amount of each payment; n141 and

c) The timing of payments scheduled to repay the obligation. n142 The payment schedule must include the amount of the payments. n143 Unless Regulation Z or the Commentary expressly provides otherwise, the payments should be disclosed as dollar amounts. An early Federal Reserve Board letter makes this clear. n144

The Homeowners Protection Act of 1998 limits the amount of private mortgage insurance ("PMI") consumers can be required to purchase, for mortgage loans consummated on or after July 1, 1999. n145 Creditors must terminate PMI automatically when certain conditions are met. In 1999, the Board amended the Commentary to provide that the payment schedule reflect the consumer's mortgage insurance payments until the date on which the creditor must automatically terminate coverage. This date occurs when the principal balance owed is 78% of the sale price. In other words, the payment schedule must list a certain number of payments in a monthly amount which includes the private mortgage insurance premium followed by the remaining number of payments in an amount which does not reflect the premium. n146

The Board added an example to the Commentary in 2003 to illustrate how mortgage insurance premiums should be disclosed on the payment schedule when some premiums are collected and escrowed at the time the loan is closed. n147 Note that since the cost of private mortgage insurance is a finance charge, it must be reflected in the finance charge disclosure and the APR. n148

[v] Disclosure of the Total of Payments

The "total of payments" must be disclosed using that term, and a brief description of the total of payments must also be provided. n149 The Regulation suggests using the description "the amount you will have paid when you have made all the scheduled payments." n150

The total of payments need not be disclosed, however, in single-payment transactions. n151 This exception does not apply if there are periodic payments of interest in addition to a single payment of principal. n152

Disclosures in a demand obligation transaction (that is, the debt is payable on demand) must be based on an assumed maturity of one year, unless an alternate maturity date is stated in the legal obligation between the parties. n153

[vi] Disclosure of Security Interests

The creditor must disclose whether it has or will acquire a security interest in the property being purchased as part of the transaction or in other property, identified by item or type. n154 A "security interest" is defined for purposes of the TILA as an interest in property that secures performance of a consumer credit obligation and that is recognized by state or federal law. n155

A security interest does not include, however, "incidental interests," interests in after-acquired property, and security interests that "arise solely by operation of law." n156 These interests may not be disclosed as security interests in the segregated disclosures regardless of whether they are recognized as such under applicable law. n157 However, nothing in the Act or Regulation prohibits the creditor from contractually reserving or enforcing these interests. n158

The term "security interest" also excludes interests in after-acquired property. n159 This exclusion presumably applies regardless of whether a security interest in after-acquired property is specifically recognized under state law. n160

The general definition of "security interest" also excludes interests that arise solely by operation of law. n161 Examples of security interests that arise by operation of law include mechanics' liens and materialmen's liens. n162 However, security interests that arise solely by operation of law nonetheless are considered security interests for purposes of rescission. n163

Despite the careful definition of security interest and the three categories of interests excluded from the definition of security interest (with the Regulation and Commentary providing long lists of excluded interests), creditors may still err on the side of inclusion in disclosing security interests without violating the "segregated" and "directly related" disclosure rules. n164 The Commentary twice gives its blessing to creditors who disclose a security interest even if they are unsure of whether an interest is a security interest under applicable law n165 or whether it is one of the interests excluded from the definition of "security interest." n166 However, this should be strictly limited to those situations where the creditor is genuinely and in good faith unsure about whether a particular interest is a security interest under state law (e.g., a right of setoff). It should not be viewed as giving creditors leeway to make overbroad disclosures of the collateral securing the transaction, a practice which the courts have refused to sanction.

If security interests are not properly disclosed the consumer is entitled to statutory damages, n167 any actual damages, and attorney fees. Improper disclosure of a security interest is not a material disclosure for the purpose of rescission. However, improper disclosure of a security interest in residential real estate in the notice of right to rescission (as opposed to disclosure in the disclosure statement) may give a right of rescission. n168

[f] Disclosure Requirements Tied to Actual Damage Relief Only

After TIL Simplification, statutory damages are no longer available for a variety of violations of the statute. n169 These provisions are tied only to actual damage relief under TIL. In addition, whether or not statutory damages are available, it may be possible to seek relief for state law unfair trade practices for disclosure violations under TIL.

Examples of disclosure requirements tied only to actual damage relief are as follows. n170

[i] Identity of the Creditor n171

Only the name of the creditor is required, but the creditor's address and/or telephone number may also be included. n172 At the option of the creditor, this disclosure may appear apart from the other disclosures. n173

[ii] Itemization of the Amount Financed

The creditor has a choice: it must either automatically disclose the itemization or it may inform the consumer, on the

segregated disclosures, that a written itemization of the amount financed will be provided on request, furnishing the itemization only if the consumer in fact requests it. n174

At a bare minimum, the amount financed must be itemized under four categories:

1) The amount of any proceeds distributed to the consumer; n175

2) The amount credited to the consumer's account with the creditor; n176

3) Any amounts paid to other persons by the creditor on the consumer's behalf, with those persons identified; n177 and

4) The prepaid finance charge. n178

If the creditor pays off "negative equity" in a trade-in vehicle as part of an automobile financing transaction, this amount must be included in the amount financed. n179 The creditor should itemize it in a category such as amounts paid to others on behalf of the consumer. n180

[iii] Demand Feature n181

The fact that an obligation has a demand feature (that is, the debt is payable on demand), must be disclosed. n182 The FRB's Model Clauses suggest disclosing, "This obligation is payable on demand" or "This obligation has a demand feature." n183

This disclosure requirement applies to any transaction which includes a demand feature contemplated by the parties as part of the legal obligation.

[iv] Total Sale Price n184

In a credit sale, the "total sale price" must be disclosed, using that term. n185 In addition, a brief description of the total sale price (including the amount of any down payment) must also be provided. n186

The "total sale price" is defined n187 as the sum of

- The cash price; n188
- Any amounts that are financed by the creditor and are not included in the finance charge (*e.g.*, title fees, credit insurance premiums); n189 and
- The finance charge. n190

[v] Prepayment Disclosures n191

For interest-bearing transactions, creditors must disclose whether there may be a prepayment penalty. For precomputed transactions, creditors must disclose whether the consumer may be entitled to a rebate of unearned interest.

[vi] Late Payment Charges

The credit must disclose any dollar or percentage charge (other than a deferral or extension charge) that may be imposed before maturity due to a late payment. n192

[vii] Insurance Charges

Premiums for insurance sold in connection with a credit transaction must be included in the finance charge unless certain disclosures are made. n193 The Regulation gives the creditor the option of including the insurance disclosures with the other segregated disclosures or giving them separately. n194 No disclosure of insurance premiums is necessary if the creditor has decided to *include* them in the finance charge, rather than in the amount financed. n195

The Commentary permits the disclosed monthly payments to include credit insurance premiums where the premiums are not part of either the amount financed or the finance charge. n196 Credit insurance premiums will not be part of either the amount financed or the finance charge when they are paid on a monthly basis throughout the loan term, rather than in a lump sum at the time of loan origination. If the premiums are added to the monthly payment amount in the payment schedule in these circumstances, the total of payments also should include the premiums as well. n197 In this situation, the finance charge plus the amount financed will not equal the total of payments. Some courts have required that PMI be disclosed on the TIL disclosure as required insurance, as well as included in the payment schedule, finance charge, and APR. n197.1

[viii] Security Interest Charges

A creditor will often impose a variety of charges allegedly to help perfect its security interest in the consumer's property. Some of these charges may be excluded from the finance charge if they are correctly itemized and disclosed. n198 If the disclosures are made properly, the premiums may be included in the amount financed. If they are included in the amount financed in error, they give rise to actual as well as statutory damages and to an extended right of rescission of rescindable transactions. Other errors give rise only to actual damages.

[ix] Information Found Elsewhere in the Contract

Creditors are now only required to include in the segregated disclosures a statement that the consumer should refer to the "appropriate contract document" for information about:

- Nonpayment;
- Default;
- The right to accelerate the maturity of the obligation;
- Prepayment penalties;
- Prepayment rebates;
- Further information about security interests (optional);
- In a residential mortgage transaction, n199 the creditor's policy regarding assumption of the obligation (optional). n200

The Regulation does not require the creditor to indicate which contract document is the "appropriate" one for the consumer to refer to. However, the Commentary does allow creditors to make reference to specific documents (*e.g.*, "promissory note" or "retail installment sale contract") in place of the reference to "appropriate contract document." n201

[x] Mortgage Lenders' Assumption Policy

In a residential mortgage transaction, n202 one important factor which could presumably affect the consumer's decision to enter into the transaction is the creditor's assumption policy, that is, whether the creditor will allow the next purchaser of the house or mobile home to assume the payments of the original transaction without any increase in the term, interest rate, or payment amounts. Therefore, the TILA requires the creditor to provide a statement of whether or not a subsequent purchaser of the dwelling from the consumer may be permitted to assume the remaining obligation on its original terms. n203

Note that this disclosure is qualified. Disclosure that the subsequent purchaser "may" be allowed to assume the mortgage does not guarantee the right to assume the loan.

[xi] Required Deposits

Occasionally, a creditor will require a consumer to maintain a deposit account (frequently with itself) as a condition of the transaction. The only requirement for a creditor who requires a deposit as a condition of the transaction is to disclose that the annual percentage rate does not reflect the effect of the required deposit. n204

[g] Special Disclosures for Variable-Rate Loans

In many consumer loans, contractual provisions permit changes to the Annual Percentage Rate after consummation. These loans are commonly known as "variable-rate" transactions. The rate change may be tied to an "index" (*e.g.*, the "prime rate") or may be completely discretionary with the creditor, but the fact remains that the consumer may not be fully cognizant of the financial significance attached to entering into a variable-rate transaction, even if his or her home is collateral for the loan. n205 As a result of Congress' concern about ARMs secured by consumers' homes, Congress enacted the Competitive Equality Banking Act of 1987, which requires creditors to impose "caps" on maximum interest rates in all adjustable rate mortgages secured by the consumer's home. n206 The FRB promulgated amendments regarding rate cap disclosures to the Regulation in order to implement the Act. n207

The Board then promulgated other amendments to the Regulation which require additional disclosures for ARMs secured by the borrower's principal dwelling with a maturity longer than one year. n208 For all other variable-rate transactions, including ARMs with a maturity of one year or shorter, or transactions not secured by the borrowers' primary residence, creditors may continue to make the shorter variable-rate disclosures similar to those prescribed by Regulation Z prior to 1987. n209 To simplify disclosure requirements, creditors may elect to give the new ARMs disclosures for any variable-rate transaction, regardless of whether it is subject to the ARM disclosure rules. n210 The reverse, however, is not allowed. n211

In 2007, the FRB and other banking agencies released illustrative information creditors can use to help consumers understand the "nontraditional" ARM products that have appeared in the market in recent years. n212 Use of these illustrations is optional. The Board did not release these examples specifically under its TIL authority. Non-use or a confusing use of these disclosures is not actionable under TILA. The illustrations explain nontraditional mortgage products, compare interest-only loans and payment option ARMs to fixed rate and traditional adjustable-rate loans, and provide information for inclusion on monthly statements for payment option ARMs. In August, the FRB and other banking agencies published another set of illustrations for comment. n213 This set addresses related issues present in many subprime loans and provides an explanation of some key features and risks of certain subprime products, including payment shock, and a chart that shows the potential consequences of payment shock in a concrete manner. Again, lenders may use these illustrations or not, as the final version will be nonbinding.

For any consumer credit "adjustable rate mortgage loan" n214 secured by the consumer's dwelling and entered into after December 9, 1987, in which the APR may increase after consummation, the Regulation now requires creditors to disclose the maximum interest rate that may be imposed during the term of the obligation. n215 The rate cap disclosure does *not* apply to dwelling-secured closed-end transactions in which the interest rate may *not* change during the term of

the obligation.

In addition to the more broadly applicable interest-cap disclosure requirement, the Regulation requires more information to consumers about the variable-rate features of certain kinds of ARMs. These amendments apply to ARMs with terms of more than one year which are secured by the consumer's principal dwelling, irrespective of whether the loan is purchase money or a home equity loan. n216 An exemption applies to ARM transactions which are not secured by the borrower's principal dwelling or with a term of one year or less, n217 although creditors may make the expanded disclosures for any transaction subject to the variable-rate disclosure requirements of the Regulation, including ARMs with a term of one year or less. n218

One of the required early disclosures is an ARM brochure. n219 In addition to the standard brochure, creditors must also clearly disclose detailed, specific information about major aspects of each variable-rate loan program which the consumer is considering. n220 Creditors are required to identify the index to which interest rate changes are tied, n221 or provide a brief description of the formula used in calculating changes if no index is used. n222

These ARM disclosures, including the ARM brochure, must be provided to prospective borrowers when an application form is furnished or before the payment of a nonrefundable fee, whichever is earlier. n223

The ARM requirements also include rules for subsequent disclosures when adjustments to the interest rate in a principal-dwelling-secured ARM are made. n224 A disclosure concerning rate adjustments is required for all ARMs which are subject to the variable-rate disclosure requirements of section 226.19(b). n225 Despite the fact that many, if not most consumers, use the monthly payment to gauge their ability to repay loans, TILA has never mandated disclosure of the maximum payment for closed-end ARMs. In 2008, Congress corrected this situation and instructed the Federal Reserve Board to implement a disclosure of the maximum payment no later than February of 2011. n226 As set out in the statute, creditors must provide "examples" of changes in the payment. Among the examples must be an example of "the maximum payment amount of the regular required payments on the extension of credit, based on the maximum interest rate allowed under the contract." n227 This goes beyond what the Board currently requires in the payment schedule for variable rate loans. The statute applies to all covered transactions, secured by any "dwelling" of the consumer. The loan need not be secured by the consumer's "principal dwelling."

There are also important regulations for variable-rate transactions which are not subject to the ARM rules. For example, variable-rate transactions which are not secured by the borrower's principal dwelling or which are for a term of one year or less are subject to alternative disclosure requirements. n228

[h] Special Disclosures for Student Loans

Effective February 14, 2010, n228.1 lenders making private student loans are required to provide special disclosures. There are three sets of required disclosures: (1) application and solicitation; (2) loan approval; and (3) final disclosures. Each is subject to special timing rules and detailed form and content requirements. All disclosures must be made clearly and conspicuously. n228.2

If the consumer indicates that the loan will be used to pay for postsecondary education expenses, the creditor must calculate the required disclosures based on the entire amount of the loan, even if only a part is intended for these expenses. The creditor may rely solely on a check-box or a purpose line on a loan application to determine the applicant's intent. n228.3 The Board decided to include multi-purpose loans despite industry objections, expressing concern that without these provisions, creditors could avoid compliance by lending more than the amount a consumer needs for educational expenses.

There are several new substantive protections. TILA now requires a self-certification form, which overviews the cost of the education and the student's financial resources. Perhaps most significantly, private student loan borrowers now have

a right of cancellation. Cobranding--the use by creditors who are not specifically endorsed by the educational institution of the name of the educational institution or symbols associated with the school, such as a school mascot--is restricted. n228.4 Borrowers must also be given at least thirty days from loan approval to accept a loan, although they may accept the loan less than thirty days after it is offered. n228.5 A creditor may withdraw an offer before consummation if the credit would be prohibited by law or if the creditor has reason to believe that the consumer has committed fraud in connection with the loan application. n228.6 The creditor may also change the interest rate based on adjustments to the index used for a loan, change the interest rate and terms if this will unequivocally benefit the consumer, or reduce the loan amount based upon a certification or other information received from the institution or consumer that the cost of attendance has decreased or the consumer's other financial aid has increased. n228.7 If the creditor changes the terms under these exceptions, no new disclosures are required and there is no requirement to provide a new thirty day period to accept. If the consumer requests a change and the creditor accommodates it, the creditor must once again provide the approval disclosures and thirty days to accept. n228.8

Practitioners handling a student loan case should be sure to familiarize themselves with National Consumer Law Center, *Student Loan Law* (3d ed. 2006 and Supp.).

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingDisclosure

FOOTNOTES:
(n1)Footnote 2. Reg. Z § 226.2(a)(10). Open-end credit is defined at Reg. Z § 226.2(a)(20). *See also § 1.07 infra*.

(n2)Footnote 3. *15 U.S.C. § 1631(b)*.

(n3)Footnote 4. Reg. Z § 226.17(d).

(n4)Footnote 5. *15 U.S.C. § 1631(a)*.

(n5)Footnote 6. Reg. Z § 226.17(d).

(n6)Footnote 7. *See* Reg. Z *§ 226.23*; *§ 1.08[1] infra* ; *Davison v. Bank One Home Loan Servs., 2003 U.S. Dist. LEXIS 514* (D. Kan. Jan. 13, 2003) (upholding the regulation).

(n7)Footnote 8. *Finch v. Household Fin. Corp. III (In re Finch), 2003 Bankr. LEXIS 2049* (Bankr. D. Kan. Nov. 7, 2003) (husband who had an ownership interest in the property but did not live there and who did not obtain the credit not entitled to a copy of the TIL disclosure statement; only the wife who lived in the property entitled to the TIL disclosure).

(n8)Footnote 9. *15 U.S.C. § 1632(a)*.

(n9)Footnote 10. Reg. Z § 226.17(a).

(n10)Footnote 11. Official Staff Commentary § 226.17(a)(1)-1. Van Jackson v. Check *'N Go of Ill., Inc., 193 F.R.D. 544, 548, 549 (N.D. Ill. 2000)* (disclosure of the security interest in the check was not clearly and conspicuously disclosed as it was provided outside of the federal box, included on the back under a paragraph titled "Method of Payment," and as understandable as Sanskrit); *Cunningham v. H.A.S., Inc., 74 F. Supp. 2d 1157 (M.D. Ala. 1999)* (written disclosures were covered up by the sales manager and borrower was directed where to sign without being given the opportunity to read before signing); *Hemauer v. ITT Fin. Servs., 751 F. Supp. 1241 (W.D. Ky. 1990)* (where creditor had for its own purposes (apparently to circumvent its refund obligations in the event of rescission) split what was in reality a single transaction into two separate loans, the disclosures violated the threshold TIL requirement that required

disclosures to be clear, conspicuous, and grouped together); *Affatato v. Beneficial Corp., 1998 U.S. Dist. LEXIS 12447* (E.D.N.Y. Aug. 7, 1998) (motion to dismiss on whether, among other things, the disclosures given in the course of making a tax refund anticipation loan were contradicted by other allegedly misleading information was denied); *Bank of N.Y. v. Ralls (In re Ralls), 230 B.R. 508 (Bankr. E.D. Pa. 1999)* ; *In re Cook, 76 B.R. 661 (Bankr. C.D. Ill. 1987)* . *Aubin v. Residential Funding Co., LLC, 565 F. Supp. 2d 392 (D. Conn. 2008)* (rescission notice not clear and conspicuous where it listed the wrong dates for loan transaction and the expiration of the right to cancel and provided the consumer no information about how to count the three business days where the third day was a Saturday; distinguishing *Palmer Champion Mortgage* on the facts).

(n11)Footnote 12. *Williams v. Empire Funding Corp., 109 F. Supp. 2d 352 (E.D. Pa. 2000)* (where financing agreement contained two paragraphs, one which disclosed a three-day right to cancel, and another which discussed a one-day right to cancel, the TILA notice of right to cancel was not clearly and conspicuously disclosed); *Apgar v. Homeside Lending, Inc. (In re Apgar), 291 B.R. 665 (Bankr. E.D. Pa. 2003)* (notice of right to cancel given to co-owner wife not "clear" as it could be read at least four different ways); *Jones v. Ameriquest Mortgage Co., 2006 U.S. Dist. LEXIS 3788* (N.D. Ill. Jan. 31, 2006) (a trier of fact could decide that Ameriquest's seven-day cancellation notice detracts from the clarity of the federal three-day form; summary judgment for the creditor denied); *Washington v. Ameriquest Mortgage Co., 2006 U.S. Dist. LEXIS 50804* (N.D. Ill. July 11, 2006) (followed the holding in *Jones*). *But see Hamm v. Ameriquest Mortgage Co., 2005 U.S. Dist. LEXIS 21755* (N.D. Ill. Sept. 27, 2005) (Ameriquest's seven-day cancellation notice does not confuse the consumer; court relied on the consumer's admission that she does not wish to cancel during either the three-day or the seven-day period).

(n12)Footnote 13. *Palmer v. Champion Mortgage, 465 F.3d 24, 28 (1st Cir. 2006)* (objective standard); *Andrews v. Chevy Chase, F.S.B., 240 F.R.D. 612 , motion for stay pending appeal granted, 474 F. Supp. 2d 1006 (E.D. Wis. 2007)* (same).

(n13)Footnote 14. *Palmer v. Champion Mortgage, 465 F.3d 24, 28 (1st Cir. 2006)* (reviewing disclosures from the vantage point of a hypothetical average consumer); *Smith v. Cash Store Mgmt., Inc., 195 F.3d 325, 327 /-/328* (7th Cir. 1999) (explaining that TIL disclosures should be viewed from the perspective of an ordinary consumer, not a federal judge); *Andrews v. Chevy Chase, F.S.B., 240 F.R.D. 612 , motion for stay pending appeal granted, 474 F. Supp. 2d 1006 (E.D. Wis. 2007)* (standard is based upon the perspective of an ordinary consumer, not that of a judge, federal reserve member, or English professor, *citing Smith v. Cash Store Mgmt., Inc.*); *Jones v. General Motors Acceptance Corp. (In re Jones), 2007 Bankr. LEXIS 2049* (Bankr. N.D. Ala. June 13, 2007) (same).

(n14)Footnote 14.1. *See Rand Corp. v. Moua, 559 F.3d 842 (8th Cir. 2009)* ("[r]equiring borrowers to sign statements [waiver of rescission rights] which are contradictory and demonstrably false" undermines clear and conspicuous disclosure of the right of rescission); *Tenney v. Deutsche Bank Trust Corp., 2009 U.S. Dist. LEXIS 12818* (D. Mass. Jan. 26, 2009) (requiring borrower to sign statement that they are not exercising at the same time they receive notice of the right to cancel undermines the clear and conspicuous disclosure of the notice of the right to cancel). *Cf. Quiles v. Washington Mut. Bank, 2008 U.S. Dist. LEXIS 107279* (D. Mass. Dec. 30, 2008) (borrower would not be confused by rescission notice that omitted date of transaction since could easily supply date, nor by failure to supply deadline, since could calculate deadline); *Omar v. Wash. Mut. Bank, 2008 U.S. Dist. LEXIS 107284* (D. Mass. Dec. 20, 2008) (same).

(n15)Footnote 15. *Handy v. Anchor Mortgage Corp., 464 F.3d 760 (7th Cir. 2006)* ; *Rivera v. Grossinger Autoplex, Inc., 274 F.3d 1118 (7th Cir. 2001)* ; ., *Smith v. Check-N-Go Inc., 200 F.3d 511 (7th Cir. 1999)* ; *Harper v. Lindsay Chevrolet Oldsmobile, L.L.C., 212 F. Supp. 2d 582 (E.D. Va. 2002)* ; *Apgar v. Homeside Lending, Inc. (In re Apgar), 291 B.R. 665 (Bankr. E.D. Pa. 2003) . See also Rodash v. AIB Mortgage Co., 16 F.3d 1142 (11th Cir. 1994)* (court granted summary judgment, thereby implying that the question is a legal one); *Herrera v. First Northern Sav. & Loan Ass'n, 805 F.2d 896 (10th Cir. 1986)* ("reasonable minds" could not differ; therefore, no dispute of material fact). *But see Knapp v. Americredit Fin. Serv., Inc., 245 F. Supp. 2d 841 (S.D. W. Va. 2003)* (whether the APR and finance charge are disclosed more conspicuously than the amount financed and the total of payments is a question of fact);

Landreneau v. Fleet Fin. Group, 197 F. Supp. 2d 551 (M.D. La. 2002) (court found issues of material fact and denied summary judgment).

(n16)Footnote 16. *68 Fed. Reg. 68786* (Dec. 10, 2003) .

(n17)Footnote 17. *69 Fed. Reg. 35541* (June 25, 2004) . *See also 69 Fed. Reg. 16769* (Mar. 31, 2004) .

(n18)Footnote 18. *15 U.S.C. § 1632(a)*; Reg. Z § 226.17(a)(2). *See Brown v. Payday Check Advance, Inc., 202 F.3d 987* (7th Cir.) , *cert. denied, 531 U.S. 820, 121 S. Ct. 61, 148 L. Ed. 2d 27 (2000)* (failure to disclose APR and finance charge more conspicuously in a payday loan constitutes a violation, but statutory damages are not available); *Dixey v. Idaho First Nat'l Bank, 677 F.2d 749 (9th Cir. 1982)* ; *Mitchem v. GFG Loan Co., 2000 U.S. Dist. LEXIS 3991* (N.D. Ill. Mar. 17, 2000) (same); *Hartke v. Illinois Payday Loans, Inc., 1999 U.S. Dist. LEXIS 14937* (C.D. Ill. Sept. 13, 1999) (failure to disclose annual percentage rate [hereinafter APR] and finance charge more conspicuously violates TILA); *Turner v. E-Z Check Cashing, Inc., 35 F. Supp. 2d 1042 (M.D. Tenn. 1999)* (payday loan); *Yazzie v. Ray Vicker's Special Cars, Inc., 12 F. Supp. 2d 1230 (D.N.M. 1998)* (pawnbroker transaction). *But see Smith v. Check-N-Go, Inc., 200 F.3d 511 (7th Cir. 1999)* (circle around the due date to highlight it does not render the APR and finance charge less conspicuously disclosed in this payday loan case); *Shabas v. Lighthouse Fin. Group, Inc., 1999 U.S. Dist. LEXIS 17228* (N.D. Ill. Oct. 15, 1999) (court found that disclosing the "monthly percentage rate" in the federal disclosures did not render the APR or finance charge disclosures less conspicuous in this payday loan case; court misconstrued meaning of Reg. Z § 226.17(a)(2), which requires the creditor to put the words "Annual Percentage Rate" (and the corresponding rate, that is, the actual percent) and "Finance Charge" (and the actual amount) more conspicuous than any other disclosures). For various exceptions to the "more conspicuous" requirement, see Official Staff Commentary § 226.17(a)(2)-1; Reg. Z § 226.17(a)(2) (referring to Reg. Z § 226.18(d) and (e)); *Kramer v. Marine Midland Bank, 559 F. Supp. 273 (S.D.N.Y. 1983)* ; Reg. Z § 226.18(a); *see, e.g., Grey v. European Health Spas, Inc., 428 F. Supp. 841 (D. Conn. 1977)* .

(n19)Footnote 19. Official Staff Commentary § 226.17(a)(1)-1.

(n20)Footnote 20. Reg. Z § 226.17(a)(1).

(n21)Footnote 21. Official Staff Commentary § 226.17(a)(1)-1; *Lifanda v. Elmhurst Dodge, Inc., 237 F.3d 803 (7th Cir. 2001)* (tiny print in comparison to the rest of the document not clear and conspicuous, as a matter of law). *See also Lacey v. William Chrysler Plymouth Inc., 2004 U.S. Dist. LEXIS 2479* (N.D. Ill. Feb. 23, 2004) (a copy of disclosures that are blank, *i.e.*, no numbers filled in, also violates this rule).

(n22)Footnote 22. Reg. Z § 226.17(a)(1).

(n23)Footnote 23. *Rivera v. Grossinger Autoplex, Inc., 274 F.3d 1118 (7th Cir. 2001)* ; *Smith v. Check-N-Go, Inc., 200 F.3d 511 (7th Cir. 1999) . See also Rodash v. AIB Mortgage Co., 16 F.3d 1142 (11th Cir. 1994)* (court granted summary judgment, thereby implying that the question is a legal one); *Herrera v. First Northern Sav. & Loan Ass'n, 805 F.2d 896 (10th Cir. 1986)* ("reasonable minds" could not differ; therefore, no dispute of material fact). *Rodrigues v. Members Mortgage Co., Inc. 323 F. Supp. 2d 202 (D. Mass. 2004)* (court applied the ordinary consumer standard to determine whether the consumer could be confused by being required to sign a confirmation of non-cancellation before the end of the 3-day cancellation period; creditor did violate TILA for this reason); *Stanley v. Household Fin. Corp. III (In re Stanley), 315 B.R. 602 (Bankr. D. Kan. 2004)* (the two or more plausible interpretations must yield different results depending upon which is adopted; in this case, two different paragraphs regarding the effect of rescission were presented, one dealing with a new loan transaction, and the other dealing with a refinancing with the same creditor; none of the boxes in front of these paragraphs were checked; the notice of right to cancel was not "clear" as a result).

(n24)Footnote 24. *15 U.S.C. § 1604(b).*

(n25)Footnote 25. *15 U.S.C. § 1604(b)*; *In re Melvin, 75 B.R. 952 (Bankr. E.D. Pa. 1987)* (use of incorrect model

rescission form is not protected by § 1604(b)).

(n26)Footnote 26. *74 Fed. Reg. 43,232* (Aug. 26, 2009) .

(n27)Footnote 26.1. *15 U.S.C. § 1601(a).*

(n28)Footnote 27. *Edmondson v. Allen-Russell Ford, Inc., 577 F.2d 291 (5th Cir. 1978)* ; *In re Cook, 76 B.R. 661 (Bankr. C.D. Ill. 1987)* (TIL disclosures should be construed through the eyes of the borrower and not those of the lender or an attorney). *Rodrigues v. Members Mortgage Co., Inc. 323 F. Supp. 2d 202 (D. Mass. 2004)* (court applied the ordinary consumer standard to determine whether the consumer could be confused by being required to sign a confirmation of non-cancellation before the end of the 3-day cancellation period; creditor did violate TILA for this reason).

(n29)Footnote 28. *See, e.g., In re Marshall, 121 B.R. 814 (Bankr. C.D. Ill. 1990)* ; *In re Hatfield, 117 B.R. 387 (Bankr. C.D. Ill. 1990)* ; London v. Chase Manhattan Bank USA, N.A., Clearinghouse No. 53,538 (S.D. Fla. Mar. 30, 2001) (where the credit insurance disclosure regarding the optional nature of the insurance was susceptible to two equally reasonable constructions and the consumer could believe that the decision to issue the credit card may be influenced by the fact that he agreed to enroll in the "LifePlus" credit insurance program, the disclosure is not meaningful).

(n30)Footnote 29. Reg. Z § 226.17(a)(1). For examples of some exceptions, see Reg. Z § 226.18(c)(1); Reg. Z § 226.17(a)(1) n.38; Official Staff Commentary § 226.17(a)(1)-4 (The Commentary was amended, effective Apr. 1, 1986, to emphasize that including the security interest charges in the amount financed itemization satisfies the itemization requirements of Reg. Z §§ 226.4(e) and 226.18(*o*). In that situation, those charges need not be listed elsewhere.); Reg. Z § 226.17(a)(1) n.37; Official Staff Commentary § 226.17(a)(1)-4.

(n31)Footnote 29.1. Official Staff Commentary § 226.17(a)(1)-1 (no disclosure may obscure another disclosure). *See, e.g., Busse v. Homebank L.L.C., 2009 WL 424278,* at *5 (D.N.J. Feb. 18, 2008) (disclosing the note interest rate of 1% on the TIL disclosure statement renders disclosure of APR "approximately 6%" not clear and conspicuous); *Andrews v. Chevy Chase, 240 F.R.D. 612 (E.D. Wis. 2007) , rev'd on other grounds, 545 F.3d 570 (7th Cir. 2008)* (disclosing rate as 2% fixed on the TIL disclosure form undermines the clear and conspicuous disclosure of the APR).

(n32)Footnote 29.2. *See, e.g., Laudani v. Tribeca Lending Corp. (In re Laudani), 401 B.R. 9 (Bankr. D. Mass. 2009)* (borrower alleged receipt of and confusion occasioned by multiple settlement statements); *NovaStar Mortgage, Inc. v. Akins, 2008 Ohio App. LEXIS 5096* (Ohio Ct. App. Nov. 21, 2008) (reconciling two conflicting settlement statements).

(n33)Footnote 29.3. *See, e.g., Lynch v. RKS Mortgage, Inc., 588 F. Supp. 2d 1254 (E.D. Cal. 2008)* ; *Pulphus v. Sullivan, 2003 U.S. Dist. LEXIS 7080* (N.D. Ill. Apr. 28, 2003) ("Because plaintiff has alleged that she received two contradictory disclosure statements simultaneously, not successively, Citizens can take no refuge in the regulation governing the correction of early disclosures."); *Reid v. Wells Fargo Bank, N.A. (In re Reid), 2009 WL 1351678* (Bankr. E.D. Va. May 14, 2009). *But see Laudani v. Tribeca Lending Corp. (In re Laudani), 401 B.R. 9 26 (Bankr. D. Mass. 2009)* (finding that even if one settlement statement was a final statement the provision of multiple statements at the same time may render the disclosures not clear and conspicuous).

(n34)Footnote 30. Pub. L. No. 106-229, *114 Stat. 464* (June 30, 2000) (codified at *15 U.S.C. § 7001*).

(n35)Footnote 31. *15 U.S.C. § 7003(c).*

(n36)Footnote 32. Electronic Signatures in Global and National Commerce Act, Conference Report, 106th Cong., 2d Sess., 146 Cong. Rec. S. 5284 (June 16, 2000).

(n37)Footnote 33. *15 U.S.C. § 7001(c).*

(n38)Footnote 34. *15 U.S.C. § 7001(c)(1)(B).*

(n39)Footnote 35. *15 U.S.C. § 7001(c)(1)(C)(i).*

(n40)Footnote 36. *15 U.S.C. § 7001(c)(1)(C)(ii).*

(n41)Footnote 37. *15 U.S.C. § 7001(c)(1)(C)(ii).*

(n42)Footnote 38. *15 U.S.C. § 7001(c)(2)(A).*

(n43)Footnote 39. *See* Statement of Sens. Hollings, Wyden, and Sarbanes, 106th Cong., 2d Sess., 146 Cong. Rec. S. 5230 (June 15, 2000) ("[I]f a statute requires that a disclosure ... include specific language set forth clearly and conspicuously[, t]hat requirement could be met by an electronic disclosure ... which ... included the specified language, set forth clearly and conspicuously."). *Accord* Statement of Rep. Dingell, 106th Cong., 2d Sess., 146 Cong. Rec. H. 4358 (June 14, 2000).

(n44)Footnote 40. *15 U.S.C. § 7001(b)(1).*

(n45)Footnote 41. *66 Fed. Reg. 17,329* (Mar. 30, 2001) .

(n46)Footnote 42. *66 Fed. Reg. 17,329* (Mar. 30, 2001) .

(n47)Footnote 43. *66 Fed. Reg. 41,439, 41,440* (Aug. 8, 2001) .

(n48)Footnote 44. Reg. Z § 226.36. *See also* National Consumer Law Center, Truth in Lending § 4.2.9 (6th ed. 2007 and Supp.).

(n49)Footnote 45. *15 U.S.C. § 1638(b)(1). See, e.g., Fiorenza v. Fremont Inv. & Loan, 2008 U.S. Dist. LEXIS 47831* (S.D.N.Y. June 20, 2008) (mere allegation that consumer did not receive disclosures until after consummation insufficient to prove a violation of the timing rule; suggesting that late disclosure may trigger damages but not rescission).

(n50)Footnote 46. Reg. Z § 226.17(b).

(n51)Footnote 47. Reg. Z § 226.2(a)(13). *See, e.g., Hershey v. Deutsche Bank Nat'l Trust Co., 2005 WL 1420813* (D. Minn. June 16, 2005) (date of loan closing equals consummation); *Betancourt v. Countrywide Home Loans, Inc., 344 F. Supp. 2d 1253 (D. Colo. 2004)* (consummation occurred when the consumer signed the loan note). *McWhorter v. Elsea, Inc., 2007 U.S. Dist. LEXIS 26914* (S.D. Ohio Apr. 11, 2007) (consumer obligated when he signed a buyer's order to purchase a mobile home and was unconditionally obligated to later sign a retail installment contract; failure to give TIL disclosures at that time violated the timing rule). Some courts hold that statutory damages are not available for the failure to timely provide the TIL disclosures. *See, e.g., Cabrera v. Lake Manawa Nissan, 2002 U.S. Dist. LEXIS 25945* (S.D. Iowa Nov. 18, 2002) .

(n52)Footnote 48. Official Staff Commentary § 226.2(a)(13)-1. *See, e.g.*, Caudill v. EZPawn Indiana, Inc., Clearinghouse No. 54,565, Case No. IP00-1850-C-Y/F (S.D. Ind. Sept. 2001) (consummation under Indiana law occurs when the contract is signed; timing requirement violated when the consumer signed the pawn ticket, exchanged the jewelry for the loan proceeds, and then received the TILA disclosures).

(n53)Footnote 49. *67 Fed. Reg. 16,980* (Apr. 9, 2002) .

(n54)Footnote 50. *See Pulphus v. Sullivan, 2003 U.S. Dist. LEXIS 7080* (N.D. Ill. Apr. 25, 2003) (motion to

dismiss alleged TIL violation denied when the creditor mailed copies of the loan papers, including the TIL disclosure, to the consumer after the closing). *See also Bragg v. Bill Heard Chevrolet, Inc., 374 F.3d 1060 (11th Cir. 2004)* (in yo-yo sale where consumer ended up signing three different purchase contracts, a bailment agreement, and four different retail installment sales contracts, the court held that consummation occurred when the consumer signed the contract even though the financing agreement contained a condition precedent because the condition of obtaining financing was within the exclusive control of the seller and third-party lender.) *See Liabo v. Wayzata Nissan, L.L.C., 707 N.W.2d 715 (Minn. Ct. App. 2006)* (when the court construed the delivery sheet to constitute only a contract to purchase and not a credit agreement, no consummation for TIL purposes upon the signing of that document). *See also Horton v. First State Bank of Eldorado, 2006 U.S. Dist. LEXIS 7647* (S.D. Ill. Feb. 9, 2006) (unsigned loan document does not trigger TIL application because consummation did not occur); *Guinn v. Hoskins Chevrolet, 836 N.E.2d 681 (Ill. App. 2005)* (consummation occurs when the consumer becomes contractually obligated on the credit contract and interest can accrue from that date); *Cartier v. Brown Credit Lot, 2005 WL 3867414* (Ohio Mun. Ct. Apr. 4, 2005) (date of signing and date on which the creditor represented that this was a done deal equal consummation).

(n55)Footnote 51. Reg. Z § 226.17(g).

(n56)Footnote 52. Reg. Z § 226.17(h).

(n57)Footnote 53. A transaction in which a mortgage or other consensual security interest is created or retained in the consumer's principal dwelling (which includes a house, condominium, cooperative unit, mobile home or trailer if it is used as the consumer's residence) to finance its acquisition or initial construction or to finance the construction of a primary dwelling on land already owned by the consumer. Reg. Z § 226.2(a)(24); Official Staff Commentary § 226.2(a)(24), *as amended by 63 Fed. Reg. 16,669* (Apr. 6, 1998) ; *see also* Reg. Z § 226.2(a)(19). But to be under the Real Estate Settlement Procedures Act [hereinafter RESPA], a mobile home transaction must be considered as involving a lien on real property, *12 U.S.C. § 2602(1)*; *Peoples Nat'l Bank v. Molz, 239 Kan. 255, 718 P.2d 306 (1986)* . (This question may vary based on state law. *See* National Consumer Law Center, Foreclosures, § 11.2 (2d ed. 2007 and Supp.). The requirement of real property does not apply to rescission rights under TILA. *See § 1.08[1] infra*.

(n58)Footnote 54. *12 U.S.C. §§ 2601*; *see also* Regulation X, 24 C.F.R. §§ 3500 *et seq*.

(n59)Footnote 55. Though RESPA coverage was considerably broadened in 1992 to cover more than first-lien purchase-money mortgages, these special timing requirements still apply only to acquisition or initial construction situations, as TIL's definition of a residential mortgage transaction includes that limitation. The transaction must meet both tests. Official Staff Commentary § 226.19(a)-1.

(n60)Footnote 56. See Reg. Z § 226.17(c)(2) and *§ 1.05[2][c] infra* , for a discussion of estimated disclosure rules; *see also* Official Staff Commentary § 226.19(a)(1)-2.

(n61)Footnote 57. *15 U.S.C. § 1638(b)(2)*; Reg. Z § 226.19(a)(1). This three-day period coincides with the time period within which creditors subject to RESPA must provide good faith estimates of settlement costs. *12 U.S.C. § 2603*; Reg. Z § 3500.7. *See* Official Staff Commentary § 226.19(a)(1)-2.

(n62)Footnote 58. Reg. Z § 226.19(a)(1); see Official Staff Commentary § 226.19(a)(1)-3 for a discussion of when under RESPA a written application has been "received."

(n63)Footnote 59. Official Staff Commentary § 226.18(c)-4; *62 Fed. Reg. 10,193, 10,197* (Mar. 6, 1997) ; *see § 1.05[2][f][ii] infra*.

(n64)Footnote 60. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2502(a), *122 Stat. 2654, 2856 (2008)* (codified at *15 U.S.C. § 1638(b)(2)*); *73 Fed. Reg. 44,522, 44,606-44,607* (July 30, 2008) .

(n65)Footnote 61. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2502(a)(6), *122 Stat.*

2654, 2856 (2008) (codified at *15 U.S.C. § 1638(b)(2)(E)*); Reg. Z § 226.19(a)(1)(iii); *73 Fed. Reg. 44,522, 44,600* (July 30, 2008) . The credit report fee is discussed in more detail at § 4.3.4A.3, *infra*.

(n66)Footnote 62. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2502(a)(4), *122 Stat. 2654, 2856 (2008)* (codified at *15 U.S.C. § 1638(b)(2)(A)*).

(n67)Footnote 63. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2502(c)(1), *122 Stat. 2654, 2857 (2008)*.

(n68)Footnote 64. *73 Fed. Reg. 44,522, 44,594* (July 30, 2008) .

(n69)Footnote 65. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2502(a)(6), *122 Stat. 2654, 2856 (2008)* (codified at *15 U.S.C. § 1638(b)(2)(F)*).

(n70)Footnote 66. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2502(a)(6), *122 Stat. 2654, 2856 (2008)* (codified at *15 U.S.C. § 1638(b)(2)(F)(i)*).

(n71)Footnote 67. *15 U.S.C. § 1635(d)*.

(n72)Footnote 68. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2502(a)(6), *122 Stat. 2654, 2857 (2008)* (codified at *15 U.S.C. § 1638(b)(2)(F)(iii)*).

(n73)Footnote 69. Reg. Z § 226.19(b). *See § 1.05[2][g] infra*.

(n74)Footnote 70. Reg. Z § 226.19(b).

(n75)Footnote 71. Reg. Z § 226.17(c)(1).

(n76)Footnote 72. Official Staff Commentary § 226.17(c)(1)-1. *See Williams v. Chartwell Fin. Serv., 204 F.3d 748 (7th Cir. 2000)* (TIL violated if an "alternative" payment schedule given to the consumer was mandatory and conflicted with the payment schedule listed in the TIL disclosures); *Demando v. Morris, 206 F.3d 1300 (9th Cir. 2000)* ; *Hubbard v. Fidelity Fed. Bank, 91 F.3d 75* , *amended by 1996 U.S. App. LEXIS 25750* (9th Cir. Oct. 2, 1996) (creditor liable for variable rate change notice if it did not accurately reflect the legal obligation between the parties); *Ralls v. Bank of N.Y. (In re Ralls), 230 B.R. 508 (Bankr. E.D. Pa. 1999)* (court found that contradictions between the TIL disclosure and the loan note and mortgage regarding the total of payments and the payment schedule violated the mandate that the disclosures reflect the legal obligation; irrelevant that homeowner did not read all of the documents since they were confusing in any case); *Affatato v. Beneficial Corp., 1998 U.S. Dist. LEXIS 12447* (E.D.N.Y. Aug. 7, 1998) (tax refund anticipation lender's motion to dismiss denied based, in part, on consumer's claim that the loan application and loan documents did not constitute an integrated agreement and court could look to other allegedly misleading information communicated to the consumer). *Compare Szumny v. American Gen. Fin., Inc., 1999 U.S. Dist. LEXIS 18665* (N.D. Ill. Nov. 29, 1999) (allegations that purported security interest may be overbroad under FTC rule or state law does not by itself create a TIL disclosure violation); *Acevedo v. Bally Total Fitness Corp., 1999 U.S. Dist. LEXIS 18029* (N.D. Ill. Nov. 9, 1999) . *Cf. Carmichael v. The Payment Ctr., Inc., 336 F.3d 636 (7th Cir. 2003)* (APR accurately reflected the legal obligation stated in the note; no violation even though the APR did not accurately reflect the relation between the disclosed finance charge and amount financed due to a huge overstatement of the finance charge). But where the legal obligation contains a typographical error, which is then construed against its drafter (the creditor), disclosure of the correct terms in the TILA statement is no violation. *Veale v. Citibank, F.S.B., 85 F.3d 577 (11th Cir. 1996)* .

(n77)Footnote 73. Official Staff Commentary § 226.17(c)(1)-1.

(n78)Footnote 74. Reg. Z § 226.17(c)(2); *Graves v. Tru-Link Fence Co., 905 F. Supp. 515 (N.D. Ill. 1995)* (in home improvement loan, where payments begin 30 days after completion of work, creditor must disclose an estimated

date, not the 30-day formula); *Danziger v. San Jacinto Sav. Ass'n, 732 S.W.2d 300 (Tex. 1987)* (where creditor knew finance charge and other disclosures were estimates, it was a TILA violation not to disclose that fact). *Cf. Jensen v. Ray Kim Ford, Inc., 920 F.2d 3 (7th Cir. 1990)* (failure to denote estimated trade-in value on auto loan as such might violate TILA, but borrowers waived the argument). *But see Comer v. Person Auto Sales, Inc., 368 F. Supp. 2d 478 (M.D.N.C. 2005)* (failure to mark a disclosure as an estimate where the car dealer knew the sales tax was understated is not a violation; amount financed would not have changed since the extra sales tax would not have been financed).

(n79)Footnote 75. *Cf. EMC Mortgage Corp. v. Davis, 167 S.W.3d 406 (Tex. App. 2005)* .

(n80)Footnote 76. Official Staff Commentary § 226.17(c)(2)-2.

(n81)Footnote 77. Official Staff Commentary § 226.17(c)(2)-2.

(n82)Footnote 78. *15 U.S.C. § 1631(c)*; Reg. Z § 226.17(c)(2)(ii). Apparently creditors can "stack" this tolerance with the $100 tolerance if the finance charge is understated due to other errors in other components of the finance charge. *See 61 Fed. Reg. 49,237, 49,242* (Sept. 19, 1996) . Official Staff Commentary § 226.17(c)(2)(ii)-1; *62 Fed. Reg. 10,193, 10,197* (Mar. 6, 1997) (see specific example).

(n83)Footnote 79. Official Staff Commentary § 226.17(c)(3).

(n84)Footnote 80. Official Staff Commentary § 226.17(c)(4).

(n85)Footnote 81. Reg. Z § 226.17(f), Official Staff Commentary § 226.17(f)-1 and (f)-2.

(n86)Footnote 82. See Reg. Z § 226.22(a) for definitions of "regular" and "irregular" transactions.

(n87)Footnote 83. Reg. Z § 226.17(f).

(n88)Footnote 84. Official Staff Commentary § 226.17(f)-1. (Presumably if a change in the finance charge is within its $10 tolerance, no redisclosure for it is required.) See Reg. Z § 226.17(c)(2) for a discussion of the permissible use of estimates.

(n89)Footnote 85. Official Staff Commentary § 226.17(f)-2.

(n90)Footnote 86. *280 F.3d 384 (3d Cir. 2002) . Cf. Roberts v. Fleet Bank (R.I.), 2001 U.S. Dist. LEXIS 19117* (E.D. Pa. Nov. 20, 2001) (consumer offered a "fixed rate," and contract contained a change of terms provision; change in the rate did not occur for over a year after the account was opened; case decided before the appellate decision in *Rossman*).

(n91)Footnote 87. *15 U.S.C. § 1638*; Reg. Z § 226.18.

(n92)Footnote 88. *15 U.S.C. § 1638*.

(n93)Footnote 89. Reg. Z § 226.18.

(n94)Footnote 90. *See generally* Official Staff Commentary § 226.18-1.

(n95)Footnote 91. Official Staff Commentary § 226.18-1.

(n96)Footnote 92. *15 U.S.C. § 1640(a)(1), (3). See § 1.10[2] infra*.

(n97)Footnote 93. *See § 1.10[3] infra*.

(n98)Footnote 94. *15 U.S.C. § 1638(a)(2)(A)*; Reg. Z § 226.18(b).

(n99)Footnote 95. *15 U.S.C. § 1638(a)(2)(A)*; Reg. Z § 226.18(b).

(n100)Footnote 96. Reg. Z § 226.18(b).

(n101)Footnote 97. *15 U.S.C. § 1640(a)(3)*.

(n102)Footnote 98. *15 U.S.C. § 1602(u)*; Reg. Z § 226.23 n.48.

(n103)Footnote 99. Reg. Z § 226.18(b).

(n104)Footnote 100. The down payment is defined as an amount, including the value of any property used as a trade-in, paid to a seller to reduce the cash price of goods or services purchased in a credit sale transaction. Reg. Z § 226.2(a)(18). As a general rule, the amount of the down payment must be disclosed as part of the disclosure of the total sale price, but not part of the amount financed. *15 U.S.C. § 1638(a)(7)*; Reg. Z § 226.18(j). For discussion of the complex rules regarding disclosure of downpayments, trade-ins, and pickup payments, see National Consumer Law Center, Truth in Lending § 4.6.2.2 (6th ed. 2007).

(n105)Footnote 101. The Commentary provides guidance regarding the disclosure of "negative equity" which occurs in credit sales when down payments involve a trade-in and an existing lien that exceeds the value of the trade-in. *See* Supplementary Information to Commentary changes in *63 Fed. Reg. 16,669, 16,673* (Apr. 6, 1998) .

(n106)Footnote 102. The prepaid finance charge, while used sometimes to calculate the amount financed, is not ever a component of a properly disclosed amount financed. Rather, where the principal amount of the credit obligation includes charges classified by TIL as finance charges, they must be subtracted from the principal in calculating the amount financed.

(n107)Footnote 103. *See § 1.04[1], [2] supra*.

(n108)Footnote 104. Official Staff Commentary § 226.18(b)(2)-1.

(n109)Footnote 105. *15 U.S.C. § 1638(a)(3)*; Reg. Z § 226.18(d); *Hyde v. Hutto Enters., Inc., 1994 U.S. Dist. LEXIS 16655* (M.D. Ala. Sept. 29, 1994) (violation where agreement expressed finance charge in numerical form as "pawn shop charge"); see generally *§ 1.04 supra* for a discussion of what must be included in the finance charge.

(n110)Footnote 106. Reg. Z § 226.18(d).

(n111)Footnote 107. Official Staff Commentary § 226.18(d)-1.

(n112)Footnote 108. Official Staff Commentary § 226.18(d)-1. *See also 15 U.S.C. § 1638(a)(3)*; *Blon v. Bank One, Akron N.H., 519 N.E.2d 363 (Ohio 1988)* (no requirement to itemize finders' fee). *Johnson v. Banc One Acceptance Corp., 278 F. Supp. 2d 450 (E.D. Pa. 2003) . See also Stump v. WMC Mortg. Corp., 2005 U.S. Dist. LEXIS 4304* (E.D. Pa. Mar. 16, 2005) (no requirement to itemize the finance charge).

(n113)Footnote 109. *15 U.S.C. § 1632(a)*; Reg. Z § 226.17(a)(2).

(n114)Footnote 110. Reg. Z § 226.17(a)(2); see Reg. Z § 226.18(a) concerning disclosure of the creditor's identity.

(n115)Footnote 111. *See § 1.10[3] infra*.

(n116)Footnote 112. *15 U.S.C. § 1640(a)(3)*; see *§ 1.10[3] infra* for a discussion of statutory damages.

(n117)Footnote 113. *15 U.S.C. § 1640(a)*, paragraph following § 1640(a)(4). However, overdisclosures of the finance charge in real-estate-secured loans do not trigger liability. *15 U.S.C. § 1605(f)(1)(B)*; *see also Vandenbroeck v.*

Commonpoint Mortgage Co., 22 F. Supp. 2d 677 (W.D. Mich. 1998) (adding a document preparation fee unnecessarily to the finance charge resulting in an overstatement did not violate TILA). See *§ 1.10[2] infra* for a discussion of actual damages.

(n118)Footnote 114. *15 U.S.C. § 1602(u)*; Reg. Z § 226.23 n.48.

(n119)Footnote 115. Reg. Z § 226.18(d)(2). NOTE: Between September 1995 and 1996, there was a technical error on the books from the 1995 amendments which appeared to provide a retroactive tolerance of $200 to non-mortgage credit. Congress corrected that technical error in September 1996, retroactive to Sept. 30, 1995.

(n120)Footnote 116. *See, e.g., Steele v. Ford Motor Credit Co., 783 F.2d 1016 (11th Cir. 1986)* ; *Keenan v. Huntington Acceptance Co., 91 Ohio App. 3d 795, 633 N.E.2d 1164 (1993)* . Except for the transactions which continue to be subject to the $10 standard tolerance, these cases have been effectively overruled by the changes in the statute.

(n121)Footnote 117. Pub. L. No. 104-29 (Sept. 30, 1995). It is also found beginning at 140 Cong. Rec. H9513 (Sept. 27, 1995). These various issues are summarized below. For a more extensive discussion, see National Consumer Law Center, Truth in Lending § 4.6.3.2 (6th ed. 2007 and supp.).

(n122)Footnote 118. *15 U.S.C. § 1635*.

(n123)Footnote 119. *15 U.S.C. § 1635(i)(2)*; Reg. Z § 226.23(h)(2)(i). *Bynum v. Equitable Mortg. Group, 2005 U.S. Dist. LEXIS 6363* (D.D.C. Apr. 7, 2005) .

(n124)Footnote 120. *15 U.S.C. § 1635(i)(2)*; Reg. Z § 226.23(h)(2)(i).

(n125)Footnote 121. *15 U.S.C. § 1635(i)(2)*; Reg. Z § 226.23(h)(2)(i).

(n126)Footnote 122. *15 U.S.C. § 1605(f)(2)(A)*; Reg. Z § 226.23(g)(1)(i).

(n127)Footnote 123. Reg. Z § 226.23(g)(1)(ii). *See also VanDenBroeck v. Commonpoint Mortgage Co., 22 F. Supp. 2d 677 (W.D. Mich. 1998)* (adding a document preparation fee unnecessarily to the finance charge resulting in an overstatement did not violate TILA). *See also Strang v. Wells Fargo, 2005 U.S. Dist. LEXIS 14135* (E.D. Pa. July 13, 2005) (overdisclosure of the finance charge is not actionable). *But cf. JP Morgan Chase Bank v. Tecl, 808 N.Y.S.2d 432 (N.Y. App. Div. 2005)* (court erroneously concluded that the correct finance charge that is higher than the disclosed finance charge is not actionable; court applied the "overstated" rule to the correct finance charge, not to the disclosed one--which was understated).

(n128)Footnote 124. *See Marquez v. New Century, 2004 U.S. Dist. LEXIS 5725* (N.D. Ill. Apr. 5, 2004) ; *Scott v. IndyMac Bank, F.S.B., 2004 U.S. Dist. LEXIS 1309* (N.D. Ill. Feb. 3, 2004) ; *Quinn v. Ameriquest Mortgage Co., 2004 U.S. Dist. LEXIS 1053* (N.D. Ill. Jan. 26, 2004) ; *Walker v. Gateway Fin. Corp., 286 F. Supp. 2d 965 (N.D. Ill. 2003)* ; *Guise v. BWM Mortgage, L.L.C., 2003 U.S. Dist. LEXIS 14914* (N.D. Ill. Aug. 26, 2003) . *See also Johnson v. Know Fin. Group, L.L.C., 2004 U.S. Dist. LEXIS 9916* (E.D. Pa. May 26, 2004) (same but applying this holding to the calculation of points and fees for HOEPA purposes).

(n129)Footnote 125. *15 U.S.C. § 1605(f)*. September 30, 1995 was the effective date of the amendments.

(n130)Footnote 126. *15 U.S.C. § 1605(f)(1)(A)*; Reg. Z § 226.18(d)(1)(i).

(n131)Footnote 127. *15 U.S.C. § 1605(f)(1)(B)*; Reg. Z § 226.18(d)(1)(ii).

(n132)Footnote 128. The term residential mortgage transaction is defined at *15 U.S.C. § 1602(w)*. It generally includes purchase money security interests on the consumer's dwelling to finance acquisition or construction.

(n133)Footnote 129. *15 U.S.C. § 1605(f)(2)(B)*; Reg. Z § 226.23(g)(2).

(n134)Footnote 130. Reg. Z § 226.23(g)(2)(ii).

(n135)Footnote 131. *15 U.S.C. § 1605(f)(2)(B)*; Reg. Z § 226.23(g)(2). *See 15 U.S.C. § 1602(aa)* and Ch. 2 *infra* .

(n136)Footnote 132. *Inge v. Rock Fin. Corp., 281 F.3d 613 (6th Cir. 2002)* (construing § 1605(f), but relevant language of § 1635(i)(2) is identical).

(n137)Footnote 133. *15 U.S.C. § 1649(a)(3)*.

(n138)Footnote 134. *15 U.S.C. § 1649(a) (1996)*. *See generally* National Consumer Law Center, Truth in Lending § 4.6.3.2.5 (6th ed. 2007 and Supp.).

(n139)Footnote 135. *15 U.S.C. § 1638(a)(4)*; Reg. Z § 226.18(e). *See, e.g., Addison v. Britt, 350 S.E.2d 158 (N.C. Ct. App. 1986)* (failure to disclose APR is "one of the most material violations a creditor can commit").

(n140)Footnote 136. Official Staff Commentary § 226.18(e)-1. APRs can be checked through an online program offered by the Office of the Comptroller of the Currency. *See* www.occ.ustreas.gov/aprwin.htm. The companion CD-ROM to National Consumer Law Center, Truth in Lending (6th ed. 2007 and Supp.), includes two programs for calculating APRs using the actuarial method. Both prepare amortization tables. While the online program has the disadvantage of not preparing an amortization table, which would enable the calculation to be checked, it is a helpful way to double-check APRs calculated by other methods, and may be given more credibility by a judge since it is government-sponsored.

(n141)Footnote 137. *15 U.S.C. § 1632(a)*; Reg. Z § 226.17(a)(2); *Turner v. E-Z Check Cashing of Cookeville, TN, 35 F. Supp. 2d 1042 (M.D. Tenn. 1999)* (finance charge not disclosed more conspicuously in a payday loan transaction); *Yazzie v. Ray Vicker's Special Cars, Inc., 12 F. Supp. 2d 1230 (D.N.M. 1998)* (same regarding a pawn ticket); *Brown v. C.I.L., Inc., 1996 U.S. Dist. LEXIS 4053* (N.D. Ill. Apr. 1, 1996) ("annual percentage rate" and "finance charge" equally prominent as "amount financed" and "total of payments"); *In re Cervantes, 67 B.R. 816 (Bankr. E.D. Pa. 1986)* ("annual percentage rate" not more conspicuous than "total of payments").

(n142)Footnote 138. Reg. Z § 226.17(a)(2); see Reg. Z § 226.18(a) concerning disclosure of the creditor's identity.

(n143)Footnote 139. *In re Cervantes, 67 B.R. 816 (Bankr. E.D. Pa. 1986)* . *See* National Consumer Law Center, Truth in Lending § 8.6.5.3 (5th ed. 2003 and supp.). Court decisions to the contrary are discussed in this section.

(n144)Footnote 139.1. Official Staff Commentary § 226.17(c)(1)-11.

(n145)Footnote 139.2. Official Staff Commentary § 226.17(c)(1)-8.

(n146)Footnote 139.3. Official Staff Commentary § 226.17(c)(1)-8.

(n147)Footnote 140. *See, e.g., Northwest Sav. Ass'n v. Distler, 354 Pa. Super. 187, 511 A.2d 824 (1986)* (an erroneous disclosure that a $5,000 loan at 7% APR required only 120 monthly payments of $52 each, for a total of payments of $6,420, was a TIL violation); Conroy v. Village Bank & Trust Co., [1980-1989 Transfer Binder] Consumer Cred. Guide (CCH) P 96,907 (D. Conn. 1982) (disclosed 37 payments when only 36 required).

(n148)Footnote 141. *Turner v. E-Z Check Cashing, Inc., 35 F. Supp. 2d 1042 (M.D. Tenn. 1999)* . A similar requirement of the amount of the regular monthly payment is included in the advance disclosures required for high rate mortgage loans. *15 U.S.C. § 1639(a)(2)*. Obviously, these disclosures should be consistent.

(n149)Footnote 142. *15 U.S.C. § 1638(a)(6)*; Reg. Z § 226.18(g). *See Turner v. E-Z Check Cashing, Inc., 35 F.*

Supp. 2d 1042 (M.D. Tenn. 1999) . See Jones v. Ameriquest Mortgage Co., 2006 U.S. Dist. LEXIS 3788 (N.D. Ill. Jan. 31, 2006) ; *Washington v. Ameriquest Mortgage Co., 2006 U.S. Dist. LEXIS 50804* (N.D. Ill. July 11, 2006) (creditor did not comply with TILA because it listed only the first and last payment due date and the total number of payments but did not include the payment frequency; irrelevant that the consumer testified she assumed the payments were due monthly); Kitchen v. Ameriquest Mortgage Co., Clearinghouse No. 55,628 (N.D. Ga. Apr. 25, 2005) (No. 1:04-CV-2750-BBM) (TILA violation where the creditor listed only the first date the payments started but failed to list the interval, i.e., "monthly"). *But see Hamm v. Ameriquest Mortgage Co., 2005 U.S. Dist. LEXIS 21755* (N.D. Ill. Sept. 27, 2005) (creditor need not state the interval, i.e., "monthly," when this was clear on other documents and the consumer believed her payment was due monthly).

(n150)Footnote 143. *See, e.g., Turner v. E-Z Check Cashing, 35 F. Supp. 2d 1042 (M.D. Tenn. 1999) . Cf . Douglas v. Foundation Funding Group, Inc., 2005 U.S. Dist. LEXIS 13918* (N.D. Ga. Feb. 24, 2005) (overdisclosure of the final payment is actionable where it is not the result of an overstated finance charge.

(n151)Footnote 144. FRB Letter No. 469 [1969-1974 Transfer Binder] Consumer Cred. Guide (CCH) P 30,669 (Apr. 19, 1971).

(n152)Footnote 145. *12 U.S.C. §§ 4901 et seq.* Certain high-rate mortgages and mortgages purchased on the secondary market by Fannie Mae and Freddie Mac are exempt from the Act. *12 U.S.C. § 4902(f).* Some special rules apply to these loans.

(n153)Footnote 146. Official Staff Commentary § 226.18(g)-5. In calculating the payment schedule, creditors may rely on assumptions used for variable-rate transactions and discounted and premium variable-rate transactions. *Id.*

(n154)Footnote 147. Official Staff Commentary § 226.18(g)-5; *68 Fed. Reg. 16,185* (Apr. 3, 2003) .

(n155)Footnote 148. *See* Supplementary Information accompanying the 1999 and 2003 Commentary changes, *68 Fed. Reg. 16,185, 16,188* (Apr. 3, 2003) ; *64 Fed. Reg. 16,614, 16,615* (Apr. 6, 1999) . PMI is a finance charge since creditors require its purchase in transactions in which the borrower cannot make a 20% down payment on the purchase of a house. *See* Official Staff Commentary § 226.4(a)(1)-1.

(n156)Footnote 149. *15 U.S.C. § 1638(a)(5)*; Reg. Z § 226.18(h).

(n157)Footnote 150. Reg. Z § 226.18(h). *But see Mize v. Joe's Auto Sales, Inc., 2005 U.S. Dist. LEXIS 1648* (S.D. Ind. Jan. 26, 2005) (court held that the description of the total of payments was not confusing even though it read--"the amount you will have to pay after you have made all payments as originally scheduled"; court held that the numbers disclosed [39 payments totaling $3919.10] on a loan of $3294.70 clearly tell the consumer the accurate information; court relied on *Carmichael v. The Payment Center, 336 F.3d 636 (7th Cir. 2003)* which the Federal Reserve Board repudiated in 2004).

(n158)Footnote 151. Reg. Z § 226.18(h) n.44.

(n159)Footnote 152. Official Staff Commentary § 226.18(h)-3.

(n160)Footnote 153. Reg. Z § 226.17(c)(5).

(n161)Footnote 154. *15 U.S.C. § 1638(a)(9)*; Reg. Z § 226.18(m). *See Leon v. Washington Mut. Bank, 164 F. Supp. 2d 1034 (N.D. Ill. 2001)* (undisclosed security interest in goods "now or hereafter attached" to the real property purchased was TIL violation); *Mitchem v. American Loan Co., 2000 U.S. Dist. LEXIS 5785* (N.D. Ill. Mar. 13, 2000) (failure to disclose security interest in post-dated check is violation); *Williams v. Gelt Fin. Corp. (In re Williams), 232 B.R. 629 (Bankr. E.D. Pa. 1999) , aff'd, 1999 U.S. Dist. LEXIS 12512* (E.D. Pa. Aug. 10, 1999) (under-disclosure of the security interest as it was described in the mortgage note violates TIL). *See Vaden v. IndyMac Bank, F.S.B., 2003 U.S.*

Dist. LEXIS 16907 (N.D. Ill. Sept. 16, 2003) (merely putting the number "2" under the heading "security" on the TILA disclosure is not a proper disclosure of the security interest taken in the consumer's home).

(n162)Footnote 155. Reg. Z § 226.2(a)(25). *See Hahn v. McKenzie Check Advance of Ill., LLC, 202 F.3d 998 (7th Cir. 2000)* (relying upon *Smith* to hold that post-dated check is security for the loan, even though the consumer agreed in the loan note to pay a $25 fee if the check is dishonored and attorney fees necessary to collect); *Smith v. Cash Store Mgmt., Inc., 195 F.3d 325 (7th Cir. 1999)* (payday lender can obtain a security interest in a post-dated check because the check secures payment beyond the mere promise to repay and can be collateral for the loan; disclosing the post-dated check as security did not, therefore, violate TILA); *Davis v. Cash for Payday, Inc., 193 F.R.D. 518, 2000 U.S. Dist. LEXIS 6484 (N.D. Ill. 2000) . But see Williams v. Chartwell Fin. Serv., Ltd., 204 F.3d 748, 754 (7th Cir. 2000)* (creditor's requirement that consumer pay $250 to be held in an account in order to get $500 loan did not create a security interest in the $250; court stated that "the real effect of the cash collateral required by Chartwell was not to make the loans more secure, but to reduce the amounts of the loans").

(n163)Footnote 156. Reg. Z § 226.2(a)(25).

(n164)Footnote 157. Official Staff Commentary § 226.2(a)(25)-1, -2; *see* Reg. Z § 226.17(a)(1).

(n165)Footnote 158. Official Staff Commentary § 226.2(a)(25)-2. Other relevant state or federal law, however, may prohibit taking or enforcing certain types of security interests. *See* National Consumer Law Center, Repossessions, Chapter 3 (6th ed. 2005).

(n166)Footnote 159. Reg. Z § 226.2(a)(25); Official Staff Commentary § 226.18(m)-4. *Cf. Doubet v. USA Fin. Servs., Inc., 714 F. Supp. 980 (C.D. Ill. 1987)* (where security agreement took security interest in "consumer goods *now owned* or hereafter acquired ... ," the language was not an after-acquired *property clause*, therefore, the creditor's failure to disclose it in the disclosure statement constituted a violation of § 226.18(m)).

(n167)Footnote 160. *See, e.g., U.C.C. §§ 9-108, 9-204*. [Note that the 1999 revisions to Article 9 of the Uniform Commercial Code [hereinafter U.C.C.], effective July 1, 2001, omit § 9-108 as no longer necessary and rephrase § 9-204 without renumbering it or changing its substance.]

(n168)Footnote 161. Reg. Z § 226.2(a)(25). Note, however, that if a creditor has an interest that arises by operation of law (such as a vendor's lien), but also takes an independent security interest in the same property (such as a U.C.C. security interest), the latter interest must generally be disclosed. Official Staff Commentary § 226.2(a)(25)-4.

(n169)Footnote 162. Official Staff Commentary § 226.2(a)(25)-5. *See, e.g., Malone v. Safety Guard Mfg. Co., 748 F.2d 312 (5th Cir. 1984)* (construction lien); *Cox v. First Nat'l Bank of Cincinnati, 633 F. Supp. 236 (S.D. Ohio 1986)* .

(n170)Footnote 163. Reg. Z § 226.2(a)(25). *See also* Reg. Z §§ 226.15, 226.23; *see § 1.08 infra*.

(n171)Footnote 164. Reg. Z § 226.17(a)(1).

(n172)Footnote 165. Official Staff Commentary § 226.2(a)(25)-1, -2.

(n173)Footnote 166. Official Staff Commentary § 226.2(a)(25)-2. *See, e.g., Goldberg v. Delaware Olds, Inc., 670 F. Supp. 125 (D. Del. 1987)* (bank's right of setoff may be included in "federal box" even though not a security interest).

(n174)Footnote 167. See paragraph following *15 U.S.C. § 1640(a)(4). See also Van Jackson v. Check'n Go of Ill., Inc., 193 F.R.D. 544 (N.D. Ill. 2000)* .

(n175)Footnote 168. *See § 1.08 infra*.

(n176)Footnote 169. *15 U.S.C. § 1640(a)*.

(n177)Footnote 170. Note that this is not an exhaustive list.

(n178)Footnote 171. *15 U.S.C. § 1638(a)(1)*; Reg. Z § 226.18(a). For a discussion of the definition of creditor, see § 1.03[1][b] *supra*.

(n179)Footnote 172. Official Staff Commentary § 226.18(a)-1.

(n180)Footnote 173. Official Staff Commentary § 226.18(a)-1.

(n181)Footnote 174. *15 U.S.C. § 1638(a)(2)(B)*; Reg. Z § 226.18(c); Official Staff Commentary § 226.18(c)-1. *Cf. Shelton v. Mutual Sav. & Loan Ass'n, 738 F. Supp. 1050 (E.D. Mich. 1990)* (not a violation of TIL to automatically give consumer itemization of amount financed). *Johnson v. Banc One Acceptance Corp., 278 F. Supp. 2d 450 (E.D. Pa. 2003)* .

(n182)Footnote 175. Reg. Z § 226.18(c)(i).

(n183)Footnote 176. Reg. Z § 226.18(c)(ii).

(n184)Footnote 177. Reg. Z § 226.18(c)(iii).

(n185)Footnote 178. Reg. Z § 226.18(c)(iv).

(n186)Footnote 179. Official Staff Commentary § 226.2(a)(18)-3. *See* National Consumer Law Center, Truth in Lending § 4.7.3.4.1 (6th ed. 2007); *Parra v. Borgman Ford Sales, Inc., 2001 U.S. Dist. LEXIS 16666* (W.D. Mich. Oct. 5, 2001) . Note, however, that if the consumer trades in a vehicle with negative equity and makes a cash down payment, the creditor has the option of netting out the two amounts and disclosing only the net amount of negative equity as part of the amount financed. *See* National Consumer Law Center, Truth in Lending § 4.7.3.1 (6th ed. 2007).

(n187)Footnote 180. Official Staff Commentary § 226.2(a)(18)-3; *Parra v. Borgman Ford Sales, Inc., 2001 U.S. Dist. LEXIS 16666* (W.D. Mich. Oct. 5, 2001) .

(n188)Footnote 181. Reg. Z § 226.18(i).

(n189)Footnote 182. Reg. Z § 226.18(i). Regulation Z treats demand clauses completely differently from balloon payments, even though they can function in exactly the same way. From the borrower's standpoint, when a demand clause is exercised, it triggers a large payment that is the equivalent of a balloon payment.

(n190)Footnote 183. Reg. Z app. H-5, Demand Feature Model Clauses.

(n191)Footnote 184. *15 U.S.C. § 1638(a)(7)*; Reg. Z § 226.18(j).

(n192)Footnote 185. *15 U.S.C. § 1638(a)(7)*; Reg. Z § 226.18(j). *See, e.g., Goldsby v. H & I Fitness, LTD., 2003 U.S. Dist. LEXIS 26680* (C.D. Ill. Sept. 18, 2003) (violation when the "total sales price" was left blank).

(n193)Footnote 186. *15 U.S.C. § 1638(a)(8)*; Reg. Z § 226.18(j).

(n194)Footnote 187. Reg. Z § 4.7.5 (6th ed. 2007 and supp.). For a discussion of how the total sales price can be different for the same transaction where a customer pays a down payment on a car and trades in a car with negative equity, see National Consumer Law Center, Truth in Lending § 4.6.2 (5th ed. 2003 and supp.).

(n195)Footnote 188. Reg. Z § 226.2(a)(9).

(n196)Footnote 189. *See* Reg. Z § 226.18(b)(2).

(n197)Footnote 190. Reg. Z § 226.18(d).

(n198)Footnote 191. *15 U.S.C. § 1638(a)(11)*; Reg. Z § 226.18(k). Note that for high rate loans made after October 1, 1995, prepayment penalties are prohibited in most instances. *See also McAnaney v. Astoria Fin. Corp., 357 F. Supp. 2d 578 (E.D.N.Y. 2005)* (document preparation, fax, and recording fees charged as part of the payoff of a mortgage loan may constitute a prepayment penalty if they are a condition of payment in full, which triggers disclosure).

(n199)Footnote 192. *15 U.S.C. § 1638(a)(10)*; Reg. Z § 226.18(1).

(n200)Footnote 193. *See* Reg. Z § 226.4(d); *see § 1.04[4][c] supra. See also Clark v. U.S. Bank Nat'l Ass'n, 2004 U.S. Dist. LEXIS 11264* (E.D. Pa. June 18, 2004) (creditor disclosed the cost of the property insurance premium on the HUD-1 settlement statement and put the statement regarding the selection of the insurer on the TIL form; court held no violation), *subsequent proceedings*, *2004 U.S. Dist. LEXIS 20657 (E.D. Pa. Oct. 13, 2004), 2004 U.S. Dist. LEXIS 23060* (E.D. Pa. Nov. 16, 2004) .

(n201)Footnote 194. Reg. Z § 226.17(a)(1) n.38.

(n202)Footnote 195. *See Robinson v. Central Loan & Fin. Corp., 609 F.2d 170 (5th Cir. 1980)* .

(n203)Footnote 196. Official Staff Commentary § 226.18(g)-1.

(n204)Footnote 197. Official Staff Commentary § 226.18(h)-2). *See, e.g., Nave v. Community America Credit Union (In re Nave), 303 B.R. 223 (Bankr. D. Kan. 2003)* (where credit insurance premiums were charged on a monthly basis and not financed, the creditor may add these premiums to the total of payments) (*Note*: in this case, it is not clear whether the insurance premiums were reflected in the payment schedule or appeared only in the total of payments; the Commentary rule applies to the payment schedule; if the premiums were not reflected in the payment schedule and only appeared in the total of payments, TILA is violated).

(n205)Footnote 197.1. *See, e.g., Altamirano v. Copiague Funding Corp., 2008 U.S. Dist. LEXIS 62762* (D. Conn. Aug. 18, 2008) (where final TIL disclosure included PMI in the payment schedule but did not list it as a required form of insurance, while other loan documents did, the TIL disclosure was capable of conflicting interpretations and not clear and conspicuous); *Madel v. GMAC Mortg. Corp. (In re Madel), 2004 Bankr. LEXIS 2367* (Bankr. E.D. Wis. Nov. 8, 2004) (where the final TIL disclosure showed that the monthly payment was $300 higher than originally disclosed in the preliminary TIL disclosure statement, yet PMI was not specifically listed as required insurance on the final disclosure and was only enumerated in the first payment letter, such a disclosure was not clear and conspicuous).

(n206)Footnote 198. Reg. Z § 226.4(e). Specifically, taxes and fees prescribed by law and actually paid to public officials, and "nonfiling insurance" premiums that do not exceed fees that otherwise would be payable.

(n207)Footnote 199. *See* Ch. 6 *infra*.

(n208)Footnote 200. Reg. Z § 226.18(p).

(n209)Footnote 201. Official Staff Commentary § 226.18(p)-1.

(n210)Footnote 202. Reg. Z § 226.2(a)(24).

(n211)Footnote 203. Reg. Z § 226.18(q); see Reg. Z § 226.20(b) for disclosure requirements when the obligation is actually assumed.

(n212)Footnote 204. Reg. Z § 226.18(r).

(n213)Footnote 205. Some lenders use the LIBOR as the index. These rates can be verified by trying this Internet

website: www.hsh.com/indices/libor.html.

(n214)Footnote 206. *12 U.S.C. § 3806*, § 1204 of Pub. L. No. 100-86, *101 Stat. 662* (effective Dec. 9, 1987). The Act also applies to open-end credit. Congress later enacted the Home Equity Loan Consumer Protection Act, Pub. L. No. 100-709 (Nov. 23, 1988), which imposed new disclosure and substantive requirements for open-end lines of credit secured by the consumer's home. *See* National Consumer Law Center, Truth in Lending § 5.10 (6th ed. 2007).

(n215)Footnote 207. Reg. Z § 226.30.

(n216)Footnote 208. Reg. Z §§ 226.18(f)(2), 226.19(b).

(n217)Footnote 209. Reg. Z § 226.18(f)(1).

(n218)Footnote 210. Reg. Z § 226.18(f) n.43.

(n219)Footnote 211. *52 Fed. Reg. 48,665* (Dec. 24, 1987) .

(n220)Footnote 212. FRB Press Release, Agencies Issue Final Illustrations of Consumer Information for Nontraditional Mortgage Products (May 31, 2007), *available at* www.federalreserve.gov/boarddocs/press/bcreg/2007/20070531/default.htm. The illustrations also appeared in *72 Fed. Reg. 31,825* (June 8, 2007) . The proposed version of these illustrations can be found at *71 Fed. Reg. 58,673* (Oct. 4, 2006) .

(n221)Footnote 213. *72 Fed. Reg. 45,495* (Aug. 14, 2007) .

(n222)Footnote 214. An "adjustable rate mortgage loan" is defined as "any consumer loan secured by a lien on a one- to-four family dwelling unit, including a condominium unit, cooperative housing unit, or mobile home, where the loan is made pursuant to an agreement under which the creditor may, from time to time, adjust the rate of interest." *12 U.S.C. § 3806(d)(2)*, *as amended* Oct. 28, 1992.

(n223)Footnote 215. Reg. Z § 226.30(a). *See 52 Fed. Reg. 43,178* (Nov. 9, 1987), *corrected at 52 Fed. Reg. 45,611* (Dec. 1, 1987).

(n224)Footnote 216. Reg. Z § 226.19(b); Official Staff Commentary § 226.19(b)-1. In 1996, Congress amended TILA to allow creditors the option of giving a statement that the periodic payments may increase or decrease substantially together with the maximum interest rate and payment amount for a $10,000 loan amount in lieu of giving the fifteen-year historical example. *15 U.S.C. § 1638(a)*. The glitch is that Congress apparently limited this change to "residential mortgage transactions" which means purchase money mortgages. The FRB, however, when amending Regulation Z to conform to the statutory change, expanded the applicability of this alternative disclosure option to all variable rate loans with a term of greater than one year and secured by a consumer's principal dwelling. *62 Fed. Reg. 63,441, 63,442* (Dec. 1, 1997) .

(n225)Footnote 217. Reg. Z § 226.18(f)(1).

(n226)Footnote 218. Reg. Z § 226.18(f)(1) n.43.

(n227)Footnote 219. Reg. Z § 226.19(b)(1).

(n228)Footnote 220. Reg. Z § 226.19(b)(2); Official Staff Commentary § 226.19(b)(2)-1.

(n229)Footnote 221. One commonly used index in the subprime market is the "LIBOR" (London Interbank Offered Rate). To verify LIBOR rates, see www.bba.org.uk. Click on "Libor."

(n230)Footnote 222. Reg. Z § 226.19(b)(2)(ii); Official Staff Commentary § 226.19(b)(2)(ii)-1. If the LIBOR is used as an index, rates can be verified by trying at: www.bba.org.uk. Click on "Libor." The LIBOR rates are listed by country and by duration. The loan note should state the specific LIBOR rate that applies. For example, if the loan note states that the "six-month LIBOR" rate applies, use the U.S. "6m" LIBOR rate for the date in question. In a recent case, the court certified a class in a case alleging a violation of TILA because the creditor failed to adequately identify the index. The disclosure only mentioned "the LIBOR" and did not specify which particular LIBOR index applied. *Abel v. Keybank USA, N.A., 313 F. Supp. 2d 720 (N.D. Ohio 2004)* .

(n231)Footnote 223. Reg. Z § 226.19(b).

(n232)Footnote 224. Reg. Z § 226.20(c). *See Collier v. Wells Fargo Home Mortgage, 2006 U.S. Dist. LEXIS 35619* (N.D. Tex. May 26, 2006) (no violation when creditor provided a timely adjustment notice that, *inter alia*, maintained the bi-weekly payment schedule but reduced the payments by re-amortizing them based on a full thirty-year term and stated the number of remaining payments).

(n233)Footnote 225. Reg. Z § 226.20(c) requires the adjustment notice be given "in a variable-rate transaction subject to section 226.19(b)," which are those secured by the consumer's principal dwelling and with terms of more than one year. These requirements have been in place since December 1, 1987. Under prior TIL rules, however, under some circumstances, an adjustment to a variable-rate transaction might constitute a "new transaction," which would require new disclosures.

(n234)Footnote 226. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, §§ 2502(a)(6), 2502(c)(2), *122 Stat. 2654, 2856 (2008)* (codified at *15 U.S.C. § 1638(b)(2)(C)*).

(n235)Footnote 227. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2502(a)(6), *122 Stat. 2654, 2856 (2008)* (codified at *15 U.S.C. § 1638(b)(2)(C)(ii)*).

(n236)Footnote 228. Reg. Z § 226.18(f)(1); Official Staff Commentary § 226.18(f)-1. Those variable-rate transactions which are secured by the borrower's principal dwelling and with a term of greater than one year are subject to Reg. Z § 226.18(f)(2) and § 226.19(b). For discussion of the alternative disclosure requirements, see National Consumer Law Center, Truth in Lending § 4.8.3 (6th ed. 2007 and Supp.).

(n237)Footnote 228.1. *74 Fed. Reg. 41,194, 41,194* (Aug. 14, 2009) .

(n238)Footnote 228.2. Reg. Z § 226.46(b).

(n239)Footnote 228.3. *Id.*

(n240)Footnote 228.4. Reg. Z § 226.48(a); Official Staff Commentary § 226.48(a)-1 to (a)-3.

(n241)Footnote 228.5. Reg. Z § 226.48(c); Official Staff Commentary § 226.48(c)-1.

(n242)Footnote 228.6. Reg. Z § 226.48(c)(3).

(n243)Footnote 228.7. *Id.*

(n244)Footnote 228.8. Reg. Z § 226.48(c)(4).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 1 Truth in Lending

1-1 Consumer Credit Law Manual § 1.06

§ 1.06 Disclosure Requirements for Refinancings and Other Subsequent Occurrences

[1] Refinancings

The basic working principle of Regulation Z is that a refinancing is a new transaction that requires all new disclosures to the consumer. n1 The problem for consumers is not this principle, but, instead, the fairly narrow definition of "refinancing."

A "refinancing" occurs where an existing obligation subject to closed-end TIL disclosures is satisfied and replaced with a new obligation to the same creditor undertaken by the same consumer. n2 The key terms are "satisfaction" and "replacement" n3 and both terms must be met absolutely. n4 To qualify as a refinancing, the new obligation must completely replace the prior obligation, regardless of whether the prior obligation's terms are changed. n5 For example, a new loan completely replacing a cancelled loan is a refinancing, even if the terms of the new loan are indistinguishable from those of the old one. n6 Whether the creditor's purchase of required property insurance after consummation ("force-placed insurance") requires new disclosures is unsettled, and may depend on the type of coverage provided by the insurance. n7

Another important requirement for refinancings is that they must involve both the original creditor (or an assignee or servicer of the original creditor) and the original consumer from the original obligation. n8 An obligation refinanced by some other creditor is not a "refinancing," but, rather, a new transaction that definitely requires new disclosures.

Typical examples of refinancings include consolidation of several existing obligations, disbursement of additional proceeds to the consumer or the consumer's other creditors, or the rescheduling of payments. n9 Unfortunately, other examples that may come to mind are probably specifically excluded from the scope of refinancing, even if they meet the cancellation/replacement rule of the definition. n10

[2] "Loan-Splitting" and Refinancing

For a variety of reasons (few of which are to benefit the consumer), a creditor may wish to split what the consumer views as a single transaction into two theoretically distinct ones. n11 One form may present the issue of whether there was a genuine refinancing, or whether the creditor was engaging in loan-splitting. Courts assess these transactions carefully, and may do so by identifying the following factors: the debtor's intended purpose for the credit, and needs he

was seeking to meet; the debtor's expectation as to the "number and sequence" of transactions; the method and clarity of the creditor's communication to the borrower about its proposal for the loan terms; the creditor's internal policies "particularly with reference to initial 'enabling' loans to finance the cost of application for a larger loan"; the extent to which such policies are the rationale for structuring the loan; and the nature and results of any bargaining. Most important is the borrower's "awareness and intent." n12

[3] Rate Adjustments in Variable-Rate Transactions

[a] Adjustable Rate Mortgages

An adjustment to the interest rate in a variable-rate transaction subject to the disclosure rules for ARMs requires new disclosures to the consumer regardless of whether there is a corresponding adjustment to the payment. n13 In these transactions, disclosures must be made at least 25, but no more than 120, calendar days before a payment is due in a changed amount. n14 This timing rule applies equally to the changes which are required when an ARM is converted to a fixed-rate transaction. n15 If no payment change is required by a change to the rate, disclosures must be made at least once each year in which a new rate is implemented. n16 The required disclosures include:

- The current and prior interest rates;
- The index values on which the current and changed rate is based; n17
- The extent of any foregone rate changes;
- The effects of the adjustment including the new payment;
- A statement of the loan balance; and
- The payment which would be required to fully amortize the loan balance if it is different from the payment required under the contract. n18

Violation of these ARM requirements may give rise to statutory damages as well as actual damages. n19

[b] Other Variable-Rate Transactions

For transactions which are not subject to the disclosure rules for adjustable rate mortgages, the change of the APR in accordance with a variable-rate feature is not considered a refinancing as long as the variable-rate feature was properly disclosed originally. n20 However, new TIL disclosures are required if the creditor increases the annual percentage rate in accordance with a variable-rate feature that was not previously disclosed. n21 Similarly, new disclosures are also required if the creditor adds a variable-rate feature to the obligation. n22 Disclosures in both instances are required even if the original obligation is not cancelled and replaced by a new one. n23

The current requirements for adjustments to variable-rate transactions not subject to the ARM rules are derived without substantive change from prior law. Under the Old Act, courts interpreting both Official Board Interpretation 226.810 and Old Regulation Z section 226.8(b)(8) n24 held that APR increases in variable-rate contracts are new extensions of credit requiring new disclosures if the variable nature of the original contact was not properly disclosed. n25 The current rule for non-ARM n26 variable-rate transactions remains essentially unchanged.

[4] Renewals

The renewal of a single payment obligation (that is, only one payment of interest and principal is required) on its original terms is not considered a refinancing. n27 The Commentary to the current rules on refinancings broadens this

exception to include transactions which require periodic payments of interest and a final payment of principal. n28

The Commentary also allows the exception to disclosure rules even if accrued unpaid interest is added to the principal balance. n29 Thus, under the Commentary, a consumer could enter into a ten-year loan of $10,000 at 12% APR, with monthly interest-only payments of $100, and a final payment of the principal of $10,000. If the consumer never made any interest payments, he would owe $22,000 at the end of the ten years. If this sum were "renewed" on its original terms, that is, for ten years with monthly interest payments of $100 (thereby creating a negative amortization situation) and a final payment of the principal of $22,000, under the Commentary this would not be considered a refinancing.

Payday and auto title lenders will frequently "rollover," "renew," or "extend" the single payment loan by charging a new fee. n30 This fee is often the same amount as the original finance charge imposed. Some lenders may take a new post-dated check and provide some receipt or other document evidencing the "new" transaction. Since these are single payment loans, arguably a "new" transaction occurs each time the loan is renewed. However, the Seventh Circuit found that where the creditor imposed a new fee for each extension, this act did not, of itself, equate to a refinancing. n31 The opinion recited no evidence that a new post-dated check was required and new documentation provided facts that reveal an intent to create a "new" loan.

[5] APR Reduction

A new obligation that has a lower annual percentage rate than the original obligation with a corresponding change in the payment schedule is not considered a refinancing. n32 Examples would include a shortened maturity date, reduced number of payments, or smaller required payments; however, the Commentary makes clear that this exception does not apply if the maturity is lengthened or if the payment amount or number of payments is increased beyond that remaining on the existing transaction. n33 The Commentary also notes, however, if the annual percentage rate is first reduced and then later is increased (even if it remains below its original level), the increase would be considered a refinancing, requiring new disclosures. n34

[6] Court Agreements

Another exception to the general refinancing disclosure rules covers agreements made in the context of litigation. n35 Examples of such agreements include reaffirmation of debts discharged in bankruptcy, n36 settlement agreements, and post-judgment agreements. n37 It is important to note that these agreements, which are basically voluntary agreements between the parties and are not considered refinancings, are distinguished from court judgments, which are not even considered to be extensions of credit. n38

[7] Workout Agreements

Often when a consumer is in default, the creditor and consumer will agree to change the terms of an obligation to (seemingly) give the consumer an opportunity to avoid some of the consequences of default (litigation, repossession). For example, the consumer may agree to make higher payments or give additional security for the obligation; in return, the creditor will not file suit. These "workout agreements" are not considered refinancings and do not require additional disclosures unless the annual percentage rate is increased or additional credit is advanced (that is, beyond the unpaid balance, earned finance charge, and new insurance premiums). n39

[8] Insurance Renewals

Sometimes "optional" insurance, such as credit insurance, is renewed prior to the expiration of the obligation and the cost of the new insurance premium (and the cost of financing that premium) is added to the payment schedule. Such a renewal is not a refinancing, assuming that the appropriate disclosures were provided for the initial purchase of the insurance, even though the renewal creates an additional charge which will increase the size of the payments. n40

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingDisclosureReal Property LawFinancingMortgages & Other Security InstrumentsGeneral OverviewReal Property LawFinancingState Regulation

FOOTNOTES:
(n1)Footnote 1. Reg. Z § 226.20(a). Refinancings after December 9, 1987 of obligations that are secured by the consumer's dwelling and that allow for interest rate changes are also subject to the new disclosures of maximum interest rates. *See* Reg. Z § 226.30.

(n2)Footnote 2. Reg. Z § 226.20(a). *But see* Official Staff Commentary § 226.20(a)-3 (re: required disclosures for the addition of a variable-rate feature even in the absence of the satisfaction/replacement feature).

(n3)Footnote 3. The parties' contract and applicable law determines whether that has occurred. Official Staff Commentary § 226.20(a)-1.

(n4)Footnote 4. *See, e.g., Garofalo v. Boyer, 2001 Conn. Super. LEXIS 932* (Jan. 24, 2001) (loan modification did not change the amount owed or the interest rate; no new note signed by the parties, and the old debt was never extinguished; therefore, no new disclosures required); *Ford Motor Credit Co. v. Russell, 519 N.W.2d 460 (Minn. Ct. App. 1994)* (existing obligation was not satisfied and replaced where car buyer cancelled credit disability insurance and extended service contract, and unused premiums were applied to loan balance and monthly payments reduced). *Sheppard v. GMAC Mortgage Corp. (In re Sheppard), 299 B.R. 753 (E.D. Pa. 2003)* (court found that the loan modification did not meet the threshold definition of a refinancing; therefore, the loan modification exceptions to refinancing rule did not apply).

(n5)Footnote 5. Official Staff Commentary § 226.20(a)-1.

(n6)Footnote 6. *See Begala v. PNC Bank, N.A., 163 F.3d 948 (6th Cir. 1998) , cert. denied, 528 U.S. 868, 120 S. Ct. 166, 145 L. Ed. 2d 141 (1999) , second lawsuit on same issue dismissed, 214 F.3d 776 (6th Cir. 2000) , cert. denied, 531 U.S. 1145, 121 S. Ct. 1082, 148 L. Ed. 2d 958 (2001)* ; *Bone v. Hibernia Bank, 493 F.2d 135 (9th Cir. 1974) . See also Jackson v. American Loan Co., 202 F.3d 911 (7th Cir. 2000)* (payment of an extension fee in a single payment loan does not, alone, equate to a refinancing). *But see Temores v. Overland Bond & Inv. Corp., 1999 U.S. Dist. LEXIS 11878* (N.D. Ill. July 29, 1999) (agreement to change payment terms in an installment loan financing the purchase of a car can be a refinancing).

(n7)Footnote 7. *Compare Pauley v. Bank One Colorado Corp., 205 B.R. 272 (D. Colo. 1997)* (no new disclosures required as court found that the cost of the insurance fit into the exception in Reg. Z § 226.20(a)(4)); *Adams v. GMAC Mortgage Corp., 1994 U.S. Dist. LEXIS 17854* (N.D. Ill. Dec. 8, 1994) (creditor's purchase of force-placed insurance is not a refinancing requiring new disclosures; court dismissed, without discussion, as "unsupportable" borrower's allegation that it included unauthorized coverages), *with* Hogan v. Valley Nat'l Fin. Servs. Co., Clearinghouse No. 40,428 (D. Colo. 1995) (court denied creditor's motion to dismiss, holding that if plaintiff proved allegations that unauthorized, credit loss coverage was included, the premiums could be a finance charge and the purchase of unauthorized coverage could constitute a new credit transaction requiring new disclosures).

(n8)Footnote 8. Official Staff Commentary § 226.20(a)-5.

(n9)Footnote 9. Official Staff Commentary § 226.20(a)-1. *See Temores v. Overland Bond & Inv. Corp., 1999 U.S. Dist. LEXIS 11878* (N.D. Ill. July 29, 1999) . Unfortunately, at best, refinancings merely require new disclosures and not comparisons of the terms of the old and new obligations, for example, when a consumer refinances an existing 10% APR mortgage with a no-interest doctor's bill to produce a new 18% consolidation mortgage loan.

(n10)Footnote 10. Reg. Z § 226.20(a); Official Staff Commentary § 226.20(a)-2.

(n11)Footnote 11. See, e.g., National Consumer Law Center, Truth in Lending § 6.5.3.2 (6th ed. 2007 and supp.), on "the two-contract dodge" in home improvement sales.

(n12)Footnote 12. *Thorp Loan & Thrift Co. v. Buckles (In re Buckles), 189 B.R. 752, 762 (Bankr. D. Minn. 1995)* ; *Kane v. Equity One, Inc., 2003 U.S. Dist. LEXIS 23810* (E.D. Pa. Nov. 21, 2003) (claim of loan splitting will not be dismissed where the complaint alleges that the loan was split into two transactions in contravention of the consumer's expectations). *See generally FTC v. Citigroup, Inc., 239 F. Supp. 2d 1302, 1307 (N.D. Ga. 2001)* (denying motion to dismiss claim that finance company violated TILA by loan splitting, i.e., "giving the borrower immediate cash, tying him to a home equity loan, and effectively nullifying the TILA three-day rescission period"). *But see Stokes v. World Savings Bank, 2001 U.S. Dist. LEXIS 13602* (N.D. Ill. Aug. 30, 2001) (no TIL violation to split home purchase financing into two loans, one for 80% of purchase price and one for amount over 80%, where the two loans had different terms and there was no evidence that borrower intended to get a single loan); *accord Rendler v. Corus Bank, N.A., 272 F.3d 992 (7th Cir. 2001)* .

(n13)Footnote 13. These charge notice rules apply to variable-rate mortgages secured by the consumer's principal dwelling, with terms greater than one year. Reg. Z § 226.20(c). *Collier v. Wells Fargo Home Mortgage, 2006 U.S. Dist. LEXIS 35619* (N.D. Tex. May 26, 2006) (creditor cannot rely upon the subsequent occurrence defense regarding variable rate adjustment notices).

(n14)Footnote 14. These charge notice rules apply to variable-rate mortgages secured by the consumer's principal dwelling, with terms greater than one year. Reg. Z § 226.20(c); *Fidler v. Central Coop. Bank (In re Fidler), 210 B.R. 411 (Bankr. D. Mass. 1997)* (dispute of material fact as to whether creditor mailed the adjustment notice in a timely way resulted in the denial of the creditor's motion for summary judgment; consumer's denial of receipt was contained in affidavit), *vacated, in part, reaff'd, in part, claim dismissed, mot. denied, in part, 226 B.R. 734 (Bankr. D. Mass. 1998)* .

(n15)Footnote 15. Official Staff Commentary § 226.20(c)-1.

(n16)Footnote 16. Reg. Z § 226.20(c).

(n17)Footnote 17. Only the index values must be disclosed. Thus, the margin used in calculating the rate need not be disclosed. Official Staff Commentary § 226.20(c)(2)-1.

(n18)Footnote 18. Reg. Z § 226.20(c).

(n19)Footnote 19. *See Essex Home Mortgage Servicing Corp. v. Fritz, 740 So. 2d 1224 (Fla. Dist. Ct. App. 1999)* ($2,000 statutory damages limited to first misdisclosure as it only affected the first rate change; consumer presented no evidence that any subsequent changes were made in error as a result of this misdisclosure).

(n20)Footnote 20. *See* Reg. Z § 226.18(f) and Official Staff Commentary § 226.20(a)-3. *See, e.g., National City Bank v. Parker, 1990 Ohio App. LEXIS 2607* (Ohio Ct. App. June 27, 1990) (variable-rate car loan; no refinancing occurred, thus new disclosures not required each time interest rate increased where all disclosures had been properly made at consummation).

(n21)Footnote 21. Official Staff Commentary § 226.20(a)-3.

(n22)Footnote 22. Official Staff Commentary § 226.20(a)-3.

(n23)Footnote 23. Official Staff Commentary § 226.20(a)-3.

(n24)Footnote 24. The text of OBI § 226.810 and Old Reg. Z § 226.8(b)(8) may be found in § 8, at p. 76 and § 8, App. A4, respectively, of National Consumer Law Center, Truth in Lending in Transition (1982).

(n25)Footnote 25. *See, e.g., Nash v. First Fin. Sav. & Loan Ass'n, 703 F.2d 233 (7th Cir. 1983)* ; *Brown v. Marquette Sav. & Loan Ass'n, 686 F.2d 608 (7th Cir. 1982)* ; *Hughes v. Cardinal Fed. Sav. & Loan Ass'n, 566 F. Supp. 834 (S.D. Ohio 1983)* (APR increase without proper disclosure constituted "refinancing"); *Preston v. First Bank of Marietta, 16 Ohio App. 3d 4, 473 N.E.2d 1210 (1983) . See also Moore v. Coral Nat'l Bank, 409 A.2d 679 (Me. 1979) .*

(n26)Footnote 26. As used here, "ARM" refers to those adjustable rate mortgages subject to Reg. Z § 226.19(b), which are secured by the borrower's principal dwelling and are written for a term of longer than one year. Adjustment notices for ARMs are governed by Reg. Z § 226.20(c).

(n27)Footnote 27. Reg. Z § 226.20(a)(1). This represents a substantive change from the Old Regulation. *See In re Scaife, 825 F.2d 357 (11th Cir. 1987) .*

(n28)Footnote 28. Official Staff Commentary § 226.20(a)(1)-1.

(n29)Footnote 29. Official Staff Commentary § 226.20(a)(1)-1.

(n30)Footnote 30. *See* National Consumer Law Center, Cost of Credit: Regulation, Preemption and Industry Abuses, § 7.5.5 (3d ed. and supp.).

(n31)Footnote 31. *Jackson v. American Loan Co., Inc., 202 F.3d 911 (7th Cir. 2000) .*

(n32)Footnote 32. Reg. Z § 226.20(a)(2); *Colman v. Wendover Funding, Inc., 89 F.3d 849 (10th Cir. 1996)* , *reported in full at 1996 U.S. App. LEXIS 14251* (10th Cir. June 12, 1996) .

(n33)Footnote 33. Official Staff Commentary § 226.20(a)(2)-2. *See Hart v. GMAC Mortgage Corp. (In re Hart), 246 B.R. 709 (Bankr. D. Mass. 2000)* (loan modification not a refinancing as it lowered the APR and consequently reduced the monthly payment).

(n34)Footnote 34. Official Staff Commentary § 226.20(a)(2)-1. The increase must be accomplished by satisfaction and replacement of the old obligation to meet the general definition of a refinancing.

(n35)Footnote 35. Reg. Z § 226.20(a)(3).

(n36)Footnote 36. *See 11 U.S.C. § 524(c).*

(n37)Footnote 37. Official Staff Commentary § 226.20(a)(3)-1.

(n38)Footnote 38. Official Staff Commentary § 226.2(a)(14)-1. Note that court *approval* of reaffirmation agreements are included in the non-credit list; reaffirmations generally, which do not always need the approval of the court, are included in the non-refinancing list.

(n39)Footnote 39. Reg. Z § 226.20(a)(4); Official Staff Commentary § 226.20(a)(4)-1. *See Hart v. GMAC Mortgage Corp. (In re Hart), 246 B.R. 709 (Bankr. D. Mass. 2000)* (loan modification not a refinancing as it lowered the APR and consequently reduced the monthly payment; forbearance agreement not a refinancing because it resulted from the homeowner's default and the rate did not increase nor did the repayment amount exceed the unpaid balance plus earned finance charges); *Garofalo v. Boyer, 2001 Conn. Super. LEXIS 932* (Conn. Super. Ct. Jan. 24, 2001) (loan modification did not change the amount owed or the interest rate; no new note signed by the parties and the old debt was never extinguished; therefore, no new disclosures required). *See also Scott v. Wells Fargo Home Mortgage Inc., 326 F. Supp. 2d 709 (E.D. Va. 2003)* (no right to rescind a loan modification because new TIL disclosures are not required if the APR does not increase and the consumer does not allege that additional credit was extended).

(n40)Footnote 40. Reg. Z § 226.20(a)(5); Official Staff Commentary § 226.20(a)(5)-1.

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Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 1 Truth in Lending

1-1 Consumer Credit Law Manual § 1.07

§ 1.07 Open-End Credit Regulations

Important Note: Major changes have recently been made to TILA and Regulation Z's provisions regarding credit cards and open-end credit, and the statutory changes necessitate further changes to Regulation Z that should go into effect by February 22, 2010. ***These further changes have not yet been announced, and thus cannot be included in this chapter***.

The Credit Card Accountability, Responsibility and Disclosure (CARD) Act (hereinafter Credit CARD Act), passed in May 2009, adds a number of substantive protections and new disclosure requirements concerning open-end credit, many of which are effective February 22, 2010. Before enactment of the Credit CARD Act, the Federal Reserve Board had issued a final rule in January 2009 making wholesale revisions to Regulation Z's open-end credit provisions, effective July 2010.

The FRB must now revise Regulation Z due to the Credit CARD Act, and that revision should be accomplished by the Credit CARD Act's February 22, 2010 effective date. We expect that many of the provisions of the new rule will be similar to the January 2009 rule. This chapter includes the January 2009 rule, and retains its announced July 2010 effective date. But significant portions of this rule will be revised in part, and will instead go into effect on February 22, 2010. The next scheduled update of this chapter will include those changes. *See also* National Consumer Law Center, Truth in Lending, Chapter 5 (2009 supp.).

[1] Scope of TIL Open-End Credit Regulations

The next set of TILA provisions apply to revolving charge accounts, credit cards and other forms of open-end credit including open-end credit secured by the consumer's dwelling. n1 These provisions can be found in TILA Chapter 2 and essential interpretations are found at Regulation Z Subpart B n2 and the Commentary. n3

TILA requires specific disclosures to be made throughout the existence of an open-end credit account. n4 Disclosures are required in the advertisement of open-end credit, n5 at the opening of an account, and before the first use of a credit card or open-end account. n6 For credit cards, TILA requires disclosures to be given even earlier, in conjunction with applications and solicitations. n7 TILA also requires a periodic (usually monthly) statement with certain disclosures to be sent to the card user or holder of the open-end account. n7.1 Disclosures are required if an account is renewed or the terms of the account changes. n7.2 Model forms appear in the appendices to Regulation Z, particularly Appendix G. It is important to note that some disclosures can now be made electronically. The Electronic Signatures in Global and National Commerce Act, n8 effective October 1, 2000, was enacted to validate electronic signatures, electronic

documents, and electronic disclosures. If its requirements, particularly the consumer consent and confirmation of consent requirements, are met, it overrides TILA's requirement that disclosures be made in writing. n9

TILA Chapter 4 includes the FCBA, n10 which provides important consumer protection in credit card transactions. Some of these protections apply broadly to credit card transactions, including nonconsumer, business cards and credit cards which do not involve open-end credit. n11 The Regulation briefly interprets the several sections of the FCBA. n12

[a] Definition of Open-End Credit

Open-end credit is defined in the Regulation n13 by reference to an "open-end credit plan" in which a creditor:

a) "Reasonably contemplates" repeated transactions;

b) Prescribes the terms of the transactions; and

c) Provides for a finance charge which may be computed from time-to-time on an outstanding unpaid balance.

The Regulation and Commentary amplify this definition. The Regulation defines open-end credit as "consumer credit" n14 extended by a "creditor" n15 under a plan in which:

a) The creditor reasonably contemplates repeated transactions;

b) The creditor may impose a finance charge from time to time on an unpaid balance. If the finance charge is pre-computed at the inception of the transaction, it is not an open-end transaction; and

c) The amount of credit that may be extended to the consumer during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid. n16

According to the Commentary, the plan must meet all three criteria n17 and also be a contractual arrangement between creditor and customer. n18 But the plan can have one or several features, such as a secured credit line, an overdraft line, or other programs, with different rate structures (multifeatured plans).

In 1998, after many proposals and much debate, the FRB amended the Official Staff Commentary to include one new provision. To dispel the myth that the reasonableness of a creditor's expectation of repeat transactions is measured on purely subjective bases, it added the following statement:

> The determination of whether a creditor can reasonably contemplate repeated transactions requires objective analysis. Information that much of the creditor's customer base with accounts under the plan make repeated transactions is relevant to the determination, particularly when the plan is opened primarily for the financing of infrequently purchased products or services. n19

The Board went on to explain, in Supplementary Information, that certain factors could be considered in making an individualized factual determination:

- whether a credit line was limited to the purchase of items not likely to be purchased in multiples; a greater variety of products and services available increases the likelihood that the expectation was reasonable;

- whether the credit was established for the purpose of purchasing a designated item;

- where the plan was established to finance the purchase of a designated item, the amount of the purchase compared to the credit line. The establishment of a $5,000 line to purchase a $4,500 satellite dish was an example of a situation where a creditor was not likely to reasonably assume repeated transactions. The Board notes that the availability of add-on sales which were nominal in amount compared to the initial transaction would not make the expectation reasonable;

- whether the creditor reasonably solicited customers for repeated transactions. For example, if a $10,000 line was filled with a $9,000 roof job, a purported solicitation of the customer for a siding job would not appear to be a bona fide offer; and

- whether the creditor had data showing that customers actually made repeated purchases. n20

Federal courts asked to decide whether creditors have extended genuine or spurious open-ended credit have largely ignored the plain language of the new addition to the commentary and the five factors listed above. n21 In *Benion v. Bank One, N.A.*, n22 the Seventh Circuit upheld the "reasonableness" of a creditor's expectations of repeated transactions. The court did analyze the new material, but determined that it did not specifically forbid the credit practice at issue in that case, which appeared to fit neatly into a regulatory loophole. The court noted that

> [w]hen an activity of a technical and specialized character is comprehensively regulated by an expert agency, as consumer credit disclosures are comprehensively regulated by the Federal Reserve Board (and no one doubts that this particular agency is a repository of genuine expertise), courts should generally leave the plugging of loopholes to the agency, lest the court's reparative efforts create confusion and disrupt the regulatory scheme. n23

Even after *Benion*, spurious open-end credit remains in litigation elsewhere. n24 It can still be argued that TILA and other consumer protection statutes are supposed to be liberally construed to effectuate their purpose, and that Congress left the matter for case-by-case analysis by courts in light of all the facts and circumstances. In addition, the deceptive use of open-end credit to finance large ticket items, such as satellite dishes, can be attacked under fraud or unfair or deceptive theories. In *Carlisle v. Whirlpool Finance National Bank*, n25 a jury awarded $580 million in two individual cases joined for trial. The trial court, though reducing the award to $300 million, found that the evidence revealed a malicious sales practice designed to target and take advantage of the poor, under-educated, elderly, and African-American citizens. Because the lender structured the loans as open-end, the payments would have lasted for eight years, rather than thirty-six months, at $34 each, the payment schedule which the consumers understood to be the arrangement. n26

More recently, a bankruptcy court decided that a home equity line of credit constituted spurious open-end credit. n27 In that case, the creditor extended two home-secured loans to the homeowners, a first lien fixed-term loan that refinanced the existing mortgage lien and a second line of credit which paid off certain credit card debt. In reaching its conclusion, the court highlighted the following factors: the creditor disbursed the entire line of credit at closing; the terms called for interest-only payments for the first three years which would result in no reduction of principal during that time; the draw period only lasted for the first three years; the creditor knew that the homeowners would not likely pay more than the interest-only payments during the draw period, given their limited monthly income and, consequently knew that the line of credit would not replenish during that time.

Note that the label of a plan or account does not determine its nature for TIL purposes. n28 A close review of the terms of a credit plan is necessary to determine whether it involves open-end credit or closed-end credit under TIL. n29 For example, many real estate transactions, including home equity "lines of credit," may be merely "so-called" open-end transactions. For instance, if advances are separately negotiated or approved, the "self-replenishing" aspect of open

credit is not met. n30 Likewise, if there is no draw period, the self-replenishing and repeated transaction aspects are absent. n31

[b] Definition of "Creditor."

Any person who "regularly" extends open-end consumer credit (that is subject to a finance charge or payable by written agreement in more than four installments) is considered a "creditor" for all TIL purposes, regardless of whether a credit card is involved. n32 A person who regularly extends open-end credit is required to make the open-end disclosures set out in Subpart B of the Regulation. n33 These creditors will also be subject to all other TIL requirements.

Second, any "card issuer" of a "credit card" n34 is required to make the Subpart B open-end credit disclosures, regardless of whether the open-end credit is subject to a finance charge or is payable in more than four installments. n35 In addition, the card issuer need not be the party to whom the obligation is initially payable to be a creditor. n36 In *Neff v. Capital Acquisitions & Management Co.*, the Seventh Circuit held that a card issuer does not include a party who purchases a delinquent credit card account and does not grant any further extensions of credit. n37 However, one of the debt collectors in the case was Capitol One, which is a major card issuer. The lower court explicitly refused to accept the argument that by being a card issuer already, Capital One was a creditor for all subsequent extensions of credit, not just the cards that it issued, n38 and the Seventh Circuit did not consider the argument. n39

Whether a card issuer who purchases delinquent credit card accounts is a creditor under TILA is of some concern, because some card issuers are buying up delinquent accounts and soliciting these cardholders for a "new" credit card as a tactic to revive old debt. n40 TILA coverage is actually probably more important for some of the substantive credit card rights n41 than to receive periodic statements, which was the basis of the TILA claim in *Neff*, because TILA does not require periodic statements if an account is considered delinquent. n42

Third, any "card issuer" that extends *closed-end* credit that is subject to a finance charge or is payable by written agreement in more than four installments is subject to the applicable open-end disclosures of Subpart B and the FCBA, as well as the closed-end provisions of Subpart C. n43

Finally, a person who honors a credit card is a creditor for the purposes of the provisions relating to discounts, disclosing a finance charge imposed at the time of the transaction, and crediting returns and refunds. n44

[c] Cardholder

A cardholder is statutorily defined as "any person to whom a credit card is issued." n45 Note that a cardholder need not be a consumer or even a natural person under the definition in TILA. However, Regulation Z limits "cardholders" to "natural persons" except with respect to the rules on unauthorized use and unsolicited issuance of credit cards, which apply to organizations and businesses. n46 When a cardholder dies, the cardholder's estate is not considered a cardholder for purposes of TILA. n47 Effective July 2010, the Commentary makes clear that the purpose of a card is determined when it is issued. n47.1 Thus, when a consumer-purpose credit card is issued, all of the provisions of Regulation Z apply, even to occasional extensions of credit for business purposes made using that consumer-purpose credit card. n47.2 For example, a consumer may assert a billing error with respect to an extension of credit on a credit card, even if the extension was made for business purposes. n47.3

A cardholder also includes "any person who has agreed with the card issuer to pay obligations arising from the issuance of a credit card to another person." n48 Thus, unlike other consumer credit, guarantors and co-obligors of credit card accounts have the co-extensive rights under TILA. n49 Authorized users, however, who are not obligated on the card are not included in the definition of "cardholder." n50 Employees who are co-obligors on cards issued to their employers for business purposes are also not considered "cardholders." n51

A person in whose name a credit card was issued should also be considered a cardholder, and therefore a consumer, at least for the dispute resolution provisions of TILA, even if the card was actually provided to an imposter. n52 However,some courts haveaccepted the argument that a victim of identify theft is not a "cardholder" under TILA, because the creditor did not issue the card to the victim; rather, the creditor issued it to the thief. n53

[2] Required Disclosures in Applications and Solicitations

The Regulation sets forth all the items concerning credit costs and terms required to be disclosed in credit and charge card applications and solicitations. n54 The disclosures must be in writing, but they do not need to be in a form that the consumer can keep. n55 Information on APRs (including variable-rate information), fees for the issuance or availability of a card, minimum and transaction charges, grace periods, balance computation methods and charge card repayment, to the extent applicable, must be provided in the form of a table with headings. n56 Beginning in July 2010, additional disclosures will required to be made in a tabular format, and those disclosures are subject to certain requirements. In total, the disclosures required to be made in the tabular format will include:

- Credit and charge card applications and solicitations; n56.1
- Account-opening disclosures; n56.2
- Convenience check disclosures; n56.3
- Change-in-terms notices; n56.4
- Notice of penalty rate imposition. n56.5

The disclosures required to be made in a tabular format must be "readily noticeable." n56.6 They must be made using at least a 10-point font. n56.7 In addition, disclosures of any purchase APRs in the tabular format for credit card application/solicitation and account-opening disclosures must be made in 16-point type, except for penalty APRs. n56.8

Effective July 2010, if the table is provided electronically, the table must be provided in close proximity to the application or solicitation. n56.9 This standard was established by amendments to TILA found in the April 2005 amendments to the Bankruptcy Act. n56.10 Although the Act referred to "Internet" solicitations, the FRB has since amended Regulation Z to apply them to all electronic solicitations, as well as applications. n56.11

If a consumer accesses a credit card application or solicitation electronically, such as on-line at a home computer, the issuer must provide the required disclosures in electronic form in order to meet the requirement to provide disclosures in a timely manner on or with the application or solicitation. n56.12 The issuer is not permitted to mail paper disclosures to the consumer because such disclosures would not be "on or with" the application. n56.13

In contrast, if a consumer is physically present in the card issuer's office, and accesses a credit card application or solicitation electronically, such as via a terminal or kiosk, the issuer may provide disclosures in either electronic or paper form, provided the issuer complies with the other timing and delivery requirements. n56.14

A brief summary of the required disclosures is set out below.

[a] APR Disclosure

Credit card issuers are required to disclose each periodic rate that may be used to compute the finance charge on an outstanding balance, expressed as a corresponding APR. n57 A periodic rate is defined as a rate of finance charge that is

or may be imposed by a creditor on a balance for a day, a week, a month, or other subdivision of a year. n58 A periodic rate does not include a transaction charge, even if it is computed as a percentage of the transaction amount, that is not connected to a period of time. n59 The length of time a creditor must abide by a rate disclosed in the application and solicitation disclosure depends on the circumstances and may be a question of fact. n60 Effective July 2010, this type size requirement has been reduced to 16-point type. n60.1 In addition, it will apply to introductory rates as well, but continue to exclude penalty rates and oral disclosures. n60.2

Whenever more than one rate applies for a category of transactions, the card issuer is required to disclose the range of balances to which each rate applies. n60.3

Effective February 2010, amendments to TILA will place certain substantive restrictions on the ability of credit card issuers to increase the APR an outstanding balance. n60.4 In addition, issuers are required to give forty-five days' notice before increasing the APR on future transactions. n60.5

[b] Teaser Rates

Card issues that offer "teaser" or introductory rates are required to disclose the "regular" rate that would apply to the card account. n61

The bankruptcy reform legislation enacted in April 2005 amended TILA to provide for additional "temporary" or introductory rate disclosures in credit card applications and solicitations. n62 The new provisions require that applications and solicitations offering a temporary APR must use the term "introductory" when providing that rate, n63 except when the rate is listed in the table required by section 1632(c). n64

The disclosures must also identify in a clear and conspicuous manner:

- The time period during which the introductory rate will apply; n65 and

- The permanent fixed APR or, for variable rate plans, the APR that will apply when the introductory period ends. n66

These disclosures must be made in a "prominent location closely proximate to the first listing of the temporary" APR. n67 The statute does not require that the temporary and permanent rates be side-by-side, but the Board could interpret "clear and conspicuous" in this context to require a side-by-side comparison.

If the introductory rate is revocable "under any circumstances or upon any event," the application or solicitation must clearly and conspicuously disclose in a prominent manner a "general" description of the circumstances that may result in a revocation of the temporary APR. n68 The APR that will apply if the temporary APR is revoked must also be disclosed. n69

The new disclosures only apply when a "temporary" APR is involved, which the statute defines as "any rate of interest applicable to a credit card account for an introductory period of less than one year, if that rate is less than an annual percentage rate that was in effect within sixty days before the date of mailing the application or solicitation." n70 This definition is confusing as it is unclear what APRs can be used as the comparison measure for this definition. Conceivably, an unscrupulous creditor could attempt to evade the rule entirely by treating a little-used APR or an APR for an entirely different program as the measure of comparison.

[c] Variable-Rate Disclosure

For accounts subject to a variable-rate, the credit card issuer is also required to disclose that the rate is variable and how

the rate is determined. n71

[d] Penalty Rates

A penalty rate is an increase in the initial APR triggered by a specific event, such as a late payment. Credit card issuers must disclose the initial rate, the penalty rate that may apply, and the specific event or events that may result in imposing the increased rate. n72 Some credit card issuers have been imposing penalty rates not only for late payments to the issuer, but for any adverse information on the consumer's credit report, or a drop in the consumer's credit score. n73 A review of credit card solicitations shows that some creditors are disclosing that a late payment to other creditors will trigger a penalty rate, but so far creditors have not disclosed that a mere drop in credit score may be the trigger. This may arguably violate the requirement to disclose the specific event that may trigger a penalty rate, because a drop in credit score is not always caused by late payments--it could be caused by being "maxed" out on revolving accounts, an excessive numbers of inquiries, or a number of other factors. n74

The Credit CARD Act also requires issuers to provide a forty-five day notice before imposing an increased APR on an account, including a penalty rate. Effective February 2010, the Credit CARD Act restricts the ability of issuers to impose penalty rates on outstanding balances as well as during the first year of an account.

Effective July 2010, all disclosures that refer to a penalty rate must use the term "penalty APR." Special rules will apply to penalty rates that consist of the loss of an introductory rate.

[e] Fees for Issuance or Availability

Credit card issuers are required to disclose any annual or other periodic fee or any one-time fee imposed for the issuance or availability of a credit or charge card. n75 This disclosure is limited to fees related to opening the account, such as one-time membership fees. The annual fee as disclosed in a TILA solicitation disclosure has an implied term of one year. n76 Thus, if an issuer states in a TILA disclosure that there is no annual fee, it violates TIL by imposing an annual fee prior to the expiration of a one-year period.

[f] Minimum Finance Charge

Credit card issuers must disclose any minimum or fixed finance charge that could be imposed for any period during which any extension of credit that is subject to a finance charge is outstanding. n77

[g] Transaction Charge for Purchases

Credit and charge card issuers must disclose any transaction charge imposed in connection with the use of the card to purchase goods and services. n78 This provision does not cover fees for cash advances. n79

[h] Grace Period for Purchases

Credit card issuers must disclose the date by which, or the period within which, any credit extended under credit card accounts for the purchase of goods or services must be repaid to avoid incurring a finance charge. n80

[i] Balance Computation Method for Purchases n81

In making this disclosure, card issuers are required to identify the balance computation method used on the account by the name provided in the Regulation's definitions of the most common balance computation methods. n82

[j] Due and Payable Statement n83

Charge card issuers must disclose that charges incurred by use of a charge card are payable when the periodic statement reflecting those charges is received by the cardholder. n84

[k] Additional Fee Disclosure

Credit and charge card issuers are required to disclose fees for cash advances, late payments or exceeding a credit limit. n85

Effective July 2010, the FRB has added another fee to the list: returned-payment fees. n85.1 Furthermore, the options for disclosing a fee that varies by state have been revised to provide that a creditor may disclose either: (1) the specific fee applicable to the consumer's account; or (2) the range of fees, if the disclosure includes a statement that the amount of the fee varies by state and refers the consumer to a table (that must be provided with the application/solicitation table) where the amount of the fee applicable to the consumer's state is disclosed. n85.2 Listing the amount of the fee for all states in the application/solicitation table is no longer permitted. n85.3

The Board has published several model forms in conjunction with the disclosure rules. n86 As with other model forms, proper use of the model forms will generally place a creditor in compliance with TILA. n87

There are also specific disclosure rules for different types of application and solicitations. These are listed below.

[i] Direct Mail Applications and Solicitations n88

Card issuers who make direct mail applications and solicitations to open a credit or charge card account must make the required disclosures described above on or with an application that is mailed to consumers. n89

[ii] Telephone Applications and Solicitations n90

These requirements apply if a telephone conversation between a card issuer and consumer may result in the issuance of a card as a result of a card issuer-initiated offer to open a credit or charge card account for which the card issuer does not require any application. It also applies where the card issuer initiates the contact and at the same time takes application information over the telephone. These requirements do not apply where no card will be issued.

The general requirements for telephone applications and solicitations are oral disclosure of the APR, annual or periodic fee, minimum finance charge, transaction charges, grace period, balance computation method, and the due and payable statement if applicable. n91 There are also alternative disclosures available to telephone solicitations and applications. n92

[iii] Applications and Solicitations Made Available to General Public n93

Card issuers may satisfy these disclosure requirements in any of three ways: a) Provision of all the required credit disclosures including indicated information; n94 or b) limited initial credit disclosures; n95 or c) no credit disclosures by providing a statement on the application or solicitation that there are costs associated with the use of the credit or charge card and that the applicant can contact the card issuer to request specific information. n96 The Regulation makes the options available to both credit and charge card issuers.

[3] Preemption of State Laws

State laws relating to the terms of credit required to be disclosed or the manner in which such terms must be disclosed are preempted as to any credit or charge card application or solicitation and as to any renewal notice for any account subject to TILA. n97 State laws relating to disclosures concerning credit and charge cards other than in applications, solicitations, or in renewal notices are not preempted as long as they are not inconsistent with TIL requirements. State

laws regarding the enforcement of the requirements or of any prohibitions against unfair and deceptive acts or practices (such as state "mini-FTC acts") also are not preempted. n98

[4] Required Initial Disclosures

Before the first transaction on an open-end credit account or a credit card account, the creditor must make several disclosures to the consumer about the terms and conditions of the account. n99 Initial disclosures must be provided to the consumer before the first transaction by which the customer becomes obligated on the plan. Disclosures must be given before the first purchase in a situation when the consumer simultaneously opens a plan and makes a purchase. n100 Once the consumer has received the disclosures, he or she must either reject the plan or accept it by use.

If an account is closed and the consumer or creditor seeks to reopen it, new initial disclosures must be provided. n101 If the account is closed as a housekeeping matter and then reopened on the same terms and conditions, new initial disclosures need not be given. n102

In general, all open-ended credit disclosures must be made "clearly and conspicuously, in writing, in a form that the consumer may keep." n103 There are a few exceptions, two of which involve the initial disclosure. n104

"Conspicuous" is not defined, although some guidance can be found from the UCC's definition of what is conspicuous. Under the UCC, whether a term or clause is conspicuous is a question of law to be decided by the court. The standard is whether a reasonable person (here, the customer) "ought to have noticed it." n105 The Commentary specifies that the disclosures need not be segregated or located in any particular place, and the numerical amounts or percentages need not be in any particular type size. n106

All disclosures required by Subpart B, including initial disclosures, must be in writing. n107 Only in two instances--when a creditor makes a solicitation or takes an application for open-end credit by telephone, n108 or when a merchant or creditor imposes a surcharge as a condition to use of a credit card n109--does Regulation Z authorize oral disclosure of open-end credit terms.

The only required terminology for initial open-end disclosures are the terms "finance charge" and "annual percentage rate." The terms "finance charge" and "annual percentage rate" must be more conspicuous than other required disclosures, n110 but only when the terms are used with a corresponding numerical amount or percentage rate. n111

TIL requires seven initial disclosures, to the extent applicable: n112

1) The conditions under which a finance charge may be imposed together with either the time period, if any, in which the customer may pay without incurring additional finance charges or the fact that there is no free ride period;

2) The method of determining the balance on which the finance charge is imposed;

3) The method of determining the amount of the finance charge, including any minimum or fixed amount;

4) Each "periodic rate," the range of balances to which it is applicable, and the corresponding nominal annual percentage rate;

5) Identification of other charges which may be imposed and their method of computation in accordance with FRB regulations;

6) If the indebtedness is or will be secured, a statement to that effect with an appropriate identification of the collateral;

7) A statement as to billing error rights and the right to assert claims and defenses in a form prescribed by the FRB (with periodic transmittal of a statement of such rights).

The FRB also specifies several variable-rate disclosures that must be made in the initial disclosures: n113

First, each periodic rate that may be used to compute the finance charge must be disclosed. n114 A periodic rate does not include a transaction charge, even if it is computed as a percentage of the transaction amount, which is not connected to a period of time. n115 The variable-rate disclosure must also state the circumstances under which the rate may increase, any limitations on the increase and the effects of the increase. n116 The disclosure must also reveal when the increase takes effect. n117 Two recent cases demonstrate the complexity of the variable rate calculations, as well as their disclosure under TILA form. In *Demry v. Citibank (South Dakota), N.A.,* n118 the creditor calculated interest rates on the last business day of the *calendar* month, but did not apply them until the first day of the *billing* cycle following the month the rate is calculated. In *Stein v. JP Morgan Chase Bank*, n119 the TILA disclosure stated that the initial interest rate for a home equity line of credit was calculated using the index when the account was "opened," which the creditor construed as the date of the application for credit, but the consumer understood to be the date of the approval for credit.

In addition, for any consumer credit open-end plan secured by the consumer's dwelling entered into after December 9, 1987, Regulation Z required the creditor to disclose the maximum interest rate that may be imposed during the term of the plan. n120

In cases where creditors advertise introductory rates which are in effect for a certain period, usually a short period of time, the creditor must disclose in the initial disclosure statement:

1) The initial discounted rate (expressed as a periodic rate and an annual percentage rate) and how long that rate will remain in effect;

2) The current rate which would be applied under the index if there were no discount (with the parallel periodic rate and annual percentage rate);

3) The circumstances under which the rate may increase;

4) Any limitations on the increase; and

5) The effect of the increase. n121

[5] Periodic Statement Requirements

[a] General Periodic Statement Requirements

Once the customer has taken advantage of the credit offered under the open-end credit plan, or used a credit card, the creditor n122 is obligated to send periodic statements disclosing the following information: n123

a) The beginning balance;

b) The amount and date of each credit extension with an identification of each;

c) The amount credited during the billing period;

d) The amount of the finance charge, itemized to show the application of various rates, and the amount of any minimum or fixed charges; n124

e) Each periodic rate, the range of balances to which it applies, and the corresponding annual percentage rate;

f) The total finance charge and the range of balances to which it applies;

g) The balance on which the finance charge is computed and how the balance was determined;

h) The outstanding balance at the end of the period;

i) The time within which payment must be made to avoid additional finance charges; and

j) The date on which the payment is due or the earliest date on which a late payment fee may be charged and the amount of the fee

k) The creditor's address for billing error purposes; and

l) A warning statement regarding the effect of paying only the minimum monthly payment**.**

Charge card issuers must make the same disclosures, except for those related to finance charges. n125

The periodic statement must be mailed or delivered to the consumer, n126 unless the consumer opts to pick it up. n127 The federal E-Sign Act allows electronic delivery if the consumer and the creditor have gone through its consent and confirmation-of-consent requirements. n128

The timing of the statements is also prescribed by statute. If there is no amount owing, no statement need be sent. n129 A creditor is only required to establish that it sent the periodic statement, and need not prove the consumer actually received the statement. n130 However, simply showing that a creditor's normal business practice is to send periodic statements is not sufficient; the creditor must also show that the particular periodic statement at issue was delivered to the post office or processed according to the general business practice. n131

In addition to the initial disclosures and the periodic disclosures, the creditor must provide two types of subsequent disclosures: A periodic statement as to the customer's billing error rights, n132 and a change in terms notice. n133

With respect to renewals, the Regulation implements the disclosure requirements for credit and charge card renewals provided in TILA. n134

[b] Change in Credit Card Account Insurance Provider

Credit card issuers that offer credit insurance (typically, life, disability, and unemployment insurance) on the outstanding balance on an account are required to make certain disclosures to their insured consumer cardholders if the card issuers change insurance providers. n135

A notice must be sent at least 30 days before a change in insurance providers occurs. n136 The regulation specifies the information that must be provided in the notice.

TILA specifically provides that none of its disclosure requirements about changes in insurance coverage shall be

construed as superseding any provision of state law which is applicable to the regulation of insurance. n137

[6] Billing Error Procedures

[a] Introduction and Definitions

The next set of required disclosures relate to billing error procedures. These procedures are intended to make the creditor listen to the consumer who has a dispute about a computerized bill or who does not understand the bill. The procedures apply to open-end credit accounts as well as all consumer credit cards. Effective July, 2010, creditors are required to include a reference that information about consumers' right to dispute transactions is included in the account agreement or other account-opening disclosures. n137.1 This reference must be made directly beneath the account-opening table, but not in the table. n137.2

The billing error procedures are an option made available to consumers. They are separate and apart from other dispute rights under TILA, such as protections for unauthorized use of a credit card n138 and a credit card holder's right to assert claims and defenses against a card issuer. n139 Failure to invoke the billing procedures does not preclude a consumer from asserting these other protections. n140 It also does not preclude them from raising a billing error as a defense in a collection action. n141 Unfortunately, creditors have wrongfully asserted in a number of cases that cardholders are barred from raising any disputes if they do not follow the billing procedures by sending a written notice within 60 days. This argument is not supported by the provisions of TILA and Regulation Z, n142 and so far the courts have consistently rejected it. n143

Creditors have also argued that the lack of a billing error notice waives a consumer's rights under other provisions of TILA and even under state or common law. n144 In a cluster of cases brought in Connecticut superior courts, a major credit card issuer even used the failure to send a billing error notice to affirmatively pursue collection lawsuits, arguing that the lack of a billing error notice barred the cardholder from disputing the amount due. The courts in cursory opinions have accepted this argument even when the cardholder has disputed the amount due. n145 In these cases, the cardholders did not argue that failure to raise a billing error dispute only affects TILA rights and not the ability to contest charges in a collection action or that § 1643(b) of TILA places the burden of proof on the creditor to show that the use of the card was authorized. It appears that credit card issuers commonly allege in their collection actions that the cardholder has not sent a FCBA notice as a means to show that the amount owed is not disputed; n146 this tactic of course ignores the possibility of disputes raised under other provisions of TILA and other laws or even that the debt was not incurred by the consumer who was sued.

Consumers are not required to have a good faith belief that they actually do not owe the disputed amount in order to invoke FCBA's billing error procedures. n147

Another source of similar rights which applies to some open and closed end mortgage transactions is the RESPA. This statute requires servicers of "federally-related" mortgage loans to respond promptly to written requests from borrowers that allege an error in the account or seek information. n148 RESPA's coverage is broader than that of TIL's billing error provisions in that it is not restricted to open-end credit, although it only applies to federally-related mortgages. RESPA requires the servicer to acknowledge receipt of the borrower's inquiry within twenty days, as opposed to the thirty days allowed by the FCBA, n149 but is otherwise quite similar to the TIL billing error procedures. RESPA provides a private cause of action for actual damages and for statutory damages if there is a pattern or practice of violations. n150

The regulation defines billing errors as certain practices found on a customer's *periodic statement*. n151 These include:

> 1) An extension of credit that was not made, n152 or a credit extension which was not made in the amount reflected on the statement; n153 This can include an allegation that the creditor charged the consumer for a transaction for which the consumer is not liable, because the debt was owed by another

person;

2) An unauthorized extension of credit, i.e., an extension of credit to someone without actual, implied or apparent authority to use the credit card or account, even if the cardholder received benefit from the unauthorized use; n154

3) An extension of credit that is not properly identified under the specific rules for identification of transactions;

4) An extension of credit for property or services that was not accepted by the consumer or the consumer's designee. Whether acceptance has occurred is a matter of state law, and will, in most states, depend on application of UCC principles; n155

5) An extension of credit for property or services not delivered to the consumer or the consumer's designee as agreed. n156 This provision includes nondelivery, late delivery, delivery to the wrong place, delivery of the wrong quantity, delivery of property or services different from that agreed upon, and the consumer's refusal to accept delivery because the goods did not comply with the contract, n157 but it does not include a dispute that relates to the quality of property or services that the consumer has accepted; n158

6) Failure to include a payment or other credit to the account;

7) Computational or accounting error in the credit related portion of the statement; n159

8) An extension of credit for which the consumer requests additional clarification or documentation; n160 and

9) Failure to send the periodic statement to the consumer's last known address, if the creditor had received the address, in writing, at least 20 days before the end of the billing cycle for the periodic statement. n161

A billing error can also consist of billing someone who was issued a credit card but had not requested it, in violation of the TIL prohibition against unsolicited issuance. n162

The consumer is entitled to actual and statutory damages under section 1640(a) for any violation of the Fair Credit Billing Act ("FCBA"). n163

Whether the improper assessment of a finance charge can be a billing error is the subject of some dispute. While such an error could conceivably fit into one or more billing error categories, the Fifth Circuit and other courts have taken a narrow view in a series of cases brought by consumers who used the services of a debt settlement company called Debt Relief Services Marketing (DSRM). n164 DSRM advised consumers to send billing error disputes challenging the assessment of finance charges during the history of the account based on the issuer's alleged failure to give proper TIL disclosures. Most of the courts in these cases have held that such challenges were not proper billing error disputes. n165 These courts believed that the challenges did not fit in the category of requests for "additional clarification including documentary evidence thereof" because such requests only apply to "extensions of credit," and finance charges are not extensions of credit. n166 In addition, some of these courts rejected the argument that the improper assessment of finance charges was a "computation error," because the courts believe this argument merely restated the "additional clarification" claim they had rejected. n167

[b] Notice of Billing Error

The consumer's billing error rights are triggered by the consumer sending a notice of billing error in a timely and proper fashion. n168 The consumer's billing error notice must be received by the creditor no later than 60 days after the creditor first transmitted the first periodic statement that reflects the billing error. n169 If the error is a failure to send a statement, the sixty-day period runs from the time when the creditor should have transmitted the periodic statement. n170

The billing error notice must be in writing n171 and must include sufficient information to enable the creditor to identify the cardholder's name and account number. n172

In order to state a claim for violation of the billing error procedures, a consumer may need to plead compliance with these notice requirements. n173 Note that the Commentary, effective July 2010, clarifies that the consumer need not send a notice to *the merchant* in a billing error dispute involving purchases not accepted or not delivered as agreed. n173.1 There are certain procedures a creditor must follow after receiving the billing error notice. n174 In brief, the creditor must acknowledge receipt of the billing error notice within 30 days of receiving it, unless it has already investigated and resolved the billing error during that time period. n175

The creditor must conduct a "reasonable" investigation. n176 Effective July 2010, the Commentary provides additional guidance as to what constitutes a reasonable investigation with respect to investigation of unauthorized use. n176.1 This Commentary is similar to that in Regulation Z § 226.12(b) as to what constitutes a reasonable investigation, which is discussed at § 5A.10.6, *infra*. Reasonable steps for investigating other types of billing errors will depend on the type of error. n176.2 If the creditor determines that the billing error occurred, it must correct the error and credit the account with any disputed amount and related charges (including charges imposed for the error resolution process, documentation, etc.), and mail or deliver a correction notice to the consumer. n177

If the creditor determines that there was no billing error, or a different error than that complained of, the creditor must: mail or deliver to the consumer an explanation of its reasons for concluding that the billing error asserted by the consumer was wrong in whole or in part; furnish copies of any documentary evidence if the consumer so requests; and correct any different error discovered and credit the account with any disputed amount and related charges (including charges imposed for the error resolution process, documentation, etc.). n178 An ambiguous and cursory statement that does not set forth a legitimate justification for rejecting the dispute is insufficient. n179 Nor does an explanation meet the statutory standard if it fails to mention the liability theory that the creditor argues at trial. n180 If the creditor thus determines that the consumer owes all or part of the disputed amount, the creditor must follow specified actions. n181 Even if the creditor's resolution does not favor the consumer, a consumer's invocation of the billing error procedures may present a defense in a collection action. For example, many card issuers will bring collection actions using a common law theory of "account stated" or "action on an account," which requires that the parties agree that a debt is valid and due. n182 The fact that a consumer had raised a billing error claim may mean the creditor cannot meet the elements of an account stated claim, because the consumer does not agree that the debt is valid. n183 TIL's protection against unauthorized use may also prevent the creditor from bringing an account stated claim in some states, as the TILA specifically imposes on the creditor the burden of showing that the use of the card was authorized. n184

Once the consumer has properly notified the card issuer of a billing error, neither the creditor nor its agent may report the disputed amount as delinquent to any person, including a credit reporting agency or a collection agency. Nor may the creditor directly or indirectly threaten to make such a report. n185 Even if the resolution does not favor the consumer, if the consumer notifies the creditor in writing that the consumer still disputes the charge, the creditor must report the amount as disputed if it reports it as delinquent. n186

The creditor must investigate and resolve the billing error dispute within two complete billing cycles (or ninety days, if that is sooner). n187 If the billing error notice is received mid-cycle, as is probably the most common situation, the creditor has the rest of that cycle, and then two complete cycles, to take the proper steps--unless that time frame is

longer than ninety days. n188 The creditor must meet the timeframes for investigation even if the billing error qualifies for another type of investigation under TILA, such as an investigation for unauthorized use or pursuant to a cardholder's right to assert claims and defenses against the merchant. n189

The creditor may not impose a charge related to any aspect of the error-resolution procedure. n190 In general, FCBA and Regulation Z require the creditor to suspend all collection activity over the disputed amount during the billing error resolution period. n191 The card issuer may pursue normal collection activities on any undisputed and delinquent amounts, including presumably reporting the amount as delinquent to a credit bureau. n192 Liability for an FCBA violation occurs when the creditor fails to meet any of the procedural requirements of the FCBA or violates any of its prohibitions. n193 The FCBA does not mandate that the creditor achieve any particular resolution, only that it undertake proper steps to investigate and follow its procedural requirements. Effective July 2010, the Commentary clarifies that the creditor must make a substantive final resolution within the time limits for investigation. If a creditor fails to complete the investigation and fails to provide a written explanation as to why there was no error or a different error, or otherwise fails to comply with the error resolution procedures required in such cases, the creditor generally must credit the disputed amount and related finance or other charges to the consumer's account. n193.1

[7] Additional Open-End TILA Requirements

Additional TILA requirements relating to open-end credit include the following.

[a] Prompt Crediting of Consumer Payments

TIL requires that open-end creditors n194 and credit card issuers n194.1 promptly credit payments made by the consumer.

Prior to passage of the Credit CARD Act, creditors often used an early hour cut-off time, such as 9:00 or 10:00 a.m., for crediting payments received that day. n194.2 In that case, if a consumer's payment had been received on the payment due date it would have been considered late, because in all likelihood the U.S. Postal Service would not have delivered the mail so early in the morning. The Credit CARD Act amends TILA's prompt posting requirement to specifically set 5:00 p.m. as the payment cut-off time. n195

[b] Treatment of Credit Balances

For credit cards, charge cards, and open-end accounts, creditors must appropriately identify on periodic statements any credit balance, n196 and refund the amount within seven business days n197 from receipt of a written request from the consumer.

[c] Record Retention Requirements

The open-end creditor and card issuer must keep evidence of compliance with the disclosure and procedural requirements of TIL for two years. n198

[d] Prohibition on Terminating Accounts

Congress amended TILA in April 2005 to prohibit a creditor from terminating an open-end account prior to its expiration date solely because the consumer has not incurred a finance charge. n199 Despite the fact it is a substantive prohibition, it is actually not a part of FCBA, but included in the open-end credit disclosures at section 1637. Thus, it applies to all open-end accounts, not just credit cards. This provision is effective within twelve months after the date of publication of final regulations by the FRB. n200 The FRB has issued proposed rules as part of its revision of the open-end provisions of Regulation Z, but they are not yet final. n201

[e] Restrictions on Issuing a Credit Card

A credit card issuer may not issue a credit card, except in response to an explicit oral or written request or application for the card from a consumer or business (or when renewing a card which the customer has already accepted). n202

The card issuer may solicit the consumer's request or application, by mail, telephone, print or broadcast advertising, and this is commonly done. n203

In 1999, in response to the widespread marketing of cards that from the outset had both credit and non-credit features, the FRB tightened the Commentary provisions that define when a creditor can issue an unsolicited non-credit device that has potential credit features. n204 The changes were made effective March 31, 1999, although compliance was optional until March 31, 2000. The new Commentary allows a creditor to add a credit feature to an unsolicited non-credit card at the consumer's specific request. However, an unsolicited non-credit card can be issued only if the issuer does not propose to connect the card to any credit plan. If the issuer includes promotional materials about credit features when it sends the cards to the customer, this demonstrates that the issuer proposes to connect the card to a credit plan and makes unsolicited issuance unlawful. n205 Likewise, mailing the TIL credit disclosures or an account agreement along with the card shows that the creditor is proposing to connect it to a credit plan. n206 The fact that the consumer has to contact the issuer and activate the card to access the credit makes no difference--it is still unlawful to send the consumer the card. n207

While the pre-1999 version of the Commentary n208 was less clear about the legality of unsolicited issuance of a non-credit card that had credit features that could be activated by a telephone call, a court still interpreted the statute and regulations to prohibit this practice. n209

A creditor can issue unsolicited personal identification numbers ("PINs"), such as those used for automated tellers or point-of-sale terminals, to existing cardholders as long as the PINs cannot be used alone to obtain credit, but must be used in conjunction with the card. n210

Under the Fair Credit Reporting Act, a creditor is permitted to use lists of consumers provided by credit bureaus to extend "firm offers of credit" to these consumers. n211 However, if a "firm offer of credit" is accompanied by the credit card itself, it will violate TILA's prohibition against unsolicited issuance, despite being permissible under the FCRA. n212

The restriction on unsolicited issuance of a credit card may be helpful in credit card collection cases as well, especially involving identity theft victims. n213

TILA statutory damages, as well as actual damages, are available for violations of the prohibition against issuance of unsolicited credit cards. n214 If an unsolicited issuance claim is brought affirmatively, it is subject to TILA's one-year statute of limitations. n215

Initial disclosures need not be provided to the customer until just before the first transaction by which the customer becomes obligated on the plan, and sometimes not even then. n216 Once the consumer has received the disclosures, he or she may reject the plan or accept it by use.

[f] Credit Card Advertising

A commercial message in any medium which promotes consumer credit transactions, including a mail solicitation of credit card applications, is regulated to some extent for open-end and credit card credit. n217 The advertising must be truthful, in that if it mentions specific credit terms, it may state only those terms that the creditor actually plans to make available. n218

If the advertiser expressly or impliedly mentions any specific terms of a credit plan, even if they are not required disclosures (such as seller's points, or the minimum periodic payment), n219 or mentions terms required to be disclosed under Regulation Z section 226.6, such as finance charge, periodic rate, annual percentage rate or security interest, n220 the advertiser must also include information as to:

a) Any minimum, fixed, transaction, activity or similar charge which may be imposed;

b) If periodic rates are to be applied, those periodic rates expressed as annual percentage rates;

c) Any membership or participation fee; and

d) A variable-rate feature, if one exists.

For additional details, see the Commentary. n221 No direct civil liability attaches to violation of these provisions, although a violation arguably would violate a state deceptive practices statute. n222

[g] Creditor Cannot Offset Consumer's Deposit Account to Pay Credit Card Account

TIL provides that the card issuer cannot take funds out of a deposit account to satisfy a credit card debt except under an automatic payment plan previously authorized by the cardholder in writing. n223 Even then, the card issuer must not take out the automatic payments with respect to a disputed amount upon timely notice. n224

The Regulation allows the card issuer to take a consensual security interest in the deposit account, and to enforce that interest. n225 But the security interest must be affirmatively agreed to by the consumer (presumably boilerplate language would not suffice), be disclosed in the initial disclosures, and be taken and enforced only through procedures equally available to other creditors. n226 The Commentary specifies that the security interest may not be the functional equivalent of the right of offset. n227 The card issuer can also accept payments on a credit card indebtedness under an automatic payment plan. n228

[h] Customer's Liability for Unauthorized Use of a Credit Card

TIL precludes customer (business or consumer) liability for unauthorized use of a credit card, except in narrowly defined circumstances. n229 "Unauthorized use" means the use of the credit card by a person other than the cardholder who does not have actual, implied or apparent authority for such use, and from which the cardholder receives no benefit. n230 Effective July 2010, the Commentary clarifies that a cardholder can be liable for unauthorized use by a person who has permission to use a card, even if the person is not officially listed as an authorized user. If the cardholder gives a credit card and grants authority to make transactions to a person, the cardholder is liable for transactions by that person even if the person exceeds the authority given, unless and until the cardholder has notified the creditor that use of the card by that person is no longer authorized. n230.1

Unfortunately, the definition of unauthorized use leaves the cardholder open to merchant fraud. If the cardholder receives some benefit from the use of the card, even if the use is not authorized, it is not an "unauthorized use" under the definition. n231

Whether a person has actual, implied or apparent authority to use the card is a question of state law. n232 Effective July 2010, the Commentary clarifies that implied or apparent authority includes instances in which the cardholder gives a credit card and grants authority to make transactions to a person, unless and until the cardholder has notified the creditor that use of the card by that person is no longer authorized. n232.1 This appears to support the view that it is the actions of the principal, not the supposed agent, that create implied or apparent authority. The card issuer has the burden of

proving that the user had actual, implied or apparent authority and that the conditions for imposing liability on the cardholder have been met. n233 Apparent authority must be proved through actions of the principal, not those of the supposed agent. n234 An authorized user is different than a joint account holder, who is fully liable on the account. A recent Fourth Circuit case has revealed, however, that some credit card issuers may not be able to distinguish between who is a joint account holder versus solely an authorized user. In *Johnson v. MBNA*, n235 the card issuer attempted to hold the plaintiff liable for an account after the primary card holder filed for bankruptcy. The plaintiff claimed she was an authorized user and the card issuer was unable to show that the plaintiff was a joint account holder, because it did not have the original account agreement, having destroyed it pursuant to its document retention policy. In many states authorized users may not be liable on a credit card account.

The cardholder or any other person may give the card issuer notice of the loss, theft, or possible unauthorized use of the credit card. n236 The notice can be oral or in writing. n237 Once notice is given, the customer's liability for unauthorized use is frozen at the amount of unauthorized use, or $50, whichever is less. n238

The card issuer must prove several elements to impose the $50 maximum liability on the cardholder for unauthorized use. The creditor must prove that the card was accepted by the cardholder. Thus, if a consumer did not apply for or request a credit card, the use of the card by another should be unauthorized use by definition. n239 This definition of unauthorized use may be important for consumers who are victims of identity theft, which is the fastest-growing crime in this country. n240 An "accepted credit card" includes a renewal or substitute for an accepted card; n241 however, a creditor cannot issue a renewal or substitute card if the account has been closed. n242 The creditor must also prove that the card issuer has provided a means to identify the cardholder or authorized user. n243

The card issuer must also give "adequate notice" to the customer, before the unauthorized use occurs, n244 of the maximum potential liability and how to notify the card issuer of the loss or theft of the card.

[8] Cardholder's Claims and Defenses

For a card issuer to be subject to the consumer's claims and defenses against a merchant, the credit card must have been used to purchase goods or services. The consumer can assert the claims or defenses whether the card was physically presented in the course of the transaction or not. n245 The credit card must have been used directly to purchase the goods or services.

A check guarantee card does not operate as a credit card for the purpose of this section. Nor does a debit card when used as a debit card. If the debit card also has credit card features and is used as a credit card, the protections of this section apply. n246

There are three conditions which must be met before a consumer who has used a credit card can assert claims or defenses as to the merchant against the card issuer. n247 The cardholder must have made a good faith attempt to resolve the matter with the merchant. Whether this has been done is a question of fact. No particular procedures are mandated. n248 Second, the amount of credit involved in the disputed transaction must be more than $50. n249 Third, the transaction must have occurred in the same state as the cardholder's current address or within 100 miles from that address. n250 The location of a transaction is a matter of state law. There are some exceptions to these conditions. n251

A consumer invokes her rights to assert claims or defenses under TILA by withholding payment or as a defense in a collection action by the creditor. There is no independent right of action for this provision, so the consumer generally must wait for the creditor to bring an enforcement action for the consumer to assert these rights in litigation. n252 However, a consumer should be able to bring an action for actual and statutory damages under section 1640(a) if the creditor violates Regulation Z provisions concerning cardholder claims or defenses, such as the prohibitions against adverse credit reporting regarding withheld payments. n253 The unauthorized use protections can be used defensively as well. TILA provides that in an action to collect a credit card debt, the creditor bears the burden of showing that the

use of the credit card was authorized. n254 And while an affirmative claim under the unauthorized use provisions would be subject to TILA's one-year statute of limitations, n255 a defensive use could be raised after the one year. The fact that TILA imposes on the creditor the burden of showing that the use was authorized might even arguably preclude the use of an "account stated" cause of action in credit card collection actions. n256

[9] Home Equity Lines of Credit (HELCs)

[a] Introduction and Definitions

In 1988, Congress passed the Home Equity Loan Consumer Protection Act, n257 amending TILA to give consumers important new information about home equity lines of credit ("HELCs") at an earlier stage in the application process than current open-end disclosure rules require. The Act also provides important new substantive consumer protection requirements on HELCs. The 1989 rules promulgated by the FRB to carry out the provisions of the 1988 Act n258 apply to any agreement to open a HELC plan or any application to open a HELC made after November 7, 1989. n259

The HELC rules apply to open-end credit plans secured by the consumer's "principal dwelling." Unlike the definition of "principal dwelling" for purposes of rescission under TIL, n260 the HELC rules will apply to the consumer's second or vacation home, as well as to primary residences. n261 If the creditor has a security interest in a consumer's dwelling which contains a "spreader" clause (also known as a "dragnet" or cross-collateralization clause) securing future loans, the HELC disclosures, in general, apply if any open-end plan is subsequently opened. n262

Sample HELC disclosures and one set of HELC model disclosure clauses are included in Appendix G of the Regulation. n263 As with other model forms, proper use of the HELC model disclosure clauses will generally place a creditor in compliance with TILA. n264

Below is a summary of the additional rules applicable to HELCs.

First, in addition to complying with all of the other provisions for advertising open-end credit, n265 creditors must also comply with requirements for advertising HELCs. n266 Generally, the advertising requirements are "triggered" by any reference in a home equity advertisement to the payment terms of the HELC (including the length of the plan, any reference to how the minimum payments are determined, and the timing of such payments) or by any reference to finance charges, APRs, or other charges (i.e., terms required to be disclosed under section 226.6(a) and 226.6(b) of the Regulation). n267 While TILA creates no liability on the part of creditors for violating credit advertising rules, there may be state law remedies, and TIL statutory and actual damages may be available if the advertising violation is repeated on an application or solicitation.

The "trigger" then requires the creditor to clearly and conspicuously set forth:

a) *Fees*. Any loan fee that is a percentage of the plan's credit limit (*e.g.,* "points") as well as an estimate of other fees that may be imposed for opening the plan. That estimate may be stated as a single dollar amount or a reasonable range. n268

b) *APR*. Any periodic rate used to compute the finance charge expressed as an APR, n269 although the APR disclosed under HELC rules does not include any costs other than interest.

c) *Maximum APR*. The highest APR which may be imposed in a variable-rate plan. n270

One of the most common abuses in advertising HELCs had been the use of "teaser rates" or discounted initial rates. That is, creditors would often advertise very low rates for HELCs without also clearly disclosing that the HELCs were variable-rate plans and that the discounted teaser rates would soon be replaced by substantially higher rates based on the index and margin of the plan. Now if a creditor states a "teaser rate," it must also state the period of time that rate will

be in effect until the non-discounted rate is imposed. n271 In addition, the creditor must state a "reasonably current" APR, with equal prominence to the teaser rate, that would have otherwise been in effect using the current index and margin. n272

The Act and the Regulation also prohibit misleading statements about deductibility. n273 The bankruptcy reform legislation enacted in April 2005 amended this provision to require additional disclosures at the time of application regarding tax deductibility. n274 In cases in which an extension of credit from the HELC exceeds the fair market value of the dwelling, the creditor must tell the consumer that the interest on that portion of the credit extension which exceeds the fair market value of the home is not tax-deductible for federal income tax purposes. n275 Similarly, the Act and Regulation prohibit the use of the term "free money" or other similarly misleading terms. n276

Finally, a HELC advertisement may not refer to a minimum periodic payment without also disclosing, if applicable, that the plan contains a "balloon payment" (generally, a very large payment at the end of the term of a HELC). n277

A balloon payment is any repayment option under which--

> (1) the account holder is required to repay the entire amount of outstanding balance as of a specified date or at the end of a specified period of time, as determined in accordance with the terms of the agreement pursuant to which such credit is extended, and
>
> (2) the aggregate amount of the minimum periodic payments required would not fully amortize such outstanding balance by such date or at the end of such period.

If making only the minimum payments in an open-end HELC plan will result in a balloon payment, any ad mentioning the minimum payment must disclose that a balloon payment "will" (not "may") result. n278

[b] Substantive Limitations

There are also some important substantive limitations on HELCs which apply to assignees and holders, as well as the original creditors. These include the following:

[i] Indices for Variable-Rate HELCs

The Act and Regulation prohibit variable-rate HELCs unless the controlling index is both publicly available and not under the control of the creditor. n279

[ii] Early Termination of HELCs n280

With the exception of the three circumstances described below, creditors may not terminate a HELC and accelerate payment of the outstanding balance before the scheduled expiration of the HELC plan.

[A] Fraud

A creditor may terminate the plan if there has been fraud or material misrepresentation by the consumer in connection with the plan. n281

[B] Default

A creditor may also terminate the plan and accelerate the balance if the consumer has failed to meet the repayment terms of the agreement. n282

[C] Security Endangered

A creditor may terminate the plan based on any action or inaction by the consumer that adversely affects the creditor's security of the HELC plan, or any right of the creditor in such security. n283

[iii] Unilateral Change in Terms

With the exception of the circumstances described below, a creditor may not unilaterally change the terms of a HELC plan, including increasing any fees or imposing any new fees, after the account has been opened. n284

[A] Events Provided for in the Contract

A creditor may implement changes set forth in the contract that are contemplated on the occurrence of an event, as long as the triggering event and the resulting change are stated with specificity. n285

However, a creditor may not include a general or "boilerplate" provision in its contract stating that it reserves the right to change the fees imposed by the plan or other terms of the plan. n286

[B] Change Index and Margin

In a variable-rate HELC, a creditor may change the index and margin used under the plan if the original index becomes unavailable, as long as historical fluctuations in the two indices were substantially similar and the new index and margin will produce a "substantially similar" new APR. n287

[C] Changes Made by Written Agreement

Creditors may change the terms after a plan is opened if the consumer expressly agrees in writing to the change at that time. n288 However, the subsequent agreement may not violate the other provisions of the Regulation.

[D] Beneficial Changes

After the plan has been entered into, creditors may make changes that "unequivocally benefit" the consumer for the remainder of the plan. n289

[E] Insignificant Changes

The Act allows unilateral changes in "insignificant terms," while the Regulation permits "insignificant changes" to terms. n290

[F] Temporary Suspensions of Credit and Reductions of Credit Limit

The circumstances under which a creditor may temporarily prohibit additional extensions of credit or reduce the credit are:

- Decline in appraised value n291
- Material change in consumer's circumstances n292
- Default of material obligations n293
- Governmental action on rate n294

- Governmental action on security interest n295
- Unsafe/unsound practice. n296

The Federal Reserve Board in the Commentary would also allow the creditor to suspend credit privileges if a consumer requested it. If the HELC plan had two cosigners, each having the ability to borrow on the plan, the agreement may permit any of the consumers to request suspension of future advances. A creditor could require all cosigners to request reinstatement. n297

[iv] Refund of Fees

A creditor must refund all fees paid by the consumer to anyone in connection with an application for a HELC if any disclosed term changes (other than one resulting from a variable-rate index change) before the plan is opened, and if, as a result of the change, the consumer decides not to enter into the plan. n298

The Federal Reserve Board in the Commentary would also allow the creditor to suspend credit privileges if a consumer requested it. If the HELC plan had two cosigners, each having the ability to borrow on the plan, the agreement may permit any of the consumers to request suspension of future advances. A creditor could require all cosigners to request reinstatement. n299

[v] Nonrefundable Fees

Neither the creditor nor any other person may impose a nonrefundable fee in connection with an application for a HELC until three business days after the disclosure and required brochure have been received by the consumer. n300

[c] Early Disclosure Rules

There are also early disclosure rules required by the Act. The rules for the form of the required disclosures are different from TIL requirements for closed-end and most other open-end credit transactions in that the disclosures provided at the time of a HELC application need not be in a form the consumer may keep. n301 However, the disclosures still must be clear and conspicuous and in writing. n302

Most of the early disclosures must be grouped together and "segregated" from unrelated information provided to the consumer in connection with the application. n303 The brochure and the variable-rate information may be provided either separately from or with the other disclosures. However, under the Regulation, greater flexibility is permitted in complying with the segregation standard than currently exists for closed-end credit.

The information required to be given to consumers when they receive an application for home equity plans is listed in the Regulation and must be provided only to the extent applicable. n304 Both creditors and third parties providing an application must also furnish consumers with a brochure prepared by the Board describing home equity plans, or a suitable substitute. n305

These requirements apply not only to creditors, but, in some limited circumstances, the disclosure duties also apply to third parties who provide application to consumers. Third parties are required to provide disclosures only if they have the disclosures for a creditor's particular home equity plan in their possession. n306

Regulation Z requires in all cases that third parties give the HELC brochure at the time an application is given to the consumer. n307 The information may be provided electronically if the consumer goes through the consent and confirmation-of-consent procedures mandated by the federal E-Sign statute. n308

[d] Additional Disclosures

In addition to these early disclosures given with a HELC application, the creditor must also provide additional disclosures at the time of opening a HELC plan. n309 Generally, the HELC creditor must give all of the open-end credit initial disclosures n310 and repeat, as applicable, a few of the early HELC disclosures. All of the disclosures must be given before the first transaction is made under the HELC plan. n311

[e] Additional Advertising Rules for HELCs

Creditors offering HELCs must comply with all the provisions for advertising open-end credit. n312 In addition, there are special requirements for advertising HELCs. n313 The Board issued new rules on July 30, 2008 significantly amending the special HELC advertising requirements. n314 These rules are effective October 1, 2009. n315

Generally, the advertising requirements are "triggered" by any reference in an HELC advertisement to payment terms (including the length of the plan, any reference to how the minimum payments are determined, and the timing of such payments) or by any reference to finance charges, APRs, or other charges (i.e., terms required to be disclosed under in the initial account opening disclosures under sections 226.6(a) and 226.6(b) of Regulation Z). n316

The "trigger" then requires the creditor to set forth:

a) *Fees*. Any loan fee that is a percentage of the plan's credit limit (e.g., "points") as well as an estimate of other fees that may be imposed for opening the plan. That estimate may be stated as a single dollar amount or a reasonable range. n317

b) *APR*. Any periodic rate used to compute the finance charge expressed as an APR. n318

c) *Maximum APR*. The highest APR which may be imposed in a variable-rate plan. n319

In addition to these affirmative disclosures, TILA and Regulation Z prohibit the use of the term "free money" or other similarly misleading terms to refer to a HELC plan. n320

The HELC advertising disclosures must be made in a clear and conspicuous manner. The Board issued new requirements for Internet, television, and oral HELC advertisements, which are effective October 1, 2009.

[a] *Internet advertisements*. To be clear and conspicuous, the required disclosures must not be obscured by graphical displays, shading, coloration, or other devices. n321

[b] *Television advertisements*. To be clear and conspicuous, the required disclosures must not be obscured by graphical displays, shading, coloration, or other devices. n322 In addition, the disclosures must be displayed in a manner that allows the consumer to read them. n323

[c] *Oral advertisements*. To be clear and conspicuous, the required disclosures must be made at a speed and volume sufficient for a consumer to hear and comprehend them. n324

Other provisions of the new rules include special disclosures for "teaser rates," n325 prohibitions on misleading statements about tax deductibility, n326, and new balloon payment disclosures. n327

[f] HELC Remedies

In adopting the Home Equity Loan Consumer Protection Act specifically as part of TILA, n328 Congress has

necessarily provided consumers with the remedies available under the civil liability section of TILA n329 for any violation other than advertising. n330 The civil liability provision applies to any failure "to comply with any requirement imposed under this chapter," n331 and HELC is undeniably a component of the chapter.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral OverviewReal Property LawFinancingMortgages & Other Security InstrumentsGeneral OverviewReal Property LawFinancingState Regulation

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. §§ 1631 et seq.*

(n2)Footnote 2. Reg. Z §§ 226.5-226.16.

(n3)Footnote 3. Official Staff Commentary §§ 226.5-226.16.

(n4)Footnote 4. National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 11.8 (4th ed. 2009).

(n5)Footnote 5. *15 U.S.C. § 1663*; Reg. Z § 226.16.

(n6)Footnote 6. *15 U.S.C. § 1637(a)*; Reg. Z § 226.6.

(n7)Footnote 7. *15 U.S.C. § 1637(c)*; Reg. Z § 226.5a.

(n8)Footnote 7.1. *15 U.S.C. § 1637(b)*; Reg. Z § 226.7.

(n9)Footnote 7.2. *15 U.S.C. § 1637(d)* and *(i)*; Reg. Z § 226.9.

(n10)Footnote 8. Pub. L. No. 106-229, *114 Stat. 464* (June 30, 2000) (codified at *15 U.S.C. §§ 7001 et seq.*).

(n11)Footnote 9. *15 U.S.C. § 7001(c)(1)*. See *§ 1.05[2][a] supra* for further discussion of the requirements of this new statute.

(n12)Footnote 10. *15 U.S.C. §§ 1666-1666j*.

(n13)Footnote 11. *15 U.S.C. § 1645*; Reg. Z § 226.2(a)(8), (17).

(n14)Footnote 12. Reg. Z § 226.13.

(n15)Footnote 13. *15 U.S.C. § 1602(i)*.

(n16)Footnote 14. *See § 1.03[1][a] supra*.

(n17)Footnote 15. *See § 1.03[1][b] supra*.

(n18)Footnote 16. Reg. Z § 226.2(a)(20). *See, e.g., In re Woods, 66 B.R. 984 (Bankr. E.D. Pa. 1986)* (failure to meet any of the criteria of § 226.2(a)(20)). Some businesses have an "open account" arrangement with consumers, where consumers are permitted to obtain services and the charges are placed on the consumer's "account." If these businesses have a contractual arrangement permitting the consumers to defer payment, these "open accounts" may be considered open-end credit under TILA. *See, e.g., Sticka v. Geller (In re Stratton), 299 B.R. 616 (Bankr. D. Or. 2003)* (client executed promissory note for attorney fees incurred in her divorce that could be adjusted to cover additional amounts of indebtedness for ongoing services; note created an open-end credit account; account not covered by TILA

because no evidence attorney extended more than 25 of these accounts, thus not meeting the test for "creditor" under TILA).

The FRB's January 2009 changes to Regulation Z revised this Commentary to clarify that the creditor may "occasionally or routinely" verify credit information but such verification may not be done as a condition of granting a consumer's request for a particular advance under the plan. Official Staff Commentary § 226.2(a)(20)-5 (effective July 1, 2010).

In addition, the January 2009 changes added a provision permitting creditors to verify collateral values in connection with a particular advance or to comply with federal, state, or other law. Official Staff Commentary § 226.2(a)(20)-6 (effective July 1, 2010). This provision was added to specifically address compliance with Regulation U, which requires a bank in connection with margin lending (i.e., lending against stocks) to not advance funds in excess of certain collateral value. *74 Fed. Reg. 5,244, 5,261* (Jan. 29, 2009) .

(n19)Footnote 17. Official Staff Commentary § 226.2(a)(20)-1.

(n20)Footnote 18. Official Staff Commentary § 226.2(a)(20)-2.

(n21)Footnote 19. Official Staff Commentary § 226.2(a)(20)-3, *as amended, 63 Fed. Reg. at 16,674* . The reference to "infrequently purchased products or services" is a reference to the legislative history of the 1980 Truth in Lending Simplification Act of 1980 amendment.

(n22)Footnote 20. *63 Fed. Reg. at 16,670* .

(n23)Footnote 21. *See Speakman v. Household Retail Servs., Inc., 1999 U.S. Dist. LEXIS 11153* (N.D. Ill. July 9, 1999) ; *Rendler v. Corus Bank, N.A., 1998 U.S. Dist. LEXIS 14246* (N.D. Ill. Sept. 3, 1998) .

(n24)Footnote 22. *144 F.3d 1056 (7th Cir. 1998)* , *cert. denied, 525 U.S. 963, 119 S. Ct. 406, 142 L. Ed. 2d 329 (1998)* . For a thorough discussion of this case, see National Consumer Law Center, Truth in Lending § 5.2.3.4 (6th ed. 2007 and Supp.).

(n25)Footnote 23. *144 F.3d. at 1059* .

(n26)Footnote 24. *See also Myers v. First Tennessee Bank, N.A., 2000 U.S. Dist. LEXIS 4177* (M.D. Ala. March 30, 2000) (nationwide class certified; satellite dish case).

(n27)Footnote 25. Carlisle v. Whirlpool Fin. Nat'l Bank, Civil Action No. CV 97-068 (Circuit Court, Hale County, Ala., Post Trial Order, Aug. 25, 1999).

(n28)Footnote 26. For a discussion of claims that can be used to attack overreaching creditor behavior, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses Ch. 11, 12 (3d ed. 2005 and supp.).

(n29)Footnote 27. *Merriam v. Chase Manhattan Mortgage Corp. (In re Merriam), 333 B.R. 22 (Bankr. W.D.N.Y. 2005)* .

(n30)Footnote 28. Official Staff Commentary § 226.2(a)(20)-6.

(n31)Footnote 29. *See* Official Staff Commentary § 226.2(a)-3, *as amended by 63 Fed. Reg at 16,674* (Apr. 6, 1998) ; *see also* Supplemental Information, *63 Fed. Reg. 16,669, 16,670* (Apr. 6, 1998) . For additional analysis of "spurious" open-end credit, see National Consumer Law Center, Truth in Lending § 5.2.3 (6th ed. 2007 and Supp.).

(n32)Footnote 30. Official Staff Commentary § 226.2(a)(20)-6.

(n33)Footnote 31. Reg. Z § 226.5b(5)(i).

(n34)Footnote 32. *15 U.S.C. § 1602(f)*; Reg. Z § 226.2(a)(17)(i).

(n35)Footnote 33. *15 U.S.C. § 1602(f)* also defines a creditor as any person who honors a credit card and offers a discount which is a finance charge. Since a discount of any size is seldom a finance charge, assuming that the creditor complies with the requirements of *15 U.S.C. § 1666f(b)*, the alternate definition is virtually nugatory.

(n36)Footnote 34. "Credit card" is statutorily defined as "any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor or services on credit." *15 U.S.C. § 1602(k)*. The Regulation also requires that the card be one "that may be used from time to time" to obtain credit. Reg. Z § 22.62(a)(15). The Regulation now defines "charge card" as "a credit card on an account for which no periodic rate is used to compute a finance charge." Reg. Z § 226.2(a)(15).

(n37)Footnote 35. Reg. Z § 226.2(a)(17)(iii).

(n38)Footnote 36. *15 U.S.C. § 1602(f)*; Reg. Z § 226.2(a)(17)(iii). *See Robb v. Capital Acquisitions & Mgmt. Co., 2002 U.S. Dist. LEXIS 22689* (N.D. Ill. Nov. 21, 2002) . *But see Canaday v. Household Retail Servs., Inc., 119 F. Supp. 2d 1258 (M.D. Ala. 2000)* (when plaintiff alleged that open-end credit account was spurious, court would not hold card issuer liable as creditor because obligation not initially payable to it), *aff'd without op., 268 F.3d 1067 (11th Cir. 2001)* .

(n39)Footnote 37. *352 F.3d 1118 (7th Cir. 2003)* .

(n40)Footnote 38. *Robb v. Capital Acquisitions & Management Co., 2002 U.S. Dist. LEXIS 22689* (N.D. Ill. Nov. 21, 2002) .

(n41)Footnote 39. *Neff v. Capital Acquisitions & Management Co., 352 F.3d 1118 (7th Cir. 2003)* .

(n42)Footnote 40. In addition to *Neff*, see, e.g., *Carbajal v. Capital One, F.S.B., 2003 U.S. Dist. LEXIS 20065* (N.D. Ill. Nov. 10, 2003) .

(n43)Footnote 41. *See, e.g.*, §§ 5.9.4 (unauthorized use protections) and 5.9.6 (cardholder's claims and defenses).

(n44)Footnote 42. Reg. Z § 226.5(b)(2).

(n45)Footnote 43. Reg. Z § 226.2(17)(iv); Official Staff Commentary § 226.2(17)(iv)-1.

(n46)Footnote 44. Reg. Z § 226.2(17)(ii). *See Swift v. First USA Bank, 1999 Dist. LEXIS 8208* (N.D. Ill. May 20, 1999) (vendor that provided telecommunications services paid for by the card issuer's credit card, but that did not offer a discount, held not to be a creditor).

(n47)Footnote 45. *15 U.S.C. § 1602(m)*.

(n48)Footnote 46. Reg. Z § 226.2(a)(8); Official Staff Commentary § 226.2(a)(8)-2.

(n49)Footnote 47. *Hess v. Citibank, (South Dakota), N.A., 459 F.3d 837 (8th Cir. 2006)* .

(n50)Footnote 47.1. Official Staff Commentary § 226.3(a)-2, effective July 2010.

(n51)Footnote 47.2. Official Staff Commentary § 226.3(a)-2(ii), effective July 2010.

(n52)Footnote 47.3. *Id*.

(n53)Footnote 48. *15 U.S.C. § 1602(m)*.

(n54)Footnote 49. Reg. Z § 226.2(a)(11).

(n55)Footnote 50. Official Staff Commentary § 226.2(a)(8)-1.

(n56)Footnote 51. *Id.*

(n57)Footnote 52. *Baker v. Citibank, N.A., 13 F. Supp. 2d 1037 (S.D. Cal. 1998)* (construing "cardholder" in state law in manner consistent with TILA, court held that identity theft victim was "cardholder" because card was issued in her name, even though imposter received card). *Cf. People v. Collins, 405 N.W.2d 182 (Mich. App. Ct. 1987)* (upholding criminal conviction against identify thief for use of credit card against "cardholder"; victim was "cardholder" despite the fact that she did not request the card and it was not physically issued to her).

(n58)Footnote 53. *Monogram Credit Card Bank v. Morris, 2002 WL 31360695* (N.Y. City Civ. Ct. May 10, 2002) (identity theft victim could not bring TIL claim against creditor because creditor never issued victim a credit card). *Cf. MacDermid v. Discover Fin. Servs., 488 F.3d 721 (6th Cir. 2007)* (issuer did not violate TILA by sending disclosures to post office box set up by forger instead of victim's residence; court did not rule on whether victim was "consumer" but held that issuer did not fail to make disclosures by sending to addressed specified on the application); *Frazier v. Washington Mut., Inc., 2006 U.S. Dist. LEXIS 35767* (W.D. Tenn. June 1, 2006) (person whose signature was forged on closed-end loan documents cannot bring TIL claim).

(n59)Footnote 54. Reg. Z § 226.5a(a) and (b). The disclosure requirements for credit card accounts differ from those for charge card accounts. Credit card issuers would have to provide all the applicable disclosures except for the due and payable statement disclosure; *see § 1.07[2][j] infra*. Charge card issuers would have to provide the applicable disclosures discussed in *§ 1.07[2][e]*, *[g]*, *[h]*, and *[k] infra*.

(n60)Footnote 55. Reg. Z § 226.5(a)(1) and n.8.

(n61)Footnote 56. Reg. Z § 226.5a(a)(2)(i). These rules do not apply to home equity plans accessible by a credit or charge card subject to the Home Equity Loan Consumer Protection Act; overdraft lines of credit tied to asset accounts that are accessed by check guarantee or debit cards; or lines of credit accessed by check guarantee or automated teller machine (ATM) cards. Reg. Z § 226.5a(a)(3).

(n62)Footnote 56.1. Reg. Z §§ 226.5(a)(3)(i), 226.5a(a)(2), effective July 2010.

(n63)Footnote 56.2. Reg. Z §§ 226.5(a)(3)(iii), 226.6(b)(1), effective July 2010.

(n64)Footnote 56.3. Reg. Z §§ 226.5(a)(3)(v), 226.9(b)(3), effective July 2010.

(n65)Footnote 56.4. Reg. Z §§ 226.5(a)(3)(vi), 226.9(c)(2)(iii)(B), effective July 2010.

(n66)Footnote 56.5. Reg. Z §§ 226.5(a)(3)(viii), 226.9(g)(3)(ii), effective July 2010.

(n67)Footnote 56.6. Official Staff Commentary § 226.5a(a)(1)-1.

(n68)Footnote 56.7. Official Staff Commentary § 226.5a(a)(1)-3, effective July 2010.

(n69)Footnote 56.8. Reg. Z §§ 226.5a(b)(1), 226.6(b)(2)(i), effective July 2010.

(n70)Footnote 56.9. Reg. Z § 226.5(a)(2)(vi)(B), effective July 2010.

(n71)Footnote 56.10. *15 U.S.C. § 1637(c)(7), added by* Pub. L. No. 109-8, tit. 13, § 1304 (2005).

(n72)Footnote 56.11. Reg. Z § 226.5(c)(1), effective July 2010.

(n73)Footnote 56.12. Official Staff Commentary § 226.5a(a)(2)-6(i).

(n74)Footnote 56.13. *Id*.

(n75)Footnote 56.14. Official Staff Commentary § 226.5a(a)(2)-6(ii).

(n76)Footnote 57. *15 U.S.C. § 1637(c)(1)(A)(i)(I)*; Reg. Z § 226.5a(b)(1).

(n77)Footnote 58. Reg. Z § 226.2(a)(21).

(n78)Footnote 59. Official Staff Commentary § 226.2(a)(21)-2. *Janos v. Wells Fargo Bank N.A., 2006 U.S. Dist. LEXIS 6758* (D. Ariz. Feb. 14, 2006) . However, these transaction charges must generally be disclosed under other provisions of Regulation Z. § 226.5a.

(n79)Footnote 60. *Roberts v. Fleet Bank (R.I.) N.A., 342 F.3d 260 (3d Cir. 2003)* (question of fact whether creditor that advertised a "fixed" APR in solicitation letter, then raised APR pursuant to a change-in-terms provision thirteen months later, violated TILA).

(n80)Footnote 60.1. Reg. Z § 226.5a(b)(1).

(n81)Footnote 60.2. *Id*., effective July 2010.

(n82)Footnote 60.3. *Id*.

(n83)Footnote 60.4. *5 U.S.C. § 1666i-1*(a) (effective Feb. 22, 2010), *added by* Pub. L. No. 111-24, § 01(b), *123 Stat. 1736* (May 22, 2009).

(n84)Footnote 60.5. *See* National Consumer Law Center, Truth in Lending, § 5.8.4.3.2 (6th ed. 2007 and supp.).

(n85)Footnote 61. Official Staff Commentary § 226.5a(b)(1)-6.

(n86)Footnote 62. *15 U.S.C. § 1637(c)(6)*, *added by* Pub. L. No. 109-8, tit. 13, § 1303 (2005). This provision is effective within twelve months of the legislation's enactment, which was April 20, 2005, or within twelve months after the date of publication of final regulations by the Board, whichever is later. Pub. L. No. 109-8, tit. 13, § 1303(b)(2)(2005).

(n87)Footnote 63. *15 U.S.C. § 1637(c)(6)(A)(i)*.

(n88)Footnote 64. Commonly referred to as the "Schumer box." The teaser-rate disclosure also does not apply to envelopes or other enclosures in which the application or solicitation is mailed. *15 U.S.C. § 1637(c)(6)(B)*.

(n89)Footnote 65. *15 U.S.C. § 1637(c)(6)(A)(ii)* and *(iii)*.

(n90)Footnote 66. *Id*.

(n91)Footnote 67. *Id*.

(n92)Footnote 68. *15 U.S.C. § 1637(c)(6)(C)(i)*.

(n93)Footnote 69. *15 U.S.C. § 1637(c)(6)(C)(ii)*.

(n94)Footnote 70. *15 U.S.C. § 1637(c)(6)(D)(i)*.

(n95)Footnote 71. *15 U.S.C. § 1637(c)(1)(A)(i)(II)*; Reg. Z § 226.5a(b)(1)(i). Misrepresentations concerning the

nature of the index may be an issue. *See, e.g., Lum v. Bank of America, 361 F.3d 217, 2004-1 Trade Cas. (CCH) P74326 (3d Cir. 2004)* , *cert. denied, 125 S. Ct. 271 (2004)* (alleging conspiracy by major banks to fix and inflate "prime rate" that was used as index for many open end products, and that this "prime rate" was not the best rate offered to banks' customers; appeals court upheld dismissal of RICO and Sherman Act claims).

(n96)Footnote 72. Official Staff Commentary § 226.5a(b)(1)-7. Similar disclosures about penalty rates must be included in the initial disclosures. If the penalty rate is based on an index and an increased margin, the index and margin must be disclosed.

(n97)Footnote 73. *See* National Consumer Law Center, Truth in Lending, § 5.4.3.2.4 (6th ed. 2007).

(n98)Footnote 74. *See* National Consumer Law Center, Fair Credit Reporting, § 14.5 (6th ed. 2006 and Supp.).

(n99)Footnote 75. *15 U.S.C. § 1637(c)(1)(A)(ii)(I), (4)(A)(i)*; Reg. Z § 226.5a(b)(2).

(n100)Footnote 76. *Rossman v. Fleet Bank (R.I.) N.A., 280 F.3d 384 (3d Cir. 2002) . But see Gaynoe v. First Union Direct Bank, N.A., 571 S.E.2d 24 (N.C. Ct. App. 2002)* (use of terms "annual fee" and "annual interest rate" does not contractually create a fixed rate for one year each time the annual fee is paid; plaintiff did not bring a TILA claim).

(n101)Footnote 77. *15 U.S.C. § 1637(c)(1)(A)(ii)(II)*; Reg. Z § 226.5a(b)(3).

(n102)Footnote 78. *15 U.S.C. § 1637(c)(1)(A)(ii)(III), (4)(A)(ii)*; Reg. Z § 226.5a(b)(4).

(n103)Footnote 79. *But see* Reg. Z § 226.5a(b)(8).

(n104)Footnote 80. *15 U.S.C. § 1637(c)(1)(A)(iii)(I)*; Reg. Z § 226.5a(b)(5).

(n105)Footnote 81. *15 U.S.C. § 1637(c)(1)(A)(iv)*; Reg. Z § 226.5a(b)(6).

(n106)Footnote 82. Reg. Z § 226.5a(g). *See* Official Staff Commentary § 226.5a(b)(6)-1. For an explanation of balance computation methodology, see National Consumer Law Center, Truth in Lending § 5.4.3.7 (6th ed. 2007).

(n107)Footnote 83. *15 U.S.C. § 1637(c)(4)(A)(iii)*; Reg. Z § 226.5a(b)(7).

(n108)Footnote 84. *15 U.S.C. § 1637(c)(4)(A)(iii)*; Reg. Z § 226.5a(b)(7).

(n109)Footnote 85. *15 U.S.C. § 1637(c)(1)(B), (c)(4)(B)*; Reg. Z § 226.5a(b)(8), (9), (10). Fees for late payments and exceeding a credit limit are not considered finance charges under TILA. The Supreme Court recently affirmed the FRB's considerable discretion to exclude these types of fees from treatment as finance charges under *TILA. Household Credit Servs. v. Pfennig, 124 S. Ct. 1741 (2004)* . For an analysis of how over-limit fees actually operate, and the unfairness of their imposition, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 11.8 (4th ed. 2009). See *id.* at § 11.7.2.2.1 for a discussion of the growth in over-limit fee income for credit card issuers.

(n110)Footnote 85.1. Reg. Z § 226.5a(a)(4), effective July 2010.

(n111)Footnote 85.2. *Id.*

(n112)Footnote 85.3. *Id.*

(n113)Footnote 86. Reg. Z app. G, G-10(A), G-10(B), G-10(C), G-11, G-12, G-13(A), G-13(B).

(n114)Footnote 87. *15 U.S.C. § 1604(b).*

(n115)Footnote 88. Reg. Z § 226.5a(c).

(n116)Footnote 89. Reg. Z § 226.5a(c).

(n117)Footnote 90. Reg. Z § 226.5a(d). The Regulation makes alternative disclosures available to telephone solicitations and applications for both credit and charge card issuers. Reg. Z § 226.5a(d)(2). *See also 15 U.S.C. § 1637(c)(2)(B).*

(n118)Footnote 91. Reg. Z § 226.5a(d)(1). *See 15 U.S.C. § 1637(c)(2)(A).* The Federal Trade Commission's Telemarketing Sales Rule also imposes disclosure requirements and restrictions when consumers are subjected to telephone solicitations for credit cards. 16 C.F.R. § 310. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.9.4.7.4 (6th ed. 2004 and Supp.).

(n119)Footnote 92. Reg. Z § 226.5a(d)(2). *See also 15 U.S.C. § 1637(c)(2)(B).*

(n120)Footnote 93. Reg. Z § 226.5a(e). *See also 15 U.S.C. § 1637(c)(3), (c)(4)(c).*

(n121)Footnote 94. *15 U.S.C. § 1637(c)(3)(B)*; Reg. Z § 226.5a(e)(1).

(n122)Footnote 95. Reg. Z § 226.5a(e)(2)(i). *See also 15 U.S.C. § 1637(c)(3)(D).*

(n123)Footnote 96. Reg. Z § 226.5a(e)(3). *See also 15 U.S.C. § 1637(c)(3)(C).*

(n124)Footnote 97. *15 U.S.C. § 1610(e)*; Reg. Z § 226.28(d).

(n125)Footnote 98. *15 U.S.C. § 1610(e)*; Reg. Z § 226.28(d).

(n126)Footnote 99. Where both a creditor and an agent for the creditor exist, each may send a statement which reflects the customer's obligation to that creditor. For example, when an American Express Gold Card is issued through a bank, the customer may have different obligations to each, depending on the use of the card. Each creditor could send a separate initial disclosure statement reflecting only the amounts owed to it. Official Staff Commentary § 226.6-2.

(n127)Footnote 100. *15 U.S.C. § 1637(a)*; Reg. Z § 226.5(b)(1). *See, e.g., Wadesboro Rainbow Farm Supply, Inc. v. Lookabill, 357 S.E.2d 373 (N.C. Ct. App. 1987)* ; *Rubino v. Circuit City Stores, 758 N.E.2d 1 (Ill. App. Ct. 2001)* (whether the disclosures were given at the proper time is a question of fact). *See also* National Consumer Law Center, Truth in Lending § 4.2.7 (6th ed. 2007 and Supp.).

(n128)Footnote 101. Official Staff Commentary § 226.5(b)(1)-3.

(n129)Footnote 102. Official Staff Commentary § 226.5(b)(1)-2.

(n130)Footnote 103. Reg. Z § 226.5(a)(1). Whether the consumer was given disclosures in a form the consumer could keep prior to consummation has been a contentious issue in closed-ended transactions, especially in the automobile finance context. This is generally an issue of fact. *Rubino v. Circuit City, 324 Ill. App. 3d 931, 259 Ill. Dec. 156, 758 N.E.2d 1 (1st Dist. 2001)* , *appeal denied, 198 Ill. 2d 608, 262 Ill. Dec. 624, 766 N.E.2d 244 (2002)* (trial court entitled to find that consumer received credit card agreement in a form he could keep, given that application form signed by consumer stated that he had received a copy of the agreement).

(n131)Footnote 104. The exceptions for the initial disclosure are that a finance charge imposed at the time of the transaction need not be disclosed in writing and that the notice as to manner of payment need not be disclosed in a form that the consumer can keep. Reg. Z. § 226.5(a)(1), nn.7 and 8.

(n132)Footnote 105. *U.C.C. § 1-201(10).*

(n133)Footnote 106. Official Staff Commentary § 226.5(a)(1)-1.

(n134)Footnote 107. Reg. Z § 226.5(a)(1).

(n135)Footnote 108. Reg. Z § 226.5(a)(1). Note, however, that if the credit card solicitation occurs by telephone and the seller represents that there is a high likelihood of credit card approval, the FTC's Telemarketing Sales Rule may prohibit advance fees altogether. *16 C.F.R. § 310.4(a)(4)*, *as amended by* Fed. Reg. 4,580 (Jan. 29, 2003). *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.9.4.7.4 (2003 Supp.).

(n136)Footnote 109. Reg. Z § 226.9(d). *See* Reg. Z § 226.5 n.7.

(n137)Footnote 110. Official Staff Commentary § 226.5(a)(2)-1.

(n138)Footnote 111. Reg. Z § 226.5(a)(2). *See also Greisz v. Household Bank, 8 F. Supp. 2d 1031 (N.D. Ill. 1998)* , *aff'd on other grounds*, *176 F.3d 1012 (7th Cir. 1999)* .

(n139)Footnote 112. *15 U.S.C. § 1637(a)*.

(n140)Footnote 113. Reg. Z § 226.6(a)(2) n.12; Official Staff Commentary § 226.6(a)(2).

(n141)Footnote 114. Reg. Z § 226.6(a)(2).

(n142)Footnote 115. Official Staff Commentary § 226.2(a)(21). *Janos v. Wells Fargo Bank N.A., 2006 U.S. Dist. LEXIS 6758* (D. Ariz. Feb. 14, 2006) . However, these transaction charges will generally be required to be disclosed as either finance charges under Regulation Z. § 226.6(a)(4) or "other charges" under Regulation Z. § 226.6(b), depending on their nature.

(n143)Footnote 116. Reg. Z § 226.6(a)(2) n.12.

(n144)Footnote 117. Official Staff Commentary § 226.6(a)(2)-6.

(n145)Footnote 118. *2003 U.S. Dist. LEXIS 1000* (S.D.N.Y. Jan 24, 2003) , *aff'd*, *81 Fed. Appx. 368 (2d Cir. 2003)* .

(n146)Footnote 119. *279 F. Supp. 2d 286 (S.D.N.Y. 2003)* . The court held that the creditor was correct because it had also listed on the TILA disclosure a rate of 5.25% APR as the initial rate. This rate turned out to be the rate calculated using the index on the date of application, not the date of approval for credit. If this reasoning seems confusing, query what an ordinary consumer would be able to understand.

(n147)Footnote 120. Reg. Z § 226.30(b). *See 52 Fed. Reg. 43,178* (Nov. 9, 1987) , *corrected at 52 Fed. Reg. 45,611* (Dec. 1, 1987) . This disclosure requirement applies to all open-end credit plans allowing for interest rate changes during the term of the obligation. It does not apply to open-end credit plans in which the interest rate may not change during the term of the obligation.

(n148)Footnote 121. Official Staff Commentary § 226.6(a)(2)-10.

(n149)Footnote 122. Where both a creditor and an agent for the creditor exist, each may send a statement which reflects the customer's obligation to that creditor. For example, when an American Express Gold Card is issued through a bank, the customer may have different obligations to each, depending on the use of the card. Each creditor could send a separate periodic statement reflecting only the amounts owed to it. Official Staff Commentary § 226.7-2.

(n150)Footnote 123. *15 U.S.C. § 1637(b)*; Reg. Z § 226.7.

(n151)Footnote 124. Under Regulation Z, issuers are not required to include genuine late charges and charges imposed for exceeding a credit limit, or "over-limit" fees, in the calculation of the finance charge. Reg. Z § 226.4(c)(2). The Sixth Circuit held that over-limit fees must be disclosed as finance charges when the card issuer permits the consumer to exceed the credit limit. *Pfennig v. Household Credit Servs., 295 F.3d 522 (6th Cir. 2002)* , *reh'g, en banc, denied*, *2002 U.S. App. LEXIS 18716* (6th Cir. Sept. 3, 2002) . The Supreme Court, however, reversed the Sixth Circuit ruling, holding that the statute is ambiguous regarding whether over-limit fees are incident to the extension of credit under *15 U.S.C. § 1605(a)* and that the Board's regulatory provision uniformly excluding over-limit fees from the finance charge is reasonable and must be followed. *Household Credit Servs. v. Pfennig, 124 S. Ct. 1741 (2004)* .

(n152)Footnote 125. Reg. Z § 226.2(a)(17)(iii); Official Staff Commentary § 226.2(a)(17)(iii)-1.

(n153)Footnote 126. Reg. Z § 226.5(b)(2).

(n154)Footnote 127. Official Staff Commentary § 226.5(b)(2)(ii)-3. A revised version of this Commentary, published at *66 Fed. Reg. 17,329* (Mar. 30, 2001) , clarifies that the consumer must initiate the request for this option. The date for mandatory compliance with the interim rules that were published along with this change to the Commentary was suspended by *66 Fed. Reg. 41,439* (Aug. 8, 2001) , but that announcement made no mention of the Commentary changes.

(n155)Footnote 128. *15 U.S.C. § 7001(c)(1)(B), (C). See* Official Staff Commentary § 226.5(b)(2)(ii)-3, *as published at 66 Fed. Reg. 17,329* (Mar. 30, 2001) , *mandatory date for compliance with interim rules suspended by 66 Fed. Reg. 41,439* (Aug. 8, 2001) . *See generally* National Consumer Law Center, Truth in Lending §§ 4.2.9.3, 5.3.6 (6th ed. 2007).

(n156)Footnote 129. *15 U.S.C. § 1637(b)*; Reg. Z § 226.7. If an account is deemed uncollectible, or delinquency or collection proceedings have begun, or if the debtor has filed bankruptcy, no periodic statement need be sent. Reg. Z § 226.5(b)(2). However, a creditor that has erroneously reported as overdue any account that was paid in full has created a new account and must send periodic statements. *Saunders v. Ameritrust of Cincinnati, 587 F. Supp. 896 (D. Ohio 1984) . See Schell v. First Union Direct Bank, N.A., 2000 U.S. Dist. LEXIS 613* (N.D. Ill. Jan. 19, 2000) (bank did not have to send periodic statement to cardholder who had zero balance, even though he had built up a positive balance in a special customer-retention program that would have resulted in a rebate of paid finance charges).

(n157)Footnote 130. Reg. Z § 226.7; *McIntyre v. Household Bank, 2004 U.S. Dist. LEXIS 25629* (N.D. Ill. Dec. 21, 2004) (noting that Reg. Z merely requires the periodic statement to be "furnished" rather than received).

(n158)Footnote 131. *McIntyre v. Household Bank, 2004 U.S. Dist. LEXIS 25629* (N.D. Ill. Dec. 21, 2004) .

(n159)Footnote 132. Reg. Z § 226.9(a).

(n160)Footnote 133. Reg. Z § 226.9(c).

(n161)Footnote 134. *15 U.S.C. 1637(d)*; Reg. Z § 226.9(e).

(n162)Footnote 135. *15 U.S.C. § 1637(g)*; Reg. Z § 226.9(f).

(n163)Footnote 136. Reg. Z § 226.9(f)(1). *See 15 U.S.C. § 1637(g)(1).*

(n164)Footnote 137. *15 U.S.C. § 1637(g)(4).*

(n165)Footnote 137.1. Reg. Z § 226.6(b)(2)(xv), effective July 2010.

(n166)Footnote 137.2. Reg. Z § 226.6(b)(1)(ii), effective July 2010.

(n167)Footnote 138. *15 U.S.C. § 1643*; Reg. Z § 226.12(b). A consumer can raise unauthorized use as a billing error, but is not required to do so. Some state statutes provide analogous billing error dispute rights. *See, e.g., Cal. Civ. Code §§ 1747/-/1747.95* (Song-Beverly Credit Card Act). *Cf. Davis v. Md. Bank, N.A., 2002 U.S. Dist. LEXIS 26468* (N.D. Cal. June 18, 2002) (noting that because FCBA provides similar protections to California's Song-Beverly Credit Card Act, it would not be contrary to California public policy to enforce Delaware choice of law provision.

(n168)Footnote 139. *15 U.S.C. § 1666i*; Reg. Z § 226.12(c).

(n169)Footnote 140. Official Staff Commentary § 226.12(b)(3)-3 (unauthorized use protections do not require invoking billing error provisions); Official Staff Commentary § 226.12(c)-1 (cardholders' preservation of claims and defenses operates independently of the billing error procedures). *See People's Bank v. Scarpetti, 1998 Conn. Super. LEXIS 351* (Feb. 5, 1998) (consumer allowed to raise unauthorized use as defense despite not having given notice and invoked billing error procedures); *Crestar Bank v. Cheevers, 744 A.2d 1043 (D.C. App. 2000)* (consumer could raise unauthorized use as defense to collection suit without having sent billing error notice); *Citibank (South Dakota) v. Mincks, 135 S.W.3d 545 (Mo. App. Ct. 2004)* .

(n170)Footnote 141. *See Citibank (South Dakota) v. Mincks, 135 S.W.3d 545 (Mo. App. Ct. 2004)* (only penalty for failing to invoke billing error procedures is loss of protections granted under § 1666; absurd result if failure to invoke billing error procedures forfeited consumer's right to contest validity of debt in collection lawsuit).

(n171)Footnote 142. With respect to unauthorized use, the Commentary specifically states that the protections do not depend upon the cardholder's invoking the billing error procedures. Official Staff Commentary § 226.12(b)(3)-3. *See also* National Consumer Law Center, Truth in Lending, § 5A.9.3 (2009 supp.).

(n172)Footnote 143. *People's Bank v. Scarpetti, 1998 Conn. Super. LEXIS 351* (Feb. 5, 1998) (consumer allowed to raise unauthorized use as defense despite not having given notice and invoked billing error procedures); *Crestar Bank v. Cheevers, 744 A.2d 1043 (D.C. App. 2000)* ; *Citibank (South Dakota) v. Mincks, 135 S.W.3d 545 (Mo. App. Ct. 2004)* .

(n173)Footnote 144. One creditor has argued that failure to send a billing error notice waived the common law defense of payment in a collection action. *Asset Acceptance Corp. v. Proctor, 804 N.E.2d 975 (Ohio App. Ct. 2004)* . Another creditor reportedly argued that a claim for violation of the TILA requirement of prompt posting of payments at § 1666c is subject to the billing error procedures.

(n174)Footnote 145. *Citibank (South Dakota) N.A. v. Currea, 2006 Conn. Super. LEXIS 1137* (Conn. Super. Apr. 13, 2006) ; *Citibank (South Dakota) N.A. v. Lovell, 2006 Conn. Super. LEXIS 1134* (Conn. Super. Apr. 13, 2006) ; *Citibank (South Dakota) N.A. v. Babuscio, 2005 Conn. Super. LEXIS 3603* (Conn. Super. Dec. 21, 2005) ; *Citibank (South Dakota) N.A. v. Forcinelli, 2005 Conn. Super. LEXIS 3584* (Conn. Super. Dec. 21, 2005) ; *Citibank (South Dakota) N.A. v. Kilberg, 2005 Conn. Super. LEXIS 3585* (Conn. Super. Dec. 21, 2005) ; *Citibank (South Dakota) N.A. v. Todd, 2005 Conn. Super. LEXIS 3586* (Conn. Super. Dec. 21, 2005) ; *Citibank (South Dakota) N.A. v. Gemske, 2005 Conn. Super. LEXIS 3588* (Conn. Super. Dec. 21, 2005) . However, in one of these cases the court granted summary judgment only as to liability and held that the consumer was entitled to a hearing on the issue of damages. *Citibank v. Morgan, 2006 Conn. Super. LEXIS 573* (Conn. Super. Feb. 27, 2006) .

(n175)Footnote 146. *Citibank (South Dakota) N.A. v. Martin, 807 N.Y.S.2d 284 (N.Y. Civ. Ct. 2005)* . This case sets out guidelines for the prima facie case that a creditor or collector must establish when bringing a collection action in New York. While the case is positive in that it rejects attempts by creditors and collectors to seek collection judgments without sufficient documentation, it does seem to accept the statement of "no FCBA dispute filed" as a proper element of a collection action.

(n176)Footnote 147. *See Kurz v. Chase Manhattan Bank, 273 F. Supp. 2d 474 (S.D.N.Y. 2003)* , *subsequent proceeding at 324 F. Supp. 2d 444 (S.D.N.Y 2004)* (denying motion for attorney fees). *See also Langenfeld v. Chase*

Bank USA, N.A., 537 F. Supp. 2d 1181 (N.D. Okla. 2008) ; *Raney v. First Nat'l Bank of Neb., 2006 U.S. Dist. LEXIS 64445* (E.D. Ky. Sept. 8, 2006) . *But see Eicken v. USAA Fed. Sav. Bank, 498 F. Supp. 2d 954 (S.D. Tex. 2007)* (creditor permitted to show "significant compelling evidence" that cardholder lacked good faith belief that a billing error actually existed; court characterizes this defense as applying to a "very narrow set of circumstances") (Eicken II).

(n177)Footnote 148. *12 U.S.C. § 2605(e).*

(n178)Footnote 149. *Compare 12 U.S.C. § 2605(e)(1)(A), with* Reg. Z § 226.13(c)(1).

(n179)Footnote 150. *12 U.S.C. § 2605(f).*

(n180)Footnote 151. Not all billing errors are found on a periodic statement. A billing error has occurred when a creditor reports as delinquent an amount that has been paid in full. *Saunders v. Ameritrust of Cincinnati, 587 F. Supp. 896 (D. Ohio 1984)* .

(n181)Footnote 152. Reg. Z § 226.13(a)(1).

(n182)Footnote 153. *15 U.S.C. § 1666(b)(1).*

(n183)Footnote 154. Reg. Z § 226.13(a)(1). *See also* Reg. Z § 226.12(b).

(n184)Footnote 155. Official Staff Commentary § 226.13(a)(3)-1.

(n185)Footnote 156. *15 U.S.C. § 1666(b)(3)*; Reg. Z § 226.13(a)(3).

(n186)Footnote 157. *15 U.S.C. § 1666(b)(3)*; Reg. Z § 226.13(a)(3).

(n187)Footnote 158. *15 U.S.C. § 1666(b)(3)*; Reg. Z § 226.13(a)(3); *Beaumont v. Citibank (South Dakota) N.A., 2002 U.S. Dist. LEXIS 5276* (S.D.N.Y Mar. 28, 2002) (no billing error when consumer returned products due to dissatisfaction); *Greisz v. Household Bank, 8 F. Supp. 2d 1031 (N.D. Ill. 1998)* (letter complaining only of "unsatisfactory service" did not trigger billing error rights), *aff'd on other grounds, 176 F.3d 1012 (7th Cir. 1999)* . In *Beaumont*, the consumer returned products and services approximately one year after purchase, thus presumably precluding him from arguing that he did not accept or he refused delivery of the goods. However, the consumer alleged that the goods and products were not the same as those he had been promised by the merchant. The court failed to consider that this return could fit within the definition of a billing error under Reg. Z § 226.12(a)(3) as a situation in which the merchant delivered goods "different from that agreed upon." Official Staff Commentary § 226.13(a)(3)-1. However, it would appear the consumer also failed to send the billing dispute within the required timeframe. The consumer can raise a dispute over the quality or service of goods defensively pursuant to TILA's preservation of a cardholder's claims and defenses against a merchant. *See generally* National Consumer Law Center, Truth in Lending, § 5.9.5 (5th ed. 2003 and supp.).

(n188)Footnote 159. Official Staff Commentary § 226.13(a)(5)-1.

(n189)Footnote 160. Reg. Z § 226.8 ns.16, 17, 20. Under Reg. Z § 226.8, the creditor can escape liability for failure to properly identify each credit transaction by treating an inquiry for clarification or documentation as a billing error. *See Burnstein v. Saks Fifth Ave. & Co., 208 F. Supp. 2d 765 (E.D. Mich. 2002)* (a request for clarification can constitute a billing error triggering creditor's obligations for resolution).

(n190)Footnote 161. Reg. Z § 226.13(a)(7).

(n191)Footnote 162. *Kennedy v. Victoria's Secret Stores, Inc., 2004 U.S. Dist. LEXIS 19525* (E.D. La. Sept. 28, 2004) . This might be a billing error claim that would be useful for victims of identity theft.

(n192)Footnote 163. *15 U.S.C. § 1640(a)*; *see, e.g., Purcell v. Universal Bank, N.A., 2003 U.S. Dist. LEXIS 7061* (E.D. Pa. Apr. 28, 2003) (actual damages may include damages from denial of subsequent credit application due to negative information submitted to credit reporting agency in violation of the Fair Credit Billing Act [hereinafter FCBA]); *Burnstein v. Saks Fifth Ave., 208 F. Supp. 2d 765 (E.D. Mich. 2002)* (evaluating an actual damages claim for a FCBA violation), *subsequent proceeding at 85 Fed. Appx. 430 (6th Cir. 2003)* (appeal mooted by jury finding of fact adverse to plaintiff); *Belmont v. Associates Nat'l Bank, 119 F. Supp. 2d 149 (E.D.N.Y. 2000)* (imposing statutory damages). Statutory damages are calculated as double the finance charge, but amendments to the statute have made it unclear whether there are a floor and a cap on statutory damages, and, if so, in what amounts. *See* National Consumer Law Center, Truth in Lending § 8.6.2.2 (6th ed. 2007).

(n193)Footnote 164. *Esquibel v. Chase Manhattan Bank USA, N.A., 276 Fed. Appx. 393 (5th Cir. Tex. 2008)* ; *Langenfeld v. Chase Bank USA, N.A., 537 F. Supp. 2d 1181 (N.D. Okla. 2008)* ; *Cunningham v. Bank One, 487 F. Supp. 2d 1189 (W.D. Wash. 2007)* .

(n194)Footnote 165. *Esquibel v. Chase Manhattan Bank USA, N.A., 276 Fed. Appx. 393 (5th Cir. Tex. 2008)* ; *Langenfeld v. Chase Bank USA, N.A., 537 F. Supp. 2d 1181 (N.D. Okla. 2008)* ; *Cunningham v. Bank One, 487 F. Supp. 2d 1189 (W.D. Wash. 2007)* . *But see Gengo v. Target Nat'l Bank, 513 F. Supp. 2d 842 (S.D. Tex. 2007)* ; *Raney v. First Nat'l Bank of Neb., 2006 U.S. Dist. LEXIS 64445* (E.D. Ky. Sept. 8, 2006) ; *Eicken v. USAA Fed. Sav. Bank, 2006 U.S. Dist. LEXIS 38843* (S.D. Tex. June 12, 2006) (Eicken I).

(n195)Footnote 166. *Esquibel v. Chase Manhattan Bank USA, N.A., 276 Fed. Appx. 393 (5th Cir. Tex. 2008)* ; *Langenfeld v. Chase Bank USA, N.A., 537 F. Supp. 2d 1181 (N.D. Okla. 2008)* ; *Cunningham v. Bank One, 487 F. Supp. 2d 1189 (W.D. Wash. 2007)* .

(n196)Footnote 167. *Esquibel v. Chase Manhattan Bank USA, N.A., 276 Fed. Appx. 393 (5th Cir. Tex. 2008)* ; *Langenfeld v. Chase Bank USA, N.A., 537 F. Supp. 2d 1181 (N.D. Okla. 2008)* .

(n197)Footnote 168. Reg. Z § 226.13(b)(1). *See Plutchok v. European Am. Bank, 143 Misc. 2d 149, 540 N.Y.S.2d 135 (Dist. Ct. 1989)* ; *see Dawkins v. Sears Roebuck & Co., 109 F.3d 241 (5th Cir. 1997)* ; *Greisz v. Household Bank, 8 F. Supp. 2d 1031 (N.D. Ill 1998)* .

(n198)Footnote 169. Reg. Z § 226.13(b)(1).

(n199)Footnote 170. Official Staff Commentary § 226.13(b)(1)-1. The Commentary seems unduly restrictive, given that the failure to provide a periodic statement means that a consumer will not have received any notice that a billing error has occurred and thus may not be in a position to discover the error within 60 days. However, the Commentary also provides that as soon as a creditor does provide a statement, the consumer has an additional 60 days to assert any billing errors on that statement. Official Staff Commentary § 226.13(b)(1)-1. *Cf. Asset Acceptance Corp. v. Proctor, 156 Ohio App. 3d 60, 2004 Ohio 623, 804 N.E.2d 975 (Ohio Ct. App. Ct.2004)* (consumer's allegation that he never received periodic statements created genuine issue of fact whether consumer waived FCBA rights by failing to send billing error notice within 60 days of disputed charges).

(n200)Footnote 171. *See, e.g., Davis v. Md. Bank, N.A., 2002 U.S. Dist. LEXIS 26468* (N.D. Cal. June 18, 2002) (plaintiff's telephone call to dispute charges insufficient to preserve billing error claim). *Payne v. Diner's Club Int'l, 696 F. Supp. 1153 (S.D. Ohio 1988)* ; *Bank One of Columbus, NA v. Henslee, 1988 Ohio App. LEXIS 1203* (Ohio Ct. App. Mar. 29, 1988) (no written notice). *But see Saunders v. Ameritrust of Cincinnati, 587 F. Supp. 896 (D. Ohio 1984)* . An erroneous report of an outstanding balance was a new account created by the creditor. Since the consumer did not know that the creditor had created the account, did not receive periodic statements, and did not expect periodic statements because the amount had been paid in full, the consumer did not have to provide written notice to trigger the billing error provisions.

(n201)Footnote 172. Reg. Z § 226.13(b)(2).

(n202)Footnote 173. *Turk v. Chase Manhattan Bank USA, 2001 U.S. Dist. LEXIS 8862* (S.D.N.Y. Feb. 20, 2001) (insufficient for cardholders to plead that they sent "timely billing inquiries" to creditor; cardholders required to plead that they met all of notice requirements for billing error procedures).

(n203)Footnote 173.1. Official Staff Commentary § 226.13(a)(3)-3 (effective July 2010).

(n204)Footnote 174. Reg. Z § 226.13(c)(1).

(n205)Footnote 175. Reg. Z § 226.13(c)(1). *See General Elec. Capital Fin., Inc. v. Bank Leumi Trust Co., 1999 U.S. Dist. LEXIS 485* (S.D.N.Y. Jan. 19, 1999) (consumer's second notice of billing error, to which creditor did not respond, was not "substantially the same" as first notice, so consumer had FCBA claim).

(n206)Footnote 176. Reg. Z § 226.13(f).

(n207)Footnote 176.1. Official Staff Commentary § 226.13(f)-3.i, effective July 2010.

(n208)Footnote 176.2. Official Staff Commentary § 226.13(f)-3, effective July 2010.

(n209)Footnote 177. Reg. Z § 226.13(e).

(n210)Footnote 178. Official Staff Commentary § 226.13(f). *15 U.S.C. § 1666(a)(3)(b)(ii)*; Reg. Z § 226.13(f).

(n211)Footnote 179. *Dillard Dep't Stores, Inc. v. Owens, 951 S.W.2d 915 (Tex. App. Corpus Christi 1997)* (interprets parallel provisions regarding unauthorized use).

(n212)Footnote 180. *Dillard Dep't Stores, Inc. v. Owens, 951 S.W.2d 915 (Tex. App. Corpus Christi 1997)* .

(n213)Footnote 181. Official Staff Commentary § 226.13(g).

(n214)Footnote 182. For a discussion of account stated claims, see National Consumer Law Center, Fair Debt Collection, § 14.5.2 (5th ed. 2004).

(n215)Footnote 183. *Cf. Discover Bank v. Walker, 787 N.Y.S.2d 677 (N.Y. Sup. App. 2004)* (consumer defeated creditor's motion for summary judgment on account stated claim by notifying card issuer of unauthorized use).

(n216)Footnote 184. *Cf. Bank of New York (Del.) v. Santarelli, 128 Misc. 2d 1003, 491 N.Y.S.2d 980 (N.Y. County Ct. 1985)* (in account stated action, TILA required card issuer to prove each charge on the account was authorized by the borrower).

(n217)Footnote 185. *15 U.S.C. § 1666a*. This would also violate the consumer's rights under the Equal Credit Opportunity Act § 701, *15 U.S.C. § 1691(e)*; *see* National Consumer Law Center, Credit Discrimination, § 3.4.4 (4th ed. 2005).

(n218)Footnote 186. *15 U.S.C. § 1666a(b)*; *see* National Consumer Law Center, Truth in Lending, § 5.8.8.2 (6th ed. 2007 and Supp.).

(n219)Footnote 187. Reg. Z § 226.13(c)(2).

(n220)Footnote 188. Official Staff Commentary § 226.13(c)(2)-1.

(n221)Footnote 189. Interim Award on Liability Phase of Arbitration Hearing, Hassibi v. Bank One Trust, Clearinghouse 55,634 (Feb. 3, 2006) (arbitration award), *reported at* www.nclc.org/unreportedcases.

(n222)Footnote 190. Of course, it could not assess such a charge unless it had been disclosed in the initial

disclosure statement or change of terms notice. Official Staff Commentary § 226.6(b)(2)-1. An erroneous charge would trigger billing error procedures.

(n223)Footnote 191. Reg. Z § 226.13(d)(1); Official Staff Commentary § 226.13(d)(1)-1. *See* National Consumer Law Center, Truth in Lending, § 5A.9.6.4 (6th ed. 2007 and supp.), for further discussion of prohibitions of collection activities during a billing error dispute.

(n224)Footnote 192. Regulation Z § 226.13(d)(1), n.30.

(n225)Footnote 193. *Vrlaku v. Citibank, 2005 U.S. Dist. LEXIS 43080* (D.N.J. Sep. 23, 2005) (insufficient to allege that creditor's response to a billing error dispute was "improper"; plaintiff must specify how creditor failed to meet its obligations under the FCBA, such as by failing to acknowledge dispute or conduct investigation).

(n226)Footnote 193.1. Official Staff Commentary § 226.13(c)(2)-2, effective July 2010.

(n227)Footnote 194. *15 U.S.C. § 1666c*; Reg. Z § 226.2(a)(17).

(n228)Footnote 194.1. Reg. Z § 226.2(a)(17).

(n229)Footnote 194.2. *See, e.g., Lawrence v. Household Bank, 343 F. Supp. 2d 1101 (M.D. Ala. 2004)* (9:00 a.m. cut-off for payment posting); *Landreneau v. Fleet Fin. Group, 197 F. Supp. 2d 551 (M.D. La. 2002)* (9:00 a.m. cut-off for payment posting); *Bond v. Fleet Bank, 2002 U.S. Dist. LEXIS 22324* (D.R.I. Oct. 10, 2002) ; Schwartz v. Citibank (S.D.), Nat'l Ass'n (C.D. Cal. May 5, 2000), *available at* www.consumerlaw.org/unreported (class action settlement notice in case challenging 10:00 a.m. cut-off); Marsh v. First U.S.A. Bank, N.A., C.N. 3-99CV0783-T (N.D. Tex. Apr. 8, 1999). *Cf.* Johnson v. Capital One Bank, *15 Cal. Rptr. 3d 917 (Cal. Ct. App. 2004)* (breach of contract claim for failing to promptly post payments; summary judgment granted for defendant on basis that Virginia state law limits defendant's liability to TILA for conduct that could be subject of TIL claim).

(n230)Footnote 195. *15 U.S.C. § 1666c(a)* (*effective* Feb. 22, 2010), as amended by Pub. L. No. 111-24, § 104(1), *123 Stat. 1741* (May 22, 2009).

(n231)Footnote 196. Official Staff Commentary §§ 226.7(a)-1, 226.7(i)-1.

(n232)Footnote 197. *15 U.S.C. § 1666d*; Reg. Z § 226.11. *See also* Reg. Z § 226.2(a)(6), Official Staff Commentary § 226.2(a)(6). A creditor is open when personnel are available to make loan distributions, open new accounts, and handle credit transaction inquiries. It is not open for purposes of this provision when it has its windows open only for limited purposes, such as deposits, withdrawals, bill paying or related services.

Oral requests are not sufficient to trigger the creditor's responsibility to refund credit balances. *See Fatahi v. Fleet Bank (R.I.) Nation Ass'n, 2002 Mass. Super. LEXIS 240* (Mass. Super. Ct. Feb. 19, 2002) (creditor did not violate TILA when it refused consumer's requests for refund of credit balance, because consumer failed to establish that requests were in writing).

(n233)Footnote 198. Reg. Z § 226.25.

(n234)Footnote 199. *15 U.S.C. § 1637(h)*, *added by* Pub. L. No. 109-8, tit. 13, § 1306 (2005).

(n235)Footnote 200. Pub. L. No. 109-8, tit. 13, § 1306(b)(2) (2005).

(n236)Footnote 201. *72 Fed. Reg. 32,948, 32,977* /-/32,978, 33,014 (June 14, 2007).

(n237)Footnote 202. *15 U.S.C. § 1642*; Reg. Z § 226.12(a). Official Staff Commentary § 226.12(a)(2)-3; *see In re DiRienzo, 254 B.R. 334, 341 (Bankr. M.D. Pa. 2000)* (bank that was subsidiary of retailer could issue new card when

accounts were assigned to it). The Commentary imposes a "one-for-one rule": in general, a creditor may not issue more than one credit card as a renewal or substitute for an accepted card. Official Staff Commentary § 226.12(a)(2)-5. A creditor may, however, replace an accepted combined debit/credit card with a credit card and a separate debit card. Official Staff Commentary § 226.12(a)(2)-6(i).

(n238)Footnote 203. An example of a prohibited solicitation would be "I'm calling from 'Money Center Bank' to *inform* you that we are sending you our Mastercard."

(n239)Footnote 204. Official Staff Commentary § 226.12(a)(1)-7, *published at 46 Fed. Reg. 16,614* (Apr. 6, 1999)
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(n240)Footnote 205. Official Staff Commentary § 226.12(a)(1)-7(ii).

(n241)Footnote 206. Official Staff Commentary § 226.12(a)(1)-7(ii).

(n242)Footnote 207. Official Staff Commentary § 226.12(a)(1)-7(ii). See also Official Staff Commentary § 226.2(a)(15)-2, which was revised at the same time as § 226.12(a)(1)-7 to add as an example of a credit card "a card or device that can be activated upon receipt to access credit, even if the card has a substantive use other than credit, such as a purchase-price discount card." The Commentary underscores the point by adding that "[s]uch a card or device is a credit card notwithstanding the fact that the recipient must first contact the card issuer to activate the credit feature."

(n243)Footnote 208. The pre-1999 version of the Commentary provided:

> "7. *Issuance of non-credit cards*. The issuance of an unsolicited device that is not, but may become, a credit card, is not prohibited provided:
>
> - The device has some substantive purpose other than obtaining credit, such as access to non-credit services offered by the issuer;
> - It cannot be used as a credit card when issued; and
> - A credit capability will be added only on the recipient's request."

For example, the card issuer could send a check guarantee card on an unsolicited basis, but could not add a credit feature to that card without the consumer's specific request. The re-encoding of a debit card or other existing card that had no credit privileges when issued would be appropriate after the consumer had specifically requested a card with credit privileges. Similarly, the card issuer may add a credit feature, for example, by reprogramming the issuer's computer program or automated teller machines, or by a similar program adjustment.

(n244)Footnote 209. *Swift v. First USA Bank, 1999 U.S. Dist LEXIS 8208* (N.D. Ill. May 20, 1999) (ruling on motion to dismiss).

(n245)Footnote 210. Official Staff Commentary § 226.12(a)(1)-8.

(n246)Footnote 211. *15 U.S.C. § 7*.3.4 (6th ed. 2006 and Supp.); *see* National Consumer Law Center, Fair Credit Reporting, § 5.3.8 (5th ed. 2002 and Supp.).

(n247)Footnote 212. *Munoz v. Seventh Ave., Inc., 2004 U.S. Dist. LEXIS 13715* (N.D. Ill. July 14, 2004) ("firm offer of credit" accompanied by form preprinted with account number constituted "credit card" that was issued unsolicited in violation of TILA).

(n248)Footnote 213. Many debt buyers do not have paper documentation of the accounts they buy, only an

electronic list of debtors. Thus, they may not have documentation that a borrower actually requested a credit card. For more on credit card collection abuses and debt buyers, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 11.7.2.3.8 (3d ed. 2005).

(n249)Footnote 214. *15 U.S.C. § 1640(a)*. The prohibition against unsolicited issuance is contained in Part B of TILA (which § 1640 refers to as "this part"). TILA's restrictions on statutory damages liability apply only to certain disclosures referred to in §§ 1637 and 1638, not to § 1642's prohibition against unsolicited issuance of credit cards.

(n250)Footnote 215. *15 U.S.C. § 1640(e)*. *See Borg v. Chase Manhattan Bank USA, N.A., 247 Fed. App'x 627 (6th Cir. 2007)* (card was "issued" at a discrete point in time when the account was opened, and "issuance" did not encompass the entire time the card was active).

(n251)Footnote 216. Official Staff Commentary § 226.5(b)(1)-1.

(n252)Footnote 217. *15 U.S.C. §§ 1661-1663*. Reg. Z § 226.16; Official Staff Commentary § 226.16. The definition of an advertisement can be found at Reg. Z § 226.2(a)(2) and Official Staff Commentary § 226.2 (a)(2), *as amended by 63 Fed. Reg. 16,669* (Apr. 6, 1998) .

(n253)Footnote 218. The definition of "advertisement" can be found at Reg. Z § 226.2(a)(2) and Official Staff Commentary § 226.2(a)(2), *as amended by 63 Fed. Reg. 16,669* (Apr. 6, 1998) .

(n254)Footnote 219. Official Staff Commentary § 226.16(a)-2.

(n255)Footnote 220. Reg. Z § 226.16(b); Official Staff Commentary § 226.16(b).

(n256)Footnote 221. Official Staff Commentary § 226.16.

(n257)Footnote 222. *See Smeyres v. General Motors Corp., 820 F.2d 782 (6th Cir. 1987)* .

(n258)Footnote 223. *15 U.S.C. § 1666h*.

(n259)Footnote 224. *15 U.S.C. § 1666h*; Reg. Z § 226.13(d)(1).

(n260)Footnote 225. Reg. Z § 226.12(d)(2).

(n261)Footnote 226. Official Staff Commentary § 226.12(d)(2)-1.

(n262)Footnote 227. Official Staff Commentary § 226.12(d)(2)-1. *See generally In re Clark, 161 B.R. 290 (Bankr. N.D. Fla. 1993)* (prohibiting offset of credit union shares against credit card account).

(n263)Footnote 228. Reg. Z § 226.12(d)(3).

(n264)Footnote 229. *15 U.S.C. § 1643*.

(n265)Footnote 230. *15 U.S.C. § 1602(o)*.

(n266)Footnote 230.1. Official Staff Commentary § 226.12(b)(1)(ii)-3, effective July 2010. Prior case law held the same. *Minskoff v. American Express Travel Related Servs. Co., 98 F.3d 703 (2d Cir. 1996)* ; *Towers World Airways Inc. v. PHH Aviation Sys. Inc., 933 F.2d 174 (2d Cir. 1991)* ; *Stieger v. Chevy Chase Sav. Bank, 666 A.2d 479 (D.C. App. Ct. 1995)* .

(n267)Footnote 231. *15 U.S.C. § 1643*; Reg. Z n.22. *See Draiman v. American Express Travel Related Servs. Co., 892 F. Supp. 1096 (N.D. Ill. 1995)* . *See Citibank (South Dakota), N.A. v. Gifesman, 63 Conn. App. 188, 773 A.2d 993 (2001)* (cardholder who received a $25 per month stipend for permitting a third party to be a secondary user on his

account could not claim unauthorized use, even if the unauthorized use may have been committed by someone other than the secondary user, because the cardholder benefited from the use).

(n268)Footnote 232. Official Staff Commentary § 226.12(b)(1)-1. *See, e.g., First Nat'l Bank v. Fulk, 57 Ohio App. 3d 44, 566 N.E.2d 1270 (1989)* (former wife was "authorized user" under state law); *Minskoff v. American Express Travel Related Servs. Co, 98 F.3d 703 (2d Cir. 1996)* .

(n269)Footnote 232.1. Official Staff Commentary § 226.12(b)(1)(ii)-3, effective July 2010.

(n270)Footnote 233. *15 U.S.C. § 1643(b). See Minskoff v. American Express Travel Related Servs. Co., 98 F.3d 703 (2d Cir. 1996)* ; *Citibank (S.D.) v. Gifesman, 773 A.2d 993 (Conn. App. Ct. 2001)* ; *Crestar Bank v. Cheevers, 744 A.2d 1043 (D.C. App. 2000)* .

(n271)Footnote 234. *Blaisdell Lumber Co. v. Horton, 242 N.J. Super. 98, 575 A.2d 1386 (App. Div. 1990)* (when a former live-in companion stole his girlfriend's card, which contained only her name on the card, there was no apparent authority for a merchant to let the boyfriend sign his name using her card); *Elder-Beerman v. Nagucki, 561 N.E.2d 553 (Ohio Ct. App. 1988)* (apparent authority must be established by act of the principal, not the agent; creditor's evidence that unauthorized user was cardholder's girlfriend, whom he had helped with utility bills and allowed occasionally to use a different credit card did not show she had actual or apparent authority to use the one in question). One court of appeals has held that a failure to review and object to unauthorized charges does not create apparent authority, because permitting liability in such instances would conflict with TILA's intent in placing the risk of fraud on card issuers, not cardholders. *DBI Architects v. American Express Travel-Related Services Co., 388 F.3d 886 (D.C. Cir. 2004)* . The D.C. Circuit Court of Appeals drew support for its conclusion from the fact that a cardholder is not required to contest charges using the billing error procedures of FCBA in order to be protected against unauthorized use. The court ultimately concluded that the cardholder did indeed create apparent authority, not because the cardholder failed to review the statements, but because the cardholder continued to send corporate checks paying off the balances for almost a year. *Carrier v. Citibank (S.D.), N.A., 383 F. Supp. 2d 334* (D. Conn.) , *aff'd, 180 Fed. Appx. 296 (2d Cir. 2006)* (unpublished summary order) (cardholder created apparent authority in office manager to incur fraudulent charges by failing to review bills and paying them over a two-year period without contesting charges); *DBI Architects v. Am. Express Travel-Related Servs. Co., 388 F.3d 886 (D.C. Cir. 2004)* (failure to review statements alone does not create apparent authority because permitting liability in such instances would conflict with TILA's intent in placing the risk of fraud on card issuers, not cardholders).

(n272)Footnote 235. *357 F.3d 426 (4th Cir. 2004)* . The plaintiff brought her case under the Fair Credit Reporting Act for the card issuer's failure to properly investigate her assertion that she was merely an authorized user. *See* National Consumer Law Center, Fair Credit Reporting § 10.2.2.1 (6th ed. 2006 and Supp.). *See also Cleveland Trust Co. v. Snyder, 9 Ohio Op. 3d 329, 380 N.E.2d 354 (Ohio Ct. App. 1978)* (wife of cardholder was not liable where she was issued "related card" on husband's account but never signed agreement to be responsible for account); *Sears, Roebuck & Co. v. Stover, 513 N.E.2d 361 (Ohio Mun. Ct. 1987)* (following *Cleveland Trust v. Snyder*).

Even if authorized users are not generally liable under state law, spouses of cardholders may be liable for credit card debt in community property states or under state necessaries doctrines. See National Consumer Law Center, Fair Debt Collection § 14.6 (5th ed. 2004 and Supp.) for a discussion of the doctrine of necessaries. However, a creditor would be required to show that the debts were incurred for "necessaries." *See Fifth Third Bank/Visa v. Gilbert, 478 N.E.2d 1324 (Ohio Mun. 1984)* (father not liable for his minor daughter's unauthorized charges under necessaries doctrine, because none of purchases were for "necessaries").

(n273)Footnote 236. Official Staff Commentary § 226.12(b)(3)-2.

(n274)Footnote 237. Reg. Z § 226.12(b)(3).

(n275)Footnote 238. Official Staff Commentary § 226.12(b)(1)-2.

(n276)Footnote 239. *See North Am. Capital Corp. v. O'Hara, 2001 N.Y. Misc. LEXIS 1078* (N.Y. Dist. Ct. Aug. 24, 2001) (father was not liable for charges on a credit card that was sent unsolicited to him, which his son with a similar name had used without authorization). If the consumer did not request the card, the card issuer is also in violation of the restrictions against issuing an unsolicited credit card. *See § 1.07[7][d] supra*.

(n277)Footnote 240. *See generally* National Consumer Law Center, Fair Credit Reporting (6th ed. 2006 and Supp.). If an imposter requests a credit card in the consumer's name, the use of the card should be considered unauthorized since the consumer did not request the card.

(n278)Footnote 241. *15 U.S.C. § 1602(l)*; Reg. Z § 226.12(b)(2)(i) and n.21.

(n279)Footnote 242. Official Staff Commentary § 226.12(a)(2)-1 ("renewal" does not encompass the opening of a new account after a previous account was closed).

(n280)Footnote 243. *15 U.S.C. § 1643(a)(1)(F)*; Reg. Z § 226.12(b)(2)(iii); *Crestar Bank v. Cheevers, 744 A.2d 1043 (D.C. App. 2000)* (consumer not liable for $50 because creditor did not prove it provided means of identification).

(n281)Footnote 244. Official Staff Commentary § 226.12(b)(2)(ii)-1.

(n282)Footnote 245. Official Staff Commentary § 226.12(c)(1)-1. The Commentary mentions mail and telephone orders specifically, but Internet purchases would also fall under the general rule it enunciates.

(n283)Footnote 246. Official Staff Commentary § 226.12(c)(1)-1.

(n284)Footnote 247. Reg. Z § 226.12(c)(3)(ii).

(n285)Footnote 248. In *Montgomery Ward v. Horgan, 448 A.2d 15 (Vt. 1982)* , the buyer had called and written notes on payment stubs. This was found to be a reasonable effort, even though the creditor claimed it had no record of the complaints.

(n286)Footnote 249. Reg. Z § 226.12(c)(3)(ii).

(n287)Footnote 250. Reg. Z § 226.12(c)(3)(ii).

(n288)Footnote 251. Reg. Z § 226.12 n.26.

(n289)Footnote 252. *Beaumont v. Citibank (South Dakota) N.A., 2002 U.S. Dist. LEXIS 5276* (S.D.N.Y Mar. 28, 2002) .

(n290)Footnote 253. Reg. Z § 226.12(c)(1) and (2). *See Moynihan v. Providian Fin. Corp., 2003 U.S. Dist. LEXIS 13732* (D. Md. July 14, 2003) (suggesting that cardholder may bring affirmative claim for violation of section 1666i if claim involves violation of a TILA provision).

(n291)Footnote 254. *15 U.S.C. § 1643(b)*.

(n292)Footnote 255. *One Beacon Ins. Co. v. Null, 2004 U.S. Dist. LEXIS 13513* (E.D. Pa. July 19, 2004) .

(n293)Footnote 256. *Cf. Bank of New York (Del.) v. Santarelli, 128 Misc. 2d 1003, 491 N.Y.S.2d 980 (N.Y. County Ct. 1985)* (in account stated action, TILA required card issuer to prove each charge on the account was authorized by the borrower). For a discussion of account stated claims in credit card collection cases, *see also* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 11.7.2.3.8 (3d ed. 2005).

(n294)Footnote 257. Pub. L. No. 100-709, *102 Stat. 4725* (Nov. 23, 1988), *codified at 15 U.S.C. § 1637a*.

(n295)Footnote 258. *54 Fed. Reg. 24,671* (June 9, 1989) . Many of these comments were incorporated into the Official Staff Commentary, see *55 Fed. Reg. 13,103* (Apr. 9, 1990) .

(n296)Footnote 259. Official Staff Commentary § 226.5b-3.

(n297)Footnote 260. *See* Reg. Z § 226.15.

(n298)Footnote 261. *15 U.S.C. § 1637a(d)*. Official Staff Commentary § 226.5b-1.

(n299)Footnote 262. Official Staff Commentary § 226.5b-6.

(n300)Footnote 263. Reg. Z app. G, G-14A, G-14B, G-14C, G-15.

(n301)Footnote 264. *15 U.S.C. § 1604(b)*.

(n302)Footnote 265. *See generally 15 U.S.C. § 1663*; Reg. Z § 226.16; Official Staff Commentary § 226.16(d)-5.

(n303)Footnote 266. *15 U.S.C. § 1665b*; Reg. Z § 226.16(d).

(n304)Footnote 267. *15 U.S.C. § 1665b(a)*; Reg. Z § 226.16(d)(1). *See also* Official Staff Commentary § 226.16(b)-7 for examples of triggering terms. "No annual fee," "no points," "we waive closing costs" are triggering terms for home equity lines of credit [hereinafter HELC] plans. Official Staff Commentary § 226.16(d)-1. A note of caution about APRs: APRs required to be disclosed by the HELC rules do not include any costs other than interest. Reg. Z § 226.14(b). By comparison, closed-end APRs reflect costs other than interest, such as "points," which are ordinarily included in the finance charge, as well as interest.

(n305)Footnote 268. *15 U.S.C. § 1665b(a)(1)*; Reg. Z § 226.16(d)(1)(i).

(n306)Footnote 269. *15 U.S.C. § 1665b(a)(2)*; Reg. Z § 226.16(d)(1)(ii).

(n307)Footnote 270. *15 U.S.C. § 1665b(a)(3)*; Reg. Z § 226.16(d)(1)(iii).

(n308)Footnote 271. *15 U.S.C. § 1665b(d)(3)*; Reg. Z § 226.16(d)(2).

(n309)Footnote 272. *15 U.S.C. § 1665b(d)(1), (2)*; Reg. Z § 226.16(d)(2).

(n310)Footnote 273. *15 U.S.C. § 1665b(b)*; Reg. Z § 226.16(d)(4).

(n311)Footnote 274. *15 U.S.C. § 1637a(a)(13)*, *amended by* Pub. L. No. 109-8, tit. 13, § 1302(a)(1) (2005). This provision is effective within twelve months of the legislation's enactment, which was April 20, 2005, or within twelve months after the date of publication of final regulations by the Board, whichever is later. Pub. L. No. 109-8, tit. 13, § 1302(c)(2)(2005).

(n312)Footnote 275. *15 U.S.C. § 1637a(a)(13)*.

(n313)Footnote 276. *15 U.S.C. § 1665b(c)*; Reg. Z § 226.16(d)(5).

(n314)Footnote 277. *15 U.S.C. § 1665b(e)*; Reg. Z § 226.16(d)(3).

(n315)Footnote 278. Official Staff Commentary § 226.16(d)-7.

(n316)Footnote 279. *15 U.S.C. § 1647(a)*; Reg. Z § 226.5b(f)(1)(i), (ii).

(n317)Footnote 280. Note that rules for early termination of reverse mortgages are found at Pub. L. No. 103-325, *108 Stat. 2160, codified at 15 U.S.C. § 1648. See 15 U.S.C. § 1647(b)*; Reg. Z § 226.5b(f)(2). *See Flagstar Bank v. Charter One Bank, 2005 Mich. App. LEXIS 2094* (Mich. Ct. App. Aug. 25, 2005) (lender may not unilaterally terminate HELC except in limited circumstances as set forth in TILA).

(n318)Footnote 281. *15 U.S.C. § 1647(b)(1)*; Reg. Z § 226.5b(f)(2)(i).

(n319)Footnote 282. *15 U.S.C. § 1647(b)(2)*; Reg. Z § 226.5b(f)(2)(ii).

(n320)Footnote 283. *15 U.S.C. § 1647(b)(3)*; Reg. Z § 226.5b(f)(2)(iii).

(n321)Footnote 284. *15 U.S.C. § 1647(c)(1)*; Reg. Z § 226.5b(f)(3). The prohibition on changing terms applies to all terms of the contract. Official Staff Commentary § 226.5b(f)(3)-1. The FRB, however, states that a creditor may pass on the consumer increases in fees and charges imposed by third parties over which the creditor has no control, *i.e.*, increases in taxes, property insurance, and certain credit insurance. Official Staff Commentary § 226.5b(f)(3)-2.

(n322)Footnote 285. Reg. Z § 226.5b(f)(3)(i).

(n323)Footnote 286. Official Staff Commentary § 226.5b(f)(3)(i)-2.

(n324)Footnote 287. *15 U.S.C. § 1647(c)(2)(A)*; Reg. Z § 226.5b(f)(3)(ii); Official Staff Commentary § 226.5b(f)(3)(ii)-1.

(n325)Footnote 288. Reg. Z § 226.5b(f)(3)(iii).

(n326)Footnote 289. *15 U.S.C. § 1647(c)(2)(F), (4)(A)*; Reg. Z § 226.5b(f)(3)(iv).

(n327)Footnote 290. *Compare 15 U.S.C. § 1647(c)(1), with* Reg. Z § 226.5b(f)(3)(v).

(n328)Footnote 291. *15 U.S.C. § 1647(c)(2)(B)*; Reg. Z § 226.5b(f)(vi)(A).

(n329)Footnote 292. *15 U.S.C. § 1647(c)(2)(C)*; Reg. Z § 226.5b(f)(vi)(B).

(n330)Footnote 293. *15 U.S.C. § 1647(c)(2)(D)*; Reg. Z § 226.5b(f)(vi)(C).

(n331)Footnote 294. *15 U.S.C. § 1647(c)(2)(E)(i)*; Reg. Z § 226.5b(f)(vi)(E).

(n332)Footnote 295. *15 U.S.C. § 1647(c)(2)(E)(ii)*; Reg. Z § 226.5b(f)(vi)(E).

(n333)Footnote 296. Reg. Z § 226.5b(f)(vi)(F).

(n334)Footnote 297. Official Staff Commentary § 226.5b(f)(3)(vi)-5. The problem of only one cosigner desiring a cash advance could arise when a couple is divorcing.

(n335)Footnote 298. *15 U.S.C. § 1647(d)*; Reg. Z § 226.5b(g).

(n336)Footnote 299. Official Staff Commentary § 226.5b(f)(3)(vi)-5. The problem of only one cosigner desiring a cash advance could arise when a couple is divorcing.

(n337)Footnote 300. *15 U.S.C. § 1647(e)(1)*; Reg. Z § 226.5b(h).

(n338)Footnote 301. *15 U.S.C. § 1637A(b)(2)(A)*; Reg. Z § 226.5b(a)(1); Official staff Commentary § 226.5b(a)(1)-1.

(n339)Footnote 302. Official Staff Commentary § 226.5b(a)(1)-1.

(n340)Footnote 303. *15 U.S.C. § 1637A(b)(2)(B)*; Reg. Z § 226.5b(a)(1); Official Staff Commentary § 226.5b(a)(1)-3.

(n341)Footnote 304. Reg. Z § 226.5b(d).

(n342)Footnote 305. *15 U.S.C. § 1637A(e)*; Reg. Z § 226.5b(e).

(n343)Footnote 306. Reg. Z § 226.5b(c). *See also 15 U.S.C. § 1637A(c)*.

(n344)Footnote 307. *15 U.S.C. § 1637A(c)(1)(B)*; Reg. Z § 226.5b(c).

(n345)Footnote 308. *15 U.S.C. § 7001(c)(1)(B), (C)*. *See* the FRB's interim rule, Reg. Z § 226.5b(c)(2), *as published at 66 Fed. Reg. 17,329* (Mar. 30, 2001), *mandatory compliance date suspended*, *66 Fed. Reg. 41,439* (Aug. 8, 2001). *See generally* National Consumer Law Center, Truth in Lending §§ 4.2.9.3, 5.3.6 (6th ed. 2007).

(n346)Footnote 309. *See generally 15 U.S.C. § 1637(a)(8)*; Reg. Z § 226.6(c).

(n347)Footnote 310. *See § 1.07[2] supra*. *See also 15 U.S.C. § 1637(a)(8)(A)*.

(n348)Footnote 311. Reg. Z § 226.5(b).

(n349)Footnote 312. Official Staff Commentary § 226.16(d)-7. *See generally 15 U.S.C. § 1663*; Reg. Z § 226.16.

(n350)Footnote 313. *15 U.S.C. § 1665b*; Reg. Z § 226.16(d).

(n351)Footnote 314. *73 Fed. Reg. 44,522* (July 30, 2008) .

(n352)Footnote 315. *Id. at 44,523*.

(n353)Footnote 316. *15 U.S.C. § 1665b(a)*; Reg. Z § 226.16(d)(1). *See also* Official Staff Commentary § 226.16(b)-7 (examples of triggering terms). "No annual fee," "no points," and "we waive closing costs" are triggering terms for HELC plans. Official Staff Commentary § 226.16(d)-1.

(n354)Footnote 317. *15 U.S.C. § 1665b(a)(1)*; Reg. Z § 226.16(d)(1)(i).

(n355)Footnote 318. *15 U.S.C. § 1665b(a)(2)*; Reg. Z § 226.16(d)(1)(ii).

(n356)Footnote 319. *15 U.S.C. § 1665b(a)(3)*; Reg. Z § 226.16(d)(1)(iii).

(n357)Footnote 320. *15 U.S.C. § 1665b(c)*; Reg. Z § 226.16(d)(5).

(n358)Footnote 321. Official Staff Commentary § 226.16-3; *73 Fed. Reg. 44,522, 44,605* (July 30, 2008) .

(n359)Footnote 322. Official Staff Commentary § 226.16-4; *73 Fed. Reg. 44,522, 44,605* (July 30, 2008) .

(n360)Footnote 323. *Id*.

(n361)Footnote 324. *Id*.

(n362)Footnote 325. *15 U.S.C. § 1665b(d)*; Reg. Z § 226.16(d)(2).

(n363)Footnote 326. *15 U.S.C. § 1665b(b)(1)*; Reg. Z § 226.16(d)(4).

(n364)Footnote 327. *15 U.S.C. § 1665b(e)*; Reg. Z § 226.16(d)(3); *73 Fed. Reg. 44,522, 44,599* (July 30, 2008) .

(n365)Footnote 328. Pub. L. No. 100-709, § 2A, *102 Stat. 4725* (Nov. 23, 1988). *See also Consumers Union v. Federal Reserve Bd., 736 F. Supp. 337 (D.D.C. 1990)* „ *remanded in part, 938 F.2d 266 (D.C. Cir. 1991)* .

(n366)Footnote 329. *15 U.S.C. § 1640*.

(n367)Footnote 330. *Cf. Smeyres v. General Motors Corp., 820 F.2d 782 (6th Cir. 1987)* . For a fuller discussion of liability for violations of the HELC advertising requirements, see National Consumer Law Center, Truth in Lending, § 5.11.12 (6th ed. 2007 and Supp.).

(n368)Footnote 331. *15 U.S.C. § 1640(a)*.

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Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 1 Truth in Lending

1-1 Consumer Credit Law Manual § 1.08

§ 1.08 Truth in Lending Rescission Rights

[1] Scope of Rescission Rights n1

In addition to being entitled to a disclosure statement prior to consummating a credit transaction, a homeowner has a right under TIL to rescind most transactions for which the home is taken as collateral, other than transactions for the purchase of the home.

TIL rescission rights arise automatically only when the transaction meets all of the following criteria: n2

a) It is a *consumer credit* transaction, n3

b) In which a *nonpurchase* lien or security interest is or will be placed, n4

c) On the *consumer's principal dwelling*.

TIL's threshold requirement that the transaction be extended by a creditor n5 who regularly extends consumer credit applies, too. The definition of "regularly" varies, n6 depending upon the type of security taken, or the type of credit extended. Generally, it means the creditor must extend consumer credit 26 times, *or* six times if secured by a dwelling, in the previous calendar year or in the current calendar year. n7 For lenders who originate high-cost, HOEP mortgages, n8 the threshold for meeting the "regularly" requirement is lower. See Chapter 2 of this volume.

There are also rescission rights associated with certain open-end credit plans that are secured by the consumer's principal dwelling. These rights generally arise with each of the following occurrences: n9

a) Opening an account;

b) Each credit extension under a plan unless it is in accordance with a previously established credit limit for the plan;

c) Increasing the credit limit;

d) Adding to an existing account a security interest in the consumer's principal dwelling; and

e) Increasing the dollar amount of the security interest taken in the dwelling to secure the plan. n10

Note that the credit need not provide the right to rescind at the time of each credit extension or advance made under an existing open-end credit plan secured by the consumer's principal dwelling as long as the credit extended does not exceed the previously established credit limit for the loan. n11

Even if the lender did not expressly incorporate TIL protections into the contract, it may be equitably estopped from denying that the right of rescission applies, though such an argument would be available only in certain factual situations. n12

[2] Transactions Exempt From Rescission

The following transactions are exempt from TIL rescission provisions:

[a] Transactions to Purchase or Construct a Residence Are Exempt

The largest group of non-rescindable credit transactions involving a home are those to finance the construction or purchase of a home or to finance the construction of a primary dwelling on land already owned by the consumer. n13 The purpose of the financing is the key.

[b] Certain Refinancings Are Exempt

The second largest category of non-rescindable credit transactions involving a home are refinancings which meet three criteria: n14

a) There are no new advances; n15

b) The prior credit was secured by the same property; and

c) The new credit is extended by the original creditor. n16

A new creditor consolidating or refinancing any credit, even refinancing a purchase money or construction loan, must comply with the TIL rescission provisions if the consumer's home is taken as collateral. n17

[i] Series of Advances

When a creditor makes a series of advances as part of a closed-end credit transaction, whether the right of rescission applies to each advance depends on the manner in which the creditor has structured the transaction. Sometimes the creditor will treat the series of advances as a single transactions for disclosure purposes. For example, a consumer may enter into a loan for the whole amount necessary for a home improvement job, but the creditor may pay out the proceeds in a series of advances as the work is done. If the creditor gave the consumer the TIL disclosures for the full amount at the outset of the transaction, then the consumer has the right to rescind only then, not at the time of each advance.

On the other hand, a series of advances may be structured as separate loans with separate disclosures. For example, a consumer may give a creditor a mortgage in an amount sufficient to cover not just an initial loan, but also future potential loans. If the terms of the future loans are known at the time the mortgage is signed, the creditor could make all the TIL disclosures then, and the consumer would only have the right to rescind at that time. If, however, the terms of

the future loans are imposed later via new loan notes, and the creditor gives or should have given separate TIL disclosures for these later advances, then the right to rescind applies to each advance. n18

[c] State Agency as Creditor

There are no rescission rights for transactions in which a state agency is the creditor. n19 County, municipal, and township creditors do not have the same exemption, n20 and ordinary rescission rules therefore apply to those transactions.

[3] Required Disclosures of Rescission Rights: Who, What, and When

[a] Who Has TIL Rescission Rights?

Any consumer "whose ownership interest is or will be subject to the security" interest has the right to rescind the transaction and to receive the disclosures. n21 As a result, owners of the secured property who are not obligors on the note or other contract are entitled to the TIL rescission notice and an opportunity to rescind the transaction. n22 It must be the principal residence of a person with an ownership interest, however. n23

In contrast to non-rescindable transactions, where required disclosures can be given to only one of multiple consumers, n24 each person having a right to rescind must receive both notice of the right to rescind and the material TIL disclosures. n25 Furthermore, each person must receive *two* copies of the notice, n26 one to keep and one to use if the option is exercised according to the intent of that provision. n27

If there are two borrowers, but the lender provides only one set of disclosures, the question may arise as to which borrower received the disclosures. This question is irrelevant if both borrowers seek rescission. Since rescission by one borrower is effective as to both, n28 it does not matter which borrower has an extended right to rescind. If only one of the borrowers seeks rescission, that borrower needs to prove that the disclosures were given only to the other borrower. n29

If more than one consumer n30 has a right to rescind, one person's exercise of that right is effective as to all of them. n31 Thus, if both spouses have a right to rescind, either one of them, acting alone, can rescind and both of them are bound by that action. n32 While either consumer, acting alone, can rescind, there may be reasons to join both in an action to enforce rescission. A ruling upholding the rescission will affect the status of the encumbrances on the home as to both the rescinding consumer's and the non-rescinding consumer's interests. In addition, if the creditor is required to refund money there may be questions about which consumer is entitled to it, and if the rescinded loan is rewritten as part of a settlement, the creditor may require the non-rescinding consumer to agree to the new terms. A non-rescinding consumer may be willing to be named as a party in the rescission complaint solely to assist the rescinding consumer's claim. In such a case the complaint should specifically describe the non-rescinding consumer's role, and the attorney should get a signed statement from him or her to this effect.

Since there are serious consequences for failure to deliver required disclosures, disputes sometimes arise over whether they were given. If debtors testify that they did not receive the notice and material disclosures, the burden shifts to the creditor to produce "*some* positive evidence (testimonial or documentary) to indicate that TILA disclosures were given." n33

However, even if the creditor produces a copy of the information with an acknowledgment of receipt signed by the debtor, that is not necessarily conclusive. The Act provides that written acknowledgment of receipt of any required disclosures or rescission notices does no more than create a rebuttable presumption of delivery in a rescindable transaction. n34 If such a document is produced by the creditor, the burden is on the debtor to prove nonreceipt. n35

The consumer may rely on documentary evidence, testimony, or both to rebut the presumption. n36

Another section of TILA, section 1641(b), provides that a consumer's acknowledgment of receipt of a statement is conclusive proof that the statement was received. This conclusive presumption only applies to assignees, however, not original creditors, and even as to an assignee it only applies if the assignee had no knowledge to the contrary at the time of the assignment. n37 More significantly, by its terms this section is inapplicable where the rebuttable presumption of section 1635(c) applies.

[b] Form and Content of Notices

Like the other required disclosures, the notice of the right to rescind must be given "clearly and conspicuously in writing, in a form that the consumer may keep." n38 The "clear and conspicuous" requirement is not simply one of legibility. n39

For closed-end transactions, the rescission right disclosures must be on a separate document. n40 The open-end rescission notice may be physically separated from the material disclosures or combined with the material disclosures, as long as the information required to be included is set forth in a clear and conspicuous manner. n41

For both types of credit, the notice must identify the transaction n42 and must disclose the following information: n43

- The retention or acquisition of a security interest in the consumer's principal dwelling; n44
- The consumer's right to rescind; n45
- How to exercise the right to rescind, with a form for that purpose, designating the address of the creditor's place of business;
- The effects of rescission; n46 and
- The date the rescission period expires. n47

The Commentary states that additional information may be provided with the closed-end notice, such as:

- A description of the property subject to the security interest;
- A statement that joint owners may have the right to rescind and that a rescission by one is effective for all;
- The name and address of an agent of the creditor who is to receive notice of rescission. n48

Model right of rescission notices are provided in appendices to the Regulation. n49

A creditor who uses the correct model form is deemed to be in compliance except as to numerical disclosures. n50 The creditor may delete unnecessary material or rearrange the format if these changes do not affect the substance, clarity, or meaningful sequence of the form. n51 However, if the creditor uses the wrong model form or alters the model forms in other ways, n52 it cannot take advantage of this safe harbor.

Some creditors have fashioned a rescission notice that has one paragraph spelling out the right to rescind for new loans and another for refinancings. If the copy of the notice given to the consumer has neither paragraph checked, the notice does not comply with the Act's requirement that the effects of rescission be disclosed, and the extended rescission

period is available. n53

In accordance with the federal E-Sign statute, the FRB has adopted an interim rule regarding electronic provision of the notice of the right to rescind, although it has suspended the mandatory compliance date. n54

In addition to the mandatory notice of rescission rights, each consumer must be given a copy of the disclosure statement with all "material" information correctly disclosed. n55 If these material disclosures are not properly supplied, the consumer has an extended right to rescind. The material disclosures must be provided clearly and conspicuously. n56

The five material disclosures that must be properly provided for closed-end transactions in order to terminate the consumer's cancellation rights after the initial three-day cooling-off period are: n57

a) The APR, including applicable variable-rate disclosures; n58

b) The finance charge; n59

c) The amount financed; n60

d) The total of payments; and

e) The payment schedule.

There are new tolerance standards for accuracy of "the finance charge and other disclosures affected by any finance charge" which apply both prospectively and retroactively, so even loans consummated prior to the enactment of the 1995 amendments will be judged by these standards. n61

Where a consumer seeks to use rescission as a remedy outside the context of foreclosure defense, the 1995 amendments allow lenders a generous tolerance for error in finance charge disclosure: inaccuracy which does not exceed 1/2 of 1% of the total amount of credit extended is considered within the range of "accurate" for most transactions. n62 In the case of certain transactions which refinance a purchase-money mortgage, n63 anywhere downstream from the original mortgage, the tolerance for error is 1% of the amount of the credit extended. n64 The special refinance tolerance only applies, though, where there are no new funds advanced and no other debts consolidated. n65 The refinance tolerance is generally available irrespective of whether the lender is the original one or a new one, but it does not apply to those high cost mortgages which are subject to HOEP. n66

There is also a third tolerance level relevant to rescission where the consumer is raising the extended rescission right as a defense to a foreclosure. In these cases, the maximum amount by which the finance charge can be understated is only $35. n67 Further, a consumer may rescind a loan in foreclosure if a mortgage broker fee that should have been included in the finance charge was omitted, without regard to the dollar amount involved, or if the creditor uses the wrong model form. n68 This special foreclosure tolerance is both retroactive and prospective. n69

In addition to creating a generally wider target for accuracy, the 1995 amendments also immunized closed-end home equity lenders from liability for misdisclosing the finance charge and other affected disclosures if the error arose from the way certain specific charges were treated. Here, too, the immunity is retroactive, except for grandfathered cases in progress. n70

The material disclosures for open-end transactions are provided in the initial TIL disclosure statement: n71

a) The APR including applicable variable-rate disclosures; n72

b) The method of determining the finance charge and the balance upon which a finance charge will be imposed, as explained in *12 C.F.R. section 226.6*;

c) The amount or method of determining any membership or participation fees;

d) For HELCs, the plan's payment terms, including the length of the draw period and repayment period, an explanation of how the minimum periodic payment will be determined, the timing of the payments; and, if applicable, that the minimum repayment would not repay any of the principal or may repay less than the outstanding balance, and a statement that a balloon payment may result. n73

For high cost mortgages which are covered by the HOEPA, n74 materiality encompasses some additional requirements.

[c] Timing of Right to Rescind

[i] The Three-Day Unconditional Right

The statute provides for an initial three-day period during which the consumers have an unconditional right to change their minds and cancel the transaction for any reason, or for no reason. This period may be extended under certain circumstances as is discussed below. n75

The statute and Regulation set forth precise rules for calculating the three days. Unless the right to rescind has been validly waived as discussed in *§ 1.08[6] infra*, the consumer may exercise the right to rescind until midnight of the third business day n76 following the latest of the following events:

- Consummation of the transaction; n77
- Delivery of a proper notice of the right to rescind; n78 or
- Delivery of all the material disclosures correctly made. n79

[ii] The Extended Right to Rescind

If the creditor does not meet certain requirements under TIL, the three-day clock never starts ticking, and so the right to rescind can extend for three years. n80

Where the mandatory information was not properly delivered, n81 the right to rescind continues until whichever of the following events occurs first:

a) The expiration of three years after consummation of the transaction; n82

b) The transfer of all of the consumer's interest in the property; n83 or

c) The sale of the property. n84

For example, a foreclosure sale of the consumer's principal residence will generally terminate the consumer's right to rescind. n85 The right to rescind may, however, continue through any redemption period. n86

One event which is notable by its absence from the statutory list of events cutting off the unexpired rescission right is the loan pay-off. n87 The issue may arise where a loan subject to the rescission right has been refinanced. Though one case, *King v. California*, n88 has held that a refinancing cut off the right to rescind the earlier mortgage because it was

no longer in effect, the analysis was virtually nonexistent. The D.C. and Sixth Circuits have rejected *King*. n89 In addition, a number of district court and bankruptcy court decisions have permitted refinanced loans to be rescinded, so long as the earlier loans were within the three-year period and the earlier loans independently had violations giving rise to the extended rescission right. n90

[4] Creditor Must Delay Performance During Rescission Period

To facilitate TIL's three-day cooling-off period, creditors are required to delay their own contractual performance until the rescission period has expired. Unless the consumer has validly waived the right of rescission, the creditor must not disburse any money (other than in escrow), perform any services, or deliver any materials until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded. n91

TIL may not be the only source of rescission rights, particularly in the area of home improvement sales. Under a FTC rule, there is a three-day cooling-off period for door-to-door sales. n92 Every state has enacted some type of analogous cancellation right for home solicitation sales. n93

[5] Waiver of Right to Rescind

The consumer may modify or waive the right to rescind if the consumer determines that the extension of credit is needed to meet a *bona fide* personal financial emergency. n94 However, the consumer's waiver will not automatically insulate the creditor from liability for failure to provide the right of rescission. n95 These waivers, like any other, must be voluntary and knowing, so the consumer must be given notice of the right before a waiver can be effective.

To modify or waive the right to rescind, the consumer must give the creditor a dated written statement (and not a form printed for this purpose) n96 that:

a) Describes the emergency; n97

b) Specifically modifies or waives the right to rescind; n98 and

c) Bears the signature of all consumers entitled to rescind. n99

[6] Rescission as a Defense to Foreclosure

[a] General

Perhaps the most important aspect of TIL's extended rescission right for consumers is its value as a defense to foreclosure. If the transaction is one subject to the rescission right, and there are valid grounds for exercising the extended right, rescission is a complete defense to foreclosure. n100 Since a valid rescission automatically voids the security interest, as well as eliminating the obligation to pay finance or other charges, the creditor is unsecured and, therefore, has no interest in the property upon which to foreclose. Furthermore, the courts may enjoin the foreclosure sale of a home until the homeowner's rescission claim has been adjudicated. n101

The use of rescission as a foreclosure defense has proven so valuable in protecting consumers that in enacting the 1995 amendments to TIL, Congress carved it out for special rules of benefit to borrowers. Lenders are held to stricter standards in these cases. These special defensive rescission standards apply to loans consummated both before and after the enactment of the 1995 amendments. n102 These include:

- Finance charge and related tolerance: $35; any overdisclosed amount; n103
- Brokers Fees as a Finance Charge: the law in effect at the time the loan is consummated applies n104

and not even the $35 tolerance should protect an error. n105

- Form of Notice of Right to Cancel: the creditor must use or have used the appropriate FRB model form or a comparable one; n106

- The liberalized immunity rules relating to treatment of certain closing costs, including those imposed by settlement agents, do apply to defense rescission.

These special defensive standards apply whether the creditor has initiated a judicial or non-judicial foreclosure, and whether the consumer raises rescission in a separate action or as a defense in the foreclosure case. n107 All the statute requires is that the consumer be exercising rescission rights "after" the initiation of a foreclosure. n108

[b] Rescission by Recoupment After the Three-Year Period

Although there is a three-year limitation on the consumer's affirmative right to cancel, n109 courts have applied traditional common law principles of recoupment to TIL rescission. n110 The line of cases approving rescission by way of recoupment beyond three years, however, was severely undercut by the Supreme Court in *Beach v. Ocwen Federal Bank*. n111 The court barred this use of federal TIL rescission, although it expressly noted it had no occasion in *Beach* to consider the issue where rescission by recoupment is allowed by state law. n112 The new defensive rescission provisions discussed above specifically recognize the possibility that rescission may be raised by recoupment, leaving that question to state law for determination. n113

An important post-*Beach* decision, *Fidler v. Central Cooperative Bank (In re Fidler)*, n114 unequivocally adopts this view, allowing rescission by recoupment under the Massachusetts Consumer Credit Cost Disclosure Act. The court noted that the limitations period in the state statute was not identical to that in TILA, and, in any event, the interpretation of the state statute was a matter of state law. *Fidler* can also be read more broadly to adopt the view that rescission by recoupment is allowed whenever state law recognizes recoupment. n115

[c] Violations Giving Rise to the Extended Right to Rescind

[i] Nondelivery

The statute clearly contemplates that the consumer has an extended right to rescind when required rescission information and forms or the enumerated "material" disclosures n116 are not delivered to the consumer, n117 as does the Regulation. n118 *All* persons entitled to rescind under the Regulation must receive two copies of the rescission notice and one copy of the material disclosures. n119 Whether the consumer received the mandated information will frequently be a disputed question of fact. n120 However, the consumer's actual knowledge is irrelevant if the disclosures were not given in the proper form. n121

[ii] Failure to Make Material Disclosures Properly

If a creditor fails to make any of the specified material disclosures, n122 the consumer has the extended rescission right. n123 A misstatement of these disclosures by any amount that is not de minimis constitutes a material nondisclosure, n124 unless the lender is protected by the 1995 TIL amendments. n125

[iii] Higher Priced Mortgage Loans

In rulemaking in July 2008, the Board added a new category of mortgage loans that, like HOEPA loans, are subject to substantive prohibitions, effective October 1, 2009. n126 These loans, called higher priced loans, were intended to cover the subprime market. n127

Although the Board identified three practices requiring substantive protection for higher priced mortgage loans--lending without regard to ability to repay, prepayment penalties longer than two years, and failure to escrow property taxes and insurance--it only chose to make one of those practices a trigger for rescission. n128 Under the new rule, if a higher priced mortgage loan contains a prepayment penalty in violation of the new Regulation Z § 226.35(b)(2), that mortgage will be subject to the extended right of rescission. n129

This new "material" disclosure applies only to closed-end loans. Home equity lines of credit and bridge loans--loans made on an existing home to finance a new home--are excluded per se from the definition of higher priced loans. n130 Although the definition of higher priced mortgages includes home purchase loans--and all the substantive restrictions will apply to home purchase loans--the right to rescission remains limited to non-purchase money mortgages.

[iv] Violations Regarding the Notice of Right to Rescind

Violations of the requirements regarding the notice of right to cancel which must be given to the consumer form the second category of "trigger" violations giving rise to the extended rescission right. n131 The 1995 amendments give lenders a safe harbor for only one specific violation regarding the notice, discussed below. In all other respects, a violation regarding the contents of the notice still triggers the right to rescind.

The importance of the 1995 amendments is felt when examining which FRB model form or comparable one was chosen to provide information concerning the effects of rescissions.

Widespread noncompliance with the forms requirement led to industry claims of widespread exposure to liability for extended rescission claims. The avenue taken by Congress was to retroactively absolve covered lenders of any civil, criminal, administrative, or rescission liability for using the wrong model form, or a comparable notice based on the wrong model form. n132 Two categories of loans consummated prior to the September 30, 1995 enactment date of the new amendments are exempt from this broad grant of immunity. A grandfather clause excludes certain actions commenced before June 1, 1995, including those in which a timely notice of the right to cancel had been sent to the creditor prior to that date. n133 More importantly, the retroactive immunity does not protect lenders when the consumer is using rescission to defend against a judicial or nonjudicial foreclosure initiated by the lender. n134 The creditor may delete unnecessary material or rearrange the format of the model form if these changes do not affect the substance, clarity, or meaningful sequence of the form. n135 However, if the creditor uses the wrong model form or alters the model forms in other ways, n136 it cannot take advantage of the safe harbor. Creditors are not required to use the model forms but may create their own forms as long as the notice meets the requirement of the statute and Regulation Z. n137

Some creditors have fashioned a rescission notice that has one paragraph spelling out the right to rescind for new loans and another for refinancings. If the copy of the notice given to the consumer has neither paragraph checked, the notice does not comply with the Act's requirement that the effects of rescission be disclosed, and the extended rescission period is available. n138

In any event, the retroactive immunity is limited to the selection of the wrong form--all other requirements regarding the notice are unaffected.

Giving the refinancing notice of right to cancel when the transaction is not in fact a refinancing gives rise to the extended right to cancel. n139 Creditors may give the refinancing form in error where:

- The prior indebtedness is not owed to the same creditor; n140
- The prior indebtedness is not secured by the consumer's principal residence; or
- There is no prior indebtedness.

The notice of the right to rescind must be a clear and conspicuous notice of the borrower's rescission rights. n141 An unclear or ambiguous description of the effects of rescission violates this standard. n142 Adding information about a contradictory state law right to cancel violates this standard. n143 If the expiration date for the three-day cooling-off period is not properly disclosed as required by Regulation Z sections 226.15(b)(5) and 226.23(b)(5), that too is a violation giving rise to the extended right. n144 The fact that the creditor actually offered the proper three-day period for cancellation is no defense if it was not disclosed properly. n145 Nor is it relevant whether the consumer suffered actual prejudice due to the errors in the notice. n146

Some lenders attempt to burnish their public image by giving the consumer a period that appears to be longer than three days to rescind the transaction. One court has concluded that giving a consumer a separate form providing a one-week right to cancel may undermine the TIL right to cancel, thereby extending the rescission period. n147 The court held that the two rescission notices together could confuse the borrower about the length of each rescission period and the consequences of choosing one method of rescission over the other.

Another court held that disclosing a longer period for exercising the right to cancel is a violation, reasoning that a contrary interpretation would allow the three-day period to be modified at the discretion of the lender. In addition, if the creditor gives the consumer a separate notice of the longer rescission period, it may set forth different rules for sending the rescission notice, counting the days, or other matters, all of which should render the TIL rescission notice not clear and conspicuous. n148

[v] Violation of Delay of Performance Rule

Whether a creditor's violation of the requirement that it delay performance during the rescission period (if there was no valid emergency waiver) n149 gives rise to the extended right may depend upon the nature of the creditor's violation. There is persuasive precedent for arguing that such a circumvention of the rescission right will trigger the extended time period, but the case law suggests that the advocate should take care in framing the claim and stating the argument.

More than most types of premature performance, spiking (home improvement loan in which the contractor begins work during the cooling-off period) n150 in a home improvement transaction should be viewed as the type of egregious violation of the delay of performance rule which triggers the extended rescission right, even under the Third Circuit's more restrictive test. n151 Spiking may violate both TILA and state Home Solicitation Sales Acts, which allow a cooling-off period for door-to-door sales. n152

A variation on standard spiking is the "two-contract dodge," which attempts to legitimize spiking by separating the contract from the work and a subsequent "direct loan" from a third party which then pays off the sales contract with a "refinancing" or "debt consolidation" loan. It is important to note that, while assignees are only liable for statutory damages for TIL violations which are apparent on the face of the loan documents assigned, n153 assignees are subject to the rescission right to the same extent as the original creditor. n154 However, advocates should also consider raising claims beyond TIL rescission for spiking or for the two-contract variant.

[7] How Rescission Works

To exercise either the basic right or the extended right, the first step in the rescission process is for the consumer to send the notice informing the creditor that he or she is electing to cancel. The consumer must exercise the right *in writing,* by notifying the creditor of the cancellation by mail, telegram, or other means. n155 When the consumer rescinds, the security interest or lien arising by operation of law on the property becomes automatically void. n156 The promissory note is also voided, since it is part of the "transaction." n157 The second automatic consequence is that the consumer's liability to pay "any finance or other charge" also is cancelled by operation of law. n158

The second step in the rescission process takes the ball into the creditor's court, creating a two part obligation. Within twenty calendar days of receiving the rescission notice, the creditor must return to the consumer any amount of money or property that has been given to anyone in connection with the transaction n159 because the consumer has no legal liability for any such charges upon rescission. Courts have permitted the required refund to take the form of an offset against the balance which the consumer is required to tender. n160 The creditor also must take affirmative steps to reflect the fact that the security interest was automatically terminated by the rescission.

In a refinancing by the same creditor, only the new money portion of the refinancing is subject to rescission. The creditor's security interest, however, will probably be a single mortgage deed or deed of trust that covers the whole debt, not just the new money portion. State real estate law may offer the creditor a procedure to record a reduction in the amount secured through a modified mortgage or deed of trust. If not, the creditor should, before the twenty-day period for taking action expires, ask a court, pursuant to its equitable authority, to modify the rescission procedures. The court could, for example, order the existing mortgage deed reformed.

Once the creditor has fulfilled its duties, the consumer must tender any money or property that has been delivered by the creditor to the consumer. n161 Regulation Z specifically provides that the courts have equitable authority to modify steps 2 and 3 of the process. n162 In 2004, the FRB Staff added language to the Commentary to make clear that the modification of step two (the creditor's obligation to return money or property and cancel the security interest) or three (the consumer's tender) "does not affect a consumer's substantive right to rescind and to have the loan amount adjusted accordingly." Further, "[w]here the consumer's right to rescind is contested by the creditor, a court would normally determine whether the consumer has a right to rescind and determine the amounts owed *before* establishing the procedures for the parties to tender any money or property." n163 The Office of the Comptroller of the Currency has instructed banks that this means that "a consumer's right to rescind is not affected by the sequence of the rescission procedures or a court order modifying those procedures in both open- and closed-end credit." n164

[8] Remedies for Creditors' Noncompliance With Rescission Requirements

The potential for damages against a noncompliant creditor in a rescission case are greater than in a nonrescission TIL case. First, TIL Simplification made it clear that if the creditor violates any of the requirements of the rescission provisions, a court may award statutory and actual damages for the disclosure violations in addition to rescinding the transaction. n165 Moreover, violations of the rescission provisions are among the violations which themselves give rise to statutory and actual damages. n166 Thus, violations of the rescission notice requirement n167 would give rise to a damage claim under *15 U.S.C. section 1640*, as would violations of the delay of performance rule. n168

Where premature performance operated to undermine the consumer's unqualified three-day cooling off right, it is possible to argue that actual damages equal the amount the consumer would otherwise have to tender. n169 Further, the creditor's failure to properly respond to the consumer's cancellation notice gives rise to a separate damage claim. n170

While assignees are only liable for statutory damages for TIL violations which are apparent on the face of the loan documents assigned, n171 assignees are subject to the rescission right to the same extent as the original creditor. n172 In addition to being liable for statutory damages for disclosure violations appearing on the face of the document, an assignee is independently liable for its own violation of the Act if it fails to respond properly to a rescission notice. n173 A few courts have held that an assignee who rejects or ignores the consumer's rescission is not liable for statutory damages unless the disclosure violations on which the rescission is based are apparent on the face of the documents. n174 These courts reason that section 1640(a) only imposes statutory damages liability on "any creditor." Since the assignee is not a creditor, these courts reason that it cannot be liable for statutory damages except under the assignee liability provisions of section 1641, which impose liability only where the violation is apparent on the face of the documents. But because the assignee in this situation is being held liable for its own action--its failure to rescind--rather than the disclosure violations of the original creditor, this assignee liability standard is a poor fit. Also, it is clear that Congress intended assignees to be liable under section 1640(a), because section 1640(b) provides that "a creditor *or*

assignee has no liability *under this section*" if it corrects errors within a certain time period. If assignees had no liability under section 1640(a), there would be no need for Congress to establish defenses for them. n175 Attorney fees are available in rescission cases. n176

One court has held, n177 however, and another court has suggested, n178 that attorney fees are available against an assignee in a rescission case only if the underlying violation was apparent on the face of the contract. These courts reason that, while rescission is always available against an assignee by virtue of section 1635(c), the right to attorney fees arises under section 1640(a), which makes them available against a "creditor" who fails to comply with TILA. These courts perceive the award of attorney fees at the end of a successful rescission action as separate from rescission, and require the award to meet the test of section 1641(e) that the violations be apparent on the face of the assigned documents. This approach is flawed because it treats the attorney fee award for a rescission action as something separate from rescission. Nonetheless, as a precaution, in cases where the underlying violations are not apparent on the face of the documents, attorneys may wish to rescind against both the original creditor and the assignee. The original creditor is still liable for rescission even though it no longer holds the obligation. n179

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral OverviewContracts LawRemediesRescission & RedhibitionGeneral OverviewReal Property LawPurchase & SaleRemediesRescission & Restitution

FOOTNOTES:
(n1)Footnote 1. This chapter deals with rescission of home-secured transactions. Pursuant to the Higher Education Opportunity Act of 2008 and the regulations adopted by the Federal Reserve Board under it, there is also a right to rescind certain private student loans. *15 U.S.C. § 1638(e)(7).*

(n2)Footnote 2. *15 U.S.C. § 1635*; Reg. Z §§ 226.15 (open-end credit), 226.23 (closed-end credit). *See also* Reg. Z § 226.2(a)(11), (12), (14), (17), (19), (24), and (25) and corresponding commentary sections.

(n3)Footnote 3. For purposes of the rescission rule, the term "transaction" encompasses the addition of a security interest in the consumer's principal dwelling to an existing transaction. Reg. Z § 226.23(a)(1) n.47. However, only the addition of the security interest is rescindable, not the underlying transaction. Official Staff Commentary § 226.23(a)(1)-5.

(n4)Footnote 4. Security interests in the consumer's principal dwelling that arise solely by operation of law, e.g., mechanic's and materialmen's liens, are sufficient to create a right of rescission. *15 U.S.C. § 1635(a)*; Reg. Z § 226.2(a)(25); Official Staff Commentary § 226.2(a)(25)-5. However, only those automatic liens which are part of the credit transaction are subject to the rescission right. Official Staff Commentary §§ 226.15(a)-3, 226.23(a)(1)-1. *See Basnight v. Diamond Developers, Inc., 146 F. Supp. 2d 754 (M.D.N.C. 2001)* (a deed of trust creates a security interest even if it is never recorded); *see also In re Tomasevic, 275 B.R. 86 (Bankr. M.D. Fla. 2001)* (purchase money loan is non-rescindable; disclosure violations do not convert it to a non-purchase money loan). *But see Milligan v. Sentry Exteriors, Inc., 2005 WL 1229791,* at *3 (D.N.J. May 24, 2005) (potential mechanics lien in favor of contractor who arranged secured home-improvement loan does not create right to rescind initial home-improvement contract; court draws untenable distinction between lien securing performance of consumer credit obligation and one securing payment for goods and services; also holds that mechanics lien does not arise solely by operation of law because it arises only upon breach and an arbitrator must approve it). *Scott v. Koons, 2006 U.S. Dist. LEXIS 7560* (N.D. Tex. Feb. 27, 2006) (no right to rescind transaction that did not include security interest in home); *Horton v. First State Bank, 2006 U.S. Dist. LEXIS 7647* (S.D. Ill. Feb. 9, 2006) (If a credit transaction is never consummated, so a security interest is never created, it is not rescindable).

(n5)Footnote 5. *See § 1.03[1] supra.*

(n6)Footnote 6. See generally *§ 1.03[1] supra*, for elaboration on the definition of "regularly."

(n7)Footnote 7. Reg. Z § 226.2(a)(17)(i)(A) n.3; Official Staff Commentary § 226.2(a)(17)(i)-3, -4.

(n8)Footnote 8. Certain high-cost mortgages are subject to special requirements under the Home Ownership and Equity Protection Act of 1994. *15 U.S.C. § 1602(aa)*; Reg. Z § 226.32.

(n9)Footnote 9. Reg. Z § 226.15; Official Staff Commentary § 226.15.

(n10)Footnote 10. However, Official Staff Commentary § 226.15(c)-1 states that a creditor may continue to allow transactions under an existing open-end credit plan during a rescission period that results solely from the addition of a security interest in the consumer's principal dwelling.

(n11)Footnote 11. *15 U.S.C. § 1635(e)(4)*; Reg. Z § 226.15(a)(11); Official Staff Commentary § 226.15(a)(1)-2.

(n12)Footnote 12. *Cf. Mutual Life Ins. Co. v. Bernasek, 235 Kan. 726, 682 P.2d 667 (1984)* (facts necessary to establish equitable estoppel were not present in case where rescission notice given in otherwise exempt transaction); *United Cos. Lending Corp. v. Skwozinski (In re Skwozinski), 2001 Bankr. LEXIS 1306* (Bankr. D.N.H. July 18, 2001) (equitable estoppel shown where borrower signed closing documents in reliance on lender's misrepresentation that he had three-day right to rescind business loan).

(n13)Footnote 13. *15 U.S.C. § 1635(e)(1)*; Reg. Z § 226.23(f)(1). *See, e.g., Bestrom v. Bankers Trust Co. (In re Bestrom), 114 F.3d 741* (8th Cir.) , *cert. denied, 522 U.S. 950, 118 S. Ct. 370, 139 L. Ed. 2d 288 (1997)* ; *Peoples Nat'l Bank v. Molz, 239 Kan. 255, 718 P.2d 306 (1986)* (transaction to finance acquisition of mobile home is not subject to rescission); *D&Y, Inc. v. Winston, 536 A.2d 1169 (Md. Ct. App. 1988)* (land installment contract to purchase dwelling was exempt as a residential mortgage transaction); *Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58 (1986)* (rescission does not cover purchase of principal residence secured by that residence). *See Bolden v. Greenpoint Mortg. Funding, Inc., 2004 U.S. Dist. LEXIS 20508* (N.D. Tex. Oct. 13, 2004) (purchase money loan); *Scott v. Wells Fargo Home Mortg., Inc., 326 F. Supp. 2d 709 (E.D. Va. 2003) , (purchase money loan), aff'd without op., 67 Fed. Appx. 238 (4th Cir. 2003)* ; *Hanson v. Ridge Homes, 1975 Ohio App. LEXIS 6106* (Ohio Ct. App., Belmont County July 8, 1975) (credit to finance construction of home on land already owned by consumer exempt under older version of Reg. Z). *See, e.g., Norwest Bank v. Lopez, 76 P.3d 624 (Haw. App. 2003) . Emery v. Wells Fargo Bank, 2006 U.S. Dist. LEXIS 6817* (D. Ariz. Feb. 16, 2006) ; *Taylor v. Nelson, 2006 U.S. Dist. LEXIS 3860* (E.D. Pa. Jan. 31, 2006) (loan to purchase home); *Nix v. Option One Mortgage Corp., 2006 U.S. Dist. LEXIS 2289* (D.N.J. Jan. 19, 2006) (if loan is to purchase the consumer's personal residence, it is not rescindable); *Vanhoose v. Advantage Homes, Inc., 2003 WL 24270520* (Ct. of C.P. of Ohio, Ross County, July 17, 2003); *Perkins v. Cent. Mortgage Co., 422 F. Supp. 2d 487 (E.D. Pa. 2006)* (loan is non-rescindable when consumers obtained it to pay off construction loan and finance completion of home after contractor walked off job).

(n14)Footnote 14. *15 U.S.C. § 1635(e)(2)*; Reg. Z § 226.23(f)(2). *See, e.g., Kucera v. Citizens Bank & Trust Co., 754 F.2d 280 (8th Cir. 1985)* . Note that there is no corresponding refinancing exception for open-end credit. Reg. Z § 226.15(f). Thus, if a closed-end loan is refinanced by the same creditor with a home equity line of credit, it should be rescindable. *See* Rohner, The Law of Truth in Lending P 8.02[2][b] n.75 (Supp.).

(n15)Footnote 15. If the refinancing involves a new advance, only the amount of the new advance is rescindable. Official Staff Commentary § 226.23(f)-4; *Fidler v. Central Coop. Bank (In re Fidler), 210 B.R. 411 (Bankr. D. Mass. 1997)* , *vacated, in part, reaff'd, in part, on other grounds, 226 B.R. 734 (Bankr. D. Mass. 1998)* .

(n16)Footnote 16. *15 U.S.C. § 1635(e)(2)*; Reg. Z § 226.23(f)(2); Official Staff Commentary § 226.23(f)(2)-4.

(n17)Footnote 17. Official Staff Commentary §§ 226.2(a)(24)-5, 226.20(a)-5, 226.23(f)-4. *See, e.g., Weeden v. Auto Workers Credit Union, Inc., 173 F.3d 857* (6th Cir.) , *reported in full at 1999 U.S. App. LEXIS 5272* (6th Cir. Mar.

19, 1999) , *cert. denied, 528 U.S. 1076, 120 S. Ct. 790, 145 L. Ed. 2d 667 (2000)* (refinancing of a residential mortgage by a creditor other than the original creditor is rescindable); *Apaydin v. Citibank Fed. Sav. Bank (In re Apaydin), 201 B.R. 716 (Bankr. E.D. Pa. 1996)* (acquisition financing credit refinanced by a different creditor was rescindable). *But see Stone & Stone Pension Plan v. Alston, 12 Conn. App. 670, 533 A.2d 898 (1987)* (mortgage loan not refinancing and not rescindable when used to acquire term sales contract).

(n18)Footnote 18. Reg. Z, § 226.23(f)(4); Official Staff Commentary § 226.23(f)-6.

(n19)Footnote 19. *15 U.S.C. § 1635(e)(3)*; Reg. Z §§ 226.15(f)(2), 226.23(f)(3).

(n20)Footnote 20. Official Staff Commentary §§ 226.15(f)-2; 226.23(f)-5.

(n21)Footnote 21. Reg. Z §§ 226.15(a)(1)(i), 226.15(b), 226.17(d), 226.23(a)(1), 226.23(b); *Soto v. PNC Bank (In re Soto), 221 B.R. 343 (Bankr. E.D. Pa. 1998)* ; *Apgar v. Homeside Lending, Inc. (In re Apgar), 291 B.R. 665 (Bankr. E.D. Pa. 2003) . See § 1.08[3][c] infra.*

(n22)Footnote 22. *See* Reg. Z § 226.2(a)(11) (definition of consumer for purposes of right of rescission includes a natural person whose interest in his or her principal dwelling will be subject to the security). The ownership interest does not include inchoate rights such as dower interests. Official Staff Commentary § 226.2(a)(11)-2. *E.g., Westbank v. Maurer, 276 Ill. App. 3d 553, 213 Ill. Dec. 360, 658 N.E.2d 1381 (1995) . See Eveland v. Star Bank, NA 976 F. Supp. 721 (S.D. Ohio 1997)* ; *Jones v. Novastar Mortg., Inc. (In re Jones), 298 B.R. 451 (Bankr. D. Kan. 2003)* (wife who co-signed mortgage securing loan to husband has right to rescind). *But see Citifinancial, Inc. v. Blosser, 2001 Ohio App. LEXIS 2645* (June 15, 2001) (erroneously concluding that creditor did not have to give TIL disclosures to husband whose wife gave security interest on her interest in the home; court does not cite Reg. Z provision to the contrary); *Moazed v. First Union Mortg. Corp., 221 F.R.D. 28 (D. Conn. 2004)* (erroneously concluding that non-obligor spouse who put up home as collateral cannot rescind; court appears to be unaware of contrary Reg. Z and Commentary provisions).

(n23)Footnote 23. Reg. Z § 226.2(a)(11). *See also § 1.08[1] supra.*

(n24)Footnote 24. In non-rescindable transactions, the required disclosures may be given to any consumer who is primarily liable on the account. Reg. Z §§ 226.5(d) (open-end), 226.17(d) (closed-end).

(n25)Footnote 25. *15 U.S.C. § 1635(a)*; Reg. Z §§ 226.5(b), 226.23(b). *See also Cintron v. Bankers Trust Co., 682 So. 2d 616 (Fla. Dist. Ct. App. 1996)* ; *§ 1.08[3][b] infra* .

(n26)Footnote 26. Reg. Z §§ 226.15(b), 226.23(b). *See, e.g., Stone v. Mehlberg, 728 F. Supp. 1341, 1353 (W.D. Mich. 1989)* (each person with an ownership interest must receive two copies; fact that joint obligors are husband and wife is irrelevant, as spouses are not interchangeable under TILA rescission provisions); *Elsner v. Albrecht, 460 N.W.2d 232 (Mich. Ct. App. 1990)* (same); *Kocsis v. Pierce, 480 N.W.2d 598 (Mich. Ct. App. 1991)* .

(n27)Footnote 27. *See, e.g., Stone v. Mehlberg, 728 F. Supp. 1341, 1353 (W.D. Mich. 1989)* (requirement of two notices to each obligor is not a mere technicality; effective exercise of the right "obviously depends upon the delivery of one copy of the rescission notice to the creditor and the retention by the obligor of the other copy"); *Elsner v. Albrecht, 460 N.W.2d 232 (Mich. Ct. App. 1990)* . See also *§ 1.08[6][c][i] infra*, on what constitutes *delivery* of the required TIL information.

(n28)Footnote 28. Reg. Z §§ 226.15(a)(4), 226.23(a)(4).

(n29)Footnote 29. *See Duren v. First Gov't Mortgage & Investors Corp., 2000 U.S. App. LEXIS 15469* (D.C. Cir. June 7, 2000) (unpublished, citation limited) (TILA does not create a presumption that, where a single set of documents was provided, the consumer seeking rescission did not receive the set).

(n30)Footnote 30. As discussed at the beginning of this subsection, the definition of consumer for purposes of the rescission right includes any natural person whose ownership interest in his or her principal dwelling is subject to the security interest irrespective of whether the person is obligated on the note or not. Reg. Z § 226.2(a)(11).

(n31)Footnote 31. Reg. Z §§ 226.15(a)(4), 226.23(a)(4).

(n32)Footnote 32. Official Staff Commentary §§ 226.15(a)(4)-1, 226.23(a)(4)-1. *See also FDIC v. Hughes, 684 F. Supp. 616, 624 (D. Minn. 1988)* ; *In re Gurst, 1988 U.S. Dist. LEXIS 7524* (E.D. Pa. July 25, 1988) ; *Desrosiers v. Transamerica Fin. Corp. (In re Desrosiers), 212 B.R. 716 (Bankr. D. Mass. 1997)* (in addition, res judicata consequences can occur where one spouse rescinds and files an affirmative case that is later dismissed. If the dismissal is a final adjudication on the merits, the other spouse may be prevented from subsequently rescinding the transaction).

(n33)Footnote 33. *In re Pinder, 83 B.R. 905, 913 (Bankr. E.D. Pa. 1988)* (emphasis in original). *See also In re Herbert, 86 B.R. 433 (Bankr. E.D. Pa. 1988)* (where debtor testified as to nonreceipt, burden shifted to more knowledgeable creditor to produce disclosure statement; if none produced, court cannot assume one exists). *Cf. Eveland v. Star Bank, 1999 U.S. App. LEXIS 20351* (6th Cir. Aug. 19, 1999) (upholding jury finding that debtors were given rescission forms where testimony was conflicting). See National Consumer Law Center, Truth in Lending §§ 4.2.7 and 10.3.2 (5th ed. 2003 and supp.), for additional cases on delivery.

(n34)Footnote 34. *15 U.S.C. § 1635(c). See Walker v. Michael W. Colton Trust, 33 F. Supp. 2d 585 (E.D. Mich. 1999)* ; National Consumer Law Center, Truth in Lending § 4.3.1 (5th ed. 2003 and supp.).

(n35)Footnote 35. *In re Pinder, 83 B.R. 905, 913 (Bankr. E.D. Pa. 1988)* .

(n36)Footnote 36. *Payne v. Equicredit Corp. of Am., 2002 U.S. Dist. LEXIS 8919* (E.D. Pa. May 20, 2002) (testimony unnecessary). *See In re Underwood, 66 B.R. 656 (Bankr. W.D. Va. 1986)* (court was persuaded that notice had not been delivered by the consumer's affidavits and testimony, the discrepancy in dates on the Notice of Right to Cancel and disclosure statement, and the creditor's failure to introduce witnesses to rebut the consumer's assertion of nondelivery). *See also Walker v. Michael W. Colton Trust, 33 F. Supp. 2d 585 (E.D. Mich. 1999)* (court would give no effect to acknowledgment if consumer proved that signature was forged); *Jackson v. US Bank Nat'l Ass'n Trustee (In re Jackson), 245 B.R. 23 (Bankr. E.D. Pa. 2000)* (debtors rebutted acknowledgment of receipt of HOEPA advance look disclosures through their testimony and by showing that disclosures included a loan amount that was not contemplated until after date on which creditor claimed to have mailed disclosures); *Williams v. Gelt Fin. Corp. (In re Williams), 232 B.R. 629 (Bankr. E.D. Pa. 1999)* , *aff'd*, *237 B.R. 590 (E.D. Pa. 1999)* (debtor's positive, unqualified testimony that he did not receive disclosures, countered only by vague and confused creditor testimony, rebutted presumption of receipt); *Cole v. Lovett, 672 F. Supp. 947 (S.D. Miss. 1987)* (evidence that borrowers signed documents seeing only signature lines and were given impression they were bound to proceed with contract rebuts the presumption of delivery of the notices), *aff'd without opinion*, *833 F.2d 1008 (5th Cir. 1987)* ; *Cintron v. Bankers Trust Co., 682 So. 2d 616 (Fla. Dist. Ct. App. 1996)* (facts which consumers alleged to rebut presumption are not clear from the decision, but they were sufficient to reverse trial court's grant of summary judgment in foreclosure action). *But cf. Young v. 1st Am. Fin. Servs., 992 F. Supp. 440 (D.D.C. 1998)* (court found that the consumer failed to rebut presumption of delivery by failing to show that the notice, though mailed to him *after* settlement, did not reach him in time to give him three days to cancel; court incorrectly calculated when the three days began to run as consumer, by definition, did not have three days to cancel if the notice was not mailed until after the closing and the expiration date on the notice gave only three days from closing to cancel); *In re Rhoades, 80 B.R. 938, 940 (Bankr. C.D. Ill. 1987)* (the creditor had in its records a copy of a rescission notice with a signed acknowledgment of receipt; the court, applying the clear and convincing evidence standard, held that the debtor did not rebut the presumption because she testified that she had thrown out "some loan papers," though she testified that they were for an earlier loan, and had found other papers in the course of preparing for trial). *But cf. Gaona v. Town & Country Credit, 2001 U.S. Dist. LEXIS 20443* (D. Minn. Nov. 20, 2001) , *aff'd in part, rev'd in part, remanded*, *324 F.3d 1050 (8th Cir. 2003)* (consumers' testimony that no rescission notices were in their file was insufficient to rebut presumption of receipt, as there could be other explanations for their absence).

(n37)Footnote 37. *15 U.S.C. § 1641(b).*

(n38)Footnote 38. Reg. Z §§ 226.5(a)(1), 226.17(a)(1). These general requirements apply to all disclosures required by subparts B (open-end credit) and C (closed-end credit), respectively. Since the rescission notices are among the disclosures required by those subparts (§ 226.15 and § 226.23, respectively), those general requirements are applicable. *See also 15 U.S.C. § 1635(a)*; Reg. Z §§ 226.15(b), 226.23(b) (required information concerning notice of right to rescind must be given clearly and conspicuously).

(n39)Footnote 39. *See, e.g., Porter v. Mid-Penn Consumer Disc., 961 F.2d 1066 (3d Cir. 1992)* (ambiguous notice did not provide clear notice of consumer's rescission rights).

(n40)Footnote 40. Reg. Z § 226.23(b). *See Reynolds v. D&N Bank, 792 F. Supp. 1035 (E.D. Mich. 1992)* . So long as the required information is clear and conspicuous, some other information, such as the itemization of the amount financed, may appear on that document. Official Staff Commentary § 226.23(b)-2. *See also* Reg. Z app. H.

(n41)Footnote 41. Reg. Z § 226.15(b); Official Staff Commentary § 226.15(b)-2, app. G.

(n42)Footnote 42. Reg. Z §§ 226.15(b), 226.23(b). *See also* Official Staff Commentary § 226.15(b)-3.

(n43)Footnote 43. Reg. Z §§ 226.15(b); 226.23(b).

(n44)Footnote 44. *See, e.g., Reynolds v. D&N Bank, 792 F. Supp. 1035 (E.D. Mich. 1992)* .

(n45)Footnote 45. *See, e.g., Murphy v. Empire of Am. FSA, 583 F. Supp. 1563, 1566 (W.D.N.Y. 1984)* , *aff'd on other grounds, 746 F.2d 931 (2d Cir. 1984)* ("right to rescind notice" was an FRB model form and, therefore, sufficient even though it did not use the word "consummation").

(n46)Footnote 46. Violation found in *Reynolds v. D&N Bank, 792 F. Supp. 1035 (E.D. Mich. 1992)* . This particular requirement was the subject of some of the 1995 statutory amendments to TILA. *See § 1.08[6][c] infra.*

(n47)Footnote 47. *See, e.g., Semar v. Platte Valley Fed. Sav. & Loan Ass'n, 791 F.2d 699 (9th Cir. 1986)* (rescission notice which omitted the expiration date, although it stated that the right expired three business days after July 16, violated TILA and entitled the borrowers to rescind the transaction); *Williamson v. Lafferty, 698 F.2d 767 (5th Cir. 1983)* (failure to fill in expiration date violated pre-Simplification TILA). *Cf. Kramer v. Home Sav. of Am., F.S.B., 721 So. 2d 1239 (Fla. Dist. Ct. App. 1998)* (notice that gave borrower four days instead of three to rescind did not violate TILA).

(n48)Footnote 48. Official Staff Commentary §§ 226.15(b)-3, 226.23(b)-3.

(n49)Footnote 49. Reg. Z apps. G and H.

(n50)Footnote 50. *15 U.S.C. § 1604(b).*

(n51)Footnote 51. *Id. See Stanley v. Household Fin. Corp. (In re Stanley), 315 B.R. 602 (Bankr. D. Kan. 2004)* ; Cruz v. Household Fin. Consumer Discount Co. (*In re* Cruz), Clearinghouse No. 55629 (Bankr. E.D. Pa. Nov. 1, 2004) (Bankr. No. 03-17888); *Finch v. Household Fin. Corp. III (In re Finch), 2003 Bankr. LEXIS 2049* (Bankr. D. Kan. Nov. 7, 2003) (creditor's additions and alterations to form also made it less concise and less clear, but court finds it unnecessary to decide whether these flaws alone would extend right to rescind).

(n52)Footnote 52. *See Finch v. Household Fin. Corp. III (In re Finch), 2003 Bankr. LEXIS 2049* (Bankr. D. Kan. Nov. 7, 2003) .

(n53)Footnote 53. *Id.*

(n54)Footnote 54. Reg. Z §§ 226.15(b), 226.23(b)(1), *as published at 66 Fed. Reg. 17,329* (Mar. 30, 2001), *mandatory compliance date suspended, 66 Fed. Reg. 41,439* (Aug. 8, 2001).

(n55)Footnote 55. *15 U.S.C. § 1635(a)*; Reg. Z §§ 226.15(a), 226.23(a); Official Staff Commentary §§ 226.15(b)-1, 226.23(b)-1. With the 1995 amendments to TIL, the target range for what constitutes a "correct" disclosure broadened considerably in the case of the finance charge and disclosures affected by an error in the finance charge.

(n56)Footnote 56. The definition of "material disclosure" requires the material information to be disclosed "as required in this title." *15 U.S.C. § 1602(u)*. "This title" requires that the disclosures be made clearly and conspicuously. The quoted language would be surplusage if those general requirements were not considered incorporated by it. See also Reg. Z §§ 226.5(a), 226.17(a), setting forth general requirements for all disclosures required by Subparts B and C, respectively, which encompasses both the rescission notices and material disclosures. At least one court has stated, however, that a creditor's failure to disclose the finance charge and the APR "more conspicuously" than the other disclosures, would not extend the right of rescission. *Malfa v. Household Bank, F.S.B., 825 F. Supp. 1018 (S.D. Fla. 1993)* . Standards for what constitutes "clearly and conspicuously" are discussed at *§ 1.05[2][a]* (closed-end) and *§ 1.07[2]* (open-end) *supra*.

(n57)Footnote 57. *15 U.S.C. § 1602(u)*; Reg. Z § 226.23(a)(3) n.48; *Barsky v. Commercial Credit Corp. (In re Barsky), 210 B.R. 683 (Bankr. E.D. Pa. 1997)* (failure to properly disclose a security interest is not a "material" non-disclosure for rescission purposes). *See Mayfield v. General Elec. Capital Corp., 1999 U.S. Dist. LEXIS 4048* (S.D.N.Y. Mar. 31, 1999) (possibility of mechanic's lien need not be disclosed under TILA and would not be a material disclosure in any event).

(n58)Footnote 58. Official Staff Commentary § 226.23(a)(3)-2. *Cf. In re Ramsey, 176 B.R. 183 (Bankr. 9th Cir. 1994)* . Borrower who brings action based on overstatement of the actual APR must demonstrate "detrimental reliance" on the overstatement in order to be entitled to the three-year rescission period. N.B.: 1995 TILA amendments provide that an overstatement of the finance charge and affected disclosures may be considered accurate. *15 U.S.C. §§ 1605(f)(1)(B)* (prospectively), 1649(a)(3)(c) (retroactively), 1635(i)(2) (prospective and retroactive rescission as a foreclosure defense).

(n59)Footnote 59. *See, e.g., In re Underwood, 66 B.R. 656 (Bankr. W.D. Va. 1986)* ($7,680 understatement of finance charge is a failure to correctly make a material disclosure). *See also* Hunter v. Richmond Equity Corp., Clearinghouse No. 43,060, No. CV85-P-2734-5 (N.D. Ala. Nov. 23, 1987).

(n60)Footnote 60. *Cf. In re Ramsey, 176 B.R. 183 (Bankr. 9th Cir. 1994)* (no rescission based on inaccurate disclosure of total amount financed, where borrower himself requested changes in terms and so was fully aware of them).

(n61)Footnote 61. *But see 15 U.S.C. § 1635(i)* (special rule for rescission as foreclosure defense, discussed below). Certain cases already in progress are exempted from the retroactive immunity. See generally *§ 1.05[2][e][ii][A] supra* for tolerance levels applicable outside the rescission context.

(n62)Footnote 62. *15 U.S.C. § 1605(f)(2)(A)*. In contrast, the general tolerance was set at $100, *15 U.S.C. § 1605(f)(1)(A)*. It seems that retroactively, the general $200 tolerance may serve as a floor for these percentage-based rescission tolerances, though that apparently was not the intent. *See § 1.05[2][e][ii][A] supra, § 1.09[2][h] infra*.

(n63)Footnote 63. That is, residential mortgage transactions as defined in *15 U.S.C. § 1602(w)*, which themselves are exempt from the rescission right. *See § 1.08[2] supra*.

(n64)Footnote 64. *15 U.S.C. § 1605(f)(2)(B)*.

(n65)Footnote 65. *15 U.S.C. § 1605(f)(2)(B)*. The language of the statute casts as absolute the requirement that

there must be no new funds advanced to qualify. However, creditors are likely to ask the FRB to interpret "new advances" to exclude the cost of refinancing. *Cf.* Official Staff Commentary § 226.23(f)-4. *See also* Statement of Sen. D'Amato, Cong. Rec. S14567 (Sept. 28, 1995).

(n66)Footnote 66. *15 U.S.C. § 1605(f)(2)(B)*. Apparently all HOEP loans, including no new-advance refinances, will be subject to the 1/2 of 1% tolerance.

(n67)Footnote 67. *15 U.S.C. § 1635(i)(2)*. Overstating the finance charge is considered accurate under the new amendment.

(n68)Footnote 68. Reg. Z § 226.23(h)(1)(I); Official Staff Commentary § 226.23(h)(i)-1. *See also Santoro v. CTC Foreclosure Serv. Corp., 2001 U.S. App. LEXIS 5024* (9th Cir. Mar. 20, 2001) (unpublished, citation limited) (defensive rescission allowed only if inclusion of borrower-paid broker fees in amount financed was disclosure violation under law in effect at time of consummation).

(n69)Footnote 69. *15 U.S.C. § 1635(i)(4)*. *See generally § 1.08[6] infra*.

(n70)Footnote 70. *15 U.S.C. §§ 1649(a), (b)*. *Editor's Note*: These provisions were intended to apply only to closed-end, real-estate secured lenders, though a drafting error made them appear more broad. A retroactive technical correction was adopted in 1996.

(n71)Footnote 71. *15 U.S.C. § 1602(u)*; Reg. Z § 226.15(a)(3) n.36.

(n72)Footnote 72. Official Staff Commentary § 226.15(a)(3)-3.

(n73)Footnote 73. Reg. Z § 226.15(a)(3) n.36. *See also* Official Staff Commentary § 226.15(a)(3)-2 (repayment terms required by § 226.6(e)(2) for the repayment phase as well as the draw phase are material disclosures; other required initial disclosures or § 226.5b disclosures do not give rise to the extended right, though violations may give rise to civil or administrative liability).

(n74)Footnote 74. *15 U.S.C. §§ 1602(aa), 1639*. *See generally* Ch. 2 *infra*.

(n75)Footnote 75. *See § 1.08[6][c] infra*.

(n76)Footnote 76. For rescission purposes only, "business days" means all calendar days except Sundays and specified legal holidays. Reg. Z § 226.2(a)(6); Official Staff Commentary § 226.2(a)(6)-2. The Commentary was amended effective April 9, 2002, to state that when New Year's Day, Independence Day, Veterans Day, or Christmas Day falls on a weekend but is observed on the preceding or following weekday, the actual day rather than the observed day is considered the non-business day. For example, if July 4th falls on a Saturday but government offices are closed on the preceding Friday, Saturday is a holiday and Friday is a business day. *66 Fed. Reg. 16,980, 16,982* (Apr. 9, 2002) .

(n77)Footnote 77. Consummation is the point at which the consumer becomes contractually obligated on a credit transaction, determined by reference to state law. Reg. Z § 226.2(a)(13); Official Staff Commentary § 226.2(a)(13). *O'Brien v. Aames Funding Corp., 374 F. Supp. 2d 764 (D. Minn. 2005)* (consummation occurred when borrower became obligated, even though closing on a second loan and providing those proceeds to the first lender was a condition precedent to the first lender's obligation to disburse funds).

(n78)Footnote 78. The date of "delivery" is the date upon which the required material disclosures and notice of right to rescind are given to the consumers in a form they may keep. Reg. Z §§ 226.5(a)(1), 226.17(a)(1).

(n79)Footnote 79. *15 U.S.C. § 1635(a)*; Reg. Z §§ 226.15(a)(4), 226.23(a)(3).

(n80)Footnote 80. *15 U.S.C. § 1635(f)*; Reg. Z § 226.15(a)(3), 226.23(a)(3). *See § 1.08[6][c] infra*. The Massachusetts statute of limitations on truth in lending claims is four years for damages and rescission. Mass. Gen. L. 140D § 10(f) and 260 § 5A. *See In re Myers, 175 B.R. 122 (Bankr. D. Mass. 1994)* ; Bourgeois v. Mortgage Funding Corp. (*In re* Bourgeois), No. 95-12036-WCH, Adv. No. 95-1541, Clearinghouse No. 52,162 (Bankr. D. Mass. Mar. 6, 1998).

(n81)Footnote 81. See *§§ 1.08[3][b]* and *1.08[6][c] infra* for discussion of the proper disclosure of the mandatory information.

(n82)Footnote 82. For open-end transactions, the three years is measured from "the occurrence giving rise to the right of rescission," Reg. Z § 226.15(a)(3), rather than loan consummation, as is the case with closed-end transactions. Reg. Z § 226.23(a)(3). *But cf. Pocatello R.R. Employees Fed. Credit Union v. Galloway, 117 Idaho 739, 791 P.2d 1318 (Ct. App. 1990)* (court erroneously applies one-year statute of limitations to rescission claim where material disclosure violations had been alleged and proven). *See also Belini v. Washington Mutual Bank, 412 F.3d 17 (1st Cir. 2005)* (stating that suit for damages for failure to respond properly to rescission notice must be filed within one year after "occurrence," which court says is probably twenty days after creditor's receipt of rescission notice).

(n83)Footnote 83. *Weber v. Langholz, 39 Cal. App. 4th 1578, 46 Cal. Rptr. 2d 677 (1995)* (rule applied). *See also Dailey v. Leshin, 2001 Fla. App. LEXIS 8304* (June 20, 2001) (right to rescind expires upon signing of contract to sell home, whether or not contract is irrevocable; presumably right would "reawaken" if sale fell through); Willis v. Friedman, Clearinghouse No. 54,564 (Md. Spec. App. May 2, 2002) (under Maryland's foreclosure procedure, which is a hybrid between judicial and non-judicial, right to rescind expires upon foreclosure sale, but if borrower rescinds prior to sale the rescission can be raised as an objection to the sale during the ratification stage).

(n84)Footnote 84. *15 U.S.C. § 1635(f)*; Reg. Z §§ 226.15(a)(3), 226.23(a)(3). In order to cut off rescission rights, the TIL Regulation requires that *all* of the consumer's interest have been transferred. Reg. Z §§ 226.23(a)(3), 226.15(a)(3). *See Kemezis v. Matthew, 2008 U.S. Dist. LEXIS 47330* (E.D. Pa. June 16, 2008) (dismissing rescission claim because property sold). *Blue v. Fremont Inv. & Loan, 562 F. Supp. 2d 33 (D.D.C. 2008)* (foreclosure sale eight months before rescission complaint filed barred rescission).

(n85)Footnote 85. Official Staff Commentary § 226.23(a)(3)-3. *See, e.g., Bestrom v. Bankers Trust Co. (In re Bestrom), 114 F.3d 741 (8th Cir. 1997)* (where purchase money mortgagor bought house at foreclosure sale and the state redemption period had passed, homeowner lost legal title; new mortgage to re-acquire property back from foreclosing lender constituted an "acquisition" loan and not subject to rescission right [note that court mistakenly concluded that this mortgage loan was not subject to "TILA"]); *Hallas v. Ameriquest Mortgage Co., 406 F. Supp. 2d 1176 (D. Or. 2005)* (foreclosure sale terminated right to rescind).

(n86)Footnote 86. *Walker v. Contimortgage (In re Walker), 232 B.R. 725, 732 (Bankr. N.D. Ill. 1999)* ("once there has been a final foreclosure sale of the borrower's principal residence and the redemption period has expired, the right to rescind will be terminated"). *But see Marschner v. RJR Fin. Servs., Inc., 382 F. Supp. 2d 918 (E.D. Mich. 2005)* (right to rescind did not continue during redemption period when consumer did not in fact redeem); *Williams v. G.M. Mortgage Corp., 2004 U.S. Dist. LEXIS 29365* (E.D. Mich. Aug. 18, 2004) (rescission right terminates upon foreclosure sale, not upon expiration of redemption period).

(n87)Footnote 87. *See Abele v. Mid-Penn Consumer Disc., 77 B.R. 460, 467 (E.D. Pa. 1987) , aff'd mem., 845 F.2d 1009 (3d Cir. 1988)* (though TILA enumerates circumstances upon which right to rescind expires, repayment of the credit extended is not one of them). Reg. Z, § 226.23(a)(3).

(n88)Footnote 88. *784 F.2d 910 (9th Cir. 1986) , cert. denied, 484 U.S. 802, 108 S. Ct. 47, 98 L. Ed. 2d 11 (1987) . See also Coleman v. Equicredit Corp., 2002 U.S. Dist. LEXIS 969,* at *4 (N.D. Ill. Jan. 22, 2002) (after refinancing "there is nothing to rescind"). *See also Monaco v. Bear Stearns Residential Mortgage Corp., 554 F. Supp. 2d 1034*

(C.D. Cal. 2008) (under *King*, federal courts in Ninth Circuit may not give effect to rescission post-refinancing).

(n89)Footnote 89. *Duren v. First Gov't Mortgage & Investors Corp., 2000 U.S. App. LEXIS 15469,* at *7 (D.C. Cir. June 7, 2000) ("[W]e disagree with First Government's contention that the refinancing of the 1994 loan rendered unavailable TILA's statutory rescission remedy, notwithstanding the Ninth Circuit's terse suggestion to the contrary in *King*. ..."). *Barrett v. JP Morgan Chase Bank, 445 F.3d 874, 879 (6th Cir. 2006)* .

(n90)Footnote 90. *E.g., Mayfield v. Vanguard Sav. & Loan Ass'n, 710 F. Supp. 143 (E.D. Pa. 1989)* (both current and prior refinanced loan rescinded); *Abele v. Mid-Penn Consumer Disc., 77 B.R. 460, 467 (E.D. Pa. 1987)* , *aff'd mem., 845 F.2d 1009 (3d Cir. 1988)* (4 in series of refinancings rescinded); *In re Milbourne, 108 B.R. 522 (Bankr. E.D. Pa. 1989)* ; *see also Wiggins v. Avco Fin. Servs., 62 F. Supp. 2d 90 (D.D.C. 1999)* (rescission allowed even though debtors paid off loan after sending rescission notice); *In re Tucker, 74 B.R. 923 (Bankr. E.D. Pa. 1987)* (debtor could have rescinded earlier, refinanced loans, though did not seek rescission). *See, e.g., Payton v. New Century Mortg. Corp., 2003 U.S. Dist. LEXIS 18366* (N.D. Ill. Oct. 14, 2003) . *See also* Pac. Shore Funding v. Lozo, *42 Cal. Rptr. 3d 283 (App. 2006)* (spelling out monetary impact of rescinding refinanced loan).

(n91)Footnote 91. Reg. Z §§ 226.15(c), 226.23(c).

(n92)Footnote 92. 16 C.F.R. § 429. *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 9.2.1 (7th ed. 2008 and supp.).

(n93)Footnote 93. National Consumer Law Center, Unfair and Deceptive Acts and Practices § 9.2.2 (7th ed. 2008 and supp.).

(n94)Footnote 94. *15 U.S.C. § 1635(d)*; Reg. Z §§ 226.15(e), 226.23(e). In 1994, Congress directed the FRB to study the question of whether waivers should be made more easy to obtain on new creditor refinances where there are no new advances. *See 59 Fed. Reg. 65,771* (Dec. 21, 1994) . The FRB issued a report to Congress on "Consumer Waivers of the Right of Rescission Under the Truth in Lending Act" in March 1995. Advocates should monitor developments.

(n95)Footnote 95. Official Staff Commentary §§ 226.15(e)-1, 226.23(e)-1.

(n96)Footnote 96. *See, e.g.*, Hunter v. Richmond Equity Corp., Clearinghouse No. 43,060, No. CV-P-2734-S (N.D. Ala. Nov. 23, 1987) (pre-printed waiver forms prohibited); *Wiggins v. Avco Fin. Servs., 62 F. Supp. 2d 90 (D.D.C. 1999)* (use of pre-printed form to waive right to rescission was violation).

(n97)Footnote 97. *See, e.g., Mortgage Mint Corp. v. Morgan, 708 P.2d 1177 (Or. Ct. App. 1985)* (handwritten statement describing consumers' need for immediate disbursal of funds for daughter's medical attention and waiving right of rescission was valid, in absence of evidence of overreaching by the creditor, even though the reasons for the waiver were false; the lender had no duty to investigate the facts underlying the waiver to determine if the reasons were genuine); *Feinerman v. Barrett, 673 A.2d 1341 (Me. 1996)* (part of typed waiver of right to cancel which contained a description of the emergency was handwritten; Maine court held a valid waiver applying Massachusetts TIL (identical to federal TIL on this point)). *But see Palmer v. Statewide Group, Inc., 134 F.3d 378 (9th Cir. 1998)* , *reported in full at 1998 U.S. App. LEXIS 1497* (9th Cir. Feb. 2, 1998) (waiver which lacked description of the emergency, stating only that consumer had a "personal financial emergency," was invalid).

(n98)Footnote 98. *See, e.g., In re* Rivera, Clearinghouse No. 47,715 (Bankr. E.D. Cal. 1991) (handwritten note that consumer wanted to close right away due to hardship did not act as waiver of right to rescind; it did not specifically waive right to cancel; apparently note had also been written upon instruction of creditor's agent).

(n99)Footnote 99. Reg. Z §§ 226.15(e), 226.23(e).

(n100)Footnote 100. *Family Fin. Servs. v. Spencer, 677 A.2d 479 (Conn. App. Ct. 1996)* (creditor's failure to accept rescission notice nullified the mortgage, barring creditor from foreclosure); *Yslas v. D.K. Guenther Builders, Inc., 342 So. 2d 859 (Fla. Dist. Ct. App. 1977)* ; Willis v. Friedman, Clearinghouse No. 54,564 (Md. Ct. Spec. App. May 2, 2002); *Community Nat'l Bank & Trust v. McClammy, 525 N.Y.S.2d 629 (App. Div. 1988)* (if rescission claim established, would be defense to a foreclosure on a nine-year-old mortgage).

(n101)Footnote 101. *See, e.g.*, Lopez v. Delta Funding Corp., Clearinghouse No. 52,140, No. CV 98-7204 (CPS) (E.D.N.Y. Dec. 23, 1998) (foreclosure sale enjoined; indigent elderly homeowners not required to post bond); *Thomas v. F.F. Fin., Inc., 1989 U.S. Dist. LEXIS 3696* (S.D.N.Y. Apr. 11, 1989) (preliminary injunction granted against foreclosure where homeowner-plaintiff alleged she had rescinded, the creditor-defendant had failed to tender back to borrower fees and costs collected as required, and mortgage was null and void; court held no bond was required, since there was no prior mortgage on the property and therefore there was adequate security against any damages arising from injunction for creditor-defendant even if it prevailed on the merits).

(n102)Footnote 102. For finance charge and related tolerance, see *15 U.S.C. § 1635(i)(2)*; for brokers fees as a finance charge, see *15 U.S.C. § 1635(i)(1)(A)*.; for form of notice of right to cancel, see *15 U.S.C. § 1635(i)(1)(B)*. The 1996 revision of Regulation Z applied the special foreclosure defense rescission rules only to closed-end transactions (Reg. Z § 226.23(h)), though this is contrary to the clear letter of the statute and consequently challengeable.

(n103)Footnote 103. *15 U.S.C. § 1635(i)(2)*. Other TIL remedies may not be subject to this special tolerance rule, even in foreclosure.

(n104)Footnote 104. *15 U.S.C. § 1635(i)(1)(A)*. *See Santoro v. CTC Foreclosure Serv. Corp., 2001 U.S. App. LEXIS 5024* (9th Cir. Mar. 20, 2001) (unpublished, citation limited).

(n105)Footnote 105. *15 U.S.C. § 1635(i)(1)* provides that the broker-fee-based right applies "*in addition* to any other right of rescission" available under § 1635. *See* Supplementary Information to 1996 revision of Regulation Z, *61 Fed. Reg. 49,237, 49,243* (Sept. 19, 1996) ("The 1995 Amendments also allow a consumer to rescind a loan in foreclosure if a mortgage broker fee was not properly disclosed, *without regard to the dollar amount involved*." Emphasis added). The 1997 Commentary makes clear that if a broker fee which should have been included in the finance is entirely omitted, the consumer may rescind without regard to the amount. Official Staff Commentary § 226.23(h)(1)(i); *62 Fed. Reg. 10,193, 10,198* (Mar. 6, 1997). If the amount of the broker fee is included in the finance charge, the $35 tolerance applies. The accuracy of the finance charge is based upon the accuracy of the total charge, rather than upon its component parts. Official Staff Commentary § 226.23(h)(1)(i) and (h)(2); *62 Fed. Reg. 10,193, 10,198* (Mar. 6, 1997) .

(n106)Footnote 106. *15 U.S.C. § 1635(i)(1)(B)*. Note all other notice requirements were unaffected by the amendments, and, hence, remain in place.

(n107)Footnote 107. *See Riopta v. Amresco Residential Mortgage Corp., 101 F. Supp. 2d 1326 (D. Haw. 1999)* .

(n108)Footnote 108. *15 U.S.C. § 1635(i)(2)*. *See. Stump v. WMC Mortg. Corp., 2005 U.S. Dist. LEXIS 4304* at *23 n.3 (E.D. Pa. Mar. 16, 2005) ($35 tolerance did not apply where no foreclosure had been initiated and bankruptcy automatic stay prohibited initiation of foreclosure).

(n109)Footnote 109. *See § 1.08[3][c] supra*.

(n110)Footnote 110. *Barsky v. Commercial Credit Corp. (In re Barsky), 210 B.R. 683 (Bankr. E.D. Pa. 1997)* ; *Fidler v. Century Coop. Bank (In re Fidler), 210 B.R. 411 (Bankr. D. Mass. 1997)* , *vacated, in part, reaff'd, in part, 226 B.R. 734 (Bankr. D. Mass. 1998)* ; *Botelho v. Citicorp Mortgage, Inc. (In re Botelho), 195 B.R. 558 (Bankr. D. Mass. 1996)* , *aff'd*, Case No. 96-12279-EFH (D. Mass. Mar. 7, 1997); *In re* Shaw (Shaw v. Federal Mortgage & Inv. Corp.), *178 B.R. 380 (Bankr. D.N.J. 1994)* ; *Westbank v. Maurer, 276 Ill. App. 3d 553, 213 Ill. Dec. 360, 658 N.E.2d 1381*

(1995) ; *FDIC v. Ablin, 532 N.E.2d 379 (Ill. App. Ct. 1988)* (four-year old contract); *Community Nat'l Bank & Trust Co. v. McClammy, 525 N.Y.S.2d 629 (App. Div. 1988)* (TIL rescission claims, if established, would be permitted as defense to foreclosure on 8-year old contract); *Dawe v. Merchants Mortgage & Trust Corp., 683 P.2d 796 (Colo. 1984)* . *Contra Beach v. Great W. Bank, 692 So. 2d 146 (Fla. 1997)* , *aff'd sub nom. Beach v. Ocwen Fed. Bank, 523 U.S. 410, 118 S. Ct. 1408, 140 L. Ed. 2d 566 (1998)* .

(n111)Footnote 111. *523 U.S. 410, 118 S. Ct. 1408, 140 L. Ed. 2d 566 (1998)* . *See also Williams v. EMC Mortgage Corp. (In re Williams), 276 B.R. 394 (Bankr. E.D. Pa. 2002)* (following *Beach*). *Cf. Wepsic v. Bankers Trust Co., 23 Fed. Appx. 694, 2001 U.S. App. LEXIS 24754 (9th Cir. 2001)* (unreported, citation limited) (applying 3-year bar).

(n112)Footnote 112. *Beach, 140 L. Ed. 2d at 574 n.6* . *See, e.g., Fidler v. Central Coop. Bank (In re Fidler), 210 B.R. 411 (Bankr. D. Mass. 1997)* , *vacated, in part, reaff'd, in part, 226 B.R. 734 (Bankr. D. Mass. 1998)* (earlier decision allowing federal TIL rescission by recoupment beyond three years reversed in conformance to *Beach*, but rescission by recoupment beyond three years upheld pursuant to Massachusetts law). For a more complete discussion of *Beach*, see National Consumer Law Center, Truth in Lending § 6.3.3.1 (6th ed. 2007 and Supp.).

(n113)Footnote 113. *15 U.S.C. § 1635(i)(3)*. There are still arguments that can be raised in favor of rescission by recoupment in some situations. *See* National Consumer Law Center, Truth in Lending §§ 6.3.3.2 to 6.3.3.7 (6th ed. 2007 and Supp.). Many states have disclosure statutes that are similar in at least some respects to TILA. Connecticut, Maine, Oklahoma, and Wyoming are of particular importance because they, like Massachusetts, have been exempted by the FRB from some of the requirements of TILA. Official Staff Commentary § 226.29(a)-4. In those states, whether rescission can be asserted by way of recoupment will be a question of state, not federal, law.

(n114)Footnote 114. *226 B.R. 734 (Bankr. D. Mass. 1998)* . *Accord* Bourgeois v. Mortgage Funding Corp. (*In re* Bourgeois), No. 95-12036-WCH, Adv. No. 95-1541, Clearinghouse No. 52,485 (Bankr. D. Mass. Mar. 16, 1998) (pre-*Beach* case allowing rescission by recoupment under Massachusetts disclosure law). *Cf. Green Tree Acceptance, Inc., v. Anderson, 981 P.2d 804 (Okla. Civ. App. 1999)* (applying *Beach* reasoning to bar rescission by recoupment after 3-year period under Oklahoma disclosure law).

(n115)Footnote 115. The *Fidler* court stated: "[e]ven if this case were governed by TILA, § 1635(i)(3), which provides that '[n]othing in this subsection affects a consumer's right of rescission in recoupment under State law,' would direct my inquiry to [the Massachusetts TIL-type statute] and other Massachusetts law concerning recoupment." *226 B.R. at 736 n.6* .

(n116)Footnote 116. *15 U.S.C. § 1602(u)*; Reg. Z § 226.23(a)(3) n.48; *see Pulphus v. Sullivan, 2003 U.S. Dist. LEXIS 7080* (N.D. Ill. Apr. 25, 2003) (providing two different disclosure statements at closing was material violation). The required "material" disclosures are discussed at *§ 1.08[3] supra*. *See* Kitchen v. Ameriquest Mortg. Co., Clearinghouse No. 55,628 (N.D. Ga. Apr. 29, 2005) (No. 1:04-CV-2750-BBM) (materiality not determined by whether reasonable consumer would view information as significant, but by whether disclosure is listed in § 1602(u)).

(n117)Footnote 117. *15 U.S.C. § 1635(f)*.

(n118)Footnote 118. Reg. Z §§ 226.15(a)(3), 226.23(a)(3).

(n119)Footnote 119. Reg. Z §§ 226.15(b), 226.23(b). *See Weeden v. Auto Workers Credit Union, Inc., 173 F.3d 857* (6th Cir.) , *reported in full at 1999 U.S. App. LEXIS 5272* (6th Cir. Mar. 19, 1999) , *cert. denied, 528 U.S. 1076, 120 S. Ct. 790, 145 L. Ed. 2d 667 (2000)* (right to rescind is extended if each obligor is not given two copies of notice of right to rescind). *See also Webster v. Centex Home Equity Corp. (In re Webster), 300 B.R. 787 (Bankr. W.D. Okla. 2003)* (failure to give two copies of notice of right to cancel extends right to rescind); *Payton v. New Century Mortg. Corp., 2003 U.S. Dist. LEXIS 18366* (N.D. Ill. Oct. 14, 2003) (failure to provide two completed copies of rescission notice is basis for rescission).

(n120)Footnote 120. *Clay v. Johnson, 77 F. Supp. 2d 879 (N.D. Ill. 1999)* (whether borrowers were delivered a blank notice of right to cancel is question of fact that will not be decided on a motion to dismiss). *See also Jones v. Novastar Mortg., Inc. (In re Jones), 298 B.R. 451 (Bankr. D. Kan. 2003)* (borrower's testimony of non-receipt is sufficient to rebut presumption of receipt and create issue for trial); *Payton v. New Century Mortg. Corp., 2003 U.S. Dist. LEXIS 18366* (N.D. Ill. Oct. 14, 2003) (fact question where creditor had her signature acknowledging receipt of two completed copies but she only had uncompleted copies and denied receipt); *Bell v. Parkway Mortg., Inc. (In re Bell), 309 B.R. 139 (Bankr. E.D. Pa. 2004) . See Kajitani v. Downey Sav. & Loan Ass'n, 2008 U.S. Dist. LEXIS 42388* (D. Haw. May 22, 2008) (denying lender's motion for summary judgment in part because consumer did not receive copies of the disclosures at closing and in part because those material disclosures received in the mail post-closing were misleading and confusing); *Burrows v. Orchid Island TRS, LLC, 2008 U.S. Dist. LEXIS 21120* (S.D. Cal. Mar. 18, 2008) (denying lender's motion to dismiss rescission claim because borrower rescinded more than two weeks after closing when borrower alleged that he was not provided with copies at closing and disclosures were mailed to an incorrect address).

(n121)Footnote 121. *Weeden v. Auto Workers Credit Union, Inc., 73 F.3d 857* (6th Cir.) , *reported in full at 1999 U.S. App. LEXIS 5272* (6th Cir. Mar. 19, 1999) , *cert. denied, 528 U.S. 1076, 120 S. Ct. 790, 145 L. Ed. 2d 667 (2000)* (consumer granted extended right to rescind even though she was a realtor who may have known about rescission rights); *Gibbons v. Interbank Funding Group, 208 F.R.D. 278 (N.D. Cal. 2002) . But see ContiMortgage Corp. v. Delawder, 2001 Ohio App. LEXIS 3410* (Ohio Ct. App. July 30, 2001) (taking oral disclosure of right to rescind and borrower's actual knowledge into account in determining that notice was satisfactory).

(n122)Footnote 122. The material disclosures are specifically defined by the statute and regulation. *See § 1.08[3] supra*.

(n123)Footnote 123. *See, e.g., Williams v. Gelt Fin. Corp. (In re Williams), 232 B.R. 629 (Bankr. E.D. Pa. 1999)* , *aff'd, 237 B.R. 590 (E.D. Pa. 1999)* (debtor had 3 years to rescind where creditor failed to give her required disclosure statement or notice of right to rescind); *England v. MG Invs., Inc., 93 F. Supp. 2d 718 (S.D. W. Va. 2000)* .

(n124)Footnote 124. *Steele v. Ford Motor Credit Co., 783 F.2d 1016 (11th Cir. 1986)* . In *Steele*, the court of appeals held that "any understatement of the finance charge is material *because* any understatement would be of some significance to a reasonable consumer." It is the disclosure that is "material," not the degree of accuracy. The court did not rule out the possibility that some overcharges could be so small as to be de minimis. However, the court strongly implied that the standard would be the tolerance levels then provided in Reg. Z § 226.18(d) n.41: $5 for a transaction with an amount financed of $1,000 or less; $10 for larger amounts financed. In *Steele* itself, the understatement was *approximately* $24.00. *Mayo v. Key Fin. Servs., Inc., 424 Mass. 862, 678 N.E.2d 1311 (1997)* (1995 amendments not applicable so the $10 standard applied; understatement by more than $10 is statutorily defined as "material").

(n125)Footnote 125. *See generally § 1.05[2][e][ii][A] supra, § 1.09[2][h] infra*.

(n126)Footnote 126. *73 Fed. Reg. 44,522* (July 30, 2008) .

(n127)Footnote 127. *73 Fed. Reg. 44,522, 44,532* (July 30, 2008) .

(n128)Footnote 128. *73 Fed. Reg. 44,522, 44,532* (July 30, 2008) .

(n129)Footnote 129. Reg. Z § 226.23 n.48; *73 Fed. Reg. 44,522, 44,601* (July 30, 2008) (including the prepayment penalty limitation on the list of material disclosures).

(n130)Footnote 130. Reg. Z § 226.35(a)(3); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n131)Footnote 131. Reg. Z §§ 226.15(a)(3), 226.23(a)(3); *Rodash v. AIB Mortgage Co., 16 F.3d 1142 (11th Cir. 1994)* ; *Reynolds v. D&N Bank, 792 F. Supp. 1035 (E.D. Mich. 1992)* ; *Jenkins v. Landmark Mortgage Corp. of Va.,*

696 F. Supp. 1089, 1095 (W.D. Va. 1988) ; *Apaydin v. Citibank Fed. Sav. Bank (In re Apaydin), 201 B.R. 716 (Bankr. E.D. Pa. 1996)* ; *In re Melvin, 75 B.R. 952, 956 (Bankr. E.D. Pa. 1987)* . *See also Semar v. Platte Valley Fed. Sav. & Loan Ass'n, 791 F.2d 699 (9th Cir. 1986)* ; *Williamson v. Lafferty, 698 F.2d 767, 768 (5th Cir. 1983)* (pre-Simplification case, but still good law).

(n132)Footnote 132. *15 U.S.C. § 1649(a)(2).*

(n133)Footnote 133. *15 U.S.C. § 1649(b).*

(n134)Footnote 134. *15 U.S.C. § 1635(i)(1)(B). See § 1.08[6] supra.*

(n135)Footnote 135. *15 U.S.C. § 1604(b).*

(n136)Footnote 136. *Id. See Stanley v. Household Fin. Corp. (In re Stanley), 315 B.R. 602 (Bankr. D. Kan. 2004)* ; Cruz v. Household Fin. Consumer Discount Co. (*In re* Cruz), Clearinghouse No. 55629 (Bankr. E.D. Pa. Nov. 1, 2004) (Bankr. No. 03-17888); *Finch v. Household Fin. Corp. (In re Finch), 2003 Bankr. LEXIS 2049* (Bankr. D. Kan. Nov. 7, 2003) (creditor's additions and alterations to form also made it less concise and less clear, but court finds it unnecessary to decide whether these flaws alone would extend right to rescind).

(n137)Footnote 137. *McKenna v. First Horizon Home Loan Corp., 429 F. Supp. 2d 291 (D. Mass. 2006)* .

(n138)Footnote 138. *See Finch v. Household Fin. Corp. (In re Finch), 2003 Bankr. LEXIS 2049* (Bankr. D. Kan. Nov. 7, 2003) . *See also Merriman v. Beneficial Mortgage Co. (In re Merriman), 329 B.R. 710 (D. Kan. 2005)* (affirming details of bankruptcy court's grant of rescission when creditor checked wrong box on hybrid rescission notice).

(n139)Footnote 139. *Gibbons v. Interbank Funding Group, 208 F.R.D. 278 (N.D. Cal. 2002)* (court notes that, even if technical violation is insufficient to extend rescission period, this error is substantively misleading).

(n140)Footnote 140. *See id.*

(n141)Footnote 141. *15 U.S.C. § 1635(a). See also Stanley v. Household Fin. Corp. (In re Stanley), 315 B.R. 602, 612 (Bankr. D. Kan. 2004)* (notice was not clear and conspicuous where it had separate paragraphs for new loans and refinancings, but no indication of which one applied to the particular transaction).

(n142)Footnote 142. *See Reynolds v. D & N Bank, 792 F. Supp. 1035 (E.D. Mich. 1992)* ; *Apgar v. Homeside Lending, Inc. (In re Apgar), 291 B.R. 665 (Bankr. E.D. Pa. 2003)* (notice that was addressed just to the consumer's husband, who was the obligor on the note and co-owned the home, was not clear and conspicuous because it was ambiguous about whether and how the consumer herself could rescind).

(n143)Footnote 143. *Williams v. Empire Funding Corp., 109 F. Supp. 2d 352 (E.D. Pa. 2000)* .

(n144)Footnote 144. *See, e.g., Jackson v. Grant, 890 F.2d 118 (9th Cir. 1989)* (notice of right to cancel specified Mar. 1 as expiration date, but event constituting consummation did not occur until Apr. 29, so a proper notice was never delivered and consumer had extended right to rescind); *Semar v. Platte Valley Fed. Sav. & Loan Ass'n, 791 F.2d 699 (9th Cir. 1986)* (rescission notice which omitted the expiration date, although it stated that the right expired three business days after July 16, violated TILA and entitled the borrowers to rescind the transaction); *Williamson v. Lafferty, 698 F.2d 767 (5th Cir. 1983) . But cf. Jenkins v. Landmark Mortgage Corp., 696 F. Supp. 1089 (W.D. Va. 1988)* (consumer advised that rescission notice expired Aug. 28, when, due to later delivery of "material" disclosures, it expired Aug. 31; court indicated that, standing alone, would not have triggered the three-year period: no discussion of § 226.23(b)(5) requirement). Bonney v. Wash. Mutual Bank, No. 08-30087 (D. Mass. July 30, 2008), *available at* www.consumerlaw.org/unreported (magistrate's recommendation) (recommending denial of lender's motion to dismiss

when both expiration date and transaction date left blank; noting that the magistrate had changed his mind based on borrower's briefing regarding how business days are calculated for TIL purposes); *Aubin v. Residential Funding Co., 565 F. Supp. 2d 392* (D. Conn. July 11, 2008) (denying lender's motion to dismiss when both the transaction and expiration dates disclosed one day too early; actual expiration date fell on a Saturday, which the court found to be surprising and therefore not clear to the average consumer).

(n145)Footnote 145. *Williams v. Empire Funding Corp., 109 F. Supp. 2d 352 (E.D. Pa. 2000)* . One court has held that disclosing a longer period than three days for exercising the right to cancel is a violation, reasoning that a contrary interpretation would allow the three-day period to be modified at the discretion of the lender. *Henlon v. Goldome Credit Corp., 1988 U.S. Dist. LEXIS 17464* (S.D. Fla. July 14, 1988) . *But see Hawaii Community Fed. Credit Union v. Keka, 11 P.3d 1 (Haw. 2000)* .

(n146)Footnote 146. *Weeden v. Auto Workers Credit Union, 173 F.3d 857* (6th Cir.) , *reported in full at 1999 U.S. App. LEXIS 5272* (6th Cir. Mar. 19, 1999) , *cert. denied, 528 U.S. 1076, 120 S. Ct. 790, 145 L. Ed. 2d 667 (2000)* (consumer granted extended right to rescind even though she was a realtor who may have known about rescission rights); *Williams v. Empire Funding Corp., 109 F. Supp. 2d 352 (E.D. Pa. 2000)* .

(n147)Footnote 147. *Jones v. Ameriquest Mortgage Co., 2006 U.S. Dist. LEXIS 3788* (N.D. Ill. Jan. 31, 2006) . *But see Hamm v. Ameriquest Mortgage Corp., 2005 U.S. Dist. LEXIS 21755* (N.D. Ill. Sept. 27, 2005) (rejecting the same argument without extended analysis).

(n148)Footnote 148. Kitchen v. Ameriquest Mortgage Co., Clearinghouse No. 55,628 (N.D. Ga. Apr. 29, 2005) (No. 1:04-CV-2750-BBM), *available at* www.consumerlaw.org/unreported; *Henlon v. Goldome Credit Corp., 1988 U.S. Dist. LEXIS 17464* (S.D. Fla. July 14, 1988) . *But see Hawaii Cmty. Fed. Credit Union v. Keka, 11 P.3d 1 (Haw. 2000)* .

(n149)Footnote 149. Reg. Z §§ 226.15(c), 226.23(c). *See § 1.08[5] supra*.

(n150)Footnote 150. "Spiking" was coined to describe a contractor's practice of doing token work and then telling the consumer the contract was not cancelable.

(n151)Footnote 151. The Third Circuit held that a violation of the delay requirements of Reg. Z § 226.23(c) is not *per se* a violation which gives rise to a continuing right to rescind. *Smith v. Fidelity Consumer Disc. Co., 898 F.2d 896, 904-05 (3d Cir. 1990)* . However, this decision, like others, recognizes that, under some circumstances, the premature performance may so undermine the information given about the rescission right that the written notice requirement is thereby violated.

(n152)Footnote 152. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.8.2.2 (6th ed. 2004 and Supp.).

(n153)Footnote 153. *15 U.S.C. § 1641(a).*

(n154)Footnote 154. *15 U.S.C. § 1641(c). See, e.g., Mount v. LaSalle Bank Lake View, 926 F. Supp. 759 (N.D.Ill. 1996)* , *summ. judgment granted, 1998 U.S. Dist. LEXIS 10252* (N.D. Ill. June 30, 1998) ; *Stone v. Mehlberg, 728 F. Supp. 1341 (W.D. Mich. 1989)* .

(n155)Footnote 155. Reg. Z §§ 226.15(a)(2), 226.23(a)(2). In 2004, the FRB amended the Commentary to provide that when the consumer sends a rescission notice, sending it to an entity that would qualify as the creditor's or assignee's agent under state law may be effective in some circumstances. Official Staff Commentary §§ 226.15(a)(2)-1, 226.23(a)(2)-1, *as amended by 69 Fed. Reg. 16769* (Mar. 31, 2004) (also establishing bright-line rule that sending rescission notice to servicer is effective unless creditor has designated a different agent to receive it).

(n156)Footnote 156. *15 U.S.C. § 1635(b)*; Reg. Z §§ 226.15(d)(1), 226.23(d)(1). See *§ 1.08[6] supra*, on rescission as a defense to foreclosure. *See also* Willis v. Friedman, Clearinghouse No. 54,564 (Md. Ct. Spec. App. May 2, 2002) ("[o]nce the right to rescind is exercised, the security interest in the debtor's property becomes void *ab initio*"). *But see Bynum v. Equitable Mortg. Group, 2005 U.S. Dist. LEXIS 6363,* at *45 n.11 (D.D.C. Apr. 7, 2005) (citing *Large* with approval; when lender contests rescission, security interest is not automatically void); *Bertram v. Beneficial Consumer Discount Co., 286 F. Supp. 2d 453 (M.D. Pa. 2003)* ; *Johnson v. GMAC Mortg. Corp., 162 S.W.3d 110, 120, 121 (Mo. App. 2005)* (citing *Large* with approval). *Lippner v. Deutsche Bank Nat'l Trust Co., 544 F. Supp. 2d 695 (N.D. Ill. 2008)* (holding that security interest becomes void upon mailing of the rescission letter); *Ricotta v. Ocwen Loan Servicing, LLC, 2008 U.S. Dist. LEXIS 13816* (D. Colo. Feb. 22, 2008) (denying lender's motion for summary judgment since genuine issue of material fact whether loan was void upon attempted rescission day after consummation, even though borrower made payments for more than three years after rescinding). *But see Dawson v. Thomas (In re Dawson), 2008 Bankr. LEXIS 1074* (Bankr. D.D.C. Apr. 9, 2008) (characterizing as "minority position" automatic operation of rescission "notwithstanding § 1635(b)"; only notice of rescission was filing of complaint); *Bank of N.Y. v. Jordan, 2007 Ohio 4293* (Ohio Ct. App., Cuyahoga County Aug. 23, 2007) (asserting that rescission does not occur automatically but only when a court orders it or a creditor takes steps to honor the right of rescission).

(n157)Footnote 157. *Arnold v. W.D.L. Invs., Inc., 703 F.2d 848, 849 (5th Cir. 1983)* (notes cancelled along with mortgage); *Elsner v. Albrecht, 185 Mich. App. 72, 460 N.W.2d 232 (1990)* (consumer can rescind " 'the transaction,' including pendent documents such as the promissory note").

(n158)Footnote 158. *15 U.S.C. § 1635(b)*; Reg. Z §§ 226.15(d)(1), 226.23(d)(1). *See Beneficial Mortgage Co. v. Leach, 2002 Ohio App. LEXIS 2240* (Ohio Ct. App. May 9, 2002) , *appeal denied, 96 Ohio St. 3d 1513, 775 N.E.2d 856 (2002)* (ordering points and fees credited to the consumer). *But see Coleman v. Equicredit Corp., 2002 U.S. Dist. LEXIS 969* (N.D. Ill. Jan. 22, 2002) (erroneously rejecting consumer's claim that upon rescission all payments made should be returned or credited to principal).

(n159)Footnote 159. *15 U.S.C. § 1635(b)*; Reg. Z §§ 226.15(d)(2), 226.23(d)(2). This time period was increased from 10 days by TIL Simplification to give the creditor a better opportunity to determine if the consumer has properly rescinded. S. Rep. No. 368, 96th Cong., 2d Sess. 29, *reprinted in* 1980 U.S.C.C.A.N. 234, 264.

(n160)Footnote 160. *E.g., Harris v. Tower Loan of Miss., Inc., 609 F.2d 120 (5th Cir. 1980)* ; *Rudisell v. Fifth Third Bank, 622 F.2d 243 (6th Cir. 1980)* ; *Mayfield v. Vanguard Sav. & Loan Ass'n, 710 F. Supp. 143 (E.D. Pa. 1989)* ; *Bilal v. Household Fin. Corp. (In re Bilal), 296 B.R. 828, 839 (D. Kan. 2003)* .

(n161)Footnote 161. *15 U.S.C. § 1635(b)*; Reg. Z §§ 226.15(d)(3), 226.23(d)(3). *See also Abbott v. Shaffer, 564 F. Supp. 1200, 1208 (D. Utah 1983)* (tender deficient because consumer tendered only the loan documents, not the loan proceeds); *Quenzer v. Advanta Mortgage Corp. (In re Quenzer), 274 B.R. 899 (Bankr. D. Kan. 2001)* , *rev'd, remanded, 288 B.R. 884 (D. Kan. 2003)* (tender amount is principal minus closing costs and all payments); *Large v. Conseco Fin. Servicing Corp., 292 F.3d 49 (1st Cir. 2002)* (in contrast to common law rescission, borrower need not first return the loan proceeds to effect rescission); *Basnight v. Diamond Developers, Inc., 146 F. Supp. 2d 754 (M.D.N.C. 2001)* (where creditor refused to cancel, borrower's duty to return the property never arose).

(n162)Footnote 162. Reg. Z §§ 226.15(d), 226.23(d). *See, e.g., Ralls v. Bank of New York (In re Ralls), 230 B.R. 508 (Bankr. E.D. Pa. 1999)* (court recognizes that it has authority to eliminate the debtor's obligation entirely and to require creditor to refund all the debtor's payments, but denies this remedy here on the ground that it should be reserved for cases where the creditor attempts to cheat or deceive the consumer; the court does, however, subtract the debtor's payments from the creditor's unsecured proof of claim); *Reynolds v. D & N Bank, 792 F. Supp. 1035 (E.D. Mich. 1992)* (court gave creditor 20 days from date of its order upholding consumer's right to rescind to comply with its obligations). For an extensive discussion of issues that arise in exercising the extended rescission right, see National Consumer Law Center, Truth in Lending § 6.6 (5th ed. 2003 and supp.), and for practical tips for enforcing rescission, see § 6.9. *See Quenzer v. Advanta Mortgage Corp. (In re Quenzer), 266 B.R. 760 (Bankr. D. Kan. 2001)* , *rev'd, remanded*, *288 B.R.*

884 (D. Kan. 2003) (for meticulous analysis of the court's equitable modification authority). *See Johnson v. GMAC Mortg. Corp., 162 S.W.3d 110, 120-21 (Mo. App. 2005)* (in contrast to common law, tender is not prerequisite for TIL rescission). *See Ramirez v. Household Fin. Corp. (In re Ramirez), 329 B.R. 727 (Bankr. D. Kan. 2005)* (fact that debt would be unsecured in bankruptcy justifies modification).

(n163)Footnote 163. Official Staff Commentary §§ 226.15(d)(4)-1 (open-end credit), 226.23(d)(4)-1 (closed-end credit) (emphasis added). *Cf. Stanley v. Household Fin. Corp. (In re Stanley), 315 B.R. 602, 615-16 (Bankr. D. Kan. 2004)* (agreeing with this interpretation of Reg. Z, but finding it contrary to the Act because voiding of the security interest is a step in the rescission procedure; court was also concerned to avoid a windfall to the debtor).

(n164)Footnote 164. Comptroller of the Currency, OCC Bulletin 2004-19 (May 7, 2004), *available at* www.occ.treas.gov/ftp/bulletin/2004-19.doc.

(n165)Footnote 165. *15 U.S.C. §§ 1635(g), 1640(g). See, e.g., Semar v. Platte Valley Fed. Sav. & Loan Ass'n, 791 F.2d 699 (9th Cir. 1986)* ; *Curry v. Fidelity Consumer Disc. Co., 656 F. Supp. 1129 (E.D. Pa. 1987)* (damages as well as rescission); *In re Moore, 117 B.R. 135 (Bankr. E.D. Pa. 1990)* (statutory damages for disclosure violations available by way of recoupment); *In re Underwood, 66 B.R. 656 (Bankr. W.D. Va. 1986)* .

(n166)Footnote 166. *15 U.S.C. § 1640(a)* (text following subparagraph (a)(4)). *See, e.g., Buick v. World Sav. Bank, 2008 U.S. Dist. LEXIS 48801* (E.D. Cal. June 11, 2008) (finding lender's failure to honor rescission notice "a distinct and actionable violation"); *Brannon v. Bridge Capital Corp., 2008 U.S. Dist. LEXIS 41949* (M.D. Ala. May 27, 2008) (awarding statutory damages for failure to make disclosures and for failure to honor rescission notice); *Ebron v. First Franklin Fin. Corp. (In re Ebron), 2008 Bankr. LEXIS 917* (Bankr. E.D. Va. Mar. 25, 2008) (denying lender's motion to dismiss statutory damages claim for failure to respond to rescission notice); *Lippner v. Deutsche Bank Nat'l Trust Co., 544 F. Supp. 2d 695 (N.D. Ill 2008)* (finding assignee who failed to respond to proper rescission notice liable for statutory damages); *In re Ameriquest Mortg. Co., 2007 U.S. Dist. LEXIS 45676 (N.D. Ill. June 25, 2007)* (denying motion to dismiss statutory damages claim when lender failed to respond to rescission notice). *But cf. Dawson v. Thomas (In re Dawson), 2008 Bankr. LEXIS 1074* (Bankr. D.D.C. Apr. 9, 2008) (granting rescission but denying claim for statutory damages for failure to honor right of rescission; creditor not obligated to rescind until court orders creditor to do so; only notice of rescission was filing of complaint).

(n167)Footnote 167. *See also In re Kenderdine, 118 B.R. 258 (Bankr. E.D. Pa. 1990)* (failure to correctly disclose on the rescission note the date the right to rescind expired violated *15 U.S.C. § 1635(a)* and Reg. Z § 226.23(b)(5) and gave rise to a claim for statutory damages). *But see 15 U.S.C. § 1649(a)(2)*; *§ 1.08[6][c][iii] supra* , on the one violation for which Congress gave immunity.

(n168)Footnote 168. *See Smith v. Fidelity Consumer Disc. Co., 898 F.2d 896 (3d Cir. 1989)* .

(n169)Footnote 169. This may arise in the home improvement context, in a spiking or two-contract dodge case. *See § 1.08[6][c][iv] supra*.

(n170)Footnote 170. *See, e.g., Gerasta v. Hibernia Nat'l Bank, 575 F.2d 580 (5th Cir. 1978)* ; *Abel v. Knickerbocker Realty Co., 846 F. Supp. 445 (D. Md. 1994)* ; *Elliott v. ITT Corp., 764 F. Supp. 102 (N.D. Ill. 1991)* ; *In re Wright, 133 B.R. 704 (E.D. Pa. 1991)* . *See also Gombosi v. Carteret Mortgage Corp., 894 F. Supp. 176 (E.D. Pa. 1995)* (failure to honor a rescission request is a separate violation, giving rise to a separate claim for damages; dicta), *aff'd without opinion, 91 F.3d 123 (3d Cir. 1996)* .

It is necessary to draft your pleadings properly to request such damages in order to receive them; see, e.g., *Rowland v. Magna Millikin Bank, 812 F. Supp. 875 (C.D. Ill. 1992)* , in which damages were denied because not properly requested in complaint. *See also* National Consumer Law Center, Consumer Law Pleadings With Disk, Number One, Ch. 8 (1994).

(n171)Footnote 171. *15 U.S.C. § 1641(a). See § 1.09[3] infra.*

(n172)Footnote 172. *15 U.S.C. § 1641(c). See § 1.09[2][g] infra. See, e.g., Stone v. Mehlberg, 728 F. Supp. 1341, 1348 (W.D. Mich. 1989)* ; *In re Myers, 175 B.R. 122 (Bankr. D. Mass. 1994)* (Freddie Mac, an assignee, liable for rescission, damages and fee claims; facial violation requirement of Massachusetts equivalent of § 1641(a) does not affect action against assignee by consumer who has right to rescind). *But cf. Brodo v. Bankers Trust Co., 847 F. Supp. 353 (E.D. Pa. 1994)* (allowed rescission, but refused to assess damages and attorney fees against assignee). *But see Coleman v. Equicredit Corp. of Am., 2002 U.S. Dist. LEXIS 969* (N.D. Ill. Jan. 22, 2002) (erroneously stating that assignee is liable for rescission only where violations are apparent on face of contract; court is apparently unaware of § 1635(c)). *Belini v. Washington Mutual Bank, 412 F.3d 17 (1st Cir. 2005)* (debtor can seek rescission against assignee as though that assignee were original creditor under either Mass. TILA or federal TILA); *Hammox v. Heartland Home Fin., Inc., 2005 WL 1130347,* at *2 (E.D. Tenn. May 13, 2005); *Adams v. Nationscredit Fin. Servs. Corp., 351 F. Supp. 2d 829, 834 (N.D. Ill. 2004)* ; *Pulphus v. Sullivan, 2004 U.S. Dist. LEXIS 13234* (N.D. Ill. July 14, 2004) . *See also Kane v. Equity One, Inc., 2003 U.S. Dist. LEXIS 23810* (E.D. Pa. Nov. 21, 2003) (rescission available against assignee, but not monetary penalty or attorney fees unless violation is apparent on face of document). *But see Murry v. America's Mortg. Banc, Inc., 2004 U.S. Dist. LEXIS 12045* (N.D. Ill. June 25, 2004) (misreading statute; stating that rescission is available against assignee only if violation is apparent on face of documents).

(n173)Footnote 173. Failure to respond to a proper rescission notice gives rise to a separate claim for statutory damages, apart from damages for any disclosure violations. *See, e.g., Shepeard v. Quality Siding & Window Factory, Inc., 730 F. Supp. 1295, 1301 n.8 (D. Del. 1990) . Cf. In re Myers, 175 B.R. 122 (Bankr. D. Mass. 1994)* (assignee Freddie Mac liable for statutory damage and fee claims for nondelivery of disclosures; facial violation requirement of state equivalent of § 1641(a) does not affect action against assignee by consumer who has right to rescind, as § 1641(e) corollary "otherwise provides" for assignee liability).

(n174)Footnote 174. *Payton v. New Century Mortg. Corp., 2003 U.S. Dist. LEXIS 18366* (N.D. Ill. Oct. 14, 2003) ; *Walker v. Gateway Fin. Corp., 286 F. Supp. 2d 965 (N.D. Ill. 2003)* ; *Brodo v. Bankers Trust Co., 847 F. Supp. 353 (E.D. Pa. 1994) . See also Siner v. Am. Gen. Fin., Inc., 2004 U.S. Dist. LEXIS 12924* (E.D. Pa. July 8, 2004) (assignees not liable for rescission violations; no discussion of liability if underlying disclosure violations are apparent on face of documents); *Kane v. Equity One, Inc., 2003 U.S. Dist. LEXIS 23810* (E.D. Pa. Nov. 21, 2003) (same).

(n175)Footnote 175. *See Fairbanks Capital Corp. v. Jenkins, 225 F. Supp. 2d 910, 916-17 (N.D. Ill. 2002)* (accepting this rationale as basis for assignee liability for attorney fees for refusing rescission; finding it unnecessary to rule whether assignee is also liable for statutory damages for rescission violation).

(n176)Footnote 176. *See, e.g., Weeden v. Auto Workers Credit Union, Inc., 173 F.3d 857* (6th Cir.) , *reported in full at 1999 U.S. App. LEXIS 5272* (6th Cir. Mar. 19, 1999) , *cert. denied, 528 U.S. 1076, 120 S. Ct. 790, 145 L. Ed. 2d 667 (2000)* (awarding fees in rescission case); *Steinbrecher v. Mid-Penn Consumer Disc. Co., 1990 U.S. Dist. LEXIS 10480* (E.D. Pa. Aug. 9, 1990) (attorney fee award of $11,248.35 in TILA rescission case litigated in debtor's bankruptcy; court noted that, in addition to the monetary judgment awarded to the debtor and the extinguishments of the creditor's claim, "there is a societal benefit to the successful assertion of private attorney general statutes beyond the monetary recovery obtained by a particular plaintiff"); *Ralls v. Bank of New York (In re Ralls), 230 B.R. 508 (Bankr. E.D. Pa. 1999)* ; *Williams v. Gelt Fin. Corp. (In re Williams), 232 B.R. 629 (Bankr. E.D. Pa. 1999)* , *aff'd, 1999 U.S. Dist. LEXIS 12512* (E.D. Pa. Aug. 10, 1999) (awarding fees). *But cf. Brodo v. Bankers Trust Co., 847 F. Supp. 353 (E.D. Pa. 1994)* (attorney fees not awarded against assignee).

(n177)Footnote 177. *Brodo v. Bankers Trust Co., 847 F. Supp. 353 (E.D. Pa. 1994) . See also Lippner v. Deutsche Bank Nat'l Trust Co., 544 F. Supp. 2d 695 (N.D. Ill. 2008)* (finding assignee liable for attorney fees since violations apparent on the face of the document).

(n178)Footnote 178. *Rowland v. Novus Fin. Corp., 949 F. Supp. 1447 (D. Haw. 1996) .*

(n179)Footnote 179. *See Myers v. Citicorp Mortgage, 878 F. Supp. 1553 (M.D. Ala. 1995)* (former holder of obligation was liable for TIL violations even though it had assigned the obligation to another entity; note that Congress enacted § 1641(f) in response to this case to exempt servicers, but did not otherwise affect its holding); *see generally* National Consumer Law Center, Truth in Lending § 6.9 (6[th] ed. 2007).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 1 Truth in Lending

1-1 Consumer Credit Law Manual § 1.09

§ 1.09 Creditor Defenses and Counterclaims

Several defenses against TILA actions are available to creditors, and the defenses apply, for the most part, to both open- and closed-end credit transactions.

[1] Statute of Limitations

Like all statutory causes of action, TILA claims are subject to a statute of limitations. There is a one-year statute of limitations for TILA actions. n1 That is, an action for civil liability under TILA must be filed within one year from the date of occurrence of the violation. There are two circumstances in which courts permit the filing of suit more than one year after the TIL disclosures were or should have been provided.

First, when there is a right of rescission, the one-year statute for statutory damages runs from the date required rescission procedures are violated, even though those violations occur up to three years after initial TIL disclosures were due. n2 Second, under principles of equity, a creditor's fraudulent concealment of facts may toll the statute of limitations, in effect extending the limitation period.

For open- and closed-end credit disclosures and for violations of the rescission process, n3 the one-year limitations period begins not the day of, but the day after the occurrence triggering the running of the period. n4 States granted exemptions may have a longer statute of limitations period. n4.1

There are different triggering dates for the running of the statute of limitations for open- and closed-end credit disclosure violations. Closed-end credit disclosures generally must be made *before* consummation of the transaction, n5 and the triggering date is the date of consummation itself. n6 If disclosures are never made, the consummation date remains the triggering date. n7 But if the disclosures are made after the consummation date, the limitation period begins to run from the date closed-end disclosures are actually given. n8

The running of the statute of limitations period for open-end credit is somewhat different than for closed-end credit. The initial disclosure statement must be given to the consumer before the first transaction which obligates the consumer to the plan. n9 However, the consumer will often be unable to discover a disclosure statement error upon receipt of the initial statement. The limitations period should not begin to run until the transaction charge is subsequently incurred and

appears on a subsequent statement. n10

Open-end credit also involves repeated billings and it is common for the same error to occur on successive billing statements. In such cases, a new statutory period begins each time the defective statement is given, thereby extending the time for bringing an action to a year from receipt of the last billing. n11 Similarly, the limitations period may not begin to run until a later time for some FCBA n12 violations.

The FCBA is part of the TILA to which the one-year statute of limitations generally applies. When a consumer sends a notice of a billing error, FCBA provides that a creditor:

- Must acknowledge the receipt of the billing error notice in 30 days;
- Must investigate and resolve the billing error dispute within two billing cycles or 90 days;
- May not attempt to collect the amount disputed prior to resolution of the dispute;
- May not threaten to report adversely on the consumer's credit standing during the pendency of correction of billing error procedures;
- May not report disputed amounts as delinquent until after correction of error procedures are completed; and
- Must report subsequent resolution of any delinquencies to whomever delinquencies were initially reported. n13

Some of these requirements have a specific time frame for the creditor to fulfill its duties under FCBA, e.g., thirty days to acknowledge the receipt of a billing error notice. For those requirements, the statute of limitations for a violation of that duty runs from the end of the time frame. n14 Other violations of FCBA, for example, a failure to report the resolution of a billing dispute to the credit bureau to which it reported the delinquency, are continuing violations. In such cases, an action is timely even if filed more than a year after the billing dispute was resolved. n15 A claim for a violation of the limits on liability for unauthorized use provision n16 accrues when the consumer's account is debited with the charge. n17

Although there is no separate statute of limitations for rescission, the combination of the one-year limitation with the rules of rescission commonly means that monetary damage claims for rescission violations may be brought up to just over four years after consummation of the consumer credit transaction. n18

The end of the statute of limitations period may be much later because the right to rescind may itself extend for up to three years in the event the creditor failed to provide all material disclosures and proper notice of the right to rescind. n19 The consumer may rescind at any time during this extended period, and the creditor's failure to respond properly to the rescission gives rise to a cause of action and damage claim at that time. The creditor's failure thus may occur up to three years and twenty days after the transaction date, and the one-year statute of limitations begins to run only then. n20

Some extensions of credit are set up in a way that creates repeat transactions. Payday loans, in which the borrower enters into a new agreement with each rollover, are the prime example. n21 Each rollover may be a separate failure to disclose, starting a new one-year period for filing suit. n22 Auto pawn transactions may be set up in the same way. n23

Fraudulent concealment of a TILA violation may toll the statute of limitations, thus extending the time in which a consumer may raise a TIL claim. The doctrine of fraudulent concealment is a matter of equity to be applied to avoid

unjust results. n24

In addition, if the statute of limitations has run and bars the filing of a suit, a consumer nevertheless may often be able to raise TILA claims as a defense by way of recoupment. n25 In this manner, a creditor's monetary recovery is reduced by the amount of the available TIL recovery. In some cases, it may also be possible to deal with a TIL statute of limitations problem by pleading a parallel cause of action under state law, such as an unfair and deceptive acts and practices ("UDAP") claim. n26 If the state law claim has a more generous statute of limitations, the consumer may be able to win at least the remedies allowed by state law.

Though, in the past, rescission claims were permitted after the three-year period had run where raised by recoupment, the Supreme Court in *Beach v. Ocwen Federal Bank* has foreclosed this possibility as a matter of federal law. n27 Rescission claims "relevant under" TILA can still be raised by way of recoupment under state law. n28

Since most creditor actions against consumers are filed in state court, state law will decide whether a consumer's TILA claim may be raised as a recoupment defense. The vast majority of federal and state courts have determined that TILA claims may be raised defensively after the limitations period has expired. n29

TIL claims may also be raised by way of recoupment in bankruptcy after the limitations period has run. n30 Bankruptcy can be an important forum for raising such claims, as it can offer a vehicle for recoupment when state law would otherwise provide none. Note that if the creditor's original claim is withdrawn, the consumer may not be permitted to proceed with a recoupment counterclaim as an independent action if filed after the limitations period. n31

[2] Statutory Defenses

[a] Good Faith Conformity

TILA provides that creditors are not liable for acts done or omitted in good faith in conformity with any FRB rule, regulation, or interpretation, or with any interpretation or approval by an authorized Federal Reserve official or employee. n32 Similarly, the creditor is deemed to be in compliance with the disclosure requirements provided it uses the appropriate model forms or clauses promulgated by the FRB as part of Regulation Z. n33 This good faith defense, if successful, shields the creditor from actual and statutory damages, attorney fees, and costs as provided by section 1640, the civil liability section of the Act. n34 However, the conformity defense should not defeat the exercise of a consumer's right to rescind a transaction. n35

Under the New Act, the creditor's good faith defense is limited to conformity with the Regulation and the Commentary, which is now the vehicle for providing official FRB staff interpretations. n36 The good faith conformity defense provides no protection for creditor's reliance on court decisions. n37

If the creditor misreads or misconstrues the provision, it is not entitled to the defense, n38 even if the mistake is a reasonable one. n39 However, where the provision is ambiguous and the creditor reasonably construes the provision as applying to its act or omission, it may be entitled to the conformity defense. n40 Whether the creditor's construction was a reasonable one requires a case-by-case determination. Whether a creditor acted in good faith is a question of fact, which cannot be determined on the pleadings. n41

[b] Bona Fide Error Defense

TILA's "bona fide error" defense provides that a creditor or assignee will not be held liable where it "shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error." n42 The defense does not include errors of legal judgment, and is sometimes called the clerical error defense.

With a successful bona fide error defense, a creditor "may not be held liable in any action brought under this section [§ 1640] or section 1635." n43 The defense therefore insulates a creditor from statutory liability for both disclosure violations and for violations of the section governing rescission procedures. n44 However, the bona fide error defense probably does not defeat the right of rescission itself.

The creditor has the burden of establishing three necessary elements of the bona fide error defense: n45

1) The error must have been unintentional;

2) It must have been the type of error falling within the statutory notion of bona fide error; and

3) Finally, the creditor must have been maintaining procedures reasonably adapted to avoid the error.

To raise this affirmative defense, the creditor must first plead it in its answer, or the defense will be waived. n46

[c] Faulty Calculation Tool Defense

This is a narrow defense, applicable only to erroneous disclosures of the finance charge or annual percentage rate. n47

[d] Correction of Errors Defense

The fourth statutory defense requires a creditor to have acted promptly to correct errors. n48 Although the TILA itself suggests that any error may be corrected, n49 courts will generally not allow the correction of informational as opposed to clerical or mathematical errors. n50 The statutory subsection that creates the correction of error defense states that the creditor has no liability "under this section [1640] or section 1607 of this title or section 1611 of this title." n51 Section 1607 deals with administrative enforcement and section 1611 deals with criminal penalties. By contrast, the section creating the bona fide error defense states that a creditor may not be held liable in any action brought "under this section [1640] or section 1635 of this title." n52 Section 1635 is the section that authorizes rescission. While there are no cases addressing the issue, the clear implication of the explicit mention of rescission in the bona fide error defense but not in the correction of error defense is that the latter defense does not apply to rescission. Allowing rescission even after the creditor corrects an error makes sense, since if the creditor's error involved a material disclosure the consumer should be given the opportunity to evaluate whether to rescind the transaction in light of the different terms. It is true that the correction of error defense explicitly protects the creditor from liability under section 1640, and 1640 mentions rescission in several places. However, the bona fide error defense protects the creditor in any action brought under either "this section [1640] or section 1635," demonstrating that, when Congress intended to grant protection from rescission it mentioned rescission explicitly. A creditor cannot use a contract clause to expand its correction-of-error rights. n53

[e] Effect of Subsequent Occurrences

A creditor pleading the fifth defense must show that initially correct disclosures became inaccurate because of subsequent occurrences. With this defense, TILA provides that there is no violation when properly disclosed information becomes inaccurate because of actions subsequent to the delivery of the disclosures. n54

[f] Governmental Agencies Acting as Creditors

Another statutory defense may be raised only by government agencies, which are exempt from TIL civil and criminal liability. Even so, a government agency must nonetheless make proper TIL disclosures. Moreover, when a government agency assigns a consumer credit contract, the assignees will be liable for violations apparent on the face of the disclosure. n55 Rescission, however, may be allowed against federal or local agencies.

[g] Assignee Liability

The extent of an assignee's liability for TIL violations depends upon what remedy is being sought and upon the nature of the violation. In cases of rescission, and for high-cost mortgages subject to the HOEPA, special rules relating to assignees apply. n56

A consumer may assert the rescission rights under section 1635 against an assignee to the full extent they would have been available against the originating creditor. n57 This right of rescission against an assignee applies whether or not the TILA violation on which the rescission is based was apparent on the face of the disclosure statement. n58

In contrast, when civil liability under section 1640 is sought, assignees are liable only for those disclosures which are apparent on the face of the documents assigned. n59 As a practical matter, this means that if by looking at the promissory note, disbursal statement, RESPA settlement statement or the like, an error in the TIL disclosures would be discernible, the assignee should be liable. n60 Duplicate charges for the same type of fee should also be apparent on the face of the documents. n61 (This limited liability provision extends only to "voluntary" assignees.) Moreover, except in a transaction subject to the right to rescind, n62 innocent assignees are entitled to an irrebuttable presumption of delivery of disclosures where there is a written acknowledgment of receipt. n63

TIL violations may occur in transactions which are subject to the FTC's "holder" rule, which makes assignees liable generally for any claims and defenses which a buyer could have asserted against a seller. The courts are split on the impact of the rule for TIL claims. n64 The Third, Seventh, and Eleventh Circuits and a number of district court decisions have, however, concluded that the TILA assignee provisions override the FTC Holder Rule. n65

There is also a good argument that the defense that the violation is not apparent on the face of the documents assigned only applies when the consumer brings an affirmative action to enforce TIL liability, not to defenses and setoffs that the consumer asserts after an assignee sues on the debt. The language of section 1641(a) reads: "any civil action for a violation of this subchapter or proceeding under section 1607 of this title [relating to administrative enforcement] which may be brought against a creditor may be maintained against an assignee" only if the violation is apparent on the face of the documents. The common meaning of a "civil action" is an affirmative suit, not a defense. This understanding of the term is consistent with Congress' use of it elsewhere in TILA. For example, in section 1640(e), in setting the limitations period for TIL claims, Congress referred to an "action" as something distinct from a defense or setoff. In contrast to section 1641(a), other defenses created by TILA, such as the effect of a signed acknowledgment of receipt of the TIL disclosures, apply more broadly to "any action or proceeding *by or against*" an assignee, n66 showing that Congress knew how to apply a defense to a setoff or recoupment claim when it wanted to.

As a general rule, assignees are liable only for TIL violations if the violation is apparent on the face of the disclosure statement. n67

If the obligation is a high-cost mortgage covered by the Home Ownership and Equity Protection Act (HOEPA), the creditor is subject to "all claims and defenses" (not just those arising under TILA) that could be asserted against the original creditor. n68

[h] Special Defenses Created by 1995 Amendments

The TILA Amendments of 1995 created some new defenses which may protect a lender from liability. The amendments offered retroactive immunity from liability for certain specific violations and granted a wider tolerance level for the finance charge disclosure and other disclosures affected by it.

Though these newly created defenses are in general quite generous to lenders, Congress carved out a special set of rules to be applied when a TIL violation is alleged as part of a rescission defense against a foreclosure. n69 The defensive

rescission standards are both retroactive and prospective.

These new defenses are discussed generally below. n70

[i] Retroactive Immunity (General)

The retroactive immunity provisions apply only to closed-end real estate or dwelling secured transactions consummated prior to September 30, 1995. n71 There is a grandfather clause, exempting certain cases in progress from this retroactive immunity.

In contrast to the bona fide error defense authorized by the statute, n72 this immunity is intended to protect lenders against good faith errors in legal judgment in determining how to treat a particular charge. It is not intended to give them room to safely pad loan fees, n73 and, thus, should not protect lenders imposing fees that are not bona fide.

There is no civil, criminal, administrative, or rescission liability n74 arising from the way the creditor treated for disclosure purposes the following types of charges:

a) Taxes on security instruments or notes where required for recording the security instrument; n75

b) Loan document preparation fees in real-estate secured loans; n76

c) Appraisal fees, pest inspection fees, or flood hazard inspections, if conducted prior to closing in real estate secured loans; n77

d) Fees and amounts imposed by third party closing agents, if the creditor does not require the imposition of the charges or services provided, and does not retain the charges. (Note that this will ordinarily apply only to incidental fees incurred by the closing agent, not to the fee for the closing agent's own services. Where a third party agent conducts a closing, in the vast majority of cases it is because the lender requires that a third party agent be used.) n78

Second, except in connection with a rescission claim being asserted to defend against foreclosure, n79 there is no liability for any disclosure error resulting from the way a borrower-paid mortgage broker fee was treated. n80 This does not provide immunity against liability under any other statute or common law theory. n81

Borrower-paid brokers' fees are now included in the finance charge as a *per se* rule. n82

Third, if a covered lender's only error was to select the wrong FRB model form (or a comparable one), no TIL liability will attach. However, all the other requirements regarding the notice of right to cancel remain in place, and a violation of any other requirement will still lead to liability. n83 This provision does not apply in connection with rescission in a foreclosure defense. n84

Fourth, there are new rules regarding the tolerance for error in disclosing the finance charge and related disclosures, except in defensive rescission. Even if an alleged finance charge error does not arise out of the treatment of one of the charges listed above, a covered creditor may still benefit from this retroactive immunity. n85

Finally, as noted earlier, while allowing "close enough" to be the measure for determining liability as a general rule, if the lender is trying to foreclose on the consumer's home, it will be held to a stricter standard of compliance. n86 The new defensive rescission standards apply both retroactively and prospectively. n87

[3] Creditor Defenses Not Expressly Provided by TILA

Below is a discussion of some defenses often raised by creditors in response to allegations of TIL violations.

[a] Technical Violations

It is not a defense that the violation is technical or de minimis. The Act now specifies certain allowable inaccuracies in the APR and finance charge. n88

A 2009 First Circuit decision, *Melfi v. WMC Mortgage Corp.*, n88.1 erroneously construes another set of TIL amendments--the 1995 *Rodash* fix--as justification for retreating from the strict compliance standard. n88.2 The 1995 amendments created a very narrow and specific set of prospective and retroactive tolerances and immunities. Congress could have eliminated substantive TIL rights altogether, or provided larger tolerances or a substantial compliance standard, but did not. The mere fact that it intended to benefit lenders with the amendments that it *did* adopt is not a reason to construe the statute as creating defenses for lenders that Congress did not adopt. n88.3

[b] Consumer Not Misled

It is also not a defense to TIL liability that the debtor was not misled by the violation or that the debtor knew about the error and was not damaged by it. n89 Creditors may be more successful in alleging that the debtor provided faulty information that directly led to the TIL violation. n90 But creditors have not been able to hide behind minor consumer errors unrelated to the TIL violation, such as inadvertently entering into a transaction under a maiden name instead of a married name. n91

[c] Waiver of TIL Rights

A general boilerplate waiver of release in the credit agreement which discharges a creditor from any claims arising out of a transaction is not effective to waive or release the creditor for its TILA violations. n92 Less clear is the effect of a specific waiver containing a clear reference to TILA claims. n93 At the least, the standard criteria that a waiver should be a voluntary relinquishment of a known right should be applicable. n94

[d] Retroactivity of Judicial Decisions and FRB Amendments

Creditors often argue that a court's TIL decision favorable to consumers should have only prospective application; that is, creditors should not be expected to comply with a disclosure requirement of which they argue they were unaware. However, in the federal court system, when a court applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open to direct review and as to all events, regardless of whether such events predate or postdate the announcement of the rule. n95

Similar questions arise when the FRB amends Regulation Z or the Commentary. The Act provides that amendments to Regulation Z or the Commentary that require new or different disclosures are, except in special circumstances, to be effective on the October 1 that is at least six months after the date of promulgation. n96 This rule only applies to changes affecting disclosure requirements, however. Further, this rule applies only to changes. When an amendment clarifies "an unsettled or confusing area of law," rather than effecting a substantive change, it has been applied retroactively. n97

[4] Jurisdictional and Procedural Defenses and Issues

TIL actions may be brought "in any United States district court, or in any other court of competent jurisdiction," n98 allowing the consumer to sue in either state or federal court. TILA is one of several federal statutes providing for concurrent state and federal court jurisdiction.

TIL suits in federal court, being based on a federal statute, need not satisfy diversity or amount in controversy requirements and may also be brought in federal bankruptcy court where the TIL claim arises from the administration of the debtor's estate. n99

A consumer plaintiff in state court who wishes to avoid removal may do so by framing the cause of action under state law and seeking only relief provided by state law, even if the same disclosure inadequacies would constitute TIL violations. n100 A consumer defendant in state court who would prefer a federal forum cannot create a basis for a section 1441 removal by filing a TIL counterclaim; the federal question must appear in the complaint. n101 Faced with a completely non-federal complaint, the consumer could get a federal forum only through bankruptcy removal n102 or filing a TIL complaint in a separate, parallel action in federal court.

Consumer TILA claims often arise out of a broader dispute with a creditor. Consequently, claims such as deceptive practices, fraud, state warranty law, and state disclosure law claims are frequently included with TILA claims. Since these other claims are frequently state claims, providing no independent basis of federal jurisdiction, consumers must depend on pendent court jurisdiction to raise them in federal court.

Civil actions filed on or after December 1, 1990 are governed by the codification of the principles of pendent and ancillary jurisdiction contained in the Judicial Improvements Act of 1990. n103 This Act should be consulted in addressing issues of federal court jurisdiction.

A creditor counterclaim on the underlying debt is a state law claim and presents no independent basis for federal jurisdiction. When a consumer has filed a TIL claim in federal court, the creditor's counterclaim must meet the test for supplemental jurisdiction included in the Judicial Improvements Act of 1990 as must a consumer's pendent state claims. n104

Sometimes a consumer who counterclaims under TILA against a state court collection suit will also file a separate, affirmative TILA action in federal court. The creditor might seek a stay of the federal court action, arguing priority or greater progress of the state court action.

Under the Supreme Court's "exceptional circumstances" test, a TILA action in federal court should normally be resistant to a motion for stay. n105 Nevertheless, the district court will have some discretion in the matter n106 and can legitimately weigh a number of factors, including the relative progress of the state and federal proceedings. n107

[5] Res Judicata May Bar Claims

Whether an earlier judgment bars a later TILA action will depend on exactly what was at issue in the earlier case and is, consequently, a case-by-case determination. n108 Generally, res judicata does not apply where a consumer brings a TIL action after having previously brought and adjudicated a state law claim involving disclosure requirements different from those required by TILA. n109 Similarly, a rescission action may not be barred by prior TIL litigation which did not involve rescission. n110 Res judicata usually applies if the litigants in the new suit are the same as in the previous suit or are in privity with the previous litigants. n111

While the doctrine of collateral estoppel can also bar relitigation of issues, it will not bar a TIL claim filed after the conclusion of a collection action unless the TIL issues were actually litigated in the collection action. Collateral estoppel generally applies only if the party against whom the estoppel is asserted was a party to the prior adjudication; the issues which form the basis of the estoppel were actually litigated and decided on the merits in the prior suit; the resolution of the particular issues was necessary to the court's judgment; and those issues are identical to issues raised in the subsequent suit. n112

A related doctrine is judicial estoppel, which prevents a party from raising issues in a legal proceeding that are

inconsistent with a position the party has previously advanced. n113 Courts have applied this doctrine to bar TIL rescission claims that debtors failed to list as assets in earlier bankruptcy proceedings. n114 Where a potential TIL claim was not listed in an earlier bankruptcy case, the consumer should consider moving to reopen that case to list the claim. Debtors are generally permitted to reopen bankruptcy cases and amend the schedules, including the list of property claimed as exempt, as long as the debtor has acted in good faith and no prejudice will result. n115

[6] TIL Claims and Arbitration Clauses

[a] Introduction

Often the consumer's loan contract will contain a clause subjecting all claims to arbitration. Another chapter n116 analyzes generally applicable challenges to arbitration clauses, such as:

- Unconscionability;
- Misrepresentation;
- Waiver;
- Lack of mutuality;
- Repeat player bias and other arbitration service provider bias; and
- Interpretation of the clause not to include the particular dispute or parties.

There are four arbitration issues, however, that have particular relevance to TIL cases: the effect of rescission on arbitration clauses, and whether an arbitration clause is enforceable if it precludes class actions, denies attorney fees or other TIL relief to the prevailing consumer, or imposes high arbitration costs.

[b] Arbitration Clauses and TIL Rescission

Rescission under TILA is self-executing: the security interest becomes void automatically by operation of law, the consumer's obligation to pay finance and other charges is cancelled, and the creditor has the obligation to take various steps, such as returning the consumer's payments. n117 If the consumer rescinds, there is no contract. If there is no contract, there can be no binding arbitration clause.

Arbitration agreements are not binding if the whole contract of which they are a part is void. n118 Decisions considering contracts that have been cancelled or voided under various statutes or common law rules hold that the arbitration clause has no effect. n119 In *Cardegna v. Buckeye Check Cashing*, the Florida Supreme Court decided that in a consumer's claim against a payday lender, the entire contract was void *ab initio* because it was illegal should be decided by a court, and not an arbitrator. n120

The U.S. Supreme Court reversed the Florida court in February, 2006. n121 The Court stated that whether a contract is void is for the arbitrator to decide, not the court. n122 Thus, if there is a dispute as to whether the consumer has rescinded properly under TIL, that issue would be for the arbitrator because it goes to the validity of the agreement as a whole. This decision will almost certainly dramatically affect this area of the law.

Courts will generally not enforce an arbitration agreement where the parties never entered into the agreement. Similarly, they should not enforce an arbitration agreement that is only provisionally entered into, subject to the consumer's automatic right to cancel.

Only a handful of cases, however, have considered whether arbitration clauses continue to be effective after the consumer sends a rescission notice. In what will become a pair of oft-cited opinions in this area, the First Circuit in *Large* and *Thompson* has ruled that, where the creditor disputes the basis for the rescission, an arbitrator and not the court must decide whether the rescission is proper. n123 The rescission is not automatic where the very basis for the rescission is disputed. The court was concerned that a consumer could send an invalid rescission letter and avoid an otherwise valid arbitration agreement.

The leading pro-consumer decision is *Wilson v. Par Builders II*, n124 where the court denied the creditor's motion to stay an action pending arbitration. It found that the issue of whether the arbitration clause was enforceable when the transaction was rescinded under TILA is a question for the court, not the arbitrator, to decide.

Even where courts follow *Large* and accept that the enforceability of a rescission clause is for the arbitrator and not the court to decide, there are a number of contexts where the consumer should still be able to avoid the arbitration requirement. These include:

- Where there is no dispute that rescission is effective, such as when the consumer rescinds during the three-day period, or where the creditor does not dispute the claim that its disclosures are defective, only the tender amount or obligation; n125

- Where the consumer seeks injunctive relief to restrain the creditor from foreclosing and to require it to terminate its security interest, if the arbitrator lacks authority to grant or enforce injunctive relief; n126

- Where relief is sought from a bankruptcy court which has discretion in a "core" proceeding, to hear a dispute, and not to refer it to arbitration, and courts consistently utilize that discretion to hear the dispute; n127 and

- Where the arbitration clause excludes self-help remedies. n128

[c] General Standards as to Whether Arbitration Can Limit Consumer Ability to Vindicate TIL Rights

TIL is a very carefully drafted statute, evidencing Congressional intent to allow private enforcement of the Act's disclosure requirements, even where it is difficult to prove actual damages. An arbitration requirement drastically changes this enforcement scheme, and effectively eliminates class actions. Attorney fees and other remedies may be limited. And the costs of arbitration may so exceed the consumer's possible recovery that individual actions are deterred, even where a prevailing consumer is able to recover all costs.

Arbitration's limit on the effectiveness of the private TIL remedial scheme can be challenged using two different approaches--that the arbitration clause is unenforceable because it conflicts with the Congressional purpose behind TIL n129 or because the clause is unconscionable. n130

An arbitration clause is enforceable only "[so] long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum." n131 A clause that waives the plaintiff's right to pursue statutory remedies is invalid as against public policy. n132 If a litigant cannot effectively vindicate a statutory cause of action through arbitration, there is a conflict between arbitration and the federal statute's underlying purposes, and the arbitration clause becomes unenforceable. n133

In addition, a growing number of state and federal courts have struck down arbitration clauses as unconscionable. n134 Courts may find arbitration clauses to be unconscionable when some aspect of their language, or some circumstance(s) surrounding their making and/or contemplated implementation render them particularly unfair.

In some cases, such as arbitration clauses that explicitly limit consumer remedies in ways that undermine consumer protection statutes, the substantive unconscionability of a clause may be identified from the face of the clause itself. However, with respect to many other types of unconscionability challenges, such as challenges based upon cost, significant discovery may be necessary to develop an adequate factual record. While most courts require a showing of both procedural *and* substantive unconscionability, the two factors are often seen as playing against one another in a sliding scale relationship. n135

As a practical matter, many of the grounds for striking down an arbitration clause as inconsistent with TIL overlap with grounds for finding an arbitration clause unconscionable, and a consumer should argue both.

[i] Arbitration Clauses That Preclude or Impede Class Actions

[A] Conflict With TIL Statute?

Many arbitration clauses explicitly preclude class actions, and even those that are silent are generally interpreted by federal courts not to allow class actions. n136

There is a strong argument that arbitration clauses that forbid class actions conflict with the explicit Congressional intent to effectuate private attorney general enforcement of TILA through class actions. TILA makes creditors liable not only for actual damages in a class action, but also for statutory damages. n137 As is true for individual statutory damage claims, TILA sets guidelines for determining the amount of a class-wide statutory damages award, including a list of factors to consider and a cap. The cap is 500 times the standard cap for individual awards. n138

Nevertheless, many recent court decisions have found no conflict between TILA and an arbitration clause that limits the class action remedy. n139 Only a few courts have ruled otherwise. n140

In 2006, there were even more cases focusing on whether waiver of the right to bring an arbitration on a class-wide basis is unconscionable. Favorable cases for consumers include those from the New Jersey Supreme Court in *Muhammad*, n141 a Michigan federal court in *Wong*, n142 an Ohio appellate court, n143 a number of California appellate courts, n144 and a Pennsylvania trial court. n145 A number of courts during that period reached the opposite conclusion. n146 Opinions to the contrary, often based on an insufficient showing of procedural unconscionability, were issued by a Florida appellate court, n147 a New Jersey court, n148 the highest courts of Maryland, n149 and North Dakota, n150 federal courts interpreting Georgia law, n151 and a federal court interpreting Texas law. n152

When the specific provisions for class actions were added to TILA in 1974, Congress stated that "potential class action liability is an important encouragement to the voluntary compliance which is so necessary to insure nationwide adherence to uniform disclosure." n153 The intent of the class action damages provision was to balance TILA's purpose "to provide creditors with a meaningful incentive to comply with the law without relying upon an extensive new bureaucracy" with its concern that creditors not be subjected to enormous penalties for technical violations. n154 The class action remedy is not merely a procedural device; it is an important *substantive* right under TILA. And class actions make it possible for individuals to play the role of private attorneys general that Congress envisioned. TILA class action lawsuits have raised and successfully challenged abusive industry practices such as charging consumers for a deceptive insurance product, n155 manipulating TILA disclosures to hide credit costs instead of disclosing them, n156 and burying grossly inflated charges in the price of the goods sold. n157 In the absence of class action lawsuits, many of these abusive practices would continue unabated.

[B] Limit on Class Actions as Unconscionable

A number of state and federal courts have held that a waiver of the right to class-wide relief is evidence of an arbitration

clause's substantive unconscionability. For example, a federal district court applying California's contract and consumer protection law held that the express class action ban in AT&T's consumer arbitration clause was substantively unconscionable, because it was effectively one-sided as it applied only against consumers and because it would prevent consumers from vindicating their rights in cases involving general practices that result in small amounts of individual damages. n158

In *Szetela v. Discover Bank*, n159 the California Court of Appeals found unconscionable an arbitration clause that restricted class actions because the clause was one-sided and unfair to customers who had small claims, and because it would serve as a disincentive for Discover to avoid the type of conduct that might lead to a class action, in effect granting it license to push the boundaries of good business practices.

A second, *ACORN v. Household International, Inc.*, n160 struck down as unconscionable an arbitration clause that explicitly limits class actions. In a third case, a Florida appellate court found substantive unconscionability in part based on the arbitration clause's restriction on class actions. The court found the class action essential to pursuit of individual rights where the amount in controversy for each class member is small. n161

Similarly, in *Powertel, Inc. v. Bexley*, n162 a Florida intermediate appellate court struck down an arbitration clause in a cellular telephone service provider's contract with its consumers in part because it would prohibit class actions, noting that the class action device was the most economically feasible way to address the kinds of claims asserted in that case. There have been three important additions to the case law in this area in 2005. Perhaps the most important is the decision of the California Supreme Court in *Discover Bank v. Superior Court (Boehr)*. n163 The court held as follows:

> [D]amages in consumer cases are often small and because "[a] company which wrongfully exacts a dollar from each of millions of customers will reap a handsome profit," ... "the class action is often the only effective way to halt and redress such exploitation." ... Moreover, such class action or arbitration waivers are indisputably one-sided. "Although styled as a mutual prohibition on representative or class actions, it is difficult to envision the circumstances under which the provision might negatively impact Discover [Bank], because credit card companies typically do not sue their customers in class action lawsuits."

Similarly, a Missouri Court of Appeals held in *Whitney v. All-Tel Communications* that a class action ban was unconscionable. n164 The court stated:

In *Kinkel v. Cingular Wireless, Inc.*, similarly, an Illinois Court of Appeals held that a contract's "limitation on class arbitration is unconscionable and thus unenforceable." n165

Other courts, however, have rejected the argument that a prohibition of consumer class actions by itself renders an arbitration clause substantively unconscionable. n166

Challenges that provisions in arbitration clauses are unconscionable are often factually intensive disputes in which consumers should be given the opportunity to present evidence. n167 As a result, courts have often held that consumers should be given an opportunity to take discovery to develop an adequate factual record. n168 These principles have been applied by several courts in the setting of challenges to class action bans. Several court decisions striking down class action bans in particular cases have focused heavily on the factual records put forward by the plaintiffs. In one case, for example, a court struck down a class action ban after a two-day evidentiary hearing during which the plaintiffs presented expert testimony that no consumer lawyer in the state would be able to handle a case of that sort on an individual basis. n169 In another case, the Washington Supreme Court struck down a class action ban when the factual record included both similar testimony from consumer law experts and also discovery responses establishing that no consumers had arbitrated any individual cases in that state against that defendant. n170

By the same token, some of the court decisions enforcing class action bans have based their holdings on the fact that the plaintiffs in those cases had failed to introduce admissible evidence that the class action bans were exculpatory in those cases. n171

Some courts have recognized that there will be some cases in which an evidentiary record is necessary, but some cases in which the sums at issue are so small that courts can apply common sense to recognize that class action bans are exculpatory. n172

[ii] Arbitration Clauses That Deny Consumers Attorney Fees or Other TIL Relief

[A] Conflict With TIL Statute?

Some arbitration agreements or rules require each party to bear their own attorney fees and costs. Such a provision conflicts with the creditor's explicit liability under TILA for the costs of the action and the consumer's attorney fees if the consumer prevails. n173

The right to recover attorney fees and costs is a critical and integral part of TILA. n174 It makes enforcement of TILA practical and deters creditors from contesting meritorious claims. n175 Denial of attorney fees makes it unlikely that a prospective litigant "effectively may vindicate [his or her] statutory cause of action in the arbitral forum." n176 Such a provision renders the clause unenforceable. n177

The same reasoning applies to arbitration clauses that undercut other TIL rights, such as the right to pursue an important statutory remedy--statutory damages--in the arbitral forum. Shortening the statute of limitations would also be inconsistent with TILA and would bar at least some consumers from vindicating their statutory claims. n178

[B] Limits on Relief as Unconscionable

A limitation on statutory attorney fees has also been found to be unconscionable. n179 The unconscionability argument is somewhat weaker when the arbitrator has the authority to award fees to a prevailing consumer, but does not usually do so. n180 On the other hand, if an award of attorney fees to a prevailing consumer is mandatory under a statute, then providing discretion to the arbitrator in deciding whether to provide those fees could lead to an unconscionability finding.

Some arbitration agreements or the rules of certain arbitration mechanisms require that the consumer's claim be brought to arbitration within a set period of time, or the claim is forfeited. This period of time may be substantially shorter than the applicable limitations period for bringing the action in court. Such a limitation has been found to be unconscionable. n181

[iii] Arbitration Clauses That Impose High Fees

[A] Conflict With TIL Statute?

Arbitration filing fees, daily arbitration charges, room charges, motion charges, and the like often make an arbitration proceeding infeasible for consumer claims. n182 The United States Supreme Court in *Randolph* has stated that excessive arbitration fees can make an arbitration agreement unenforceable, as inconsistent with a grant of federal statutory rights. n183 The Court found, however, that the burden was on the consumer to prove the costs were inconsistent with the statute, and on the facts before it that the consumer in *Randolph* had not met this burden. To establish that an arbitration clause is unenforceable because of the cost to the consumer, the consumer must show that amount of costs involved deterred him or her from vindicating rights under TILA through arbitration. n184

Some clauses require the consumer to advance the costs of arbitration, but give the arbitrator the authority to allocate

costs at the end of arbitration. This authority does not cure the entry barriers caused by the requirement of upfront costs, which would deter most consumers. n185 Similarly, clauses which provide that the creditor will pay all the initial fees, but that fees will be charged to the consumer if the consumer loses, deter enforcement of TILA because they greatly increase the risk to the consumer.

Because of the Supreme Court's ruling in *Randolph*, the consumer must have an opportunity to conduct discovery on the fee issue. n186 Simply providing the consumer with the arbitration mechanism's fee schedule does not fulfill this right to discovery.

[B] High Fees as Unconscionable

A growing number of courts have found high arbitration fees to be unconscionable. n187 Of particular note are a number of recent cases. A federal court in Tennessee found an arbitration clause unconscionable because American Arbitration Association ("AAA") rules impose fees and costs beyond those present in a case before a judge. n188 The court relied on the individual's affidavit that her income was $7253, and concluded that this showed she could not afford to pay AAA fees and costs.

Neither the fact that the AAA may have waived some of its fees nor the company's offer during litigation to pay for the fees was sufficient to save the arbitration clause. The possibility of high fees will discourage some from pursuing litigation, and companies should not be able to craft unconscionable clauses only to alter them for those few who press the matter.

The California Court of Appeals also has recently refused to enforce an arbitration clause where the record showed that the arbitration proceeding would cost the parties many times more than a court action and that the consumer would be required to pay at least part of that amount. n189 An appeals court in the state of Washington has similarly found that an impoverished consumer cannot be required to arbitrate a $1500 claim where there was evidence that the consumer's filing fee would be $2000. n190

An Ohio appellate court also found an arbitration clause unconscionable where a contract limited consumer remedies to the amount paid to the merchant ($265), and uncontroverted evidence showed that the cost of the arbitration proceeding for the consumer would have been at least $500. n191

The Third Circuit has ruled that consumers must be able to conduct discovery into arbitration costs to prove that resort to arbitration will deny them a forum to vindicate their statutory rights. n192 Some courts have focused not on the ability of plaintiffs to pay arbitration fees, however, but upon the relationship of those fees to the amount at issue. n193

The burden is on the consumer to prove that arbitration costs are inconsistent with statutory rights. The consumer must show that amount of costs involved deterred the consumer from vindicating rights under TILA through arbitration. n194

These decisions and others make clear that *if a detailed and persuasive factual case is not made, the court will enforce an arbitration clause*. n195

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingLiabilityContracts LawDebtor & Creditor Relations

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1640(e)* (TILA actions must be brought "within one year from the date of the occurrence of the violation"). The Massachusetts statute of limitations on truth in lending claims is four years for damages and

rescission. Mass. Gen. L. 260 § 5A. *See One Beacon Ins. Co. v. Null, 2004 U.S. Dist. LEXIS 13513* (E.D. Pa. July 19, 2004) (one-year statute of limitations applies to claim for violation of § 1643 regarding unauthorized use of credit card). *Cf. Rodrigues v. Members Mortg. Co., 323 F. Supp. 2d. 202 (D. Mass. 2004)* (statute of limitations for statutory damages for disclosure violation is one year; rescission based on same disclosure violation lasts for three years).

(n2)Footnote 2. *Clay v. Johnson, 77 F. Supp. 2d 879 (N.D. Ill. 1999)* , *rev'd on other grounds*, *264 F.3d 744 (7th Cir. 2001)* (plaintiff is entitled to statutory damages for disclosure violation if suit filed within 1 year, and to statutory damages for rescission violation if right to rescind is exercised within 3 years); *Jackson v. US Bank Nat'l Ass'n Trustee (In re Jackson), 245 B.R. 23 (Bankr. E.D. Pa. 2000)* (one-year statute of limitations only bars damages for disclosure violations, not damages for refusing to respond to valid, timely, rescission notice). *See McNinch v. Mortgage Am., Inc. (In re McNinch), 250 B.R. 848 (Bankr. W.D. Pa. 2000)* (statute of limitations for damages for rescission violation runs from date of violation, which is the failure to act, and which becomes a violation 20 days after the creditor receives the notice).

(n3)Footnote 3. Notwithstanding the one-year statute of limitations, the right of rescission may extend up to three years. Consequently, the one-year limitations period may be triggered up to three years after disclosures are required. *See § 1.08 supra*.

(n4)Footnote 4. *See, e.g., Maahs v. United States, 840 F.2d 863 (11th Cir. 1988)* ; *Lawson v. Conyers Chrysler, Plymouth & Dodge Trucks, Inc., 600 F.2d 465 (5th Cir. 1979)* .

(n5)Footnote 4.1. *See, e.g., Mass. Gen. Laws ch. 260, § 5A* (four-year statute of limitations for violations of Mass. Gen. Laws ch. 140D); Mass. Gen. Laws ch. ch. 140D, § 10(f) (right to rescind expires four years after closing).

(n6)Footnote 5. Reg. Z § 226.17(b). *See § 1.05[2][b] supra*.

(n7)Footnote 6. *See, e.g., Moor v. Travelers Ins. Co., 784 F.2d 632 (5th Cir. 1986)* ; *King v. California, 784 F.2d 910 (9th Cir. 1986)* , *cert. denied, 484 U.S. 802, 108 S. Ct. 47, 98 L. Ed. 2d 11 (1987)* ; *Steib v. St. James Bank & Trust Co., 642 F. Supp. 910 (E.D. La. 1986)* (date promissory note is signed in closed-end transaction begins running of the one year period; even though not all the funds were immediately disbursed, the finance charge was imposed almost immediately).

(n8)Footnote 7. *King v. California, 784 F.2d 910 (9th Cir. 1986)* , *cert. denied, 484 U.S. 802, 108 S. Ct. 47, 98 L. Ed. 2d 11 (1987)* ; *Wachtel v. West, 476 F.2d 1062 (6th Cir. 1973)* , *cert. denied, 414 U.S. 874, 94 S. Ct. 161, 38 L. Ed. 2d 114 (1973)* ; *Lawson v. Nationwide Mortgage Corp., 628 F. Supp. 804 (D.D.C. 1986)* . *See also Gibbons v. Interbank Funding Group, 208 F.R.D. 278 (N.D. Cal. 2002)* (date that loan was consummated was an issue of fact precluding summary judgment, given that documents and parties' affidavits were in conflict regarding the issue); *McNinch v. Mortgage Am., Inc. (In re McNinch), 250 B.R. 848, 857 (Bankr. W.D. Pa. 2000)* (consummation occurs when there is a "meeting of the minds"; consummation occurs when the parties agree on essential terms and intend them to be binding, even if a formal document with additional terms is adopted at a later date).

(n9)Footnote 8. *Postow v. OBA Fed. Sav. & Loan Ass'n, 627 F.2d 1370 (D.C. Cir. 1980)* .

(n10)Footnote 9. *See § 1.07[2] supra*.

(n11)Footnote 10. *See, e.g., Goldman v. First Nat'l Bank of Chicago, 532 F.2d 10, 21 (7th Cir. 1976)* , *cert. denied, 429 U.S. 870 (1976)* ; *Larobina v. First Union, 2001 Conn. Super. LEXIS 3549* (Conn. Super. Ct. Dec. 13, 2001) (for open-ended credit, statute of limitations begins to run when consumer is on notice that a violation has occurred).

(n12)Footnote 11. Ralph J. Rohner & Fred H. Miller, Truth in Lending P 12.05[4][a] (2000); *Schmidt v. Citibank (South Dakota) N.A., 645 F. Supp. 214 (D. Conn. 1986)* , *further proceedings, 677 F. Supp. 687 (D. Conn. 1987)* .

(n13)Footnote 12. *15 U.S.C. § 1666*.

(n14)Footnote 13. *15 U.S.C. § 1666a*. See *§ 1.07[6] supra* for more details of a creditor's duty under the FCBA.

(n15)Footnote 14. *Burnstein v. Saks Fifth Ave. & Co., 208 F. Supp. 2d 765 (E.D. Mich. 2002)* ; *Steimel v. Trans Union Corp., 1988 U.S. Dist. LEXIS 4100* (E.D. Pa. May 4, 1988) . *Kennedy v. Victoria's Secret Stores, Inc., 2004 U.S. Dist. LEXIS 19525* (E.D. La. Sept. 28, 2004) (suit may be filed within one year of creditor's failure to respond properly to timely notice of billing error).

(n16)Footnote 15. *Burnstein v. Saks Fifth Ave. & Co., 208 F. Supp. 2d 765 (E.D. Mich. 2002)* ; *Steimel v. Trans Union Corp., 1988 U.S. Dist. LEXIS 4100* (E.D. Pa. May 4, 1988) .

(n17)Footnote 16. *15 U.S.C. § 1643*.

(n18)Footnote 17. *Draiman v. American Express Travel Related Servs. Co., 892 F. Supp. 1096 (N.D. Ill. 1995)* .

(n19)Footnote 18. *But see Blue v. Fremont Inv. & Loan, 562 F. Supp. 2d 33 (D.D.C. 2008)* (rejecting argument that one-year statute of limitations can be added to three-year rescission period to create four-year limitations period for damages claim).

(n20)Footnote 19. *See § 1.08[3][c] supra*.

(n21)Footnote 20. *See McNinch v. Mortgage Am., Inc. (In re McNinch), 250 B.R. 848 (Bankr. W.D. Pa. 2000)* (statute of limitations for damages for rescission violation runs from date of violation, which is the failure to act, and which becomes a violation 20 days after the creditor receives the notice). *See, e.g., Ralls v. Bank of N.Y. (In re Ralls), 230 B.R. 508 (Bankr. E.D. Pa. 1999)* (rescission claim allowed where notice of rescission sent within three years and suit filed less than one year later, even though suit was filed outside three-year period); *Mayfield v. Vanguard Sav. & Loan Ass'n, 710 F. Supp. 143 (E.D. Pa. 1989)* (violation of failing to honor the consumer's exercise of the right to rescind occurs on the 21st day after creditor's receipt of the notice). *Cf. Wiggins v. Avco Fin. Servs., 62 F. Supp. 2d 90 (D.D.C. 1999)* (damages claim for nondisclosure must be brought within one year of consummation even if same disclosure violations also extend time for rescission; no discussion of damages for failure to respond to rescission notice); *Gibbons v. Interbank Funding Group, 208 F.R.D. 278 (N.D. Cal. 2002)* (claim for statutory damages for failure to recognize the plaintiff's right to rescind was not barred by the statute of limitations when the claim was brought within one year after the expiration of the 20-day period after rescission). *Belini v. Washington Mutual Bank, 412 F.3d 17 (1st Cir. 2005)* (statute of limitations begins to run, at earliest, on date creditor received rescission notice, and "likely 20 days later"). *See also McIntosh v. Irwin Union Bank & Trust Co., 215 F.R.D. 26, 30 (D. Mass. 2003)* (suggesting that if a claim for rescission is timely because it was exercised within the three-year period set by section 1635(f), then the consumer can also seek damages for disclosure violations even if they would normally be barred by the one-year statute of limitations. *But see Brown v. Nationscredit Fin. Servs. Corp., 349 F. Supp. 2d 1134 (N.D. Ill. 2005)* ; *Bell v. Ameriquest Mortg. Co., 2004 U.S. Dist. LEXIS 24289* (N.D. Ill. Nov. 30, 2004) ; *Rodrigues v. Members Mortg. Co., 323 F. Supp. 2d 202 (D. Mass. 2004)* (rejecting this argument). *Jones v. Ameriquest Mortgage Co., 2006 U.S. Dist. LEXIS 3788* (N.D. Ill. Jan. 31, 2006) (although statutory damages for disclosure violations were time-barred, statutory damages for failure to respond properly to rescission notice were not, when complaint was filed within one year of rescission).

(n22)Footnote 21. *See* National Consumer Law Center, Truth in Lending § 2.5.5 (6th ed. 2007 and Supp.).

(n23)Footnote 22. *Arrington v. Colleen, Inc., 2000 U.S. Dist. LEXIS 20651* (D. Md. Aug. 7, 2000) . *See also* National Consumer Law Center, Truth in Lending (6th ed. 2007 and Supp.) § 4.9.4 (discussion of whether renewal of payday loan is a refinancing), *and* § 8.6.3.1 (discussion of multiple transactions in context of statutory damages issues).

(n24)Footnote 23. *See* National Consumer Law Center, Truth in Lending § 2.5.2 (6th ed. 2007 and Supp.).

(n25)Footnote 24. The four leading cases holding that the TILA statute of limitations may be equitably tolled are *Ellis v. GMAC, 160 F.3d 703 (11th Cir. 1998)* ; *Ramadan v. Chase Manhattan Corp., 156 F.3d 499 (3d Cir. 1998)* ; *King v. California, 784 F.2d 910 (9th Cir. 1986)* , *cert. denied, 484 U.S. 802, 108 S. Ct. 47, 98 L. Ed. 2d 11 (1987)* ; and *Jones v. TransOhio Sav. Ass'n, 747 F.2d 1037 (6th Cir. 1984)* . *See Weil v. Long Island Sav. Bank, FSB, 77 F. Supp. 2d 313 (E.D.N.Y. 1999)* (statute of limitations tolled until secret kickback scheme was revealed by publication of OTS investigation); *Camunas Cordova v. Banco Bilbao Vizcaya De P.R., 73 F. Supp. 2d 133 (D.P.R. 1999)* (recognizing equitable tolling, but holding it inapplicable on facts where consumer could have discovered any disclosure violations more than a year before action filed); *Kent v. Celozzi-Ettleson Chevrolet, Inc., 1999 U.S. Dist. LEXIS 17282* (N.D. Ill. Nov. 1, 1999) (discovery rule applies to TIL claim; defendant's motion to dismiss denied). *See also Lawyers Title Ins. Corp. v. Dearborn Title Corp., 118 F.3d 1157 (7th Cir. 1997)* (holding that fraudulent concealment tolls RESPA statute of limitations, analogizing to TILA); *Cardiello v. Money Store, Inc., 2001 U.S. Dist. LEXIS 7107* (S.D.N.Y. May 31, 2001) ; *In re* Consolidated "Non-Filing Insurance" *Fee Litig., 195 F.R.D. 684 (M.D. Ala. 2000)* ; *Rizzo v. H&R Block, Inc., 2000 U.S. Dist. LEXIS 13259* (W.D. Mo. Mar. 10, 2000) (TIL limitations period is subject to equitable tolling); *Kerby v. Mortgage Funding Corp., 992 F. Supp. 787 (D. Md. 1998)* ; Anderson v. FNMA, Clearinghouse No. 42,568 Civ. No. 87-0236 (E.D. Va. Nov. 25, 1987) (denies creditor's motion to dismiss based on statute of limitations where consumers alleged fraudulent concealment, citing *Jones*); *Burton v. U.S. Postal Serv., 612 F. Supp. 1057 (N.D. Ohio 1985)* (citing *Jones* in a non-TIL case, court held fraudulent concealment could toll statute of limitations if that would serve the congressional purpose); *Roberson v. Cityscape Corp. (In re Roberson), 262 B.R. 312 (Bankr. E.D. Pa. 2001)* ; *Matthews v. New Century Mortgage Corp., 185 F. Supp. 2d 874 (S.D. Ohio 2002)* (statute of limitations equitably tolled when borrowers were not given opportunity to review TILA disclosures and did not receive copies of any disclosures or loan documents at closing). *Reiser v. Residential Funding Corp., 380 F.3d 1027 (7th Cir. 2004)* (either equitable tolling or equitable estoppel may apply); *Tammerello v. Ameriquest Mortg. Co., 2005 U.S. Dist. LEXIS 11746* (N.D. Ill. June 2, 2005) ; *McAnaney v. Astoria Fin. Corp., 357 F. Supp. 2d 578 (E.D.N.Y. 2005)* ; *Bolden v. Aames Funding Corp., 2005 U.S. Dist. LEXIS 44091* (W.D. Tenn. Feb. 25, 2005) ; *Jackson v. Adcock, 2004 U.S. Dist. LEXIS 16888* (E.D. La. Aug. 20, 2004) ; *Gonzalez v. Ameriquest Mortg. Co., 2004 U.S. Dist. LEXIS 22705* (N.D. Cal. Mar. 1, 2004) (denial of motion to dismiss). *But see Bryant v. Mortgage Capital Res. Corp., 197 F. Supp. 2d 1357 (N.D. Ga. 2002)* (no equitable tolling when violations were readily apparent on the face of disclosure documents); *Greer v. Bank One, 2002 U.S. Dist. LEXIS 13715* (N.D. Ill. July 23, 2002) , *aff'd, 54 Fed. Appx. 232, 2002 U.S. App. LEXIS 26352 (7th Cir. 2002)* , *reh'g, en banc, denied, 54 Fed. Appx. 450, 2003 U.S. App. LEXIS 566 (7th Cir. 2003)* . Note also that the three-year period for the extended right to rescind certain real estate-secured loans is not subject to equitable tolling because it is a statute of repose, not a statute of limitations. *See Williams v. EMC Mortgage Corp. (In re Williams), 276 B.R. 394 (Bankr. E.D. Pa. 2002)* ; *Garrett v. Fleet Fin. Inc., 252 Ga. App. 47, 556 S.E.2d 140 (2001)* ; National Consumer Law Center, Truth in Lending § 7.2.3.1 (5th ed. 2003 and Supp.). *See also* Ephraim v. e*HomeCredit Corp., 2006 U.S. Dist. LEXIS 13916* (M.D. Pa. Mar. 13, 2006) ; *Veal v. Crown Auto Dealerships, Inc., 236 F.R.D. 572 (M.D. Fla. 2006)* (equitable tolling can be established on class-wide basis if plaintiff can show a fraudulent scheme by defendant to conceal the true cost and benefit of the product); *Deaville v. Capital One Bank, 425 F. Supp. 2d 744 (W.D. La. 2006)* ; *Benjamin v. Centier Bank, 2006 U.S. Dist. LEXIS 9315* (N.D. Ind. Feb. 15, 2006) ; *Veal v. Crown Auto Dealerships, Inc., 2006 U.S. Dist. LEXIS 8243* (M.D. Fla. Feb. 21, 2006) ; *Porter v. NationsCredit Consumer Discount Co., 2006 U.S. Dist. LEXIS 14925* (E.D. Pa. Mar. 31, 2006) (denying creditor's motion for summary judgment; statute of limitations may be tolled when closing documents and a post-closing postcard said that plaintiff had not purchased credit insurance), *reconsideration denied in part, granted in part on other issues, 2006 U.S. Dist. LEXIS 41947* (E.D. Pa. June 22, 2006) .

(n26)Footnote 25. *15 U.S.C. § 1640(e), 1605(i)(7). See, e.g., Moor v. Travelers Ins. Co., 784 F.2d 632 (5th Cir. 1986)* ; *Roberson v. Cityscape Corp. (In re Roberson), 262 B.R. 312 (Bankr. E.D. Pa. 2001)* .

(n27)Footnote 26. *See Lawyers Title Ins. Corp. v. Dearborn Title Corp., 118 F.3d 1157 (7th Cir. 1997)* (allowing trial court to consider a fraudulent conveyance claim based on a RESPA violation even where the RESPA violation claim is itself time-barred).

(n28)Footnote 27. *523 U.S. 410, 118 S. Ct. 1408, 140 L. Ed. 2d 566 (1998)* ; *Williams v. EMC Mortgage Corp (In*

re Williams), 276 B.R. 394 (Bankr. E.D. Pa. 2002) ; *Garrett v. Fleet Fin., 556 S.E.2d 140 (Ga. Ct. App. 2001)* . *But see Bank of N.Y. v. Waldon, 751 N.Y.S.2d 341 (Sup. Ct. 2002)* (three-year period for rescission is subject to equitable tolling).

(n29)Footnote 28. *See Fidler v. Central Coop. Bank (In re Fidler), 226 B.R. 734 (Bankr. D. Mass. 1998)* (rescission by recoupment allowed under Massachusetts statute that parallels TILA).

(n30)Footnote 29. *See, e.g., In re Werts, 48 B.R. 980 (Bankr. E.D. Pa. 1985)* ; *Soto v. PNC Bank (In re Soto), 221 B.R. 343 (Bankr. E.D. Pa. 1998)* ; *Money Store/Delaware, Inc. v. Kamara, 1997 Del. Super. LEXIS 280* (Del. June 19, 1997) ; *Key Sav. Bank, F.S.B. v. Dean, 695 So. 2d 808 (Fla. Dist. Ct. App. 1997)* (set off of actual damages available even though statute of limitations prevented rescission); *First Trust Nat'l Ass'n v. Chiang, 242 A.D.2d 599, 662 N.Y.S.2d 137 (1997)* ; *Groves v. Construction Equip. Fed. Credit Union, 1997 Tex. App. LEXIS 6683* (Tex. App. Dec. 18, 1997) ; *Ballew v. Associates Fin. Serv., 450 F. Supp. 253 (D. Neb. 1976)* ; *First State Bank of Crosset v. Phillips, 13 Ark. App. 157, 681 S.W.2d 408 (1984)* ; *Ex parte Fletcher, 429 So. 2d 1041 (Ala. 1982)* ; *Dawe v. Merchants Mortgage & Trust Corp., 683 P.2d 796 (Colo. 1984)* ; Household Fin. Co. v. Gibson, Clearinghouse No. 21,412 (Cal. Mun. Ct. 1977). *But see Beach v. Great W. Bank, 692 So. 2d 146 (Fla. 1997)* (TILA damage claim in recoupment allowed, but rescission defense rejected), *aff'd sub nom. Beach v. Ocwen Fed. Bank, 523 U.S. 410, 118 S. Ct. 1408, 140 L. Ed. 2d 566 (1998)* .

(n31)Footnote 30. *See, e.g., Barsky v. Commercial Credit Corp. (In re Barsky), 210 B.R. 683 (Bankr. E.D. Pa. 1997)* ; *Fidler v. Central Coop. Bank (In re Fidler), 210 B.R. 411 (Bankr. D. Mass. 1997)* , *vacated, in part, reaff'd, in part, 226 B.R. 734 (Bankr. D. Mass. 1998)* ; *Botelho v. Citicorp Mortgage, Inc. (In re Botelho), 195 B.R. 558 (Bankr. D. Mass. 1996)* , *aff'd*, Case No. 96-12279-EFH (D. Mass. Mar. 7, 1997); *In re Coxson, 43 F.3d 189 (5th Cir. 1995)* (TIL claim can be raised defensively by way of adversary proceeding objecting to proof of claim in a chapter 13 case); *In re Jones, 122 B.R. 246 (W.D. Pa. 1990)* ; *In re Werts, 48 B.R. 980 (E.D. Pa. 1985)* ; *In re Bishop, 79 B.R. 94 (Bankr. D.D.C. 1987)* . *See also In re Shaw, 178 B.R. 380, 1994 Bankr. LEXIS 2167 (Bankr. D.N.J. 1994)* (TIL rescission by recoupment allowed in bankruptcy court against creditor's proof of claim); *In re Galea'i, 31 B.R. 629 (Bankr. D. Hawaii 1981)* (existence of prior state court collection action justified recoupment claim in bankruptcy).

(n32)Footnote 31. *Savings Bank of Rockville v. Wielgos, 2001 Conn. Super. LEXIS 1764* (Conn. Super. Ct. June 29, 2001) .

(n33)Footnote 32. *15 U.S.C. § 1640(f). See, e.g., Cades v. H&R Block, Inc., 43 F.3d 869 (4th Cir. 1994)* (creditor, relying on official commentary, properly based the APR of the loan on a maturity date of one year). *But cf. In re Melvin, 75 B.R. 952 (Bankr. E.D. Pa. 1987)* (use of an incorrect FRB model form is not protected by § 130(f)).

(n34)Footnote 33. *15 U.S.C. § 1604(b). See Rubino v. Circuit City Stores, Inc., 2001 Ill. App. LEXIS 54* (Feb. 9, 2001) (use of model form is complete defense). The model forms defense does not, however, apply to numerical disclosures (*see Gibson v. Bob Watson Chevrolet-Geo, 112 F.3d 283 (7th Cir. 1997))* and the creditor must have selected the "appropriate" model form. *See, e.g., Porter v. Mid-Penn Consumer Disc. Co. (In re Porter), 961 F.2d 1066 (3d Cir. 1992)* (creditor incorrectly gave the model rescission notice for a new loan instead of a refinanced loan); *Gibbons v. Interbank Funding Group, 208 F.R.D. 278 (N.D. Cal. 2002)* (creditor violated TILA when it gave a notice of rescission for a refinanced home-secured loan instead of a new loan; not entitled to model forms defense). Some creditors are now actually combining the two forms into a single form; in those cases, it is especially critical to determine whether the correct box is checked off, i.e., whether the box for a new loan versus a refinancing is appropriately checked off.

(n35)Footnote 34. It also operates as a defense to administrative and criminal enforcement under §§ 1607 and 1611.

(n36)Footnote 35. *Cf. FDIC v. Hughes Dev. Co., 684 F. Supp. 616 (D. Minn. 1988)* , *aff'd, 938 F.2d 889 (8th Cir. 1991)* (rescission is not a "penalty" within the meaning of *15 U.S.C. § 1612(b)* (governmental exemption); rather,

purpose of rescission is to return parties to status quo ante); *French v. Wilson, 446 F. Supp. 216 (D.R.I. 1978)* ("bona fide error" defense (prior to 1980 amendments) held inapplicable against rescission because it shielded against "liability" under *15 U.S.C. § 1640*, not to "rescission" under § 1635); *Pfennig v. Household Credit Servs., 295 F.3d 522 (6th Cir. 2002)* (good faith conformity defense provides immunity from "civil liability," thus court dismissed plaintiff's claim for monetary damages, but not her claim for non-monetary equitable relief), *rev'd on other grounds*, *124 S. Ct. 1741, 158 L. Ed. 2d 450 (2004)* .

(n37)Footnote 36. Reg. Z app. C; Official Staff Commentary app. C-1 ("individual interpretations generally will not be issued separately from the Commentary"). Under the Old Act, creditors frequently claimed reliance on unofficial staff interpretations, written and oral. The majority of courts found such reliance misplaced. *Ives v. W.T. Grant Co., 522 F.2d 749 (2d Cir. 1975)* (reliance defense not available for staff letters or pamphlets); *Brown v. U.S. Life Credit Corp., 602 S.W.2d 94 (Tex. Civ. App. 1980)* (reliance on FRB Opinion Letter insufficient because the opinion is not a rule, regulation or interpretation). *But see Welmaker v. W.T. Grant Co., 365 F. Supp. 531 (N.D. Ga. 1972)* (creditor not liable where it relied on FTC and FRB staff opinions, advice, and negotiations).

(n38)Footnote 37. *Hamilton v. Southern Disc. Co., 656 F.2d 150 (5th Cir. 1981)* ; Fabricant v. Sears Roebuck, Clearinghouse No. 54,563 (S.D. Fla. Mar. 5, 2002).

(n39)Footnote 38. *Sentinel Fed. Sav. & Loan Ass'n v. Office of Thrift Supervision, 946 F.2d 85 (8th Cir. 1991)* (creditor's "mistaken belief that it could ignore the Commentary and rely on its supposed compliance with general mandates of Regulation Z does not entitle it to statutory good faith defense found in *15 U.S.C. § 1640(f)*"); Fabricant v. Sears Roebuck, Clearinghouse No. 54,563, Case No. 98-1281-Moreno (S.D. Fla. Mar. 5, 2002) (creditor's mistaken interpretation of Reg. Z does not entitle it to the good faith conformity defense); *Cannon v. Cherry Hill Toyota, Inc., 161 F. Supp. 2d 362 (D.N.J. 2001)* (creditor not entitled to rely on its interpretation of Official Staff Commentary section when interpretation was "preposterous").

(n40)Footnote 39. *Valencia v. Anderson Bros. Ford, 617 F.2d 1278 (7th Cir. 1980)* , *rev'd on other grounds, 452 U.S. 205, 101 S. Ct. 2266, 68 L. Ed. 2d 783 (1981)* (creditor's mistaken interpretation of Reg. Z, even if honest and reasonable, is not a defense under § 1640(f)); *Kessler v. Associates Fin. Servs. Co., 573 F.2d 577, 579 (9th Cir. 1977)* ; *Smith v. Wells Fargo Credit Corp., 713 F. Supp. 354 (D. Ariz. 1989)* ; *Pearson v. Easy Living, Inc., 534 F. Supp. 884 (S.D. Ohio 1981)* . *See also Hendley v. Cameron-Brown Co., 840 F.2d 831 (11th Cir. 1988)* ; *Warren v. Darnell, 164 Ill. App. 3d 273, 115 Ill. Dec. 225, 517 N.E.2d 636 (1987)* .

(n41)Footnote 40. *Charles v. Krauss Co., 572 F.2d 544 (5th Cir. 1978)* (creditor's good faith belief that its contract form complied with the literal language of § 226.801 forms exception provided a good faith defense); *Brown v. Coleman Invs., 993 F. Supp 439 (M.D. La. 1998)* (dealer relied on Commentary provision about dealer upcharges, which court characterizes as ambiguous); *Baldwin v. Laurel Ford Lincoln-Mercury, Inc., 32 F. Supp. 2d 894 (S.D. Miss. 1998)* (assignee who relied on good faith interpretation of FRB's dealer upcharge Commentary, which court considered ambiguous, entitled to defense).

(n42)Footnote 41. *Leon v. Washington Mut. Bank, F.A., 164 F. Supp. 2d 1034 (N.D. Ill. 2001)* .

(n43)Footnote 42. *15 U.S.C. § 1640(c). See Warren v. Darnell, 164 Ill. App. 3d 273, 115 Ill. Dec. 225, 517 N.E.2d 636 (1987)* . *See Yarnall v. Four Aces Emporium, Inc. (In re Boganski), 322 B.R. 422 (B.A.P. 9th Cir. 2005)* (no bona fide error where clerk made handwritten changes to some disclosures but failed to change APR, where this was a failure to follow lender's own protocol; even a cursory check would have revealed the error, and lender did not correct the error after discovering).

(n44)Footnote 43. *15 U.S.C. § 1640(c).*

(n45)Footnote 44. The prior version of the bona fide error defense did not apply to rescission. Old TILA § 130(c), *15 U.S.C. § 1640(c)*; *French v. Wilson, 446 F. Supp. 216 (D.R.I. 1978)* .

(n46)Footnote 45. *See Turner v. Firestone Tire & Rubber Co., 537 F.2d 1296 (8th Cir. 1976)* ; *Mirabal v. GMAC, 537 F.2d 871 (7th Cir. 1976)* ; *In re Underwood, 66 B.R. 656 (Bankr. W.D. Va. 1986)* ; *Associates Fin., Inc. v. Cedillo, 89 Ill. App. 3d 179, 411 N.E.2d 1194 (1980)* ; Ellis v. Hensley, [1974-1980 Transfer Binder] Consumer Cred. Guide (CCH) P 97,606, Clearinghouse No. 27,967 (Ohio Ct. App. 1979); *Ballard v. Hillcrest State Bank, 592 S.W.2d 373 (Tex. Civ. App. 1979)* ; *see also Pedro v. Pacific Plan of Cal., 393 F. Supp. 315 (N.D. Cal. 1975)* (where appraisal fee was expunged from account since appraisal had not been conducted, but fee appeared in pre-printed disclosure form, creditor had not met its burden of proving procedures to avoid the error). *See also Webster v. Centex Home Equity Corp. (In re Webster), 300 B.R. 787 (Bankr. W.D. Okla. 2003)* (no bona fide error where creditor presented no evidence of a safety catch or rechecking mechanism).

(n47)Footnote 46. *Ray v. City Motors, Inc., 1998 U.S. Dist. LEXIS 22809* (S.D. W. Va. June 30, 1998) ; Fair v. Dartmouth Plan, Inc., [1974-1980 Transfer Binder] Consumer Cred. Guide P 96,940 (D. Conn. 1982).

(n48)Footnote 47. Reg. Z § 226.14 n.31a (open-end); Reg. Z § 226.22 n.45d (closed-end).

(n49)Footnote 48. *15 U.S.C. § 1640(b). See, e.g., In re Mitchell, 75 B.R. 593 (Bankr E.D. Pa. 1987)* (if disclosures were inaccurate at date of closing, creditor had 60 days to make correct disclosures). *See, e.g., Yarnall v. Four Aces Emporium, Inc. (In re Boganski), 322 B.R. 422 (B.A.P. 9th Cir. 2005)* (rejecting correction of error defense where there was no evidence that lender ever corrected the error).

(n50)Footnote 49. *15 U.S.C. § 1640(b)* (no liability "for *any* failure to comply with *any* requirement imposed") (emphasis added).

(n51)Footnote 50. *Hamilton v. Southern Disc. Co., 656 F.2d 150 (5th Cir. 1981)* ; *Thomka v. A.Z. Chevrolet, Inc., 619 F.2d 246 (3d Cir. 1980)* ; *Nigh v. Koons Buick Pontiac GMC, Inc., 143 F. Supp. 2d 563 (E.D. Va. 2001) cert. granted, 124 S. Ct. 1144, 157 L. Ed. 2d 1041 (2004)* ; *Pearson v. Easy Living, Inc., 534 F. Supp. 884 (S.D. Ohio 1981)* ; *Hardin v. Cliff Pettit Motors, Inc., 407 F. Supp. 297 (E.D. Tenn. 1976)* ; Forrester v. Century Fin. Co., Clearinghouse No. 19,434 (N.D. Ga. 1974). *See also Molenbeek v. Western Mich. Auto & Truck Outlet, Inc., 2001 U.S. Dist. LEXIS 3433* (W.D. Mich. Mar. 15, 2001) (correction of errors defense probably does not apply to timing error). *Contra* Kukonu v. Beneficial Fin. Co., Clearinghouse No. 22,524 (D. Hawaii 1978); *Baker v. Sunny Chevrolet, Inc., 349 F.3d 862 (6th Cir. 2003)* (court allowed a creditor to rely on the correction of error defense where the violation was failure to provide disclosures prior to consummation).

(n52)Footnote 51. *15 U.S.C. § 1640(b).*

(n53)Footnote 52. *15 U.S.C. § 1640(c).*

(n54)Footnote 53. *Abercrombie v. Wells Fargo Bank, 417 F. Supp. 2d 1006 (N.D. Ill. 2006)* .

(n55)Footnote 54. *15 U.S.C. § 1634*; Reg. Z § 226.17(e). *Smith v. Fidelity Consumer Disc. Co., 898 F.2d 896 (3d Cir. 1990)* (fee intended for payment of official fee to clear title, but retained by the creditor because the lienholder had gone out of business, is not a finance charge; creditor did not use fee as intended, but through no fault of its own, and, thus, was protected from liability by the subsequent occurrence defense); *see, e.g.*, Harris v. Research Fed. Credit Union, [1974-1980 Transfer Binder] Consumer Cred. Guide (CCH) P 97,737 (E.D. Mich. 1979). *See also Billions v. White & Stafford Furniture Co., 528 So. 2d 878 (Ala. Ct. Civ. App. 1988)* (changing APR disclosure from 21.00% to 20.99% is a subsequent occurrence and favored the consumer to boot).

Note that, in some cases, new disclosures may be required, however. *See* Reg. Z §§ 226.17(e), 226.17(f), 226.19, and 226.20.

(n56)Footnote 55. *In re Gillespie, 110 B.R. 742 (Bankr. E.D. Pa. 1990)* ; *Kasket v. Chase Manhattan Mortgage Corp., 695 So. 2d 431 (Fla. Dist. App. Ct. 1997)* (bank to which Resolution Trust Co. assigned obligation was subject to

recoupment claim for TIL damages).

(n57)Footnote 56. *See* Ch. 2, *§ 2.06 infra* .

(n58)Footnote 57. *15 U.S.C. § 1641(c). But see Coleman v. Equicredit Corp. of Am., 2002 U.S. Dist. LEXIS 969* (N.D. Ill. Jan. 22, 2002) (in dicta, court questions whether right of rescission automatically extends to assignees).

(n59)Footnote 58. *15 U.S.C. § 1641(c).*

(n60)Footnote 59. *15 U.S.C. § 1641(a).* The limitation also applies to administrative enforcement under *15 U.S.C. § 1607. Kennedy v. BMW Fin. Servs., 363 F. Supp. 2d 110, 118 (D. Conn. 2005)* (assignee not liable for overstatement of fees for title, registration, and licensing); *Pulphus v. Sullivan, 2004 U.S. Dist. LEXIS 13234* (N.D. Ill. July 15, 2004) ; *Siner v. Am. Gen. Fin., Inc. 2004 U.S. Dist. LEXIS 12924* (E.D. Pa. July 8, 2004) (assignee not liable for statutory damages for rescission violations unless disclosure violations are apparent on face of documents); *Parker v. Potter, 2006 U.S. Dist. LEXIS 32924* (M.D. Fla. May 24, 2006) (assignee has no duty to inquire beyond face of document to determine whether appropriate disclosures were made); *McMaster v. CIT Group/Consumer Fin., Inc., 2006 U.S. Dist. LEXIS 28831* (E.D. Pa. May 11, 2006) (assignee has no duty of inquiry). *See Marcelos v. Dominguez, 2008 U.S. Dist. LEXIS 91916* (N.D. Cal. Apr. 21, 2008) (fact question whether highly unusual $200,000 broker fee, apparent on face of documents, made assignee liable; note, however, that court erroneously appears to treat assignee's liability for rescission as depending on violation being apparent on face of documents).

(n61)Footnote 60. *Brown v. Mortgagestar, 194 F. Supp. 2d 473 (S.D. W. Va. 2002)* (discrepancies between TILA disclosure, deed of trust, and note were sufficient for assignee liability); *England v. MG Invs., Inc., 93 F. Supp. 2d 718 (S.D. W. Va. 2000)* (denying assignee's motion for summary judgment where inaccuracy of disclosures was apparent from comparison of note to disclosure statement); *Mount v. LaSalle Bank Lake View, 926 F. Supp. 759 (N.D. Ill. 1996)* (violation of clear and conspicuous disclosure requirement is apparent on face of the statement). *See also Vaden v. IndyMac Bank, 2003 U.S. Dist. LEXIS 16907* (N.D. Ill. Sept. 16, 2003) (use of the wrong model form is apparent on the face of the documents, as is identifying the collateral with a number instead of a description); *Johnson v. Thomas, 794 N.E.2d 919 (Ill. App. 2003)* (visible use of liquid paper to change the disclosures, without evidence such as the consumer's initials to show consent to the changes, is apparent on the face of the documents).

(n62)Footnote 61. *But see Murry v. America's Mortgage Banc, Inc., 2004 U.S. Dist. LEXIS 12045* (N.D. Ill. June 29, 2004) (erroneously concluding that violation was not apparent on face of documents where consumer was charged twice for title insurance; decision also misconstrues assignees' liability for rescission).

(n63)Footnote 62. *15 U.S.C. § 1635(c).* In a transaction subject to the right of rescission, a written acknowledgment of receipt entitles the assignee to no more than a rebuttable presumption of delivery. *Id. See Bryant v. Mortgage Capital Res. Corp, 197 F. Supp. 2d 1357 (N.D. Ga. 2002)* ("rebuttable presumption" standard in § 1635(c) trumps the "conclusive proof" standard in § 1641(b), even with respect to assignees).

(n64)Footnote 63. *15 U.S.C. § 1641(b).* If the assignee knew when it acquired the debt that there was no delivery, it is not entitled to this irrebuttable presumption.

(n65)Footnote 64. *E.g., Cox v. First Nat'l Bank of Cincinnati, 633 F. Supp. 236 (S.D. Ohio 1986)* ; *In re Stewart, 93 B.R. 878 (Bankr. E.D. Pa. 1988) . See also Chandler v. MVM Constr., Inc., 501 S.E.2d 533 (Ga. App. 1998)* (citing Holder Rule as one basis for conclusion that assignee's liability must be decided by jury).

(n66)Footnote 65. *See, e.g., Ellis v. GMAC, 160 F.3d 703 (11th Cir. 1998)* ; *Taylor v. Quality Hyundai, 150 F.3d 689 (7th Cir. 1998) , cert. denied, 525 U.S. 1141, 119 S. Ct. 1032, 143 L. Ed. 2d 41 (1999)* ; *Walker v. Wallace Auto Sales, Inc., 155 F.3d 927 (7th Cir. 1998)* ; *Brown v. Coleman Invs., 993 F. Supp. 416 (M.D. La. 1998)* (Holder Rule does not subject assignee to liability for disclosure violations not apparent on face of contract); *Cemail v. Viking Dodge, Inc., 982 F. Supp. 1296 (N.D. Ill. 1997) .*

(n67)Footnote 66. *15 U.S.C. § 1641(b)* (emphasis added).

(n68)Footnote 67. *15 U.S.C. § 1641(a). See, e.g., Balderos v. City Chevrolet, 214 F.3d 849 (7th Cir. 2000)* (assignee not liable where documents assigned did not reveal whether charge was passed on to credit customers); *Ellis v. GMAC, 160 F.3d 703 (11th Cir. 1998)* (dealer upcharge not apparent on face of disclosure statement); *Walker v. Wallace Auto Sales, Inc., 155 F.3d 927 (7th Cir. 1998)* (even actual knowledge not sufficient if violation is not apparent from face of assigned documents); *England v. MG Invs., Inc., 93 F. Supp. 2d 718 (S.D. W. Va. 2000)* (denying assignees' motion for summary judgment where inaccuracy of disclosures was apparent from comparison of note to disclosure statement); *Johnson v. Fleet Fin., Inc., 785 F. Supp. 1003 (S.D. Ga. 1991)* (assignee not liable for failure to include brokers' fee in finance charge because not apparent on face of disclosures that a broker was required); *Shepeard v. Quality Siding & Window Factory, Inc., 730 F. Supp. 1295 (D. Del. 1990)* (assignee who received two contracts from a home improvement loan and was defending claimed violations on second one could not rely on first one, even assuming it was the operative disclosure form, to evidence proper disclosure when, on its face, it had several violations); *Brown v. Mortgagestar, Inc., 194 F. Supp. 2d 473 (S.D. W. Va. 2002)* (discrepancies between TILA disclosure, deed of trust, and note were sufficient for assignee liability). *But see Kane v. Equity One, Inc., 2003 U.S. Dist. LEXIS 23810* (E.D. Pa. Nov. 21, 2003) (assignee does not have duty of additional inquiry; no liability for assignor's loan splitting).

(n69)Footnote 68. *15 U.S.C. § 1641(d)*. There is an exception if the creditor could not, using ordinary due diligence, determine from specified loan documents that HOEPA covered the transaction.

(n70)Footnote 69. *See § 1.08[6] supra*.

(n71)Footnote 70. For a more extensive analysis, see *§§ 1.04[4][d]*, *1.05[2][e][ii][A]*, *1.08[3][b] supra* .

(n72)Footnote 71. The Truth in Lending Act Amendments of 1995, Pub. L. No. 104-29 § 4 (Sept. 30, 1995), *creating 15 U.S.C. § 1649*, *as corrected by* the Omnibus Consolidated Appropriations Act of 1996, Pub. L. No. 104-208, § 2107(a) (Sept. 30, 1996).

(n73)Footnote 72. *See § 1.09[2][b] supra*. That applies to arithmetic errors, not to errors in legal judgment.

(n74)Footnote 73. "It is obviously not intended to give lenders the right to pad fees up to the tolerance limit ... ." Cong. Rec. S14567 (Sept. 28, 1995) (statement of Sen. Sarbanes). "This legislation provides greater flexibility for honest mistakes. ..." 141 Cong. Rec. 314567 (Sept. 28, 1995) (statement of Sen. D'Amato). *But see Egert v. FT Mortgage Cos., 1999 U.S. Dist. LEXIS 11212* (N.D. Ill. July 16, 1999) (finding no good faith requirement for tolerances).

(n75)Footnote 74. For this group of charges, the immunity applies to rescission in foreclosure defense, as well as affirmative rescission and damages.

(n76)Footnote 75. *15 U.S.C. § 1649(a)(1)(A)*.

(n77)Footnote 76. *15 U.S.C. § 1649(a)(1)(B)*.

(n78)Footnote 77. *15 U.S.C. § 1649(a)(1)(B)*. Fees for post-consummation services are not protected by this immunity.

(n79)Footnote 78. *15 U.S.C. § 1649(a)(1)(C)*. In real estate loans, the agent's fees may qualify for a different exclusion from the finance charge, though.

(n80)Footnote 79. *See § 1.08[6] supra*.

(n81)Footnote 80. *15 U.S.C. § 1649(a)(1)(D). See* also *15 U.S.C. § 1635(i)(1)(A), (4)*.

(n82)Footnote 81. *See* National Consumer Law Center, Cost of Credit: Regulation, Preemption and Industry Abuses, 11.5.4.3 (3d ed. and supp.).

(n83)Footnote 82. The Truth in Lending Act Amendments of 1995, Pub. L. No. 104-29 § 2 (Sept. 30, 1995) (adding *15 U.S.C. § 1605(a)(6)*).

(n84)Footnote 83. *15 U.S.C. § 1649(a)(2)*. See *§ 1.08[6][c][iii] supra*, for a more detailed discussion of this defense. *See also § 1.08[3][b], [c] supra*.

(n85)Footnote 84. *15 U.S.C. § 1635(i)(1)(B), (2)*.

(n86)Footnote 85. *See §§ 1.04[4][d]* and *1.05[2][e][ii] supra* .

(n87)Footnote 86. *See § 1.08[3][b], [6] supra*.

(n88)Footnote 87. *15 U.S.C. § 1635(i)(4)*.

(n89)Footnote 88. *See Steele v. Ford Motor Credit Co., 783 F.2d 1016 (11th Cir. 1986)* ("unearned" interest should have been disclosed and was not de minimis because finance charge "is somehow more important than other required disclosures"); *Shroder v. Suburban Coastal Corp., 729 F.2d 1371, 1380 (11th Cir. 1984)* (liability will flow from "even minute deviations"); *Riopta v. Amresco Residential Mortgage Corp., 101 F. Supp. 2d 1326 (D. Haw. 1999)* ; *Acevedo v. Bally Total Fitness Corp., 1999 U.S. Dist. LEXIS 18029* (N.D. Ill. Nov. 9, 1999) ; *Clay v. Johnson, 77 F. Supp. 2d 879 (N.D. Ill. 1999)* (damages are mandatory for technical violation); *Pinkett v. Moolah Loan Co., 1999 U.S. Dist. LEXIS 17276* (N.D. Ill. Nov. 1, 1999) ; *Smith v. Cash Store Mgmt., Inc., 195 F.3d 325 (7th Cir. 1999)* (creditors are strictly liable for TILA inaccuracies, even if they are not misleading); *Gibbons v. Interbank Funding Group, 208 F.R.D. 278 (N.D. Cal. 2002)* (technical or minor violations of TILA or Reg. Z impose liability); *Decos v. Jojo Motors, 2002 U.S. Dist. LEXIS 6873* (N.D. Ill. Apr. 17, 2002) (failure to provide copy of TILA disclosures that consumer can keep is not a de minimis violation); *Basnight v. Diamond Developers, 146 F. Supp. 2d 754 (M.D.N.C. 2001)* (technical violations of TILA impose liability; creditor liable for misdated notice of right to rescind); *Fabricant v. Sears Roebuck, 202 F.R.D. 306 (S.D. Fla. 2001)* ("black letter law" that once a court finds a TILA violation, even if technical, it must impose liability); *Gilkey v. Central Clearing Co., 202 F.R.D. 515 (E.D. Mich. 2001)* (lenders are generally strictly liable under TILA for inaccuracies, even absent a showing that the inaccuracies are misleading); *Lifanda v. Elmhurst Dodge, 2001 U.S. Dist. LEXIS 9210* (N.D. Ill. June 29, 2001) (TILA requires absolute compliance and even technical violations form the basis for liability); *Rodrigues v. U.S. Bank (In re Rodrigues), 278 B.R. 683 (Bankr. D.R.I. 2002)* (courts must impose strict liability for technical or minor violations of TILA); *Patterson v. Bob Wade Lincoln-Mercury, 52 Va. Cir. 319, 2000 Va. Cir. LEXIS 282* (Va. Cir. Ct. June 14, 2000) (Consumer Leasing Act is a strict liability statute; once a court finds a violation, no matter how technical, it has no discretion regarding the imposition of liability); *Vaden v. IndyMac Bank, 2003 U.S. Dist. LEXIS 16907* (N.D. Ill. Sept. 16, 2003) ; *Bilal v. Household Fin. Corp. (In re Bilal), 296 B.R. 828, 832 (D. Kan. 2003)* ; *Floyd v. Security Fin. Corp., 181 F. Supp. 2d 1137 (D. Nev. 2001)* ; *Johnson v. Thomas, 794 N.E.2d 919, 926 (Ill. App. 2003)* (even technical violations provide basis for liability). *But see Cowen v. Bank United, FSB, 70 F.3d 937 (7th Cir. 1995)* (affirming district court that a $10 fee improperly excluded from the finance charge was "de minimis" as it was within the tolerances of Reg. Z § 226.18(d), but noting that "hypertechnicality reigns" with respect to TILA violations; interestingly, this case has been cited for the latter proposition several times); *ContiMortgage Corp. v. Delawder, 2001 Ohio App. LEXIS 3410* (Ohio Ct. App. July 30, 2001) (when lender only provided one copy of a notice of right to rescind for two borrowers, it was a technical mistake that did not violate TILA; court also held that to be no TILA violation for post-dated waiver of right to rescind, but even if there was a violation, it was technical; court's opinion extremely hostile to TILA's strict liability); *Lattier-Holmes v. Peoples State Bank, 796 So. 2d 176 (La. App. 2d Cir. 2001) , cert. denied, 537 U.S. 897, 123 S. Ct. 197, 154 L. Ed. 2d 167 (2002)* (technical violation was not material and did not give rise to statutory damages). The decision in *Holmes* is perplexing, because the violation in question was a gross misstatement of an APR--the creditor stated an APR of 14.36% when the actual APR was 31.11%. The violation was neither technical nor immaterial. *See also Rodrigues v. Members Mortg. Co., 323*

F. Supp. 2d 202 (D. Mass. 2004) (even if creditor's listing of address of assignee as agent to receive rescission notice, without listing its own address, violated TILA, it would not extend right to rescind because it is a minor deviation with no potential for actual harm).

(n90)Footnote 88.1. *568 F.3d 309 (1st Cir. 2009) . See also Santos-Rodriguez v. Doral Mortgage Corp., 485 F.3d 12, 17 n.6 (1st Cir. 2007)* (asserting that the 1995 amendments adopt a clear and conspicuous standard in place of "hyper-technicality").

(n91)Footnote 88.2. *Melfi v. WMC Mortgage Corp., 568 F.3d 309, 313 (1st Cir. 2009)* .

(n92)Footnote 88.3. *Id.*; The Homeownership and Equity Protection Act of 1994, Pub. L. No. 104-29, § 8, *109 Stat. 274, 275* (Sept. 30, 1995) (codified as *15 U.S.C. § 1635(i)(2)*).

(n93)Footnote 89. *Rodash v. AIB Mortgage Co., 16 F.3d 1142 (11th Cir. 1994)* ; *Porter v. Mid-Penn Consumer Disc., 961 F.2d 1066 (3d Cir. 1992)* (rescission notice given was not clear notice of consumer's right; no matter that borrower may not have been confused by--or even have read--the notice; TILA is a strict liability statute); *Zamarippa v. Cy's Car Sales, Inc., 674 F.2d 877 (11th Cir. 1982)* ; *Charles v. Krauss Co., 572 F.2d 544 (5th Cir. 1978)* , *reh'g denied, 575 F.2d 881 (5th Cir. 1978)* ; *Williams v. Empire Funding Corp., 109 F. Supp. 2d 352 (E.D. Pa. 2000)* ; *Rendler v. Corus Bank, N.A., 2000 U.S. Dist. LEXIS 5093* (N.D. Ill. Mar. 30, 2000) (whether borrowers expected to receive two simultaneous loans is irrelevant to whether giving two sets of disclosures was TIL violation); *Bank of New York v. Ralls (In re Ralls), 230 B.R. 508 (Bankr. E.D. Pa. 1999)* (irrelevant that homeowner did not read all of the disclosures). *See also Stutsman County State Bank v. FDIC, 207 F.3d 464 (8th Cir. 2000)* (restitution order upheld even though creditor presented evidence that it had told consumers orally and in a letter about fee that was omitted from disclosure statement); *Vaden v. IndyMac Bank, 2003 U.S. Dist. LEXIS 16907* (N.D. Ill. Sept. 16, 2003) ; *Kurz v. Chase Manhattan Bank, 273 F. Supp. 2d 474 (S.D.N.Y. 2003) . Jones v. Ameriquest Mortgage Co., 2006 U.S. Dist. LEXIS 3788* (N.D. Ill. Jan. 31, 2006) .

(n94)Footnote 90. *See, e.g., Conrad v. Smith, 42 Wash. App. 559, 712 P.2d 866 (1986)* (borrower's preloan conduct, in obfuscating the true consumer purpose of the loan, led the court to deny rescission because the loan was ostensibly for commercial purposes). *See Milhollin v. Ford Motor Credit Co., 531 F. Supp. 379 (D. Or. 1981)* , *aff'd and rev'd in part on other grounds, 588 F.2d 753 (9th Cir. 1978)* , *rev'd on other grounds, 444 U.S. 555, 100 S. Ct. 790, 63 L. Ed. 2d 22 (1980)* (where consumer gave creditor incorrect figure, creditor not liable for understating an estimated down payment).

(n95)Footnote 91. *Clay v. Johnson, 22 F. Supp. 2d 832 (N.D. Ill. 1998)* , *reconsid. denied, 50 F. Supp. 2d 816 (N.D. Ill. 1999)* (consumer's allegedly unclean hands not a defense); Harris v. McCrory Corp., Clearinghouse No. 24,478 (N.D. Ga. 1976) (recommendation of special master).

(n96)Footnote 92. *Parker v. DeKalb Chrysler Plymouth, 673 F.2d 1178 (11th Cir. 1982)* ; *see also Myers v. American Fin. Sys., 615 F.2d 368 (5th Cir. 1980)* (parol evidence was admissible under a Georgia statute to determine whether debtor, who signed an agreement releasing the creditor from "all claims" in connection with a wrecked vehicle held as security by the creditor, intended to release his TIL claim).

(n97)Footnote 93. *Compare Parker v. DeKalb Chrysler Plymouth, 673 F.2d 1178 (11th Cir. 1982)* (while invalidating waiver because release contains no reference to TILA, court refuses to apply absolute rule that all releases of TILA claims are null and void), *with Buford v. American Fin. Co., 333 F. Supp. 1243 (N.D. Ga. 1971)* (any release of TILA claims are null and void). *See Abercrombie v. Wells Fargo Bank, 417 F. Supp. 2d 1006 (N.D. Ill. 2006)* (clause requiring consumer to give creditor the opportunity to correct any violations is invalid; it would gut TILA since a consumer who received corrected disclosures after having signed the contract would be unable to use them to shop for credit); *Tucker v. Beneficial Mortgage Co., 437 F. Supp. 2d 584 (E.D. Va. 2006)* (enforcing release waiving TIL claims, which consumers signed when they opted in to class action settlement negotiated by state attorney general; releases

were not presented by creditor acting in its own interest, and attorney general's bargaining power was equal to creditor's).

(n98)Footnote 94. *Mills v. Home Equity Group, Inc., 871 F. Supp. 1482 (D.D.C. 1994)* (work-out agreement on defaulted loan negotiated by attorney which purported to waive TIL claims did not waive the consumer's right to exercise her extended rescission right; to be valid, she would have had to know she had it, and explicitly waived it. *See § 1.08[6] infra*).

(n99)Footnote 95. *Harper v. Virginia Dep't of Taxation, 509 U.S. 86, 113 S. Ct. 2510, 125 L. Ed. 2d 74 (1993)* (overruling the more complex test set forth in *Chevron Oil Co. v. Huson, 404 U.S. 97, 92 S. Ct. 349, 30 L. Ed. 2d 296 (1971))* .

(n100)Footnote 96. *15 U.S.C. § 1604(d)*. The statute gives the FRB authority to allow a longer or shorter phase-in period in certain circumstances.

(n101)Footnote 97. *See, e.g., Cowen v. Bank United, FSB, 70 F.3d 937 (7th Cir. 1995)* ; *Pettola v. Nissan Motor Acceptance Corp., 44 F. Supp. 2d 442 (D. Conn. 1999)* (Commentary merely interpreted existing law rather than changing it, so may be applied retroactively); *McPhillips v. Gold Key Lease, Inc., 38 F. Supp. 2d 975 (M.D. Ala. 1999)* (if agency Commentary clarifies unsettled law, but does not change law, it may be applied retroactively); *Barlow v. Evans, 992 F. Supp. 1299 (M.D. Ala. 1997)* (applying Commentary revision because it was meant to clarify rather than change existing law concerning pawn transactions); *Smith v. Highland Bank, 915 F. Supp. 281 (N.D. Ala. 1996)* (giving retroactive application to FRB Commentary provision that favored creditor, where it was a clarification rather than a change), *aff'd on other grounds, 108 F.3d 1325 (11th Cir. 1997)* .

(n102)Footnote 98. *15 U.S.C. § 1640(e)*. For TIL actions seeking only damages, this choice exists even in those states which have been granted an exemption from Regulation Z in favor of similar state law, because the state exemptions extend to the Regulation Z disclosure rules, but not to the TILA's civil liability provisions in section 1640. *15 U.S.C. § 1610(a)(2)*. Melvin v. U.S. Bank N.A., Clearinghouse No. 54,569, Civil Action No. 01-30082 (D. Mass. Sept. 28, 2001). However, a consumer in an exempted state may not be able to rescind under section 1635 of TILA, but would need to use the analogous state law provision.

(n103)Footnote 99. *See Williams v. Sears, Roebuck & Co. (In re Williams), 244 B.R. 858 (S.D. Ga. 2000)* (bankruptcy court has jurisdiction over TIL claim arising from creditor's actions in securing reaffirmation agreement while bankruptcy case was pending; court can hear class-wide claim but only for debtors who filed their bankruptcy cases in that judicial district).

(n104)Footnote 100. *Schwartz v. Visa Int'l Corp., 2001 U.S. Dist. LEXIS 105* (N.D. Cal. Jan. 8, 2001) (UDAP claim based on TIL violation not removable); *Monday v. Coast to Coast Wireless Cable, 1997 U.S. Dist. LEXIS 2970* (M.D. Ala. Feb. 19, 1997) ; *Walker v. Commercial Credit Corp., 192 B.R. 260 (M.D. Ala. 1996)* (TILA does not provide basis for removal of complaint based on state usury law); *McCrae v. Commercial Credit Corp., 892 F. Supp. 1385 (M.D. Ala. 1995)* ; *Anderson v. Household Fin. Corp. of Ala., 900 F. Supp. 386 (M.D. Ala. 1995)* ; *Bonds v. H&R Block, Inc., 1990 U.S. Dist. LEXIS 6648* (N.D. Ill. June 1, 1990) ; *Walker v. Atwood Chevrolet-Olds, 189 F. Supp. 2d 594 (S.D. Miss. 2001)* (because the plaintiff had viable state law claims, court remanded case back to state court, finding that the "artful pleading" doctrine requiring removal was not implicated); *Brown v. Vickers Employees Credit Union, 162 F. Supp. 2d 528 (S.D. Miss. 2001)* (consumer's state law claims for misrepresentation were not disguised TILA claims and thus did not warrant removal under the artful pleading doctrine); *Howell v. Grant Holding, Inc., 2004 U.S. Dist. LEXIS 9400* (D. Minn. May 12, 2004) (where TIL and HOEPA violations were among several alternate bases for state law claim, it was not removable).

(n105)Footnote 101. *Bastrop Loan Co. v. Burley, 392 F. Supp. 970 (W.D. La. 1975) . See also General Elec. Capital Auto Lease, Inc. v. Mires, 788 F. Supp. 948 (E.D. Mich. 1992)* (creditor-plaintiff cannot remove case to federal

court based on consumer-defendants' TIL counterclaim).

(n106)Footnote 102. *See* Collier Consumer Bankruptcy Practice Guide (Matthew Bender).

(n107)Footnote 103. *28 U.S.C. § 1367*, Pub. L. No. 101-650, *104 Stat. 5113 (1990). But see Campbell v. Machias Sav. Bank, 865 F. Supp. 26 (D. Me. 1994)* , in which the court granted pendent jurisdiction over the borrower's state law claims following dismissal of the federal TILA claim, seemingly without considering the new standards; and *Fairley v. Turan-Foley Imports, Inc., 864 F. Supp. 4 (S.D. Miss. 1994)* (similar holding). *See, e.g., Hinson v. Norwest Fin. S.C., Inc., 239 F.3d 611 (4th Cir. 2001)* (district court did not abuse its discretion in remanding state claims to state court after TILA claims settled); *Wepsic v. Bankers Trust Co., 23 Fed. Appx. 694, 2001 U.S. App. LEXIS 24754* (9th Cir. Nov. 5, 2001) (district court did not abuse its discretion in declining supplemental jurisdiction over state law claims after it dismissed borrower's TILA claims); *Clement v. Amscot Corp., 176 F. Supp. 2d 1292 (M.D. Fla. 2001)* (dismissing without prejudice state usury claims after dismissing TILA claim); *Prifti v. PNC Bank, 2001 U.S. Dist. LEXIS 16387* (E.D. Pa. Oct. 9, 2001) (dismissing state UDAP claims after dismissing TILA claims); Melvin v. U.S. Bank N.A., Clearinghouse No. 54,569, Civil Action No. 01-30082 (D. Mass. Sept. 28, 2001) (supplemental jurisdiction is discretionary when plaintiff's federal claims are dismissed early in the litigation); *Fielder v. Credit Acceptance Corp., 98 F. Supp. 2d 1104 (W.D. Mo. 2000)* (remanding plaintiff's state claims after dismissing TILA claims).

(n108)Footnote 104. *See Bastrop Loan Co. v. Burley, 392 F. Supp. 970 (W.D. La. 1975) . See also General Elec. Capital Auto Lease, Inc. v. Mires, 788 F. Supp. 948 (E.D. Mich. 1992)* (creditor-plaintiff cannot remove case to federal court based on consumer-defendants' TIL counterclaim); *Johnson v. Aronson Furniture Co., 1998 U.S. Dist. LEXIS 14454* (N.D. Ill. Sept. 11, 1998) (declining supplemental jurisdiction over collection counterclaim in a TILA/RICO class action citing chilling effect; only link between the TILA claim and the collection counterclaim is the initial execution of the contract, which is insufficient to support a finding that they are so related as to form part of the same case or controversy); *Channell v. Citicorp Nat'l Servs., Inc., 1996 U.S. Dist. LEXIS 14506* (N.D. Ill. Sept. 27, 1996) (court declined jurisdiction over counterclaims citing "tremendous chilling effect" on private enforcement of the Consumer Leasing Act). *Cf. Jones v. Ford Motor Credit Corp., 2002 U.S. Dist. LEXIS 10902* (S.D.N.Y. June 14, 2002) (declining jurisdiction over collection counterclaims in an Equal Credit Opportunity Act [hereinafter ECOA] class action, citing concerns that allowing supplemental jurisdiction would undermine ECOA's enforcement scheme).

(n109)Footnote 105. *See* Rodash v. AIB Mortgage Co., Clearinghouse No. 46,796 (S.D. Fla. order denying defendant's motion to dismiss or stay Apr. 21, 1992).

(n110)Footnote 106. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 19, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983) . See Kent v. Celozzi-Ettleson Chevrolet, Inc., 1999 U.S. Dist. LEXIS 17282* (N.D. Ill. Nov. 1, 1999) (granting stay in favor of state court case raising similar claims).

(n111)Footnote 107. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. at 15* , 16, 21. When the district court considers the relevant factors, the balance should be "heavily weighted in favor of the exercise of jurisdiction." *Id. at 16* . The relative progress of the state and federal cases is a key factor. *Murphy v. Uncle Ben's, Inc., 168 F.3d 734 (5th Cir. 1999)* .

(n112)Footnote 108. *See, e.g., Smith v. Wells Fargo Credit Corp., 713 F. Supp. 354 (D. Ariz. 1989)* (state court action involving, *inter alia*, TIL disclosure violations did not bar a subsequent action based on rescission notice violations in conjunction with same transaction which were not alleged or litigated in prior action); *Desrosiers v. Transamerica Fin. Corp. (In re Desrosiers), 212 B.R. 716 (Bankr. D. Mass. 1997)* (previous affirmative TILA suit filed by husband dismissed under *Fed. R. Civ. P. 41(b)* is res judicata to the filing of an adversary case in a bankruptcy proceeding filed by husband and wife; wife's claims barred under an "identity of interests" standard articulated in *Gonzalez v. Banco Cent. Corp., 27 F.3d 751, 755 (1st Cir. 1994)*). *Cf. Smith v. RBC Mortgage, 2006 U.S. Dist. LEXIS 10282* (S.D.N.Y. Mar. 23, 2006) (must be adjudication on merits, not dismissal for lack of subject matter jurisdiction).

(n113)Footnote 109. *White v. World Fin. of Meridian, Inc., 653 F.2d 147 (5th Cir. 1981)* ; Ralph J. Rohner & Fred H. Miller, Truth in Lending P 12.02[4] (2000). *But see In re Laubach, 77 B.R. 483 (Bankr. E.D. Pa. 1987)* (doctrine of merger bars raising state and federal law claims arising from a transaction on which a previous successful federal TILA action was based; merger does not bar, however, rescission-based claims based on the same transaction); *Weston v. AmeriBank, 1999 U.S. Dist. LEXIS 20287* (W.D. Mich. Dec. 30, 1999) (res judicata barred TIL claim that could have been asserted in earlier class action).

(n114)Footnote 110. *See, e.g., Eubanks v. Liberty Mortgage Banking Ltd., 976 F. Supp. 171 (E.D.N.Y. 1997)* (New York does not have compulsory counterclaim rule, so prior foreclosure judgment did not bar TIL damage suit); *Smith v. Wells Fargo Credit Corp., 713 F. Supp. 354 (D. Ariz. 1989)* (state court action involving, *inter alia*, TIL disclosure violations did not bar a subsequent action based on rescission notice violations in conjunction with same transaction which were not alleged or litigated in prior action). *See also In re Laubach, 77 B.R. 483 (Bankr. E.D. Pa. 1987)* (doctrine of merger bars raising state and federal law claims arising from a transaction on which a previous successful federal TILA action was based; merger does not bar, however, rescission-based claims based on the same transaction). *Dye v. Ameriquest Mortgage Co., 2007 WL 4418195* (E.D. Wis. Dec. 17, 2007) (foreclosure judgment was not res judicata as to appraiser); *White v. Long Beach Mortg., 2007 U.S. Dist. LEXIS 84830* (E.D. Pa. Nov. 7, 2007) (prior foreclosure judgment does not bar claims that could have been raised as permissive counterclaims); *Daniels v. Funding USA, Inc. (In re Daniels), 350 B.R. 619 (Bankr. S.D. Fla. 2006)* (most of debtor's TIL claims not barred by foreclosure judgment because not compulsory counterclaims).

(n115)Footnote 111. *R.G. Fin. Corp. v. Vergara-Nunez, 446 F.3d 178* (1st Cir. Apr. 21, 2006) (applying Puerto Rico law) (servicer is in privity with a related corporation that extended the loan, so res judicata applies); *Albano v. Norwest Fin. Haw., Inc., 244 F.3d 1061 (9th Cir. 2001)* ; *R.G. Fin. Corp. v. Garcia (In re Garcia), 340 B.R. 680 (Bankr. D. P.R. 2006)* (related corporations, one of which was servicer for loan made by the other, are in privity for res judicata purposes). *See also Spinney v. Greenwich Capital Fin. Prods., Inc., 2006 U.S. Dist. LEXIS 26009* (D. Haw. May 3, 2006) (non-TILA case filed by mother and son is barred by prior foreclosure judgment entered against mother).

(n116)Footnote 112. *Walker v. Contimortgage, 232 B.R. 725, 1999 Bankr. LEXIS 464 (N.D. Ill. 1999)* .

(n117)Footnote 113. *New Hampshire v. Maine, 532 U.S. 742, 750/-/51, 121 S. Ct. 1808, 149 L. Ed. 2d 968 (2001)* . *See also Burnes v. Pemco Aeroplex, Inc., 291 F.3d 1282, 1286/-/87* (11th Cir. 2002) (even a party who was not a creditor in the bankruptcy case can raise judicial estoppel; inadvertent error does not create estoppel, but intentional manipulation can be inferred from failure to list valuable claim that debtor was pursuing during the bankruptcy); *Browning v. Levy, 283 F.3d 761, 775/-/76* (6th Cir. 2002) (declining to infer intent where debtor had no motive for concealing the claim); *Judicial Estoppel and Unscheduled Claims: Trap for the Unwary*, 22 NCLC REPORTS, *Bankruptcy and Foreclosures Ed.* 14 (Jan./Feb. 2004).

(n118)Footnote 114. *Petroski v. First Horizon Home Loans Inc., 2004 U.S. Dist. LEXIS 13159* (E.D. Pa. July 9, 2004) ; *Tennyson v. Challenge Realty (In re Tennyson), 313 B.R. 402 (Bankr. W.D. Ky. 2004)* .

(n119)Footnote 115. *See, e.g., In re Goswami, 304 B.R. 386 (B.A.P. 9th Cir. 2003)* . *But see Barger v. City of Cartersville, 348 F.3d 1289, 1297 (11th Cir. 2003)* (debtor should not be allowed to reopen bankruptcy case to list omitted asset since this would reduce incentives for truthful initial disclosure of assets).

(n120)Footnote 116. *See § 6.08[5][i] infra. See also* National Consumer Law Center, Consumer Arbitration Agreement (5th ed. 2007). This volume also discusses the scope of the Federal Arbitration Act, construction of arbitration clauses to exclude certain parties or claims, the effect of state law, and challenges to clauses that purport to limit explicit statutory remedies.

(n121)Footnote 117. *See § 1.08[7] supra.*

(n122)Footnote 118. *See Sphere Drake Ins. v. All Am. Ins. Co., 256 F.3d 587 (7th Cir. 2001)* , *cert. denied sub*

nom. American Gen. Life Ins. Co. v. Sphere Drake Ins. Ltd., 538 U.S. 961, 123 S. Ct. 1754, 155 L. Ed. 2d 512 (2003) .

(n123)Footnote 119. *See, e.g., Ex parte Payne, 741 So. 2d 398 (Ala. 1999)* (where seller backed out of contract because financing condition was not satisfied, arbitration clause does not bind buyer); *Rosenthal v. Great Western Fin. Sec. Corp., 14 Cal. 4th 394, 58 Cal. Rptr. 2d 875, 926 P.2d 1061 (1996)* (arbitration clause unenforceable where contract containing it was void due to fraud in the factum; party's assent to the contract is negated by fraud in the execution); *Party Yards, Inc. v. Templeton, 751 So. 2d 121 (Fla. Dist. Ct. App. 2000)* (arbitration clause in contract that is illegal due to usury is void); *Fastfunding The Co., Inc. v. Betts, 758 So. 2d 1143 (Fla. Dist. Ct. App. 2000)* (same); *Island House Developers v. AMAC Constr. Co., 686 So. 2d 1377 (Fla. Dist. Ct. App. 1997)* (where contract is void under state law because contractor was not licensed, arbitration clause is also void); *Ackel v. Ackel, 696 So. 2d 140* (La. App. 5th Cir.) , *writ denied, 703 So. 2d 1310 (La. 1997)* (whether contract is void as against public policy is not arbitrable).

(n124)Footnote 120. *894 So. 2d 860 (Fla. 2005)* .

(n125)Footnote 121. *546 U.S. 440, 126 S. Ct. 1204, 163 L. Ed. 2d 1038 (2006)* .

(n126)Footnote 122. Id.

(n127)Footnote 123. *Large v. Conseco Fin. Servicing Corp., 292 F.3d 49 (1st Cir. 2002)* . *See also Thompson v. Irwin Home Equity Corp., 300 F.3d 88 (1st Cir. 2002)* . A number of federal courts have now ruled that the arbitrator and not the court must consider whether a transaction has been rescinded under Truth in Lending. *See Anderson v. Delta Funding Corp., 316 F. Supp. 2d 554, 562, 563 (N.D. Ohio 2004)* ; *Bertram v. Beneficial Consumer Discount Co., 286 F. Supp. 2d 453, 459 (M.D. Pa. 2003)* .

(n128)Footnote 124. *879 F. Supp. 1187 (M.D. Fla. 1995)* (the borrower's other challenges to the mandatory arbitration did not fare as well).

(n129)Footnote 125. *Cf. Thompson v. Irwin Home Equity Corp., 300 F.3d 88 (1st Cir. 2002)* (dispute over adequacy of creditor's rescission form must be submitted to arbitration). *See also, Chapman v. Mortgage One Corp., 359 F. Supp. 2d 831 (E.D. Mo. 2005)* . In *Chapman*, the creditor had marked the note rescinded and did not dispute the consumer's claim that the consumer had rescinded the note within the three-day rescission period. Since the contract was clearly rescinded, the court had no problem finding that its terms became void, and the arbitration clause thus became unenforceable.

Large, note 110 *supra* , distinguished between cases where "the creditor acknowledges that the right of rescission is available or because the appropriate decision maker has so determined" from cases where "a lender disputes a borrower's purported right to rescind." Only in the latter case, the arbitrator must decide whether the conditions for rescission have been met.

(n130)Footnote 126. Whether effective injunctive relief is available under a particular arbitration program and clause should be thoroughly investigated and analyzed. Note that in *Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 111 S. Ct. 1647, 114 L. Ed. 2d 26 (1991)* , a plaintiff claimed that an arbitration clause was unenforceable because it did not allow for broad equitable relief. The Supreme Court rejected the challenge, finding that the rules of the arbitration program did not limit the types of relief the arbitrator could award. *Lozada v. Dale Baker Oldsmobile, Inc., 91 F. Supp. 2d 1087 (W.D. Mich. 2000)* (arbitration clause unenforceable because, *inter alia*, it failed to give arbitrator the power to grant declaratory and injunctive relief). *See Broughton v. CIGNA Healthplans, 21 Cal. 4th 1066, 90 Cal. Rptr. 2d 334, 988 P.2d 67 (1999)* (case seeking injunctive relief in the public interest cannot be forced into arbitration, although damages portion may; court declines to decide whether cases seeking less sweeping injunctive relief can be forced into arbitration); *Mitchell v. American Fair Credit Ass'n, 99 Cal. App. 4th 1345, 122 Cal. Rptr. 2d 193, 2002 Cal. App. LEXIS 4375 (1st Dist. 2002) , review denied, 2002 Cal. LEXIS 7253* (Cal. Oct. 23, 2002) . *See also* National

Consumer Law Center, Truth in Lending, § 7.7.2.5 (5th ed. 2003 and supp.).

(n131)Footnote 127. Such an action involves a "determination of the validity, extent or priority of liens." *28 U.S.C. § 157(b)(1)(K). See, e.g., Zimmerman v. Continental Airlines, 712 F.2d 55, 8 C.B.C.2d 1202 (3d Cir. 1983)* , *cert. denied, 464 U.S. 1038, 104 S. Ct. 699, 79 L. Ed. 2d 165 (1984)* (bankruptcy judge has discretion to decide whether to enforce arbitration clause or hear dispute itself). *See generally* National Consumer Law Center, Consumer Arbitration Agreements § 4.2.3 (5th ed. 2007). For a discussion of litigating a Truth in Lending claim in bankruptcy, see National Consumer Law Center, Consumer Bankruptcy Law and Practice § 13.4.4 (6th ed. 2000 and Supp.).

(n132)Footnote 128. *Franklin v. Hartland Mortgage Ctrs., Inc., 2001 U.S. Dist. LEXIS 24016* (N.D. Ill. June 18, 2001) , *motion to strike denied, 2001 U.S. Dist. LEXIS 24238* (N.D. Ill. June 18, 2001) . *But see Thompson v. Irwin Home Equity Corp., 300 F.3d 88 (1st Cir. 2002)* ("Assuming arguendo that the [debtors'] demand for rescission of the loan agreement under TILA constitutes a self-help remedy, the same cannot be said of their subsequent commencement of litigation in federal court challenging [the creditor's] refusal to cooperate with their attempt at self-help.").

(n133)Footnote 129. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 105 S. Ct. 3346, 87 L. Ed. 2d 444 (1985) . See also Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 111 S. Ct. 1647, 114 L. Ed. 2d 26 (1991) . See* National Consumer Law Center, Consumer Arbitration Agreements (4th ed. 2004).

(n134)Footnote 130. *9 U.S.C. § 2*. Section 2 of the Federal Arbitration Act states that arbitration clauses are enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract."

(n135)Footnote 131. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637 n.19, 105 S. Ct. 3346, 3359 n.19, 87 L. Ed. 2d 444, 462 (1985)* (international antitrust case; court upheld arbitration agreement but announced general standards for evaluating the validity of arbitration agreements).

(n136)Footnote 132. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637 n.19, 105 S. Ct. 3346, 3359 n.19, 87 L. Ed. 2d 444, 462 (1985) .*

(n137)Footnote 133. *Paladino v. Avnet Computer Techs., 134 F.3d 1054 (11th Cir. 1998) .*

(n138)Footnote 134. *See, e.g., Ingle v. Circuit City Stores, Inc., 328 F.3d 1165 (9th Cir. 2003)* ; *Circuit City Stores v. Adams, 279 F.3d 889* (9th Cir.) , *cert. denied, 535 U.S. 1112, 122 S. Ct. 2329, 153 L. Ed. 2d 160 (2002)* ; *Ticknor v. Choice Hotels Int'l, Inc., 265 F.3d 931 (9th Cir. 2001)* , *cert. denied, 534 U.S. 1133, 122 S. Ct. 1075, 151 L. Ed. 2d 977 (2002)* ; *Shankle v. B-G Maint. Mgmt. of Colo., Inc., 163 F.3d 1230 (10th Cir. 1999)* ; *Ting v. AT&T, 182 F. Supp. 2d 902 (N.D. Cal. 2002)* , *aff'd in part, rev'd in part, 319 F.3d 1126 (9th Cir. 2003)* ; *Brennan v. Bally Total Fitness, 198 F. Supp. 2d 377 (S.D.N.Y. 2002)* ; *Prevot v. Phillips Petroleum Co., 133 F. Supp. 2d 937 (S.D. Tex. 2001)* ; *Lozada v. Dale Baker Oldsmobile, Inc., 91 F. Supp. 2d 1087 (W.D. Mich. 2000)* ; *Nicholson v. Labor Ready, Inc., 1997 U.S. Dist. LEXIS 23494* (N.D. Cal. May 23, 1997) ; *Knepp v. Credit Acceptance Corp. (In re Knepp), 229 B.R. 821 (Bankr. N.D. Ala. 1999)* ; *Harold Allen's Mobile Home Factory Outlet, Inc. v. Butler, 825 So. 2d 779 (Ala. 2002)* ; *American Gen. Fin., Inc., v. Branch, 793 So. 2d 738 (Ala. 2000)* , *cert. denied, 534 U.S. 949, 122 S. Ct. 342, 151 L. Ed. 2d 258 (2001)* ; *Armendariz v. Foundation Health Psychcare Servs., 24 Cal. 4th 83, 99 Cal. Rptr. 2d 745, 6 P.3d 669 (2000)* ; *Graham v. Scissor-Tail, Inc., 28 Cal. 3d 807, 171 Cal. Rptr. 604, 623 P.2d 165 (1981)* ; *Mercuro v. Superior Court, 96 Cal. App. 4th 167, 116 Cal. Rptr. 2d 671 (2d Dist. 2002)* , *review denied, 2002 Cal. LEXIS 3328* (Cal. May 15, 2002) ; *Flores v. Transamerica HomeFirst, Inc., 93 Cal. App. 4th 846, 113 Cal. Rptr. 2d 376 (1st Dist. 2001)* , *review denied, 2002 Cal. LEXIS 298* (Cal. Jan. 16, 2002) ; *Bolter v. Superior Court, 87 Cal. App. 4th 900, 104 Cal. Rptr. 2d 888 (4th Dist. 2001)* , *review denied, 2001 Cal. LEXIS 4031* (Cal. June 13, 2001) ; *McCoy v. Superior Court, 87 Cal. App. 4th 354, 104 Cal. Rptr. 2d 504 (4th Dist. 2001)* , *review denied, opinion withdrawn by order of court, 2001 Cal. LEXIS 3784* (Cal. June 20, 2001) ; *Pinedo v. Premium Tobacco, Inc., 85 Cal. App. 4th 774, 102 Cal. Rptr. 2d 435 (2d Dist. 2000)* ; *Villa Milano Homeowners Ass'n v. Il Davorge, 84 Cal. App. 4th 819, 102 Cal. Rptr. 2d 1* (4th Dist.) , *reh'g denied, 2000 Cal. App. LEXIS 901 (Cal. App. 2000)* ; *Patterson v. ITT Consumer Fin. Corp., 14 Cal. App. 4th 1659, 18 Cal. Rptr. 2d 563*

(1st Dist. 1993) , *cert. denied, 510 U.S. 1176, 114 S. Ct. 1217, 127 L. Ed. 2d 563 (1994)* ; *Worldwide Ins. Group v. Klopp, 603 A.2d 788 (Del. 1992)* ; *Powertel, Inc. v. Bexley, 743 So. 2d 570 (Fla. Dist. Ct. App. 1999)* , *review denied, 763 So. 2d 1044 (Fla. 2000)* ; *Ballard v. Southwest Detroit Hosp., 119 Mich. App. 814, 327 N.W.2d 370 (1982)* ; *Iwen v. U.S. W. Direct, 293 Mont. 512, 977 P.2d 989 (1999)* ; *Teleserve Sys. v. MCI Telecommunications Corp., 230 A.D.2d 585, 659 N.Y.S.2d 659* (4th Dep't 1997) , *appeal denied, 1997 N.Y. App. Div. LEXIS 10626* (N.Y. App. Div. 4th Dep't Sept. 30, 1997) ; *Williams v. Aetna Fin. Co., 83 Ohio St. 3d 464, 700 N.E.2d 859 (1998)* , *cert. denied, 526 U.S. 1051, 119 S. Ct. 1357, 143 L. Ed. 2d 518 (1999)* ; *Myers v. Terminix Int'l Co., 91 Ohio Misc. 2d 41, 697 N.E.2d 277 (Ct. App. 1998)* ; *Zak v. Prudential Prop. & Cas. Ins. Co., 713 A.2d 681 (Pa. Super. Ct. 1998)* ; *In re Turner Bros. Trucking Co., 8 S.W.3d 370 (Tex. App. Texarkana 1999)* ; *Sosa v. Paulos, 924 P.2d 357 (Utah 1996)* ; *Arnold v. United Cos. Lending Corp., 204 W. Va. 229, 511 S.E.2d 854 (1998)* . In claiming that an arbitration clause is unconscionable, the consumer should have an opportunity to present evidence as to the commercial setting, purpose, and effect of the arbitration provision. *See, e.g., Montrosse v. Conseco Fin. Servicing Corp., 2000 U.S. Dist. LEXIS 20792* (S.D. W. Va. Dec. 20, 2000) .

(n139)Footnote 135. *Armendariz v. Foundation Health Psychcare Servs., 24 Cal. 4th 83, 114, 99 Cal. Rptr. 2d 745, 6 P.3d 669 (2000)* .

(n140)Footnote 136. *See Champ v. Siegel Trading Co., 55 F.3d 269, 275 (7th Cir. 1995)* ; *American Centennial Ins. Co. v. National Cas. Co., 951 F.2d 107, 108 (6th Cir. 1991)* ; *Baesler v. Continental Grain Co., 900 F.2d 1193, 1195 (8th Cir. 1990)* ; *Protective Life Ins. Corp. v. Lincoln Nat'l Life Ins. Corp., 873 F.2d 281, 282 (11th Cir. 1989)* (*per curiam*); *Del E. Webb Constr. v. Richardson Hosp. Auth., 823 F.2d 145, 150 (5th Cir. 1987)* ; *Weyerhaeuser Co. v. Western Seas Shipping Co., 743 F.2d 635, 637* (9th Cir.) , *cert. denied, 469 U.S. 1061, 105 S. Ct. 544, 83 L. Ed. 2d 431 (1984)* . Note that some state courts find these federal decisions, which are based on the Federal Arbitration Act, not to be applicable to state court litigation. *See generally* National Consumer Law Center, Consumer Arbitration Agreements § 9.4 (4th ed. 2004).

(n141)Footnote 137. *15 U.S.C. § 1640(a)(1)* and text following *§ 1640(a)(4)* ("In determining the amount of award in any class action, the court shall consider, among other relevant factors, the amount of any actual damages awarded ... ."); *15 U.S.C. § 1640(a)(2)(B).*

(n142)Footnote 138. The cap for a statutory damage award in a class action is $500,000 (or 1% of the creditor's net worth), as compared to $1000 for an individual claimant in a transaction not secured by real property. *15 U.S.C. § 1640(a)(2).*

(n143)Footnote 139. *Randolph v. Green Tree Fin. Corp., 244 F.3d 814 (11th Cir. 2001)* ; *Johnson v. West Suburban Bank, 225 F.3d 366 (3d Cir. 2000)* , *cert. denied, 531 U.S. 1145, 121 S. Ct. 1081, 148 L. Ed. 2d 957 (2001)* ; *Bowen v. First Family Fin. Servs., 233 F.3d 1331 (11th Cir. 2000)* ; *Lloyd v. MBNA Am. Bank, N.A., 2001 U.S. Dist. LEXIS 8279* (D. Del. Feb. 22, 2001) , *aff'd without opinion, 2002 U.S. App. LEXIS 239* (3d Cir. Jan. 7, 2002) , *reported in full, 27 Fed. Appx. 82, 2002 U.S. App. LEXIS 1027 (3d Cir. 2002)* ; *Gray v. Conseco, Inc., 2000 U.S. Dist. LEXIS 14821* (C.D. Cal. Sept. 29, 2000) ; *Marsh v. First USA Bank, N.A., 103 F. Supp. 2d 909 (N.D. Tex. 2000)* ; *Thompson v. Illinois Title Loans, Inc., 2000 U.S. Dist. LEXIS 232* (N.D. Ill. Jan. 6, 2000) ; *Wood v. Cooper Chevrolet, Inc., 102 F. Supp. 2d 1345 (N.D. Ala. 2000)* ; *Sagal v. First USA Bank, N.A., 69 F. Supp. 2d 627 (D. Del. 1999)* , *aff'd without opinion, 254 F.3d 1078 (3d Cir. 2001)* ; *Zawikowski v. Beneficial Nat'l Bank, 1999 U.S. Dist. LEXIS 514* (N.D. Ill. Jan. 7, 1999) ; *Lopez v. Plaza Fin. Co., 1996 U.S. Dist. LEXIS 5566* (N.D. Ill. Apr. 25, 1996) .

(n144)Footnote 140. *Lozada v. Dale Baker Oldsmobile, Inc., 91 F. Supp. 2d 1087 (W.D. Mich. 2000) . See also Johnson v. Tele-Cash, Inc., 82 F. Supp. 2d 264 (D. Del. 1999)* , *rev'd on this ground sub nom. Johnson v. West Suburban Bank, 225 F.3d 366 (3d Cir. 2000)* , *cert. denied, 531 U.S. 1145, 121 S. Ct. 1081, 148 L. Ed. 2d 957 (2001)* ; *Bantolina v. Aloha Motors, 419 F. Supp. 1116, 1120 (D. Haw. 1976)* ; *Powertel, Inc. v. Bexley, 743 So. 2d 570 (Fla. Dist. Ct. App. 1999)* , *review denied, 763 So. 2d 1044 (Fla. 2000)* .

(n145)Footnote 141. *Muhammad v. County Bank of Rehoboth Beach, 189 N.J. 1 (2006)* .

(n146)Footnote 142. *Wong v. T-Mobile USA, Inc., 2006 U.S. Dist. LEXIS 49444* (E.D. Mich. July 20, 2006) .

(n147)Footnote 143. *Schwartz v. Alltel Corp., 2006 Ohio 3353 (2006)* .

(n148)Footnote 144. *Lee v. AT&T Wireless Servs., Inc., 2006 Cal. App. Unpub. LEXIS 4582* (Cal. Ct. App. May 26, 2006) ; *Klussman v. Cross Country Bank, 134 Cal. App. 4th 1283* (Dec. 15, 2005) ; *Aral v. Earthlink, Inc., 134 Cal. App. 4th 544* (Nov. 29, 2005) . *See also Ramsdell v. Lenscrafters, Inc., 135 Fed. Appx. 130* (9th Cir. June 15, 2005) (California law); *Tamayo v. Brainstorm USA, 154 Fed. Appx. 564* (9th Cir. Sept. 21, 2005) (California law); *Laster v. T-Mobile USA, Inc., 407 F. Supp. 2d 1181 (S.D. Cal. 2005)* .

(n149)Footnote 145. *Thibodeau v. Comcast, 2006 Phila. Ct. Com. Pl. LEXIS 59* (Pa. C.P. Jan. 24, 2006) . *But see Dambrosio v. Comcast Corp., 2006-1 Trade Cas. (CCH) P75079, 2005 U.S. Dist. LEXIS 35871* (E.D. Pa. Dec. 27, 2005) , *vacated by agreement*, *2006 U.S. Dist. LEXIS 48163* (E.D. Pa. Apr. 12, 2006) .

(n150)Footnote 146. *See, e.g., Sherr v. Dell, Inc., 2006 U.S. Dist. LEXIS 51864* (S.D.N.Y. July 27, 2006) ; *Delta Funding Corp. v. Harris, 189 N.J. 28 (2006)* (New Jersey Supreme Court, on the same day it ruled in *Muhammad*, found no unconscionability in class action waiver in another case, based on the facts of that case); *Tillman v. Commercial Credit Loans, Inc., 629 S.E.2d 865 (N.C. Ct. App. 2006)* ; *Spann v. American Express Travel Related Servs. Co., 2006 Tenn. App. LEXIS 582* (Tenn. Ct. App. Aug. 30, 2006) (Utah law).

(n151)Footnote 147. *Fonte v. AT&T Wireless Servs., Inc., 903 So. 2d 1019* (Fla. Dist. Ct. App. June 15, 2005) .

(n152)Footnote 148. *Cunningham v. Citigroup, 2005 U.S. Dist. LEXIS 33805* (D.N.J. Dec. 16, 2005) .

(n153)Footnote 149. *Walther v. Sovereign Bank, 872 A.2d 735 (Md. 2005)* .

(n154)Footnote 150. *Strand v. U.S. Bank Nat'l Ass'n ND, 693 N.W.2d 918 (N.D. 2005)* .

(n155)Footnote 151. *Caley v. Gulfstream Aerospace Corp., 428 F.3d 1359 (5th Cir. 2005)* (Georgia law); *Jenkins v. First Am. Cash Advance of Ga., L.L.C., 400 F.3d 868 (11th Cir. 2005)* (Georgia law).

(n156)Footnote 152. *Provencher v. Dell, Inc., 409 F. Supp. 2d 1196 (C.D. Cal. 2006)* (Texas law).

(n157)Footnote 153. *See* S. Rep. No. 93-278, at 15 (1973) (quoting 1972 F.R.B. Ann. Rep. on Truth in Lending 13).

(n158)Footnote 154. S. Rep. No. 93-278 to accompany S. 2101, Truth in Lending Act *Amendments 14-15* (June 28, 1973).

(n159)Footnote 155. *See Adams v. Plaza Fin. Co., 168 F.3d 932 (7th Cir. 1999)* , *reh'g denied, 1999 U.S. App. LEXIS 5231* (7th Cir. Mar. 18, 1999) ; *Edwards v. Your Credit, 148 F.3d 427 (5th Cir. 1998)* , *amended, reh'g, en banc, denied*, *1998 U.S. App. LEXIS 20916* (5th Cir. Aug. 17, 1998) .

(n160)Footnote 156. *See* Minnesota v. First Alliance Mortgage Co., C9-98-11416 (Dist. Ct., 2d Judicial Dist. Minn. Mar. 10, 1999) (order for final judgment).

(n161)Footnote 157. *See Balderos v. City Chevrolet, 214 F.3d 849 (7th Cir. 2000)* ; *Walker v. Wallace Auto Sales, Inc., 155 F.3d 927 (7th Cir. 1998)* .

(n162)Footnote 158. *Ting v. AT&T, 182 F. Supp. 2d 902, 930-31 (N.D. Cal. 2002)* , *aff'd in part, rev'd in part, 319 F.3d 1126 (9th Cir. 2003)* . *See also Al-Safin v. Circuit City Stores, Inc., 394 F.3d 1254 (9th Cir. 2005)* (provision in

arbitration clause that barred employees from bringing or participating in class actions was unconscionable).

(n163)Footnote 159. *97 Cal. App. 4th 1094, 118 Cal. Rptr. 2d 862 (4th Dist. 2002)* , *cert. denied*, *537 U.S. 1226, 123 S. Ct. 1258, 154 L. Ed. 2d 1087 (2003)* .

(n164)Footnote 160. *211 F. Supp. 2d 1160 (N.D. Cal. 2002)* .

(n165)Footnote 161. *Bellsouth Mobility LLC v. Christopher, 819 So. 2d 171 (Fla. App. 2002)* . *See also Comb v. Paypal, Inc., 218 F. Supp. 2d 1165 (N.D. Cal. 2002)* ; *Luna v. Household Fin. Corp. III, 236 F. Supp. 2d 1166 (W.D. Wash. 2002)* ; *Lozada v. Dale Baker Oldsmobile, Inc., 91 F. Supp. 2d 1087, 1104-05 (W.D. Mich. 2000)* (holding arbitration clause unconscionable for violation of state consumer protection statute's explicit provision of class-wide recovery); *Leonard v. Terminix Int'l Co., 854 So. 2d 529 (Ala. 2002)* ; State *ex rel. Dunlap v. Berger, 567 S.E.2d 265 (W. Va. 2002)* .

(n166)Footnote 162. *743 So. 2d 570 (Fla. Dist. Ct. App. 1999)* , *review denied*, *763 So. 2d 1044 (Fla. 2000)* . *See also Lozada v. Dale Baker Oldsmobile, Inc., 91 F. Supp. 2d 1087, 1104-05 (W.D. Mich. 2000)* (holding arbitration clause unconscionable for violation of state consumer protection statute's explicit provision of class-wide recovery).

(n167)Footnote 163. *2005 Cal. LEXIS 7319* (Cal. June 27, 2005) .

(n168)Footnote 164. *173 S.W.3d 300 (Mo. Ct. App. 2005)* .

(n169)Footnote 165. *828 N.E.2d 812, 814 (2005)* .

(n170)Footnote 166. *See Edelist v. MBNA Am. Bank, 790 A.2d 1249, 1261 (Del. Super. Ct. 2001)* ("The surrender of that class action right was clearly articulated in the arbitration amendment. The [c]ourt finds nothing unconscionable about it and finds the bar on class actions enforceable."); *Pick v. Discover Fin. Servs., Inc., 2001 U.S. Dist. LEXIS 15777*, at *16 (D. Del. Sept. 28, 2001) ("[I]t is generally accepted that arbitration clauses are not unconscionable because they preclude class actions.").

(n171)Footnote 167. *See* National Consumer Law Center, Consumer Arbitration Agreements § 6.2 (5th ed. 2007 and Supp.).

(n172)Footnote 168. *Id.* § 2.4.

(n173)Footnote 169. *Reuter v. Davis, 2006 WL 3743016*, at *4 (Fla. Cir. Ct. Dec. 12, 2006).

(n174)Footnote 170. *Scott v. Cingular Wireless, 161 P.3d 1000 (Wash. 2007)* .

(n175)Footnote 171. *In re Cotton Yarn Antitrust Litig., 505 F.3d 274, 285 (4th Cir. 2007)* .

(n176)Footnote 172. *Fiser v. Dell Computer Corp., 144 N.M. 464 (N.M. 2008)* .

(n177)Footnote 173. *15 U.S.C. § 1640(a)(3).*

(n178)Footnote 174. *Baron v. Best Buy Co., Inc., 79 F. Supp. 2d 1350 (S.D. Fla. 1999)* (opinion granting stay pending appeal).

(n179)Footnote 175. See National Consumer Law Center, Truth in Lending § 8.9.1,(6th ed. 2007) for a discussion of the purposes of the TILA attorney fee provision.

(n180)Footnote 176. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637 n.19, 105 S. Ct. 3346, 3359 n.19, 87 L. Ed. 2d 444, 462 (1985)* .

(n181)Footnote 177. *Baron v. Best Buy Co., 75 F. Supp. 2d 1368 (S.D. Fla. 1999)* . *See also McCaskill v. SCI Mgmt. Corp., 285 F.3d 623 (7th Cir. 2002)* , *upheld on reconsideration*, *298 F.3d 677 (7th Cir. 2002)* ; *Perez v. Globe Airport Sec. Servs., 253 F.3d 1280 (11th Cir. 2001)* , *vacated*, *294 F.3d 1275 (11th Cir. 2002)* ; *Graham Oil Co. v. ARCO Prods. Co., 43 F.3d 1244 (9th Cir. 1994)* , *cert. denied, 516 U.S. 907, 116 S. Ct. 275, 133 L. Ed. 2d 195 (1995)* (Petroleum Marketing Practices Act); *Gourley v. Yellow Transp., LLC, 178 F. Supp. 2d 1196 (D. Colo. 2001)* (agreement denying attorney fees violates public policy); *Horenstein v. Mortgage Mkt., 1999 U.S. Dist. LEXIS 21463* (D. Or. Jan. 7, 1999) , *aff'd*, *9 Fed. Appx. 618, 2001 U.S. App. LEXIS 9267 (9th Cir. 2001)* (employment case); *DeGaetano v. Smith Barney, Inc., 983 F. Supp. 459 (S.D.N.Y. 1997)* ; *Alexander v. Anthony Int'l, Ltd. P'ship, 341 F.3d 256, 267 (3d Cir. 2003)* (Virgin Islands Wrongful Discharge Act); *Romano v. ManorCare, Inc., 861 So. 2d 59, 63 (Fla. Dist. Ct. App. 2004)* ; *Holt v. O'Brien Imports, 862 So. 2d 87, 90 (Fla. Dist. Ct. App. 2003)* . *But see Livingston v. Associates Finance, Inc., 339 F.3d 553 (7th Cir. 2003)* (AAA rules allow attorney fees to be awarded if they are authorized by law, so no conflict with TIL that limits defendant's fees; court ignores language that also allows fees where TIL does not allow); *Faber v. Menard, Inc., 367 F.3d 1048, 1055 (8th Cir. 2004)* (clause denying attorney fees to ADEA claimant enforced; arbitrator decides remedial issue); *Hawkins v. Aid Ass'n for Lutherans, 338 F.3d 801, 807 (7th Cir. 2003)* (same).

(n182)Footnote 178. *Circuit City Stores v. Adams, 279 F.3d 889, 894* (9th Cir.) , *cert. denied*, *535 U.S. 1112, 122 S. Ct. 2329, 153 L. Ed. 2d 160 (2002)* (arbitration clause that "imposes a strict one year statute of limitations on arbitrating claims ... would deprive [the employee] of the benefit of the continuing violation doctrine available in FEHA suits"); *Graham Oil Co. v. ARCO Prods. Co., 43 F.3d 1244 (9th Cir. 1994)* , *cert. denied, 516 U.S. 907, 116 S. Ct. 275, 133 L. Ed. 2d 195 (1995)* ; *In re Managed Care Litig., 132 F. Supp. 2d 989, 1000 (S.D. Fla. 2000)* ("[a]dditionally, the one year statute of limitations raises grave concerns that Dr. Porth's statutory claims will not be adjudicated appropriately in an arbitration forum"; refusing to compel arbitration with respect to Dr. Porth's statutory claims, though compelling arbitration with respect to his common law claims despite the limitations issue); *Parilla v. IAP Worldwide Services VI, Inc. 368 F.3d 269, 277, 278 (3d Cir. 2004)* (employer's clause requiring employee to provide notice of discrimination claims within thirty days is unconscionable); *Alexander v. Anthony Int'l, Ltd. P'ship, 341 F.3d 256, 266, 267 (3d Cir. 2003)* (same); *Circuit City Stores, Inc. v. Ingle, 328 F.3d 1165, 1175 (9th Cir. 2003)* (employer's one-year limitations period is unconscionable for unreasonably shortening applicable statutory period).

(n183)Footnote 179. *Perez v. Globe Airport Sec. Servs., 253 F.3d 1280 (11th Cir. 2001)* , *vacated*, *294 F.3d 1275 (11th Cir. 2002)* ; *Broughton v. CIGNA Healthplans, 21 Cal. 4th 1066, 90 Cal. Rptr. 2d 334, 988 P.2d 67 (1999)* ; *Maciejewski v. Alpha Sys. Lab, Inc., 73 Cal. App. 4th 1372, 87 Cal. Rptr. 2d 390* , *review granted and opinion superseded*, *89 Cal. Rptr. 2d 834, 986 P.2d 170 (1999)* , *vacated and transferred*, *101 Cal. Rptr. 2d 198, 11 P.3d 954 (2000)* ; *Armendariz v. Foundation Health Psychcare Servs., Inc., 68 Cal. App. 4th 374, 80 Cal. Rptr. 2d 255 (1st Dist. 1998)* , *review granted*, *83 Cal. Rptr. 2d 274, 973 P.2d 51 (1999)* , *rev'd, superseded, remanded*, *24 Cal. 4th 83, 99 Cal. Rptr. 2d 745, 6 P.3d 669 (2000)* ; *Stirlen v. Supercuts, Inc., 51 Cal. App. 4th 1519, 60 Cal. Rptr. 2d 138 (1st Dist. 1997)* , *review denied,* (Apr. 16, 1997); *see also Baron v. Best Buy Co., 75 F. Supp. 2d 1368 (S.D. Fla. 1999)* .

(n184)Footnote 180. *Stehli v. Action Custom Homes, Inc., 1999 Ohio App. LEXIS 4464* (Ohio Ct. App. Sept. 24, 1999) .

(n185)Footnote 181. *Stirlen v. Supercuts, Inc., 51 Cal. App. 4th 1519, 60 Cal. Rptr. 2d 138 (1st Dist. 1997)* , *review denied* (Apr. 16, 1997).

(n186)Footnote 182. For example, in *Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465, 1480 (D.C. Cir. 1997)* , the parties stipulated that arbitrators' fees are commonly $500 to $1000 per day. The American Arbitration Association [hereinafter AAA] requires that claimants who request an in-person hearing for a small claim pay all fees and costs. In disputes valued at between $10,000 and $100,000, a consumer must pay a filing fee of $500 to $1250, a daily hearing fee of $150, a daily room rental fee of $150, and a portion of the arbitrator's fee of $100 to $350 per hour. AAA, *Commercial Dispute Resolution Procedures*, www.adr.org/rules/commercial/commercial_rules.html (visited July 20, 2000).

(n187)Footnote 183. *Green Tree Fin. Corp.-Alabama v. Randolph, 531 U.S. 79, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000)* .

(n188)Footnote 184. *Hale v. First USA Bank, N.A., 2001 U.S. Dist. LEXIS 8045* (S.D.N.Y. June 12, 2001) . *Cf. Lloyd v. MBNA Am. Bank, N.A., 2001 U.S. Dist. LEXIS 8279* (D. Del. Feb. 22, 2001) (burden not met where creditor will front arbitration costs and costs will be no higher than in court proceeding), *aff'd without opinion, 2002 U.S. App. LEXIS 239* (3d Cir. Jan. 7, 2002) , *reported in full, 27 Fed. Appx. 82, 2002 U.S. App. LEXIS 1027 (3d Cir. 2002)* ; *Vera v. First USA Bank, N.A., 2001 U.S. Dist. LEXIS 9052* (D. Del. Apr. 19, 2001) (consumer did not meet burden); *Kennedy v. Conseco Fin. Corp., 2000 U.S. Dist. LEXIS 17704* (N.D. Ill. Nov. 29, 2000) (where creditor agreed to pay 100% of arbitration costs, agreement is enforceable); *Brown v. Surety Fin. Serv., 2000 U.S. Dist. LEXIS 5734* (N.D. Ill. Mar. 23, 2000) (fees not unreasonable); *Livingston v. Associates Finance, Inc., 339 F.3d 553 (7th Cir. 2003)* .

(n189)Footnote 185. *Wood v. Cooper Chevrolet, Inc., 102 F. Supp. 2d 1345 (N.D. Ala. 2000)* . *See also Floss v. Ryan's Family Steak Houses, Inc., 211 F.3d 306 (6th Cir. 2000)* , *cert. denied, 531 U.S. 1072, 121 S. Ct. 763, 148 L. Ed. 2d 664 (2001)* (expressing concern that requirement that employee pay half of arbitration fees as condition of pursuing ADA and FLSA dispute could prevent employees from prosecuting claims, but invalidating arbitration agreement on other grounds); *Armendariz v. Foundation Health Psychcare Servs., Inc., 24 Cal. 4th 83, 110, 99 Cal. Rptr. 2d 745, 764, 6 P.3d 669, 687 (2000)* (risk of having to bear substantial arbitration costs "deters the exercise of the constitutional right of due process").

(n190)Footnote 186. *Contra Livingston v. Associates Fin., Inc., 2001 U.S. Dist. LEXIS 8678* (N.D. Ill. June 22, 2001) (report and recommendation of magistrate judge).

(n191)Footnote 187. *See Circuit City Stores v. Adams, 279 F.3d 889 (9th Cir. 2002)* , *cert. denied, 535 U.S. 1112, 122 S. Ct. 2329, 153 L. Ed. 2d 160 (2002)* ; *Ting v. AT&T, 182 F. Supp. 2d 902, 933-34 (N.D. Cal. 2002)* , *aff'd in part, rev'd in part, 319 F.3d 1126 (9th Cir. 2003)* ; *Pitchford v. Oakwood Mobile Homes, Inc., 124 F. Supp. 2d 958 (W.D. Va. 2000)* (arbitration fees of several thousand dollars are so unfair as to make the arbitration agreement unconscionable; fees serve to bar rather than provide a means for an economical solution to controversies); *Knepp v. Credit Acceptance Corp. (In re Knepp), 229 B.R. 821 (Bankr. N.D. Ala. 1999)* (arbitration was unconscionable when it would cost the consumer initially anywhere from $500 to $7000, plus daily costs of hundreds of dollars, to arbitrate a dispute and the consumer, being in bankruptcy, could not afford that amount); *Pinedo v. Premium Tobacco Stores, Inc., 85 Cal. App. 4th 774, 102 Cal. Rptr. 2d 435 (2d Dist. 2000)* (one factor cited in finding an arbitration clause unconscionable is that it required an employee to front all fees in the arbitration); *Ramirez v. Circuit City Stores, Inc., 76 Cal. App. 4th 1229, 90 Cal. Rptr. 2d 916 (1st Dist. 1999)* , *review granted and opinion superseded, 94 Cal. Rptr. 2d 1, 995 P.2d 137 (2000)* , *review dismissed, 101 Cal. Rptr. 2d 199, 11 P.3d 955 (2000)* ; *Maciejewski v. Alpha Sys. Lab, Inc., 73 Cal. App. 4th 1372, 87 Cal. Rptr. 2d 390* , *review granted and opinion superseded, 89 Cal. Rptr. 2d 834, 986 P.2d 170 (1999)* , *vacated and transferred, 101 Cal. Rptr. 2d 198, 11 P.3d 954 (2000)* ; *Patterson v. ITT Consumer Fin. Corp., 14 Cal. App. 4th 1659, 18 Cal. Rptr. 2d 563 (1st Dist. 1993)* , *cert. denied, 510 U.S. 1176, 114 S. Ct. 1217, 127 L. Ed. 2d 563 (1994)* ; *Brower v. Gateway 2000, 246 A.D.2d 246, 676 N.Y.S.2d 569* (1st Dep't 1998) ($4,000 fee, only $2,000 of which would be refunded if the consumer prevailed); *Licitra v. Gateway, Inc., 189 Misc. 2d 721, 728, 734 N.Y.S.2d 389, 394 (Civ. Ct. 2001)* (tracing the National Arbitration Forum's arbitration fees and concluding that "[i]t is obvious that these costs can make arbitration not a viable alternative for many consumers"); *Williams v. Aetna Fin. Co., 83 Ohio St. 3d 464, 700 N.E.2d 859 (1998)* , *cert. denied, 526 U.S. 1051, 119 S. Ct. 1357, 143 L. Ed. 2d 518 (1999)* ; *Myers v. Terminix Int'l Co., 91 Ohio Misc. 2d 41, 697 N.E.2d 277 (Ct. App. 1998)* (fees not only excessive, but not disclosed to the consumer in the original arbitration agreement); *Alexander v. Anthony Int'l, Ltd. P'ship, 341 F.3d 256, 269, 270 (3d Cir. 2003)* ; *Murphy v. Mid-West Nat'l Life Ins. Co. of Tenn., 78 P.3d 766 (Idaho 2003)* ; *D.R. Horton, Inc. v. Green, 96 P.3d 1159 (Nev. 2004)* . *But see Rollins, Inc. v. Foster, 991 F. Supp. 1426 (M.D. Ala. 1998)* (high fees could lead to an unconscionability finding, but not justified based on the facts of this case); *Commercial Credit Corp. v. Leggett, 744 So. 2d 890 (Ala. 1999)* (no unconscionability when the consumer must pay $125, the other party then pays for the first day of the arbitrator's time, and the losing party pays all remaining fees).

(n192)Footnote 188. *Cooper v. MRM Inv. Co., 199 F. Supp. 2d 771 (M.D. Tenn. 2002)* . Cooper has been affirmed both as to the unaffordability of the fees and the irrelevance of the company's offer during litigation to pay for the fees. But the Sixth Circuit ordered the case to be remanded to reconsider the decision in light of the AAA's new fee schedule that significantly reduces an employee's up-front arbitration costs in an employment dispute. *Cooper v. MRM Investment Co., 367 F.3d 493 (6th Cir. 2004)* .

(n193)Footnote 189. *Szetela v. Discover Bank, 97 Cal. App. 4th 1094, 118 Cal. Rptr. 2d 862 (4th Dist. 2002)* , *cert. denied, 537 U.S. 1226, 123 S. Ct. 1258, 154 L. Ed. 2d 1087 (2003)* .

(n194)Footnote 190. *Mendez v. Palm Harbor Homes, Inc., 111 Wash. App. 446, 45 P.3d 594 (2002)* .

(n195)Footnote 191. *O'Donoghue v. Smythe, Cramer Co., 2002 Ohio 3447, 2002 Ohio App. LEXIS 3571 (Ct. App. 2002)* (July 3, 2002).

(n196)Footnote 192. *Blair v. Scott Specialty Gases, 283 F.3d 595 (3d Cir. 2002)* . *See also Kloss v. Edward D. Jones & Co., 310 Mont. 123, 54 P.3d 1 (2002)* .

(n197)Footnote 193. *E.g., McNulty v. H & R Block, 843 A.2d 1267, 1274 (Pa. Super. Ct. 2004)* ("This arbitration clause requires a consumer to pay $50.00 in the hopes of receiving, at most, $37.00 ... . [T]his is a situation where the costs of arbitration, minimal though they may seem, work to preclude the individual presentation of claims"). A detailed discussion of AAA and NAF arbitration fees and whether they are unconscionable is found in NCLC's *Consumer Arbitration Agreements* §§ 4.3.2.3, 4.3.2.4 (4th ed. 2004).

(n198)Footnote 194. *Green Tree Fin. Corp. v. Randolph, 531 U.S. 79, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000)* ; *Blair v. Scott Specialty Gases, 283 F.3d 595 (3d Cir. 2002)* ; *Gruber v. Louis Hornick & Co., 2003 U.S. Dist. LEXIS 8764* (S.D.N.Y. May 22, 2003) ; *Fluehmann v. Associates Fin. Servs., 2002 U.S. Dist. LEXIS 5755* (D. Mass. Mar. 29, 2002) ; *Hale v. First USA Bank, N.A., 2001 U.S. Dist. LEXIS 8045 (S.D.N.Y. 2001)* . *Cf. LLoyd v. MBNA Am. Bank, N.A., 2001 U.S. Dist. LEXIS 8279* (D. Del. Feb. 22, 2001) (burden not met where creditor will front arbitration costs and costs will be no higher than in court proceeding); *Vera v. First USA Bank, N.A., 2001 U.S. Dist. LEXIS 9052* (D. Del. Apr. 19, 2001) (consumer did not meet burden); *Kennedy v. Conseco Fin. Corp., 2000 U.S. Dist. LEXIS 17704* (N.D. Ill. Nov. 30, 2000) (where creditor agreed to pay 100% of arbitration costs, agreement is enforceable); *Brown v. Surety Fin. Serv., Inc., 2000 U.S. Dist. LEXIS 5734* (N.D. Ill. Mar. 23, 2000) (fees not unreasonable).

(n199)Footnote 195. *See generally* National Consumer Law Center, Consumer Arbitration Agreements (5th ed. 2007). *See, e.g., Faber v. Menard, Inc., 367 F.3d 1048, 1054 (8th Cir. 2004)* ("Faber has not provided the evidence necessary to estimate the length of the arbitration and the corresponding amount of arbitrators' fees (e.g., sophistication of the issues, average daily or hourly arbitrator costs in the region). He has also failed to provide evidence of his particular financial situation."); *Owner-Operator Independent Drivers Ass'n, Inc. v. Swift Transp. Co., 288 F. Supp. 2d 1033 (D. Ariz. 2003)* ("the plaintiffs have not cited the Court to any evidence establishing that any such costs that might reasonably be incurred would in fact be prohibitive to the affected plaintiffs"); *Livingston v. Associates Fin., Inc., 339 F.3d 553, 557 (7th Cir. 2003)* ("the Livingstons have not offered any specific evidence of arbitration costs that they may face in this litigation, prohibitive or otherwise, and have failed to provide any evidence of their inability to pay such costs, even though the district court permitted discovery on that very question").

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 1 Truth in Lending

1-1 Consumer Credit Law Manual § 1.10

§ 1.10 Consumer Remedies

[1] Standing to Bring Claims for TIL Damages

Violations of TIL requirements give rise to several remedies: actual damages, individual statutory damages, class action statutory damages, and attorney fees. Injunctive and declaratory relief are not specifically mentioned in TILA, but several courts have found that this relief is also available. n1 In general, liability arises when any creditor fails to comply with requirements "with respect to any person." n2 The mere loss of a statutory right to disclosure is an injury that gives the consumer standing for Article III purposes. n3

Parties who are liable include the creditor--the person to whom the transaction is initially payable on its face. n4 The creditor is liable for actual and statutory damages. n5 Given the limited definition of creditor, there will not often be multiple creditors, n6 but they are likely to be jointly and severally liable for the damage award.

The liability of an assignee depends on several factors. For ordinary transactions, assignees are liable for monetary damages only for violations which are apparent on the face of the documents. n7 Also, rescission is available against assignees to the same extent as it would be against the creditor. There may be greater liability for assignees of high cost mortgage transactions subject to the HOEPA. n8

[2] Actual Damages

The most likely source of actual damages in TIL cases is the dollar difference between the misstated disclosures and the hidden, correct amount. The reported TIL actual damages decisions are divided over whether a consumer must establish detrimental reliance upon inaccurate financial disclosures to obtain the corresponding dollar amount as actual damages or whether more objective standards of liability apply. n9

A TILA statutory provision which may help define actual damages is the restitution scheme included in the Act in 1980. TILA actual damages may include consequential damages, even including emotional distress caused by the creditor's disclosure violations. n10 It is also possible, although difficult, to obtain missed opportunity damages. n11

[3] Statutory Damages

[a] Availability of Statutory Damages

Any creditor who violates certain TILA requirements is liable to the consumer, in an individual action, for twice the finance charge. n12 If the transaction giving rise to the claim is closed-end and real property or dwelling secured, the statutory damages are limited to not less than $200 nor more than $2000, as a result of 1995 amendments to the Act. n13 The floor and ceiling amounts for violations occurring after July 30, 2008 for transactions secured by real estate or a dwelling were increased. n14 These "statutory damages" are available in addition to actual damages, costs, and attorney fees. n15 Contrary to the plain language of the statute, the Supreme Court, in an opinion written by Justice Ginsburg, held that the $100/$1000 limits on TILA statutory damages limit clause (i), thus applying this ceiling to all leases and all non-real-estate loans. n16 Justice Ginsburg reasoned that before the 1995 amendment, the lower courts had consistently held that the $1000 cap applied to both clause (i), relating to loan transactions, and clause (ii), relating to leases, even though the cap was only located in clause (ii). Moreover, she explained that there is no independent evidence, outside of the statutory language, that Congress intended to change the rules for statutory damage recoveries. Justice Ginsburg noted that Congress retained the "liability under this subparagraph" language, which, in her view, applies the limits to all claims addressed in section 1640(a)(2)(A), since a "subparagraph" is a unit that follows a capital letter, whereas a "clause" follows a lower case Roman numeral. More broadly, the *Koons* case affirms that statutory damages equal twice the finance charge, with applicable minimums and maximums based on the type of transaction. For open-end credit not secured by real estate or a dwelling, beginning February 22, 2010, statutory damages will be double the finance charge with a minimum of $500 and a cap of $5,000. There will be no cap for "an established pattern or practice" of noncompliance. n16.1

To obtain statutory damages, the consumer need not show that the creditor intended or knew about the violation or that the consumer was deceived. n17 The consumer need not even have been aware of the information in the disclosure statement. n18 The consumer is also not required to show any actual damages. n19 In addition, statutory damages may be awarded even after the loan in question has been paid off. n20 In 1974, Congress amended the TILA to provide for only a single statutory recovery even for multiple disclosure violations committed in a single transaction or open-end account. n21 Nevertheless, it is still possible to win multiple damages for multiple violations in certain situations.

First, the statute prohibits multiple statutory damages only for disclosure violations. For other violations--such as refusing to implement a consumer's rescission, n22 or including a prohibited term or engaging in a prohibited practice in a HOEPA loan n23--there is no prohibition. Thus, one statutory damage award can be made for a disclosure violation, another for a refusal to rescind, another for including a prohibited term in a HOEPA loan, and yet another for engaging in a prohibited practice in a HOEPA loan.

Second, the statute as amended expressly provides that, if a creditor continues to violate the act after a consumer has recovered damages, the consumer may seek additional recoveries. n24

Multiple obligors are limited to one recovery of statutory damages. n25 This limitation does not apply to class actions or actual damage claims. n26

[b] Violations Giving Rise to Statutory Damages

As a general rule, statutory and actual damages are available for *any* violation of TILA Part B (credit transactions), with some important exceptions for specified disclosure items. n27 They are also available for violations of Part D (credit billing) or Part E (consumer leases). n28

The Act unequivocally provides for statutory damages for the failure to disclose those specific items listed in *15 U.S.C. section 1640(a)(3). For closed-end disclosures,* statutory damages are available for the failure to disclose accurately: n29

- The amount financed; n30
- The unitemized finance charge; n31
- The annual percentage rate; n32
- The total of payments; n33
- The number, amount, and due dates or periods of payments; n34 and
- A statement that a security interest has been retained. n35

Statutory damages also appear to be available for violation of two requirements regarding identification of the holder of an obligation. The first of these requirements was added in 1995. It requires servicers to provide the name, address, and telephone number of the owner or master servicer of a loan on the borrower's request. n35.1 The second was added as part of the Helping Families Save Their Homes Act of 2009. It requires third-party transferees of mortgage loans to notify borrowers of the transfer. n35.2

For open-end disclosures, statutory damages are unequivocally available for the failure to disclose any of the full range of information required to be in the *initial disclosure* and to make those disclosures in a timely fashion, n36 and, with regard to *periodic statements,* for the failure to disclose:

- The amount of the finance charge, itemized if appropriate; n37
- Periodic rates; n38
- The annual percentage rate; n39
- The balance upon which the finance charge is computed; n40
- The new balance; n41
- The free-ride period; n42 and
- The address for billing errors. n43

Statutory damages are more broadly available for violations of Parts B (Credit Transactions) and D (Fair Credit Billing). n44

[4] TIL Class Actions

[a] Introduction

Many TILA violations are unusually well-suited to class action treatment. Violations are often apparent on the face of the written documents and typically are identical for each class member. In addition, class certification is important for TIL cases, "where the small amounts of money involved and the difficult financial situations of many of the litigants may inhibit individual litigation." n45

The TILA explicitly provides for class action relief comprised of actual damages, statutory damages not to exceed the lesser of $500,000 or one percent of the creditor's net worth, and attorney fees. n46

This discussion concentrates on two TIL class action issues--class certification and class monetary remedies--and covers TIL class actions in federal court only. n47

A final warning is in order: The inclusion of arbitration clauses by some creditors in their loan papers may present an obstacle to TIL class actions. n48

[b] Certifying the TIL Class Action

The plaintiff's motion for class certification should be made very early in a case, but not too early. The motion should await review of the defendant's answer to the TIL class action complaint and the development of enough discovery that the plaintiff class can carry its burden of proving the elements for class certification. n49 In addition, the defendant's motion to dismiss is usually resolved before class certification.

Any motions for summary judgment by either side should await determination of the class certification issue.

TIL class actions are nearly always brought as actions for damages under *Fed. R. Civ. P. 23(b)(3)*. TIL actions will rarely qualify under *Fed. R. Civ. P. 23(b)(2)*, since they do not primarily seek equitable relief. Consequently, the TIL class action will have to qualify under both Rules 23(a) and 23(b)(3), and meet prerequisites dealing with numerosity, n50 commonality, n51 typicality, n52 adequacy of representation, n53 predominance of common questions of law or fact, n54 and superiority of the class action to other methods to adjudicate the controversy.

Adequacy of representation can be particularly troublesome in a TIL case because the class recovery is limited to the lesser of $500,000 or one percent of the creditor's net worth. In an individual TIL action, a successful consumer is guaranteed a recovery of double the finance charge, subject, at least in some cases, to a minimum of $100 or $200 and a maximum of $1,000 or $2,000. n55 In TIL classes with large numbers of class members, each member's maximum recovery often will be far less than these amounts.

This discrepancy between the potential recovery for each consumer in an individual versus a class action raises several questions. However, courts generally are not troubled by the issue that the class representative is deciding for other class members that their recovery will be less than in an individual action as long as the class action notice clearly discloses the choice to class members so that they can opt out if they choose. n56

[c] Class Action Relief

The relief available in a TILA class action is attorney fees n57 plus actual damages n58 plus statutory damages in an amount not more than the lesser of $500,000 or one percent of the creditor's net worth. n59 Class action statutory damages do not require individual calculation, but are awarded to the class as a whole. n60 As with an individual action, statutory damages are only available for certain TIL violations, n61 and the consumer can recover *both* actual and statutory damages, as applicable, for the same violation. n62

The statutory damage formula in an individual action--twice the finance charge, with a minimum of $200 and a maximum of $2000 in real property-secured transactions--does not apply to class actions. Instead, statutory damages are "such amount as the court may allow" up to a maximum of $500,000 or one percent of the creditor's net worth, whichever is less. n63

[5] Attorney Fees

TILA provides that in the case of "any successful action" to enforce TILA monetary liability or rescission, the creditor is also liable for the "costs of the action, together with a reasonable attorney's fee as determined by the court." n64

Consumers are awarded TILA attorney fees in "any successful action." n65

An action is successful even if the consumer prevails on only one TILA count, and even if other TILA and other state or federal claims are not successful or not addressed. n66 The *size* of the fee award in some circumstances may depend on how many of the claims are successful, but not whether fees should be awarded. A court can award attorney fees after a settlement on the merits because a settlement can be a successful action, n67 even where the creditor does not admit a TILA violation and claims the settlement is responsive to other of the consumer's legal claims. n68 However, language in a 2001 U.S. Supreme Court decision, *Buckhannon Board and Care Home v. West Virginia Department of Health and Human Resources*, casts some doubt on whether a settlement that is not incorporated into a court order can be the basis for attorney fees. n69 Attorneys should therefore take care about the manner in which a settlement is documented in light of the Supreme Court's decision. *Buckhannon* rejected the "catalyst" theory, under which courts had held a plaintiff a prevailing party even if a favorable order was never entered, as long as the suit achieved the desired result by bringing about a voluntary change in the defendant's behavior. In doing so, the Court reaffirmed its view that both "enforceable judgments on the merits and court-ordered consent decrees" can establish that a party has prevailed and is entitled to a fee award. n70 The Court's frequent references to "court-ordered consent decrees" and a footnote in which it appears to back off from the view that fee awards are allowed for "private settlements" n71 may give defendants an argument that fees cannot be awarded for TIL settlements that are not incorporated into a court order but are, for example, accomplished by means of mutual releases and a dismissal of the case.

TILA states that the creditor "is liable to such person [i.e., the consumer] in an amount equal to the sum of" the damage award and attorney fees. n72 Thus, fees are usually paid directly to the consumer and not the consumer's attorney, n73 allowing the consumer and his or her attorney to calculate the attorney's compensation. TILA provides no attorney fees for prevailing creditors, even if the consumer's action is frivolous or in bad faith. n74

Successful TILA consumers must be awarded attorney fees and these fees are not limited by the amount of the consumer's damage recovery. n75 Similarly, it is impermissible to limit the fee award by the contingent fee recoverable or awards in similar cases. n76

The exact amount is in the court's discretion, and an appellate court will only review the amount for an abuse of discretion. n77 But the U.S. circuit courts have developed standards for calculating these awards, and failure to follow these standards or even failure to show clearly that these standards were followed may be an abuse of discretion. n78

In calculating fees, courts begin with a "lodestar": the number of allowable hours times an hourly rate. n79 There is a strong presumption that the lodestar amount represents an adequate and appropriate fee award. n80 The allowable hours are those hours claimed and documented by the attorney that were reasonably expended in reaching a favorable result. n81 Defendants often assert, and courts sometimes examine, the nature and number of claims made in relation to the claims upon which relief is granted. n82

Attorney fees should compensate not only for attorney time, but also for that of paralegals and law clerks who work on the case. n83 The work of paralegals and law student interns should be compensated at the fair market value of those services. n84 An attorney's travel time may be compensable. n85

The lodestar, with certain narrow exceptions discussed in this subsection, will, in all but the most extraordinary circumstances, form the upper limit for a fee award. n86 However, attorneys should be familiar with the leading attorney fee calculation cases for their circuit, as these factors are still utilized in establishing the hourly rate and in justifying the hours claimed. n87 The lodestar figure is presumed reasonable unless one of the parties carries the burden of showing why the figure should be adjusted up or down. n88

TILA also requires that, in any successful TIL action, the creditor is liable to the consumer for "the costs of the action." n89 In order to obtain reimbursement for costs, the plaintiff must take care to justify the expenses. n90

If the TILA action is successful, but the attorney fee award is inadequate, this issue alone may be appealed. n91 Even if the consumer does not wish to pursue the appeal, the attorney has standing to pursue the appeal.

[6] Right to Jury Trial

Whether a party to a TIL action may demand a jury trial as a matter of right is an issue that has been litigated only infrequently. n92 The TILA does not specify whether jury trials are available in TILA actions. n93 The Fourth Circuit in *Barber v. Kimbrell's, Inc.*, n94 to date the most authoritative opinion on point, held that there is a constitutional right to a jury trial in a TILA suit for damages. n95

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral OverviewCivil ProcedureClass ActionsGeneral OverviewContracts LawDebtor & Creditor Relations

FOOTNOTES:
(n1)Footnote 1. *In re* Consolidated "Non-Filing Insurance" *Fee Litig., 195 F.R.D. 684, 692 (M.D. Ala. 2000)* ; *Sarafin v. Sears, Roebuck & Co., 446 F. Supp. 611, 614 (N.D. Ill. 1978)* ; *Welmaker v. W.T. Grant Co., 365 F. Supp. 531, 545 (N.D. Ga. 1973)* (enjoining illegal TILA conduct).

(n2)Footnote 2. *15 U.S.C. § 1640(a).*

(n3)Footnote 3. *Demando v. Morris, 206 F.3d 1300 (9th Cir. 2000)* .

(n4)Footnote 4. *See § 1.03[1][b] supra.*

(n5)Footnote 5. *15 U.S.C. § 1640(a).*

(n6)Footnote 6. Multiple creditors must choose which of them will make disclosures. *See* Official Staff Commentary §§ 226.5(d)-1, 226.17(d)-1.

(n7)Footnote 7. The 1995 amendments, adding *15 U.S.C. § 1641(c)*, seem only to have changed the rule for assignees of real-property secured credit in very subtle ways.

(n8)Footnote 8. *See generally* Ch. 2 *infra.*

(n9)Footnote 9. The most detailed judicial analysis of the actual damage provision appears in *In re Russell, 72 B.R. 855 (Bankr. E.D. Pa. 1987)* . *See Ray v. City Motors, Inc., 1998 U.S. Dist. LEXIS 22809* (S.D. W. Va. June 30, 1998) (following *Russell* and awarding difference between finance charge charged and finance charge disclosed); *Lopez v. Orlor, 176 F.R.D. 35 (D. Conn. 1997)* ; Iuteri v. Branhaven Motors, Inc., Clearinghouse No. 41,259 (D. Conn. Nov. 14, 1985); *Sutliff v. County Savings & Loan Co., 533 F. Supp. 1307 (N.D. Ohio 1982)* ; *Hill v. Allright Mortgage Co. (In re Hill), 213 B.R. 934 (Bankr. D. Md. 1996)* , *aff'd, 213 B.R. 943 (D. Md. 1977)* ; *In re Russell, 72 B.R. 855 (Bankr. E.D. Pa. 1987)* ; *Preston v. First Bank of Marietta, 473 N.E.2d 1210 (Ohio Ct. App. 1983)* . *But see Wiley v. Earl's Pawn & Jewelry, Inc., 950 F. Supp. 1108 (S.D. Ala. 1997)* ; *Swanagan v. Al Piemonte Ford Sales, 1999 U.S. Dist. LEXIS 11167* (N.D. Ill. July 8, 1999) ; *Anderson v. Rizza Chevrolet, Inc., 9 F. Supp. 2d 908 (N.D. Ill. 1998)* (to recover actual damages, consumer must show that she would have sought and obtained a different warranty or a lower price if dealer upcharge had been disclosed); Batcher v. Mid City Motors, Inc., Civ. Action No. 97-1105-A-M2 (M.D. La. Nov. 3, 1998); *Murray v. First Nat'l Bank of Chicago (In re Murray), 239 B.R. 728, 734 (Bankr. E.D. Pa. 1999)* (actual damages measured by amount of undisclosed broker fee and attorney fee; "unexplained, inscrutable, and improperly disclosed" charges are actual damages). For full analysis of detrimental reliance standards of proof, see National

Consumer Law Center, Truth in Lending, § 8.5.4 (5th ed. 2003 and supp.). *See also Peters v. Jim Lupient Oldsmobile Co., 220 F.3d 915, 917 (8th Cir. 2000)* (requires consumer to show that: (1) he read the TIL disclosure statement; (2) he understood the charges being disclosed; (3) had the disclosure statement been accurate, he would have sought a lower price; and (4) he would have obtained a lower price); *Hamilton v. O'Connor Chevrolet, Inc., 2004 U.S. Dist. LEXIS 11474* (N.D. Ill. June 23, 2004) (plaintiffs must show they were stopped from getting better credit elsewhere; cites *Nevarez*); *Nevarez v. O'Connor Chevrolet, Inc., 303 F. Supp. 2d 927 (N.D. Ill. 2004)* (plaintiffs could not show detrimental reliance where they could not read or understand English and therefore could not have relied upon the contract); *Haun v. Don Mealy Imports, Inc., 285 F. Supp. 2d 1297 (M.D. Fla. 2003)* (plaintiff must allege facts in complaint that, if proven, would constitute actual damages; in this case plaintiff summarily claimed actual damages under TILA without identifying any injury at all that was caused by the alleged TILA violation). *Accord Cannon v. Cherry Hill Toyota, Inc., 161 F. Supp. 2d 362 (D.N.J. 2001)* ; *Parra v. Borgman Ford Sales, Inc., 2001 U.S. Dist. LEXIS 16666* (W.D. Mich. Oct. 5, 2001) ; *Gourrier v. Joe Myers Motors, Inc., 78 S.W.3d 651 (Tex. App. 2002)* , *opinion withdrawn, substituted opinion, 2002 Tex. App. LEXIS 5839* (Tex. App. Aug. 8, 2002) . *See also Marshall v. Webb Chevrolet, Inc., 2002 U.S. Dist. LEXIS 10250* (N.D. Ill. June 5, 2002) (TIL actual damages need not be calculated with scientific precision or mathematical accuracy); *Burnstein v. Saks Fifth Ave. & Co., 208 F. Supp. 2d 765 (E.D. Mich. 2002)* (lost access to credit due to a negative report submitted to a credit reporting agency by a creditor in violation of the credit billing provisions of TILA can be actual damages, as long as causation is shown). *See also Warburton v. Foxtons, 2005 U.S. Dist. LEXIS 39615* (D.N.J. June 13, 2005) (requiring detrimental reliance even where plaintiffs allege that defendant violated TILA's timing requirements; for timing claims, plaintiffs must allege that they would have sought, and obtained, a loan at a lower price); *Yarnall v. Four Aces Emporium (In re Boganski), 322 B.R. 422 (Bankr. 9th Cir. 2005)* (no actual damages for disclosure violation where payday borrower did not show that he would have rejected the payday loan if he had been advised of the actual APR); *Egipciaco-Ruiz v. R&G Mortgage Corp, 2005 U.S. Dist. LEXIS 40857* (D. P.R. Sept. 21, 2005) (actual damages for TILA disclosure violations available when consumer can show that, "had he been properly informed, he would have engaged in different or less-expensive transaction"; awarded damages for lost work in association with the litigation). *Cf. Ephraim v. Ehomecredit Corp., 2006 U.S. Dist. LEXIS 13916* (M.D. Pa. Mar. 13, 2006) (detrimental reliance standard satisfied with allegation that plaintiff suffered financial and other harm as direct and proximate result of creditor conduct).

(n10)Footnote 10. For full discussion of restitution scheme methods of calculating damages, see National Consumer Law Center, Truth in Lending, § 8.5.4 (6th ed. 2007 and Supp.).

(n11)Footnote 11. Another provision which sheds some light on what actual damages might be is the correction-of-error-defense. *15 U.S.C. § 1640(b). See* Fabricant v. Sears, Roebuck, Clearinghouse No. 54,563 (S.D. Fla. Mar. 5, 2002) (if plaintiff proves she could have entered into a more favorable transaction if disclosures had been made, she can recover difference between what she paid and what she would have paid; if she proves that she would not have entered into transaction at all, remedy is to restore her to original position). *See also* National Consumer Law Center, Truth in Lending, § 8.5.5.3 (5th ed. 2003 and supp.). *But see Perrone v. GMAC, 232 F.3d 433 (5th Cir. 2000)* (rejecting correction of error as analogy), *cert. denied, 532 U.S. 971, 121 S. Ct. 1601, 149 L. Ed. 2d 468 (2001)* ; *Mayberry v. Ememessay, Inc., 201 F. Supp. 2d 687 (W.D. Va. 2002)* (damages denied where consumer had no intent or desire to shop for better terms); *Tripp v. Charlie Falk Auto, 2001 U.S. Dist. LEXIS 14096* (E.D. Va. Aug. 22, 2001) .

(n12)Footnote 12. *But see Strange v. Mongram Credit Card Bank, 129 F.3d 943 (7th Cir. 1997)* (applying clause in statute setting $100 floor and $1000 in leasing cases to statutory damages in other actions).

(n13)Footnote 13. The Truth in Lending Act Amendments of 1995, Pub. L. No. 104-29, § 6 (Sept. 30, 1995), *amending 15 U.S.C. § 1640(a)(2)(A).*

(n14)Footnote 14. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2502(b), *122 Stat. 2654, 2857 (2008)* (codified at *15 U.S.C. § 1640(a)(2)(A)(ii)*).

(n15)Footnote 15. *15 U.S.C. § 1640(a)(2)(A)* and *(3).*

(n16)Footnote 16. *Koons Buick Pontiac GMC, Inc. v. Nigh, 543 U.S. 50* ; *125 S. Ct. 460* ; *160 L. Ed. 2d 389 (2004)* , *reversing*, *319 F.3d 119 (4th Cir. 2003)* (holding that the 1995 amendments eliminated the $1000 cap on statutory damages for non-mortgage, non-lease transactions subject to clause (i)). A case from the Seventh Circuit provided a view in *dicta* similar to that of the Supreme Court. *Strange v. Monogram Credit Card Bank, 129 F.3d 943 (7th Cir. 1997)* . Reaching the issue only because it was "a matter of considerable commercial interest," *Strange, 129 F.3d at 947* . The court concluded that the $100 floor and $1000 ceiling survived the 1995 amendments. The court noted that neither clause (i) nor (ii) was changed and that, prior to the 1995 amendments, the $1000 cap in the final clause had been understood as limiting both clauses (i) (non-leasing cases) and (ii) (leasing cases). The court concluded that the 1995 amendment "was designed simply to establish a more generous minimum and maximum for certain secured transactions, without changing the general rule on minimum and maximum damage awards for the other two parts of § 1640(a)(2)(A)." *Id., 129 F.3d at 947* .

(n17)Footnote 16.1. *15 U.S.C. § 1640(a)(2)(A)(iii)* (effective Feb. 22, 2010), *added by* Pub. L. No. 111-24, § 107, *123 Stat. 1734, 1743* (May 22, 2009).

(n18)Footnote 17. *Zamarippa v. Cy's Car Sales, Inc., 674 F.2d 877 (11th Cir. 1982)* ; *Smith v. Chapman, 614 F.2d 968 (5th Cir. 1980)* ; *Dzadovsky v. Lyons Ford Sales, Inc., 593 F.2d 538 (3d Cir. 1979)* ; *McGowan v. King, Inc., 569 F.2d 845 (5th Cir. 1978)* ; *In re Norris, 138 B.R. 467 (E.D. Pa. 1992)* (TILA violation presumed to injure borrower by frustrating legislative purpose; debtor need not establish actual harm); *Shepeard v. Quality Siding & Window Factory, Inc., 730 F. Supp. 1295, 1299 (D. Del. 1990)* ; *Warren v. Darnell, 517 N.E.2d 636 (Ill. App. Ct. 1987)* ; *Ralls v. Bank of New York (In re Ralls), 230 B.R. 508 (Bankr. E.D. Pa. 1999)* .

(n19)Footnote 18. *Ralls v. Bank of New York (In re Ralls), 230 B.R. 508 (Bankr. E.D. Pa. 1999)* .

(n20)Footnote 19. *Demando v. Morris, 206 F.3d 1300 (9th Cir. 2000)* ; *Pinkett v. Moolah Loan Co., 1999 U.S. Dist. LEXIS 17276* (N.D. Ill. Nov. 1, 1999) ; *Edwards v. Your Credit, Inc., 148 F.3d 427 (5th Cir. 1998)* , *amended, reh'g, en banc, denied, 1998 U.S. App. LEXIS 20916* (5th Cir. Aug. 17, 1998) ; *Herrera v. First Northern Sav. & Loan Ass'n, 805 F.2d 896 (10th Cir. 1986)* ; *Mars v. Spartanburg Chrysler-Plymouth, Inc., 713 F.2d 65 (4th Cir. 1983)* ; *Huff v. Stewart-Gwinn Furniture, 713 F.2d 67 (4th Cir. 1983)* (creditor liable for technical violation even though borrower suffered no damage or actual injury and was not misled as a result of the violations); *Dryden v. Lou Budke's Arrow Fin. Co., 630 F.2d 641 (8th Cir. 1980)* (creditor's abandonment of transaction and his refund of the consumer's money does not relieve liability; the consumer need not show any actual damages); *Smith v. Chapman, 614 F.2d 968 (5th Cir. 1980)* (an objective standard is to be used in determining TILA violations; the consumer need not be deceived for there to be a violation); *Dzadovsky v. Lyons Ford Sales, Inc., 593 F.2d 538 (3d Cir. 1979)* .

(n21)Footnote 20. *See, e.g., Vollett v. Remy, 1993 Ohio App. LEXIS 5012* (Ohio Ct. App. Oct. 15, 1993) .

(n22)Footnote 21. Former *15 U.S.C. § 1640(g)*, *as amended by* Pub. L. No. 94-240, § 407 (1974).

(n23)Footnote 22. *See § 1.08 supra*.

(n24)Footnote 23. *See* Ch. 2 *infra*.

(n25)Footnote 24. *15 U.S.C. § 1640(g)*.

(n26)Footnote 25. *15 U.S.C. § 1640(d). Herrera v. First Northern Sav. & Loan Ass'n, 805 F.2d 896 (10th Cir. 1986)* (TIL Simplification applies to a pre-1980 transaction, so only one statutory damages recovery was awarded to several obligors). *See Brown v. Marquette Sav. & Loan Ass'n, 686 F.2d 608 (7th Cir. 1982)* .

(n27)Footnote 26. *See* McCullough v. Bank of Stamford, Inc., 14 Conn. L. Trib. 35 No. 44,553 (D. Conn. Feb. 10, 1988) (each obligor may recover separate actual damages).

(n28)Footnote 27. *15 U.S.C. §§ 1631-1647*. The exceptions are for some specific open-end disclosures required by *15 U.S.C. § 1637*, and some of the closed-end disclosure requirements of *15 U.S.C. § 1638*.

(n29)Footnote 28. *See* Ch. 3 *infra*.

(n30)Footnote 29. "Accuracy" has taken on a new, somewhat Orwellian meaning, in light of the increased level of tolerance and other immunity given certain mortgage lenders in the 1995 amendments. These amendments limit liability both retroactively and prospectively. *See generally §§ 1.08[3][b]*, *1.09[2][h] supra* .

(n31)Footnote 30. *15 U.S.C. § 1638(a)(2). See § 1.05[2][e][i] supra. Cannon v. Cherry Hill Toyota, Inc., 161 F. Supp. 2d 362 (D.N.J. 2001)* (statutory damages are available for misstatements in itemization of amount financed).

(n32)Footnote 31. *15 U.S.C. § 1638(a)(3). See § 1.05[2][e][ii] supra*; *Larson v. Lynch Ford, Inc., 2001 U.S. Dist. LEXIS 9211* (N.D. Ill. June 29, 2001) (improper treatment of deferred downpayment threw off amount financed, so statutory damages available). *See also § 1.04 supra*.

(n33)Footnote 32. *15 U.S.C. § 1638(a)(4). See Ray v. City Motors, Inc., 1998 U.S. Dist. LEXIS 22809* (S.D. W. Va. June 30, 1998) (awarding statutory damages for underdisclosure of APR); *see § 1.05[2][e][iii] supra*.

(n34)Footnote 33. *15 U.S.C. § 1638(a)(5). See § 1.05[2][e][v] supra*.

(n35)Footnote 34. *15 U.S.C. § 1638(a)(6). See § 1.05[2][e][iv] supra*.

(n36)Footnote 35. *15 U.S.C. § 1638(a)(9)*. Statutory damages are also recoverable if there is an inaccurate disclosure of the security interest. *See Doubet v. USA Fin. Servs., Inc., 714 F. Supp. 980 (C.D. Ill. 1987)* ; *In re Perkins, 106 B.R. 863 (Bankr. E.D. Pa. 1989)* ; *Hill v. GFC Loan Co., 2000 U.S. Dist. LEXIS 4345* (N.D. Ill. Feb. 15, 2000) . *See generally § 1.05[2][e][vi] supra*.

(n37)Footnote 35.1. *15 U.S.C. § 1641(f)(2)*.

(n38)Footnote 35.2. *15 U.S.C. § 1641(g)*; Pub. L. No. 111-22, § 404 (May 20, 2009). *See Six Ways to Find Out Who Owns and Services the Mortgage*, 27 NCLC REPORTS *Bankruptcy and Foreclosures Ed.* 27 (May/June 2009). *See also* National Consumer Law Center, Truth in Lending, § 8.6.5.6A (2009 supp.).

(n39)Footnote 36. *15 U.S.C. § 1637(a). See § 1.07[4] supra*.

(n40)Footnote 37. *15 U.S.C. § 1637(b)(4). See § 1.07[4] supra*.

(n41)Footnote 38. *15 U.S.C. § 1637(b)(5). See § 1.07[4] supra*.

(n42)Footnote 39. *15 U.S.C. § 1637(b)(6). See § 1.07[4] supra*.

(n43)Footnote 40. *15 U.S.C. § 1637(b)(7). See § 1.07[4] supra*.

(n44)Footnote 41. *15 U.S.C. § 1637(b)(8). See § 1.07[4] supra*.

(n45)Footnote 42. *15 U.S.C. § 1637(b)(9). See § 1.07[4] supra*.

(n46)Footnote 43. *15 U.S.C. § 1637(b)(10). See § 1.07[4] supra*.

(n47)Footnote 44. For detained discussion of violations giving rise to statutory damages, see National Consumer Law Center, Truth in Lending § 8.6 (5th ed. 2003 and supp.).

(n48)Footnote 45. *Williams v. Chartwell Fin. Servs., 204 F.3d 748, 760 (7th Cir. 2000)* .

(n49)Footnote 46. *15 U.S.C. § 1640(a).*

(n50)Footnote 47. NCLC's Consumer Class Actions: A Practical Litigation Guide covers class case selection criteria, defining the class, drafting the complaint, class discovery, preliminary motions, class briefs, representing the named plaintiff at deposition, class notice, negotiations and settlement, stipulation of proposed settlement, the fairness hearing, administration of class notice, scrip settlements, distribution of benefits and *cy pres* provisions. National Consumer Law Center, Consumer Class Actions: A Practical Litigation Guide (6th ed. 2006).

(n51)Footnote 48. *See Gammaro v. Thorp Consumer Disc. Co., 828 F. Supp. 673 (D. Minn. 1993)* (after creditor insisted on arbitration, court refused to order arbitrator to decide TIL claims on behalf of the class, holding that in the absence of explicit authorization for class actions in the arbitration clause, it lacked authority to compel arbitration of class claims). *But see Randolph v. Green Tree Fin. Corp., 178 F.3d 1149 (11th Cir. 1999)* (arbitration clause will be enforceable only if it provides "an effective and easily accessible forum" for small TIL claims), *cert. granted, 529 U.S. 1052, 120 S. Ct. 1552, 146 L. Ed. 2d 458 , aff'd in part, rev'd in part, 531 U.S. 79, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000)* ; *McCarthy v. Providential Corp., 122 F.3d 1242 (9th Cir. 1997) , cert. denied, 525 U.S. 921, 119 S. Ct. 275, 142 L. Ed. 2d 227 (1998)* (dismissing appeal from district court's order compelling arbitration but refusing to submit class claims to arbitration).

(n52)Footnote 49. *See Arroyo v. Wagon Wheel Auto Sales, 2000 Ohio App. LEXIS 3612* (Aug. 11, 2000) (class certification denied where discovery not pursued to show how many consumers were given defendant's standard form).

(n53)Footnote 50. To certify a TIL class action, the court must find that the class is so numerous that joinder is impractical. *Fed. R. Civ. P. 23(a)(1).* Numerosity is rarely in issue in TIL class litigation. A creditor may not defeat class certification by dividing the class into subclasses based on factors that are immaterial to the plaintiffs' claims. *Yazzie v. Ray Vicker's Special Cars, Inc., 12 F. Supp. 2d 1230 (D.N.M. 1998) . See also Powell v. Advanta Nat'l Bank, 2001 U.S. Dist. LEXIS 14048* (N.D. Ill. Sept. 4, 2001) (court may make reasonable inference of numerosity). *But see Roman v. First Franklin Fin. Corp., 2001 U.S. Dist. LEXIS 3968* (N.D. Ill. Apr. 2, 2001) (fact that lender makes a large number of loans is insufficient to show number that have this defect); *Van Slee v. Don McCue Chevrolet Geo, Inc., 2001 U.S. Dist. LEXIS 13956* (N.D. Ill. Sept. 4, 2001) (sampling of contracts insufficient to show numerosity without evidence about how many customers received rebate offer on which TIL claim was based).

(n54)Footnote 51. In TIL class actions, the TIL violation will usually involve an error common to the whole class and so this requirement is usually easily met. *Johnson v. Aronson Furniture Co., 1998 U.S. Dist. LEXIS 14454* (N.D. Ill. Sept. 10, 1998) . *But see Hickey v. Great W. Mortgage Corp., 1995 U.S. Dist. LEXIS 3357* (N.D. Ill. Mar. 17, 1995) (order decertifying class, in part, because question of whether third party charging fees was creditor's agent was a fact-intensive, individual question), *summ. judgment granted, in part, summ. judgment denied, in part, 1995 U.S. Dist. LEXIS 4495* (N.D. Ill. Apr. 4, 1995) . *Murry v. America's Mortgage Banc, 2005 U.S. Dist. LEXIS 11751* (N.D. Ill. May 5, 2005) (commonality satisfied where claim is related to standard formula used by defendants to determine title insurance charges); *adopted in relevant part by 2006 U.S. Dist. LEXIS 42900* (N.D. Ill. June 5, 2006) . (commonality satisfied where claim is related to standard formula used by defendants to determine title insurance charges). *Mirfasihi v. Fleet Mortgage Corp., 2005 U.S. Dist. LEXIS 16701* (N.D. Ill. Aug. 11, 2005) (common question related to telemarketing information-sharing practice that allegedly violated TILA and FCRA), *rev'd on other grounds, 450 F.3d 745 (7th Cir. 2006)* ; *but see Reiser v. Residential Funding Corp., 236 F.R.D. 425 (S.D. Ill. 2005)* (finding plaintiffs failed to satisfy commonality requirement when defendants showed that settlement provider performed varying services to borrowers in association with closing and did not have a standardized practice).

(n55)Footnote 52. The named TIL class representative usually alleges that the creditor used a common practice affecting all class members; typicality should present no difficulty in such a case. *See, e.g., Johnson v. Aronson Furniture Co., 1998 U.S. Dist. LEXIS 14454* (N.D. Ill. Sept. 10, 1998) ; *Johnson v. Rohr-Ville Motors, Inc., 189 F.R.D. 363 (N.D. Ill. 1999)* (typicality established where claims arise from same allegedly unlawful practice, course of conduct, and standardized form documents). *But see Hickey v. Great W. Mortgage Corp., 1995 U.S. Dist. LEXIS 3357* (N.D. Ill.

Mar. 17, 1995) (class decertified, in part, because class definition overbroad and plaintiff's claim atypical for many class members; question at issue was purpose for which courier fees were charged), *summ. judgment granted, in part, summ. judgment denied, in part, 1995 U.S. Dist. LEXIS 4495* (N.D. Ill. Apr. 4, 1995) . *See Weil v. Long Island Sav. Bank, FSB, 200 F.R.D. 164 (E.D.N.Y. 2001)* (immaterial differences in named plaintiffs' claims do not make them atypical); *Gilkey v. Central Clearing Co., 202 F.R.D. 515 (E.D. Mich. 2001)* (atypical facts that are not related to central legal issues do not prevent class certification); *Fabricant v. Sears Roebuck & Co., 202 F.R.D. 310 (S.D. Fla. 2001)* (named plaintiff's claim can be typical even though she is eligible only for statutory damages while other class members may be eligible for actual damages). *Murry v. America's Mortgage Banc, 2005 U.S. Dist. LEXIS 11751* (N.D. Ill. May 5, 2005) (typicality satisfied where the issue is a standard disclosure regarding title insurance charges). *Cf. McIntyre v. Household Bank, 2004 U.S. Dist. LEXIS 25629* (N.D. Ill. Dec. 21, 2004) (claims and defenses regarding named plaintiff are substantially different from those of most class members and therefore the class fails the typicality requirement). *In re Community Bank of N. Va., 418 F.3d 277 (3d Cir. 2005)* (allegation of common scheme satisfies typicality, even when some plaintiffs may have additional state or federal law claims); *Veal v. Crown Auto Dealerships, Inc., 236 F.R.D. 572 (M.D. Fla. 2006)* (typicality satisfied because named plaintiff's claims share "same essential characteristics" with class members); *McKenna v. First Horizon Home Loan Corp., 429 F. Supp. 2d 291 (D. Mass. 2006)* (plaintiff's claim is typical because it is based on standard use of form); *Mirfasihi v. Fleet Mortgage Corp., 2005 U.S. Dist. LEXIS 16701* (N.D. Ill. Aug. 11, 2005) (claim is typical because based on common practice that was standardized); *rev'd on other grounds, 450 F.3d 745 (7th Cir. 2006)* ; *Porter v. Nationscredit Consumer Discount Co., 229 F.R.D. 497 (E.D. Pa. 2005)* (claim by named plaintiff alleging misleading conversations prior to purchase of credit life insurance does not satisfy typicality because the claim is unique to her experience).

(n56)Footnote 53. This requirement is met where the class representative has no interests antagonistic to the other class members, has sufficient interest in the outcome of the litigation, and is represented by a qualified, experienced attorney. *See, e.g., Greisz v. Household Bank, 176 F.3d 1012 (7th Cir. 1999)* (court's view of attorney's proven lack of qualification defeats class certification).

(n57)Footnote 54. In the typical TIL class action, this requirement is met because the alleged TIL violation is the same for each consumer, making issues of law and fact the same for all class members. *See Hoffman v. Grossinger Motor Corp., 1999 U.S. Dist. LEXIS 4172* (N.D. Ill. Mar. 25, 1999) (standard practice of inflating selling price to conceal hidden finance charge), *summ. judgment granted, mot. dismissed, 1999 U.S. Dist. LEXIS 19377* (N.D. Ill. Dec. 9, 1999) . A class action seeking primarily injunctive or declaratory relief need not meet this standard, even if some monetary relief is also sought. *Fed. R. Civ. P. 23(b)(2)*; *Fielder v. Credit Acceptance Corp., 175 F.R.D. 313 (W.D. Mo. 1997)* , *mot. denied, partial summ. judgment denied, 10 F. Supp. 2d 1101 (W.D. Mo. 1998)* , *partial summ. judgment granted, in part, partial summ. judgment denied, in part, 19 F. Supp. 2d 966 (W.D. Mo. 1998)* , *vacated, remanded, mot. denied, 188 F.3d 1031 (8th Cir. 1999)* ; *Hamilton v. Ohio Sav. Bank, 82 Ohio St. 3d 67, 694 N.E.2d 442 (1998)* . *See Rivera v. Grossinger Autoplex, Inc., 2000 U.S. Dist. LEXIS 13073* (N.D. Ill. Sept. 1, 2000) (misallocation of GAP insurance to amount financed is common issue), *aff'd in part, 274 F.3d 1118 (7th Cir. 2001)* ; *Abel v. Keybank, 313 F. Supp. 2d 720* (N.D. Ohio Mar. 4, 2004) (certifying class seeking statutory damages for TILA violations in connection with form contracts for student loans). Commonality can be established where the creditor followed a standard procedure that violated TILA, such as failing to give copies of the disclosure statement to the consumer until after consummation. *Lozada v. Dale Baker Oldsmobile, Inc., 197 F.R.D. 321 (W.D. Mich. 2000)* .

(n58)Footnote 55. *15 U.S.C. § 1640(a)(2)(A).*

(n59)Footnote 56. *See, e.g., Goldman v. First Nat'l Bank of Chicago, 532 F.2d 10 (7th Cir. 1976)* ; *Chevalier v. Baird Sav. Ass'n, 72 F.R.D. 140 (E.D. Pa. 1976)* .

(n60)Footnote 57. *15 U.S.C. § 1640(a)(3).*

(n61)Footnote 58. *15 U.S.C. § 1640(a)(1).* See *§ 1.10[2] supra* for a discussion of actual damages.

(n62)Footnote 59. *15 U.S.C. § 1640(a)(2)(B).*

(n63)Footnote 60. *Bolin v. Sears, Roebuck & Co., 231 F.3d 970 (5th Cir. 2000)* .

(n64)Footnote 61. *See § 1.10[3] supra.*

(n65)Footnote 62. *See § 1.10[3] supra.*

(n66)Footnote 63. *15 U.S.C. § 1640(a)(2)(B).* For a more extensive discussion of class action issues in TIL cases, see National Consumer Law Center, Truth in Lending § 8.8 (5th ed. 2003 and supp.). For an analysis of class actions generally, see National Consumer Law Center, Consumer Class Actions: A Practical Litigation Guide (6th ed. 2006).

(n67)Footnote 64. *15 U.S.C. § 1640(a)(3). See, e.g., Semar v. Platte Valley Fed. Sav. & Loan Ass'n, 791 F.2d 699 (9th Cir. 1986)* (attorney fees must be awarded in a successful TIL rescission action; $135/hour was reasonable and reflected prevailing rates in similar TIL litigation); *In re Mattera, 144 B.R. 687 (E.D. Pa. 1992)* ; *First Union Nat'l Bank of Ga. v. Big John's Auto Sales, Inc., 203 Ga. App. 797, 417 S.E.2d 416 (1992)* (amount of attorney fees is to be determined by the court).

(n68)Footnote 65. *15 U.S.C. § 1640(a)(3).*

(n69)Footnote 66. *See, e.g., Postow v. OBA Fed. Sav. & Loan Ass'n, 627 F.2d 1370 (D.C. Cir. 1980)* ; *McGowan v. Credit Ctr. of N. Jackson, Inc., 546 F.2d 73 (5th Cir. 1977)* ; *Greene v. Gibraltar Mortgage Inv. Co., 529 F. Supp. 186 (D.D.C. 1981)* ; *see also City of Riverside v. Rivera, 477 U.S. 561, 106 S. Ct. 2686, 91 L. Ed. 2d 466 (1986)* ; *Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983)* ; *Love v. Deal, 5 F.3d 1406 (11th Cir. 1993)* ; *Jones v. Mid-Penn Consumer Disc. Co., 93 B.R. 66 (E.D. Pa. 1988)* ; *Kramer v. Marine Midland Bank, 577 F. Supp. 999 (S.D.N.Y. 1984)* ; *Payton v. New Century Mortgage Corp., 2004 U.S. Dist. LEXIS 3876* (N.D. Ill. Mar. 11, 2004) (although plaintiff did not recover for TILA statutory damages claim, plaintiff did obtain rescission and therefore court granted fees for work on both claims); *Johnson v. Thomas, 794 N.E.2d 919 (Ill. App. 2003)* (no reduction in fees and costs where appellate court reduced number of TILA violations from three to two). *Mourer v. Equicredit Corp. of America, 313 B.R. 701 (Bankr. W.D. Mich. 2004)* (consumers succeeded where they prevailed on one claim out of four). *But cf. Scott v. Forest Lake Chrysler-Plymouth-Dodge, 668 N.W.2d 45 (Minn. App. 2003)* (upholding trial court's division of fees request by seven, where consumer prevailed on only one of seven state law claims against automobile dealership; court did not analyze whether claims were related). *Dykstra v. Wayland Ford, Inc.,134 Fed. Appx. 911 (6th Cir. 2005)* (where creditor violated TILA but violation did not trigger statutory damages under § 1640, attorney fees are not available; court declined to apply language allowing for fees for "foregoing liability" to include violations broader than those that trigger an award).

(n70)Footnote 67. *Kissinger v. Board of Trustees, 5 F.3d 177 (3d Cir. 1993)* ; *Sablan v. Department of Fin., 856 F.2d 1317 (9th Cir. 1988)* ; *Gram v. Bank of La., 691 F.2d 728 (5th Cir. 1982)* ; *James v. Home Constr. Co., 689 F.2d 1357 (11th Cir. 1982)* ; *Copeland v. Marshall, 641 F.2d 880 (D.C. Cir. 1980)* ; *Knighton v. Watkins, 616 F.2d 795 (5th Cir. 1980)* ; *In re Marine Midland Motor Vehicle Leasing Litig., 155 F.R.D. 416 (W.D.N.Y. 1994)* (approval of $6 million TILA and RICO class settlement, plus almost $1 million in attorney fees and expenses); *In re Szostek, 1989 U.S. Dist. LEXIS 8021* (E.D. Pa. July 6, 1989) ; *Freeman v. B & B Assocs., 595 F. Supp. 1338 (D.D.C. 1984)* , *rev'd on other grounds, 790 F.2d 145 (D.D.C. 1986)* ; *In re Mattera, 128 B.R. 107 (Bankr. E.D. Pa. 1991)* , *aff'd, 144 B.R. 687 (E.D. Pa. 1992)* (though settlement precluded a ruling on the merits, court assessed probable merits of various claims in allocating hours for fee computation); *see also Maher v. Gagne, 448 U.S. 122, 100 S. Ct. 2570, 65 L. Ed. 2d 653 (1980)* (Civil Rights Act case). *Short v. Wells Fargo Bank Minn., 2006 U.S. Dist. LEXIS 37988* (S.D. W. Va. June 8, 2006) (at the time of settlement only one of plaintiff's eight claims had been dismissed; plaintiff therefore prevailed to some extent on all of the remaining claims through her monetary settlement); *Williams v. Viking Dodge, 2006 U.S. Dist. LEXIS 27469* (N.D. Ill. Apr. 26, 2006) (offer of judgment settling for modest amount still results in a final judgment for the plaintiff and therefore plaintiff prevailed).

(n71)Footnote 68. *Freeman v. B & B Assocs., 595 F. Supp. 1338 (D.D.C. 1984)* , *rev'd on other grounds, 790 F.2d 145 (D.D.C. 1986)* ; *Poussard v. Commercial Credit Plan, 479 A.2d 881 (Me. 1984)* .

(n72)Footnote 69. *Buckhannon Bd. & Care Home v. West Va. Dep't of Health & Human Res., 532 U.S. 598, 121 S. Ct. 1835, 149 L. Ed. 2d 855 (2001)* .

(n73)Footnote 70. *532 U.S. at 605, 121 S. Ct. at 1840, 149 L. Ed. 2d at 863* .

(n74)Footnote 71. *Id.* at n.7.

(n75)Footnote 72. *15 U.S.C. § 1640(a)*; *see also Freeman v. B & B Assocs., 790 F.2d 145 (D.C. Cir. 1986)* ; *Smith v. South Side Loan Co., 567 F.2d 306 (5th Cir. 1978)* ; *cf. Evans v. Jeff D., 475 U.S. 717, 730 n.19, 106 S. Ct. 1531, 1539 n.19, 89 L. Ed. 2d 747, 759 n.19 (1986)* . *Mourer v. Equicredit Corp. of America, 313 B.R. 701 (Bankr. W.D. Mich. 2004)* (consumers succeeded where they prevailed on one claim out of four). *But see James v. Home Constr. Co., 689 F.2d 1357 (11th Cir. 1982)* .

(n76)Footnote 73. *See Zeisler v. Neese, 24 F.3d 1000 (7th Cir. 1994)* ; *Ehlert v. Ward, 588 S.W.2d 500 (Mo. 1979)* .

(n77)Footnote 74. *Semar v. Platte Valley Fed. Sav. & Loan Ass'n, 791 F.2d 699, 703 n.10 (9th Cir. 1986)* .

(n78)Footnote 75. *Strange v. Monogram Credit Card Bank of Ga., 129 F.3d 943 (7th Cir. 1997)* ; *Martinez v. Idaho First Nat'l Bank, 755 F.2d 1376 (9th Cir. 1985)* ; *In re Pine, 705 F.2d 936 (7th Cir. 1983)* ; *Reneau v. Mossy Motors, 622 F.2d 192 (5th Cir. 1980)* ; *Johnson v. Johnson Chevrolet, Inc., 633 F.2d 716 (5th Cir. 1980)* ; *Price v. Franklin Inv. Co., 574 F.2d 594 (D.C. Cir. 1978)* ; *Freeman v. B & B Assocs., 595 F. Supp. 1338 (D.D.C. 1984)* , *rev'd on other grounds, 790 F.2d 145 (D.C. Cir. 1986)* ; *Redic v. Gary H. Watts Realty Co., 586 F. Supp. 699 (W.D.N.C. 1984)* , *rev'd on other grounds, 762 F.2d 1181 (4th Cir. 1985)* ; *Allright Mortgage Co. v. Hill, 213 B.R. 943 (D. Md. 1997)* (reversing bankruptcy court's use of "cost-benefit" analysis to reduce fee award); *see also City of Riverside v. Rivera, 477 U.S. 561, 106 S. Ct. 2686, 91 L. Ed. 2d 466 (1986)* ; *Krosscent Trust III v. EMC Mortgage Corp., 2003 Cal. App. Unpub. LEXIS 10015* (Cal. App. Oct. 24, 2003) (remanding to the district court to redetermine attorneys fees in TILA case where the district court grossly reduced the attorneys fees request by evaluating the fee petition only on the basis of the amount in controversy. The court specifically noted that fees for a claim resolved before trial should not be reduced simply because trial was not needed and that the court should consider fees associated with the "full effort legitimately expended in obtaining a favorable result"). *But see Mirabal v. GMAC, 576 F.2d 729 (7th Cir. 1978)* .

(n79)Footnote 76. *Blanchard v. Bergeron, 489 U.S. 87, 109 S. Ct. 939, 103 L. Ed. 2d 67 (1989)* ; *see also Yohay v. City of Alexandria Employees Credit Union, Inc., 827 F.2d 967 (4th Cir. 1987)* ; *Varner v. Century Fin. Co., 738 F.2d 1143 (11th Cir. 1984)* (district courts must compare TIL attorney's work to rates earned by attorneys in similarly complicated federal litigation, and not merely by reference to TIL cases; artificially low hourly rates for TIL claims will not be tolerated); *In re Pine, 705 F.2d 936 (7th Cir. 1983)* .

(n80)Footnote 77. *Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983)* ; *Strange v. Monogram Credit Card Bank of Ga., 129 F.3d 943 (7th Cir. 1997)* ; *Mares v. Credit Bureau of Raton, 801 F.2d 1197 (10th Cir. 1986)* ; *Martinez v. Idaho First Nat'l Bank, 755 F.2d 1376 (9th Cir. 1985)* ; *Varner v. Century Fin. Co., 738 F.2d 1143 (11th Cir. 1984)* ; *Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp. (Lindy II), 540 F.2d 102 (3d Cir. 1976)* ; *Johnson v. Georgia Highway Express, 488 F.2d 714 (5th Cir. 1974)* ; *Warren v. Darnell, 164 Ill. App. 3d 273, 517 N.E.2d 636 (1987)* .

(n81)Footnote 78. *Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983)* ; *Martinez v. Idaho First Nat'l Bank, 755 F.2d 1376 (9th Cir. 1985)* ; *Reneau v. Mossy Motors, 622 F.2d 192 (5th Cir. 1980)* (mere statement that "all the factors" were weighed is not enough); *McGowan v. King, Inc., 616 F.2d 745 (5th Cir. 1980)* . See also guidelines for attorney fees in *Pennsylvania v. Delaware Valley Citizens Council of Clean Air, 478 U.S. 546, 106 S.*

Ct. 3088, 92 L. Ed. 2d 439 (1986) ; *Ex parte* Edwards (Edwards v. Alabama Farm Bureau Mut. Cas. Ins. Co.), *591 So. 2d 491 (Ala. 1990)* (failure of trial court to articulate its reasons for reducing legal services attorneys' requested fees of $75,301.56 to $9,00.00 requires reversal and remand for adequate determination), *later proceeding, 601 So. 2d 82 (Ala. 1992)* ; *GMAC Mortgage Corp. v. Larson, 232 Ill. App. 3d 697, 597 N.E.2d 1245 (1992)* (fee set as a percentage of benefit to the borrowers found improper); *Mt. Vernon Mem'l Estates, Inc. v. Wood, 88 Ill. App. 3d 666, 410 N.E.2d 995 (1980)* . *See also Newton v. United Cos. Fin. Corp., 33 Fed. Appx. 23, 2002 U.S. App. LEXIS 6061 (3d Cir. 2002)* (unpublished, citation limited) (remanding TIL fee award for trial court to articulate in greater detail its rationale for granting full request).

(n82)Footnote 79. *Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983)* (civil rights case, but Court stated that the standards "are generally applicable in all cases in which Congress has authorized an award of attorney's fees to a 'prevailing party' "); *see also Blum v. Stenson, 465 U.S. 886, 104 S. Ct. 1541, 79 L. Ed. 2d 891 (1984)* . *Brannon v. Bridge Capital Corp., 2008 U.S. Dist. LEXIS 41949* (M.D. Ala. May 27, 2008) (TILA case where court awarded lodestar amount without adjustment).

(n83)Footnote 80. *Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983)* ; *Davis v. City & County of San Francisco, 976 F.2d 1536, 1544 (9th Cir. 1992)* .

(n84)Footnote 81. *Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983)* . *See Bostic v. American Gen. Fin., Inc., 87 F. Supp. 2d 611 (S.D. W. Va. 2000)* (15% reduction because of inadequate documentation in TIL case); *Patterson v. Bob Wade Lincoln-Mercury, Inc., 55 Va. Cir. 499 (2000)* (hours were excessive, but court takes into account fact that issues were complex and attorney did good job). *Arch v. Nissan, 2005 U.S. Dist. LEXIS 12198* (N.D. Ill. June 7, 2005) (TIL case) (eleven hours to research and prepare complaint alleging several federal and state claims, including TILA theory of first impression, is not excessive; however, time spent by experienced attorneys on duplicative or administrative tasks disallowed); *Harris v. River View Ford, 2001 U.S. Dist. LEXIS 25867* (N.D. Ill. Dec. 19, 2001) (TIL case) (allowing time for class action allegations that were not certified but reducing time for status conferences from 3.3 hours to 1.4 hours each, and reducing by half the hours billed for drafting amended complaints to 2.25 hours per complaint). *See also Williams v. Viking Dodge, 2006 U.S. Dist. LEXIS 27469* (N.D. Ill. Apr. 26, 2006) (cutting by half the one hour of paralegal time charged for printing, formatting, and serving forms; disallowing an undocumented $40 internet search fee); *Rockwell v. Talbott, Adams & Moore, 2006 U.S. Dist. LEXIS 10170* (D. Neb. Feb. 21, 2006) (awarding just over $5000 when attorney sought over $30,000 in light of excessive time spent on preparation of a simple case, overstaffing of the case and failure to delegate work from attorney to paralegals and other assistants); *Turner v. Beneficial Nat'l Bank, 405 F. Supp. 2d 929 (N.D. Ill. 2005)* (reducing fee in case--for representing individual class representative who then opted out of class action settlement--from lodestar amount of over $185,000 to $16,525, when requested amount was thirty-seven times greater than individual plaintiff's recovery, more than 6800 times her actual loss of $27, and much of the requested time was for class action work, not work on behalf of only this individual).

(n85)Footnote 82. *See Pennsylvania v. Delaware Valley Citizens' Council for Clean Air, 483 U.S. 711, 107 S. Ct. 3078, 97 L. Ed. 2d 585 (1987)* (Delaware Valley II) (O'Connor, J., concurring). *See also Payne v. Equicredit Corp. of Am., 2002 U.S. Dist. LEXIS 8919* (E.D. Pa. May 20, 2002) (adjusting fee downward where consumer prevailed only on TIL claims, and only against one defendant). *Short v. Wells Fargo Bank Minn., 2006 U.S. Dist. LEXIS 37988* (S.D. W. Va. June 8, 2006) (plaintiff's claims arose out of a common core of facts; court did not separate work by claim, although one of plaintiff's eight claims had been dismissed); *Chavarria v. Fleetwood Retail Corp. of New Mexico, 115 P.3d 799 (N.M. Ct. App. 2005)* (allowing fees for work on non-fee-generating claims when they had common legal elements with fee-generating claims), *review granted, 115 P.3d 2130 (N.M. 2005)* .

(n86)Footnote 83. *Missouri v. Jenkins, 491 U.S. 274, 109 S. Ct. 2463, 105 L. Ed. 2d 229 (1989)* ; *Postow v. Oriental Bldg. Ass'n, 455 F. Supp. 781 (D.D.C. 1978)* , *aff'd sub nom. Postow v. OBA Fed. Sav. & Loan Ass'n, 627 F.2d 1370 (D.C. Cir. 1980)* ; *Frazier v. Franklin Inv. Co., 468 A.2d 1338 (D.C. 1983)* ; *Merchandise Nat'l Bank v. Scanlon, 86 Ill. App. 3d 719, 408 N.E.2d 248 (1980)* ; *see also City Consumer Servs., Inc. v. Horne, 631 F. Supp. 1050 (D. Utah*

1986) . Cf. Blanchard v. Bergeron, 489 U.S. 87, 109 S. Ct. 939, 103 L. Ed. 2d 67 (1989) (reserving for another day issue of fees for legal assistants).

(n87)Footnote 84. *Missouri v. Jenkins, 491 U.S. 274, 109 S. Ct. 2463, 105 L. Ed. 2d 229 (1989)* . This means that such services should be compensated at the normal billing rate charged to clients, and not the worker's hourly wage or her cost to the employer, provided that these kinds of expenses are normally billed to clients. *Davis v. City & County of San Francisco, 976 F.2d 1536, 1544 (9th Cir. 1992)* .

(n88)Footnote 85. *Davis v. City & County of San Francisco, 976 F.2d 1536, 1544 (9th Cir. 1992)* ; *In re Pine, 705 F.2d 936 (7th Cir. 1983)* ; *In re Mattera, 128 B.R. 107 (Bankr. E.D. Pa. 1991)* (travel time allowed but deduction made); *DeCarlo v. Perales, 963 F. Supp. 181, 185 (N.D.N.Y. 1997)* (travel time awarded at reduced rates). *Arch v. Nissan, 2005 U.S. Dist. LEXIS 12198* (N.D. Ill. June 7, 2005) (travel time allowed because it reflects lost opportunity, whether the attorney works on contingency or hourly-rate basis).

(n89)Footnote 86. *See generally City of Burlington v. Dague, 505 U.S. 557, 112 S. Ct. 2638, 2640, 120 L. Ed. 2d 449 (1992)* ; *Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983)* ; *Envtl. Def. Fund v. Reilly, 1 F.3d 1254 (D.C. Cir. 1994)* .

(n90)Footnote 87. District of Columbia Circuit: *Environmental Defense Fund v. Reilly, 1 F.3d 1254 (D.C. Cir. 1994)* (Resource Conservation and Recovery Act); *McKenzie v. Kennickell, 875 F.2d 330 (D.C. Cir. 1989)* (Civil Rights Act of 1964); *Copeland v. Marshall, 641 F.2d 880 (D.C. Cir. 1980)* (Civil Rights Act of 1964); *see also Etta v. Seaboard Enters., Inc., 674 F.2d 913 (D.C. Cir. 1982)* (TILA); *Greene v. Gibraltar Mortgage Inv. Co., 529 F. Supp. 186 (D.D.C. 1981)* (TILA).

First Circuit: *Coutin v. Young & Rubicam Puerto Rico, Inc., 124 F.3d 331 (1st Cir. 1997)* (§ 1988 case); *Brewster v. Dukakis, 3 F.3d 488 (1st Cir. 1993)* ; *Phetosomphone v. Allison Reed Group Inc, 984 F.2d 4 (1st Cir. 1993)* (Title VII): *DeJesus v. Banco Popular de Puerto Rico, 951 F.2d 3 (1st Cir. 1991)* (TILA); *Segal v. Gilbert Color Sys., Inc., 746 F.2d 78 (1st Cir. 1984) (20 U.S.C. § 1875* case).

Second Circuit: *LeBlanc-Sternberg v. Fletcher, 143 F.3d 765 (2d Cir. 1998)* (§ 1988 case); *Mautner v. Hirsch, 32 F.3d 37 (2d Cir. 1994)* ; *Lunday v. City of Albany, 42 F.3d 131 (2d Cir. 1994) (20 U.S.C. § 1988); City of Detroit v. Grinnell Corp. (Grinnell II), 560 F.2d 1093 (2d Cir. 1977)* (private antitrust case); *City of Detroit v. Grinnell Corp. (Grinnell I), 495 F.2d 448, 1974-1 Trade Cas. (CCH) P74986 (2d Cir. 1974)* (private antitrust case); *Seabrook v. Postal Fin. Servs., 527 F. Supp. 1006 (S.D.N.Y. 1981)* (TILA).

Third Circuit: *Washington v. Philadelphia County Court of Common Pleas, 89 F.3d 1031 (3d Cir. 1996)* (civil rights); *Keenan v. City of Philadelphia, 983 F.2d 459 (3d Cir. 1992)* ; *Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp. (Lindy II), 540 F.2d 102, 117 (3d Cir. 1976)* (antitrust case); *Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp. (Lindy I), 487 F.2d 161 (3d Cir. 1973)* (antitrust case); *Johnson v. Second Nat'l Fund Corp., 515 F. Supp. 1380 (E.D. Pa. 1981)* (TILA).

Fourth Circuit: *Diamond Star Bldg. Corp. v. Sunset Builders Inc., 30 F.3d 503 (4th Cir. 1994)* (copyright infringement suit); *Run Creek Coal Sales v. Caperton, 31 F.3d 169 (4th Cir. 1994)* (§ 1988); *Hyatt v. Shalala, 6 F.3d 250 (4th Cir. 1993)* (EAJA); *Barber v. Kimbrell's, Inc., 577 F.2d 216 (4th Cir. 1978)* ; *Vaughns v. Board of Educ. of Prince George's County, 598 F. Supp. 1262 (D. Md. 1984)* .

Fifth Circuit: *Walker v. United States HUD, 99 F.3d 761 (5th Cir. 1996)* (§ 1988 case), *cert. denied, mot. granted sub nom., Walker v. City of Mesquite, 528 U.S. 1131, 120 S. Ct. 969, 145 L. Ed. 2d 840 (2000)* ; *Watkins v. Fordice, 7 F.3d 453 (5th Cir. 1993)* ; *Powell v. C.I.R., 891 F.2d 1167 (5th Cir. 1990)* (*26 U.S.C. § 7430(c)(2)(A)(i)*); *Wheeler v. Mental Health & Mental Retardation Auth., 752 F.2d 1063, 1073 (5th Cir. 1985)* ; *Harris v. Tower Loan of Miss., Inc., 609 F.2d 120 (5th Cir. 1980)* (TILA); *McGowan v. King, Inc, 616 F.2d 745 (5th Cir. 1980)* (TIL).

Sixth Circuit: *Wooldridge v. Marlene Indus., 898 F.2d 1169 (6th Cir. 1990)* ; *Coulter v. Tennessee, 805 F.2d 146 (6th Cir. 1986)* ; *Louisville Black Police Officers v. City of Louisville, 700 F.2d 268 (6th Cir. 1983)* (§ 1988 case); *Northcross v. Board of Educ. of Memphis City Schs., 611 F.2d 624 (6th Cir. 1979)* , *cert. denied, 447 U.S. 911 (1980)* (§ 1988 case).

Seventh Circuit: *Jaffee v. Redmond, 142 F.3d 409 (7th Cir. 1998)* (§ 1988 case); *People Who Care v. Rockford Bd. of Educ., 90 F.3d 1307 (7th Cir. 1996)* (§ 1988 case), *reh'g, en banc, denied, 1996 U.S. App. LEXIS 26453* (7th Cir. Oct. 8, 1996) ; *Smith v. Village of Maywood, 17 F.3d 219 (7th Cir. 1994)* ; *Skelton v. General Motors Corp., 860 F.2d 250 (7th Cir. 1988)* (Federal Magnuson Moss Act); *Lynch v. City of Milwaukee, 747 F.2d 423 (7th Cir. 1984)* (§ 1988 case); *Henry v. Webermeier, 738 F.2d 188 (7th Cir. 1984)* (§ 1988 case); *In re Pine, 705 F.2d 936, 938 (7th Cir. 1983)* (TILA).

Eight Circuit: *Missouri v. Jenkins, 838 F.2d 260* (8th Cir.) , *aff'd, 491 U.S. 274, 109 S. Ct. 2463, 105 L. Ed. 2d 229 (1989)* ; *Loggins v. Delo, 999 F.2d 364 (8th Cir. 1993)* (§ 1988); *Murphy v. Ford Motor Credit Co., 629 F.2d 556, 561 (8th Cir. 1980)* (TILA); *Brown v. Bathke, 588 F.2d 634 (8th Cir. 1978)* (§ 1988 case); *Dougherty v. Hoolihan, Neils, & Boland, Ltd., 531 F. Supp. 717 (D. Minn. 1982)* .

Ninth Circuit: *Morales v. City of San Rafael, 96 F.3d 359 (9th Cir. 1996)* (§ 1988 case), *amended, reh'g, en banc, denied, 108 F.3d 981 (9th Cir. 1997)* ; *Davis v. City & County of San Francisco, 976 F.2d 1536 (9th Cir. 1992)* ; *Gates v. Deukmejian, 987 F.2d 1392 (9th Cir. 1992)* ; *Martinez v. Idaho First Nat'l Bank, 755 F.2d 1376 (9th Cir. 1985)* (TILA); *Boncyk v. Cavanaugh Motors, 673 F.2d 256 (9th Cir. 1981)* (TILA); *Kessler v. Associates Fin. Servs. Co., 639 F.2d 498 (9th Cir. 1981)* (TILA); *Kerr v. Screen Extras Guild, 526 F.2d 67 (9th Cir. 1975)* , *cert. denied, 425 U.S. 951 (1976)* (a Labor-Management Reporting and Disclosure Act of 1959 case); *In re Jansen, 47 B.R. 641 (Bankr. D. Ariz. 1985)* .

Tenth Circuit: *Phelps v. Hamilton, 120 F.3d 1126 (10th Cir. 1997)* (§ 1988 case); *Joseph A. v. New Mexico Dep't of Human Servs., 28 F.3d 1056 (10th Cir. 1994)* ; *Homeward Bound v. Hissom Memorial Ctr., 963 F.2d 1352 (10th Cir. 1992)* (Rehabilitation Act).

Eleventh Circuit: *Love v. Deal, 5 F.3d 1406 (11th Cir. 1993)* (Voting Rights Act); *Church of Scientology v. City of Clearwater, 2 F.3d 1509 (11th Cir. 1993)* ; *Varner v. Century Fin. Co., 738 F.2d 1143 (11th Cir. 1984)* (TILA).

See also Farrar v. Hobby, 506 U.S. 103, 113 S. Ct. 566, 121 L. Ed. 2d 494 (1992) ; *City of Burlington v. Dague, 505 U.S. 557, 112 S. Ct. 2638, 120 L. Ed. 2d 449 (1992)* ; *Texas State Teachers Ass'n v. Garland Indep. Sch. Dist., 489 U.S. 782 (1989)* ; *Pennsylvania v. Delaware Valley Citizens' Council for Clean Air, 483 U.S. 711 (1987)* (Delaware Valley II).

(n91)Footnote 88. *City of Burlington v. Dague, 505 U.S. 557, 112 S. Ct. 2638, 120 L. Ed. 2d 449 (1992)* ; *see also Blum v. Stenson, 465 U.S. 886, 104 S. Ct. 1541, 79 L. Ed. 2d 891 (1984)* ; *Copeland v. Marshall, 641 F.2d 880 (D.C. Cir. 1980)* ; *Ex parte Edwards, 601 So. 2d 82 (Ala. 1992)* (creditor's claim that 490 hours were unreasonable was not supported by specific challenge to excessive, redundant, or otherwise unnecessary hours; court concluded the time was reasonable); *Payne v. Equicredit Corp., 2002 U.S. Dist. LEXIS 8919* (E.D. Pa. May 20, 2002) (approving $300/hour for highly experienced attorney). *Mourer v. Equicredit Corp. of America, 313 B.R. 701 (Bankr. W.D. Mich. 2004)* (TILA case); *Harris v. River View Ford, 2001 U.S. Dist. LEXIS 25867* (N.D. Ill. Dec. 19, 2001) (TILA case) (fee award *not* reduced although plaintiff recovered less than full monetary amount sought; court noted that the goal of fees in a TILA case is to enable plaintiffs to bring cases despite limited damages). *But cf. Fogle v. William Chevrolet/Geo, Inc., 275 F.3d 613 (7th Cir. 2001)* (affirming trial court's reduction of hourly rate from $310 to $185).

(n92)Footnote 89. *15 U.S.C. § 1640(a)(3)*.

(n93)Footnote 90. *Hamm v. Ameriquest Mortg. Co., 549 F. Supp. 2d 1018 (N.D. Ill. 2008)* (discounting most of requested reimbursement for costs where plaintiff did not justify substantial costs incurred for transcript fees, filing fees, and computer legal research; court also failed to grant reimbursement for duplicative transactions involving both postage and fax expenses).

(n94)Footnote 91. *Price v. Franklin Inv. Co., 574 F.2d 594 (D.C. Cir. 1978)* . The merits judgment and the attorney fee are separate appealable orders. *Herbert v. Federal Nat'l Mortgage Ass'n, 102 B.R. 407 (E.D. Pa 1989)* (citing *White v. Department of Employment Security, 455 U.S. 445, 452-53 n.14, 102 S. Ct. 1162, 1167 n.14, 71 L. Ed. 2d 325, 331-32 n.14 (1982))* .

(n95)Footnote 92. *E.g., Barber v. Kimbrell's, Inc., 577 F.2d 216 (4th Cir. 1978)* ; *Mosley v. Nat'l Fin. Co., 440 F. Supp. 621 (M.D.N.C. 1977)* ; Warren v. G.A.C. Fin. Corp., [1969-1973 Transfer Binder] Consumer Cred. Guide (CCH) P 98,968 (N.D. Ga. 1973); *In re McCormick, 61 B.R. 595 (Bankr. D. Nev. 1986)* (bankruptcy debtors have right to trial by jury on complaint for TIL violations). *See also Good Housekeeping Shop v. Hines, 247 S.E.2d 142 (Ga. Ct. App. 1978)* (determination of TILA attorney fees is question for court, not jury).

(n96)Footnote 93. *See Barber v. Kimbrell's, Inc., 577 F.2d 216 (4th Cir. 1978)* (TILA and its legislative history are inconclusive on jury trial issue). *But cf. Good Housekeeping Shop v. Hines, 247 S.E.2d 142 (Ga. Ct. App. 1978)* (TILA expressly provides that court should decide what attorney fees are reasonable).

(n97)Footnote 94. *577 F.2d 216 (4th Cir. 1978)* . The liability sections of TILA have been amended since this decision, but in ways immaterial to its rationale.

(n98)Footnote 95. *See also Kobs v. Arrow Serv. Bureau, 134 F.3d 893 (7th Cir. 1998)* (citing *Barber* with approval in concluding that FDCPA statutory damages should be decided by jury); *Mosley v. National Fin. Co., 440 F. Supp. 621 (M.D.N.C. 1977)* (right to jury trial under TILA); *In re McCormick, 61 B.R. 595 (Bankr. D. Nev. 1986)* (right to jury trial for TILA action seeking damages and rescission even in bankruptcy court). *But see* Warren v. G.A.C. Fin. Corp., [1969-1973 Transfer Binder] Consumer Cred. Guide (CCH) P 98,968 (N.D. Ga. 1973) (no right to jury trial in TILA action); *Duren v. First Gov't Mortgage & Investors Corp., 2000 U.S. App. LEXIS 15469* (D.C. Cir. June 7, 2000) (no right to jury trial on TIL rescission claim since it is an equitable claim). *But cf. Bank of New Haven v. Liner, 1993 Conn. Super. LEXIS 2939* (Conn. Super. Ct. Nov. 9, 1993) (since foreclosure is an equitable action, no right to jury trial on defenses, including TILA).

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PART I Consumer Credit
CHAPTER 2 High Rate Home Equity Loan Protections

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PART I Consumer Credit
CHAPTER 2 High Rate Home Equity Loan Protections

1-2 Consumer Credit Law Manual § 2.01

§ 2.01 Introduction

In 1994 Congress passed high rate home equity loan protections designed to prevent some predatory lending practices targeted at vulnerable consumers. n1 The Home Ownership and Equity Protection Act ("HOEPA") created a special class of regulated closed-end loans made at high annual percentage rates or with excessive costs and fees. HOEPA is an amendment to the Truth in Lending Act ("TILA"). n2

It is to be hoped that the legislation will reverse the trend of the past decade which has made predatory home equity lending a growth industry. It tells legitimate lenders that there are limits--not quite "anything goes," even in a period of deregulatory fervor--and it provides consumers who are victimized by unethical lenders with an additional avenue for relief. However, it is not expected that these amendments to the TILA will cure the problem of abusive home equity lending entirely. The law continues to allow high rate home equity loans to be made, albeit with fewer terms designed to hide the true disadvantages and risks of such loans. Additionally, it does nothing to regulate abusive terms in transactions defined outside the class of protected loans.

These weaknesses underscore the importance of considering other causes of action in addition to the high rate home equity loan protections. In fact, the legislative history makes clear that the new law does not preempt more protective alternative laws n3 and does not preclude attacks on loans which are not covered by the bill. n4 Other provisions of the TILA, especially including rescission, as discussed elsewhere in this volume, will continue to be of primary importance in attacking abusive loans. In addition, state unfair trade practice law, n5 warranty law, n6 usury, n7 unconscionability, n8 fraud and old-fashioned contract law create remedies which an advocate can use to challenge predatory mortgages.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingFederal RegulationsHome Owners Equity Protection Act

FOOTNOTES:
(n1)Footnote 1. Home Ownership and Equity Protection Act of 1994 [hereinafter HOEPA], Subtitle B of Title I of the Riegle Community Development and Regulatory Improvement Act, Pub. L. No. 103-325 (1994), *codified at* § 129 (*15 U.S.C. § 1639*) and in §§ 31 and 32 of Regulation Z. Official Staff Commentary which fleshes out relevant provisions of

Regulation Z has been published at *61 Fed. Reg. 14,952 (April 4, 1996), 62 Fed. Reg. 10,193* (March 6, 1997) , and *63 Fed. Reg. 16,669* (April 6, 1998). In December 2001, the Federal Reserve Board amended the HOEPA regulations and commentary. *66 Fed. Reg. 65,604* (Dec. 20, 2001). In doing so, it lowered the annual percentage rate trigger and tightened the points and fees trigger.

(n2)Footnote 2. *Foster v. Equicredit Corp., No. 99-6393, 2001 U.S. Dist. LEXIS 1881* (E.D. Pa. Jan. 25, 2001) (HOEPA amends the Truth in Lending Act [hereinafter TILA] and is governed by the same statute of limitations); *Harris v. EMC Mortgage Corp., 2002 U.S. Dist. LEXIS 12251* (E.D. Pa. Apr. 10, 2002) (same).

(n3)Footnote 3. *See* H.R. Conf. Rep. No. 103-652, at 147, 162 (1994) (accompanying H.R. 3474). For further discussion of legislative history, see National Consumer Law Center, Truth in Lending, § 9.1.2 (6th ed. 2007 and supp.).

(n4)Footnote 4. H.R. Conf. Rep. No. 103-652, at 147, 159 (1994) (accompanying H.R. 3474).

(n5)Footnote 5. *See* Ch. 4 *infra*.

(n6)Footnote 6. National Consumer Law Center, Consumer Warranty Law (3d ed. 2006 and supp.).

(n7)Footnote 7. *See generally* Ch. 6 *infra*.

(n8)Footnote 8. *See generally § 6.09 infra*.

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PART I Consumer Credit
CHAPTER 2 High Rate Home Equity Loan Protections

1-2 Consumer Credit Law Manual § 2.02

§ 2.02 Coverage of the Act

There are two triggers for the special protections of the law. These triggers are found in the Truth in Lending ("TIL") definition section at *15 U.S.C. section 1602(aa)*. The first of the two triggers is based on the annual percentage rate ("APR") for the loan. The other is based on the total amount of points and fees charged. These triggers are discussed below.

In addition to the trigger requirements, all covered loans must be "consumer credit" transactions and must be secured by the consumer's principal dwelling. n1

Certain transactions are exempt from the high rate protections. As in the case of the rescission provision of TILA, "residential mortgage transactions" are exempted. n2 That term is generally defined by TILA to include purchase money security interests used to finance the acquisition or initial construction of the consumer's dwelling. n3 Consequently, all refinancing and other home equity loans are covered, but purchase and construction loans are generally not. n4

As with rescission, loan products deliberately designed to evade the terms of the Act should be covered. n5 However, the law contains an explicit exemption for reverse mortgages n6 and for open-end credit. n7

It is anticipated that some creditors will seek to evade the high rate home equity loan protections discussed in this chapter by structuring abusive loans as open-end credit. n8 When that occurs, the transaction should be carefully examined to make sure that it meets the definition in the statute and the regulations. The definition of open-end credit is contained in *15 U.S.C. section 1602(i)* and is amplified by Regulation Z section 226.2(a)(20). n9 The Board took action to curb attempts to circumvent HOEPA by structuring home loans as open-end lines of credit when it revised Regulation Z in December 2001. After October 1, 2002, the new rule prohibits creditors from attempting to evade HOEPA in this fashion. n10 The Commentary discusses the factors to consider in determining the "amount financed" for purposes of applying the points and fees trigger. n11 Whenever coverage is in question, practitioners should submit to the court their own calculations of the triggers giving rise to coverage. n11.1

[1] The Annual Percentage Rate Trigger

The first category of covered loans under the Act is loans for which the APR at the time of consummation exceeds by

more than ten percentage points the yield on treasury securities having comparable maturities at the time the loan is made. n12 The relevant date for selecting the comparable treasury bond rates will be the fifteenth day of the month immediately preceding the month in which the application for an extension of credit is received by the creditor. n13 Treasury bond rates do fluctuate over time. Since coverage is determined as of the date of consummation, a loan will not be included if rates increase subsequently.

The necessary yields to determine whether a particular loan is covered are published in a variety of places. n14 For the purpose of evidence in litigated cases, the Federal Reserve publications or the Wall Street Journal's published records should suffice.

All of the applicable requirements for calculating the annual percentage rate will apply. n15 It will be the accurate rate which controls, so the APR must be evaluated for errors. Where an error is found, for example, because the creditor has misallocated a component of the finance charge to the amount financed, the correct rate should be calculated and coverage should be evaluated based on that number.

For adjustable rate loans, coverage will be determined by evaluating the APR on the date of consummation. If a teaser rate is involved, the properly calculated composite APR is the relevant one. n16

[2] APR Calculations in Foreclosure Rescue Scams

The phrase "foreclosure rescue scam" describes various types of schemes targeted at homeowners already facing foreclosure and in financial distress. n17 One of the more common and insidious versions occurs when homeowners deed their property to the "rescuers" or third parties either unknowingly or believing that they are saving their home. These transactions take the form of sale/leaseback contracts or complicated trust arrangements. Rarely are any of these transactions structured as a loan. However, the courts will assess these scams under the prism of the equitable mortgage doctrine. n18 Once the court finds the transaction to be, in reality, an equitable mortgage, the next issue is whether the "rescuer" qualifies as a creditor for TILA and HOEPA purposes.

To determine whether a foreclosure rescue transaction meets the HOEPA APR trigger, one can consider the terms of the repurchase portion of the transaction alone or the unified impact of the sale and the repurchase. When the homeowner's repurchase price is higher than the sale price, the lost equity is arguably a finance charge that should be considered in the calculation. Foreclosure rescue scams are structured in a variety of ways, however, so other ways of determining the APR may be appropriate for a particular case.

Assume that the homeowner's regular monthly mortgage payment was $733.76 per month (this would be the monthly payment on a $100,000 thirty-year mortgage at 8%). Assume also that the homeowner was $10,000 in arrears on mortgage payments and $2000 in arrears on property taxes but had $40,000 in equity in the property. A typical rescuer might pay the combined $12,000 arrearage in exchange for a quit claim deed on the property and allow the homeowner to "rent" the property for $1233.76 per month (the $733.76 regular mortgage payment plus $500 toward the $12,000 arrearage) for twenty-four months, followed by a balloon payment of $60,000 to exercise an option to reacquire the home.

The annual percentage rate for a $12,000 loan with this payment schedule is 154.15%. Assuming that the "application" date of the sale/leaseback was June 1, 2006, this APR is well in excess of the HOEPA APR trigger of 14.99% (the Treasury bond rate of 4.99% on the 15th of the prior month plus 10%). n19

[3] The Points and Fees Trigger

The alternative trigger for coverage is the charging of total points and fees in excess of 8% of the total loan amount. n20 However, for coverage under this section to apply, the total points and fees must exceed the set floor, which will change

each year on January 1 by the amount the APR change in the consumer price index as reported on June 1 of the year before the adjustment. n21 For 2009, the floor is $583. n22

There is an explicit four-part definition of points and fees under the Act (for loans consummated after October 1, 2002). n23 It includes specified charges that are payable by the consumer at or before closing. These charges include, first, all items included in the finance charge for the loan, other than interest and time-price differential. n24

The second element of points and fees is "all compensation paid to mortgage brokers." n25 The total compensation of the broker is to be included whether or not the use of the broker was required by the creditor. n26 The fee must be counted irrespective of whether it is denominated as a finance charge or not. n27 Because the definition refers to "all compensation," advocates should be alert to the possibility that the broker may receive an undisclosed kickback from the lender. There will be some dispute as to how to treat these fees. For purposes of calculating the APR trigger, it would not matter if the interest rate or points concealed a kickback. n28 Either way, the broker compensation is reflected in the APR.

An issue arises when the broker (as opposed to the lender) provides a credit against the closing costs. A broker might provide a credit against his own broker fee if the lender pays him a yield spread premium and he has charged the consumer a fee directly. If the broker credits an amount against the direct broker fee listed on the settlement statement, then arguably the amount of the broker fee for HOEPA points and fees purposes (and for finance charge purposes) could be reduced by the amount of the credit. n29 When the credit is larger than direct broker fee or when the creditor provides a credit, refer to *Section 1.04[2] supra* , regarding the consequences to the finance charge analysis. However, if the broker received a yield spread premium, that amount arguably is a point and fee as discussed in the next section.

Problems arise when cash from the loan proceeds is siphoned off by a broker or employee of a brokerage firm or other third party. In these cases, the settlement statement, if it lists this activity at all, will show the "legitimate" broker fee on one line and this additional payout on another line with or without the name of the recipient. In one case, the settlement statement revealed $10,500 paid to a third-party entity (owned by an employee of the brokerage firm) that the consumer did not understand or apparently authorize. The brokerage firm separately received $6350. The court held that the $10,500 was not a "broker" fee (and, thus, not a point and fee) because the employee was not a director or officer of the brokerage firm and the firm never received any of this money. n30 In contrast, another federal court in the same district refused to dismiss the HOEPA claim in a case in which the consumer alleged that the lender's employees who were vice-presidents in the firm caused fees to be disbursed to separate companies in which they were involved. n31 The court held that the fees could be disguised broker fees and, if so, the loan would be covered under HOEPA.

The third element of points and fees is real estate charges included under *15 U.S.C. section 1605(e)* other than escrow charges for future payment of taxes. n32 These charges do not count toward the points and fees trigger if they meet the following three part exception:

1) The charge is reasonable;

2) The creditor receives no direct or indirect compensation; and

3) The charge is paid to a third party unaffiliated with the creditor. n33

The fourth element applies to loans entered into on or after October 1, 2002. The points and fees trigger for these loans includes premiums and other charges for credit life, accident, health, loss-of-income insurance and debt cancellation coverage written in connection with the loan in the points and fees trigger. n34 This is a significant step forward in addressing loan-packing practices. To include the credit insurance premium or debt cancellation charge in the points and fees trigger, the credit insurance must be written in connection with the loan transaction. n35 The "written in connection" language will exclude charges for pre-existing policies owned by the borrower before entering into the loan

transaction or those purchased after consummation. Thus, the premiums paid for insurance purchased on a monthly basis after the loan was signed cannot be counted in the points and fees trigger. n36 Significantly, the Commentary states that premiums paid at or before closing are included regardless of whether they are paid in cash or financed, and whether the amount represents the entire premium for the coverage or an initial payment. n37 Finally, debt cancellation charges are included in the points and fees trigger whether or not the coverage is considered insurance under applicable law. n38

[4] Points and Fee Trigger Calculations in Foreclosure Rescue Scams

To determine whether a foreclosure rescue transaction n39 meets the HOEPA points and fees trigger, one can consider the terms of the repurchase portion of the transaction alone or the unified impact of the sale and the repurchase. Foreclosure rescue scams are structured in a variety of ways, however, so other ways of determining the points and fees may be appropriate for a particular case.

For most foreclosure rescue transactions, the APR trigger will present a clearer analysis. n40 However, the following example illustrates the application of the points and fees trigger in a hypothetical foreclosure rescue transaction.

Assume that the homeowner's regular monthly mortgage payment was $733.76 per month (this would be the monthly payment on a $100,000 thirty-year mortgage at 8%). Assume also that the homeowner was $10,000 in arrears on mortgage payments and $2000 in arrears on property taxes but had $40,000 in equity in the property. A typical rescuer might pay the combined $12,000 arrearage in exchange for a quit claim deed on the property and allow the homeowner to "rent" the property for $1233.76 per month (the $733.76 regular mortgage payment plus $500 toward the $12,000 arrearage) for twenty-four months, followed by a balloon payment of $60,000 to exercise an option to reacquire the home. Assume further that the rescuer charged the homeowner an up-front fee of $500 and required the homeowner to make two additional monthly payments of $400 to the rescuer while the rescuer was finalizing the transaction. Finally, assume that the rescuer required the homeowner to pay $300 for an appraisal before closing but funneled the money to an appraisal company owned by the rescuer.

All of these up-front charges, totaling $1600, at least arguably count toward the HOEPA points and fees trigger as they were "payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." n41 These points and fees would amount to 13.3% of the total loan amount of $12,000, n42 exceeding the HOEPA triggers of $528 (the floor for 2006) and 8% of the total loan amount.

Note that this example provides a road map for calculating the points and fees trigger in the most conservative manner. Alternatively, if the rescuer structures the deal to capture a profit by creating a difference between the homeowner's "sale" price for the property and a much larger "repurchase" price in those cases in which there is a "repurchase" contract, the difference arguably is a finance charge and, consequently, a point and fee.

In conventional loans, the charges that count toward the points and fees trigger are usually paid out of the proceeds of the loan at closing (or paid by the lender before closing and then added to the principal of the loan). Sometimes, however, borrowers pay these charges in cash before closing or bring cash to the closing. With foreclosure rescue scams, the points and fees analysis is clearest if the homeowner made cash payments to the rescuer at or before closing. Charges may also count toward the points and fees trigger if the rescuer paid them at or before closing and then added them to the amount the consumer agreed to pay to repurchase the home. n43

[5] Expanded Definition of Creditor

These home equity protections create a special definition of creditor for high rate loans. Any person who makes two *or* more mortgages which qualify for coverage under the triggers or who makes one or more such mortgage through a mortgage broker is covered. n44

Interestingly, if individuals or entities become creditors because they meet the expanded definition of creditor under HOEPA, they are a creditor for all TIL purposes. The language added by HOEPA to the definition of "creditor" is written as a separate, free-standing definition, apparently independent of the general definition. Under this interpretation, anyone who originates two HOEPA loans, or one HOEPA loan through a broker, meets the definition of "creditor" even if the debt is not initially payable to that creditor and is not payable by agreement in more than four installments. Under this reading, a mortgage broker who originated one or more HOEPA loans would be a "creditor" even if the obligation was payable to a separate lender. The Fourth Circuit recently addressed this issue, aligning itself with several other courts and placing itself at odds with the first decision to discuss this question. n45

The Fourth Circuit case arose in the context of whether certain closing costs were paid to an affiliate of the creditor for purposes of counting them towards the HOEPA points and fees trigger. An affiliate of the broker received the fees, and the homeowners argued that the broker constituted a "creditor" under this arguably independent sentence in *15 U.S.C. § 1602(f)*. The court decided that section 1602(f) could be read sensibly to mean that the first sentence must be met first. That sentence indicates that both of the requirements contained therein must be met before an entity can be a creditor under the Act. Therefore, the last sentence in that section does not override that mandate. The last sentence cannot stand alone, the court reasoned, because it has no tie to any current transaction. Arguably, any person could be a creditor even if it was not the creditor in the loan in question. A reading of the last sentence also shows that it refers to a brokered loan. According to the court, Congress meant that the "broker" and "creditor" be separate and distinct entities. Even though the second and third sentences in section 1602(f) clearly are stand-alone sentences, the court stated that they predated the HOEPA amendments to that provision and Congress "added the last sentence of § 1602(f) as a patch to extend the first-sentence definition of 'creditor' in the context of mortgages to include persons who have originated only two prior high-cost mortgages." n46 Finally, the court held that Regulation Z and its Commentary n47 support its reading of the statute and rejected the homeowners' attack on the validity of the regulation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral OverviewReal Property LawFinancingFederal RegulationsHome Owners Equity Protection Act

FOOTNOTES:
(n1)Footnote 1. Reg. Z § 226.32(a). By defining covered loans to include "consumer credit," Congress presumably intended to reference the Federal Reserve Board's [hereinafter FRB] definition of that term in Regulation Z, *12 C.F.R. § 226.2(a)(12)*. The term "dwelling" is defined in *15 U.S.C. § 1602(a)(v)* and Regulation Z § 226.2(a)(19). It includes one- to four-family housing units, condominiums, cooperatives, and mobile homes.

(n2)Footnote 2. *15 U.S.C. § 1602(aa)(1). See, e.g., Taylor v. Nelson, 2006 U.S. Dist. LEXIS 3860* (E.D. Pa. Jan. 31, 2006) (consumer used the two mortgage loans at issue to purchase her home; therefore, the transactions were not covered by HOEPA). *Provencher v. T&M Mortg. Solutions, Inc., 2008 U.S. Dist. LEXIS 47616* (D. Me. June 18, 2008) (HOEPA did not apply to loan made to consumer to pay off tax lien and re-acquire title from the town, even though she alleged that she had obtained title prior to closing the loan; construing Official Staff Commentary § 226.2(a)(24)-5i to require consumer to have both purchased and acquired some interest in the home prior to loan closing to take transaction out of the residential mortgage exemption); *Johnson v. Scala, 2007 U.S. Dist. LEXIS 73442* (S.D.N.Y. Oct. 1, 2007) (S.D.N.Y. Oct. 1, 2007) (holding that HOEPA did not apply where the transaction admittedly was a purchase money loan).

(n3)Footnote 3. *15 U.S.C. § 1602(w)*. The Commentary defines this phrase to include a loan for financing the construction of a primary dwelling on land already owned by the consumer. Official Staff Commentary § 226.2(a)(24)-7, *as amended by 63 Fed. Reg. 16,669* (Apr. 6, 1998) .

(n4)Footnote 4. *See* Flynn v. People's Mortgage, Inc., No. 98-*C3760, 1998 U.S. Dist. LEXIS 18891* (N.D. Ill. Nov. 18, 1998) .

(n5)Footnote 5. *See generally § 1.08 supra*.

(n6)Footnote 6. *15 U.S.C. § 1602(aa)(1)*.

(n7)Footnote 7. *15 U.S.C. § 1602(aa)(1)*.

(n8)Footnote 8. This problem was anticipated by Congress as the legislation specifically directs the FRB to study the question of whether open-end borrowers are adequately protected and to submit recommendations to Congress. Pub. L. No. 103-325, § 157 (Sept. 23, 1994). *See, e.g.,* Merriam v. Chase Manhattan Mortgage Corp. (*In re* Merriam), 333 B.R. 22 (Bankr. W.D.N.Y. 2005) (in a case in which the creditor extended two home-secured loans to the homeowners, a first lien fixed-term loan that refinanced the existing mortgage lien and a second line of credit that paid off certain credit card debt, the home equity line of credit constituted spurious open-end credit; in reaching its conclusion, the court highlighted the following factors: the creditor disbursed the entire line of credit at closing; the terms called for interest-only payments for the first three years that would result in no reduction of principal during that time; the draw period only lasted for the first three years; the creditor knew that the homeowners would not likely pay more than the interest-only payments during the draw period, given their limited monthly income and, consequently, knew that the line of credit would not replenish during that time; as to the HOEPA status of this transaction, the court held that neither of the loans alone was a HOEPA loan and treating the loans as one big loan with both sets of points and fees did not push the transaction into HOEPA).

(n9)Footnote 9. That definition is set out more fully and analyzed in Ch. 1, *§ 1.07[1][a] supra . See also* Official Staff Commentary § 226.2(a)(20).

(n10)Footnote 10. Reg. Z § 226.34(b).

(n11)Footnote 11. Official Staff Commentary § 226.34(b)-1. The Board indicates that the determination of the amount financed is a factual one. Factors in calculating the amount of credit that would have been extended if the loan had been structured as a closed-end loan include: the amount of money the consumer originally requested, the amount of the first advance or the highest outstanding balance, or the amount of the credit line. "The amount of the credit line is considered only to the extent that it is reasonable to expect that the consumer might use the full amount of credit." *Id*.

(n12)Footnote 11.1. *See Laudani v. Tribeca Lending Corp. (In re Laudani), 401 B.R. 9, 32-33 (Bankr. D. Mass. 2009)* (rejecting HOEPA claim where creditor provided court with detailed calculations of both triggers, but borrower provided no calculations or evidence of coverage beyond "bald assertions that the APR was calculated improperly").

(n13)Footnote 12. *15 U.S.C. § 1602(aa)(1)(A)*; Reg. Z § 226.32(a)(i).

(n14)Footnote 13. *15 U.S.C. § 1602(aa)(1)(A)*; Reg. Z § 226.32(a)(i). *See also* Official Staff Commentary § 226.32(a)(1)(i)-2 (if the 15th is not a business day, the creditor must use the yield as of the immediately preceding business day).

(n15)Footnote 14. The Federal Reserve website provides the necessary information. Go to www.federalreserve.gov/releases. Scroll down to "Weekly Releases" and under "H.15," click on "historical data." Scroll down to "Treasury constant maturities." Find the comparable term and then click on "weekly."

(n16)Footnote 15. This includes the following general tolerance levels: a) 1/8 of 1% (or 1/4 of 1% in the case of irregular transactions); b) any overdisclosure; or c) an annual percentage rate [hereinafter APR] error resulting from an understated finance charge of no more than $100. The tolerance levels applicable in rescission matters, Reg. Z § 226.23(g), do *not* apply in evaluating the Home Opportunity and Equity Protection [hereinafter HOEP] trigger. Reg. Z §

226.31(g).

It is a bit unclear how the Board's "additional" tolerance of § 226.22(a)(5) fits into the HOEP trigger tolerance, since it keys off of both the finance charge-related $100 tolerance (which applies) and the rescission tolerance levels (which do not). However, given the Board's clear intent that the loose rescission standards not apply to the HOEP trigger, the § 226.22(a)(5) tolerance should logically only be applicable when it is keyed to the $100 finance charge-related tolerance.

(n17)Footnote 16. *See § 1.05[2][g] supra. Moore v. Chase Bank, 2008 WL 961161* (N.D. Cal. Apr. 7, 2008) (rejecting the consumer's argument that the maximum relevant rate permitted in the ARM loan note is the relevant APR; rather, the APR disclosed at closing must be used).

(n18)Footnote 17. *See* National Consumer Law Center, Cost of Credit: Regulation, Preemption, and Industry Abuses § 11.6.7 (4th ed. 2009).

(n19)Footnote 18. *See* § National Consumer Law Center, Truth in Lending, § 2.5.3 (6th ed. 2007 and Supp.); National Consumer Law Center, Cost of Credit: Regulation, Preemption, and Industry Abuses §§ 7.5.2.1, 11.6.7 (4th ed. 2009).

(n20)Footnote 19. In this example, the 10% APR trigger for junior lien mortgages is used. Since the rescuer only paid the delinquent amount of the existing first mortgage, not the full balance, a conservative approach treats the transaction with the rescuer as a junior lien mortgage loan.

(n21)Footnote 20. *15 U.S.C. § 1602(aa)(1)(B)*; Reg. Z § 226.32(a)(1)(ii).

(n22)Footnote 21. *15 U.S.C. 1602(aa)(3)*; Reg. Z. § 226.32(a)(ii).

(n23)Footnote 22. *73 Fed. Reg. 46,190* (Aug. 8, 2008) .

(n24)Footnote 23. *15 U.S.C. § 1602(aa)(4)*; Reg. Z § 226.32(b)(1). The fourth part of the definition, premiums for credit insurance, was added by the FRB's final revisions to Regulation Z and the Commentary published on December 20, 2001. The changes became mandatory on October 1, 2002. Reg. Z § 226.32(b)(iv). For loans consummated prior to October 1, 2002, only the first three parts of the definition are applicable.

(n25)Footnote 24. *15 U.S.C. § 1602(aa)(4)(A)*; Reg. Z § 226.32(b)(1)(i). *See* Reg. Z § 226.4.

(n26)Footnote 25. *15 U.S.C. § 1602(aa)(4)(B)*; Reg. Z § 226.32(b)(1)(ii).

(n27)Footnote 26. *15 U.S.C. § 1602(aa)(4)(B)*; Reg. Z § 226.32(b)(1)(ii). *See also 60 Fed. Reg. 15,466* (Mar. 24, 1995) (explanation of § 226.32(b)(1)).

(n28)Footnote 27. Official Staff Commentary § 226.32(b)(1)(ii)-1.

(n29)Footnote 28. Some of the hidden fees to brokers may be concealed in the finance charge, and so would be recaptured by the APR trigger, as in the case of yield-spread premiums, whereby brokers and creditors split an increase in the interest rate. *See, e.g., Culpepper v. Inland Mortgage Co., 132 F.3d 692 (11th Cir. 1998) , reh'g, en banc, denied, 144 F.3d 717 (11th Cir. 1998) , class cert. granted, 189 F.R.D. 668 (N.D. Ala. 1999) , class cert. granted, 1999 U.S. Dist. LEXIS 11846* (N.D. Ala. Mar. 22, 1999) , *stay granted, mot. denied, 1999 U.S. Dist. LEXIS 15986* (N.D. Ala. July 19, 1999) , *aff'd by, sub nom. at 253 F.3d 1324 (11th Cir. 2001) , cert. denied, mot. granted, 122 S.Ct. 930, 151 L. Ed. 2d 893 (2002)* ; National Consumer Law Center, Credit Discrimination, § 8.4 (4th ed. 2005 and supp.); National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 12.2.1.5 (3d ed. 2005 and Supp.). Advocates should also be aware that RESPA prohibits kickbacks and fee-splitting arrangements except for services performed. *12 U.S.C. § 2607*, Reg. X, *24 C.F.R. § 3500.14*; U.S. Dept. of Housing and Urban Development,

RESPA Statement of Policy 1999- 1 Regarding Lender Payments to Mortgage Brokers, *64 Fed. Reg. 10,080* (Mar. 1, 1999) . Now that many of these loans may also be subject to RESPA, which authorizes treble damages for a violation of that provision, there is an additional means of addressing this problem. *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption,and Industry Abuses, Chapter 12 (3d ed. 2005 and Supp.) *See also Webster v. Centex Home Equity Corp. (In re Webster), 300 B.R. 787 (Bankr. W.D. Okla. 2003)* (bankruptcy court counted the yield spread premium as a point and fee, by focusing on the "all compensation" broker language in section 1602(aa)(4)(B) of the statute). *But see Bell v. Parkway Mortgage, Inc. (In re Bell), 309 B.R. 139 (E.D. Pa. 2004)* (deciding without analysis that the yield spread premium is not paid by the consumer at or before closing relying on a case that, after some lengthy analysis on the issue of whether a yield spread premium is a finance charge [finding that it is], held merely that the consumer failed to allege that the premium was a "prepaid" finance charge); *Collins v. Canton Home Improvement (In re Canton), 310 B.R. 299 (2004)* (court used a dictionary definition of "payable" to find that the consumer must pay the yield spread premium "at once," otherwise, it does not qualify as a point and fee. However, that sixth edition *Black's Law Dictionary* definition has been superseded by the seventh edition which defines "payable" as a sum "that is to be paid"); *Sigle v. Canton Home Improvement (In re Sigle), 310 B.R. 303 (Bankr. N.D. Miss. 2004)* (same judge; identical opinion).

(n30)Footnote 29. *See Morrison v. Brookstone Mortgage Co., 415 F. Supp. 2d 801 (S.D. Ohio 2005)* (broker credit reduces the point and fees total for HOEPA calculations purposes).

(n31)Footnote 30. *Cunningham v. Equicredit Corp. of Ill., 427 F. Supp. 2d 838 (N.D. Ill. 2006)* . The court failed to consider the fact that the Act defines a finance charge as the cost of credit to the consumer. In this set of facts, the lender knew that $10,500, over 10% of the loan amount, was paid to this third party because either it or its closing agent prepared the settlement statement and disbursed the loan proceeds. The court rejected an argument that the $10,500 constituted a finance charge on the grounds that the lender must have retained a portion of the fee, which it did not do. However, the question is whether the creditor imposed the fee directly or indirectly, not whether the lender retained a portion of the fee. If the creditor knew this fee was paid in other transactions involving the same brokerage firm or if it had reason to suspect that embezzlement may be involved, then, arguably, the creditor indirectly imposed the charge by disbursing it.

(n32)Footnote 31. *Durham v. The Loan Store, Inc., 2005 U.S. Dist. LEXIS 22059* (N.D. Ill. Sept. 30, 2005) , *subsequent proceedings, 2006 U.S. Dist. LEXIS 33550* (N.D. Ill. May 16, 2006) .

(n33)Footnote 32. *15 U.S.C. § 1602(aa)(4)(C)*; Reg. Z § 226.32(b)(1)(iii). *See* Reg. Z § 226.40(c)(7).

(n34)Footnote 33. *15 U.S.C. § 1602(aa)(4)(C)*; Reg. Z § 226.32(b)(1)(iii). *See* Reg. Z § 226.40(c)(7). For examples, see Official Staff Commentary § 226.32(b)(1)(ii)-2. "Affiliate" is defined by reference to the Bank Holding Company Act of 1956, *12 U.S.C. § 1841(k)*; Reg. Z § 226.32(b)(2). It includes any company that controls, or is controlled by or is under common control, with the creditor. *See Lopez v. Delta Funding Corp., 1998 U.S. Dist. LEXIS 23318* (E.D.N.Y. Dec. 23, 1998) .

(n35)Footnote 34. Reg. Z § 226.32(b)(1)(iv).

(n36)Footnote 35. Reg. Z § 226.32(b)(1)(iv).

(n37)Footnote 36. For a discussion of "written in connection with a credit transaction," see National Consumer Law Center, Truth in Lending, § 3.9.4.4 (6th ed. 2007 and Supp.).

(n38)Footnote 37. Official Staff Commentary § 226.32(b)(1)(iv)-1.

(n39)Footnote 38. Reg. Z § 226.32(b)(1)(iv).

(n40)Footnote 39. *See* National Consumer Law Center, Cost of Credit: Regulation, Preemption, and Industry

Abuses § 11.6.7 (4th ed. 2009) for general discussion of foreclosure rescue scams.

(n41)Footnote 40. See an example of the APR calculation in *§ 2.02[2], supra* .

(n42)Footnote 41. *12 C.F.R. §§ 226.32(b), 226.4.*

(n43)Footnote 42. In this example, the homeowner paid the points and fees up front in cash. In a standard mortgage loan, the points and fees are often paid out of the proceeds of the loan and then financed as part of that loan. In that case, the "total loan amount" as defined by HOEPA is the proceeds of the loan minus the points and fees.

(n44)Footnote 43. One court counted the $10,000 fee imposed by the rescuer to be paid when and if the homeowner exercised his "option" to repurchase the property against the loan of $11,113.99 that covered the mortgage arrearage, approximately five months of payments going forward, and $5000 to the homeowner. *Perry v. Queen, 2006 U.S. Dist. LEXIS 17120* (M.D. Tenn. Feb. 27, 2006) .

(n45)Footnote 44. *15 U.S.C. § 1602(f)*; Reg. Z § 226.2 n.3.

(n46)Footnote 45. *Cetto v. LaSalle Bank, N.A., 518 F.3d 263 (4th Cir. 2008)* ; *Wilson v. Bel Fury Invs. Group, LLC, 2006 U.S. Dist. LEXIS 35740* (D. Neb. Feb. 6, 2006) (foreclosure rescue scam case); *Dawson v. Thomas (In re Dawson), 2008 Bankr. LEXIS 1074* (Bankr. D.D.C. Apr. 9, 2008) (applying the "regularly extends" and "to whom payable" language of Regulation Z § 226.2(a)(17) without directly addressing this issue; finding broker was not a creditor for HOEPA liability); *Carter v. Alston, 2005 U.S. Dist. LEXIS 28365* (E.D. Va. Nov. 10, 2005) ; *Viernes v. Executive Mortgage, Inc., 372 F. Supp. 2d 576 (D. Haw. 2004)* . See also *Hruby v. Larsen, 2005 U.S. Dist. LEXIS 42281* (D. Minn. June 17, 2005) (court applied the "to whom payable" rule without commenting on this issue). But see *Anderson v. Wells Fargo Home Mortgage, Inc., 259 F. Supp. 2d 1143 (W.D. Wash. 2003)* .

(n47)Footnote 46. *Cetto v. LaSalle Bank, N.A., 518 F.3d 263, 271 (4th Cir. 2008)* .

(n48)Footnote 47. Reg. Z § 226.2(a)(17)(i) n.3; Official Staff Commentary § 226.2(a)(17)-1 (transaction counts toward numerical tests only if it meets four-installment/finance-charge requirement and is originally payable to the creditor).

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PART I Consumer Credit
CHAPTER 2 High Rate Home Equity Loan Protections

1-2 Consumer Credit Law Manual § 2.03

§ 2.03 Disclosure Requirements

New disclosure requirements applicable to covered loans are found in *15 U.S.C. section 1639*. n1 The new disclosures do not replace the existing disclosure requirements under *15 U.S.C. section 1638*, but, rather, are supplementary. n2 The new disclosures will have to be made in conspicuous type size. n3

For all covered loans made before October 1, 2002, the creditor must make the following disclosures: n4

> 1) "You are not required to complete this agreement merely because you received these disclosures or have signed a loan application."
>
> 2) "If you obtain this loan, the lender will have a mortgage on your home. You could lose your home and any money you have put into it, if you do not meet your obligations under the loan."

For fixed-rate loans, the creditor must also disclose the annual percentage rate and the amount of the regular monthly payment. n5 For variable rate loans, the additional disclosures include the annual percentage rate, the amount of the regular monthly payment, a statement that the interest rate and the monthly payment may increase, and the amount of the maximum potential monthly payment, based on the maximum allowable interest rate set by contract for that loan. n6

For loans consummated on or after October 1, 2002, the HOEPA notice must include two additional important pieces of information. First, the creditor must state the total amount the consumer will borrow, defined to be the face amount of the note (*i.e.*, the principal). n7 This information is intended to alert consumers to a common tactic of high cost lenders: inflating the loan amount to refinance a first lien mortgage (so the new lender can be in first lien position); finance high fees and costs; and pad the principal, without the knowledge or consent of the borrower. n8 Further, the Board created a special tolerance for the disclosure of the total amount borrowed. The creditor may disclose a total amount borrowed above or below the actual amount of no more than $100. If the regular payment is affected by the misdisclosure of the total amount borrowed, the error is acceptable as long as the total amount borrowed is within the tolerance. n9

Second, if the amount borrowed does include premiums or charges for optional credit insurance or debt cancellation coverage, that fact must be stated grouped together with the disclosure of the amount borrowed. n10 The consumer must agree to the purchase of these products before delivery of the HOEPA notice. n11 The Board revised its model HOEPA notice accordingly. n12

The disclosures required for covered loans must be given not less than three business days prior to consummation of the transaction. n13 Where there is an issue regarding delivery of disclosures, the lender's procedures should be scrutinized to determine if delivery most likely took place. n14 Once disclosures are made, the terms of the loan may not be changed if they make the disclosures inaccurate, unless new disclosures are made. n15

Some lenders may add information to the HOEPA notice or may include a separate notice or letter when the HOEPA notice is provided. While a lender can provide more information than required by law, the additional verbiage, if inconsistent with the required language, may violate the clear and conspicuous requirement in *15 U.S.C. section 1632*. This violation could trigger the rescission remedy, where applicable. n16 Remember, the required language must be in conspicuous type size in relation to non-mandated information. However, one court held that adding the note rate with a one-sentence explanation to the HOEPA notice in a less conspicuous location than the APR disclosure did not violate the clear and conspicuous requirement when the note rate explanation did not contradict the other required information. n17 The court did not address the conspicuous type size mandate, however.

The Federal Reserve Board created a model HOEPA disclosure form which creditors may use. n18 However, one court held that the creditor must modify the form if the monthly payments will vary, in this case, because of the addition of an FHA insurance premium. n19

In 2001, the FRB issued an interim rule governing electronic disclosures under TILA. n20 The rule was immediately effective and contained a mandatory compliance date of October 1, 2001. n21 After the comment period expired, however, the Board lifted the mandatory compliance date because the "Board is considering adjustments to the rules to provide additional flexibility." n22 Because the landscape of the interim rule is in doubt, it is unlikely that creditors will engineer their computer software and gear up to engage in electronic credit transactions until some version of the rule becomes final. The interim regulation makes clear that the HOEPA notice can be given electronically, provided the creditor complied with the E-Sign Act's consumer consent provisions. In the spring of 2007, the FRB published proposed regulations that remove certain portions of the interim rules and retain others. n23 As of August 31, 2007, the agency had not finalized the proposals.

The Electronic Signatures in Global and National Commerce Act, n24 effective October 1, 2000, was enacted to validate electronic signatures, electronic documents, and electronic disclosures. If its requirements, particularly the consumer consent and confirmation-of-consent requirements, are met, it overrides TILA's requirement that disclosures be made in writing. n25 The new federal statute applies to all transactions, not just those that the consumer initiates electronically, and it allows electronic disclosures even when all the other documents are paper. n26

Failure to properly make the necessary disclosures will give rise to civil liability under *15 U.S.C. § 1640(a)* and enhanced damages pursuant to *15 U.S.C. § 1640(a)(4)*. n27

In addition, failure to make the new disclosures will constitute a failure to make "material disclosures" under the amended Act. n28 Thus, failure to properly make the new disclosures will give rise to an extended right to rescind the transaction for up to three years from the date of consummation. n29

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingDisclosureReal Property LawFinancingFederal RegulationsHome Owners Equity Protection Act

FOOTNOTES:
(n1)Footnote 1. The regulations for the new disclosures are in Reg. Z §§ 226.31 and 226.32. See Official Staff

Commentary § 226.32(c) for additional guidance, especially with regard to disclosure of regular payments and worst-case variable rate payment examples.

(n2)Footnote 2. *15 U.S.C. § 1639(a)(1)*; Reg. Z § 226.31(a). For a discussion of the general closed-end disclosure requirements, see Ch. 1, *§ 1.05 supra* .

(n3)Footnote 3. *15 U.S.C. § 1639(a)(1)*. In the 2001 revisions to the HOEPA regulations, the Board added the conspicuous type size requirement to Regulation Z in order to conform to the statute. Reg. Z § 226.32(c).

(n4)Footnote 4. *15 U.S.C. § 1639(a)(1)*; Reg. Z § 226.32(c).

(n5)Footnote 5. *15 U.S.C. § 1639(a)(2)(A)*; Reg. Z § 226.32(c). Since the accurate APR must be disclosed, revisions in the 1995 amendments to TILA which affect the general tolerance for the disclosure of the APR similarly affect that disclosure for the purposes of HOEP. Revisions which affect the APR tolerance rule are discussed in Ch. 1, *§§ 1.04[4][d]*, *1.05[2][e][ii][A]*, *1.08[3][b]*, *1.09[2][h] supra* .

(n6)Footnote 6. *15 U.S.C. § 1639(a)(2)(B)*; Reg. Z § 226.32(c)(4). All adjustable-rate mortgage loans made since Dec. 9, 1987, must specify a maximum interest rate. Absent any applicable usury ceiling, it can be as high as the creditor likes, but a cap must be included in the contract. *12 U.S.C. § 3806(a)*; Reg. Z § 226.30.

(n7)Footnote 7. Reg. Z § 336.32(c)(5).

(n8)Footnote 8. *66 Fed. Reg. 65,604, 65,611* (Dec. 20, 2001) .

(n9)Footnote 9. Reg. Z § 226.32(c)(3) and (5).

(n10)Footnote 10. Reg. Z § 226.32(c)(5); Official Staff Commentary § 226.32(c)(5)-1.

(n11)Footnote 11. Official Staff Commentary § 226.32(c)(3)-1.

(n12)Footnote 12. Reg. Z app. H, at H-16.

(n13)Footnote 13. *15 U.S.C. § 1639(b)(1)*; Reg. Z § 226.31(c)(1). The Commentary clarifies that this means the consumer must receive the disclosures then. It is not adequate to mail them within that time frame. Official Staff Commentary § 226.31(c)-1; *61 Fed. Reg. 14,954* (Apr. 4, 1996) . "Business day," for these purposes, is defined to exclude only Sundays and federal holidays. *See* Reg. Z § 226.2(a)(6), *as amended by 61 Fed. Reg. 49,237* (Sept. 19, 1996) .

(n14)Footnote 14. A federal court in Pennsylvania sifted through evidence introduced at trial on this issue and held that notices were not provided to several homeowners. *Newton v. United Cos. Fin. Corp., 24 F. Supp. 2d 444 (E.D. Pa. 1998) , costs and fees proceedings at, remanded by 2002 U.S. App. LEXIS 6061* (3d Cir. Apr. 3, 2002) . *See also Jackson v. US Bank Nat'l Ass'n Trustee (In re Jackson), 245 B.R. 23 (Bankr. E.D. Pa. 2000)* (based upon typed date on HOEPA notice, consumer's testimony, lack of credibility of lender's witnesses, and the fact that the HOEPA notice listed the loan amount as $19,000, which amount had not been approved as of the date listed on the notice, court held notice not timely); *Williams v. Gelt Fin. Corp. (In re Williams), 232 B.R. 629 , aff'd, 237 B.R. 590 (Bankr. E.D. Pa. 1999)* (court found HOEPA notice was not given based on consumer's testimony and creditor's failure to rebut it).

(n15)Footnote 15. *15 U.S.C. § 1639(b)(2)(A)*; Reg. Z § 226.31(c)(1)(i); Official Staff Commentary § 226.31(c)(1)(i)-1 (this includes situations where the disclosures were labeled as estimates; and where the change was from a formal written agreement).

In some situations where new disclosures are required, they may be made by telephone at least three days before confirmation. For the telephone provisions to apply, three conditions must be met:

- The change must be initiated by the consumer;
- The creditor must provide the new disclosures in writing at the time of consummation; and
- The creditor and consumer must certify in writing at the time of consummation that the new disclosures were provided by telephone not later than three days prior to the date of consummation of the transaction.

15 U.S.C. § 1639(b)(2)(B); Reg. Z § 226.31(c)(1)(ii); Official Staff Commentary § 226.31(c)(1)(ii).

(n16)Footnote 16. *See Ralls v. Bank of N.Y. (In re Ralls), 230 B.R. 508 (Bankr. E.D. Pa. 1999)* .

(n17)Footnote 17. *Lewis v. Delta Funding Corp. (In re Lewis), 290 B.R. 541 (Bankr. E.D. Pa. 2003)* .

(n18)Footnote 18. Model Form H-16, Reg. Z App. H.

(n19)Footnote 19. *Jeanty v. Washington Mutual Bank, F.A., 305 F. Supp. 2d 962 (E.D. Wis. 2004)* (the creditor failed to properly disclose the "regular payment" on the HOEPA form and did not modify it to take into account that fact that payments would vary).

(n20)Footnote 20. *66 Fed. Reg. 17,329* (Mar. 30, 2001) . *See* National Consumer Law Center, Truth in Lending, § 4.2.9.3 (6th ed. 2007 and Supp.).

(n21)Footnote 21. *66 Fed. Reg. 17,329* (Mar. 30, 2001) .

(n22)Footnote 22. *66 Fed. Reg. 41,439, 41,440* (Aug. 8, 2001) .

(n23)Footnote 23. *72 Fed. Reg. 21,141* (Apr. 30, 2007) .

(n24)Footnote 24. Pub. L. No. 106-229, *114 Stat. 464 (2000)* (codified at *15 U.S.C. §§ 7001 et seq.*). The statute is discussed in more detail in National Consumer Law Center, Truth in Lending § 4.2.9.3 (6th ed. 2007).

(n25)Footnote 25. *15 U.S.C. § 7001(c)(1)*.

(n26)Footnote 26. This E-sign statute applies to disclosures required by HOEPA, and other provisions of TILA, as discussed at *§ 1.05[2][a] supra*.

(n27)Footnote 27. *Newton v. United Cos. Fin. Corp., 24 F. Supp. 2d 444 (E.D. Pa. 1998)* ; *Williams v. Gelt Fin. Corp. (In re Williams), 232 B.R. 629 , aff'd, remanded, 237 B.R. 590 (Bankr. E.D. Pa. 1999)* (court properly awarded $2,000 for failure to give the HOEPA notice in the first transaction; unfortunately, the district court, when affirming the bankruptcy court, improperly reduced a separate statutory award for TIL violations in the second non-HOEPA loan.

(n28)Footnote 28. *15 U.S.C. § 1602(u)* (as amended). *See* Reg. Z § 226.23 n.48 (as amended). Failure to disclose a balloon payment on the notice triggers rescission as is evident from a perusal of Regulation Z and the Commentary. Specifically, Regulation Z § 226.23(a)(3) n.48 specifies that material disclosures include the disclosures referred to in § 226.32(c). Regulation Z § 226.32(c)(3) requires that the HOEPA early disclosure include an accurate statement of the "regular payment." The Board defined "regular payment" to include a balloon payment. Official Staff Commentary § 226.32(c)(3)-2.

(n29)Footnote 29. *15 U.S.C. § 1635*; Reg. Z § 226.23(a)(3); *Decision One Mortgage Co., 2000 U.S. App. LEXIS 33881* (6th Cir. Dec. 19, 2000) (court recognized the right to rescind for failure to give the HOEPA notice; court

conditioned rescission upon payment of loan balance, however); *Newton v. United Cos. Fin. Lending Corp., 24 F. Supp. 2d 444 (E.D. Pa. 1998) . But see Williams v. Gelt Fin. Corp. (In re Williams), 232 B.R. 629 , aff'd, remanded, 237 B.R. 590 (Bankr. E.D. Pa. 1999)* (court refused to rescind the first loan which was quickly refinanced, using the rationale that the lender did everything it would have done if the loan had been rescinded, *i.e.,* the lender canceled the lien and returned all payments made by the homeowner [no payments were credited as the homeowner made none]; the lender had not, however, credited the account with the closing costs which the court erroneously failed to consider). *See* Official Staff Commentary § 226.23(d)(2)-1.

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PART I Consumer Credit
CHAPTER 2 High Rate Home Equity Loan Protections

1-2 Consumer Credit Law Manual § 2.04

§ 2.04 Substantive Regulations and Remedies

Below is a list of prohibited terms for covered high-cost loans. Most of these prohibitions are not absolute and, therefore, care should be taken to make sure that where an exception is invoked, the creditor has met the preconditions to the exception.

As part of the FRB's review of the HOEPA regulations and commentary during 2000-2001, it decided to create a new section within Regulation Z titled: "Prohibited acts or practices in connection with credit secured by a consumer's dwelling." By doing so, the Board separated the prohibited contract provisions (these remain in section 226.32) from the prohibited acts or practices (now in new section 226.34). n1 Section 226.34 contains three familiar prohibitions related to home improvement contractors, ability to repay, and notice to the assignee, as well as two newcomers related to refinancings within one year and structuring a loan as open-end to evade HOEPA. A discussion of each follows.

[1] Limitations on Prepayment Penalties

All prepayment penalties are prohibited for covered loans with a complex five-part exception. n2 Prepayment penalties are defined to include any method of calculating a rebate less favorable than the actuarial method. n3 This will eliminate use of the Rule of 78 in covered loans unless the exception applies. n4

To invoke the exception, the creditor is required to meet all five preconditions contained in the statute. First, measured as of the time the loan is consummated, the loan must not cause the consumer to pay more than 50% of his or her monthly gross income toward "monthly indebtedness payments." n5 The second prerequisite to the exception is that the income and expenses of the consumer must be verified by a financial statement signed by the consumer, and by a credit report.

The third precondition to the exception is that it does not apply to repayments by refinancing with the creditor who made the initial mortgage or with an affiliate of that creditor. n6 The fourth prerequisite is that the penalty can only be imposed during the first five years of the loan, calculated from the date on which the mortgage is consummated. n7 The final prerequisite is that the penalty must be legal under other applicable law. n8 This preserves state law limits on prepayment penalties. n9

The Federal Reserve Board issued regulations in 2008 that broaden the prohibition against prepayment penalties. n10 However, these changes will not be effective until October 9, 2008. n11

As with the current rules, the amendments define prepayment penalties to include any method of calculating a rebate less favorable than the actuarial method. n12 Like its current counterpart, the regulation contains a multi-part exception that creditors must meet in order to legally charge a prepayment penalty in a HOEPA loan. However, the Board narrowed, changed, and added exceptions.

First, by the terms of the loan, the penalty will expire after two years following consummation, an improvement over the current five-year duration limitation. n13

Second, the amount of the periodic payment of principal and interest or both may not change during the four-year period following consummation. n14 Examples of when payment changes do and do not violate this condition appear in the Commentary. n15

Third, like the current rule, at consummation, the consumer's total monthly debt payments, including amounts owed under the mortgage, cannot exceed fifty percent of the consumer's monthly income. n16 However, the verification requirements differ from the current rules but a track new verification regime applicable to the repayment ability standard in revised Regulation Z § 226.34(a)(4). n17 In addition, the Commentary specifies that creditors may verify debt with a credit report. n18 The new Commentary also allows creditors to not count amounts paid by the consumer in cash at closing or amounts from the loan proceeds that directly repay an existing debt as "debt" for purposes of this analysis. n19 Creditors can consider the combined debt-to-income ratios for loans involving joint applicants. n20

Fourth, the prepayment penalty cannot apply if the source of the repayment funds is a refinancing by the same creditor or an affiliate of the creditor. n21 The Board tightened this condition by covering affiliates of the creditor.

Fifth, the prepayment penalty must be otherwise permitted by law, as in the current rule. n22

[2] Prohibition of Interest Rate Increases on Default

A covered loan may not include a term which increases the interest rate in the event of a default. n23

[3] Limitation on Balloon Payments

Balloon payments are large payments which come due during a loan term, usually at the end of a loan. Balloon payments are prohibited in covered loans which have a term of less than five years. n24

The FRB has created a limited exception to the prohibition on balloon payments by exempting some "bridge" loans connected with the construction or acquisition of a dwelling from the prohibition on balloon payment terms. n25 Since most of those loans would be subject to the "residential mortgage transaction" exception, n26 the FRB's additional protection for these loans would seem to have little impact. However, where this exception is invoked, it creates an exception only for the balloon term and not to other protections under HOEPA. n27

[4] Prohibition of Negative Amortization

Negative amortization, which occurs when the payments due each period are insufficient to cover the interest on the loan as it comes due, is entirely prohibited in covered loans. n28

[5] Limitations on Due-on-Demand Clauses

The Board added due-on-demand clauses to the list of prohibited provisions for loans entered into on or after October 1,

2002. n29 A "due-on-demand" or "call" provision allows the creditor to call in the loan or accelerate the note at any time. The Board believed due-on-demand clauses raise the same concerns as short-term balloon provisions: they both allow a creditor to force the consumer to refinance by demanding a large payment (either the balloon amount or the remaining balance due) within a relatively short time after loan consummation. n30 Exercising its authority under HOEPA, the Board decided to ban the use of these clauses entirely, except in three circumstances.

The exceptions are listed in Regulation Z and examples are found in the Commentary. n31 Like the prepayment penalty exceptions, creditors should include these limitations in the contract provision itself in order to comply with HOEPA.

A due-on-demand provision will not violate HOEPA if it can be exercised only when: (1) there is fraud or material misrepresentation by the consumer in connection with the loan; (2) the consumer fails to meet the repayment terms of the agreement for an outstanding balance; n32 or (3) there is any action or inaction by the consumer that adversely affects the creditor's security for the loan, or any right of the creditor in such security.

[6] Limitation on Prepaid Payments

The amendments preclude taking more than two prepaid payments in covered loans. n33

[7] Extending Credit Without Regard to Ability to Pay

A problem that has plagued an increasing portion of the mortgage loan market is the making of loans which the lender knew or should have known the consumer would be unable to repay. n34

HOEPA addresses this issue through a compromise provision which prohibits a creditor from engaging in "a pattern or practice of extending credit to consumers [in covered loans] based on the consumers' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, and employment." n35 The Federal Reserve Board amended Regulation Z in 2008 and removed the pattern and practice requirement because the burden on the consumer to prove this element would leave many homeowners without a realistic remedy. n36 This change became effective October 1, 2009. n37

In addition, the 2008 amendments remove the presumption of illegality if the creditor fails to verify and document the consumer's ability to repay, revise the verification and documentation standards, and create a safe harbor for creditors. n38

The current pattern and practice requirement is a curious provision because it makes an individual consumer establish not only that the lender has made a loan based on the consumer's equity and without regard to her repayment ability, but also that the loan is part of a "pattern or practice" of making loans on that basis. This makes such cases difficult and expensive by extending the scope of relevant discovery in an individual case to include the lender's general underwriting practices, and, essentially, its entire loan portfolio.

Congress did not define "pattern or practice," nor had the Federal Reserve Board provided any guidance concerning an injured consumer's burden regarding such proof until it revised the Commentary effective on October 1, 2002. n39

Essentially, the courts were left to determine the meaning of a phrase that is susceptible to different interpretations, though now, at least, a bit more guidance from the Board exists.

For loans consummated on or after October 1, 2001, Regulation Z contains a presumption that the creditor violated the repayment ability provision if the creditor engages in a pattern or practice of making HOEPA loans without verifying and documenting the consumer's ability to repay. n40

For loans made after October 1, 2009, the Board has removed the pattern and practice requirement, and revamped the general standard. The Supplementary Information in the *Federal Register* discusses the background, relevant data, and rationale supporting the Board's actions. For applicable loans, the new rules prohibit creditors from making loans to consumers "based on the value of the consumer's collateral without regard to the consumer's repayment ability *as of consummation*, including the consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and *mortgage-related obligations*." n41 The words in italics are new. Further, the modified section no longer contains the presumption of violation if the creditor did not verify and document the consumer's repayment ability.

These changes clarify that: 1) repayment ability is assessed as of the date of consummation; 2) the income and assets of the consumer must be reasonably expected; and 3) the lender must take into account not merely the principal and interest payment when assessing ability to repay but also the property tax and insurance costs required by the lender. The rest of the new regulation and the related Commentary teases out the parameters of this general standard and creates an exception and a rebuttable presumption.

In addition to the factors that creditors must consider when deciding whether to grant or deny credit, the new rules mandate that the creditor verify the consumer's repayment ability. n42 To accomplish this, the creditor must validate current and reasonably expected income and assets and current obligations. n43 It can rely upon information from the Internal Revenue Service, including tax returns and W-2 forms, payroll receipts, records from financial institutions, or other third party documents that provide reasonably reliable evidence of income and assets. n44

The information obtained must be specific to the consumer. A credit report is acceptable to document current obligations. n45

A creditor who is extending new credit to a current customer or refinancing its own loan need not obtain a document previously collected from the customer if the creditor has no information that would reasonably lead it to believe that the document has changed since the receipt of its original version. n46

If a creditor relies upon expected income, the expectation must be reasonable and the creditor must verify this income. n47

If the consumer has two sources of income but the creditor depends upon only one source to ascertain repayment ability, the creditor need only verify the one source. n48 If two persons jointly apply for credit, the lender must verify the repayment ability of both, unless it relies only on the income and assets of one of the applicants in assessing repayment ability. n49

Regulation Z creates an exception to these verification rules in this situation: when the amounts of income and assets that the creditor relied upon in assessing ability to repay are not materially greater than the amounts of the consumer's income or assets that the creditor could have verified by following the rules at the time of consummation. n50

In addition to this exception, Regulation Z creates a presumption of compliance if the creditor meets three conditions. n51 First, the creditor must verify the consumer's repayment ability following the Regulation Z rules described above. n52 Second, the creditor must use the largest payment of principal and interest scheduled in the first seven years of the loan term taking into account current obligations and mortgage-related obligations as defined in the rules. n53 Third, the creditor must underwrite the loan using *either* a debt-to-income ratio that takes into account the total debt obligations or the income the consumer will have after paying debt obligations, i.e., residual income. n54 The presumption is not available if a mortgage loan has either of following characteristics: during the first seven years it either negatively amortizes or contains a balloon payment. n55

The consumer may rebut the presumption with evidence that the creditor disregarded repayment ability despite

following these procedures.

[8] Payments to Home Improvement Contractors

There are also special requirements for payments to home improvement contractors. When a creditor finances a home improvement contract, payments in covered loans may not be made in an instrument payable directly to the contractor alone. n56 The payment must be made either to the consumer only or in a jointly payable instrument. n57 At the election of the consumer, payments may also be made through a third party escrow agent based on an agreement signed by the consumer, the creditor, and the contractor before the date of payment. n58

One issue likely to arise under this provision is whether a particular loan involves a home improvement contract. Certainly, any time the creditor knows or has reason to know that a payment is being made from the loan proceeds to a contractor, this provision should be invoked.

[9] FRB's Power to Prohibit Unfair Trade Practices

The FRB is required under the Act to prohibit acts or practices in connection with loans which the Board finds to be unfair, deceptive, or designed to evade the provisions of Section 1639. n59 In addition, the Board is to prohibit acts or practices related to refinancing which the Board finds to be abusive or otherwise not in the interests of the borrower. n60

The Board held hearings and obtained public comment on a variety of issues relevant to HOEPA in 1997. n61 The next year, the Board released a Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act. n62 While agreeing that abusive mortgage practices continue despite HOEPA, the Board suggested only modest changes to that Act. With one exception, the Board has issued no regulations on this subject. n63

Federal and state agency and media attention on predatory mortgage lending heated up in 2000. HUD and the Department of the Treasury held a series of hearings to obtain evidence and suggestions about regulatory action. n64 The Federal Reserve Board once again scheduled hearings and requested comments on ways it could take regulatory action under the authority delegated to it by Congress to deal with predatory practices in the home-equity lending market. n65 In 2001, the Board issued final changes to Regulation Z and the Commentary, adding two new prohibited acts: the refinancing of HOEPA loans within one year unless the refinancing is in the borrower's interest or acts or practices to evade this rule; and the structuring of loans as open-end to evade HOEPA. The only remaining issue for the Board is whether and how to regulate the refinancing of special mortgage products, such as Habitat for Humanity or other low-rate mortgage loans and deferred payment loans often made by municipalities to help low-income homeowners obtain essential home repairs. Given the amount of time and effort the Board put into obtaining evidence of abuses and in drafting regulations over the last few years, it is unlikely the Board will tackle other abusive acts and practices or amend the HOEPA regulations any time in the near future.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral OverviewBanking LawConsumer ProtectionUnfair & Deceptive Credit PracticesReal Property LawFinancingFederal RegulationsHome Owners Equity Protection Act

FOOTNOTES:
(n1)Footnote 1. *Compare* Reg. Z § 226.32, *with* Reg. Z § 226.34.

(n2)Footnote 2. *15 U.S.C. § 1639(c)*; Reg. Z § 226.32(d)(6), (7); Official Staff Commentary § 226.32(d)(6), (7).

(n3)Footnote 3. *15 U.S.C. § 1639(c)*; Reg. Z § 226.32(d)(6), (7); Official Staff Commentary § 226.32(d)(6), (7). See Ch. 6, *§ 6.03[4][b] infra* , for an explanation of the actuarial rebate method. Both the statute and the regulation define the "actuarial method" by reference to *15 U.S.C. § 1615(d)* and the explanation accompanying the regulation suggests that other more expansive state law definitions of that term might generate prepayment penalties within the meaning of the act and regulations. *See 60 Fed. Reg. 15,467* (Mar. 24, 1995) (explanation of § 226.32(d)(6)). *See also* Official Staff Commentary § 226.32(d)(6)-1; National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 5.6 (3d ed. 2005 and Supp.) for an explanation of the actuarial rebate method.

(n4)Footnote 4. The Rule of 78 is an anachronistic, shorthand formula for *approximating* the rebate of unearned charges upon the early termination of credit which has been widely used by creditors because it has an inherent bias in the creditors' favor--the rebate to the consumer will always be smaller under the Rule of 78 than under the technically precise actuarial method. *See* Ch. 6, *§ 6.03[4][b] infra* . *See also* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 5.6.3.3 (3d ed. 2005 and Supp.)

(n5)Footnote 5. *15 U.S.C. § 1639(c)(2)(A)(i)*; Reg. Z § 226.32(d)(7)(iii).

(n6)Footnote 6. *15 U.S.C. § 1639(c)(2)(B)*; Reg. Z § 226.32(d)(7)(ii). The term "affiliate" is defined for these purposes as it is in § 2(k) of the Bank Holding Company Act of 1956, *12 U.S.C. § 1841(k)*; *15 U.S.C. § 1639(k)*; Reg. Z § 226.32(b)(2). That definition is "any company which controls, is controlled by, or is under common control with another company."

(n7)Footnote 7. *15 U.S.C. § 1639(c)(2)(C)*; Reg. Z § 226.32(d)(7)(i).

(n8)Footnote 8. *15 U.S.C. § 1639(c)(2)(D)*.

(n9)Footnote 9. In other words, a national lender that meets the other exceptions nevertheless violates HOEPA if a particular state's law prohibits such a penalty. *See Williams v. Gelt Fin. Corp. (In re Williams), 232 B.R. 629* (Bankr. E.D. Pa.) , *aff'd, 237 B.R. 590 (E.D. Pa. 1999)* .

(n10)Footnote 10. *73 Fed. Reg. 44,522* (July 30, 2008) .

(n11)Footnote 11. More specifically, the changes apply to new transactions for which the creditor receives an application on or after October 1, 2009. Official Staff Commentary § 226.1(d)(5)-1; *73 Fed. Reg. 44,522, 44,605* (July 30, 2008) .

(n12)Footnote 12. Reg. Z § 226.32(d)(6); Fed. Reg. 44,522, 44,603 (July 30, 2008).

(n13)Footnote 13. Reg. Z § 226.32(d)(7)(i); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n14)Footnote 14. Reg. Z § 226.32(d)(7)(iv); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n15)Footnote 15. Official Staff Commentary § 226.32(d)(7)(iv)-1; *73 Fed. Reg. 44,522, 44,610-44,611* (July 30, 2008) .

(n16)Footnote 16. Reg. Z § 226.32(d)(7)(iii); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n17)Footnote 17. *Id.*

(n18)Footnote 18. Official Staff Commentary § 226.32(d)(7)(iii)-2; *73 Fed. Reg. 44,522, 44,610* (July 30, 2008) .

(n19)Footnote 19. Official Staff Commentary § 226.32(d)(7)(iii)-1; *73 Fed. Reg. 44,522, 44,610* (July 30, 2008) .

(n20)Footnote 20. Reg. Z § 226.32(d)(7)(ii); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n21)Footnote 21. Reg. Z § 226.32(b)(2).

(n22)Footnote 22. Reg. Z § 226.32(d)(7); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n23)Footnote 23. *15 U.S.C. § 1639(d)*; Reg. Z § 226.32(d)(4). This applies to "default rate" provisions. It does not prohibit a routine rate change in a variable-rate transaction in accordance with the contract when the index rises, even if it happens that the debtor is in default then. Official Staff Commentary § 226.32(d)(4)-1. *See also Lopez v. Delta Funding Corp., 1998 U.S. Dist. LEXIS 23318* (E.D.N.Y. Dec. 23, 1998) (mortgage loans undeniably contained provisions for an increased interest rate upon default; issue at preliminary injunction stage was whether consumers could demonstrate a likelihood of success on the merits of their claim that the loans were covered by HOEPA; court found that loans were covered and granted injunction to stop the foreclosures of certain named plaintiffs); *Dailey v. Leshin, 792 So. 2d 527 (Fla. Dist. Ct. App. 2001)* (case remanded to allow the trial court to hear a motion to amend adding in a HOEPA claim based upon allegation that the lender filed an affidavit in the foreclosure action imposing a default interest rate of 18%; not clear whether the note contained a default interest rate provision), *rev. denied, 821 So. 2d 294 (Fla. 2002)* .

(n24)Footnote 24. *15 U.S.C. § 1639(e)*; Reg. Z § 226.32(d)(1); Official Staff Commentary § 226.32(c)(3)-2; *62 Fed. Reg. 10,139, 10,198* (Mar. 6, 1997) (if the term of the loan is for five or more years, the balloon payment must be disclosed).

(n25)Footnote 25. Reg. Z § 226.32(d)(1)(ii).

(n26)Footnote 26. *15 U.S.C. § 1602(w)*; Reg. Z § 226.2(a)(24).

(n27)Footnote 27. Reg. Z § 226.32(d)(1)(ii).

(n28)Footnote 28. *15 U.S.C. § 1639(f)*; Reg. Z § 226.32(d)(2). For further discussion of negative amortization, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 4.3.1.2 (4th ed. 2009).

(n29)Footnote 29. Reg. Z § 226.32(d)(8).

(n30)Footnote 30. See the discussion in *65 Fed. Reg. 81,438, 81,444* (Dec. 26, 2000) and in *66 Fed. Reg. 65,604, 65,611* (Dec. 20, 2001) .

(n31)Footnote 31. Reg. Z § 226.32(d)(8); Official Staff Commentary §§ 226.32(d)(8)(ii)-(iii).

(n32)Footnote 32. The Commentary states that the consumer must actually fail to make payments. A creditor may not terminate and accelerate if the consumer, in error, sent a payment to the wrong location, such as a branch rather than the main office. The filing of bankruptcy alone cannot trigger the demand clause unless the consumer fails to meet the repayment terms of the agreement. Further, this exception for failing to repay does not override any state or other law that requires a creditor to cure, or otherwise place a duty on the creditor before it can terminate the loan and accelerate. Official Staff Commentary §§ 226.32(d)(8)(ii)-1.

(n33)Footnote 33. *15 U.S.C. § 1639(g)*; Reg. Z § 226.32(d)(3).

(n34)Footnote 34. Causes of action, other than under HOEPA, can be alleged to attack this type of behavior. *See, e.g., Opportunity Mgmt. Co., Inc. v. Frost, 1999 Wash. App. LEXIS 336* (Wash. Ct. App. Feb. 16, 1999) (allegation that making a loan which lender knew or had reason to believe was destined to fail stated UDAP claim). *But see Bankers Trust Co. v. Brown, 107 P.3d 609 (Okla. Civ. App. 2004) . See also* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses Ch. 11, 12 (4th ed. 2009).

(n35)Footnote 35. *15 U.S.C. § 1639(h)*; Reg. Z § 226.32(e)(1). *See also* H.R. Conf. Rep. No. 652, 103d Cong. 2d

Sess. 147, 160 (1994); 1994 U.S.C.C.A.N. 1987 (accompanying H.R. 3474); *Bankers Trust Co. v. Brown, 107 P.3d 609 (Okla. Civ. App. 2004))* .

(n36)Footnote 36. *73 Fed. Reg. 44,522, 44,545-44,546* (July 30, 2008) .

(n37)Footnote 37. More specifically, the changes apply to new transactions for which the creditor receives an application on or after October 1, 2009. Official Staff Commentary § 226.1(d)(5)-1; *73 Fed. Reg. 44,522, 44,605* (July 30, 2008) .

(n38)Footnote 38. Reg. Z § 226.34(a)(4); Official Staff Commentary § 226.34(a)(4); *73 Fed. Reg. 44,522, 44,603, 44,611-44,613* (July 30, 2008) .

(n39)Footnote 39. Official Staff Commentary § 226.34(a)(4)-2.

(n40)Footnote 40. Reg. Z § 226.34(a)(4).

(n41)Footnote 41. Reg. Z § 226.34(a)(4); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) (emphasis added).

(n42)Footnote 42. Reg. Z § 226.34(a)(4)(ii); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n43)Footnote 43. Reg. Z § 226.34(a)(4)(ii)(A), (C); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n44)Footnote 44. Reg. Z § 226.34(a)(4)(ii)(A); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) . The creditor may use an electronic retrieval service for obtaining the consumer's W-2 or tax return information. Official Staff Commentary § 226.34(a)(4)(ii)(A)-1, (A)-2; *73 Fed. Reg. 44,522, 44,611-44,612* (July 30, 2008) .

(n45)Footnote 45. Official Staff Commentary § 226.34(a)(4)(ii)(A)-4; *73 Fed. Reg. 44,522, 44,612* (July 30, 2008) .

(n46)Footnote 46. Official Staff Commentary § 226.34(a)(4)(ii)(A)-5; *73 Fed. Reg. 44,522, 44,612* (July 30, 2008) .

(n47)Footnote 47. Official Staff Commentary § 226.34(a)(4)(ii)-3; *73 Fed. Reg. 44,522, 44,611* (July 30, 2008) .

(n48)Footnote 48. Official Staff Commentary § 226.34(a)(4)(ii)-1; *73 Fed. Reg. 44,522, 44,611* (July 30, 2008) .

(n49)Footnote 49. Official Staff Commentary § 226.34(a)(4)(ii)-2; *73 Fed. Reg. 44,522, 44,611* (July 30, 2008) .

(n50)Footnote 50. Reg. Z § 226.34(a)(4)(ii)(B); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n51)Footnote 51. Reg. Z § 226.34(a)(4)(iii); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n52)Footnote 52. Reg. Z § 226.34(a)(4)(iii)(A); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n53)Footnote 53. Reg. Z § 226.34(a)(4)(iii)(B); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) . To calculate the maximum scheduled payment, the creditor should follow the guidance in Official Staff Commentary § 226.17(c)(1). Official Staff Commentary § 226.34(a)(4)(iii)(B)-1; *73 Fed. Reg. 44,522, 44,612* (July 30, 2008) .

(n54)Footnote 54. Reg. Z § 226.34(a)(4)(iii)(C); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n55)Footnote 55. Reg. Z § 226.34(a)(4)(iv); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) ; Official Staff Commentary § 226.34(a)(4)(iv)-1; *73 Fed. Reg. 44,522, 44,613* (July 30, 2008) .

(n56)Footnote 56. *15 U.S.C. § 1639(i)*. Reg. Z § 226.32(e)(2).

(n57)Footnote 57. If there is more than one consumer primarily obligated on the note, all such consumers must be listed as joint payees with the contractor. *See 60 Fed. Reg. 15,467* (Mar. 24, 1995) (explanation of § 226.32(e)(2)).

(n58)Footnote 58. *See 60 Fed. Reg. 15,467* (Mar. 24, 1995) (explanation of § 226.32(e)(2)). If the creditor chooses to use an affiliate as an escrow agent, RESPA requires that certain disclosures be made. Regulation X, *24 C.F.R. § 3500.15. See 60 Fed. Reg. 15,467-68* (Mar. 24, 1995) (explanation of § 226.32(e)(2)).

(n59)Footnote 59. *15 U.S.C. § 1639(l)(2)(A).*

(n60)Footnote 60. *15 U.S.C. § 1639(l)(2)(B).*

(n61)Footnote 61. *62 Fed. Reg. 23,189* (Apr. 29, 1997) . Senators Grassley and Breaux also co-sponsored a hearing before the Senate Special Committee on Aging in March 1998 which highlighted some of the continuing mortgage abuses which plague senior citizens. *Equity Predators: Stripping, Flipping and Packing Their Way to Profits: Hearing Before the Special Committee on Aging, United States Senate,* 105th Cong. 18 (1998).

(n62)Footnote 62. Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act, Board of Governors of the Federal Reserve System and the Department of Housing and Urban Development, July 1998.

(n63)Footnote 63. The Board is treating failure to provide the notice of liability to assignees which must be contained in a covered transaction as a prohibited act or practice. Failure to include the notice should then arguably give rise to enhanced damages and civil liability for a violation. Reg. Z § 226.32(e)(3). *See 15 U.S.C. § 1641(d)(4).*

(n64)Footnote 64. See HUD's web site, where it created a special space for predatory lending updates--www.hud.gov/fha/predlend.html.

(n65)Footnote 65. *See 65 Fed. Reg. 42,889* (July 12, 2000) .

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 2 High Rate Home Equity Loan Protections

1-2 Consumer Credit Law Manual § 2.05

§ 2.05 Remedies

The violation of any provision of the new law gives rise to standard TIL civil liability under *15 U.S.C. section 1640(a)* for actual damages, statutory damages, attorneys' fees and costs. In addition, failure to make the new disclosures will constitute a failure to make "material disclosures" under the amended Act. n1 Thus, failure to properly make the new disclosures will give rise to an extended right to rescind the transaction for up to three years from the date of consummation. n2 This should apply equally to failure to make the necessary disclosures at all, failure to make accurate disclosures, and failure to follow the proper disclosure procedures required under section 1639(a).

Inclusion of any of the prohibited terms discussed above will give rise to civil liability under *15 U.S.C. section 1640(a)* and enhanced damages pursuant to *15 U.S.C. section 1640(a)(4)*. n3 In addition, inclusion of a prohibited term gives rise to the extended right to rescind the loan under *15 U.S.C. section 1635*. n4

There are also special enhanced damages for violations of *15 U.S.C. section 1639* available under *15 U.S.C. section 1640(a)(4)*, unless the creditor demonstrates that the failure to comply is not material. The enhanced damages include all finance charges and fees paid by the consumer.

With respect to enhanced damages, a substantial issue will be the meaning of the term "material" as used in section 1640(a)(4). Although, based on the statutory language, it is the creditor's burden to establish that a violation is not material, presumably many creditors will seek that protection on a variety of grounds.

In enacting the amendments, Congress made clear that it did not intend to limit more restrictive state laws. n5 This means that there is no new preemption of state laws that more stringently regulate consumer credit. In addition to the existing administrative enforcement provision, n6 a state's attorney general may bring actions to enforce the 1995 amendments. n7 There is a three-year limitations period for such actions, which may be brought in federal or state court. The state Attorney General is required to provide prior written notice and a copy of the complaint to the federal agency responsible for administrative enforcement unless prior notice is not feasible. The federal agency may then intervene if it so chooses.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingLiabilityBanking LawConsumer ProtectionUnfair & Deceptive Credit PracticesReal Property LawFinancingFederal RegulationsHome Owners Equity Protection Act

FOOTNOTES:

(n1)Footnote 1. *15 U.S.C. § 1602(u)* (as amended). *See* Reg. Z § 226.23 n.48 (as amended).

(n2)Footnote 2. *15 U.S.C. § 1635*; Reg. Z § 226.23(a)(3).

(n3)Footnote 3. *See generally* Ch. 1, *§ 1.10 supra* .

(n4)Footnote 4. *15 U.S.C. § 1639(j)*; Reg. Z § 226.23 n.48 (defining those limitations incorporated in § 226.32(d) as "material" for rescission purposes). For a full discussion of the rescission remedy, see Ch. 1, *§ 1.08 supra* . Note that although it is clear that rescission will be available for including prohibited terms in mortgages, it is less clear that Congress intended to provide the rescission remedy for the pattern and practice of disregarding the consumer's ability to repay or for paying a home improvement contractor directly.

(n5)Footnote 5. *15 U.S.C. § 1610(b)(ii)*.

(n6)Footnote 6. *15 U.S.C. § 1607*.

(n7)Footnote 7. *15 U.S.C. § 1640(e)*.

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PART I Consumer Credit
CHAPTER 2 High Rate Home Equity Loan Protections

1-2 Consumer Credit Law Manual § 2.06

§ 2.06 Additional Provisions: Extension of Assignee Liability

One of the contributing causes to abusive loan schemes is the transfer of fraudulently obtained mortgages to assignees who then assert the protections of a holder in due course.

For some home improvement loans, this problem is addressed by the Federal Trade Commission's Holder Rule which abrogates the traditional protections of a holder in due course for certain loans. n1 In other cases, it may be possible to avoid application of assignee protections by establishing that the assignee is not a holder in due course. n2

Assignees also have some potential liability for TILA violations under existing law, including liability for rescission when that remedy is available. n3 All of those remedies will continue to be available for assignees of loans covered by the new home equity protections. n4

In addition, the high rate loan protections provide that assignees of covered mortgages are liable for all claims and defenses with respect to the assigned mortgage that the consumer could assert against the originator. n5 There are, however, certain limitations on damages discussed below. n6 However, assignees will continue to be entitled to protection from liability if they legitimately could not have known that the assigned mortgage was a covered loan.

An assignee will not be held liable under the act when it "demonstrates, by a preponderance of the evidence, that a reasonable person exercising ordinary due diligence" could not have determined that the loan was covered. n7

The standard created by new section 1641(d) is generally an objective one. The actions of the assignee are generally irrelevant as long as a "reasonable person exercising ordinary due diligence" could not have determined that the loan was covered. However, as stated above, the lender will be charged (subjectively) with any actual knowledge it does possess.

Where assignees are found to be liable, they will be subject to the full range of claims which could have been asserted against the maker of the loan. This includes liability for the originator's unfair trade practices, fraud, consumer credit abuses, RICO violations, and any other claims within the imagination of litigators and the limits of Rule 11.

However, damages on those actions will be limited to the amounts permissible under *15 U.S.C. section 1641(d)(2)* and

(3). Note that these limitations apply only to the extent that the action is made permissible solely by section 1641(d)(1). They are inapplicable if the action against an assignee is available under another provision of section 1641 or by any other means of establishing assignee liability.

There are two substantive limits. For actions brought under TILA, liability is available to the extent of the "amount specified in § 1640." n8 This limitation will rarely come into play since most TILA cases brought against assignees will continue to be brought under section 1641(a) or (c).

For actions based on any other claim, damages are limited to the amount of all remaining indebtedness and the total amount already paid by the consumer. n9 When damages are awarded both on TILA and on other claims, the TILA damages must be offset against the damages awarded on the other claims. n10

Read together, it is clear that the maximum damages available against an assignee who is liable under section 1641(d) is the amount of the loan then due, plus the amount already paid on the loan. It does not matter under the statute whether the payments were made to the original creditor or to the assignee.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingLiabilityContracts LawNegotiable InstrumentsEnforcementDuties & Liabilities of PartiesTypes of PartiesHolders in Due CourseRightsReal Property LawFinancingFederal RegulationsHome Owners Equity Protection ActReal Property LawFinancingSecondary FinancingAssignees & PriorityReal Property LawFinancingSecondary Mortgage MarketGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See* Ch. 14 *infra*.

(n2)Footnote 2. *See* Ch. 14 *infra*.

(n3)Footnote 3. *15 U.S.C. § 1641(a), (c). See* Ch. 1, *§§ 1.08[8], 1.09[2][g] supra* .

(n4)Footnote 4. *15 U.S.C. § 1641(d)(1). See also* H.R. Conf. Rep. No. 103-652, at 163 (1994) (assignee liability provisions for covered loans are "not intended to limit assignee liability under other portions of the TILA ... or other causes of action").

(n5)Footnote 5. *15 U.S.C. § 1641(d)(1)*. By its plain language, the statute does not limit assignee liability to TILA or HOEPA violations. Literally, Congress eliminated the holder in due course doctrine that can protect an assignee if that assignee purchases a high cost loan as defined by HOEPA. This means that a consumer could sue a holder of a HOEPA loan for state law or other federal law violations that she or he could raise against the original creditor without raising any TILA/HOEPA claims. *See VanDenBroeck v. ContiMortgage Corp., 53 F. Supp. 2d 965 (W.D. Mich. 1999)* . The court specifically rejected the argument that federal law creates the consumer's claims because the causes of action could not have been brought against the assignee but for § 1641(d)(1). *VanDenBroeck v. ContiMortgage Corp., 53 F. Supp. 2d 965, 968 (W.D. Mich. 1999)* . The 2001 Commentary reinforces the plain language of the statute. Official Staff Commentary § 226.34(a)(2)-3. The new language states: "For such loans, a purchaser's or other assignee's liability for all claims and defenses that the consumer could assert against the creditor is not limited to violations of the act." *See also Bryant v. Mortgage Capital Res. Corp., 197 F. Supp. 2d 1357 (N.D. Ga. 2002)* ; *Rodrigues v. U.S. Bank (In re Rodrigues), 278 B.R. 683, 688 (Bankr. D.R.I. 2002)* ("The legislative history indicates Congress's intent to establish a strict liability standard for assignees of such loans."); *Short v. Wells Fargo Bank Minn., N.A., 401 F. Supp. 2d 549 (S.D. W. Va. 2005)* (assignee is subject to all federal or state claims and defenses if the loan is covered by HOEPA; loan note contained the HOEPA notice to assignees), *subsequent proceedings, 2006 U.S. Dist. LEXIS 37988* (S.D. W. Va. June 8, 2006) ; *Schwartz v. Bann-Cor Mortgage,197 S.W.3d 168 (Mo. App. 2006)* (assignees of HOEPA loans are subject to

state secondary mortgage loan law claims); *Cazares v. Pacific Shore Funding, 2006 U.S. Dist. LEXIS 1081* (C.D. Cal. Jan. 3, 2006) (court recognized that liability for prepayment penalties illegal under state law can extend to the assignee in a HOEPA loan). *But see Harvey v. EMC Mortgage Corp. (In re Harvey), 2003 Bankr. LEXIS 642* (Bankr. E.D. Pa. June 9, 2003) (court disagrees that HOEPA assignee liability provision allows all claims and defenses to be raised against assignee without looking at the operative law to see whether claims against assignees are foreclosed but refuses to define the scope of liability at this stage of the case; however, the court rejects the assignee's argument that § 1641(d)(1) only results in creating assignee liability if the law under which the claim was asserted provides for assignee liability since this argument makes § 1641(d)(1) superfluous).

(n6)Footnote 6. *15 U.S.C. § 1641(d)(1).*

(n7)Footnote 7. *15 U.S.C. § 1641(d)(1). See Durham v. The Loan Store, Inc., 2005 U.S. Dist. LEXIS 22059* (N.D. Ill. Sept. 30, 2005) (court refused to dismiss, finding that complaint sufficiently alleged that assignee received notice that loan was subject to HOEPA and that the documents facially revealed HOEPA coverage under the points and fees trigger), *subsequent proceedings, 2006 U.S. Dist. LEXIS 33550* (N.D. Ill. May 16, 2006) ; *Cooper v. First Gov't Inv. Corp., 238 F. Supp. 2d 50 (D.D.C. 2002) . But see McMaster v. CIT Group/Consumer Fin., Inc., 2006 U.S. Dist. LEXIS 28831* (E.D. Pa. May 11, 2006) (assignee could not tell that a $91 title examination fee was unreasonable when the evidence beyond the loan documents showed that it may be duplicative of the attorney's closing fee; summary judgment granted to the assignee).

(n8)Footnote 8. *15 U.S.C. § 1641(d)(2)(A).*

(n9)Footnote 9. *15 U.S.C. § 1641(d)(2)(B).*

(n10)Footnote 10. *15 U.S.C. § 1641(d)(3).*

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PART I Consumer Credit
CHAPTER 2 High Rate Home Equity Loan Protections

1-2 Consumer Credit Law Manual § 2.07

§ 2.07 "Higher-Priced" Mortgage Loans: Prohibited Acts or Practices

[1] Introduction

On July 30, 2008, the Federal Reserve Board released final regulations that prohibit four acts or practices in mortgage loans that carry APRs exceeding a new "higher-priced" APR trigger. n1 This trigger is significantly lower than the HOEPA APR trigger and is tied to a different index. The rule covers all higher-priced loans secured by the consumer's principal dwelling, including purchase loans. It only excludes loans to finance the initial construction of a home, a temporary or bridge loan with a term of twelve months or less, and a home equity line of credit. n2 The Supplementary Information in the *Federal Register* discusses the background, relevant data, and rationale supporting the Board's actions.

New section 226.35 is effective for transactions for which the creditor receives an application on or after October 1, 2009, except for the escrow provision. The escrow rule applies to most new transactions for which the creditor receives an application on or after April 1, 2010. However, the regulation applies to new transactions secured by manufactured housing for which the creditor receives an application on or after October 1, 2010.

[2] The Annual Percentage Rate Trigger

A first lien loan secured by the consumer's principal dwelling meets the APR trigger if its annual percentage rate exceeds the average prime offer rate for a comparable transaction by 1.5% or more percentage points. The APR on a subordinate lien loan must exceed the average prime offer rate for a comparable transaction by 3.5% or more percentage points. n3

The relevant date is the date the creditor sets the interest rate on the consumer's mortgage loan. n4

[3] Prohibited Acts or Practices

If a loan meets the APR trigger, Regulation Z imposes four restrictions on creditors who originate higher-priced mortgage loans.

First, the creditor must evaluate the consumer's ability to repay using the same standards set in the revised rules

applicable to HOEPA loans. n5

Second, a higher-priced loan may not include a prepayment penalty (as defined in Regulation Z § 226.32(d)(6)) unless the creditor can show that:

- The penalty is otherwise permitted by law;
- Under the terms of the loan, the penalty will not apply for longer than two years from consummation;
- Under the terms of the loan, the penalty will not apply if the source of the prepayment funds is a refinancing by the same creditor or an affiliate; and
- The amount of the periodic payment of principal and/or interest is fixed for the four years following consummation. n6

Third, the creditor must establish an escrow account before consummation for the payment of property taxes and premiums for mortgage-related insurance, insurance covering the loss or damage to the home, or insurance protecting the creditor against the consumer's default or other credit loss for all covered first lien loans required by the creditor. n7 A premium for optional insurance need not be escrowed. n8

The escrow account must remain in place for the life of the loan, unless cancelled by the consumer. Regulation Z allows the consumer to cancel the escrow account by tendering a dated written request to the creditor or servicer at any time after one year from consummation. n9

Fourth, as with HOEPA loans, the creditor cannot structure a home-secured loan as an open-end plan to evade the higher-priced loan protections. n10

[4] Remedies

The Board implemented this regulation under the authority granted to it by Congress in section 1639(l). n11 This section requires the Board to prohibit acts or practices in connection with mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section. n12 In the Supplementary Information accompanying the proposed regulation, the Board listed the remedies it believes are available under section 1640 for a creditor violation of the substantive rules that appear in sections 226.35 and 226.36 of Regulation Z. These include:

- Actual damages under section 1640(a)(1);
- Statutory damages of up to $2,000 under section 1640(a)(2), capped in a class action;
- Special statutory damages for a section 1639 violation of all the sum of all finance charges and fees paid by the consumer; *and*
- attorney fees and costs n13

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingFederal RegulationsHome Owners Equity Protection ActBanking LawConsumer ProtectionBanking LawConsumer ProtectionTruth in LendingDisclosure

FOOTNOTES:

(n1)Footnote 1. Reg. Z § 226.35; *73 Fed. Reg. 44,522, 44,603-44,604* (July 30, 2008) .

(n2)Footnote 2. Reg. Z § 226.35(b)(3); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n3)Footnote 3. Reg. Z § 226.35(a)(1); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n4)Footnote 4. Reg. Z § 226.35(a)(1); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) ; Official Staff Commentary § 226.35(a)(2)-3; *73 Fed. Reg. 44,522, 44,613* (July 30, 2008) .

(n5)Footnote 5. Reg. Z § 226.35(b)(1); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n6)Footnote 6. Reg. Z § 226.35(b)(2); *73 Fed. Reg. 44,522, 44,603* (July 30, 2008) .

(n7)Footnote 7. Reg. Z § 226.35(b)(3); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n8)Footnote 8. Official Staff Commentary § 226.35(b)(3)(i)-3; *73 Fed. Reg. 44,522, 44,613* (July 30, 2008) .

(n9)Footnote 9. Reg. Z § 226.35(b)(3)(iii); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n10)Footnote 10. Reg. Z § 226.35(b)(4); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n11)Footnote 11. *See* Supplementary Information accompanying the final regulation. *73 Fed. Reg. 44,522, 44,529, 44,536, 44,539, 44,557* (July 30, 2008) .

(n12)Footnote 12. *15 U.S.C. § 1639(l)(2)(A).*

(n13)Footnote 13. *73 Fed. Reg. 1,672, 1,716-1,717* (Jan. 9, 2008) .

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PART I Consumer Credit
CHAPTER 2 High Rate Home Equity Loan Protections

1-2 Consumer Credit Law Manual § 2.08

§ 2.08 Loans Secured by the Consumer's Principal Dwelling: Prohibited Acts or Practices

[1] Introduction

On July 30, 2008, the Federal Reserve Board announced expanded regulation of most loans secured by the consumer's principal dwelling originated in *all* segments of the mortgage market. This rule appears in a new section of Regulation Z. n1 It extends to creditors, mortgage brokers, and servicers. The rule addresses abuses related to coerced appraisals and to servicing practices involving the dilatory crediting of payments, the pyramiding of late fees, and the tardy response to requests for payoff statements. Home equity lines of credit and loans not secured by the consumer's principal dwelling are the only types of consumer mortgage loans not covered. n2

The Supplementary Information in the *Federal Register* discusses the background, relevant data, and rationale supporting the Board's actions. Section 226.36 is effective for new transactions for which the creditor receives an application on or after October 1, 2009, except for the servicer rules which apply to all covered loans serviced on or after October 1, 2009.

[2] Coercion of Appraisers

Regulation Z prohibits creditors, mortgage brokers, and their affiliates from directly or indirectly coercing, influencing, or encouraging any appraiser to misstate or misrepresent the value of the consumer's principal home when appraised in connection with a consumer credit transaction secured by that property. n3 This rule represents the first time the Board has regulated mortgage brokers.

Examples of actions that violate the coercion prohibition include:

- Implying to an appraiser that current or future use of the appraiser depends on the value the appraiser sets for the consumer's dwelling; n4

- Excluding an appraiser from consideration of future use because the appraiser reports a value of the home that does not meet or exceed a minimum threshold; n5

- Informing the appraiser of a minimum reported value of a consumer's principal dwelling that is

needed to approve the loan; n6

- Failing to pay the appraiser because the appraiser did not value the home at or above a certain amount; n7 and

- Conditioning an appraiser's compensation on loan consummation. n8

If a creditor knows, at or before loan consummation, that a violation of this rule occurred, it may not extend credit based upon that appraisal, unless the creditor documents that it acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of the dwelling. n9 The creditor is deemed to have acted with reasonable diligence if it relies upon an appraisal other than the one involving the violation to extend the credit. n10 A misstatement or misrepresentation is not "material" if it does not affect the credit decision or the terms on which the credit is extended. n11

[3] Servicing Practices

For the first time, Regulation Z addresses certain activities of "servicers." The new rule covers three practices.

First, a servicer must credit payments to the consumer's loan account as of the date of receipt. n12 The servicer need only credit the payment as of the date of receipt. It need not actually post the payment on the date of receipt. n13

There are two exceptions to this "same-day" requirement: (1) when a delay in posting does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency; n14 and (2) when a servicer specifies in writing requirements for the consumer to follow in making payments but accepts a payment that does not conform to these requirements. n15 In this latter case, the servicer must credit the nonconforming payment within five days after receipt.

The date of receipt is the date when the payment (in whatever form) reaches the servicer. n16

Second, a servicer cannot impose any late or delinquency fee when the only delinquency is attributable to the late or delinquency fee itself and the payment is otherwise a full payment for the applicable period and is paid on its due date or during an applicable grace period. n17

Third, a servicer must provide an accurate statement of the amount that would be necessary to pay off an account in full as of a specific date within a reasonable time of the receipt of a request from a consumer or the consumer's representative. n18 Payoff statements must be accurate when issued. n19

[4] Remedies

The Board implemented this regulation under the authority granted to it by Congress in section 1639(l). n20 This section requires the Board to prohibit acts or practices in connection with mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section. n21 In the Supplementary Information accompanying the proposed regulation, the Board listed the remedies it believes are available under section 1640 for a creditor violation of the substantive rules that appear in sections 226.35 and 226.36 of Regulation Z. These include:

- Actual damages under section 1640(a)(1);

- Statutory damages of up to $2,000 under section 1640(a)(2), capped in a class action;

- Special statutory damages for a section 1639 violation of all the sum of all finance charges and fees

paid by the consumer; *and*

- Attorney fees and costs. n22

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingFederal RegulationsHome Owners Equity Protection ActBanking LawConsumer ProtectionBanking LawConsumer ProtectionTruth in LendingDisclosure

FOOTNOTES:
(n1)Footnote 1. Reg. Z § 226.36; *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n2)Footnote 2. Reg. Z § 226.36; *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n3)Footnote 3. Reg. Z § 226.36(b)(1); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n4)Footnote 4. Reg. Z § 226.36(b)(1)(i)(A); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n5)Footnote 5. Reg. Z § 226.36(b)(1)(i)(B); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n6)Footnote 6. Reg. Z § 226.36(b)(1)(i)(C); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n7)Footnote 7. Reg. Z § 226.36(b)(1)(i)(D); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n8)Footnote 8. Reg. Z § 226.36(b)(1)(i)(E); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n9)Footnote 9. Reg. Z § 226.36(b)(2); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n10)Footnote 10. Official Staff Commentary § 226.36(b)(2)-1; *73 Fed. Reg. 44,522, 44,614* (July 30, 2008) .

(n11)Footnote 11. Official Staff Commentary § 226.36(b)(2)-2; *73 Fed. Reg. 44,522, 44,614* (July 30, 2008) .

(n12)Footnote 12. Reg. Z § 226.36(c)(1)(i); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n13)Footnote 13. Official Staff Commentary § 226.36(c)(1)(i)-1; *73 Fed. Reg. 44,522, 44,614* (July 30, 2008) .

(n14)Footnote 14. Reg. Z § 226.36(c)(1)(i); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) ; Official Staff Commentary § 226.36(c)(1)(i)-1; *73 Fed. Reg. 44,522, 44,614* (July 30, 2008) .

(n15)Footnote 15. Reg. Z § 226.36(c)(2); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n16)Footnote 16. Official Staff Commentary § 226.36(c)(1)(i)-3; *73 Fed. Reg. 44,522, 44,614* (July 30, 2008) .

(n17)Footnote 17. Reg. Z § 226.36(c)(1)(ii); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n18)Footnote 18. Reg. Z § 226.36(c)(1)(iii); *73 Fed. Reg. 44,522, 44,604* (July 30, 2008) .

(n19)Footnote 19. Official Staff Commentary § 226.36(c)(1)(iii)-4; *73 Fed. Reg. 44,522, 44,614* (July 30, 2008) .

(n20)Footnote 20. *See* Supplementary Information accompanying the final regulation. *73 Fed. Reg. 44,522, 44,529, 44,563, 44,566, 44,570 n.119, 44,572* (July 30, 2008) .

(n21)Footnote 21. *15 U.S.C. § 1639(l)(2)(A).*

(n22)Footnote 22. *73 Fed. Reg. 1,672, 1,716-1,717* (Jan. 9, 2008) .

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PART I Consumer Credit
CHAPTER 3 The Consumer Leasing Act and Automobile Leases

1-3 Consumer Credit Law Manual 3.syn

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PART I Consumer Credit
CHAPTER 3 The Consumer Leasing Act and Automobile Leases

1-3 Consumer Credit Law Manual § 3.01

§ 3.01 Introduction to the Consumer Leasing Act and Repossessions of Automobile Leases

Many of the most important consumer remedies for leasing abuses can be found in the federal Consumer Leasing Act ("CLA"). n1 There are two major sources of CLA law beside the statute itself and existing case law. The first is Federal Reserve Board ("FRB") Regulation M on Consumer Leasing, n2 including model forms and instructions. This regulation is found at 12 C.F.R. Part 213. The second source of CLA law is the FRB Official Staff Commentary on Regulation M.

The FRB in 1996 issued a new Rule to amend Regulation M on Leasing, containing the most significant changes to the Regulation since its enactment. n3 The New Regulation was effective October 31, 1996, but compliance was optional until January 1, 1998. n4 The Commentary has also been updated. n5

All leases signed and advertised disseminated beginning January 1, 1998 were required to comply with the New Regulation. However, because compliance with the New Regulation was optional until that time, this volume will cover significant issues in both the former regulation and the New Regulation. n6

The only other primary source of precedent is the relatively small number of state and federal cases interpreting the Act. Truth in Lending ("TIL") case law is useful precedent for certain CLA issues, particularly those involving remedies and defenses. n7

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionConsumer LeasingContracts LawDebtor & Creditor Relations

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. §§ 1667 et seq.* The Consumer Leasing Act [hereinafter CLA] is reprinted in Vol. 1A *infra*.

(n2)Footnote 2. Regulation M is reprinted in Vol. 1A *infra*.

(n3)Footnote 3. *61 Fed. Reg. 52,246-52,281* (Oct. 7, 1996) , *amended by 62 Fed. Reg. 15,364* (Apr. 1, 1997) *and by 63 Fed. Reg. 52,107* (Sept. 29, 1998) . Further proposed changes to this Regulation concerning electronic disclosures

were published for comment at *63 Fed. Reg. 14,538* (Mar. 25, 1998) .

(n4)Footnote 4. *62 Fed. Reg. 51,006* (Sept. 30, 1997) , *as corrected by 62 Fed. Reg. 53,733* (Oct. 16, 1997) .

(n5)Footnote 5. *62 Fed. Reg. 16,053* (Apr. 4, 1997) .

(n6)Footnote 6. Note also that this chapter covers the topic of automobile and other consumer leases. It does not cover leases of real property, apartments, or mobile home park space. It also does not deal with rent-to-own transactions which are covered in Ch. 6, *§ 6.05[5]*, and Ch. 7 *infra* .

(n7)Footnote 7. For further discussion of Truth in Lending [hereinafter TIL], see Ch. 1 *supra*.

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PART I Consumer Credit
CHAPTER 3 The Consumer Leasing Act and Automobile Leases

1-3 Consumer Credit Law Manual § 3.02

§ 3.02 Scope of the CLA

The CLA applies to the following leases:

[1] Leases That Exceed Four Months n1

If a lease is terminable without penalty before four months have expired, the courts have held that such a lease is not covered by the Act. n2 For example, a majority of courts have held that rent-to-own appliance ("RTO") leases that are terminable at any time without penalty are not covered by the Act. n3

[2] Leases for Less Than $25,000

The CLA does not apply to leases where the total contractual obligation exceeds $25,000. n4 The "total contractual obligation" is not defined in the CLA, but probably includes the total of lease payments plus any trade-in allowance or initial payment.

[3] CLA Does Not Apply to Credit Sales

The CLA does not apply to transactions that meet all of TIL's technical requirements for a credit sale. For example, where the lessor/creditor does not satisfy TIL's definition of "creditor," the transaction cannot be a credit sale, n5 but is instead a lease as long as it otherwise meets the CLA requirements for a lease. n6

[4] Consumer Leases Only

The CLA applies only to "consumer leases," defined as being primarily for personal, family, or household purposes. n7 Only natural persons are protected under the CLA. n8

[5] CLA Applies to Lessors, Arrangers of Leases, Certain Assignees

The CLA only applies to lessors who regularly engage in leasing, offering to lease, or arranging to lease under a consumer lease. n9 "Arranging to lease" means to provide or offer to provide a lease which will be extended by another whereby the arranger receives a fee or other tangible consideration or participates in the preparation of the lease

documents. n10 The term "lessor" applies not only to the lessor, but to assignees of the lessor, if the assignees are substantially involved in the transaction. n11 An automobile dealer, for example, is a lessor under the Act if it is the originating lessor, even if it immediately assigns the lease to the party that drafted the lease and lease disclosures. n12

A federal trial court in *BMW Financial Services* has reached the preposterous conclusion that a creditor cannot at the same time be a lessor and an assignee, within the meaning of those terms in the CLA, but that, for some CLA requirements, it is a lessor, and for others it is an assignee. n13 When it is a lessor, it can be liable for that CLA violation, but when it is treated as an assignee, it can only be liable for that violation if it is apparent on the face of the lease.

For one thing, this flies in the face of clear United States Supreme Court precedent in *Cenance* discussing the status of assignees involved in a credit sale--at the time, creditor was defined under TIL in the same way as lessor is defined in the CLA today. The Supreme Court found that the auto financer could be *both* a creditor and an assignee at the *same time*, and that such a creditor is liable for all disclosure violations, even if it would not be so if it merely were just an assignee. n14 It is particularly strange that the *BMW* court ignores *Cenance* because the *BMW* court quotes from the first sentence of a Commentary provision, where *Cenance* is specifically referenced in the second sentence of that same provision. n15

The *BMW* court also accepts that the creditor (BMW Financial Services) was substantially involved in the lease, meeting the *Cenance* test. It also admits that the Second Circuit and federal courts in its own federal district have found assignees to be lessors under this CLA test. n16 Nevertheless, the court decides to create its own paradigm, classifying the finance company either as a lessor or as an assignee separately for each of the alleged CLA violations. It then concludes that BMW is a lessor for some violations, but an assignee for others. It is hard to believe that another court would follow this tortured and confusing logic.

Clearly, the correct interpretation followed by all other courts is that some assignees are lessors and some are not. When an assignee is not, it is only liable as an assignee. When the assignee is also a lessor, it is liable also as a lessor, and not just as an assignee.

[6] Real Property Leases Are Not Covered n17

The determination as to whether mobile homes, houseboats, or other items are real or personal property is to be based on the law of the state where the property is situated at the time the property is offered for lease. n18

[7] Other Exempt Property

The FRB Official Staff Commentary to Regulation M exempts certain specific leases from the Act's coverage. Safety deposit box leases are exempted. n19 So are the following leases incidental to a service: home entertainment systems requiring the consumer to lease equipment that enables a television to receive the transmitted programming; propane gas service where the consumer must lease a propane tank to receive the service; and burglar alarm systems requiring the installation of leased equipment that triggers a telephone call when a home is burglarized. n20

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionConsumer Leasing

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1667(1).*

(n2)Footnote 2. *See, e.g., Smith v. ABC Rental Sys. of New Orleans, Inc., 618 F.2d 397 (5th Cir. 1980) , aff'g 491*

F. Supp. 127 (E.D. La. 1978) ; *Givens v. Rent-A-Center, Inc., 720 F. Supp. 160 (S.D. Ala. 1988)* , *aff'd, 885 F.2d 879 (11th Cir. 1989)* .

(n3)Footnote 3. See Ch. 6, *§ 6.05[5]*and Ch. 7 *infra* , for discussion of rent-to-own transactions.

(n4)Footnote 4. *15 U.S.C. § 1667(1). See also* Grion v. Milford Gateway, Inc., Clearinghouse No. 50,430 (D. Conn. 1994); *Delta Leasing Servs. Corp. v. Gentile, 1994 Conn. Super. LEXIS 564 (Mar. 1 1994)* .

(n5)Footnote 5. *Ayers v. National Vehicle Mgmt. Co., 1992 U.S. Dist. LEXIS 16635 (W.D.N.Y. Oct. 23 1992)* . For a further discussion of TIL and the definition of creditor, see *§ 1.03[1] supra*.

(n6)Footnote 6. *Ayers v. National Vehicle Mgmt. Co., 1992 U.S. Dist. LEXIS 16635 (W.D.N.Y. Oct. 23 1992)* .

(n7)Footnote 7. *15 U.S.C. § 1667(1)*. See Reg. M, *12 C.F.R. § 213.2(a)(3)* for a definition of agricultural purposes; *Clement v. American Honda Fin. Corp., 145 F. Supp. 2d 206 (D. Conn. 2001)* (consumer's submission of documentary evidence not rebutted by lessor sufficient to prove lease for consumer purposes). *See also* Official Staff Commentary § 213.2(e)-5, *reprinted in 62 Fed. Reg. 16,059* (Apr. 4, 1997) .

(n8)Footnote 8. *15 U.S.C. § 1667(1)*; Reg. M, *12 C.F.R. § 213.2(a)(9)*; Official Staff Commentary § 213.2(j)-1, *reprinted in 62 Fed. Reg. 16,059* (Apr. 4, 1997) .

(n9)Footnote 9. *15 U.S.C. § 1667(3)*.

(n10)Footnote 10. Reg. M, *12 C.F.R. § 213.2(a)(4). Cf.* Official Staff Commentary § 213.2(h)-2, *reprinted at 62 Fed. Reg. 16,059* (Apr. 4, 1997) .

(n11)Footnote 11. *Jordan v. Schaumburg Toyota, 1999 U.S. Dist. LEXIS 2553* (N.D. Ill. Feb. 24, 1999) ; Official Staff Commentary § 213.2(h)-3, *reprinted at 62 Fed. Reg. 16,059* (Apr. 4, 1997) . *See also Kennedy v. BMW Financial Services, N.A., 2003 U.S. Dist. LEXIS 18031* (D. Conn. Oct. 3, 2003) (refusing to dismiss claim against assignee). *But cf. Bescos v. Bank of Am., 105 Cal. App. 4th 378 (2003)* (court finds no coverage under state leasing law because consumer did not prove assignee bank's substantial involvement, where consumer only proved that bank had reviewed the consumer's application to determine credit-worthiness).

(n12)Footnote 12. *Applebaum v. Nissan Motor Acceptance Corp., 1999 U.S. Dist. LEXIS 5548* (E.D. Pa. Apr. 21, 1999) , *rev'd on other grounds, 226 F.3d 214 (3d Cir. 2000)* , *cert. denied, 533 U.S. 929 (2001)* .

(n13)Footnote 13. *Kennedy v. BMW Financial Services, 363 F. Supp. 2d 110 (D. Conn. 2005)* .

(n14)Footnote 14. *Ford Motor Credit Co. v. Cenance, 452 U.S. 155 (1981)* .

(n15)Footnote 15. Official Staff Commentary § 213.2(h)-3.

(n16)Footnote 16. Citing *Turner v. General Motors Acceptance Corp., 180 F.3d 451 (2d Cir. 1999)* ; *Hildabrand v. DiFeo Partnership, 89 F. Supp. 2d 202 (D. Conn. 2000)* ; *Pettola v. Nissan Motor Acceptance Corp., 44 F. Supp. 2d 442 (D. Conn. 1999)* .

(n17)Footnote 17. *15 U.S.C. § 1667(1)*.

(n18)Footnote 18. *15 U.S.C. § 1667(4)*.

(n19)Footnote 19. Official Staff Commentary § 213.2(e)-8, *reprinted at 62 Fed. Reg. 16,059* (Apr. 4, 1997) .

(n20)Footnote 20. Official Staff Commentary § 213.2(e)-7, *reprinted at 62 Fed. Reg. 16,059* (Apr. 4, 1997) . *See*

also Ysasi v. Nucentrix Broadband Networks, Inc., 205 F. Supp. 2d 683 (S.D. Tex. 2002) (consumer could not avoid television transmission equipment exemption by narrowing claim to remote control accompanying that equipment).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 3 The Consumer Leasing Act and Automobile Leases

1-3 Consumer Credit Law Manual § 3.03

§ 3.03 Required Lease Disclosures Under the CLA

[1] Timing and Form of Disclosures

[a] Old Regulation Requirements

The Old Regulation M mandates the disclosure of fifteen different terms, as applicable. These are discussed below in *§ 3.03[2]*. The timing and form of the disclosures are also prescribed by the regulations and discussed below.

Under the Old Regulation, the disclosures must be made prior to the lease's consummation (as defined by state law), n1 on a dated written statement identifying the lessor and lessee, n2 and a copy of the statement must be given to the lessee at that time. n3 While the requirement of a written statement is met if the disclosures are included in the lease itself, n4 it is not enough if the disclosures appear on the original of the lease, but not on the copy provided to the consumer. n5 The disclosures must be on one page only--interpreted to mean both sides of one page n6--and above the place for the lessee's signature. n7

Lease disclosures must be clear, conspicuous, and in meaningful sequence, n8 so as to be in a reasonably understood form. n9 Regulation M contains model forms that meet this standard, n10 but lessors need not use the model forms. n11 All disclosures must be made in English, except in Puerto Rico, n12 but foreign language translations that do not contradict the English version are permitted where the lessor so chooses or where federal or state law so requires. n13

Where a lessor does not know information that must be disclosed, the lessor can label the information as an estimate or approximation and provide an estimate or approximation. This must be a reasonable estimate. n14

A lease being renegotiated or extended is considered a new lease subject to all disclosure requirements. n15

[b] New Regulation Requirements

As discussed above, there have been a number of important changes in the CLA regulations. With respect to the timing and form of required disclosures, New Regulation section 213.3(a) replaces Old Regulation section 213.4(a). The disclosures must continue to be made clearly and conspicuously, but the requirement of a meaningful sequence is deleted. Instead, the regulation sets out a particular order for most disclosures within a segregated box, and does not

require a meaningful sequence for the non-segregated, required disclosures.

In addition, the New Regulation deletes the requirement that disclosures be on one page and above the consumer's signature, in a certain type size. n16 Nevertheless, the FRB indicates that the clear and conspicuous standard provides consumers with the same protection as these deleted requirements.

The English language requirement from the Old Regulation is liberalized. The disclosures may be made in a language other than English, provided that they are made available in English upon the consumer's request. n17

The FRB has issued an interim rule on Regulation M electronic disclosures, n18 effective on March 30, 2001, but with compliance voluntary until some future date that the FRB has not yet specified. n19 Because of this, few, if any, lessors are taking advantage of the interim rule to make electronic disclosures.

The interim rule allows any disclosure that must be in writing under Regulation M to be made electronically. n20 With the exception of the advertising disclosures, the lessor must first obtain the consumer's consent and the lessee must demonstrate the ability to access the information electronically. n21 The disclosure can be e-mailed to the consumer or posted on a website, if the consumer is notified of the posting and the information is left on the website for at least ninety days. n22

The New Regulation substantially reorganizes and changes the format of disclosure requirements. The requirement that the disclosures be made prior to consummation has been moved to section 213.3(a)(3). A new requirement is that the disclosures be made in a form the consumer may keep. n23

One of the most significant changes in the New Regulation is the requirement that enumerated disclosures be segregated from the rest of the required disclosures and from other lease information. The segregated disclosure (commonly called the federal box) must be separate from other information and shall contain only the following information:

a) The amount due at lease signing (which includes for automobile leases both the itemization of the amount due and how the amount due will be paid);

b) The payment schedule and total of periodic payments;

c) Other charges;

d) Total of payments;

e) The eleven step payment calculation;

f) The early termination notice (i.e., the warning that the charge can be substantial, not the actual disclosure of the early termination method);

g) The statement referencing the other required disclosures found elsewhere on the disclosure form;

h) The warning and amount or method of determining the charges for excessive wear or use; and

i) The end of term purchase option price (not the purchase option price earlier in the lease).

The headings, content, and format for the segregated disclosures shall be in a manner substantially similar to the applicable model form. No additional information can be included in the segregated box. Even information required by state law cannot be included. n24

Lessors can get into trouble when they re-write a vehicle transaction. Dealers may provide the vehicle to the consumer contingent on the financing going through, then cancel the transaction, but then re-write the transaction at some later time as a lease on terms less favorable to the consumer. The dealer will have violated the CLA if it backdates that lease to when the consumer received the vehicle, so that the disclosures are made at a date well after the dealer states the transaction was consummated. n25 Where the lessor offers a lease contingent on the lease being assigned, but the lessor later cancels the transaction because the assignment did not go through, then the lessor cannot defend a disclosure violation by arguing that the lease was never finalized. The obligation to make disclosures is not dependent on the signing of a written agreement or on whether a condition to the lease has been met. n26

[c] State Disclosure Statutes

In the mid and late 1990s, a number of states enacted consumer leasing or motor vehicle leasing laws, many of which set out disclosure requirements. States with statutes setting out leasing disclosure requirements include California, n27 Colorado, n28 Connecticut, n29 District of Columbia, n30 Florida, n31 Hawaii, n32 Illinois, n33 Indiana, n34 Iowa, n35 Kansas, n36 Louisiana, n37 Maine, n38 Maryland, n39 Michigan, n40 New Hampshire, n41 New Jersey, n42 New York, n43 Oklahoma, n44 South Carolina, n45 Washington, n46 West Virginia, n47 and Wisconsin. n48

These statutes may have additional disclosure provisions not required by Regulation M; they may apply to leases outside the scope of the CLA (such as leases over $25,000 n49 they may have longer or different limitation periods n50 and they may offer a different remedial scheme (such as treble damages and enhanced damages if the consumer is over 62 years old. n51 There is little uniformity among state statutes, and the state statutes themselves were frequently amended in the late 1990s to comply with current Regulation M and for other reasons. Consequently, practitioners should refer to the version of their state statute, if any, in effect at the time the lease was signed.

[2] Specific Required Disclosures

The CLA and Regulation M set out a number of disclosures that are required in consumer leases. The required disclosures are summarized below.

[a] Description of Property n52

The lessor must provide a brief description of the leased property sufficient to identify the property to both the lessor and lessee. n53 The FRB's model forms specify for vehicle leases the vehicle's year, make, model, body style, and vehicle identification number. n54 The instructions to the FRB model forms indicate that the vehicle identification number is not required. The form for furniture leases lists the item's name, color, stock number, manufacturer and quantity. n55

A lease that misidentifies the property should violate the description requirement. For example, the wrong vehicle identification number or model should trigger a CLA violation. n56

[b] Payments Made at Lease Consummation

Under the Old Regulation, the lessor must disclose the total amount to be paid at lease consummation, identifying the purposes to which that payment is made. n57 Examples are refundable security deposits, advance lease payments, trade-in allowances, mechanical breakdown protection, registration fees, and capitalized cost reductions. n58

Only payments paid at consummation should be disclosed here; when consummation occurs is determined by state law. n59 The trade-in amount must be included in the total due at lease consummation. n60

This disclosure requirement has been substantially changed under the New Regulation, and has been renumbered

section 213.4(b), from section 213.4(g)(2). The New Regulation requires an itemization by type and also of amount of all amounts to be paid prior to or at lease signing. The Old Regulation only required a total amount. Note, however, that where a consumer seeks waiver of some of the amount due at lease inception, the lessor's agreement to do so does not make the prior disclosed amount inaccurate or lead to a CLA violation. n61

[c] The Schedule and Amount of Lease Payments

The lessor must disclose the number of lease payments, the amount of each payment, the due dates, and the total of such periodic payments. n62 The disclosure must be placed among the segregated disclosures in a form that is substantially similar to the FRB model forms. n63 The model forms provide sample language. n64

[d] Official Fees and Taxes

The lessor must disclose the total amount that will be payable *during the entire lease term* for official fees, registration, certificate of title, license fees, or taxes. n65 If this amount is not known, the lessor must use a good faith estimate. n66

It is not enough for the lessor to disclose the amount of different fees. The lease must indicate the total amount of all of these different figures. Consumers may not be asked to do this arithmetic for themselves. n67 The Commentary provides amplification as to how certain taxes are to be treated. Taxes paid at lease signing are disclosed both as an amount paid at lease signing and as part of the total of taxes. n68 Taxes that are part of a periodic payment are disclosed as part of the total of taxes, as part of the total of periodic payments, and as part of the disclosure of the components of the periodic payment. n69

[e] Other Charges

Lessors are required also to disclose other charges that are not included in the periodic payments n70 or included in the payments at consummation or elsewhere. n71 If the total states that there are no "other" charges, then it is a CLA violation to assess a disposition fee or some other fee that must be treated as an "other" charge. n72

[f] Insurance

The lessor must briefly identify required insurance in connection with the lease: the types and amount of coverage and the cost to the consumer if provided by the lessor, or the types and amounts of coverage required to be purchased by the consumer. n73

[g] Identification of Express Warranties

The lessor must identify express warranties made by the lessor or manufacturer with respect to the leased property. n74 Typically, the lessor makes no warranties, and, instead, disclaims any warranties. Although disclosure of such a disclaimer is not required under the CLA, its disclosure is permitted as additional information. n75

[h] Party Responsible for Maintenance; Excess Wear and Use

The lease must disclose which party, usually the consumer, is responsible for maintaining or servicing the property, with a brief statement of that responsibility. n76

This provision has been changed in some respects. The New Regulation is renumbered section 213.4(h) from section 213.4(g)(8), and certain stylistic changes have been made. The New Regulation also states more clearly that the standards disclosed must be reasonable. Clear disclosure of unreasonable standards for wear and use should be a disclosure violation.

In addition, a new requirement for motor vehicle leases n77 provides that a notice substantially similar to the following appear in the segregated portion of the disclosures: "Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use." This notice also must specify the amount or method for determining any charge for excess mileage. That method must be reasonable. n78

In a surprising number of cases, there is confusion over the actual charge per mile, or, more likely, the number of miles before an excess mileage charge kicks in. The consumer's copy of a lease, for example, may contain no mileage limit or a high one. The copy that is forwarded to the lease's assignee (the finance company typically viewed as the lessor) may have a different number completely. Such alterations and forgeries should be actionable under common law theories, n79 and may also violate the CLA.

[i] Security Interest

The lessor must disclose any security interest in connection with the lease (other than the security deposit), clearly identifying the collateral. n80 The lessor's security interest in the leased property has to be disclosed as a security interest if it is treated as such under state law. n81

[j] Late Payment and Default Charges

Penalties or other charges for delinquency, default, or late payment must be disclosed. n82 The disclosed charges must be reasonable in amount. n83 Any default charge must also be disclosed.

The New Regulation is renumbered section *213.4(q)* from section 213.4(g)(10), and contains a significant change. The New Regulation explicitly states that disclosed charges for default, delinquency and late payment must be *reasonable*. Thus, even a clear disclosure of unreasonable charges should be a disclosure violation.

[k] Purchase Option

The lease must state whether or not the consumer has the option to purchase the leased property. n84 If there is no such option, it is not enough to leave the lease silent on this issue; the lease must contain a specific statement indicating either that there is or is not a purchase option. n85

If there is a purchase option, the disclosure must identify whether that option exists at the end of the lease or earlier or both. Some lessors may also charge a fee when consumers exercise the purchase option. The lessor must include this fee in the purchase option disclosure. n86

[l] Interest on Security Deposit

In what apparently is a widespread industry practice, auto lessors require consumers to provide a security deposit at the beginning of the lease, but retain the interest on that deposit for themselves. Two 1996 federal court decisions have held that unless the lease specifies otherwise, Uniform Commercial Code ("UCC") Article 9 requires that lessors must repay that interest to the consumer. n87 These two courts have also held that the undisclosed failure to repay this interest to the consumer violates the CLA, and adequately states a UDAP claim. These two rulings triggered a number of class action filings against many of the major national lessors. Judicial response has been quite negative, consistently rejecting consumer claims in this area. n88

Because the security deposit creates an Article 9 security interest, Article 9 rules apply to the deposit. Consequently, lessors must comply with *UCC section 9-207(c)*, which requires that any profit derived from the collateral while the secured party retains the collateral be remitted to the consumer unless the parties otherwise agreed.

Even though virtually no lessor returns interest on security deposits to consumers, not every consumer will have a CLA

claim against a lessor. If the lease contains a provision that the lessor will retain the interest on the security deposit, then the lessor is entitled to retain this interest, unless state law says otherwise. Several states have enacted a specific statute dealing with the treatment of security deposits in personal property leases. n89

Nevertheless, as part of judicial hostility to consumer actions in this area, courts have interpreted these statutes quite narrowly or found other ways to avoid the applicability of these laws. n90 For example, the New York statute, since amended, required the deposit to be segregated and deposited with a bank, with any accrued interest to go to the lessee. n91 But a court has interpreted this as not requiring the lessor to deposit the security deposit in an interest bearing account. Consequently, Ford could deposit the money in a non-interest bearing account, even though the bank reciprocated for this deposit by providing certain monetary benefits to Ford. The court found these monetary benefits not to be interest. n92 That statute has now been amended to require that deposits of $750 or more must be held in interest bearing accounts; even this statute will offer little protection to the lessee since most automobile lease security deposits are less than $750. The CLA requires that this "charge" be properly disclosed. No court has yet reached the issue of how this charge must be disclosed.

Secondly, consumers will have CLA claims if they terminated the lease within one year of filing the CLA claim. Otherwise, they are prevented from bringing an affirmative CLA action by the CLA's statute of limitations, though the consumer can bring the action by way of recoupment against the lessor's collection action even after the one-year limitation period has expired.

[m] Liability for Difference Between Estimated and Realized Value

The lessor must state, if it is the case, that the consumer will be liable, at early termination or at the end of the lease, for the difference between the property's estimated value and its realized value. n93 Under the new law, this provision is renumbered section 213.4(k) from section 213.4(g)(13), but contains only minor stylistic changes.

[n] Right to an Appraisal

Whenever the consumer's liability at either early termination or at the end of the lease term is based on the estimated value of the leased property, the lessor must disclose the consumer's right to obtain a mutually binding appraisal of the car's resale value. n94 Under the new law, this section, renumbered section *213.4(l)* from section 213.4(g)(14), contains stylistic changes and one significant clarification. The New Regulation applies if the early termination or scheduled termination liability is based on a "realized" value, while the Old Regulation triggered the disclosure if liability is based on an "estimated" value.

[o] Initial Capitalized Cost, Sticker Price and Residual Value

Under the Old Regulation, the CLA does not explicitly require for closed-end leases the disclosure of a car's initial capitalized cost, sticker price, or expected residual value. Nevertheless, the method of computing early termination charges and purchase option prices must be disclosed. To the extent to which these methods require the consumer to compute the initial capitalized cost, sticker price, or expected residual value, then the lease will have to disclose these numbers (or at least a method for computing these numbers). In addition, there is a growing trend for state laws to require disclosure of some or all of these terms.

The most significant change in the New Regulation is a completely new *section 213.4(f)*. This provision only applies to motor vehicle leases. The lessor must include in the segregated box, in a form similar to that found in the Model Forms, a series of eleven disclosures that show the derivation of the monthly payment amount: the gross capitalized cost, capitalized cost reductions, the adjusted capitalized cost, the residual value, depreciation and other amortized costs, rent charges, the total of base periodic payments, the lease term, the base periodic payment, the itemization of the periodic payment, and the total periodic payment. n95

One issue that has been raised with respect to the gross capitalized cost is the propriety of dealers adding as much as $450 to the gross capitalized cost for an "acquisition charge." This is a charge the assignee assesses to the dealer, who passes it on in turn to the consumer. Under TIL, this would be considered a finance charge, but Regulation M does not explicitly state whether this should be treated as part of the gross capitalized cost or part of a rent charge. In one case, the lessor included it in the gross capitalized cost and the court found this permissible. n96

Because there is so little guidance as to whether items should go into the rent charge or the capitalized cost, the consumer should focus instead on the implication of the lessor including this in the capitalized cost. It means that the full acquisition charge (e.g., $450) must be paid even at early termination, and there is no rebate for unearned acquisition charges. The issue is whether this is a reasonable early termination charge or whether the assignee lessor should rebate some of this charge to the consumer if the lease is terminated early.

[p] Total of Payments

This is a new disclosure requirement that is different from, and in addition to, the total of periodic payments. The lessor must disclose, in the segregated section of the disclosure, the total of payments, with a description such as "the amount you will have paid by the end of the lease." n97 This is computed as the amount due at lease signing or delivery (minus the security deposit or other refundable amount), the total of periodic payments (not including any periodic payment included in the amount due at lease signing), and the total of other charges (as disclosed pursuant to section 213.4(d)).

[q] Special Open-End Lease Requirements

At the time the CLA was enacted, most auto leases were open-ended, and it was largely open-end lease abuses to which the CLA was targeted. Today few leases are open end, and, thus, the CLA's special open-end disclosures usually are not directly relevant.

For open-end leases, the lessor must disclose the value of the property at lease consummation, the total lease obligation, and the difference between them. n98 The total lease obligation includes down payments, trade-ins and similar non-refundable amounts paid at consummation, the scheduled periodic lease payments, plus the estimated value of the leased property at the end of the lease term. n99

For open-end leases only, the lessor must also disclose that there is a rebuttable presumption that the estimated value of the property at the end of the lease term is unreasonable and not in good faith to the extent to which it exceeds the realized value by more than three times the average monthly payment. n100 The lessor must also disclose that it cannot collect such excess liability of more than three times the average monthly payment (except for unreasonable wear or use) unless the lessor brings a successful court action where the lessor pays the lessee's attorney fees. n101 The lessor must finally disclose that the lessee can still make any mutually agreeable final adjustment for excess liability. n102

In addition, the lessor must disclose the rent and other charges paid by the lessee and required by the lessor as an incident to the lease transaction. These should be described with terms similar to "the total amount of rent and other charges imposed in connection with your lease." n103 This disclosure must be placed among the segregated disclosures, in a form that is substantially similar to the FRB model forms. n104

The New Regulation is renumbered *section 213.4(m)* from section 213.4(g)(15) and stylistic changes are made.

[r] Early Termination and Default Charges

One of the key issues in most lease cases is the early termination or default clause. The lessor must disclose the method of determining the amount of any penalty or charge for early termination n105 and for default. n106 A later section of

this volume discusses the CLA requirement that the disclosed method must be reasonable. n107 This subsection only analyzes the requirement that the method be clearly disclosed. It is important to note that while issues have arisen as to whether a consumer has standing to challenge an early termination formula's substantive reasonableness where the formula is not enforced against that consumer, there is no question that any lessee can challenge an improper *disclosure* of an early termination or default formula. n108

Lessors cannot avoid this requirement by claiming that the consumer's obligation to pay all of the remaining payments in the lease is not an early termination charge, and thus need not be disclosed, because it is just what is owed under the lease. n109

The disclosure must indicate the conditions under which the consumer can terminate early, and the method of calculating any penalty. When default triggers early termination, then default charges for such early termination must be disclosed here as well. n110

There are some significant changes under the New Regulation. The New Regulation specifies that the disclosed amount must be reasonable. Disclosure of an unreasonable formula, even one that is clear and conspicuous, should be a disclosure violation. This has important practical consequences. While unreasonable early termination charges also violate a substantive CLA requirement, n111 some courts find that consumers do not have standing to challenge an unreasonable early termination charge (as a CLA substantive violation) if they have not suffered actual damage as a result of that charge. On the other hand, there can be no question but that actual damage is not a precondition to a challenge based on misdisclosure.

For motor vehicle leases, the lessor must now make two early termination disclosures. In the non-segregated disclosures, the lessor must describe the method of computing the early termination charge. In the segregated disclosures, information similar to the following must be provided: "Early Termination. You may have to pay a substantial charge if you end this lease early. *The charge may be up to several thousand dollars*. The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be."

Below is a brief list of potential disclosure problems concerning early termination and default charges. n112

a) *Key numbers not defined, missing, or not clearly defined*; n113

b) *Formula requires consumer to perform numerous unnecessary computations*; n114

c) *Formula difficult to understand;* n115

d) *Does lease disclose penalty for both default and voluntary early termination?* n116

The lease must specify exactly how the lease can be terminated early and what payments the lessee owes at that termination. n117 Nor can the lessor prohibit voluntary early termination in the lease, but then routinely allow lessees to terminate early. n118

e) *Failure to apply in practice formula disclosed in lease*.

The Seventh Circuit has ruled that an early termination formula is not properly disclosed where the lessor in practice uses a different formula. n119 This is the case even though the lessor's actual practice is more generous to consumers than the disclosed formula. For example, Nissan Motor Credit, realizing that its early termination formula sometimes charged consumers more than the total of all remaining payments, had a practice instead of charging the consumer all remaining payments on the lease or the number produced by its early termination formula, whichever is less. A federal court has found this methodology to violate the CLA because it is not the same methodology disclosed in the lease. n120

[3] Common Closed-End Automobile Lease Disclosure Violations

Consumer attorneys should particularly look for the following nine common lease disclosure violations.

[a] Trade-Ins and Down Payments

Make sure that the value of any trade-in or down payment is disclosed, n121 even where a dealer accepts the trade-in, but a financial institution is the actual lessor. Also, explore the existence of any manufacturer's rebates and how those were treated in the lease.

[b] Official Fees and Taxes

Lessors often trip up on the disclosure of total fees and taxes because the lessor's employee must compute a number and fill in a blank line. The disclosure is the total amount that will be payable during the entire lease term for fees, registration, taxes, and similar charges. n122

[c] Express Warranties

The lessor must identify any manufacturer and lessor warranties that go with the lease. n123 It is not enough for the lessor to disclaim its own warranties. Nor is it enough for the lessor to disclose that the lessor is assigning "the manufacturer's warranties, if any," or that there "may" be manufacturer's warranties. A federal court has recently ruled that a disclosure is defective where it states "to the extent the vehicle is still subject to the manufacturer's new vehicle warranty, Lessor assigns to you all the rights and remedies under that warranty, to the extent they are assignable." n124

[d] Excess Mileage

The charge for excess mileage must be reasonable. n125

[e] Purchase Option

Look for violations of the purchase option disclosure requirements. n126 The lessor must disclose the actual purchase option amount, not just a method of computing an amount.

[f] Failure to Define Key Terms Used to Compute Early Termination or Default Charges

The lessor must disclose the amount or method for computing early termination and default charges. Consequently, a formula for computing the early termination charge that includes terms not disclosed in the lease involves a CLA violation n127 because the lessee or an expert cannot determine the amount of the early termination charge by an examination of the lease.

The Third Circuit has carefully considered when a term used in the early termination formula must be defined. n128 The CLA requires the disclosure to be "clear" and the term "clear" means more than just legible, but must also include the ability to understand the formula specified in the disclosure. n129 While the early termination formula must be in "reasonably understandable form," it need not be within the understanding of the average consumer. n130 The inherent complexity of the formula must be considered, and requiring a disclosure to be understandable should not place substantive restrictions on the nature of the formula itself.

Consequently, the Third Circuit did not require that the term "constant yield method" or "rate implicit in the lease" be defined in the lease. These terms are capable of understanding and have a common meaning in the field.

On the other hand, the failure to specify the dollar value of the residual value is a CLA violation where knowledge of

that value is required to compute the early termination charge. "An early termination clause that fails to reveal an otherwise unknowable variable used in determining an early termination penalty cannot be regarded as 'reasonably understandable' in any meaningful sense of the term." n131

[g] Early Termination Formulas Not Clearly Disclosed

A common lease disclosure violation is the failure to clearly disclose early termination formulas.

[h] Failure to Disclose Penalty at Both Voluntary and Involuntary Early Termination

The lessor must disclose the lessee's liability both when the lessee defaults and when the lessee terminates the lease voluntarily. n132

[i] Failure to Follow Disclosed Termination Methodology

In a significant number of cases, lessors utilize a different methodology in computing default and early termination penalties than that disclosed in the lease. This should be a disclosure violation, particularly where the deviation is part of the lessor's standard practice and is not a mere computational error. n133 It is not a defense to the disclosure violation that the lessor's actual computation practice is more lenient to the consumer than the penalty disclosed in the lease.

[4] Regulation M's Treatment of Electronic Disclosures

The FRB's interim rule on electronic lease disclosures n134 has been withdrawn and replaced with final changes to Regulation M, with compliance mandatory October 1, 2008. n135 For lease disclosures, the amended rule simply states that they may be provided the lessee in electronic form, subject to compliance with the consumer consent and other applicable provisions of the E-Sign Act. n136

[5] Remedies: Disclosure Violations

The CLA specifies that anyone failing to comply with the consumer lease disclosure requirement n137 is liable to the consumer as specified by the TIL remedy section. n138 Unlike TIL, *any* CLA disclosure violation leads to statutory damages. n139 In other words, even one minor disclosure violation, where there is no proof of actual damages, leads to a full statutory damage award. n140 In one case, Ford initiated a state court action for an excessive early termination charge. When the consumer raised a CLA counterclaim, Ford amended its complaint to seek only a fraction of the original amount sought, and then claimed that the consumer no longer had CLA standing, because the consumer was no longer being damaged. The Eleventh Circuit found the consumer in fact did have standing even if there were now no actual damages, in part because the consumer could seek statutory damages even in the absence of actual damages. n141

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionConsumer LeasingDisclosure

FOOTNOTES:
(n1)Footnote 1. Official Staff Commentary § 213.2(b)-2.

(n2)Footnote 2. *15 U.S.C. § 1667a*. While disclosure must always be clear and conspicuous, the words "lessor" and "lessee" need not be used when identifying these parties. *See* Official Staff Commentary § 213.4(a)(2)-2.

(n3)Footnote 3. Reg. M, *12 C.F.R. § 213.4(a)(2)*.

(n4)Footnote 4. *Anderson v. Ford Motor Credit Co., 323 Md. 327, 593 A.2d 678 (Md. 1991)* .

(n5)Footnote 5. Reg. M, *12 C.F.R. § 213.4(a)(2)(i)*.

(n6)Footnote 6. Official Staff Commentary § 213.4(a)(2)-4.

(n7)Footnote 7. Reg. M, *12 C.F.R. § 213.4(a)(2)*. *See also* Nix v. Advance Leasing & Rent-a-Car, Inc., Clearinghouse No. 49,946 (N.D. Ga. Nov. 30, 1993).

(n8)Footnote 8. Reg. M, *12 C.F.R. § 213.4(a)(1)*.

(n9)Footnote 9. Official Staff Commentary § 213.4(a)(1)-1.

(n10)Footnote 10. Reg. M, 12 C.F.R. pt. 213 app. C.

(n11)Footnote 11. Official Staff Commentary § 213.4(a)(1)-1.

(n12)Footnote 12. Reg. M, *12 C.F.R. § 213.4(a)(4)*.

(n13)Footnote 13. Official Staff Commentary § 213.4(a)(4)-1.

(n14)Footnote 14. Reg. M, *12 C.F.R. § 213.4(d)*.

(n15)Footnote 15. Reg. M, *12 C.F.R. § 213.4(h)*. For exceptions to this requirement, see Regulation M, *12 C.F.R. section 213.4(h). Kennedy v. BMW Financial Services, 363 F. Supp. 2d 110 (D. Conn. 2005)* .

(n16)Footnote 16. *See 12 C.F.R. § 213.3*, *reprinted in 61 Fed. Reg. 52,259* (Oct. 7, 1996) .

(n17)Footnote 17. *12 C.F.R. § 213.3(a)(4)*, *reprinted in 61 Fed. Reg. 52,259* (Oct. 7, 1996) .

(n18)Footnote 18. *66 Fed. Reg. 17,322* (Mar. 30, 2001) .

(n19)Footnote 19. *66 Fed. Reg. 41,439, 41,440* (Aug. 8, 2001) .

(n20)Footnote 20. *66 Fed. Reg. 17,322* (Mar. 30, 2001) , *adding § 213.6(b)*.

(n21)Footnote 21. *66 Fed. Reg. 17,322* (Mar. 30, 2001) , *adding § 213.6(c) and adding* Official Staff Commentary 213.6(b)-2ii.

(n22)Footnote 22. *66 Fed. Reg. 17,322* (Mar. 30, 2001) , *adding § 213.6(d)*.

(n23)Footnote 23. *12 C.F.R. § 213.3(a)*, *reprinted in 61 Fed. Reg. 52,259* (Oct. 7, 1996) .

(n24)Footnote 24. *See* Official Staff Commentary § 213.3(b)-1, *reprinted* at *62 Fed. Reg. 16,060* (Apr. 4, 1997) .

(n25)Footnote 25. *See* Jafri v. Lynch Ford, Clearinghouse No. 53,536 (N.D. Ill. Aug. 25, 2000).

(n26)Footnote 26. *Dauti v. Hartford Auto Plaza, Ltd., 2001 U.S. Dist. LEXIS 1953* (Feb. 16, 2001) , *judgment entered, 213 F. Supp. 2d 116 (D. Conn. 2002)* .

(n27)Footnote 27. *Cal. Civ. Code § 2985.8* (amended by 1998 Cal. Laws ch. 800, compliance mandatory as of Mar. 1, 1998) (unique and detailed requirements).

(n28)Footnote 28. Colo. Rev. Stat. §§ 5-2-311/-/313 (similar requirements as Old Regulation M).

(n29)Footnote 29. *Conn. Gen. Stat. § 42-390* (effective July 1, 2003).

(n30)Footnote 30. *D.C. Code Ann. § 28-3810* (minimal disclosure requirements).

(n31)Footnote 31. Fla. Stat. § 521 (as amended by *1998 Senate Bill 1366,* effective July 1, 1998) (similar disclosures to *New* Regulation M).

(n32)Footnote 32. Haw. Rev. Stat. § 481L (14 point bold type disclosure of specified language, requirements as to non-English disclosures, and trade-ins).

(n33)Footnote 33. 815 Ill. Comp. Stat. Ann. § 636 (effective Jan. 1, 1997) (similar disclosures to *New* Regulation M).

(n34)Footnote 34. *Ind. Code §§ 9-23-2.5-1* (as amended by 1998 Indiana Laws 467, effective July 1, 1998), 24-4.5-2-101 (same as *New* Regulation M).

(n35)Footnote 35. *Iowa Code § 537.1101* (similar to Old Regulation M).

(n36)Footnote 36. *Kan. Stat. Ann. § 16a-1-101* (administrator adopts regulations specifying disclosures; presently regulations consistent with Old Regulation M).

(n37)Footnote 37. La. Rev. Code § 9:3301 (places substantive limits on lease charges).

(n38)Footnote 38. Me. Rev. Stat. Ann. tit. 9A, § 5-101 (similar to Old Regulation except requirement for capitalized cost disclosure); Maine Consumer Credit Code Regulation Z-2, Rule 240 (adopts Regulation M).

(n39)Footnote 39. *Md. Code Ann., Com. Law § 14-2001* (CLA disclosure requirements, and disclosure of capitalized cost).

(n40)Footnote 40. *Mich. Comp. Laws § 445.991* (requiring notice of early termination balance only).

(n41)Footnote 41. N.H. Rev. Stat. Ann. ch. 361-D (disclosures similar to the new Regulation).

(n42)Footnote 42. *N.J. Rev. Stat. § 56:12-60* (names and addresses of parties, date of execution, certain additional disclosures for purchase options, mileage limitations, availability of GAP insurance, and similar disclosures to those found under the New Regulation).

(n43)Footnote 43. *N.Y. Pers. Prop. Law § 331* (CLA disclosures plus extensive additional disclosures concerning early termination, capitalized cost, and other terms).

(n44)Footnote 44. *Okla. Stat. Ann. tit. 14A, § 1-101* (similar to Old Regulation M).

(n45)Footnote 45. *S.C. Code Ann. § 37-1-101* (same as CLA requirements).

(n46)Footnote 46. *Wash. Rev. Code § 63.10.010* (as amended by 1998 H.B. 2680, effective June 11, 1998) (similar to *New* Regulation M).

(n47)Footnote 47. *W. Va. Code § 46A-1-104* (similar to Old Regulation M).

(n48)Footnote 48. *Wis. Stat. §§ 429.101* (as amended by 1997 Wis. Laws 48, effective Jan. 12, 1998) (similar to the *New* Regulation), 429.101.

(n49)Footnote 49. *See, e.g., Cal. Civ. Code § 2985.7(a)* (no dollar limit); Fla. Stat. § 521 (no dollar limit); Haw. Rev. Stat. § 481L (no dollar limit); *Ind. Code § 9-23-2.5-1* (no dollar limit); *Ind. Code § 24-4.5-2-101* ($50,000,

adjusted up for inflation); *Md. Code Ann., Com. Law § 14-2001* (applies to vehicle leases that have purchase option at least as high as 20% of vehicle's initial purchase option); *Mich. Comp. Laws § 445.991* (requiring notice of early termination balance only) (no dollar limit); N.H. Rev. Stat. Ann. ch. 361-D (no dollar limit); *N.J. Rev. Stat. § 56:12-60* (no dollar limit); *N.Y. Pers. Prop. Law § 331* (no dollar limit); *Okla. Stat. Ann. tit. 14A, § 1-101* ($45,000 limit); *S.C. Code Ann. § 37-1-101* ($62,500 limit); *W. Va. Code § 46A-1-101* ($45,000 limit).

(n50)Footnote 50. Haw. Rev. Stat. § 481L (4 years).

(n51)Footnote 51. *Id.*

(n52)Footnote 52. Reg. M, *12 C.F.R. § 213.4(g)(1)*. Under the New Regulation, this provision is unchanged, except that it has been renumbered § 213.4(a), instead of § 213.4(g)(1).

(n53)Footnote 53. Reg. M, *12 C.F.R. § 213.4(g)(1)*.

(n54)Footnote 54. Reg. M, 12 C.F.R. § 213 apps. C-1, C-2.

(n55)Footnote 55. Reg. M, 12 C.F.R. § 213 app. C-3.

(n56)Footnote 56. *Cf.* National Consumer Law Center, Repossessions § 3.2.7.1 (6th ed. 2005) (collateral not sufficiently described for purposes of Uniform Commercial Code [hereinafter U.C.C.] Article 9 where identification number incorrect).

(n57)Footnote 57. Reg. M, *12 C.F.R. § 213.4(g)(2)*.

(n58)Footnote 58. Reg. M, *12 C.F.R. § 213.4(g)(2)*; Official Staff Commentary § 213.4(g)(2)-1.

(n59)Footnote 59. Official Staff Commentary § 213.2(b)-2.

(n60)Footnote 60. *See Taylor v. United Mgmt., Inc., 51 F. Supp. 2d 1212 (D.N.M 1999)* ; *Cummings v. Warren Henry Motors, Inc., 648 So. 2d 1230 (Fla. Dist. Ct. App. 1995)* .

(n61)Footnote 61. *See Dauti v. Hartford Auto Plaza, Ltd., 213 F. Supp. 2d 116 (D. Conn. 2002)* (no violation where dealer agreed to accept $3000 instead of the disclosed $3045.15); *Hildabrand v. Difeo P'ship, Inc., 89 F. Supp. 2d 202 (D. Conn. 2000)* (where consumer seeks waiver of some of the amount due at lease inception, lessor's agreement to do so does not make the prior disclosed amount inaccurate or lead to a CLA violation).

(n62)Footnote 62. Reg. M, *12 C.F.R. § 213.4(g)(3)*. Under the new law, this provision is unchanged except that the Regulation has been renumbered *§ 213.4(c)* from § 213.4(g)(3). The new model forms provide sample language.

(n63)Footnote 63. Reg. M, *12 C.F.R. § 213.3(a)(2)*.

(n64)Footnote 64. *See* Reg. M, app. A.

(n65)Footnote 65. Reg. M, *12 C.F.R. § 213.4(g)(4)*. Under the new law, this provision is unchanged, except that the New Regulation has been renumbered *§ 213.4(n)* from § 213.4(g)(4), and except for certain stylistic changes.

(n66)Footnote 66. The estimate must not be used to evade or circumvent the Act's disclosure requirements. Reg. M, *12 C.F.R. § 213.4(d)*.

(n67)Footnote 67. *Thomka v. A.Z. Chevrolet, Inc., 619 F.2d 246 (3d Cir. 1980)* .

(n68)Footnote 68. Official Staff Commentary § 213.4(n)-1.

(n69)Footnote 69. See Official Staff Commentary § 213.4(n)-1(ii). This provision previously was unclear, and one interpretation indicated that such taxes were not included in the total of taxes and fees. This was not clarified as incorrect until late 1998, effective October 1, 1999. *See 63 Fed. Reg. 67,434* (Dec. 7, 1998) . At least one court has indicated that reliance on the old interpretation is appropriate for leases made prior to October 1, 1999. *See McPhillips v. Gold Key Lease, Inc., 38 F. Supp. 2d 975 (M.D. Ala. 1999)* .

(n70)Footnote 70. Reg. M, *12 C.F.R. § 213.4(g)(5)*.

(n71)Footnote 71. Official Staff Commentary § 213.4(g)(5)-3. This provision is unchanged except that the New Regulation has been renumbered *§ 213.4(d)* from § 213.4(g)(5), and except for minor technical wording clarifications.

(n72)Footnote 72. *Abt v. Mazda Am. Credit, 25 F. Supp. 2d 860 (N.D. Ill. 1998)* .

(n73)Footnote 73. Reg. M, *12 C.F.R. § 213.4(g)(6)*. Under the new law, the provision is unchanged except that the Regulation has been renumbered *§ 213.4(o)* from § 213.4(g)(6), and except for certain stylistic changes.

(n74)Footnote 74. Reg. M, *12 C.F.R. § 213.4(g)(7)*. Under the new law, this provision is unchanged except that the Regulation has been renumbered *§ 213.4(p)* from § 213.4(g)(7), and except for stylistic changes.

(n75)Footnote 75. Official Staff Commentary § 213.4(g)(7)-2.

(n76)Footnote 76. Reg. M, *12 C.F.R. § 213.4(g)(8)*.

(n77)Footnote 77. *12 C.F.R. § 213.4(h)(3), reprinted in 61 Fed. Reg. 52,260* (Oct. 7, 1996) .

(n78)Footnote 78. *12 C.F.R. § 213.4(h)(2), reprinted in 61 Fed. Reg. 52,260* (Oct. 7, 1996) .

(n79)Footnote 79. *See, e.g., Howell v. Midway Holdings, Inc., 362 F. Supp. 2d 1158 (D. Ariz. 2005)* .

(n80)Footnote 80. Reg. M, *12 C.F.R. § 213.4(g)(9)*. Under the new law, this provision is unchanged except that the New Regulation is renumbered *§ 213.4(r)* from § 213.4(g)(9), and except for stylistic changes.

(n81)Footnote 81. Official Staff Commentary § 213.2(*o*)-2. *See* National Consumer Law Center, Repossessions Ch. 14 (6th ed. 2005) for a discussion of the distinction between a lease and a sale under the U.C.C.).

(n82)Footnote 82. Reg. M, *12 C.F.R. § 213.4(g)(10)*.

(n83)Footnote 83. Official Staff Commentary § 213.4(g)(10)-5.

(n84)Footnote 84. Reg. M, *12 C.F.R. § 213.4(g)(11)*; *see also Rentacolor, Inc., 103 F.T.C. 400 (1984)* . Under the new law, this provision is renumbered § 213.4(i), from § 213.4(g)(11). The provision remains unchanged except for stylistic improvements.

(n85)Footnote 85. Official Staff Commentary § 213.4(g)(11)-1.

(n86)Footnote 86. Official Staff Commentary § 213.4(i)-3, *reprinted at 62 Fed. Reg. 16,062* (Apr. 4, 1997) .

(n87)Footnote 87. *Demitropoulos v. Bank One Milwaukee, N.A., 924 F. Supp. 894 (N.D. Ill. 1996)* ; *Werbosky v. Ford Motor Credit Co., 1996 U.S. Dist. LEXIS 1816* (S.D.N.Y. Feb. 22, 1996) .

(n88)Footnote 88. *See Turner v. GMAC, 180 F.3d 451 (2d Cir. 1999)* ; *Personal Fin. Servs., Inc. v. GMAC, 169 F. Supp. 2d 49 (D. Conn. 2001)* ; *Martin v. Gold Key Lease, Inc., 988 F. Supp. 1101 (N.D. Ill. 1998)* ; *Steinmetz v. Toyota Motor Credit Co., 963 F. Supp. 1294 (E.D.N.Y. 1997)* ; *Doe v. GMAC, 635 N.W.2d 7, 45 U.C.C. Rep. Serv. 2d 1162 (Wis. Ct. App. 2001)* ; *Rosen v. PRIMUS Auto. Fin. Servs., 618 N.W.2d 606, 42 U.C.C. Rep. Serv. 2d 1163 (Minn. Ct.*

App. 2000) , *rev. denied, 2001 Minn. LEXIS 52* (Minn. Jan. 26, 2001) ; *Dolan v. GMAC, 739 N.E.2d 848 (Ohio Ct. App. 2000)* .

(n89)Footnote 89. *See* 815 Ill. Comp. Stat. 165/1-5 (lessor must post a bond or place deposits in a separate account with any interest going to the lessee); *N.Y. Gen. Oblig. Law § 7-101* (security deposit must be placed in separate account with any interest belonging to the lessee; provision waiving this right is void); *W. Va. Code § 45-1-7* (applies only to non-resident lessors).

(n90)Footnote 90. *See Brooks v. General Motors Acceptance Corp., 1998 U.S. Dist. LEXIS 3102* (N.D. Ill. Mar. 16, 1998) (after dismissing CLA claims, federal court agreed to consider and reject state UDAP claim, but decided not to consider claim under state statute dealing with lease security deposits). *See also Turner v. General Motors Acceptance Co., 980 F. Supp. 737 (S.D.N.Y. 1997)* , *aff'd on other grounds, 180 F.3d 451 (2d Cir. 1999)* (after dismissing federal claim, declining to rule on state claims).

(n91)Footnote 91. *N.Y. Gen. Oblig. Law § 7-101.*

(n92)Footnote 92. *Werbosky v. Ford Motor Credit Co., 998 U.S. Dist. LEXIS 4174* (S.D.N.Y. April 1, 1998) (also finding that Ford complied with the "spirit" of the statute by calculating total deposits received and putting that amount, not consumers' actual deposits, in an account).

(n93)Footnote 93. Reg. M, *12 C.F.R. § 213.4(k).*

(n94)Footnote 94. Reg. M, *12 C.F.R. § 213.4(g)(14).* Some state laws require disclosure of the right to an appraisal where the consumer is only liable for excess wear and tear on the vehicle. *See* N.J. Rev. Stat. § 56-12-67.

(n95)Footnote 95. For a more extensive discussion of this section, see National Consumer Law Center, Truth in Lending § 10.3.6.7 (5th ed. 2003 and supp.).

(n96)Footnote 96. *Hildebrand v. Difeo P'ship, Inc., 89 F. Supp. 2d 202 (D. Conn. 2000)* .

(n97)Footnote 97. *12 C.F.R. § 213.4(e), reprinted in 61 Fed. Reg. 52,259* (Oct. 7, 1996) .

(n98)Footnote 98. *12 C.F.R. § 213.4(g)(15)(i).*

(n99)Footnote 99. *12 C.F.R. § 213.2(a)(17). See also* Official Staff Commentary §§ 213.4(g)(15)-2, 213.4(g)(15)-3.

(n100)Footnote 100. Reg. M, *12 C.F.R. § 213.4(g)(15)(ii).*

(n101)Footnote 101. Reg. M, *12 C.F.R. § 213.4(g)(15)(ii).*

(n102)Footnote 102. Reg. M, *12 C.F.R. § 213.4(g)(15)(iii).*

(n103)Footnote 103. Reg. M, *12 C.F.R. § 213.4(m)(i).*

(n104)Footnote 104. Reg. M, *12 C.F.R. § 213.3(a)(2).*

(n105)Footnote 105. Reg. M, *12 C.F.R. § 213.4(g)(12).*

(n106)Footnote 106. Reg. M, *12 C.F.R. § 213.4(g)(10).* In addition to the CLA's disclosure requirement for early termination charges, a number of states have their own requirements. Perhaps the most important is the Arkansas statute that requires disclosure of actual dollar charges at 12 month intervals. 1999 Ark. Acts 1059.

(n107)Footnote 107. *See § 3.05 infra*; *see also* Official Staff Commentary § 213.4(g)(12)-3. One case has indicated

that an unreasonable, but clearly disclosed, early termination formula would not involve a disclosure violation, but only a violation of the substantive requirement that the formula be reasonable. *See Highsmith v. Chrysler Credit Corp., 150 B.R. 997 (Bankr. N.D. Ill. 1993)* , *aff'd in part and rev'd in part on other grounds, 18 F.3d 434 (7th Cir. 1994)* .

(n108)Footnote 108. *See Jordan v. Schaumburg Toyota, 1999 U.S. Dist. LEXIS 2553* (N.D. Ill. Feb. 24, 1999) ; Nix v. Advance Leasing & Rent-a-Car, Inc., Clearinghouse No. 49,946 (N.D. Ga. Nov. 30, 1993).

(n109)Footnote 109. *Miller v. Nissan Motor Acceptance Corp., 2000 U.S. Dist. LEXIS 15645* (E.D. Pa. Oct. 27, 2000) , *appeal dismissed, remanded, without op., 275 F.3d 36 (3d Cir. 2001)* .

(n110)Footnote 110. Official Staff Commentary § 213.4(g)(12)-1.

(n111)Footnote 111. *15 U.S.C. § 1667b(b).*

(n112)Footnote 112. For a more extensive analysis, see National Consumer Law Center, Truth in Lending § 10.3.6.8 (6th ed. 2007 and Supp.).

(n113)Footnote 113. *See, e.g., Applebaum v. Nissan Motor Acceptance Corp., 226 F.3d 214 (3d Cir. 2000)* ; Nix v. Advance Leasing & Rent-a-Car, Inc., Clearinghouse No. 49,946 (N.D. Ga. Nov. 30, 1993); McCarthy v. PNC Credit Corp., Clearinghouse No., 47,959 (D. Conn. 1992). *But see Wiskup v. Liberty Buick Co., 1996 U.S. Dist. LEXIS 390* (N.D. Ill. Jan. 17, 1996) (Regulation M does not require disclosure of residual value; court appears not to understand that disclosure of residual value is necessary in the lease at issue so that the consumer can compute the early termination charge). Note that the 1996 amendments to Reg. M have now imposed a requirement that the residual value be disclosed in motor vehicle leases.

(n114)Footnote 114. Johnson v. Steven Sims Subaru, Inc., Clearinghouse No. 49,951 (N.D. Ill. Aug. 20, 1993). *See also Thomka v. A.Z. Chevrolet, Inc., 619 F.2d 246 (3d Cir. 1980)* (CLA violation to require a consumer to interpolate information from various paragraphs).

(n115)Footnote 115. A federal court recently has found a disclosure to violate the CLA because it contained too many concepts piled into a single paragraph and because the whole disclosure was obscure and convoluted. *Clement v. American Honda Fin. Corp., 145 F. Supp. 2d 206 (D. Conn. 2001) . But see Jordan v. Toyota Motor Credit Corp., 236 F.3d 866* (7th Cir.) , *cert. denied, 533 U.S. 902 (2001)* . The Commentary provides guidance on this issue:

> Section 213.4(g)(1) requires a full description of the method of determining an early termination charge. The lessor should attempt to provide consumers with clear and understandable descriptions of its early termination charges. Descriptions that are full, accurate, and not intended to be misleading will comply with § 213.4(g)(1), even if the descriptions are complex.

Official Staff Commentary § 213.4(g)-2.

(n116)Footnote 116. *See Candelaria v. Nissan Motor Acceptance Corp., 740 F. Supp. 806 (D.N.M. 1990)* .

(n117)Footnote 117. *See Candelaria v. Nissan Motor Acceptance Corp., 740 F. Supp. 806 (D.N.M. 1990)* .

(n118)Footnote 118. Lundquist v. Sec. Pac. Auto. Fin. Servs. Corp., Clearinghouse No. 47,956 (D. Conn. June, 9 1992) (opinion concerning motion to dismiss).

(n119)Footnote 119. *Highsmith v. Chrysler Credit Corp., 18 F.3d 434 (7th Cir. 1994)* . The Seventh Circuit has recently reaffirmed this decision, holding that it is a CLA violation to disclose one early termination charge and use a different one, even if the actual charge is smaller than the disclosed charge. *Channell v. Citicorp Services, Inc. 89 F.3d 379* (7th Cir.) , *reh'g, en banc, denied, 1996 U.S. App. LEXIS 20256* (7th Cir. Aug. 9, 1996) , *on remand, complaint*

dismissed sub nom., 1996 U.S. Dist. LEXIS (N.D. Ill. Sept. 27, 1996). *See also Miller v. Nissan Motor Acceptance Corp., 2000 U.S. Dist. LEXIS 15645* (E.D. Pa. Oct. 27, 2000) , *appeal dismissed, remanded, without op., 275 F.3d 36 (3d Cir. 2001)* ; McCarthy v. PNC Credit Corp., Clearinghouse No. 47,959 (D. Conn. 1992).

(n120)Footnote 120. *Miller v. Nissan Motor Acceptance Corp., 2000 U.S. Dist. LEXIS 15645* (E.D. Pa. Oct. 27, 2000) , *appeal dismissed, remanded, without op., 275 F.3d 36 (3d Cir. 2001)* .

(n121)Footnote 121. *See § 3.03[2] supra*.

(n122)Footnote 122. *See § 3.03[2][d] supra*.

(n123)Footnote 123. *See § 3.03[2][g] supra*.

(n124)Footnote 124. *Clement v. American Honda Fin. Corp., 145 F. Supp. 2d 206 (D. Conn. 2001)* .

(n125)Footnote 125. *See § 3.03[2][e], [h] supra*.

(n126)Footnote 126. *See § 3.03[2][k] supra*.

(n127)Footnote 127. *See § 3.03[2][r] supra*.

(n128)Footnote 128. *Applebaum v. Nissan Motor Acceptance Corp., 226 F.3d 214 (3d Cir. 2000)* .

(n129)Footnote 129. *Applebaum v. Nissan Motor Acceptance Corp., 226 F.3d 214 (3d Cir. 2000)* .

(n130)Footnote 130. *Applebaum v. Nissan Motor Acceptance Corp., 226 F.3d 214, 220 (3d Cir. 2000)* .

(n131)Footnote 131. *Applebaum v. Nissan Motor Acceptance Corp., 226 F.3d 214* , *cert. denied, 533 U.S. 929 (2001)* .

(n132)Footnote 132. *See § 3.03[2][r] supra*.

(n133)Footnote 133. *See Highsmith v. Chrysler Credit Corp., 18 F.3d 434 (7th Cir. 1994)* .

(n134)Footnote 134. *66 Fed. Reg. 17,322* (Mar. 30, 2001) .

(n135)Footnote 135. *72 Fed. Reg. 63,456* (Nov. 9, 2007) .

(n136)Footnote 136. *72 Fed. Reg. 63,461* (Nov. 9, 2007) , *amending* Reg. M. § 213.3(a).

(n137)Footnote 137. *See § 3.03[2] supra*.

(n138)Footnote 138. *15 U.S.C. § 1667d(a)*.

(n139)Footnote 139. *See 15 U.S.C. § 1640(a)*.

(n140)Footnote 140. *See* Nix v. Advance Leasing & Rent-a-Car, Inc., Clearinghouse No. 49,946 (N.D. Ga. Nov. 30, 1993) (disclosure violation need not actually mislead the lessee); *Kedziora v. Citicorp Nat'l Servs., Inc., 780 F. Supp. 516 (N.D. Ill. 1991)* (although action for unreasonable termination formula may require actual damages, claim based on disclosure violations does not). *See also* Simon v. World Omni Leasing, Inc., Clearinghouse No. 47,958 (S.D. Ala. July 13, 1992) (rulings on motion to dismiss). For more discussion of remedy issues, see *§§ 3.05[4], 3.06 infra* .

(n141)Footnote 141. *Higginbotham v. Ford Motor Credit Co., 270 Fed. Appx. 864 (11th Cir. 2008)* .

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 3 The Consumer Leasing Act and Automobile Leases

1-3 Consumer Credit Law Manual § 3.04

§ 3.04 Required Advertising Disclosures

Unlike TIL, the CLA provides private remedies for advertising disclosure violations, but only where the consumer "suffers actual damages from the violation." n1

Under the New Regulation, the CLA advertising requirements apply to any "advertisement for a consumer lease." n2 Regulation M and its Commentary broadly define advertising to include: any commercial message in any newspaper, magazine, leaflet, flyer, catalog, on radio, television or public address system, in direct mail literature or other printed material on any interior or exterior sign or display, in any window display, in any point-of-transaction literature or price tag which is delivered or made available to a lessee or prospective lessee in any manner whatsoever. n3

The CLA advertising requirements specify the disclosure of certain items discussed below whenever the advertisement indicates the amount of any payment or down payment (or the lack of a down payment) n4 or a statement of any capitalized cost reduction or other payment required prior to or at consummation or delivery. n5

The items that must be disclosed pursuant to the statute are listed below. These terms may be disclosed by way of an example of one or more typical leases. Note that the following is a list of requirements under the New Regulation which made significant changes to the previous advertising requirements: n6

1. That the transaction is a lease;

2. The amount of any payment required at the lease inception, including amounts due at delivery if delivery occurs after consummation; n7

3. The number, amounts, due dates or periods of scheduled payments under the lease; n8

4. For an open-end lease, a short statement that an additional charge may be imposed at the end of the lease term;

5. Whether or not a security deposit is required.

Advertising disclosures must be clear and conspicuous. n9 The new regulation provides two specific requirements as to clear and conspicuous advertising. First, no component of the total due at lease signing or delivery shall be more prominent than the total amount due at lease signing or delivery. For example, a statement that no capitalized cost reduction is required cannot be more conspicuous than the amount due at lease signing.

Second, a lease *rate* disclosure in advertising cannot be more conspicuous than any other required disclosure term. In addition, the lessor cannot use "annual percentage rate," "annual lease rate," or equivalent term. n10

In addition, there are special rules for radio advertising. n11

A lessor's failure to comply with the CLA's advertising requirements triggers a private remedy only where the consumer "suffers actual damage from the violation." n12 But if there is actual damage, the lessor is liable for *any* advertising violation. n13

Recently, the Federal Trade Commission has been bringing actions against dealerships for their lease advertising, alleging that advertising disclosures were in too fine a print, that they were otherwise inadequately conspicuous, and that required disclosures were not made. n14

The Federal Trade Commission has issued final consent orders covering five major automobile manufacturers' lease advertising practices. The consent orders apply to Honda, Isuzu, General Motors, Mazda, and Mitsubishi. n15 (State attorneys general in twenty-three states have entered similar agreements with four of the manufacturers. n16 Regulation M was amended in 2007 to adopt final rules concerning electronic advertising, with compliance mandatory October 1, 2008. n17 Electronic advertising (such as an advertisement appearing on a website) that provides a table or schedule of the required disclosures shall be considered a single advertisement if, for lease terms that appear without all the required disclosures, the advertisement refers to the page on which the table or schedule appears. n18 Some additional detail is provided by an amended Commentary on this point. n19

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionConsumer LeasingDisclosure

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1667d(b). See also* 1976 U.S.C.C.A.N. 447 ("[A]llowing persons affected by the false advertising to bring suit would add a vital watch dog enforcement provision.").

(n2)Footnote 2. *15 U.S.C. § 1667c(a), amended by* The Omnibus Consolidated Appropriations Act of 1996 § 2605(c), Pub. L. No. 104-208 (Sept. 30, 1996).

(n3)Footnote 3. Reg. M, *12 C.F.R. § 213.2(a)(2).*

(n4)Footnote 4. *See* Omnibus Consolidated Appropriations Act of 1996 § 2605(c), Pub. L. No. 104-208 (Sept. 30, 1996). Note that the New Regulation amended the old CLA advertising provision, which was also triggered by a statement of the number of required payments.

(n5)Footnote 5. Reg. M, *12 C.F.R. § 213.7(d)(1)(ii).*

(n6)Footnote 6. *See* Omnibus Consolidated Appropriations Act of 1996 § 2605(c), Pub. L. No. 104-208 (Sept. 30, 1996).

(n7)Footnote 7. *See also Rentacolor, Inc., 103 F.T.C. 400 (1984)* (failure to disclose installation charge).

(n8)Footnote 8. *See also Rentacolor, Inc., 103 F.T.C. 400 (1984)* (failure to disclose monthly payment). Disclosure of the periodic payment may exclude third party fees such as taxes, licenses and registration fees, as long as the fact of the exclusion is disclosed. Alternatively, the lessor can provide a periodic payment amount that includes these fees based on the amount a particular state or locality will charge, as long as that fact and the fact that fees may vary are disclosed. Official Staff Commentary § 213.7(d)(2)-1, *amended by 64 Fed. Reg. 16,614* (Apr. 6, 1999) (effective Mar. 31, 1999; compliance optional until Mar. 31, 2000).

(n9)Footnote 9. Reg. M, *12 C.F.R. § 213.5(c). But see* Official Staff Commentary § 213.5(c)-1 (no specific type size or location requirements). A new § 213.7(b) requires that advertising be clear and conspicuous, and provides two specific requirements as to clear and conspicuous advertising. *See 12 C.F.R. § 213.7(b), as amended by 62 Fed. Reg. 15,368* (Apr. 1, 1997) ; Official Staff Commentary § 213.7(b)(1)-2, *reprinted at 62 Fed. Reg. 16,063* (Apr. 4, 1997) .

(n10)Footnote 10. Further restrictions on lease rate disclosures concerning the location of the statement accompanying the rate are found at Official Staff Commentary § 213.7(b)(2)-1, *reprinted at 62 Fed. Reg. 16,063* (Apr. 4, 1997) .

(n11)Footnote 11. *15 U.S.C. § 1667c(b)(1)*. Section 213.7(f) is a new section on radio and television advertising.

(n12)Footnote 12. *15 U.S.C. § 1667d(b)*.

(n13)Footnote 13. *See 15 U.S.C. § 1640(a)*.

(n14)Footnote 14. *See* Dumphy Nissan, Inc., FTC File C 3924 (Feb. 11, 2000) (consent order); Norristown Automobile Co., FTC File C-3925 (Feb. 11, 2000) (consent order); NORTHEAST Auto Outlet, Inc., FTC File C-3922 (Feb. 11, 2000) (consent order); Pacifico Ardmore, Inc., FTC File C-3920 (Feb. 11, 2000) (consent order); Marty Sussman Organization, Inc., FTC File C-3923 (Feb. 11, 2000) (consent order); Pacifico Ford Inc., FTC File C-3921 (Feb. 11, 2000) (consent order); Simmons Rockwell Ford Mercury, Inc., FTC File 992, 3247 (April 27, 2000) (proposed consent order); R.N. Motors, Inc., FTC File 992, 3246 (April 27, 2000) (proposed consent order). All these FTC actions and the accompanying complaints are available at www.ftc.gov, and by going to Commissions on the relevant date.

(n15)Footnote 15. *See 62 Fed. Reg. 17,829, 17,930* (Apr. 11, 1997) . *See also 61 Fed. Reg. 64,524* (Dec. 5, 1996) .

(n16)Footnote 16. *See* Consumer Cred. Guide (CCH) Report 749 p.5 (1996).

(n17)Footnote 17. *72 Fed. Reg. 63,456* (Nov. 9, 2007) .

(n18)Footnote 18. *72 Fed. Reg. 63,461* (Nov. 9, 2007) , *amending* Reg. M. § 213.7(c).

(n19)Footnote 19. *72 Fed. Reg. 63,462* (Nov. 9, 2007) , *amending* Official Staff Commentary § 213.7(c)-2.

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PART I Consumer Credit
CHAPTER 3 The Consumer Leasing Act and Automobile Leases

1-3 Consumer Credit Law Manual § 3.05

§ 3.05 Early Termination and Default Penalties

The most common consumer problem with automobile leases is the threat or actual assessment of large early termination and default penalties.

[1] Applicable Laws

[a] Consumer Leasing Act

The consumer's major challenge to unreasonable early termination and default provisions will usually be under the CLA. n1

Where the CLA is violated, the consumer recovers $1,000 statutory damages *plus* actual damages *plus* attorney fees. n2 Since actual damages may equal all or much of the sought deficiency, and since a CLA violation automatically leads to $1,000 statutory damages in addition to the actual damages, a consumer defending a collection action to recover an early termination penalty may even be able to obtain a *net positive recovery* plus attorney fees.

Another important aspect of the CLA is that it requires clear and conspicuous disclosure of early termination charges. n3 To the extent that a formula is not clearly disclosed, even if it is reasonable, the consumer may have suffered actual damages because the consumer would not have entered into the lease knowing the extent of the early termination liability. The CLA would then provide an action for actual and statutory damages and attorney fees.

[b] UCC Article 2A and Common Law Contract Principles

Although the CLA's early termination provision is derived from UCC Article 2 on sales, lease early termination provisions today are governed by UCC Article 2A on leases, which has now been adopted by most states. *UCC section 2A-504* allows liquidated damages clauses only in an amount "reasonable in light of the then anticipated harm caused by the default or other act or omission." UCC Article 2A (the applicable state law on leasing in most states) limits a lessor's early termination remedies, where the lease's liquidated damages clause is not reasonable, to the default damages as provided in *UCC section 2A-528*. n4 *UCC section 2A-528* states that the lessor's damages are the *present value* (as of the date of default) of the difference between the remaining lease payments and the market rent for those payments if the lessor re-rented the property. In addition, the lessor can recover incidental damages less expenses saved in

consequence of the default. n5

In states not enacting UCC Article 2A, courts are likely to adopt the UCC Article 2 and common law approach to unreasonable liquidated damages clauses: they are void as a penalty, n6 forcing the lessor to prove in court its actual damages. In one case, the consumer argued that the court should use as statutory damages for an unreasonable early termination charge the statutory damages specified in *UCC § 2A-504(3)*. The federal court had little trouble pointing out that this Article 2A provision only applied where the lessor withholds or stops delivery of the goods to the lessee. n7

[c] State Leasing Statutes

Several states have enacted specific leasing statutes that set out early termination and default standards, that provide disclosure requirements not found in the CLA, or that are otherwise useful supplements to the CLA. n8 Connecticut has recently enacted the Uniform Consumer Leasing Act, n9 that provides minimal protections for consumers. No early termination charges can be assessed in certain cases where the vehicle is a total loss and an insurance claim is paid; the early termination charge cannot exceed the remaining lease payments.

[d] State Deceptive Practices Legislation

UDAP statutes provide an effective remedy to challenge not only unfair lease terms, but other aspects of the lease transaction, including the lessor's oral misrepresentations. n10

[e] Other Theories in the Nature of Fraud

Particularly where a dealer or lessor's actions involve intent and scienter, other theories in the nature of fraud are also available to challenge deceptive practices. This includes state and federal RICO claims, n11 common law fraud, n12 civil theft, n13 and conversion claims. n14

[f] Unconscionability

UCC Article 2A's unconscionability provision may be helpful in dealing with unreasonable early termination formulas. In an unconscionability challenge, consumer attorneys should demonstrate the substantive unconscionability of the default provisions. They should also point out procedural unconscionability--obtuse, technical language, small print, standard form, take it or leave it nature of the contract, lack of bargaining, unequal resources, important terms are undefined or found in other provisions of the lease, and the like. n15

[2] Early Termination Charges Based on an Adjusted Lease Balance

As described in the prior subsection, the CLA, UCC Article 2A, state leasing legislation, deceptive practices statutes, unconscionability concepts, and other theories provide ample grounds to challenge unreasonable early termination and default charges. The important analysis is when an early termination or default charge is unreasonable. There are different methods to determine whether a charge is substantively unreasonable, including the adjusted lease balance method, formulas based on repayment of remaining lease payments, inadequate rebate of unearned lease charges, and inadequate credit for car's increased value at early termination. n16

In general, the adjusted lease balance method for determining early termination charges assesses the consumer for the difference between an adjusted lease balance and the car's value at early termination. An adjusted lease balance is the amount the lessor has invested in a vehicle at any point in the lease. It is the initial cost of the car, less those portions of lease payments that have been made and that are allocated to the car's depreciation.

In challenging the reasonableness of an adjusted lease balance formula, the first step is to determine whether the lease utilizes a reasonable method to compute the adjusted lease balance. If an adjusted lease balance is in fact greater than

the lessor's investment in the transaction at that point in time, then a charge based on the difference between the adjusted lease balance and the car's value will produce an unreasonable windfall for the lessor. The two major issues in determining the reasonableness of an adjusted lease balance are the size of the initial lease balance and the size of the residual value. n17 A residual value is a car's estimated value at scheduled termination, and the Consumer Leasing Act requires that this term be disclosed in leases. n18 The easiest way to determine the reasonableness of a residual value is to refer to one of the standard industry automotive guides that provide the residual value, such as the *Black Book Official Residual Value Guide*, which provides residual values for each make and model after two, three, four, and five years.

The other point in challenging the reasonableness is the method and result used to determine the vehicle's value at early termination. If the vehicle's value is based on a commercially unreasonable sale, this makes the early termination charge unreasonable.

A lessee's early termination liability formula is clearly unreasonable where the formula charges the consumer for the vehicle's residual value or the adjusted lease balance, but fails to provide a credit for the vehicle's realized value. n19 This is the case even where the lessor has a practice of crediting the consumer for that value--if the formula does not contain such a provision, the formula is unreasonable. n20

[3] Early Termination Charges Based on the Remaining Payments

Most early termination formulas not based on an adjusted lease balance method are based in some fashion on charging the consumer for the remaining monthly payments plus the residual value (the car's expected value at the end of the lease), less unearned lease charges and less the car's value at early termination. It is widely accepted now that an early termination formula is unreasonable if the consumer must pay all remaining lease payments with no rebate for unearned lease charges. n21 The issue in most cases then is whether the lessor has provided an adequate rebate. As with the prior section, another key issue is whether the vehicle's value at early termination is reasonably calculated.

[4] Remedies: Unreasonable Early Termination Penalties

The CLA specifies that anyone failing to comply with the provisions dealing with lessee's liability on expiration or termination of the lease is liable to the consumer as specified by the TIL remedy section (*15 U.S.C. section 1640*). n22 Unlike TIL, *any* CLA violation leads to statutory damages. n23

Consequently, there should be no question that a lessor's attempt to enforce an unreasonable penalty against a lessor automatically leads to private remedies. Nevertheless, there is much confusion concerning a consumer's ability to challenge an unreasonable early termination penalty where the consumer has not in fact defaulted or terminated early or where a particular part of the early termination formula would not apply to the consumer.

One approach looks at the literal language of the statute as indicating that the mere inclusion of an unreasonable penalty in a lease is a violation, and that any violation triggers remedies. Under this approach, remedies are triggered even if the client has not terminated early and there is no deficiency being assessed, as long as the default formula is unreasonable. n24 In effect, the statute provides consumers with standing to challenge an unreasonable early termination formula, even if the formula would have no adverse impact on the plaintiff. n25

Nevertheless, several federal courts have reached the opposite conclusion, requiring a consumer to independently establish standing to raise the unreasonableness of an early termination formula. n26 Courts that require potential consumer injury to establish an Article III case or controversy standing will generally require that the early termination formula be unreasonable as applied to the situation of the particular plaintiff. n27

A recent Third Circuit decision is an example of a case where standing is not found. The lessor did not use the formula

stated in the lease to compute early termination charges, but instead used another formula that the court found reasonable in the circumstances. The Third Circuit found the consumer had no standing to challenge the formula stated in the lease because it was not applied to the consumer. n28

The same provision that requires early termination charges to be reasonable also requires that charges for delinquency be reasonable. Despite lessor arguments to the contrary, this applies to late payment charges as well. There is no basis to distinguish the reasonableness of late payment charges from delinquency charges. n29 There is no meaningful distinction between the two terms, and Congress intended none. n30

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionConsumer LeasingLiability

FOOTNOTES:
(n1)Footnote 1. When an early termination or default charge is unreasonable is discussed below in *§ 3.05[4]*.

(n2)Footnote 2. *See § 3.06 infra*.

(n3)Footnote 3. *See § 3.03[2][r] supra*.

(n4)Footnote 4. *U.C.C. § 2A-504(2). Cf. Abrams v. Toyota Motor Credit Corp., 2001 Phila. Ct. Com. Pl. LEXIS 83* (Dec. 5, 2001) (Article 2A does not authorize recovery of unreasonable charges already voluntarily paid by the consumer). *See also In re Northwest Airlines Corp., 393 B.R. 352 (Bankr. S.D.N.Y. 2008)* (early termination computation is unreasonable under Article 2A standards).

(n5)Footnote 5. *U.C.C. § 2A-528(1)*.

(n6)Footnote 6. *U.C.C. § 2-718(1)*; 5 Corbin on Contracts § 1054.

(n7)Footnote 7. *Miller v. Nissan Motor Acceptance Corp., 2000 U.S. Dist. LEXIS 15645* (E.D. Pa. Oct. 27, 2000) , *appeal dismissed, remanded, without op., 275 F.3d 36 (3d Cir. 2001)* .

(n8)Footnote 8. *Cal. Civ. Code § 2985.8*; Colo. Rev. Stat. §§ 5-2-311 to 5-2-313; *Conn. Gen. Stat. §§ 36a-675 to 36a-685*; 1995 Conn. Pub. Acts 337 (uncodified) (regulating excess wear and tear charges only); Fla. Stat. § 521; 1997 Hawaii Laws 82, *as amended by* 1998 Hawaii Senate Bill 2833; *815 Ill. Comp. Stat. Ann. §§ 636/35 to 636/60*; *Ind. Code §§ 9-23-2.5-1*, *24-4.5-2-101*; *Iowa Code § 537.1101*; *Kan. Stat. Ann. § 16a-1-101*; *La. Rev. Stat. Ann. §§ 9:3316 to 9:3330*; Me. Rev. Stat. Ann. tit. 9-A; Maine Consumer Credit Code Reg. Z-2, Rule 240; *Md. Code Ann. Com. Law § 14-2001*; *Mich. Comp. Laws § 445.991*; N.H. Rev. Stat. Ann. ch. 361-D; *N.J. Rev. Stat. § 56:12-60*; *N.Y. Pers. Prop. Law §§ 340 to 343*; *Okla. Stat. Ann. tit. 14A, § 1-101*; *S.C. Code Ann. § 37-1-101*; *Wash. Rev. Code § 63.10.010*; *W. Va. Code § 46A-1-101*; *Wis. Stat. § 429.101. But cf. Hart v. Autowest Dodge, 147 Cal. App. 4th 1258 (2007)* (California leasing statute provides attorney fees to lessor where consumer's action under the statute was unsuccessful).

(n9)Footnote 9. 2002 Conn. Legis. Serv. P.A. 02-81 (S.H.B. 5248) (effective July 1, 2003).

(n10)Footnote 10. For a more extensive discussion of UDAP statutes, see Ch. 4 *infra*.

(n11)Footnote 11. *See* Ch. 4 *infra*.

(n12)Footnote 12. *Cummings v. Warren Henry Motors, Inc., 648 So. 2d 1230 (Fla. Dist. Ct. App. 1995)* .

(n13)Footnote 13. *Cummings v. Warren Henry Motors, Inc., 648 So. 2d 1230 (Fla. Dist. Ct. App. 1995)* .

(n14)Footnote 14. *Cummings v. Warren Henry Motors, Inc., 648 So. 2d 1230 (Fla. Dist. Ct. App. 1995)* .

(n15)Footnote 15. *See John Deere Leasing Co. v. Blubaugh, 636 F. Supp. 1569 (D. Kan. 1986)* .

(n16)Footnote 16. These are discussed in detail in National Consumer Law Center, Truth in Lending § 10.5.3.2 (6th ed. 2007 and Supp.).

(n17)Footnote 17. For a detailed discussion of how to find problems with the calculation of the adjusted lease balance, see National Consumer Law Center, Truth in Lending § 10.5.3.2.3 (6th ed. 2007 and Supp.).

(n18)Footnote 18. Reg. M, *12 C.F.R. § 213.4(f)(4)*.

(n19)Footnote 19. *See Atel Fin. Corp. v. Quaker Coal Co., 132 F. Supp. 2d 1233 (N.D. Cal. 2001)* , *aff'd, 321 F.3d 924 (9th Cir. 2003)* .

(n20)Footnote 20. *See Atel Fin. Corp. v. Quaker Coal Co., 132 F. Supp. 2d 1233 (N.D. Cal. 2001)* , *aff'd, 321 F.3d 924 (9th Cir. 2003)* .

(n21)Footnote 21. *See, e.g., McCarthy v. PNC Credit Corp., 1992 U.S. Dist. LEXIS 21719* (D. Conn. May 27, 1992) ; *Kedziora v. Citicorp Nat'l Servs., Inc., 780 F. Supp. 516 (N.D. Ill. 1991)* , *aff'd in part and rev'd in part on other grounds sub nom. Channell v. Citicorp Nat'l Servs., 89 F.3d 379 (7th Cir. 1996)* .

(n22)Footnote 22. *15 U.S.C. § 1667d(a)*.

(n23)Footnote 23. *See 15 U.S.C. § 1640(a)*.

(n24)Footnote 24. *See* Lundquist v. Security Pac. Auto. Fin. Servs. Corp., Clearinghouse No. 47,956 (D. Conn. June 9, 1992), *aff'd on other grounds, 993 F.2d 11 (2d Cir. 1993)* , *cert. denied, 510 U.S. 959, 114 S. Ct. 419, 126 L. Ed. 2d 365 (1993)* .

(n25)Footnote 25. *See* Lundquist v. Security Pac. Auto. Fin. Servs. Corp., Clearinghouse No. 47,956 (D. Conn. June 9, 1992), *aff'd on other grounds, 993 F.2d 11 (2d Cir. 1993)* , *cert. denied, 510 U.S. 959, 114 S. Ct. 419, 126 L. Ed. 2d 365 (1993)* .

(n26)Footnote 26. Simon v. World Omni Leasing Inc., Clearinghouse No. 47,958 (S.D. Ala. July 13, 1992); *Kedziora v. Citicorp Nat'l Servs., Inc., 780 F. Supp. 516 (N.D. Ill. 1991)* , *aff'd in part and rev'd in part on other grounds sub nom. Channell v. Citicorp Nat'l Servs., 89 F.3d 379 (7th Cir. 1996)* .

(n27)Footnote 27. *See Kedziora v. Citicorp Nat'l Servs. Inc., 780 F. Supp. 516 (N.D. Ill. 1991)* , *aff'd in part and rev'd in part on other grounds sub nom. Channell v. Citicorp Nat'l Servs., 89 F.3d 379 (7th Cir. 1996)* . Note that the Seventh Circuit chose a different approach, avoiding standing issues by finding it premature to rule, prior to early termination, whether a penalty formula is unreasonable. *Highsmith v. Chrysler Credit Corp., 18 F.3d 434 (7th Cir. 1994)* . Even under the Seventh Circuit analysis, a consumer could seek a determination of a provision's reasonableness simultaneously with the consumer terminating the lease, and need not wait for the lessor to enforce the provision.

(n28)Footnote 28. *Miller v. Nissan Motor Acceptance Corp., 362 F.3d 209 (3d Cir. 2004)* .

(n29)Footnote 29. *See Corum v. Fifth Third Bancorp, 2003 U.S. Dist. LEXIS 12247* (W.D. Ky. July 10, 2003) .

(n30)Footnote 30. *Id.*

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PART I Consumer Credit
CHAPTER 3 The Consumer Leasing Act and Automobile Leases

1-3 Consumer Credit Law Manual § 3.06

§ 3.06 Remedies for CLA Violations

As discussed above, *any* CLA violation (with the exception of advertising violations where the consumer is not damaged) should lead to remedies under *15 U.S.C. section 1640*. The lessor's liability is:

a) The actual damage sustained as a result of the lessor's failure; n1 *plus*

b) Twenty-five percent of the total periodic lease payments, except that this statutory liability shall be no less than $100 or greater than $1,000; n2 *plus*

c) The costs of the action and reasonable attorney fees. n3

The lessor's liability for the consumer's attorney fees is the same as under TIL. n4

The lessor's liability in a class action is also the same as for TIL: n5

a) The class members' actual damage sustained by the CLA violation; n6 *plus*

b) Such amount as the court may allow, being no more than the lesser of $500,000 or one percent of the creditor's net worth; n7 *plus*

c) The costs of the action and reasonable attorney fees. n8

Where more than one consumer is obligated on a lease, each consumer cannot recover the maximum amount of statutory damages. n9 This limitation does not apply to actual damages. Nor does the limitation affect the lessor's liability in a class action for a large statutory damage award based on multiple leases.

Where a lessor has engaged in multiple disclosure violations in the same lease, the statute specifies that the consumer is entitled to only one statutory damage award. n10 In addition, a Virginia court has ruled that, as a matter of law, a CLA disclosure violation is a complete defense to a lessor's claim for breach of contract. n11

The CLA does not limit the consumer's ability to recover statutory damages against multiple lessors. Nevertheless, few courts have addressed this issue. One court has found that only one statutory damage award is recoverable per lease, even if multiple lessors are liable. n12

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionConsumer LeasingContracts LawDebtor & Creditor RelationsContracts LawRemedies

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1640(a)(1).*

(n2)Footnote 2. *15 U.S.C. § 1640(a)(2)(A)(ii).* Where 25% of the lease payments exceeds $1,000, statutory damages should be $1,000. *See Patterson v. Bob Wade Lincoln-Mercury, Inc., 55 Va. Cir. 499 (2000)* (statutory damages awarded even where no actual damages). *But see Lasman v. Primus Auto. Fin. Servs., Inc., 1998 Mass. App. Div. 279, 1998 Mass. App. Div. LEXIS 118* (Dec. 31, 1998) (court has discretion to reduce statutory damages from $1,000 to $300).

(n3)Footnote 3. *15 U.S.C. § 1640(a)(3). See also Patterson v. Bob Wade Lincoln-Mercury, Inc., 55 Va. Cir. 499 (2000)* (attorney fees can be awarded to the consumer in a CLA claim based on recoupment).

(n4)Footnote 4. *See § 1.10[5] supra.*

(n5)Footnote 5. *See § 1.10[4] supra.*

(n6)Footnote 6. *15 U.S.C. § 1640(a)(1).*

(n7)Footnote 7. *15 U.S.C. § 1640(a)(2)(B).*

(n8)Footnote 8. *15 U.S.C. § 1640(a)(3).*

(n9)Footnote 9. *15 U.S.C. § 1640(d).*

(n10)Footnote 10. *15 U.S.C. § 1640(g).*

(n11)Footnote 11. *Patterson v. Bob Wade Lincoln-Mercury, Inc., 55 Va. Cir. 499 (2000) .*

(n12)Footnote 12. *Kittrell v. RRR, L.L.C., 280 F. Supp. 2d 517 (E.D. Va. 2003) .*

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PART I Consumer Credit
CHAPTER 3 The Consumer Leasing Act and Automobile Leases

1-3 Consumer Credit Law Manual § 3.07

§ 3.07 Procedural Issues and Defenses

[1] Statute of Limitations

The CLA has a more generous statute of limitations than TIL. The action must be brought within one year of the termination of the lease agreement, n1 while TIL only allows actions within one year of the occurrence of the violation. n2 In other words, the one-year CLA statute of limitation period begins to run at the expiration of the lease or its early termination, not with the signing of the lease. (Upon early termination, the limitation period will run from when the lease actually terminates, not when it is scheduled to terminate.) n3 The date of termination is counted from when the lessor repossesses the vehicle, not a later date when the lessor assesses the early termination charge. n4 Where a consumer's complaint was filed within the one-year period alleging disclosure violations, that complaint can be amended after the one-year period had elapsed to add other CLA claims, such as a claim that the early termination charge was unreasonable. The added claims related back to the same transaction. n5

It seems clear that CLA claims may be raised by way of recoupment after the one year limitation period has expired. The CLA specifies that lessors are liable as provided in *15 U.S.C. § 1640*. *15 U.S.C. § 1640(e)* specifies that:

> This subsection does not bar a person from asserting a violation of this subchapter in an action to collect the debt which was brought more than one year from the date of the occurrence of the violation as a matter of defense by recoupment or set-off in such action, except as otherwise provided by State law.

[2] Jurisdiction

CLA violations may be brought in any United States district court or in any other court of competent jurisdiction. n6

[3] Leasing Act Statutory Defenses

With the exception of the requirement that advertising violations be brought only by those who suffer actual damage from the violation, the CLA does not contain within its own sections any statutory defenses. But the CLA does state that the lessor's liability is as provided in *15 U.S.C. section 1640*, n7 and *15 U.S.C. section 1640* specifies a number of "creditor" defenses. n8 Since the term "creditor" in section 1640 includes "lessors," n9 these defenses also apply to CLA cases.

[a] Assignee Liability

With regard to any failure to "make disclosures" required under the CLA, liability shall be imposed only upon the lessor required to make disclosure, except that the assignee is liable for violations apparent on the face of the disclosure statement or where the assignment is involuntary. n10

[b] Correction Defense

The correction defense provides that a lessor has no liability for failure to comply with a CLA violation if within sixty days of discovering the error, but before the consumer notifies the lessor of the error, the lessor notifies the consumer of the error. n11 Courts will allow this defense only for clerical or mathematical errors, not for informational errors. n12

[c] Bona Fide Error Defense

A lessor is not liable for a CLA violation if the lessor shows by a preponderance of the evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adopted to avoid any such error. n13 A court has found the bona fide error defense to apply when a number was misaligned on the page so that it did not clearly state a purchase option of $11,000 but could be interpreted as $1000. n14

[d] Good Faith Conformity With FRB Rulings and Official Interpretations

Lessors are not liable under the CLA for acts done or omitted in good faith in conformity with any FRB rule, regulation, or interpretation. n15

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionConsumer LeasingGeneral OverviewBanking LawConsumer ProtectionTruth in LendingLiabilityCommercial Law (UCC)Leases (Article 2A)General Overview

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1667d(c).*

(n2)Footnote 2. *Cf. 15 U.S.C. § 1640(e).*

(n3)Footnote 3. *See Pettola v. Nissan Motor Acceptance Corp., 44 F. Supp. 2d 442 (D. Conn. 1999) . Cf. Patterson v. Bob Wade Lincoln-Mercury, Inc., 48 Va. Cir. 471, 1999 Va. Cir. LEXIS 121 (Va. Cir. Ct. 1999)* (rejecting an ingenious argument that lease termination does not occur at default, but only when the literal contractual preconditions of early termination have been fully met).

(n4)Footnote 4. *Carmichael v. Nissan Motor Acceptance Corp., 291 F.3d 1278 (11th Cir. 2002) .*

(n5)Footnote 5. *Miller v. Nissan Motor Acceptance Corp., 2000 U.S. Dist. LEXIS 15645* (E.D. Pa. Oct. 27, 2000) , *appeal dismissed, remanded, without op., 275 F.3d 36 (3d Cir. 2001) .*

(n6)Footnote 6. *15 U.S.C. § 1640(e).*

(n7)Footnote 7. *See 15 U.S.C. § 1667d(a).*

(n8)Footnote 8. *See § 1.09 supra.*

(n9)Footnote 9. *15 U.S.C. § 1667d(b).*

(n10)Footnote 10. *15 U.S.C. §§ 1640(a)(3), 1641(a). See also Jarvis v. South Oak Dodge, Inc., 201 Ill. 2d 81, 773 N.E.2d 641* (Ill. June 20, 2002) (where a state leasing statute was ambiguous as to whether claims not apparent on the face of lease could be brought against assignee, court interpreted statute as consistent with CLA and required claim to be apparent on face of the lease).

(n11)Footnote 11. *15 U.S.C. § 1640(b). See also* Johnson v. Steven Sims Subaru, Inc., Clearinghouse No. 49,951 (N.D. Ill. Aug. 20, 1993) (no defense where consumer first notified lessor of the violation).

(n12)Footnote 12. *See Thomka v. A.Z. Chevrolet, Inc., 619 F.2d 246 (3d Cir. 1980)* ; Johnson v. Steven Sims Subaru, Inc., Clearinghouse No. 49,951 (N.D. Ill. Aug. 20, 1993) (inaccurate disclosure that no official fees or taxes owed).

(n13)Footnote 13. *15 U.S.C. § 1640(c).*

(n14)Footnote 14. *Watson v. U.S. Bank Nat'l Assoc., Inc., 2006 U.S. Dist. LEXIS 7875* (S.D. Ala. Feb. 10, 2006) .

(n15)Footnote 15. *15 U.S.C. § 1640(f). See McPhillips v. Gold Key Lease, Inc., 38 F. Supp. 2d 975 (M.D. Ala. 1999) .*

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PART I Consumer Credit
CHAPTER 3 The Consumer Leasing Act and Automobile Leases

1-3 Consumer Credit Law Manual § 3.08

§ 3.08 Repossession Issues

The first step in analyzing the repossession rights and responsibilities of automobile lessors and lessees is to determine if UCC Article 9 applies.

Whether Article 9 governs an automobile lease will usually depend on whether the lease is closed-end or open-end. In part because of Consumer Leasing Act restrictions on open-end leases, few automobile leases today are open-end.

Courts almost unanimously find that closed-end leases are not covered by Article 9. n1 The major contrary decision, by a U.S. bankruptcy court, n2 was overturned by a federal district court that found the standard Ford Motor Credit Company closed-end vehicle lease was not intended for security and, thus, *not* covered by UCC Article 9. n3 Of course, a lessor can structure a closed-end lease so that it is covered by UCC Article 9. There are reports of used car dealers offering leases with a purchase option that can be exercised at the end of the lease for nominal consideration. In that case, the lease is probably a secured transaction.

If Article 9 does not apply to a car lease, the lessor's right to seize the car will be governed by UCC Article 2A. Article 2A allows the lease agreement to determine what consumer conduct is defined as a default of the lease agreement. n4 When the consumer's conduct leads to a default, the lessor need not notify the consumer that he or she is in default on the lease or that the lessor will enforce default remedies, n5 unless required to do so by other law or by the lease agreement.

Nevertheless, under Article 2A, not all defaults authorize the lessor to seize the leased vehicle. The lessor can seize the leased vehicle only in certain circumstances. n6

For other types of default, the lessor's sole remedy is an action for damages, not seizure of the vehicle. n7 However, even a minor default can lead to seizure if the lease agreement specifies that this specific default leads to the lessor's right to seize the vehicle. Since ambiguities in standard form contracts are construed against their drafters, the agreement that particular defaults will lead to seizure of the leased property must be clear and unambiguous. n8

UCC Article 2A provides no right for a consumer to cure a default or reinstate the lease. In fact, the lessor need not even notify the consumer that the consumer is in default on the lease or notify the consumer that the lessor will enforce

default remedies. n9 However, a number of state statutes do provide consumers a right to cure or reinstate the vehicle lease. n10 UCC Article 2A allows lessors to seize the vehicle only if this can be done without breach of the peace. n11

The sale of the repossessed vehicle has a different purpose in a lease transaction than in a secured transaction. In a lease, the car belongs to the lessor and will eventually be returned to the lessor. If the consumer does not make lease payments, the lessor can recover its property early, and also sue for any damages caused by the early termination of the lease. There is no requirement that the lessor sell the car because it has always been the lessor's car, and the lessor has always been expecting to recover it. n12 The lessor can retain the vehicle, re-lease it, or sell it. The lessor's decision on what it does with its property when it is returned to the lessor early does not have a necessary connection to the consumer's liability for the default.

Article 2A provides several measures of the lessor's damages on the consumer's default, but these damages are based on the difference between the size of the consumer's lease payments and the amount for which the lessor can *re-lease* the vehicle after repossession. Article 2A remedies do not provide for the sale of the leased property. n13

The CLA does restrict the use of a sale price in the default formula in one respect. Whenever the consumer's liability at either early termination or at the end of the lease term is based on the estimated value of the leased property, the lessor must disclose the consumer's right to obtain a mutually binding appraisal of the car's resale value. n14 The appraisal is at the consumer's expense, by an independent, professional, third-party appraiser agreed to by the consumer and lessor. n15

The CLA has no other requirements as to the sale of the vehicle, although, again, the liquidated damages formula must be reasonable overall. n16 On the other hand, several state leasing statutes do provide limits on how collateral is to be sold, if the consumer's liability is based on the sale price.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionConsumer LeasingGeneral OverviewCommercial Law (UCC)Leases (Article 2A)DefaultRemediesCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See Sine Enters., Inc. v. Jaguar Credit Corp., 139 F.3d 912 (10th Cir. 1998)* (unpublished); *Lamar v. Mitsubishi Motors Credit of Am., Inc. (In re Lamar), 249 B.R. 822 (Bankr. S.D. Ga. 2000)* ; *In re Murray, 201 B.R. 381 (Bankr. E.D. Pa. 1996)* ; *In re Winston, 181 B.R. 589 (Bankr. N.D. Ala. 1995)* ; *In re Zaleha, 159 B.R. 581 (Bankr. D. Idaho 1993)* ; *Woodson v. Ford Motor Credit Co. (In re Cole), 114 B.R. 278 (Bankr. N.D. Okla. 1990)* . *See generally* National Consumer Law Center, Repossessions § 14.2.2.2 (6th ed. 2005).

(n2)Footnote 2. *Woodson v. Ford Motor Credit Co. (In re Thompson), 101 B.R. 658 (Bankr. N.D. Okla. 1989)* , *rev'd, 114 B.R. 278 (N.D. Okla. 1990)* .

(n3)Footnote 3. *Woodson v. Ford Motor Credit Co. (In re Cole), 114 B.R. 278 (Bankr. N.D. Okla. 1990)* .

(n4)Footnote 4. *U.C.C. § 2A-501(1).*

(n5)Footnote 5. *U.C.C. § 2A-502.*

(n6)Footnote 6. *U.C.C. § 2A-525(2).*

(n7)Footnote 7. *U.C.C. § 2A-523(3).*

(n8)Footnote 8. Another possible lessor technique to avoid Article 2A's major default/minor default dichotomy is to state in the lease that the lessor can accelerate the remaining lease payments at will or when it deems itself insecure. It could then seize on a minor default or even no default to accelerate the lease payment schedule. The consumer's failure to pay the accelerated amount gives the lessor the right to seize the vehicle, even if the consumer has kept current with all of the original scheduled payments. Article 2A limits this technique by stating that the terms accelerate "at will" and accelerate "when the lessor deems itself insecure" shall be construed to allow acceleration of payments only if the lessor in good faith believes the prospect of payment or performance is impaired. The lessor has the burden of proving good faith. *U.C.C. § 2A-109(1).*

(n9)Footnote 9. *U.C.C. § 2A-502.*

(n10)Footnote 10. *See* National Consumer Law Center, Repossessions § 14.2.4 (6th ed. 2005 and Supp.).

(n11)Footnote 11. *U.C.C. § 2A-525(3). Wis. Stat. Ann. § 425.206* prohibits self-help repossession outright, and limits the lessor's ability to recover the leased vehicle to court action or voluntary surrender by the consumer.

(n12)Footnote 12. *See Siemens Fin. Servs., Inc. v. Phymed Diagnostic Imaging Ctr. of Dallas, Inc., 2000 U.S. Dist. LEXIS 7978* (N.D. Tex. June 6, 2000) .

(n13)Footnote 13. *U.C.C. § 2A-527(2).*

(n14)Footnote 14. Reg. M, *12 C.F.R. § 213.4(g)(14).* New Jersey's new motor vehicle leasing statute also requires disclosure of the right to an appraisal where the consumer is liable for excess wear and tear on the vehicle. *See* N.J. Rev. Stat. § 56-12-67.

(n15)Footnote 15. Reg. M, *12 C.F.R. § 213.4(g)(14).*

(n16)Footnote 16. *See Highsmith v. Chrysler Credit Corp., 18 F.3d 434 (7th Cir. 1994) . See also Miller v. Nissan Motor Acceptance Corp., 2000 U.S. Dist. LEXIS 15645* (E.D. Pa. Oct. 27, 2000) . For further discussion of early termination and default charges, as well as consumer challenges to these charges, see National Consumer Law Center, Repossessions, § 14.2.7 (6th ed. and supp.).

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PART I Consumer Credit
CHAPTER 4 Unfair and Deceptive Credit Practices

1-4 Consumer Credit Law Manual 4.syn

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PART I Consumer Credit
CHAPTER 4 Unfair and Deceptive Credit Practices

1-4 Consumer Credit Law Manual § 4.01

§ 4.01 Introduction

All fifty states, the District of Columbia, Puerto Rico, Guam, and the Virgin Islands have enacted at least one statute with broad applicability to most consumer transactions, aimed at preventing consumer deception and abuse in the marketplace. Many of these statutes are patterned after the language found in section 5(a)(1) of the Federal Trade Commission ("FTC") Act, n1 which prohibits "unfair or deceptive acts or practices"; the term "UDAP" is an acronym for this prohibition.

This chapter focuses on the use of state UDAP statutes to challenge abusive credit practices. n2 The chapter also examines a related challenge to those practices under the federal RICO or racketeering statute. n3

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionDeceptive Acts & PracticesGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 45(a)(1).*

(n2)Footnote 2. The Internet is an increasingly important resource for unfair and deceptive acts and practices [hereinafter UDAP] precedent. For example, the Federal Trade Commission [hereinafter FTC] has its own website at www.ftc.gov. An extremely useful site is found at www.consumerworld.org. Other useful sites include www.advertisinglaw.com and National Consumer Law Center's own site, www.consumerlaw.org.

(n3)Footnote 3. RICO is shorthand for the federal Racketeer Influenced and Corrupt Organization provisions of the Organized Crime Control Act of 1970 and various similar state statutes. The text of the RICO Act is reprinted in Vol. 1B *infra*. For more detail on UDAP statutes, federal and state RICO statutes, and the applicability of those statutes to credit practices, see National Consumer Law Center, Unfair and Deceptive Acts and Practices (6th ed. 2004 and Supp.).

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PART I Consumer Credit
CHAPTER 4 Unfair and Deceptive Credit Practices

1-4 Consumer Credit Law Manual § 4.02

§ 4.02 Applicability of UDAP Statutes to Credit Practices

In general, UDAP statutes are broadly applicable to all types of consumer transactions. Nevertheless, several state statutes do not apply to credit practices for several reasons. But even if a UDAP statute exempts creditors, this should only insulate creditors from UDAP liability for their own misconduct. The FTC's Holder Rule subjects assignees and related creditors to claims and defenses including UDAP claims arising from the seller's misconduct. n1

Courts have little problem finding that credit practices are included in the term "trade or commerce." Consequently, banking and credit activities are covered by UDAP statutes that apply broadly to "trade or commerce." n2 Where a UDAP statute limits coverage to transactions involving "goods or services," most courts hold that this language encompasses credit transactions. n3 The Texas courts have developed some fine distinctions about whether credit and banking activities are the purchase of a "good" or "service" n4 and a few courts do find that credit transactions are outside the scope of "goods and services." n5 No matter which way a court rules on whether a credit extension is a "service," there should be little doubt that services in connection with the loan are covered. n6

A final problem with UDAP coverage of credit practices is possible preemption by other credit statutes or regulatory schemes. The FTC regulates some of the credit market but does not regulate unfair banking practices; regulation of unfair banking practices is reserved for the federal regulatory agencies, such as the Federal Reserve Board ("FRB") and the Comptroller of the Currency, that regulate these financial institutions. But even though the FTC Act does not apply to banks, and even though state courts are guided by the FTC Act in interpreting state UDAP statutes, the FTC's scope does not prevent UDAP statutes from applying to banks. n7

Whether a state regulatory scheme displaces applicability of the UDAP statute is a complicated issue. While most UDAP statutes will not be so displaced, the answer may depend on the specific language of the UDAP statute, the exact nature of state regulation, the adequacy of state remedies, and whether the state permits or regulates the very practice being challenged. n8 Louisiana has an exemption for actions or transactions subject to the jurisdiction of the state commissioner of financial institutions, regulators of financial institutions in other states, and federal banking regulators who have authority to regulate unfair or deceptive trade practices. n9 This exemption formerly was worded as a blanket exemption for chartered banks, and some courts still interpret it to exempt particular entities rather than practices. n10 However, the better view is that it exempts only actions or transactions that are specifically regulated by one of the named banking regulators. n11 Under this view, the state UDAP statute does apply to a bank's wrongful foreclosure,

because this aspect of a bank's activities is not specifically regulated. n12

Whether a UDAP statute applies to debt collection practices raises additional issues. Where a UDAP statute applies to conduct "in trade or commerce," the statute can be used to challenge debt collection activities. n13 Most courts also find that debt collection involves the sale of goods or services. n14

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionDeceptive Acts & PracticesGeneral OverviewBanking LawConsumer ProtectionGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See § 4.04[1][a] infra. See* Ch. 14 *infra. See also Williams v. ITT Fin. Servs., 1997 Ohio App. LEXIS 2721* (June 25, 1997) , *aff'd on other grounds, 83 Ohio St. 3d 464, 700 N.E.2d 859 (1998)* , *cert. denied, 526 U.S. 1051, 119 S. Ct. 1357, 143 L. Ed. 2d 518 (1999)* ; *Nations Credit v. Pheanis, 102 Ohio App. 3d 71, 656 N.E.2d 998 (1995)* (mobile home financer held liable under FTC rule for UDAP violations of mobile home dealer). *But see Vannoy v. Capital Lincoln-Mercury Sales, Inc., 88 Ohio App. 3d 138, 623 N.E.2d 177 (1993)* (bank not liable for seller's post-sale UDAP violations, no discussion of FTC rule).

(n2)Footnote 2. *Morse v. Mutual Fed. Sav. & Loan Ass'n, 536 F. Supp. 1271 (D. Mass. 1982)* ; *Petersen v. State Employees Credit Union (In re Kittrell), 115 B.R. 873 (Bankr. M.D.N.C. 1990)* ; *Stogsdill v. Cragin Fed. Bank, 645 N.E.2d 564 (Ill. App. Ct. 1995)* (UDAP statute covers banking practices). *See also Beattie v. Nations Credit Fin. Servs. Corp., 69 Fed. Appx. 585* (4th Cir. May 27, 2003) (unpublished, citation limited) (S.C. UDAP statute applies to bank's collection and foreclosure activities).

(n3)Footnote 3. *See Smith v. Commercial Banking Corp., 866 F.2d 576 (3d Cir. 1989)* (Pennsylvania law); Hogan v. Valley Nat'l Fin. Servs. Co., Clearinghouse No. 40,428 (D. Colo. Feb. 1, 1995) (denying motion to dismiss and holding that a loan is a "service" covered by Colorado's UDAP law); *Jackson v. Culinary Sch. of Washington, 788 F. Supp. 1233 (D.D.C. 1992)* ; *McTeer v. Provident Life & Acc. Ins., 712 F. Supp. 512 (D.S.C. 1989)* ; *Flores v. Shapiro & Kreisman, 246 F. Supp. 2d 427 (E.D. Pa. 2002)* (UDAP covers loans that finance goods or services for personal use); *Apgar v. Homeside Lending, Inc. (In re Apgar), 291 B.R. 665, 684 (Bankr. E.D. Pa. 2003)* (mortgage loan is service); *State ex rel. Miller v. Cutty's Des Moines Camping Club, Inc., 694 N.W.2d 518 (Iowa 2005)* ; *Johnson v. Long Beach Mortg. Loan Trust 2001-4, 451 F. Supp. 2d 16* (D.D.C. Aug. 4, 2006) (following *DeBerry*; mortgage finance transaction is "sale" covered by D.C. UDAP law); *Losure v. Capital One Services, Inc., 2006 U.S. Dist. LEXIS 3977* (M.D. Fla. Jan. 23, 2006) ; *Knox v. Ameriquest Mortg. Co., 2005 U.S. Dist. LEXIS 40709* (N.D. Cal. Aug. 10, 2005) (Consumer Legal Remedies Act covers mortgage loans).

(n4)Footnote 4. *Compare Flenniken v. Longview Bank & Trust Co., 661 S.W.2d 705 (Tex. 1984)* ; *Riverside Nat'l Bank v. Lewis, 603 S.W.2d 169 (Tex. 1980)* , *with Clardy Mfg. Co. v. Marine Midland Bus. Loans, Inc., 88 F.3d 347 (5th Cir. 1996)* . *See also Baker v. Countrywide Home Loans, Inc., 2009 U.S. Dist. LEXIS 53704* (N.D. Tex. June 24, 2009) (Texas UDAP statute does not apply to purchase money mortgage loan).

(n5)Footnote 5. *See Barber v. Nat'l Bank of Alaska, 815 P.2d 857 (Alaska 1991)* ; *Haeger v. Johnson, 25 Or. App. 131, 548 P.2d 532 (1976)* .

(n6)Footnote 6. *Phillips v. Dukes (Matter of Dukes), 24 B.R. 404 (Bankr. E.D. Mich. 1982)* ; *Allan v. M & S Mortgage Co., 359 N.W.2d 238 (Mich. Ct. App. 1984)* ; *Riverside Nat'l Bank v. Lewis, 603 S.W.2d 169 (Tex. 1980)* ; *see also Stogsdill v. Cragin Fed. Bank, 645 N.E.2d 564 (Ill. App. Ct. 1995)* (banking services, including cashing of checks, are covered by UDAP statute); *Fortner v. Fannin Bank in Windom, 634 S.W.2d 74 (Tex. Civ. App. 1982)* ; *Lubbock Mortgage & Inv. Co. v. Thomas, 626 S.W.2d 611 (Tex. Civ. App. 1981)* . The issue applies to real estate and securities

transactions and those cases are also supportive of the inclusion of credit services. *See also Ford v. City State Bank of Palacios, 44 S.W.3d 121 (Tex. App. 2001)* (Although a personal loan is not subject to UDAP claims, the creditor may be so inextricably intertwined with the purchase for which the loan was sought that it is liable under UDAP.); *In re Wiggins, 273 B.R. 839 (Bankr. D. Idaho 2001)* (company that purchases individuals' structured settlements in exchange for cash, and that promises financial planning and other services, is engaged in the sale of services).

(n7)Footnote 7. *Normand Josef Enters. v. Connecticut Bank, 230 Conn. 486, 646 A.2d 1289 (1994)* ; *Raymer v. Bay State Nat'l Bank, 384 Mass. 310, 424 N.E.2d 515 (1981)* ; *Farmers & Merchants State Bank v. Ferguson, 605 S.W.2d 320 (Tex. Civ. App. 1980)* , *modified on other grounds*, *617 S.W.2d 918 (Tex. 1981)* . *But see Chavers v. Fleet Bank (RI), N.A., 844 A.2d 666, 2004 R.I. LEXIS 38 (R.I. 2004)* (Rhode Island Supreme Court interpreted its UDAP statute's exclusion of "actions or transactions permitted under laws administered by" a state or federal regulatory body to exclude a national bank's deceptive credit card solicitations because of the authority of the Office of the Comptroller of the Currency to enforce Truth in Lending standards and the FTC Act's prohibition against unfair and deceptive acts).

(n8)Footnote 8. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 2.3.3 (7th ed. 2008 and supp.).

(n9)Footnote 9. *La. Rev. Stat. § 51:1406(1).*

(n10)Footnote 10. *Suffern v. Countrywide Home Loans, Inc., 2006 U.S. Dist. LEXIS 51563* (E.D. La. July 14, 2006) (mortgage lender is exempt; consumers claimed that lender failed to disburse insurance proceeds in manner required by loan agreement).

(n11)Footnote 11. *Levine v. First Nat'l Bank, 917 So. 2d 1235 (La. Ct. App. 2005)* .

(n12)Footnote 12. *Id.*

(n13)Footnote 13. *In re Scrimpsher, 17 B.R. 999 (Bankr. N.D.N.Y. 1982)* ; *State v. O'Neill Investigations, Inc., 609 P.2d 520 (Alaska 1980)* ; People *ex rel. Daley v. Datacom Sys., Inc., 176 Ill. App. 3d 697, 531 N.E.2d 839 (1988)* . *See Holley v. Gurnee Volkswagen & Oldsmobile, Inc., 2001 U.S. Dist. LEXIS 7274* (N.D. Ill. Jan. 4, 2001) (repossession is in trade or commerce). *But see Walker v. Gallegos, 167 F. Supp. 2d 1105 (D. Ariz. 2001)* (false allegations that creditor made in repossession complaint against person who was not original buyer are too attenuated from sale or advertisement of merchandise to be covered). *See Losure v. Capital One Services, Inc., 2006 U.S. Dist. LEXIS 3977* (M.D. Fla. Jan. 23, 2006) (court held that a debt collector's activities in collecting for a credit card issuer were covered as they fell within definition of trade and commerce. *But see City of Cars, Inc. v. Simms, 526 So. 2d 119 (Fla. Dist. Ct. App. 1988)* (post-sale repossession practices not covered); *Pursell v. First Am. Nat'l Bank, 937 S.W.2d 838 (Tenn. 1996)* (post-sale repossession practices do not relate to the original sale and are thus not covered).

(n14)Footnote 14. *In re Western Acceptance Corp., 788 P.2d 214 (Idaho 1990)* ; *Baird v. Norwest Bank, 843 P.2d 327 (Mont. 1992)* .

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PART I Consumer Credit
CHAPTER 4 Unfair and Deceptive Credit Practices

1-4 Consumer Credit Law Manual § 4.03

§ 4.03 General Definition of Deception and Unfairness

[1] Deception

The UDAP deception standard is a broad and expansive one. A detailed examination of state case law defining UDAP deception is beyond the scope of this volume. n1 But, briefly, UDAP deception is much broader than common law fraud. n2 Intent is generally not required, n3 and knowledge of a statement's falsity, "scienter," is not a necessary element of deception. n4 A seller's good faith is not a defense; n5 neither is the fact that the seller has ceased the deceptive practice at the time of the suit. n6 A standard approved by the Supreme Court and the U.S. Circuit Courts is that actual deception is unnecessary; all that need be shown is that the practice has the "capacity" or "tendency" to deceive. n7

Puffing is a common defense to FTC actions, although usually not a successful one. n8 To prove that a claim is mere puffing, the seller will have to show that the exaggerated claim is harmless, purely fanciful, or a spoof, calculated to amuse and with *no* capacity to deceive. n9

In determining whether a practice has a capacity or tendency to deceive, federal courts historically have considered whether the ignorant, the unthinking, the credulous, and the least sophisticated consumer would be deceived. n10 While it may not be enough if only an insignificant and unrepresentative segment of the public is misled, a practice can be deceptive even if most consumers are not misled and only especially vulnerable consumers are deceived.

Literally true statements can be deceptive. n11 A literally true statement may have implications that are deceptive. Deception can be accomplished through innuendo and not just outright false statements. n12 A statement or omission may convey more than one reasonable meaning, and if one of those meanings is deceptive, it violates the UDAP statute. n13

One of the most important uses of a UDAP statute is to attack the failure to disclose material facts. Where sellers do not make affirmative misrepresentations or it is difficult to prove oral misrepresentations, the key to a UDAP case often is the claim that the seller did not disclose important information.

In a surprising number of situations where the consumer is having difficulty explaining what was deceptive about the

seller's conduct, the solution is found in detailing what was not said--what important information was not disclosed to the consumer. For example, a finance company offers to refinance a loan at far worse terms than are available elsewhere, but the complexity of the transaction is such that the consumer does not understand this. The best approach may be to claim it is deceptive for the creditor to fail to disclose that preferable terms are available elsewhere. n14

Representations are deceptive if necessary qualifications are not made, if material facts are not disclosed, or if these disclosures or qualifications are too inconspicuous. n15 Several UDAP statutes, however, explicitly require that non-disclosure be knowing or intentional. n16 Some other courts imply the same requirements into the statute; sellers need not disclose information they do not know and should not have known. n17 "To tell less than the whole truth is a well known method of deception." n18 Even if proper disclosures are made in writing, if a sales presentation effectively obscures the meaning of those disclosures, the total representation is deceptive. n19

Deception can be found where there is no breach of contract or warranty. n20 Waiver, ratification, and other common law defenses do not apply to a UDAP claim because the claim is not based on the contract, but on oral and other misrepresentations. n21 For the same reason, the following do not apply to UDAP claims:

- The parol evidence rule; n22
- Contractual limitations on liability; n23
- Contractual limitations on remedies; n24
- Privity of contract; n25
- A practice is deceptive even if subsequently clarified; n26
- Point of sale disclosure is not sufficient to clarify deceptive media advertising; n27
- Estoppel. n28

The doctrine of voluntary payment, whereby money paid with full knowledge of the facts generally cannot be recovered, even if the demand is unlawful, n29 also should not apply to UDAP claims. Payments made as a result of fraud, n30 under mistake of law, n31 or duress or compulsion n32 are not "voluntary."

[2] Unfairness

Many state UDAP statutes, patterning themselves after the FTC Act, prohibit not only deceptive but also "unfair" acts or practices. This unfairness standard reaches various abusive business practices that are not deceptive. While deception is a broad standard, particularly when the failure to disclose is aggressively challenged as a deceptive practice, certain practices do not mislead, but only take advantage of consumers. In states providing a private right of action for unfair practices, consumers are given a highly flexible remedy that can be used innovatively. n33

The FTC's 1994 Reauthorization Act defines those unfair practices that the FTC can declare unlawful:

> "The Commission shall have no authority [through FTC adjudications or rulemaking] to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. In determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not

serve as a primary basis for such determination." n34

At the time of the early development of state UDAP case law in the 1960s and 1970s, the FTC utilized the " *S&H*" definition of unfairness: whether the practice is within the penumbra of common law, statutory, or other established concepts of fairness; whether it is immoral, unethical, oppressive, or unscrupulous; and whether it causes substantial injury. n35 As described above, a different definition is codified now in the FTC Act. Nevertheless, most courts in interpreting state UDAP statutes do not apply this current FTC unfairness definition. Instead, they continue to use the " *S&H*" standard. n36 The Comptroller of the Currency, which enforces the FTC Act against national banks, has adopted the FTC's standard. n37

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawTrade Practices & Unfair CompetitionGeneral OverviewBanking LawConsumer ProtectionGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 4.2 (7th ed. 2008 and supp.).

(n2)Footnote 2. *Fisher v. Quality Hyundai, Inc., 2002 U.S. Dist. LEXIS 407* (N.D. Ill. Jan. 8, 2002) (UDAP statute provides broader protections than common law); *Blue Cross & Blue Shield v. Philip Morris, Inc., 178 F. Supp. 2d 198 (2001) , costs/fees proceeding, 190 F. Supp. 2d 407 (E.D.N.Y. 2002)* ; *Meyer v. Dygert, 156 F. Supp. 2d 1081 (D. Minn. 2001)* ; *Parker-Smith v. Sto Corp., 262 Va. 432, 551 S.E.2d 615 (2001)* (construing false advertising statute); State *ex rel. Brady v. Publishers Clearing House, 787 A.2d 111 (Del. Ch. 2001)* ; State *ex rel. Brady v. Gardiner, 2000 Del. Super. LEXIS 208* (June 5, 2000) ; *Chandler v. American Gen. Fin., Inc., 329 Ill. App. 3d 729, 768 N.E.2d 60 (2002)* (one goal of UDAP statute was to give protection broader than that afforded by common law fraud); *Campbell v. Beak, 568 S.E.2d 801 (Ga. Ct. App. 2002)* (scienter and intent unnecessary); *Billingham v. Dornemann, 771 N.E.2d 166 (Mass. App. Ct. 2002)* (application of common law fraud restrictions to UDAP claim was error); *Miller v. Keyser, 90 S.W.3d 712 (Tex. 2002)* .

(n3)Footnote 3. *FTC v. Algoma Lumber Co., 291 U.S. 67, 54 S. Ct. 315, 78 L. Ed. 655 (1934)* ; *FTC v. Amy Travel Serv., Inc., 875 F.2d 564 (7th Cir. 1989)* (intent unnecessary even for action for monetary redress). *But see* State *ex rel. Brady v. 3-D Auto World, 2000 Del. Super. LEXIS 17* (Jan. 19, 2000) (plaintiff must show that defendant intended that others rely on omission).

(n4)Footnote 4. *Equitable Life Assurance Soc. v. Porter-Englehart, 867 F.2d 79 (1st Cir. 1989)* (Massachusetts law); *Clarkson v. Orkin Exterminating Co., 761 F.2d 189 (4th Cir. 1985)* (South Carolina law); *In re Russell, 181 B.R. 616 (Bankr. M.D. Ala. 1995)* (liability shown where dealer should have been aware of damage to vehicle). *But see Ji v. Palmer, 333 N.J. Super. 451, 755 A.2d 1221 (App. Div. 2000)* (only knowing omissions are UDAP violations).

(n5)Footnote 5. *Orkin Exterminating Co. v. FTC, 849 F.2d 1354 (11th Cir. 1988) , cert. denied, 488 U.S. 1041, 109 S. Ct. 865, 102 L. Ed. 2d 989 (1989)* ; *Chrysler Corp. v. FTC, 561 F.2d 357 (D.C. Cir. 1977)* ; *Gray v. North Carolina Ins. Underwriting Ass'n, 352 N.C. 61, 529 S.E.2d 676 (2000)* . Smith v. *Baldwin, 611* S.W.2d 611 (Tex. 1980) (substantial performance not a defense). *But cf. Sprenger v. Trout, 375 N.J. Super. 120, 866 A.2d 1035, 1047-48 (App. Div. 2005)* (substantial compliance may be a defense, but not shown here where repair shop had many opportunities to provide paperwork required by UDAP regulation).

(n6)Footnote 6. *Beneficial Corp. v. FTC, 542 F.2d 611 (3d Cir. 1976)* ; *Fedders Corp. v. FTC, 529 F.2d 1398 (2d Cir. 1976) , cert. denied, 429 U.S. 818, 97 S. Ct. 63, 50 L. Ed. 2d 79 (1976)* .

(n7)Footnote 7. *FTC v. Colgate-Palmolive Co., 380 U.S. 374, 85 S. Ct. 1035, 13 L. Ed. 2d 904 (1965)* ; *FTC v. Raladam Co., 316 U.S. 149, 62 S. Ct. 966, 86 L. Ed. 1336 (1942)* ; *FTC v. Algoma Lumber Co., 291 U.S. 67, 54 S. Ct. 315, 78 L. Ed. 655 (1934)* ; *FTC v. Royal Milling Co., 288 U.S. 212, 53 S. Ct. 335, 77 L. Ed. 706 (1933)* ; *Clarkson v. Orkin Exterminating Co., 761 F.2d 189 (4th Cir. 1985)* (South Carolina law); *American Home Prods. Corp. v. FTC, 695 F.2d 681 (3d Cir. 1983)* ; *Aurigemma v. Arco Petroleum Products Co., 734 F. Supp. 1025 (D. Conn. 1990)* ; *Committee on Children's Television, Inc. v. General Foods Corp., 35 Cal. 3d 197, 197 Cal. Rptr. 783, 673 P.2d 660 (1983)* (actual deception unnecessary under *Cal. Bus. & Prof. Code § 17*, 200to obtain private injunction or where restitution necessary to prevent unfair practice). *FTC v. Freecom Communications, Inc., 401 F.3d 1192, 1203 (10th Cir. 2005)* (reciting likely to deceive standard). *See also* FDIC Financial Institution Letter, Unfair or Deceptive Acts or Practices by State-Chartered Banks (Mar. 11, 2004), *available at* www.fdic.gov/news/financial/2004/fil2604a.html (adopting FTC standard). *FTC v. Cyberspace.com, 453 F.3d 1196 (9th Cir. 2006)* (proof of deception not necessary, but evidence that large number of consumers were deceived is highly probative).

(n8)Footnote 8. *FTC v. Colgate-Palmolive Co., 380 U.S. 374, 85 S. Ct. 1035, 13 L. Ed. 2d 904 (1965)* ; *J.B. Williams Co. v. FTC, 381 F.2d 884 (6th Cir. 1967) . But see Bernstein v. Extendicare Health Servs., Inc., 653 F. Supp. 2d 939 (D. Minn. 2009)* (statement insufficiently specific); *Stearns v. Select Comfort Retail Corp., 2009 U.S. Dist. LEXIS 48367* (N.D. Cal. June 5, 2009) ("perfect night's sleep" is puffing).

(n9)Footnote 9. *FTC v. Colgate-Palmolive Co., 380 U.S. 374, 85 S. Ct. 1035, 13 L. Ed. 2d 904 (1965) .*

(n10)Footnote 10. The FTC's current deception standard is somewhat different than that adopted by federal courts or by courts interpreting state UDAP statutes--that the practice is "likely" to deceive consumers acting reasonably (*i.e.,* reasonably for consumers possessing the degree of sophistication that those consumers actually possess). *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 4.2.9 (7th ed. 2008). *See also Cobb v. Monarch Fin. Co., 913 F. Supp. 1164 (N.D. Ill. 1995)* (in order to constitute a deceptive practice under Illinois UDAP statute, it is enough that statement be misleading); *Massachusetts Mut. Life Ins. Co. v. Superior Ct., 97 Cal. App. 4th 1282, 119 Cal. Rptr. 2d 190, 195 (2002) .* The FTC's policy statement setting forth its current standard is included as an appendix to its decision in *In re Cliffdale Assocs., Inc., 103 F.T.C. 110 (1984) .* The Comptroller of the Currency, which enforces the FTC Act against national banks, has adopted the FTC's standard. *See* OCC Advisory Letter 2002-3, *Guidance on Unfair or Deceptive Acts or Practices* (Mar. 22, 2002). *See also* OCC Advisory Letter 2003-2, *Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices* (Feb. 21, 2003) (applying analysis to predatory lending practices). *See Top Rank, Inc. v. Gutierrez, 236 F. Supp. 2d 637 (W.D. Tex. 2001)* (Under Texas UDAP, an act is "false, misleading, or deceptive" if it has the capacity to deceive an "ignorant, unthinking, or credulous person.").

(n11)Footnote 11. *Ambrose v. New Eng. Ass'n of Schs. and Colls., Inc., 252 F.3d 488 (1st Cir. 2001)* ; *American Home Prods. Corp. v. FTC, 695 F.2d 681 (3d Cir. 1983)* ; *Parker-Smith v. Sto Corp., 262 Va. 432, 551 S.E.2d 615 (2001)* (construing false advertising statute). *Aspinall v. Philip Morris Cos., 813 N.E.2d 476 (Mass. 2004) . FTC v. Peoples Credit First, LLC, 2006-1 Trade Cas. (CCH) P75192, 2005 U.S. Dist. LEXIS 38545* (M.D. Fla. Dec. 18, 2005) (solicitation for "platinum card" gave false impression that major credit card was being offered, even though definitions section disclosed that product was buying club membership); *FTC v. Cyberspace.com, 453 F.3d 1196 (9th Cir. 2006)* (small print on back of fake invoice disclosed that cashing "refund" check committed consumer to purchase of Internet service, billed to monthly phone bill; solicitation was deceptive).

(n12)Footnote 12. *Regina Corp. v. FTC, 322 F.2d 765 (3d Cir. 1963)* ; Minnesota *ex rel. Hatch v. Fleet Mortgage Corp., 158 F. Supp. 2d 962 (D. Minn. 2001)* (promoting "free trial period" while obscuring fact that monthly charges will be assessed unless consumer cancels is deceptive); *Chandler v. American Gen. Fin., Inc., 329 Ill. App. 3d 729, 768 N.E.2d 60 (2002)* (ads that created impression that new loan was offered, when lender actually intended only to offer refinancing, could be deceptive).

(n13)Footnote 13. *Carter v. Gugliuzzi, 168 Vt. 48, 716 A.2d 17 (1998) .*

(n14)Footnote 14. *See In re Milbourne, 108 B.R. 522 (Bankr. E.D. Pa. 1989)* . *But see Nevarez v. O'Connor Chevrolet, Inc., 426 F. Supp. 2d 806, 815 (N.D. Ill. 2006)* (statement that consumers were getting "best rate available" is mere opinion so not actionable as UDAP violation); *Cooper v. GGGR Investments, L.L.C., 334 B.R. 179 (E.D. Va. 2005)* (statement of opinion not a UDAP violation); *Park Rise Homeowners Ass'n, Inc., v. Resource Construction Co., 2006 Colo. App. LEXIS 926* (Colo. Ct. App. June 15, 2006) ("quality construction" is puffing).

(n15)Footnote 15. *FTC v. Brown & Williamson Tobacco Corp., 778 F.2d 35 (D.C. Cir. 1985)* (small print disclosure cannot save deceptive general claim); *Sterling Drug, Inc. v. FTC, 741 F.2d 1146 (9th Cir. 1984)* ; *American Home Prods. Corp. v. FTC, 695 F.2d 681 (3d Cir. 1983)* .

(n16)Footnote 16. *Varacallo v. Massachusetts Mut. Life Ins. Co., 332 N.J. Super. 31, 752 A.2d 807 (App. Div. 2000)* ; *Ji v. Palmer, 333 N.J. Super. 451, 755 A.2d 1221 (App. Div. 2000)* (only knowing omissions are UDAP violations); *Colonial County Mut. Ins. Co. v. Valdez, 30 S.W.3d 514 (Tex. App. 2000)* ; *Nwaigwe v. Prudential Prop. & Cas. Ins. Co., 27 S.W.3d 558 (Tex. App. 2000)* . *See De La Cruz v. Cohen (In re Cohen), 191 B.R. 599 (Bankr. D.N.J. 1996)* (New Jersey UDAP statute requires that omissions be knowing, with intent that others rely on them, resulting in ascertainable damages, but knowledge and intent are not required in the case of affirmative acts), *aff'd on other grounds, 106 F.3d 52 (3d Cir. 1997)* , *aff'd, 523 U.S. 213 (1988)* . *See, e.g., Crandall v. Grbic, 138 P.3d 365, 378 (Kan. Ct. App. 2006)* (statute requires willfulness for omissions); *Vagias v. Woodmont Props., L.L.C., 384 N.J. Super. 129, 894 A.2d 68 (App. Div. 2006)* (intent is necessary for omissions but statement that house was "in Montville" is affirmative misrepresentation).

(n17)Footnote 17. *Griffin v. Security Pac. Auto. Fin. Servs., 33 F. Supp. 2d 926 (D. Kan. 1998)* (omission must be willful); *Hayes v. Hambruch, 841 F. Supp. 706 (D. Md. 1994)* , *aff'd, 1995 U.S. App. LEXIS 22272 (4th Cir. 1995)* ; *Siudyla v. ChemExec Relocation Sys., Inc., 23 Conn. App. 180, 579 A.2d 578 (1990)* (no UDAP violation where real estate seller was not in position to make representations about the property and so advised buyer). The seller may have a duty under a law or regulation to investigate and discover certain facts, in which case knowledge will be imputed. *Benik v. Hatcher, 358 Md. 507, 750 A.2d 10 (2000)* .

(n18)Footnote 18. *P. Lorillard Co. v. FTC, 186 F.2d 42, 58 (4th Cir. 1950)* . *See Ramirez v. C.L.A.S., Inc., 2000 Mass. App. Div. LEXIS 6* (Mass. App. Ct. Jan. 13, 2002) (failure to disclose that vehicle lacked visible VIN and could not be legally driven until state provided replacement VIN). *But see Key v. Lewis Aquatech Pool Supply, Inc., 58 Va. Cir. 344 (2002)* (nondisclosure not a UDAP violation where it was not deliberately deceptive).

(n19)Footnote 19. *Horizon Corp., 97 F.T.C. 464 (1981)* . More on failure to disclose as a UDAP violation is found at National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 4.2.14 (6th ed. and Supp.).

(n20)Footnote 20. *Prestwick Golf Club, Inc. v. Prestwick Ltd. P'ship, 331 S.C. 385, 503 S.E.2d 184 (Ct. App. 1998)* , *reh'g denied,* (Aug. 20, 1998); *Heller v. Silverbranch Constr. Corp., 376 Mass. 621, 382 N.E.2d 1065 (1978)* .

(n21)Footnote 21. *Sergeant Oil & Gas Co. v. National Maint. & Repair, 861 F. Supp. 1351 (S.D. Tex. 1994)* . *But see Vera v. North Star Dodge Sales, Inc., 989 S.W.2d 13 (Tex. App. 1998)* (waiver of claims in post-transaction settlement is permitted).

(n22)Footnote 22. *Torrance v. AS & L Motors, 459 S.E.2d 67 (N.C. Ct. App. 1995)* ; *Love v. Keith, 383 S.E.2d 674 (N.C. Ct. App. 1989)* . *Devan Motors of Fairfield, Inc. v. Infiniti Div. of Nissan N. Am., Inc., 2004 U.S. Dist. LEXIS 25161* (D. Conn. Dec. 14, 2004) ; *Wall v. Planet Ford, Inc., 825 N.E.2d 686, 692 (Ohio App. 2005)* . *See also Eicher v. Mid Am. Fin. Inv. Corp., 270 Neb. 370, 702 N.W.2d 792, 2005 Neb. LEXIS 157 (2005)* . *But see Yocca v. Pittsburgh Steelers Sports, Inc., 854 A.2d 425 (Pa. 2004)* (applying parol evidence rule to rebut claim of justifiable reliance on brochure).

(n23)Footnote 23. *Cummings v. HPG Int'l, Inc., 244 F.3d 16 (1st Cir. 2001)* (Mass. law) (party cannot induce a contract by fraudulent representation and then use contractual devices to escape liability); *International Nickel Co. v.*

Trammel Crow Distrib., 803 F.2d 150 (5th Cir. 1986) (Texas law); *Bakhico Co. v. Shasta Beverages, Inc., 1998 U.S. Dist. LEXIS 14266 (N.D. Tex. 1998)* ; *McCullough v. Lewensohn, 221 Wis. 2d 595, 586 N.W.2d 698 (1998)* (contractual disclaimer does not affect UDAP liability). *But see Lefebvre Intergraphics, Inc. v. Snaden Mach., Ltd., 946 F. Supp. 1358 (N.D. Ill. 1996)* .

(n24)Footnote 24. *High Plains Nat'l Gas Co. v. Warren Petroleum Co., 875 F.2d 284 (10th Cir. 1989)* (Texas law); *Bakhico Co. v. Shasta Beverages, Inc., 1998 U.S. Dist. LEXIS 14266 (N.D. Tex. 1998)* (waiver of right to seek indemnity from third party not itself subject to suit). *But see Kruger v. Subaru of Am., Inc., 996 F. Supp. 451 (E.D. Pa. 1998)* (where UDAP claim based solely on breach of warranty and where limitation on remedy clause found valid for purposes of warranty claim).

(n25)Footnote 25. *Wellborn v. Sears, Roebuck & Co., 970 F.2d 1420 (5th Cir. 1992)* (Texas law); *In re Methyl Tertiary Butyl Ether Prods. Liab. Litig., 175 F. Supp. 2d 593* , *recons. denied, 2001 U.S. Dist. LEXIS 13886* (S.D.N.Y. Sept. 6, 2001) (plaintiffs could assert UDAP claim against gasoline manufacturers who sold gasoline to the public with additives that leaked into plaintiffs' water supply); *Reisman v. KPMG Peat Marwick LLP, 965 F. Supp. 165 (D. Mass. 1997)* ; *Boos v. Abbott Labs., 925 F. Supp. 49 (D. Mass. 1996)* ; *Ciardi v. F. Hoffmann-La Roche, Ltd., 436 Mass. 53, 762 N.E.2d 303 (2002)* ; *Gennari v. Weichert Co. Realtors, 148 N.J. 582, 691 A.2d 350 (1997)* ; *Vitolo v. Dow Corning Corp., 166 Misc. 2d 717, 634 N.Y.S.2d 362 (Sup. Ct. 1995)* , *aff'd, modified, 234 A.D.2d 361, 651 N.Y.S.2d 104 (2d Dept. 1996)* ; *Bohls v. Oakes, 75 S.W.3d 473 (Tex. App. 2002)* , *pet. for rev. denied,* (Sept. 12, 2002), *mot. for reh'g on pet. for discretionary rev. denied,* (Oct. 31, 2002); *Oakwood Mobile Homes, Inc. v. Cabler, 73 S.W.3d 363 (Tex. App. 2002)* , *pet. for rev. filed,* (May 13, 2002), *pet. for rev. denied,* (Aug. 29, 2002), *reh'g denied,* (Oct. 17, 2002); *Long Distance Int'l, Inc. v. Telefonos de Mex., S.A., 2002 Tex. App. LEXIS 1839 (Mar. 13, 2002), 2002 Tex. App. LEXIS 6330* (Tex. App. Aug. 30, 2002) . *Speakman v. Allmerica Fin. Life Ins., 367 F. Supp. 2d 122 (D. Mass. 2005)* (privity unnecessary for UDAP claims except those involving breach of warranty, but defendant must have taken active role in the wrongful conduct); *Bildstein v. MasterCard Int'l, Inc., 2005 U.S. Dist. LEXIS 10763* (S.D.N.Y. June 6, 2005) ; *Pelican Ventures LLC v. Azimut S.p.A., 2004 U.S. Dist. LEXIS 26764, 18 Fla. L. Weekly Fed. D 242* (S.D. Fla. July 28, 2004) ; State *ex rel. Miller v. Cutty's Des Moines Camping Club, Inc., 694 N.W.2d 518 (Iowa 2005)* ; *State v. Weinschenk, 868 A.2d 200 (Me. 2005) . But cf. Marshall v. Kusch, 84 S.W.3d 781 (Tex. App. 2002)* (original seller can be liable for making misrepresentation that reaches ultimate buyer; also liable if original seller benefits from intermediate buyer's resale; neither shown here).

(n26)Footnote 26. *Resort Car Rental Sys., Inc. v. FTC, 518 F.2d 962* (9th Cir.) , *cert. denied sub nom. Mackenzie v. United States, 423 U.S. 827 (1975)* .

(n27)Footnote 27. *State v. Amoco Oil Co., 97 Wis. 2d 226, 293 N.W.2d 487 (1980)* .

(n28)Footnote 28. *ARA Auto. Group v. Central Garage, Inc., 124 F.3d 720 (5th Cir. 1997)* .

(n29)Footnote 29. *See Randazzo v. Harris Bank Palatine, 262 F.3d 663 (7th Cir. 2001)* ; *Progressive Mich. Ins. Co. v. United Wis. Life Ins. Co., 84 F. Supp. 2d 848, 854 (E.D. Mich. 2000)* ; *Cotton v. Med-Cor Health Info. Solutions, Inc., 221 Ga. App. 609, 472 S.E.2d 92 (1996)* .

(n30)Footnote 30. *Buechlin v. Ogden Chrysler-Plymouth, Inc., 159 Ill. App. 3d 237, 250, 251, 511 N.E.2d 1330 (1987)* (where seller committed fraud in misrepresenting used car as "new," buyer did not waive claims by paying for car after learning of fraud); *Williams v. Consolvo, 237 Va. 608, 615, 379 S.E.2d 333 (1989)* ; *Kemp v. Am. Tel. & Tel. Co., 393 F.3d 1354 (11th Cir. 2004)* (Georgia's codification of voluntary payment doctrine does not apply to payment that is product of fraud).

(n31)Footnote 31. *Durant v. Servicemaster, 159 F. Supp. 2d 977, 981 (E.D. Mich. 2001)* .

(n32)Footnote 32. *See Randazzo v. Harris Bank Palatine, 262 F.3d 663, 668 n.1 (7th Cir. 2001)* (lengthy discussion of circumstances that may constitute duress). *But cf. King v. First Capital Fin. Servs. Corp., 828 N.E.2d*

1125 (Ill. 2005) (no coercion where consumers did not sufficiently allege that they were required either to pay illegal fee or to forego loans).

(n33)Footnote 33. *See Curtis Mfg. Co. v. Plastic-Clip Corp., 888 F. Supp. 1212 (D.N.H. 1994)* (New Hampshire UDAP statute's list of unfair and deceptive acts is non-exhaustive, and the facts can establish that other conduct is unfair). *See also In re Pharmaceutical Indus. Avg. Wholesale Price Litig., 252 F.R.D. 83, 95-96 (D. Mass. 2008)* (listing states that broadly prohibit unfair practices); National Consumer Law Center, Consumer Protection in the States: A 50-State Report on Unfair and Deceptive Acts and Practices Statutes (Feb. 2009), *available at* www.consumerlaw.org (state-by-state survey of substantive prohibitions of UDAP statutes).

(n34)Footnote 34. The Federal Trade Commission Act Amendments of 1994, Pub. L. No. 103-312, § 9, adding a new *15 U.S.C. § 45(n)* (Aug. 26, 1994).

(n35)Footnote 35. *See § 4.04[1][i] infra.*

(n36)Footnote 36. *Pepsi-Cola Metro. Bottling Co. v. Checkers, Inc., 754 F.2d 10 (1st Cir. 1985)* (Massachusetts law); *Basnight v. Diamond Developers, Inc., 146 F. Supp. 2d 754* (North Carolina law) , *costs/fees proceeding, mot. denied, 178 F. Supp. 2d 589 (M.D.N.C. 2001)* ; *Informix Software, Inc. v. Oracle Corp., 927 F. Supp. 1283 (N.D. Cal. 1996)* ; *Brandewiede v. Emery Worldwide, 890 F. Supp. 79 (D. Conn. 1994)* ; *Curtis Mfg. Co. v. Plastic-Clip Corp., 888 F. Supp. 1212 (D.N.H. 1994)* ; *Retail Serv. Assocs. v. Conagra Pet Prods. Co., 759 F. Supp. 976 (D. Conn. 1991)* ; *Lake Mary Ltd. P'ship v. Johnston, 551 S.E.2d 546* (N.C. App.) , *rev. denied, 557 S.E.2d 538* , *rev. denied, mot. granted, 557 S.E.2d 539 (N.C. 2001)* . *See also Dalton v. Camp, 353 N.C. 647, 656, 548 S.E.2d 704, 711 (2001)* (defining unfair as "unethical or unscrupulous"); *DeBondt v. Carlton Motorcars, Inc., 342 S.C. 254, 536 S.E.2d 399 (Ct. App. 2000)* (South Carolina). *State v. Moran, 861 A.2d 763 (N.H. 2004)* (*S&H* definition provides guidance).

For a detailed analysis of both standards, how they differ, and how they have been applied to credit practices and other consumer transactions, see National Consumer Law Center, Unfair and Deceptive Acts and Practices § 4.3.3.3.2 (7th ed. 2008 and supp.).

(n37)Footnote 37. OCC Advisory Letter 2002-3, *Guidance on Unfair or Deceptive Acts or Practices* (Mar. 22, 2002). *See* OCC Advisory Letter 2003-2, *Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices* (Feb. 21, 2003) (applying unfairness analysis to predatory lending practices).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 4 Unfair and Deceptive Credit Practices

1-4 Consumer Credit Law Manual § 4.04

§ 4.04 Unfair and Deceptive Credit Practices

[1] Creditor Remedies and the FTC Credit Practices Rule

[a] General

The FTC Trade Regulation Rule Concerning Credit Practices ("FTC Rule" or "the Rule") n1 sets an important standard as to what type of creditor remedies are unfair or deceptive. The Rule applies to credit transactions generally. Transactions covered by the FTC Rule include lease-purchase contracts where the consumer is obligated to pay a specified amount and is permitted to become the owner of the property for little or no additional consideration. The Rule also covers creditors, such as physicians and contractors, who use deferred payment plans. The Rule does not, however, cover nonprofit organizations or a city that administers a housing rehabilitation grant program.

The FTC Rule prohibits the following six practices:

- Confessions of judgment, cognovits, and other waivers of the right to notice and opportunity to be heard in the event of suit (this provision does not apply to executory process in Louisiana);

- The debtor's waiver of protections concerning property exempt from attachment or execution, such as waiver of a homestead exemption, or the waiver of an exemption for property that is the subject of a security interest granted in that credit transaction (this provision does not prohibit security interests in exempt property);

- Most irrevocable wage assignments;

- Non-purchase money security interests in certain household goods, but creditors can still take security interests in works of art, items acquired as antiques, jewelry (except wedding rings), and electronic entertainment equipment (except one television and one radio);

- Pyramiding late charges by assessing more than one delinquency charge for one late payment (pyramiding late charges for a missed payment is not prohibited); and

- The failure to provide cosigners with a specified warning indicating the potential obligations of a cosigner. n2

The best sources for understanding the FTC's Credit Practices Rule are the FTC's Statement of Basis and Purpose for the Rule and, to a lesser extent, the informal FTC staff opinion letters on the Rule. n3 The FTC is empowered to enforce the rule.

The FTC Rule applies to finance companies, retailers, and other creditors within the FTC's jurisdiction. The FTC Rule does not apply to most banks. Nevertheless, the Office of Thrift Supervision ("OTS") and the FRB have enacted analogous rules for savings and loan institutions n4 and for all other banks, n5 respectively. Credit unions are covered by a comparable rule enacted by the National Credit Union Administration ("NCUA"). n6

While all of these rules are similar, the FRB, OTS and NCUA Rules only prohibit banks and credit unions from entering into credit agreements containing or enforcing the prohibited creditor remedies. The FRB, OTS and NCUA Rules do not prohibit a bank or credit union from purchasing consumer credit agreements containing the prohibited terms as long as the financial entity does not enforce the prohibited creditor remedy.

Important materials for interpreting the FRB Rule are FRB staff guidelines. n7

[b] Confession of Judgment Provision

The FTC Rule's confession of judgment prohibition bars the use of a clause waiving the right to a hearing before the creditor gets a repossession order from a magistrate. On the other hand, the Rule provision does not prohibit a "power of sale" clause that allows a creditor, upon default, to exercise a self-help right to take possession of property and sell it, nor does it prohibit waiver of notice of default. Furthermore, at least one court has ruled that a confession of judgment provision did not violate the Pennsylvania UDAP statute. n8 The protections of the confessed judgment prohibition cannot be waived by the consumer.

[c] Wage Assignment Provision

The Rule's prohibition of wage assignments contains an exception for wage assignments that are revocable at the will of the debtor. n9 According to informal FTC staff opinion letters, a creditor may require that revocation of a wage assignment be in writing, but not that it be done a specified number of days before it is given effect. Mandatory irrevocable wage assignments are allowed in the context of payroll deduction plans of the sort used in credit union loans, as long as only part of the debtor's paycheck is taken. Another exception allows assignment of wages that the consumer has already earned; n10 the FTC staff has construed this exception to allow assignment of the portion of his or her monthly salary that the consumer has earned at the time credit is extended.

[d] Provisions Dealing With Household Goods Security

Construing the prohibition against non-purchase money, non-possessory security interests in household goods, the FTC staff has indicated that the following items fall within the Rule's definition of "household goods": sewing machines, vacuum cleaners, telephones and answering machines, air conditioners, household pets, freezers, floor polishers, patio furniture, ovens, including microwave ovens, dishwashers, fans, clocks, lamps, toasters, and electric can openers. Duplicate items are protected by the Rule, except that only one television and one radio is protected.

The FTC staff has indicated that the following items would not fall within the definition of "household goods":

> "bicycles, typewriters, power tools, a butane tank, livestock, barbecue grills, luggage, carpets and

> rugs, a hot tub, fireplace equipment, a child's car seat, firearms, camping and sports equipment, hunting and fishing equipment, cameras, musical instruments, home computers and computer equipment, lawn equipment, mechanic and carpenter tools, boats, snowmobiles, stamp and coin collections, stereo equipment, bank deposits, credit insurance proceeds, tape players, and VCRs."

The FTC staff considers "personal effects" to be limited to items that an individual would ordinarily carry about on his or her person and possessions of a uniquely personal nature, such as family photographs, personal papers, or a Bible. Where the FTC Rule is unclear, state law will determine whether an item is considered furniture or an appliance. A security interest in "fixtures" is permissible even if it includes items that might be considered household goods if they were not attached to the real property.

These staff opinions are not binding on the courts, but are often used by creditors to justify their practices.

A creditor who lists a security interest in household goods violates the Rule even if a clause in the contract says that the security interest does not apply to non-purchase money consumer loans.

[e] Pyramiding Late Charges Provision

The prohibition against pyramiding late charges does not, according to the FTC staff, affect a creditor's choice of accounting methods, as long as the method chosen does not result in the assessment of late charges where the only delinquency is attributable to late charges assessed on earlier installments. Pyramiding late charges for a *missed* payment is not prohibited.

[f] Cosigner Provision

The rule requires notice to cosigners in the form prescribed by the FTC. The type size and style of the notice should be clear and conspicuous.

A person who signs to be liable on someone else's consumer credit contract, but does not receive compensation, is a cosigner under the Rule even if he or she is described as a "buyer" in the contract documents. If the person is to be the co-owner of the property purchased or is to share in its use, however, he or she is not a cosigner. The same is true where two people apply for a loan together and are both entitled to receive the proceeds. A person who merely provides collateral for an extension of credit without becoming obligated on the underlying debt is not considered a cosigner. A creditor does not violate the Rule by providing the notice to persons involved in the transaction who may not technically be "cosigners," as long as there is no deception.

[g] Private UDAP Actions Utilizing the FTC Rule

There is generally no private right of action under the FTC Act for a violation of an FTC Rule. It seems clear, however, that a consumer can challenge an FTC Credit Practices Rule violation under the almost forty state UDAP statutes that prohibit "unfair" and/or "unconscionable" practices. The Rule is an official FTC ruling that use of certain creditor remedies is an "unfair" trade practice. This FTC ruling guides courts in interpreting what is unfair under a state UDAP statute. Moreover, under many state UDAP laws, it is a per se state UDAP violation to violate an FTC Rule. The Truth in Lending Act ("TILA") may also provide a remedy here.

[h] Attempts to Circumvent FTC Credit Practices Rule

Some creditors seek to circumvent the FTC Credit Practices Rule's provisions. Finance companies now wishing to take consumer goods as collateral can no longer identify the property as "all household goods," but must identify each specific item. Many creditors use a preprinted form listing the types of collateral falling outside the FTC Rule's definition of "household goods," and then just check appropriate items.

The FTC staff has also stated that it is unfair and deceptive to try to evade the Rule by taking a prohibited security interest in household goods and then later disclaiming that interest in the contract.

[i] Using the FTC Unfairness Theory, as Applied in the Credit Practices Rule

The FTC Credit Practices Rule Statement of Basis and Purpose is significant because it provides an "unfairness" approach which can apply to many kinds of adhesive consumer credit provisions, and not just the six creditor remedies prohibited by the Rule. The FTC defines an unfair practice as one that (1) causes substantial injury (including emotional distress); (2) is not outweighed by any countervailing benefits to consumers or competition; and (3) consumers themselves could not reasonably have avoided.

This analysis is further bolstered by the D.C. Circuit opinion upholding the Credit Practices Rule. n11 The D.C. Circuit specifically approved of the FTC's three-part unfairness test, describing this standard as "the most precise definition of unfairness articulated by either the Commission or Congress," and finding that the FTC had properly applied this standard in its Credit Practices Rule.

Taking the third element first, the FTC concludes that consumers cannot reasonably avoid creditor remedies found in standard form credit agreements.

[j] Case Law Finding Creditor Remedies Unfair or Deceptive

Cases have established that:

- It is unfair to use terms that result in an overly harsh penalty
- It is deceptive to calculate late charges at variance with the language of the credit agreement
- Charging excessive late payment penalties has been found to be a UDAP violation.

Finally, a number of creditor remedies have been found unconscionable under the Uniform Commercial Code ("UCC"), section 2-302. These unconscionable creditor remedies include cross-collateral n12 or waiver-of-defense n13 clauses, attorney fee provisions, consent to breach of the peace on self-help repossession, and waiver of the consumer's interest in personal property seized with the collateral unless the creditor is notified. Practices found unconscionable under the UCC can be argued to be unfair or unconscionable pursuant to a UDAP statute.

On the other hand, courts have upheld several established creditor remedies. A Washington court refused to strike down a due-on-sale clause where there was no showing of oppression or substantial injury. Nor does a bank have a duty to inform depositors that a hold has been placed on their account because of their default on a loan. n14 It is not a UDAP violation for a bank to extend the due date of a loan, even if the extension is concealed from a co-obligor. n15

The fact that a creditor does not, or claims not to, enforce a particular clause does not mean that its inclusion in the contract is not unfair or deceptive. Such a position would mean that creditors could reap the benefits of the clause's *in terroram* effect on consumers without any consequences. n16

[2] Credit Balances

The FTC has found it unfair or deceptive for a retailer:

- To fail to disclose to customers all material facts relating to its revolving credit balance practices (where an amount is owed to the customer in connection with the charge account);

- To fail to provide those having credit balances with periodic billing statements detailing the amounts of such balances, and with notices that they have a continuing right to request a refund of their credit balance; or

- To transfer out credit balances from charge customers' accounts without notice.

A lender may also commit a UDAP violation by misrepresenting the payoff amount on a loan. n17

[3] Misrepresentations, Nondisclosure of Credit Terms

The violation of a federal or state credit statute meant to protect the public may be a per se state UDAP violation. n18 The FTC has specifically held that violations of FRB Regulation Z n19 and the TILA n20 are unfair and deceptive practices under the FTC Act. n21 Oregon and Massachusetts UDAP regulations specify that a violation of the Federal Truth in Lending or Consumer Leasing Acts are *per se* UDAP violations.

Misrepresentations of easy credit terms are deceptive. n22 Promising a loan at 9 1/2% but including a variable rate has been held *per se* fraudulent. n23

Offering low-cost financing when the seller knows that there are conditions and restrictions on the availability of the low-cost financing is deceptive. n24 A credit-seller may engage in a deceptive practice where it promises to find the consumer the best available financing, but where it instead looks for financing that will provide a large discount on the assignment, in effect providing a kickback to the credit-seller. n25 Characterizing a fee as a "loan discount fee" when the fee does not actually reduce the interest rate may be deceptive. n26

It is a UDAP violation to misrepresent that a mortgage is not required as a condition of a loan. n27 Disclosing a security interest greater than that allowed by state law is deceptive. An advertisement offering $99 a month, no money down is deceptive where the creditor offers only one or the other term, but not both. n28

A credit card statement's disclosure of a service charge was deceptive where balances less than $25 were not being so charged. n29 Creditors cannot misrepresent a consumer loan as a cash advance on a refund of federal income taxes, and that as such they are superior to a normal consumer loan. n30 It is also deceptive to misrepresent a sale and lease-back scheme as a refinancing.

It is a UDAP violation to fail to disclose adequately all credit charges, such as not disclosing the annual percentage rate, the dollar credit charge, and the cash price, or to misrepresent the interest to be paid, or hiding the true cost of a loan. n31 Failing to disclose to the consumer that a new loan would be less expensive than refinancing an old loan is a UDAP violation. n32 Quoting a " *per annum*" rate based on a 360-day year is deceptive even though it is customary practice and even though the actual annual percentage rate ("APR") is subsequently disclosed. n33

Inducing the consumer to sign a contract by understating the amount of the monthly payment is a UDAP violation. n34 It is also deceptive to misrepresent the legality of the transaction. n35

Oral misrepresentations about the terms of a contract are UDAP violations, and the parol evidence rule is inapplicable to such a claim. n36 Baiting consumers with an offer of a new loan, and then switching them to a more expensive refinancing, is a UDAP violation. n37

[4] Oppressive Credit Practices

[a] Attempts to Evade Credit Legislation

It is deceptive to incorporate a consumer to avoid state usury limits on consumer loans. n38 Other schemes to avoid state usury laws may also be actionable. n39 Finding loopholes in the Federal TILA to hide the true cost of a loan is unfair and deceptive. n40

Hiding a broker's commission in the loan documents so that the consumer must pay extra at the closing is deceptive. n41 A creditor engages in unfair or deceptive conduct by entering into a car "lease" that is really a contract for sale, violating state and federal disclosure loans, disguising the finance charge, creating a large balloon payment at the end, and having a total of payments far exceeding the purchase price of the vehicle. n42 A car pawn scheme has been held to violate a UDAP statute where the pawn was really a loan scheme. n43 A creditor may commit a UDAP violation by listing a cosigner as a co-buyer, contrary to a state law designed to ensure that those who do not actually receive the property are treated only as guarantors. n44

[b] Excessive Credit Charges

Charging interest in excess of that allowed by state law is a UDAP violation. n45 Double-charging for the same interest charge is also a UDAP violation. n46 A federal court has found a 240% APR implicit in a pawn transaction to be oppressive and thus unfair. n47 Failing to disclose to the consumer that a new loan would be less expensive than refinancing an old loan is a UDAP violation.

Charging 200% interest on a $99,000 secured loan has been found unconscionable. n48 It is a UDAP violation to charge a disproportionate late fee that is void as a penalty under common law. n49

Another court has ruled that a "debt pooler" violates UDAP by charging an extremely high interest rate, adding substantial loan broker charges, placement fees, acceptance fees, and attorney fees, and falsely disclosing or failing to disclose important loan terms. n50

Selling credit insurance at inflated premiums, receiving a 25% commission, and failing to disclose these facts is a UDAP violation, where the finance company is in a fiduciary relationship. It is a UDAP violation to charge a higher post-default interest rate than that allowed by the credit agreement. n51 Imposing a prepayment charge contrary to the contract is also a UDAP violation where it reveals a pattern of misrepresentation that no fee would be charged. n52 It is also a UDAP violation to fail to credit debtors' payments promptly, while charging interest on the unpaid balance. n53

[c] Discrimination

It is a violation of federal and state law to discriminate on a prohibited basis in the granting of credit. n54 A UDAP claim may be an alternative or additional claim to these anti-discrimination statutes. Targeting a particular group for unfair practices should clearly be unfair.

[d] Coercive Tactics

In one case, a debtor was awarded approximately $3 million in UDAP multiple damages and $100,000 in attorney fees for a lender's misconduct in luring the debtor into a loan the debtor could not afford. n55 It can be an unfair practice for a seller to request the consumer to sign a blank credit card slip for certain purposes, and then add charges to that blank slip for other purposes. n56 Charging a consumer's credit card account without authorization is a UDAP violation. n57 It is unconscionable for a creditor to miscalculate the pay-off figure on a loan and then refuse to return the overpayment. n58 Coercing the consumer's payment of spurious charges in order to get a payoff statement so a home can be sold is a UDAP violation. n59

[5] Home Mortgage Loans

The Comptroller of the Currency has issued a detailed analysis of why certain lending practices are predatory and abusive. n60 The OCC states a fundamental characteristic of predatory lending is the aggressive marketing of credit to prospective borrowers who cannot afford to repay it. Typically, such credit is underwritten predominantly on the basis of the foreclosure value of the home. The OCC identifies a variety of other practices that accompany the marketing of abusive loans:

- Loan flipping, *i.e.*, frequent refinancings that result in little or no economic benefit to the borrower and are undertaken with the primary objective of generating fees or prepayment penalties;
- Refinancings of special subsidized mortgages issued by government or non-profit agencies;
- Packing of excessive and hidden fees into the amount financed;
- Using loan terms such as negative amortization to make it harder for borrowers to repay the debt;
- Using balloon payments to conceal the true burden of the refinancing and to force borrowers into costly refinancing transactions or foreclosures;
- Targeting older, financially unsophisticated, or otherwise vulnerable borrowers for inappropriate or excessively expensive credit products;
- Targeting borrowers who could qualify for mainstream credit products and terms;
- Inadequately disclosing the true costs and risks of a loan, and its appropriateness or inappropriateness for the particular borrower;
- Offering single premium credit life insurance;
- Using mandatory arbitration clauses.

A second Comptroller Advisory Letter advises national banks to set clear standards to avoid acquiring predatory loans originated by brokers. n61

A creditor committed an unfair practice by conspiring with a home seller to avoid a purchase and sale agreement by stalling, and then refusing to offer the home buyer a mortgage until it was too late for the buyer to find alternative financing. n62 It is deceptive for a creditor to represent that it will provide a mortgage loan, but then back out of the deal. n63 It is deceptive to claim falsely that a home purchaser would be eligible for low-cost financing through a government benefit program. n64 Failing to make specific disclosure of a recording fee for assigning the mortgage to another company, and then springing it upon the borrowers at closing, is an unfair practice. n65 Predatory mortgage lending which seeks to strip away a home's equity by luring the homeowner into an unaffordable loan that will result in foreclosure may give rise to a UDAP violation. n66 A lender's failure to disclose the disadvantageous cost or nature of a loan can lead to UDAP liability. n67 Submitting an inflated appraisal and misrepresenting to consumers that the payments on a loan will be set at an amount they can afford is deceptive. n68 A Connecticut appellate court held that it was an unfair practice under the state UDAP statute to lend at an arbitrarily high annual percentage rate while knowing that the borrower could not repay the loan unless it was refinanced by a second loan, and refusing to allow the borrower an opportunity to discuss or evaluate the terms of the second loan. n69 An intermediate appellate court has upheld a preliminary injunction obtained by the Massachusetts Attorney General that restricted foreclosures by a subprime lender on loans that combined four predatory features. n70 The court held that, even though each of the four loan features was

legal in and of itself, it could be an unfair practice under the UDAP statute to make loans that combined all four features.

[6] Loan Brokers

Loan broker abuses are becoming so widespread that states are beginning to enact special statutes covering such abuses, which may provide their own remedial scheme or that violations may be treated as state UDAP violations. n71

A widespread form of loan broker abuse involves advance fees. The broker takes cash up front from the consumer, promising to find the consumer a loan, but never follows through and never refunds to the consumer the fee. The FTC's Telemarketing Rule prohibits brokers from requesting or receiving payment of any fee in advance of obtaining a loan when the broker has guaranteed or represented a high likelihood of success in obtaining the loan. n72

Similarly, loan brokers cannot take an advance fee to obtain a loan and then fail to refund that fee as promised when the broker does not obtain a loan. It is also deceptive to misrepresent that advance payments will be applied to the consumer's loan repayments and to fail to disclose to consumers various non-refundable charges imposed by the loan broker. n73

A widespread practice in both the home mortgage and auto finance industries is charging interest rates that include "yield spread premiums." Lenders provide brokers, car dealers, or other arrangers of credit a range of acceptable interest rates. If the broker arranges the loan at a rate higher than the minimum of that range, then the broker gets to keep all or some of the amount exceeding the minimum rate. Most litigation in this area concerning home mortgage loans is based on claims under the Federal Real Estate Settlement Procedures Act. n74 In addition, it can also be a UDAP violation to fail to disclose to the consumer that the lender is willing to write the loan at a lower interest rate, and that all or some of the amount exceeding that lower rate is being paid to the arranger. n75

The Comptroller of the Currency has issued an advisory letter to the national banks it regulates, cautioning them of the heightened risk that loans originated by brokers and other intermediaries will be abusive. n76 The letter points out that, since these intermediaries do not take on the ultimate credit risk of the loan and are less intensely supervised than banks, they are more likely to be tempted to originate loans that the borrower does not have a reasonable prospect of repaying. The letter advises national banks to establish specific policies and procedures to avoid these loans. In litigating against a bank that acquired an abusive loan through a broker, it may be useful to inquire through discovery whether the bank had such policies and procedures in place.

[7] Debt Consolidators

Many state statutes prohibit the business of debt pooling or debt adjusting except by nonprofit agencies and lawyers. Check local laws.

[8] Mortgage Assistance Scams

Various scams involving foreclosure prevention, promised refinancing, assistance with filing bankruptcy, etc., to save consumer's homes have been found to be UDAP violations when the services, such as a referral to a bankruptcy attorney, were available for free and the promised activities never took place. n77

In another variant, entrepreneurs buy delinquent debts before foreclosure begins. Then they contact the homeowner, threaten foreclosure, and by one means or another, acquire control of the property. Firms even offer seminars on these tactics. n78 A Massachusetts court held that a home-saver who followed this pattern may have committed UDAP violations by representing to the homeowner that signing the agreements was a mere formality after the homeowner made it clear that he could not afford the payments. n79

A District of Columbia trial court found that a home-saver committed numerous deceptive and unconscionable acts. These included failure to disclose the appraised value of the home and that he was the other contracting party and would profit personally from the transaction; presenting himself as helping the homeowner save her home, when his real intention was to acquire the home for a pittance; and acquiring a home at a grossly disproportionate price from an aged and infirm homeowner. n80 The equitable mortgage doctrine may provide additional claims for homeowners who have been victims of homesaver fraud. In addition, a few jurisdictions have special laws applying to homesaver or foreclosure rescue frauds.

[9] Fringe Lenders: Pawnbrokers, Trading Posts, and Others

There is a growing trend toward fringe lending--non-traditional techniques to make small consumer loans at extremely high interest rates. UDAP claims may be helpful in dealing with auto pawns, refund anticipation loans, and pay day loans.

The FTC has accepted a number of consent agreements dealing with practices of trading posts serving Native Americans. These cases also have applicability to other pawnbroker situations. Pawnbrokers often fail to provide written notice of the sale of pawned goods, entitling the consumer to statutory damages under *UCC section 9-507*. n81

[10] Banking, Check Cashing Practices, "Telechecks" or Preauthorized Drafts

A series of cases have found excessive bank fees to be unconscionable. Another fast growing area of consumer abuse involves "telechecks," "preauthorized drafts," or "demand drafts." The technique can be perfectly legitimate--a party obtains the consumer's advance permission to have money taken from a checking account to pay an obligation. Instead of a signed check, the party presents to the bank an unsigned draft.

The abuse occurs where a scam operator obtains the consumer's account number and bank's routing number (the "MICR" numbers on the bottom of the check) and presents a draft to the bank without the consumer's authorization. n82 The same is the case with credit repair organizations, n83 and companies that promise, for a fee, to find the consumer unused scholarships and grants. n84 Other scam operators ask for the checking account number which is to be used only when specified services have been provided, but then take money out of the account before providing the services and without authorization. n85

The consumer's challenge on the withdrawal instead should be based on the fact that the consumer did not provide authorization for the merchant to debit the consumer's account. Because it is very likely that the consumer's own bank will bear the eventual loss if the consumer does not, n86 be prepared for the consumer's own bank to resist the consumer's claim. n87 A proposed revision of UCC Articles 3 and 4 would change the rule to put the loss in the first instance on the transferor of the check rather than the drawee-payor bank where a check is drawn on a consumer account and does not contain a handwritten signature purporting to be the consumer drawer's signature. n88 This might make the consumer's bank less resistant when the consumer claims he did not authorize the draft. Some states have already enacted non-uniform amendments to the UCC which accomplish this. n89

The FTC Telemarketing Rule prohibits any seller or telemarketer from obtaining or submitting for payment a check, draft, or other form of negotiable paper drawn on a person's checking, savings or other account without that person's express verifiable authorization. n90 Verifiable authorization means the consumer's express written authorization, tape recorded express oral authorization which must be made available to the consumer's bank on request, or written confirmation of the transaction sent to the consumer prior to submission of payment to the customer's bank. Effective March 31, 2003, the FTC applies these requirements to all methods of payment other than debit cards that are subject to the protection of the Electronic Fund Transfers Act and credit cards that are subject to the protections of the Truth in Lending Act. n91

Telemarketing rule violations may result not only in a UDAP claim against the seller, but the standards for verification may be useful to consumers in dealing with their own banks.

[11] Credit Reporting Agency Practices

Consumer litigants may argue that violations of the Federal Fair Credit Reporting Act n92 ("FCRA") or state credit reporting statutes are *per se* state UDAP violations. n93 The FCRA itself states that, for purposes of FTC enforcement, violations are treated as unfair or deceptive practices. n94

In addition, a UDAP challenge should be considered for practices by both reporting agencies and suppliers of information to those agencies where those practices are not prohibited by the FCRA.

Amendments to the FCRA effective in 1997 preempt state laws imposing any requirement or prohibition with respect to a short laundry list of subject matter areas, including FCRA consumer dispute resolution processes, obligations of users of consumer reports, and some content of consumer reports. One of the subject matter areas preempted regards the obligations of furnishers (suppliers) of information to reporting bureaus.

While the specific scope of each area of preemption merits close analysis, n95 the effect of the new FCRA preemption on potential UDAP actions is unclear. Clearly, the FCRA provision overrides, in the subject matter areas that are preempted, any state law provision applying different requirements specifically to credit reporting activities. Whether more general standards with potential but no specific application to credit reporting, such as discrimination laws and UDAP, are also preempted is an open question and must be approached with care. Caution suggests raising UDAP claims only in strong factual cases and when one is prepared to argue the potential preemption issues. n96

In addition to the specific preemptions of state law generally, the FCRA also gives, to reporting agencies, users of consumer reports, and furnishers of information to reporting agencies, a limited immunity from certain tort claims. The FCRA, though, does not provide this qualified immunity for UDAP claims. Consequently, a UDAP claim may be important in a credit reporting case where tort claims are unavailable. n97

[12] Credit Card Finders

Firms may not misrepresent their ability to obtain credit cards for consumers, or claim that a full refund will be made if a card is not obtained, but then withhold a ten dollar processing fee. n98 Similarly, credit card finders may not misrepresent their relationship to creditors. n99

If the credit card finder markets its services over the telephone and promises a high likelihood of success in obtaining credit, the FTC's Telemarketing Rule prohibits requesting or receiving a fee or other consideration before the credit is obtained for the consumer. n100 The same Rule's general prohibitions against deception and abusive tactics also apply to credit card finder services that are marketed by telephone, even if the seller does not promise easy credit. n101 A telemarketer violated this prohibition by offering "pre-approved Resource Cards," when it only provided booklets and application forms for credit cards from other institutions. n102 Many states have a credit services organization act that applies to entities such as credit card finders who, for a fee, offer to obtain extensions of credit for consumers. The state may also have an applicable loan broker law, or its credit repair statute may cover entities that promise to arrange credit for consumers. n103

[13] Lost Credit Card Reporting Services

A number of companies offer, for a fee, to report to credit card issuers that a consumer has lost his or her credit cards. The FTC has ruled that it is deceptive for these companies not to disclose the limitations of the cardholder's maximum

liability under the Consumer Credit Protection Act. n104

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawU.S. Federal Trade Commission ActionsGeneral OverviewBanking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionUnfair & Deceptive Credit PracticesBanking LawFederal ActsFederal Trade Commission ActGeneral Overview

FOOTNOTES:
(n1)Footnote 1. 16 C.F.R. pt. 444 (effective Mar. 1, 1985), *reprinted in* Vol. 1B *infra*. See also the accompanying Statement of Basis and Purpose, at *49 Fed. Reg. 7,740* (Mar. 1, 1984). After reviewing the regulation as required by the Regulatory Flexibility Act the FTC concluded, in 1995, that revisions to the rule were not warranted. *60 Fed. Reg. 24,805* (May 10, 1995) .

(n2)Footnote 2. The FTC has exempted New York contracts from the cosigner disclosure because state law offers similar or greater protections; *see 51 Fed. Reg. 28,328* (Aug. 7, 1986) .

(n3)Footnote 3. Informal FTC staff opinion letters should be available from Public Records, Federal Trade Commission, Room 130, Washington, D.C. 20580. See National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.1.3.1 (5th ed. 2001 and Supp.), for a detailed discussion of these letters and the Rule.

(n4)Footnote 4. 12 C.F.R. pt. 535.

(n5)Footnote 5. *12 C.F.R. §§ 227.11-227.16*.

(n6)Footnote 6. *See* 12 C.F.R. § 706.

(n7)Footnote 7. *50 Fed. Reg. 47,036* (Nov. 14, 1985) , *as updated at 51 Fed. Reg. 39,646* (Oct. 30, 1986) , *and at 53 Fed. Reg. 29,225 (Aug. 1988)* .

(n8)Footnote 8. *Zhang v. Southeastern Fin. Group, Inc., 980 F. Supp. 787 (E.D. Pa. 1997)* .

(n9)Footnote 9. *16 C.F.R. § 444.2(a)(3)(i)*.

(n10)Footnote 10. *16 C.F.R. § 444.2(a)(3)(iii)*.

(n11)Footnote 11. *American Fin. Servs. Ass'n v. FTC, 767 F.2d 957 (D.C. Cir. 1985)* , *cert. denied, 475 U.S. 1011, 106 S. Ct. 1185, 89 L. Ed. 2d 301 (1986)* .

(n12)Footnote 12. *Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965)* ; *In re Jackson, 9 U.C.C. Rep. Serv. 2d 1152 (W.D. Mo. 1971)* .

(n13)Footnote 13. *Quality Fin. Co. v. Hurley, 337 Mass. 150, 148 N.E.2d 385 (1958)* ; *Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967)* .

(n14)Footnote 14. *Southington Sav. Bank v. Rodgers, 40 Conn. App. 23, 668 A.2d 733 (1995)* .

(n15)Footnote 15. *Norwich Sav. Soc'y v. Caldrello, 38 Conn. App. 859, 663 A.2d 415 (1995)* .

(n16)Footnote 16. *See Baierl v. McTaggart, 245 Wis. 2d 632, 629 N.W.2d 277 (2001)* (refusing to allow illegal clause to be severed so that remainder of lease could be enforced). *See generally* National Consumer Law Center,

Unfair and Deceptive Acts and Practices § 5.2.3.3 (6th ed. 2004 and Supp.). *Goodwin v. Hole No. 4, L.L.C., 2006 U.S. Dist. LEXIS 86157* (D. Utah Nov. 15, 2006) (contract that is skillfully drawn to place virtually no obligation on seller may violate UDAP unconscionability prohibition).

(n17)Footnote 17. *Osbourne v. Capital City Mortgage Corp., 667 A.2d 1321 (D.C. App. 1995)* .

(n18)Footnote 18. *See Brazier v. Sec. Pac. Mortg., Inc., 245 F. Supp. 2d 1136 (W.D. Wash. 2003)* (RESPA requirements are incorporated into state UDAP statute).

(n19)Footnote 19. 12 C.F.R. pt. 226, *reprinted in* Vol. 1B *infra*.

(n20)Footnote 20. *15 U.S.C. §§ 1601 et seq., reprinted in* Vol. 1B *infra*.

(n21)Footnote 21. Burnett v. Ala Moana Pawn Shop, Clearinghouse No. 46,771 (D. Hawaii 1991), *aff'd, 3 F.3d 1261 (9th Cir. 1993)* .

(n22)Footnote 22. *Tashof v. FTC, 437 F.2d 707 (D.C. Cir. 1970)* .

(n23)Footnote 23. *Peoples Trust & Sav. Bank v. Humphrey, 451 N.E.2d 1104 (Ind. Ct. App. 1983)* (foreclosure dismissed, contract reformed, $1000 actual and $40,000 punitive damages awarded). *See also Washington v. Ameriquest Mortg. Co., 2006 U.S. Dist. LEXIS 50804* (N.D. Ill. July 11, 2006) (denying lender's motion for summary judgment; borrower's statement that she was promised lower interest rate creates fact issue even though she signed documents reflecting true interest rate).

(n24)Footnote 24. Illinois Attorney General Consumer Protection Rules, *14 Ill. Admin. Code §§ 475.620, 475.630*; *Stephenson v. Capano Dev., Inc., 462 A.2d 1069 (Del. 1983)* .

(n25)Footnote 25. *Fairman v. Schaumburg Toyota, Inc., 1996 U.S. Dist. LEXIS 9669* (N.D. Ill. July 10, 1996) .

(n26)Footnote 26. *Hauschildt v. Ben. Wis., Inc., 2003 U.S. Dist. LEXIS 24668* (W.D. Wis. Dec. 17, 2003) (denial of motion to dismiss).

(n27)Footnote 27. *Capitol Builders, Inc., 92 F.T.C. 274 (1978)* (consent order); *United Builders, Inc., 92 F.T.C. 291 (1978)* (consent order).

(n28)Footnote 28. *State v. Terry Buick, Inc., 520 N.Y.S.2d 497 (Sup. Ct. 1987)* .

(n29)Footnote 29. *Garland v. Mobil Oil Corp., 340 F. Supp. 1095 (N.D. Ill. 1972)* .

(n30)Footnote 30. *Beneficial Corp. v. FTC, 542 F.2d 611 (3d Cir. 1976)* .

(n31)Footnote 31. *Tashof v. FTC, 437 F.2d 707 (D.C. Cir. 1970)* ; *Taylor v. Bob O'Connor Ford, Inc., 1998 U.S. Dist. LEXIS 5095* (N.D. Ill. Apr. 10, 1998) ; Foster v. New Dimensions Funding, Clearinghouse No. 47,070 (D.N.H. Nov. 24, 1992). *See* DBC Fin., 5 *Trade Reg. Rep. (CCH) 24,700* (FTC Dkt. No. C-3931 2000) (consent order against company that falsely advertised ATM card as having free overdraft protection and no fees). Paying a yield spread premium to a mortgage broker solely for arranging a higher interest rate on a consumer's loan may be a UDAP violation in and of itself. *Michalowski v. Flagstar Bank, 2002 U.S. Dist. LEXIS 1245* (N.D. Ill. Jan. 24, 2002) . *See also Conseco Fin. Serv. Corp. v. Hill, 556 S.E.2d 468 (Ga. Ct. App. 2001)* (inducing the consumer to sign a contract by understating the amount of the monthly payment is a UDAP violation; misrepresenting the legality of the transaction, as well as failing to inform buyers of "step interest rate" and removing that page from their copy of contract, are UDAP violations). *See also* FTC v. Chase Fin. Funding, Inc., No. SACV04-549 (C.D. Cal. May 28, 2004), *available at* www.ftc.gov/opa/2004/chasefinancial.htm (stipulated permanent injunction) (misrepresenting that lender was offering fixed, low interest rate); FTC v. Stewart Fin. Co., 5 *Trade Reg. Rep. (CCH) P 15,477* (N.D. Ga. Sept. 4, 2003) (Civil

Action No. 103CV-2648) (complaint alleging that subprime lender deceptively induced consumers to purchase expensive add-on products such as insurance and auto club memberships, and to participate in a direct deposit program that imposed additional fees), 5 *Trade Reg. Rep. (CCH) P 15,499* (Oct. 28, 2003) (preliminary injunction). *State of North Carolina v. NCCS Loans, Inc., 624 S.E.2d 371 (N.C. Ct. App. 2006)* (payday lender's attempt to couch its loans as a rebate for entering into an internet service contract is violation of usury laws and UDAP violation).

(n32)Footnote 32. *In re Milbourne, 108 B.R. 522 (Bankr. E.D. Pa. 1989)* .

(n33)Footnote 33. *Chern v. Bank of Am., 15 Cal. 3d 866, 127 Cal. Rptr. 110, 544 P.2d 1310 (1976)* .

(n34)Footnote 34. *Conseco Fin. Servicing Corp. v. Hill, 556 S.E.2d 468 (Ga. App. 2001)* , *recons. denied,* (Dec. 5, 2001).

(n35)Footnote 35. *Id.* (misrepresentation of legality of "straw man" or "buy for" arrangement).

(n36)Footnote 36. *Wang v. Massey Chevrolet, 97 Cal. App. 4th 856, 118 Cal. Rptr. 2d 770 (2002)* .

(n37)Footnote 37. *Chandler v. American Gen. Fin., Inc., 329 Ill. App. 3d 729, 768 N.E.2d 60 (2002)* .

(n38)Footnote 38. *Rutter v. Troy Mortgage Servicing Co., 145 Mich. App. 116, 377 N.W.2d 846 (1985)* . *See also State ex rel. Bryant v. R & A Inv. Co., 336 Ark. 289, 985 S.W.2d 299 (1999)* .

(n39)Footnote 39. *Vaughan v. Kalyvas, 342 S.E.2d 617 (S.C. Ct. App. 1986)* .

(n40)Footnote 40. *Therrien v. Resource Fin. Group, 704 F. Supp. 322 (D.N.H. 1989)* . *See also Bernhauser v. Glen Ellyn Dodge, Inc., 288 Ill. App. 3d 984, 683 N.E.2d 1194 (1997)* (use of model Truth in Lending [hereinafter TIL] disclosure form would not excuse UDAP violation that involved substance rather than form of disclosures).

(n41)Footnote 41. *Russell v. Fidelity Consumer Disc. Co., 72 B.R. 855 (Bankr. E.D. Pa. 1987)* .

(n42)Footnote 42. Barco Auto Leasing Corp. v. House, Clearinghouse No. 40,641 (Conn. Super. Ct. Oct. 26, 1983).

(n43)Footnote 43. *Commonwealth v. Car Pawn of Va., 37 Va. Cir. 412 (1995)* .

(n44)Footnote 44. *Lee v. Nationwide Cassel, L.P., 660 N.E.2d 94 (Ill. App. Ct. 1995)* .

(n45)Footnote 45. *United Cos. Lending Corp. v. Sargeant, 20 F. Supp. 2d 192 (D. Mass. 1998)* ; *In re Arsenault, 184 B.R. 864 (Bankr. D.N.H. 1995)* .

(n46)Footnote 46. *Hill v. Allright Mortgage Co., 213 B.R. 934 (Bankr. D. Md. 1996)* , *aff'd in relevant part, 1997 U.S. Dist. LEXIS 21406* (D. Md. July 10, 1997) . *See McMaster v. CIT Group/Consumer Finance, Inc., 2006 U.S. Dist. LEXIS 4760* (E.D. Pa. Feb. 8, 2006) (denying closing attorney's motion for summary judgment on claim that charging twice for title exam was UDAP violation).

(n47)Footnote 47. Burnett v. Ala Moana Pawn Shop, Clearinghouse No. 46,771 (D. Haw. 1991), *aff'd, 3 F.2d 1261 (9th Cir. 1993)* .

(n48)Footnote 48. *Carboni v. Arrospide, 2 Cal. Rptr. 2d 845 (Ct. App. 1991)* .

(n49)Footnote 49. *District Cablevision Ltd. P'ship v. Bassin, 828 A.2d 714 (D.C. 2003)* .

(n50)Footnote 50. *In re Fricker, 115 B.R. 809 (Bankr. E.D. Pa. 1990)* . *See also Williams v. Resolution GGF 04, 417 Mass. 377, 630 N.E.2d 581 (1994)* (concurring opinion; dictum).

(n51)Footnote 51. *Fielder v. Credit Acceptance Corp., 19 F. Supp. 2d 966 (W.D. Mo. 1998)* , *vacated on other grounds, 188 F.3d 1031 (8th Cir. 1999)* (appellate decision holds that District Court did not have authority to issue injunction requiring creditor to move to have state court judgments amended to delete interest overcharges; remands that portion of case to state court).

(n52)Footnote 52. *Stutman v. Chemical Bank, 95 N.Y.2d 24, 731 N.E.2d 608 (2000)* .

(n53)Footnote 53. *Asch v. Teller, Levit & Silvertrust, P.C., 2003 U.S. Dist. LEXIS 16747* (N.D. Ill. Sept. 23, 2003) .

(n54)Footnote 54. *See, e.g., 15 U.S.C. § 1691* (Equal Credit Opportunity Act); *42 U.S.C. § 3601* (Fair Housing Act); *42 U.S.C. §§ 1981*, *1982*, *1988* (Civil Rights Acts). *See also* Ch. 5 *infra*; *Galbraith v. TAPCO Credit Union, 88 Wash. App. 939, 946 P.2d 1242 (1997)* , *rev. denied*, *135 Wash. 2d 1006, 959 P.2d 125 (1998)* .

(n55)Footnote 55. Sweeney v. Comfed Sav. Bank, Clearinghouse No. 45,751 (Mass. Super. Ct. 1991). *But see Wachovia Bank & Trust v. Carrington Dev. Assocs., 459 S.E.2d 17 (N.C. Ct. App. 1995)* (no UDAP violation for refusal to disburse additional funds on a construction loan because the borrower has defaulted in paying subcontractors).

(n56)Footnote 56. *Sprayfoam, Inc. v. Durant's Rental Ctrs., Inc., 39 Conn. Supp. 78, 468 A.2d 951 (Super. Ct. 1983)* .

(n57)Footnote 57. FTC v. Vacation Travel Club, Inc., 5 *Trade Reg. Rep. (CCH) P 22,822 (M.D. Fla. 1990)* (consent order); FTC v. Creative Adver. Specialty House, 5 *Trade Reg. Rep. (CCH) P 22,740* (E.D. Cal. Oct. 10, 1989) (consent order); FTC v. Amy Travel Servs., Inc., 3 *Trade Reg. Rep. (CCH) P 22,546 (N.D. Ill. 1988)*.

(n58)Footnote 58. *Griffith v. Porter, 817 S.W.2d 131 (Tex. Ct. App. 1991)* .

(n59)Footnote 59. *Negrin v. Norwest Mortgage, Inc., 263 A.D.2d 39, 700 N.Y.S. 2d 184 (1999)* (reversing grant of motion to dismiss).

(n60)Footnote 60. OCC Advisory Letter 2003-2, *Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices* (Feb. 21, 2003).

(n61)Footnote 61. OCC Advisory Letter 2003-3, *Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans* (Feb. 21, 2003).

(n62)Footnote 62. *Pedwell v. First Union Nat'l Bank, 51 N.C. App. 236, 275 S.E.2d 565 (1981)* .

(n63)Footnote 63. *Investors, Inc. v. Hadley, 738 S.W.2d 737 (Tex. Ct. App. 1987)* .

(n64)Footnote 64. *Danny Darby Real Estate, Inc. v. Jacobs, 760 S.W.2d 711 (Tex. Ct. App. 1988)* .

(n65)Footnote 65. *Weatherman v. Gary-Wheaton Bank, 286 Ill. App. 3d 48, 676 N.E.2d 206 (1st Dist. 1996)* , *aff'd in part, rev'd in part, 186 Ill. 2d 472, 713 N.E.2d 543 (1999)* .

(n66)Footnote 66. *Associates Home Equity Servs. v. Troup, 343 N.J. Super. 254, 778 A.2d 529 (App. Div. 2001)* . *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 6.7.4 (7th ed. 2008 and supp.). Many states have predatory lending laws that prohibit at least some abusive mortgage lending practices. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 12.2.4 (4th ed. 2009).

(n67)Footnote 67. *Barker v. Altegra Credit Co. (In re Barker), 251 B.R. 250 (Bankr. E.D. Pa. 2000)* ; *In re Milbourne, 108 B.R. 522 (Bankr. E.D. Pa. 1989)* . *See also Besta v. Beneficial Loan Co., 855 F.2d 532 (8th Cir. 1988)* .

(n68)Footnote 68. *Vaughn v. Consumer Home Mortg., Inc., 2003 U.S. Dist. LEXIS 8233* (E.D.N.Y. Mar. 27, 2003) . Charging an above-market price for an appraisal by concealing the lender's share of the fee may also be a UDAP violation. *Szczubelek v. Cendant Mortg. Corp., 215 F.R.D. 107 (D.N.J. 2002)* .

(n69)Footnote 69. *Monetary Funding Group, Inc. v. Pluchino, 867 A.2d 841 (Conn. App. 2005)* .

(n70)Footnote 70. *Com. v. Fremont Inv. & Loan, 2008 WL 2312648* (Mass. App. Ct. May 2, 2008).

(n71)Footnote 71. *State of Washington v. WWJ Corp., 138 Wash. 2d 595, 980 P.2d 1257 (1999)* (assessing $500,000 in UDAP civil penalties for violation of state mortgage broker statute).

(n72)Footnote 72. *16 C.F.R. § 310.4(a)(4). See also* FTC v. Ideal Credit Referral Servs., Ltd., 5 *Trade Reg. Rep. (CCH) P 24,253 (W.D. Wash. 1997)* (proposed consent decree); FTC v. Amstar Fin. Corp., Inc., 5 *Trade Reg. Rep. (CCH) P 24,221 (C.D. Cal. 1997)* (proposed consent decree).

(n73)Footnote 73. *See State v. Gartenberg, 488 N.W.2d 496 (Minn. Ct. App. 1992)* .

(n74)Footnote 74. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 12.2.1 (4th ed. 2009). *See also Nosek v. Ameriquest Mortg. Co. (In re Nosek), 2006 Bankr. LEXIS 1279* (Bankr. D. Mass. June 30, 2006) (unspecified RESPA violation is UDAP violation).

(n75)Footnote 75. *Michalowski v. Flagstar Bank, 2002 U.S. Dist. LEXIS 1245* (N.D. Ill. Jan. 24, 2002) (paying yield spread premium to mortgage broker solely for arranging higher interest rate may be UDAP violation); *Moses v. Citicorp Mortgage, Inc., 982 F. Supp. 897 (E.D.N.Y. 1997)* (denying defendant's motion to dismiss claim in home mortgage case). *But see Ex parte Ford Motor Credit Co., 717 So. 2d 781 (Ala. 1997)* (in transaction with unusually knowledgeable buyer, seller had no duty to disclose kickback it received from financing entity), *on remand sub nom. Bramlett v. Adamson Ford, 717 So. 2d 790 (Ala. Civ. 1998)* .

(n76)Footnote 76. OCC Advisory Letter 2003-3, *Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans* (Feb. 21, 2003).

(n77)Footnote 77. *See State v. Midland Equities, 117 Misc. 2d 203, 458 N.Y.S.2d 126 (Sup. Ct. 1982)* . The National Consumer Law Center has published a report detailing the fraudulent tactics homesavers use and the harm they cause. National Consumer Law Center, Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure "Rescue" Scams (June 2005), *available at* www.nclc.org. Representing homeowners victimized by foreclosure assistance scams is discussed in greater detail in National Consumer Law Center, Foreclosures,Ch. 15 (2d ed. 2007)**.**

(n78)Footnote 78. *See Billingham v. Dornemann, 771 N.E.2d 166 (Mass. App. Ct. 2002) . But see In re Drew, 2006 BNH 29, 2006 Bankr. LEXIS 1779* (Bankr. D.N.H. Aug. 17, 2006) (foreclosure rescue transaction not unfair when homeowner understood and agreed to essential elements of the transaction).

(n79)Footnote 79. *See Billingham v. Dornemann, 771 N.E.2d 166 (Mass. App. Ct. 2002)* .

(n80)Footnote 80. *Jackson v. Byrd 2004 D.C. Super. LEXIS 19* (D.C. Super. May 11, 2004) , *later op., 902 A.2d 778 (2004)* (awarding damages). *See also Eicher v. Mid Am. Fin. Investment Corp., 270 Neb. 370 (Neb. 2005)* (upholding fraud and civil conspiracy judgment and award of attorney fees under UDAP statute against homesaver who told homeowners they were signing papers for a loan when actually they were transferring the home to the homesaver).

(n81)Footnote 81. *Keith v. Howerton, 2001 Tenn. App. LEXIS 646* (Aug. 28, 2001) , *appeal after remand, remanded, costs/fees proceeding, 2002 Tenn. App. LEXIS 895* (Tenn. Ct. App. Dec. 19, 2002) ; *Babbitt Bros. Trading Co., 84 F.T.C. 623 (1974)* (consent order); *Bruce Barnard Co. of Shiprock, Inc., 84 F.T.C. 680 (1974)* (consent order);

Lower Sunrise Trading Post, 84 F.T.C. 661 (1974) (consent order); *McGee Traders, Inc., 84 F.T.C. 689 (1974)* (consent order).

(n82)Footnote 82. *In re National Credit Mgmt. Group, L.L.C., 21 F. Supp. 2d 424 (D.N.J. 1998)* .

(n83)Footnote 83. FTC v. Ellis, 5 *Trade Reg. Rep. (CCH) P 24,179 (C.D. Cal. 1996)* (proposed consent decree).

(n84)Footnote 84. FTC v. Student Aid Inc., 5 *Trade Reg. Rep. (CCH) P 24,312 (S.D.N.Y. 1997)* (proposed consent decree).

(n85)Footnote 85. FTC v. Regency Servs., Inc., 5 *Trade Reg. Rep. (CCH) P 24,219 (M.D. Fla. 1997)* (proposed consent decree).

(n86)Footnote 86. *See U.C.C. §§ 3-418, 4-208(a)(3).*

(n87)Footnote 87. *See U.C.C. § 3-308*; *U.C.C. § 3-406*. The consumer must report the problem within a reasonable period of time after receiving the monthly statement. Problems arise where the consumer's returned checks are "truncated," meaning that the bank does not send the cancelled checks to the consumer as part of the monthly statement. (For example, all credit union share drafts are truncated.) Then the consumer may not notice the unauthorized check for some time. For a detailed description of consumer liability for unauthorized signatures, see National Consumer Law Center, *Consumer Banking and Payments Law* (3d ed. 2005).

(n88)Footnote 88. Uniform Commercial Code, Proposed Revisions to Articles 3 and 4, Council Draft No.1 (Nov. 8, 2001) (amending §§ 3-416, 3-417, 4-201, and 4-208). The Reporter's Note explains that the proposed change is prompted by the "difficulties with telephonically originated checks.").

(n89)Footnote 89. *E.g.,* California, Ch. 316 of 1996 statutes, amending various sections of the U.C.C. to shift the risk of loss for fraudulent demand drafts from the drawee to the depositary bank. *See also* Gino A. Chilleri, *An Exception to* Price v. Neay*: California's Presentment and Transfer Warranties With Respect to Fraudulent Telemarketing Drafts, 30 UCC L.J. 44 (1997).*

(n90)Footnote 90. *16 C.F.R. § 310.3(a)(3).* The FTC has proposed significant amendments to the Telemarketing Rule. *See 67 Fed. Reg. 4,492* (Jan. 30, 2002) .

(n91)Footnote 91. *16 C.F.R. § 310.3(a)(3), as amended by 68 Fed. Reg. 2580* (Jan. 29, 2003) .

(n92)Footnote 92. *15 U.S.C. § 1681, reprinted in* Vol. 1B *infra.*

(n93)Footnote 93. *Cisneros v. U.D. Registry, 39 Cal. App. 4th 548, 46 Cal. Rptr. 2d 233 (1995)* (violation of state and federal fair credit reporting statutes is a violation of California's UDAP statute).

(n94)Footnote 94. *15 U.S.C. § 1681(s).*

(n95)Footnote 95. National Consumer Law Center, Fair Credit Reporting, § 10.7 (6th ed. 2006 and Supp.).

(n96)Footnote 96. For a more detailed discussion of Fair Credit Reporting Act [hereinafter FCRA] preemption, and the limited immunity that the FCRA provides from certain tort claims, see National Consumer Law Center, Fair Credit Reporting (6th ed. 2006 and Supp.).

(n97)Footnote 97. *See Commonwealth v. Source One Assocs., 1999 Mass. Super. LEXIS 402, 10 Mass. L. Rep. 579 (Super. Ct. 1999)* ; National Consumer Law Center, Fair Credit Reporting, § 10.4 (6th ed. 2006 and Supp.).

(n98)Footnote 98. FTC v. S&L Prof'l Credit Clinic, Inc., 5 *Trade Reg. Rep. (CCH) P 23,301 (N.D. Tex. 1992). See*

also FTC v. SurecheK Sys., Inc., 5 *Trade Reg. Rep. (CCH) P 24,431 (N.D. Ga. 1998)* (stipulated final judgment); FTC v. Hart, 5 *Trade Reg. Rep. (CCH) P 24,431 (N.D. Ga. 1998)* (stipulated final judgment); FTC v. M.J.S. Fin. Servs., Inc., 5 *Trade Reg. Rep. (CCH) P 24,461 (N.D. Ga. 1998)* (stipulated final judgment). *See also* FTC v. Westcal Equipment, Inc., 5 Trade Reg. Rep. (CCH) (15388 (W.D. Wash. Mar. 26, 2003) (proposed consent decree against defendants who promised major credit card but delivered card that could only be used for merchandise in their catalog). *See also* FTC v. Capital Choice Consumer Credit, Inc., 5 *Trade Reg. Rep. (CCH) P 15,447* (S.D. Fla. May 21, 2003) (Civil Action No. 02-21050-CIV) (settlement of advance fee credit card scam; sellers promised unsecured major credit card but delivered card that could only be used to purchase items from defendants' catalogs; also debited consumers' bank accounts for other items sold through upselling, without providing disclosures required by telemarketing rule); 5 *Trade Reg. Rep. (CCH) P 15,563* (Mar. 11, 2004) (final judgment against remaining defendants, barring them from selling credit cards or telemarketing and prohibiting them from obtaining money from any consumer's account without written authorization); FTC v. Tyme Lock 2000, Inc., Civil Action No. CV-S-02-1078, 5 *Trade Reg. Rep. (CCH) P 15,473* (D. Nev. July 11, 2003) (stipulated final judgment against advance fee credit card marketers; defendants promised credit cards but delivered set of applications, many of which required additional fees or long-term commitments); FTC v. 1st Beneficial Credit Servs., Civil Action No. 1:02CV1591, 5 *Trade Reg. Rep. (CCH) P 15,484* (N.D. Ohio Sept. 19, 2003) (final consent order against advance fee credit card scam; promoters promised major credit card but delivered worthless information or catalog card); FTC v. Bay Area Business Council, (7th Cir. 2005) (affirming judgment against individual and corporate defendants who led consumers to believe they would receive a major credit card but delivered a card that could only be used as a stored value card).

(n99)Footnote 99. FTC v. S&L Prof'l Credit Clinic, Inc., 5 *Trade Reg. Rep. (CCH) P 23,301 (N.D. Tex. 1992). See, e.g., FTC v. Consumer Alliance, Inc., 2003 U.S. Dist. LEXIS 17423* (N.D. Ill. Sept. 29, 2003) .

(n100)Footnote 100. *16 C.F.R. § 310.4(a)(4). See In re National Credit Mgmt. Group, 21 F. Supp. 2d 424 (D.N.J. 1998)* (issuing preliminary injunction).

(n101)Footnote 101. *16 C.F.R. §§ 310.3, 310.4. See FTC v. Bay Area Business Council, Inc., 423 F.3d 627 (7th Cir. 2005)* (telephone solicitation, targeted to consumers who had recently been denied credit, would lead reasonable person to believe credit card was being offered; consumers paid $200 for opportunity to order stored value card); *FTC v. Peoples Credit First, L.L.C., 2006-1 Trade Cas. (CCH) P75192, 2005 U.S. Dist. LEXIS 38545* (M.D. Fla. Dec. 18, 2005) (promised "platinum card" could be used only for buying club catalog purchases).

(n102)Footnote 102. *New York v. Financial Servs. Network, U.S.A., 930 F. Supp. 865 (W.D.N.Y. 1996) . Accord In re National Credit Mgmt. Group, L.L.C., 21 F. Supp. 2d 424 (D.N.J. 1998) . See also* FTC v. OPCO Int'l Agency, Inc., 5 *Trade Reg. Rep. (CCH) 24,879* (W.D. Mich. Feb. 21, 2001) (TRO against telemarketer that offered low-interest consolidation loan for a fee but delivered list of banks).

(n103)Footnote 103. *See People v. Telehublink, 301 A.D.2d 1006, 756 N.Y.S.2d 285 (App. Div. 2003)* (affirming permanent injunction against advance-fee credit card telemarketer). *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 6.15.1 (7th ed. 2008).

(n104)Footnote 104. *Credit Card Serv. Corp. v. FTC, 495 F.2d 1004 (D.C. Cir. 1974) . See also* FTC v. Tracker Corp. of Am., 5 *Trade Reg. Rep. (CCH) P 24,477 (N.D. Ga. 1998)* (proposed consent decree).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 4 Unfair and Deceptive Credit Practices

1-4 Consumer Credit Law Manual § 4.05

§ 4.05 Debt Collection

[1] General

The federal Fair Debt Collection Practices Act ("FDCPA"), n1 state debt collection acts, and common law tort theories provide a number of remedies for debt collection abuses. Another chapter in this book n2 analyzes these remedies in detail. A private UDAP action provides yet another approach in those states where debt collection practices are within the UDAP statute's scope. n3

UDAP actions can reach practices outside the scope of the FDCPA. In particular, a UDAP claim can challenge creditors' collection practices, and not just collection agency practices. A UDAP statute may also cover collection of types of debts that are excluded from FDCPA coverage. n4 A creditor may be subject to UDAP liability not only for its own collection practices, but also for failing to oversee the practices of independent collection agencies it hires. n5 The UDAP remedy may also provide better relief, such as attorney fees and minimum or multiple damages, than is available under state debt collection practices statutes or common law theories.

In addition, UDAP debt collection principles can apply to many different forms of collection, such as foreclosures, repossessions, evictions, landlord lockouts, utility company or landlord-induced utility shutoffs. n6 When a practice is unfair or deceptive if engaged in by a debt collector, an analogous practice by a landlord, mobile home park, mortgage holder, utility company, secured party, or other party should equally be unfair or deceptive.

However, in a few states collection practices may be outside the UDAP statute's scope. In the case of particularly abusive debt collection practices, a tort theory may be the primary approach because of the availability of punitive damages and a jury trial right.

If debt collection practices are within the scope of a state's UDAP statute, there are several important sources of precedent as to whether a particular practice is unfair or deceptive. A few states have UDAP regulations that define certain practices as unfair or deceptive. Activities prohibited by a state's own debt collection practices statute have been found to be per se UDAP violations. n7 Courts may also recognize collection agency violations of the FDCPA as per se deceptive under state UDAP statutes. n8

Even creditors, whose collection activities are not covered by the FDCPA, may violate the state UDAP statute if they commit acts that would be FDCPA violations if committed by a collection agency. The FTC uses the FDCPA as its standard for determining whether a creditor has violated the FTC Act's general prohibition of unfair and deceptive practices. n9

Other important sources of precedent for unfair or deceptive debt collection practices are the extensive series of FTC consent orders and some litigated cases in this area, and a number of state regulations and cases. Some collection practices that may give rise to UDAP claims include:

- Disguising the purpose for which information is sought while attempting to locate the address of the debtor ("skip tracing"); n10
- Misrepresenting the identity and nature of the collector;
- Misrepresenting the imminency of threatened actions or damage to consumer's credit rating; n11
- Misrepresenting the legal consequences of debt nonpayment;
- Threats of violence, the use of obscene language, telephone calls not disclosing the creditor's and telephone caller's identity, and causing the debtor to pay for long distance telephone calls or other charges;
- Collecting debts not legally owed;
- Taking illegal actions against the consumer or the consumer's property. n12
- Misrepresenting the amount of a debt. n13

[2] Creditor's Abusive Use of Arbitration to Collect on a Debt

A growing number of creditors are initiating collection actions not in court, but through arbitration. Collection via arbitration is grounded on a clause in credit agreements (or notices stuffed in with monthly statements) providing for this method of resolving disputes between creditor and debtor.

Creditors can have several motivations for collection via arbitration. A default arbitration plus a judicial confirmation of the arbitration award may be less costly in legal and court fees or faster than a default judgment. Creditors may decide it is easier to handle contested actions via arbitration than through the courts, or that the nature of the arbitration proceeding, the high fees the consumer must pay, and the lack of attorney fees for a prevailing consumer will discourage contested actions. It certainly makes class counterclaims almost impossible to raise.

Contesting an arbitration proceeding may be economically prohibitive for a consumer. The consumer may even have to pay $100 or more just to file an answer, and even more to conduct discovery or file a motion.

The arbitration process may give rise to a variety of UDAP claims. Before the creditor can use judicial powers to enforce its arbitration award, the creditor must first obtain court confirmation of the award. The debtor can seek to vacate the award where there was evident partiality of the arbitrator, the arbitrator refused to hear evidence or postpone a hearing, or the arbitrator engaged in other arbitrator misconduct or exceeded his authority. n14 A creditor seeking to collect a debt via arbitration may be open to UDAP challenges if the creditor misrepresents to the consumer the effect of the arbitration award. Until the award is confirmed by a court, the creditor has no right to garnish wages or place liens on the consumer's property, and cannot represent a present right to do so.

If the arbitration agreement is unenforceable, then it may be a UDAP violation to represent to the consumer that the creditor has the right to arbitrate the dispute. Assessing large fees to defend an arbitration collection action may be an unfair practice because it costs the consumer far more to defend a collection action than the amount being sought. The D.C. Circuit has found that it is unfair for creditors to place in standard form credit agreements creditor remedies that are injurious to consumers and that do not have countervailing benefits for competition or the consumer. n15

A creditor's systematic use of a biased arbitrator may also be an unfair practice. n16 Just as it is a UDAP violation to require a consumer to contest a collection action in an inconvenient venue, it should be a UDAP violation if the arbitration mechanism requires the consumer to contest some distance from the consumer's residence either the arbitration proceeding or the judicial action to confirm the award. n17

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Debt CollectionGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1692.*

(n2)Footnote 2. *See* Ch. 8 *infra*. *See also* National Consumer Law Center, Fair Debt Collection (6th ed. 2008).

(n3)Footnote 3. Yet another option is an action under the federal or state RICO statute for collection of an unlawful debt. *See § 4.07 infra*. *See also Brown v. C.I.L., Inc., 1996 U.S. Dist. LEXIS 4053* (N.D. Ill. Mar. 29, 1996) (denying defendant's motion to dismiss).

(n4)Footnote 4. *People ex rel. Daley v. Datacom Sys. Corp., 146 Ill. 2d 1, 585 N.E.2d 51 (1991)* (collection of parking ticket debts covered by UDAP statute).

(n5)Footnote 5. *See* American Family Publishers, *58 Fed. Reg. 8,762* , Clearinghouse No. 47,965 (FTC Dkt. 9240, Feb. 17, 1993) (consent order).

(n6)Footnote 6. *See, e.g., In re Clarkson, 105 B.R. 266 (Bankr. E.D. Pa. 1989)* (deceptive for landlord to sell tenant's property without legal right); *In re Aponte, 82 B.R. 738* , *later proceeding at 91 B.R. 9 (Bankr. E.D. Pa. 1988)* (landlord's termination of heat and hot water).

(n7)Footnote 7. Wagner v. American Nat'l Educ. Corp., Clearinghouse No. 36,132 (D. Conn. 1984); *In re Scrimpsher, 17 B.R. 999 (Bankr. N.D.N.Y. 1982)* ; *Connelly v. Puget Sound Collections, Inc., 16 Wash. App. 62, 553 P.2d 1354 (1976)* . *But compare Conboy v. AT&T Universal Card Servs. Corp., 241 F.3d 242 (2d Cir. 2001)* (New York's UDAP statute may incorporate state debt collection statute's prohibitions of deceptive conduct, but does not incorporate prohibitions of abusive conduct).

(n8)Footnote 8. *But see In re Scrimpsher, 17 B.R. 999 (Bankr. N.D.N.Y. 1982)* (New York law); *Lamb v. M&M Assocs., Inc., 1998 U.S. Dist. LEXIS 13773* (S.D. Ohio Sept. 1, 1998) (failure to include validation notice was not UDAP violation; some but not all FDCPA violations are UDAP violations).

(n9)Footnote 9. *See 60 Fed. Reg. 40,263* (Aug. 8, 1995) . *Cf. In re Scrimpsher, 17 B.R. 999 (Bankr. N.D.N.Y. 1982)* (declining to find creditor's violation of the Fair Debt Collections Practices Act [hereinafter FDCPA] to be *per se* violation of New York UDAP statute, but finding acts deceptive on their own; case was decided before FTC's announcement of its use of FDCPA standards for creditors).

(n10)Footnote 10. *Commonwealth v. Source One Assocs., 436 Mass. 118, 763 N.E.2d 42 (2002)* (obtaining

confidential information from banks and credit reporting agencies by impersonating the debtor or bank officers or through other pretexts is a UDAP violation).

(n11)Footnote 11. *See Caputo v. Prof'l Recovery Servs., 261 F. Supp. 2d 1249 (D. Kan. 2003)* ; *Campion v. Credit Bureau Servs., Inc., 2000 U.S. Dist. LEXIS 20233* (E.D. Wash. Sept. 19, 2000) (deceptive to imply, by the use of the word "judgment," that certain costs have been added to a debt).

(n12)Footnote 12. *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 5.1.1 (6th ed. 2004). The companion CD to the NCLC manual has two sample debt collection complaints, including UDAP counts, discovery requests, a motion to compel discovery, a summary judgment motion, and an appellate brief.

(n13)Footnote 13. *Asch v. Teller, Levit & Silvertrust, P.C., 2003 U.S. Dist. LEXIS 16747* (N.D. Ill. Sept. 23, 2003) .

(n14)Footnote 14. Federal Arbitration Act [hereinafter FAA], *9 U.S.C. § 10*, *12*.

(n15)Footnote 15. *Amerian Fin. Servs. Ass'n v. FTC, 767 F.2d 957 (D.C. Cir. 1985)* , *cert. denied, 475 U.S. 1011, 106 S. Ct. 1185, 89 L.Ed. 2d 301 (1986)* .

(n16)Footnote 16. *See Baron v. Best Buy Co., 75 F. Supp. 2d 1368 (S.D. Fla. 1999)* (refusing to enforce arbitration agreement specifying the NAF (National Arbitration Forum) because the creditor failed to demonstrate that the NAF "is a neutral, inexpensive, and efficient forum to determine these claims as required by law"); *see also Patterson v. ITT Consumer Fin. Corp., 14 Cal. App. 4th 1659, 18 Cal. Rptr. 2d 563 (1993)* (refusing to enforce arbitration clause specifying NAF, when NAF's rules at that time required consumers in California to arbitrate their claims in Minnesota). *But see Lloyd v. MBNA Am. Bank, 2001 U.S. Dist. LEXIS 8279* (D. Del. Feb. 22, 2001) ("Plaintiff offers no persuasive evidence that the National Arbitration Forum is anything but neutral and efficient."), *aff'd*, *2002 U.S. App. LEXIS 239* (3d Cir. Jan. 7, 2002) ; *Bank One v. Harris, 2001 U.S. Dist. LEXIS 9615* (S.D. Miss. Jan. 2, 2001) ("[T]he rules governing the conduct of NAF arbitrations belie defendants' speculation that suspected bias by the NAF has any realistic potential for affecting decisions of arbitrators in NAF arbitrations"), *aff'd, 2002 U.S. App. LEXIS 77 (5th Cir. 2002)* .

(n17)Footnote 17. *Patterson v. ITT Consumer Fin. Corp., 14 Cal. App. 4th 1659, 18 Cal. Rptr. 2d 563* , *review denied 1993 Cal. LEXIS 4322 (1993)* , *cert. denied, 510 U.S. 1176, 114 S. Ct. 1217, 127 L. Ed. 2d 563 (1994)* ; *see also Brower v. Gateway 2000, 246 A.D.2d 246, 676 N.Y.S.2d 569 (App. Div. 1998)* (arbitration of a consumer product dispute under the rules of the International Chamber of Commerce, which required consumer to arbitrate in Chicago and send all correspondence to France); *Brown v. Karemor Int'l, Inc., 1999 Tenn. App. LEXIS 249* (Tenn. Ct. App. Apr. 19, 1999) (where Tennessee franchisee required to arbitrate claims against franchisor in Nevada). *But cf. Doctor's Assocs., Inc. v. Stuart, 85 F.3d 975 (2d Cir. 1996)* (arbitration clause not unconscionable where franchisees were required to travel to either Connecticut or Florida to arbitrate claims against franchisor).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 4 Unfair and Deceptive Credit Practices

1-4 Consumer Credit Law Manual § 4.06

§ 4.06 Private UDAP Remedies

[1] Introduction

UDAP statutes provide an important weapon to attack deceptive credit practices. The remedy sections of these statutes are the most important part and are entitled to the same liberal construction as the rest of the statute. UDAP statutes should be construed to authorize the broadest remedy possible. n1 Most such statutes provide for some combination of actual damages, statutory damages, restitution, multiple damages, minimum damages, and punitive damages, as well as attorney fees and costs.

Because there is no implied private right of action under the FTC Act, the availability of private (that is, non-governmental agency) remedies under UDAP statutes is crucial. As of 2009, when Iowa added a private cause of action to its UDAP statute, a private UDAP damages remedy clearly exists in every state. While states all have at least one UDAP statute with a private damage remedy, a number of states have a second UDAP statute patterned after the Uniform Deceptive Trade Practices Act ("UDTPA"). A violation of the UDTPA statute's enumerated prohibitions should be a per se deceptive practice under the state's other UDAP statute that does provide a private damage remedy.

[2] Calculating Actual Damages

[a] Introduction

Although courts often distinguish between incidental and consequential damages, there is not always a clear dividing line. Incidental or direct damages are those directly and immediately resulting from the unfair or deceptive act or practice and pertain directly to the goods or services involved in the transaction.

UDAP litigants may obtain relief based not just on these direct damages, but also from proximate or consequential damages--damages flowing from an unfair or deceptive act or practice. Such consequential damages are often far greater than the direct, incidental damages from the UDAP violation. For example, in the case of a defective used car, consequential damages may include the costs of substitute transportation, repairs to the car, towing expenses, lost earnings due to the inability to drive to work, and the like.

In some states, UDAP damages case law is not fully developed, or is limited by confused or aberrational decisions. n2

In these states, attorneys should explore other claims, such as breach of warranty, fraud, and rescission at the pleading stage, in hopes of avoiding problems in establishing damages.

[b] Direct Actual Damages

Normally, loss-of-bargain damages are more than out-of-pocket damages. Unless the language in the statutory damage provision specifically limits damages to "restitution," courts will normally grant loss-of-bargain damages. Thus, courts have awarded the difference between the value of the product as represented and as sold, an amount equalling the difference between the final sale price and the lower price originally agreed upon. n3

Loss-of-bargain damages are especially helpful in cases dealing with credit terms. For example, a creditor disclosed a stated interest rate that was lower than the actual rate because the amount financed was disbursed in two installments. The court calculated the consumer class' damages based on the class' loss-of-the-bargain damages, assuming the class bargained for the interest rate stated in the loan documents. Damages were the difference between the actual total of payments and the total correctly adjusted for the two disbursements of the amount financed, assuming the interest rate remained constant. n4

Where a buyer could not obtain financing at the rates promised by the seller, the buyer's damages were the difference between the interest payments as promised and the rates then available. n5 Where a lessor promised a purchase option of $1, but then demanded the market value of the property, the measure of damages was calculated as the difference between the market value and the $1 price. n6

In some cases, restitution or out-of-pocket damages may be more preferable to the consumer than other forms of damage calculations. Courts are normally generous in allowing restitution. n7 Not every state provides for restitution n8 through its UDAP statute, however. Ten jurisdictions expressly name restitution as a remedy available to a private litigant (as opposed to a state attorney general). n9 Other states do not specifically authorize restitution as a remedy, but do authorize equitable relief in general terms or give judges broad discretion in fashioning an appropriate UDAP remedy. n10 Consumers who have suffered an illicit overcharge should argue that the judge should use that discretion to order restitution against an overreaching seller. Such provisions have been construed to permit restitution in appropriate circumstances. n11 Case law construing UDAP statutes as remedial and subject to liberal construction may also support an argument that restitution is within the statute's scope.

An UDAP provision requiring sellers to "restore money acquired in violation" of the act has been interpreted as allowing full restitution of all money paid for a franchise. In granting restitution, courts may award both return of the purchase price plus the consumer's other out-of-pocket expenditures as damages. n12

[c] Consequential Damages

UDAP litigants may obtain relief based not just on direct damages, but also from proximate or consequential damages--all damages foreseeably flowing from an unfair or deceptive act or practice. n13 Such consequential damages are often far greater than the direct, incidental damages from the UDAP violation.

Courts differ as to proof requirements for recovery of consequential damages. Some courts require more than a causal connection between the deceptive practice and the consumer's damage; the damage may have to be a foreseeable consequence of the deception, n14 or the UDAP violation may have to be willful. At least some Florida courts, on the other hand, hold that consequential damages cannot be recovered on a UDAP claim. n15 A consumer may also have to mitigate damages.

An important example of consequential damages is the various financing costs that relate to the unfair or deceptive practice. Where the purchase price of a defective car is found to be actual damages, interest payments attributed to the

car loan are also recoverable.

Similarly, courts award as additional UDAP damages any interest or finance charges the consumer was forced to pay by reason of a deceptive sale. n16 Even where prejudgment interest is not allowed, a consumer can still recover the interest lost when the consumer had to take money out of a savings account to perform repairs the seller failed to perform. n17 And consumers may recover increased construction and financing costs caused when the building of a home was delayed by their refusal to pay a deceptively inflated real estate commission. n18

Often a consumer's consequential damage is not evidenced by payment of extra expenses, but by additional efforts required of the consumer, and this lost time is a possible source of damages. n19 Lost future earnings caused by the UDAP violation should be awarded as consequential damages. The Hawaii Supreme Court has ruled that out-of-pocket costs such as gasoline and parking incurred to respond to a deceptive ad are compensable even if the consumer declined to make the purchase. n20

Consumers may also be able to recover damages for injury to their credit rating resulting from the deceptive practice. In some states, the consumer must plead specifically each type of consequential damages, including damage to credit rating. n21 To recover more than nominal damages in Texas, a consumer must show that the injury to credit rating resulted in either (1) a denial of credit and resulting damages, or (2) a requirement of a higher interest rate. n22

In general, it will be difficult to receive attorney fees as consequential damages, instead of being based on a statutory authorization. But there are situations where a court will award attorney fees as UDAP consequential damages. n23

In general, pain and suffering should be available in a UDAP case at least to the same extent that they are recoverable at common law. Some jurisdictions allow mental anguish damages where fraud is proven, where there is an intentional invasion of the consumer's peace of mind, or where the deception was grossly negligent, made knowingly, or willful. n24 In a number of states, courts are awarding pain and suffering damages even where there is no physical injury or intent to deceive. Authority to award "actual damages" is sufficiently broad to encompass emotional distress damages. n25

In at least some jurisdictions, while damages for mental anguish are recoverable in proper circumstances, there can be no recovery for mere aggravation; aggravation should just be offered as evidence of mental anguish. However, the Kentucky Supreme Court has held that damages for inconvenience were properly awarded on a UDAP claim arising from a yo-yo car sale. n26 Likewise, an Illinois appellate courtaffirmed a UDAP damage award for aggravation and inconvenience resulting from misrepresentations in a car sale. n27 Decisions under the New York, n28 Ohio, n29 Oklahoma, n30 and West Virginia UDAP statutes n31 hold that losses such as annoyance, loss of time, inconvenience, travel, and telephone expenses are compensable. n32 There should be no requirement that a consumer prove other actual damages in order to recover damages for pain and suffering.

[d] Prejudgment Interest

Whether a court will provide prejudgment interest on a UDAP claim will normally depend on a state's general treatment of prejudgment interest.

[3] Contractual Limitation on Damages

The consumer's UDAP damage award may not be limited by a provision in the original sales contract limiting the consumer's remedies against the seller. Such a provision is not only against public policy, but also usually will not by its own terms specifically apply to a UDAP remedy. n33

[4] Mitigation of Damages

Some courts may find that the consumer has a duty to mitigate damages, n34 but, even then, the defendant has the burden of proving that the consumer has not used reasonable diligence to do so. n35

[5] Statutory Minimum Damages

About half the state UDAP statutes authorize private litigants who have proved a UDAP violation to obtain minimum damage awards ranging from $25 to $5,000, even if actual damages have not been proved. n36 Statutory minimum damages for a consumer litigant must be distinguished from civil penalty provisions that allow the state attorney general to seek civil penalties ranging from $500 to $25,000 for initial UDAP violations. Statutory minimum damages not only allow consumers more sizeable recoveries when actual damage is small, but also avoid proof of damage problems. Minimum damages can be awarded even if the consumer cannot prove the amount of his or her loss. n37 In some states, statutory damages are mandatory upon proof of a violation. n38

While a consumer may not be able to recover UDAP actual damages and UDAP statutory damages for the same UDAP violation, multiple recoveries are possible for multiple violations. n39 Statutory damages are not considered punitive, but compensatory, so that courts may award both statutory and punitive damages. UDAP statutory damages can be awarded to each member of a prevailing class.

[6] Multiple Damages

[a] General

About half of all UDAP statutes authorize treble or other multiple damage awards. The actual damage award, under specified conditions, is multiplied to calculate these damages. Unlike minimum damages, multiple damages are awarded only if actual damages are proved. n40 Where an individual consumer's actual damages are nominal, three times this amount will still be nominal. The possibility of multiple damages may, however, significantly affect settlement negotiations and a consumer litigant's willingness to press the action. n41 In some states, multiple damages are mandatory; in others they are discretionary. n42 Treble damages may be awarded in a default judgment or in an arbitrator's decision. n43 Courts have upheld the constitutionality of multiple damages provisions. n44

[b] Limits on Treble Damages Award

Most UDAP statutes limit a treble damages recovery to situations where intent, willfulness, or bad faith is shown. n45 It is not necessary to show the seller knew it was violating the UDAP statute or knew that its practice was illegal in some more general sense. n46 Good faith, the fact that the consumer has already been adequately compensated, and equitable considerations are not grounds for denying treble damages. n47 In addition, the accumulation of a large number of minor UDAP violations over a period of time can show willfulness. The knowing misrepresentation of an agent is imputed to the principal. n48

Other UDAP statutes trigger multiple damages not upon the seller's intent to deceive, but upon the seller's bad faith refusal to grant the injured consumer relief after the consumer notifies the merchant of the deception. In these states, a seller can avoid liability for treble damages by making a reasonable settlement offer. n49

A few UDAP statutes mandate treble damages if the seller violates a UDAP rule or other clear standard. n50 In states that do not specify the standards for an award of treble damages, courts have looked to such factors as the deterrent effect of an award and whether the defendant's acts were deliberate, unconscionable, obdurate, repeated, knowing, or otherwise aggravated. In Connecticut the Supreme Court has held that multiple damages are appropriate where the actions of the defendant show a reckless indifference to the rights of others. n51 As multiple damages are within the trial court's discretion, their use will not be disturbed on appeal absent a showing of manifest abuse of that discretion. n52

The U.S. Supreme Court has held that private parties can agree to arbitrate claims for multiple damages even though such claims also serve a public function. The Court found no inherent problem in plaintiffs being forced to arbitrate RICO treble damages claims as long as the arbitrator could award treble damages. n53 Similarly, an arbitration agreement can require a UDAP multiple damages claim to be pursued through arbitration, as long as the arbitrator has authority to award such damages. n54

[c] Interrelation of Treble Damages With Other Awards

A consumer generally may not recover twice for the same injury, by receiving treble damages under a UDAP count and compensatory damages under another statute or a common law fraud count. n55 Nor can the consumer recover treble damages on a UDAP count, plus treble damages on another statutory claim for the same conduct. n56 A consumer can, however, recover compensatory damages on non-UDAP counts, plus the punitive or exemplary component of UDAP damages. n57 Two recoveries can also be had if separate wrongs causing separate damage are alleged. n58 Some courts and statutes restrict treble damages and fraud damages, finding that one form of exemplary damages is enough, or require an election if both are awarded. A California statute allows the trier of fact to treble any civil penalty (or any other remedy if its purpose or effect is to punish or deter) when the person affected is an older or disabled person and certain other factors apply. n59

[d] How to Calculate Multiple Damages

If a consumer is awarded multiple damages, it is clearly most advantageous to the consumer to first treble and then offset any seller's recovery in the same action, but not all courts allow this procedure. n60

Some courts hold that only the amount awarded on the UDAP claim can be trebled. n61 A federal court in New Jersey holds that statutory damages awarded on a TIL count should not be included in the amount trebled on a UDAP count because the burdens of proof are different. n62 However, the Wisconsin Supreme Court held that the multiple damage award should be based on the entire amount of the consumer's pecuniary loss, even though conduct by the defendant separate from the UDAP violations contributed to some loss and even though the jury apportioned some of the loss to non-UDAP claims. n63

Courts are split as to whether prejudgment interest should be trebled. n64 However, there should be no question that financing costs necessitated by the consumer's purchase of substitute goods and which are awarded as actual damages should be trebled like any other actual damages. Likewise, where an element of actual damages is the amount of interest the plaintiff lost on money paid to the defendant, it can be trebled. n65 Moreover, post-judgment interest should be computed on the whole award, including treble damages. n66

[e] Parties Liable for Treble Damages

A company is liable in treble damages for acts its agents engaged in within the scope of employment whenever the employer would be vicariously liable for the tortious conduct of its employees. Where treble damages are predicated on the seller's knowledge that a practice is deceptive, the corporation is assumed to possess whatever knowledge that its employees possess; n67 conversely, employees are assumed to have whatever knowledge that the corporation possesses.

[7] Punitive Damages

[a] General

Ten UDAP statutes explicitly authorize punitive damages. n68 A separate Minnesota statute authorizes punitive damages for UDAP and other claims. n69 The Arkansas UDAP statute expands the private cause of action to include punitive damages if the consumer is older or disabled. n70 The Illinois UDAP statute authorizes the court to award any

other relief it deems proper, and then restricts the circumstances under which punitive damages can be awarded against car dealers, necessarily implying that they are allowed as "other relief." (The Illinois Supreme Court has held the special protection for car dealers unconstitutional. n71 Courts in other states may find such a remedy within their inherent authority, particularly where courts award punitive damages for common law fraud. n72

If a UDAP statute does not authorize punitive damages, in appropriate cases, consumer attorneys should add a common law fraud count to their UDAP action and seek punitive damages under the common law fraud claim. The availability of UDAP remedies does not preempt common law tort claims or remedies.

Unless a UDAP statute specifies other standards, courts are likely to use a state's common law fraud standards (such as the presence of malice, willful or wanton conduct, practices showing seller's ill will, or a reckless indifference to the interests of others) in determining whether UDAP punitive damages are appropriate in a particular case. n73 In some jurisdictions, punitive damages can be awarded in fraud cases even if actual damages are not proved. n74

If the contract arbitration provision prohibits punitive damages, that provision will generally be given effect; if the provision allows punitive damages, such a provision will also be given effect. If ambiguous or silent, the Supreme Court appears strongly in favor of allowing punitive damages. n75

[b] Calculating the Size of Punitive Damage Awards

While computation of punitive damages awards under state UDAP or other state law theories is fundamentally a state law issue, federal constitutional due process standards can limit the size of this award. In light of recent U.S. Supreme Court cases, n76 some lower courts will likely use ratios of punitive to actual damages to determine if the punitives are excessive. If such a standard is used, it is essential to consider not just the one plaintiff's actual damages, but all potential damages by all victims or potential victims of the defendant's practice. n77 Some state statutes limit the size of punitive damage awards. These caps may apply to UDAP or fraud claims in some states, but not in others. n78 A number of courts have concluded that in cases involving multiple punitive damages awards against the same defendant, repetitive awards were acceptable because they were reasonable in their amount and rational in light of their purpose to punish what had occurred and to deter future misconduct and did not violate due process. n79

In 2003, the Supreme Court issued a second opinion, *State Farm Mutual Automobile Insurance Co. v. Campbell*, n80 striking down a punitive damage award on due process grounds. The Utah Supreme Court had reinstated a $145 million punitive damage award against an insurance company that courted financial disaster for its insureds by refusing to settle a serious third-party claim, then refusing to appeal it, and then suggesting that they start trying to sell their home to pay the judgment. A jury had awarded the insureds $2.6 million (reduced by the trial court to $1 million) in compensatory damages, primarily emotional distress. The Supreme Court held that the punitive damage award clearly exceeded constitutional limits. A key point of the opinion is an insistence that evidence of other misconduct must bear a high degree of similarity to the acts toward the plaintiff. The Court also stated that punitive damage awards that exceed a single-digit ratio to compensatory damages will rarely pass constitutional muster.

In *State Farm*, the Supreme Court reiterated several factors to determine the reprehensibility of the defendant's conduct. Courts should consider whether:

- The harm caused was physical as opposed to economic;
- The tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others;
- The target of the conduct had financial vulnerability;
- The conduct involved repeated actions or was an isolated incident; and

- The harm was the result of intentional malice, trickery, or deceit, or mere accident. n81

[c] Who Is Liable for Punitive Damages?

Principals are liable for punitive damages for the acts of their agents only where:

- The principal authorized the doing and the manner of the act;
- The agent was unfit and the principal was reckless in employing the agent;
- The agent was employed in a managerial capacity and was acting in the scope of employment; or
- The principal or a manager of the principal ratified or approved the act. n82

Generally, a corporation can be liable for punitive damages for the actions of a nonmanagerial employee even without any of the above four criteria being met. In one case against ITT Credit Corporation, a trial court awarded punitive damages against ITT even though it was the home improvement contractor's conduct that was fraudulent, and even though the contractor was not ITT's agent. The punitive damages award was instead based on the fact that ITT and the contractor had engaged in a civil conspiracy to further the contractor's fraudulent practices. The Ohio Supreme Court upheld the $1.5 million punitive damages award because, based on the nature of the conspiracy, either party was fully liable for the acts of the other, including liability for punitive damages. n83

[d] Interrelation of Punitive Damages With Other Remedies

Some courts allow both treble and punitive damages recoveries, n84 but other courts have held to the contrary n85 and forced a successful consumer litigant to timely elect which award to accept. n86

[8] Class Actions n87

[a] General

This section briefly addresses the use of class actions as a means of challenging UDAP violations. Theoretically, class actions are well suited for securing wide-scale redress for marketplace deception. Class actions adjudicate numerous claims that individually damaged consumers would not pursue because they are uninformed of their rights, deterred from filing individual suits because of an ongoing relationship with the prospective defendant, or have claims too small to merit individual adjudication. n88

A UDAP class action seeking damages allows the aggregation of many small consumer claims, thereby deterring merchant misconduct far more effectively than one individual damage action. Such an action makes it feasible for an attorney to handle the case, even though individual consumer injury is minimal. Some courts have allowed multi-state class action UDAP suits which are essentially national class actions. These factors lead some courts to look with particular favor on class actions in the consumer context. n89

UDAP class actions may also prove to be useful vehicles to obtain injunctive relief. Class injunctive actions face fewer procedural hurdles than do class damage actions. Courts may be willing to issue a broad injunction for a class when it finds that an individual litigant does not have the requisite interest in such a broad injunction.

Despite the advantages of a class action, an attorney should not initiate a UDAP class action lightly. Class actions demand a significant commitment of legal resources, and notice, discovery and other procedural requirements may prove costly to consumer litigants. While the two parties to an individual action can often reach a quick compromise,

class actions may be less prone to easy settlement. Nevertheless, once class certification has been granted, and the seller's inevitable summary judgment motion defeated, class actions almost invariably settle without a full trial, usually on terms quite favorable for the class.

If a contract is involved which includes an arbitration agreement, the agreement may purport to restrict the right to bring claims in a class action. n90 Briefly, the first question is what the arbitration agreement and the rules of any referenced arbitration mechanism provide. Most arbitration mechanism rules and clauses do explicitly prohibit class treatment. Unless this agreement is found to be unconscionable or against public policy, it will be enforced. The more common issue is whether the consumer has the right to bring an arbitration proceeding as a class where the agreement and the relevant rules are silent on this subject. The predominant view among federal courts is stated in the Seventh Circuit's decision in Champ v. Siegel Trading Co., Inc. that "absent a provision in the parties' arbitration agreement providing for class treatment of disputes, a district court has no authority to certify class arbitration." n91

[b] UDAP Class Action Procedures

Some state UDAP statutes contain class action provisions that supplement or supersede the general class action statute, n92 while others specifically foreclose class actions. n93 Ohio's UDAP statute allows a class action only if the defendant has violated a UDAP rule or a prior judicial determination, on file with the attorney general, that the practice is a violation. n94 Limitations on a UDAP class action found in the UDAP statute itself may apply even to UDAP actions litigated in federal court. State and federal rules regarding class actions will apply to areas not specifically covered by the UDAP statute.

[c] UDAP Class Actions Where Individual Damage Is Minimal

One of the most important uses of a consumer class action is where individual damage is so minimal that there is no economic incentive for an individual UDAP action. n95 If there is a concern that the value of recovery for each consumer will be too small to justify notification, etc., or that consumers may not be locatable, courts can use "fluid recovery" under which the unclaimed portion of the damages incurred by the class as a whole is applied to the benefit of the class. n96

[d] Proving a UDAP Violation Is Common to the Class

UDAP statutes that prohibit deceptive, and not just fraudulent, practices radically alter the difficult proof situation arising under common law fraud statutes. In most states, deception can be proved even if: the seller's intent or knowledge is not shown; no actual deception is shown, only a tendency or likelihood to deceive; n97 or the consumer's reliance or the materiality of the deception is not indicated. n98 And even where reliance need be proven, where multiple plaintiffs, standing in the same shoes, are subject to a uniform deceptive practice, reliance can be implied from the circumstances. n99 As a result, much individual proof can be avoided, particularly when liability and damages can be established by documentary evidence, *e.g.*, advertising copy and form contracts.

The critical element to establish liability in a UDAP class action is the existence of a common deceptive practice involving each class member. The deception practiced against each different class member must not only be sufficiently alike so that there is a community of interest, but also questions common to the class must predominate.

Proving damages for individual class members is not as critical. If the issues of liability are sufficiently common, courts will allow the liability issues to go forward as a class action, postponing the decision as to how the damage issues are to be treated to a later date. Individual litigation as to the amount of damage can subsequently be handled through a variety of methods, such as special masters and affidavits. n100

Proving the existence of a common deceptive scheme is not as difficult as it first appears. In many cases, media

advertising or standard sales presentations or similar methods have been used to disseminate the same deceptive message to all class members.

A common pattern of deception can also be established if all class members purchased a similar product or service and if the UDAP violation involves the product itself, such as price unconscionability or a product's inability to perform its normal function. Where a seller overcharges all consumers for a particular item, this can provide a basis for class certification. For example, where official fees or taxes are set at a specified amount, a seller accepting more than that amount from consumers to pay for those charges engages in a common UDAP violation, even if the sales presentations are different and even if the amount of the overcharge varies with each consumer. n101 Unfair or deceptive standard form contract provisions and standard disclosures, standard debt-collection procedures, or a seller's consistent failure to disclose a material fact n102 are ideal for class treatment. n103

[e] Statutory Damages for Each Class Member

Some courts allow minimum statutory damages for each class member in cases of minimal individual injury in states whose UDAP statutes authorize minimum statutory damages.

[f] Settlements

Class action settlements will be subject to appellate court review to determine whether the settlement is fair, adequate, and reasonable to the class. Where it is not, the settlement will be rejected. n104

[9] Injunctions

[a] Advantages of the Injunctive Remedy

In every state, the state attorney general or similar state official can seek to enjoin UDAP violations. However, these state officials have limited resources and their own priorities. Attorney general offices must also make priority decisions regarding when to follow up to determine if a seller is complying with an injunctive order. Private litigants not wishing to be bound by state attorney general priority decisions find it useful to act as a "private attorney general," bringing their own injunctive actions and monitoring seller's compliance with the court order themselves. There is little case law in the UDAP area determining whether a private litigant can act as a private attorney general or otherwise seek injunctive relief. This section will explore this issue as completely as present case law allows.

[b] Does a UDAP Statute Authorize Private Injunctive Relief?

Most UDAP statutes explicitly authorize private injunctive actions. (A number of states have two different UDAP statutes authorizing injunctive relief.) Eleven UDAP statutes n105 modeled after the UDTPA provide that a "person likely to be damaged by deceptive practices of another" may seek injunctive relief. A primary function of the UDTPA is to provide businesses with a means of enjoining deceptive and thus unfairly competitive practices of other businesses. The UDTPA has also been found to provide injured consumers with an injunctive remedy. Therefore, for violations of the specific prohibitions found in state UDAP statutes patterned after the UDTPA, a private injunctive remedy is available.

In Delaware, Georgia, Hawaii, Illinois, Maine, Minnesota, Nebraska, Ohio, and Oklahoma, consumer litigants should not confuse the UDAP statute patterned after the UDTPA n106 with the state's other UDAP statute that provides a private damages remedy, with which they may be more familiar. n107 Aggressive consumer litigants will select the more advantageous statute for a particular case, or will even bring claims under both statutes.

In addition, in twenty-two states, UDAP statutes not patterned after the UDTPA explicitly authorize a private injunctive remedy. n108 The Missouri UDAP statute explicitly authorizes private injunctions, n109 but an intermediate appellate

court has held that the court has authority to issue injunctive relief in an individual action only to protect the individual consumer, not to protect the general public. n110 Since procedural requirements for class injunctive actions are less burdensome than for damage class actions, this may not significantly impair a litigant's ability to seek an injunction. Private injunctions may also be available in most other states, particularly where the UDAP statute generally authorizes the court to grant other forms of relief. n111 Some UDAP statutes specifically limit those who can seek injunctive relief to those who have suffered actual monetary loss, have been aggrieved, or have been adversely affected by a violation. n112

[10] Voiding and Rescinding Contracts

UDAP statutes may be used to void or rescind an agreement where the sales transaction involved deception. This remedy may be more preferable to a consumer than damages or an injunction, since it can result in the dismissal of a collection action by the seller or its assignees, without proof of the consumer's actual damages. However, relatively few state UDAP statutes explicitly provide rescission or voiding the transaction as a remedy. n113 If a state UDAP statute does not explicitly state whether a court can void or rescind a transaction based on UDAP violations, this remedy may be implied from statutory remedy language or from the court's inherent authority. n114

When a consumer seeks to rescind a contract, he or she should follow the special procedures for rescission actions in the UDAP statute or be careful to follow common law requirements concerning notice, tender, etc., if they are applied by the courts. n115 UDAP statutes vary greatly as to whether a consumer may rescind and also recover UDAP damages. The seller may be entitled to a setoff for the rental value and any damages to the item purchased. n116

[11] Attorney Fees

[a] Introduction

Virtually all UDAP statutes that authorize a private remedy offer attorney fees to successful consumer litigants, although there is considerable variety among the various statutes as to who can recover, what defenses apply, etc. By requiring sellers that violate UDAP statutes to pay the consumer's legal expenses, UDAP statutes make it possible for attorneys to devote significant resources to a case, even if the consumer's dollar losses are relatively minor compared to commercial disputes. This not only encourages consumers to remedy marketplace abuses, but also increases sellers' maximum liability if they refuse to settle consumers' just claims. The purpose of UDAP fee-shifting provisions is to ensure that plaintiffs with bona fide claims are able to find lawyers to represent them. n117

Courts should construe UDAP statutory attorney fee provisions in favor of consumers since attorney fee provisions promote the UDAP statute's underlying legislative purpose. Consumers with legitimate UDAP claims would be deterred from enforcing their rights if they were required to absorb all costs of litigation. Unless reasonable attorney fees are awarded in consumer protection cases, the doors to the courthouse will be closed to all but those with either potentially substantial damages or sufficient economic resources to afford the litigation expenses. n118 Even where there is no explicit statutory authority for fees, several courts have awarded attorney fees. n119 Many UDAP statutes indicate that attorney fees *shall* be awarded if damages are awarded to the consumer. Here, such fees are mandatory. If attorney fees are discretionary, any fee award made must be reasonable. n120

In general, courts are liberal in allowing UDAP attorney fees as long as the consumer has prevailed in some way on at least some of the claims against at least one defendant. Consumers do not have to recover on all counts of their complaint to receive attorney fees for all their efforts. n121 The consumer must prevail on the UDAP claim in order to recover fees. n122 Where only one of two defendants is found to have violated the UDAP statute, only that defendant can be found liable for UDAP attorney fees.

Attorney fees should be recoverable for successful work performed to obtain a default judgment, time spent opposing a

motion to set aside a default, or work done to protect or collect a judgment. Courts are divided about the award of fees after settlement or in arbitration. Fees can be awarded for appellate work, n123 as long as the consumer's judgment is preserved in at least some respect on appeal. The procedure to obtain such fees and which court awards them is subject to local court rules.

[b] The Catalyst Theory and How To Preserve a Fee Claim When Settling a Case

Until 2001, federal courts accepted the "catalyst" rule, which held that a plaintiff prevails and is therefore entitled to recover under a federal fee-shifting statute when the lawsuit causes a change of conduct by the defendant, even if a favorable order on the merits is never entered. In *Buckhannon Board & Care Home, Inc. v. West Virginia Department of Health and Human Resources*, n124 the Court rejected this rule and held that a plaintiff can achieve prevailing party status only by obtaining a "material alteration of the legal relationship of the parties." n125 While this standard can be met by "enforceable judgments on the merits and court-ordered consent decrees," n126 the plaintiff's case lacked "the necessary judicial imprimatur." n127 The Supreme Court made it clear that it was announcing a general rule that applied to most, if not all, federal fee-shifting statutes. n128

Of course, *Buckhannon* only controls as to federal law. Courts interpreting state fee-shifting statutes may find *Buckhannon* persuasive, n129 but are free to adopt their own views about the catalyst theory and the formal requirements of settlements. Nonetheless, it is prudent to assume that state courts will impose the same requirements and to draft settlement documents accordingly.

For courts that follow *Buckhannon*, the following ways of settling a case are likely to preserve entitlement to fees:

- Negotiation of payment of fees in an acceptable amount as part of the settlement on the merits.

- An agreed judgment for money, as long as it is clear that fees have not been waived. The ability to enforce a money judgment by judicial process should be considered the functional equivalent of the judicial oversight that was the hallmark of a court-ordered consent decree for the *Buckhannon* court. However, the Supreme Court's decision is silent on this point.

- An agreed order that specifies the steps the defendant will take (*e.g.*, repair of a vehicle, cancellation of a contract), as long as the court retains jurisdiction to enforce it. It is clearer that the plaintiff is the prevailing party if the order the court signs actually recites the steps the defendant will take, rather than referring to a separately filed document, although the latter format is probably also sufficient. When there are two or more related cases, it is unclear whether a favorable order entered in one is sufficient to qualify the plaintiff as a prevailing party in the other case, n130 so it is best to get a favorable order in both cases.

- An agreed order of any sort that includes a finding or stipulation that the plaintiff is the prevailing party. Even a stipulation not signed by the court that the plaintiff is the prevailing party is probably sufficient. While *Buckhannon* does not explicitly endorse this method of preserving the right to attorney fees, the court never indicated that winning an enforceable judgment or a court-ordered consent decree is a jurisdictional requirement that cannot be satisfied by a stipulation. At least one court has held, however, that merely reserving the issue of attorney fees for the court, without stipulating that the plaintiff is the prevailing party, is insufficient. n131

Settlement methods that are less likely to preserve the right to fees are:

- A stipulation that is filed with the court but is signed only by the parties and does not state that the plaintiff is the prevailing party.

- A dismissal entry, even if the case is dismissed pursuant to an agreement signed by the parties under which the defendant agrees to the relief the plaintiff sought. n132

[c] Types of Representation Entitled to Fees

Legal services attorneys receiving funds from the Legal Services Corporation ("LSC") may have restrictions on their ability to seek attorney fees because of LSC restrictions. In the absence of such regulations, courts invariably hold that attorney fees can be awarded to legal services attorneys who bring successful UDAP actions.

No state UDAP statute now mandates attorney fees for a prevailing seller, but a number of UDAP statutes indicate that attorney fees may be awarded, in the court's discretion, to the prevailing party. In these states, a much tougher standard should be used to award fees to prevailing consumers than to award fees to prevailing merchants.

Where a UDAP statute does not explicitly provide for a seller's attorney fees, the court should not find that such a recovery is implied. However, other state law or the state equivalent of *Fed. R. Civ. P. 11* may provide a defendant with fees.

[d] How Attorney Fees Are Calculated

The size of a damage award should not limit the size of an attorney fee award, since this would frustrate the legislative intent in providing consumers with UDAP attorney fees. n133 There is great variety in how states calculate attorney fee awards. Some are spelled out explicitly in the statute; others rely o n the "lodestar" approach widely used in civil rights cases. n134

A court can award attorney fees in excess of a contingency fee arrangement. The existence of a contingency fee agreement also does not force the attorney to take fees out of the client's recovery instead of seeking an award from the opposing party.

Where cases involve UDAP and non-UDAP claims, some courts have ruled that the consumer can obtain attorney fees for work on all claims, successful and unsuccessful. n135 Other courts find that it is not unreasonable for a trial court to award fees to the consumer's attorney only for work on counts that were successfully prosecuted. n136

Careful contemporaneous records, detailing all work and time devoted to a UDAP case, are important to a later award of attorney fees.

In some jurisdictions (such as Illinois), certain claims must go to mandatory arbitration, although the consumer can reject the award and proceed to trial. It may be a mistake not to seek fees before the arbitration panel, accept the award, and then seek fees in the court. The Illinois Supreme Court has held that the consumer's failure to seek fees in the arbitration proceeding forecloses any fee award. n137

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Debt CollectionGeneral OverviewBanking LawConsumer ProtectionState LawRemediesBanking LawConsumer ProtectionUnfair & Deceptive Credit Practices

FOOTNOTES:
(n1)Footnote 1. *See, e.g., In re Bryant, 111 B.R. 474 (Bankr. E.D. Pa. 1990)* ; *Roane-Barker v. Southeastern Hosp. Supply Corp., 99 N.C. App. 30, 392 S.E.2d 663 (1990)* .

(n2)Footnote 2. *See, e.g., Fort Lauderdale Lincoln Mercury v. Corgnati, 715 So. 2d 311 (Fla. Dist. Ct. App. 1998)* (declining to award consequential damages in a UDAP case).

(n3)Footnote 3. Scott v. Bill Swad Datsun, Inc., Clearinghouse No. 46,639 (6th Cir. 1984); *Aurigemma v. Arco Petroleum Prods. Co., 734 F. Supp. 1025 (D. Conn. 1990)* ; *Fort Lauderdale Lincoln Mercury v. Corgnati, 715 So. 2d 311 (Fla. Dist. Ct. App. 1998)* (measure of damages is difference between value of goods in condition promised and value in condition delivered). *See Cardwell v. Henry, 145 N.C. App. 194, 549 S.E.2d 587 (2001)* (measure of UDAP damages for substandard housing conditions is the difference between the fair rental value of the property in a warranted condition and its actual fair rental value, but damages cannot exceed total amount of rent paid by tenant). *But cf. Tucker v. Boulevard at Piper Glen, 150 N.C. App. 150, 564 S.E.2d 248 (2002)* (no damages where townhome's actual value exceeded purchase price); *Zanakis-Pico v. Cutter Dodge, Inc., 47 P.3d 1222 (Haw. 2002)* (difference between advertised "bait" price and actual price not recoverable where consumer declined to buy). *See also In re Lutheran Brotherhood Variable Ins. Prods. Co. Sales Practices Litig., 2004 U.S. Dist. LEXIS 7789* (D. Minn. Apr. 28, 2004) (court applied the state's rules for fraud damages--a cross between the out-of-pocket and benefit of the bargain rules--to a UDAP claim in a vanishing insurance premium case); *Lesoon v. Metropolitan Life Ins. Co., 898 A.2d 620 (Pa. Super. Ct. 2006)* (difference in price between value of insurance policy promised vs. delivered). *See also Agliori v. Metropolitan Life Ins. Co., 879 A.2d 315 (Pa. Super. Ct. 2005)* (damages may be based on proceeds that would have been paid on insurance policies consumer was deceptively induced to surrender as part of purchase transaction). *But cf. Solarchick v. Metropolitan Life Ins. Co., 430 F. Supp. 2d 511 (W.D. Pa. 2006)* (taking narrow view of benefit of bargain damages).

(n4)Footnote 4. *Leibert v. Financial Factors Ltd., 788 P.2d 833 (Haw. 1990)* .

(n5)Footnote 5. *Stephenson v. Capano Dev., Inc., 462 A.2d 1069 (Del. 1983)* .

(n6)Footnote 6. *A.V.I., Inc. v. Heathington, 842 S.W.2d 712 (Tex. Ct. App. 1992)* .

(n7)Footnote 7. *See State v. Cottman Transmissions Sys., Inc., 86 Md. App. 714, 587 A.2d 1190 (1991)* .

(n8)Footnote 8. Restitution, or disgorgement, is seen as a substantively different remedy from ordinary damages. For example, the California Supreme Court held that a bank's insurance policy, which insured against "damages," did not cover sums the bank was forced to pay out pursuant to the state UDAP statute's restitution provision. *Bank of the W. v. Superior Ct., 10 Cal. Rptr. 2d 538, 545, 546 (1992)* .

(n9)Footnote 9. *Alaska Stat. § 45.50.531*; *Cal. Civ. Code § 1780*; *Cal. Bus. & Prof. Code § 17203*; *D.C. Code Ann. § 28-3905*; *Idaho Code § 48-608*; Ind. Code § 24.5-0.5-4(a)(d); *Me. Rev. Stat. Ann. tit. 5, § 213*; *Neb. Rev. Stat. § 87-303.07*; *Tex. Bus. & Com. Code § 17.50*; *Vt. Stat. Ann. tit. 9, § 2461*; *Va. Code Ann. § 59.1-205*.

(n10)Footnote 10. *Conn. Gen. Stat. Ann. § 42-110g*; *815 Ill. Comp. Stat. 505/10a*; *Ky. Rev. Stat. Ann. § 367.220*; *Mass. Gen. Laws ch. 93A, § 9*; *Minn. Stat. § 8.31*; *Mo. Rev. Stat. § 407.025*; *Mont. Code Ann. § 30-14-133*; *N.H. Rev. Stat. Ann. § 358-A:10*; *N.J. Stat. Ann. § 56:8-19*; *Or. Rev. Stat. § 646.638*; *73 Pa. Cons. Stat. § 201-9.2*; *R.I. Gen. Laws § 6-13.1-5.2*; *S.C. Code Ann. § 39-5-140*; *Tenn. Code Ann. § 47-18-109*; *W. Va. Code § 46A-6-106*. *See also Nev. Rev. Stat. § 598.0977* (authorizing suit by elderly or disabled person for actual damages, but also referring to this relief as "restitution"); *Ohio Rev. Code Ann. § 1345.09(D)* (authorizing "declaratory judgment, injunction, or other appropriate relief"); *Utah Code § 13-11-10(3)* (authorizing class action for "declaratory judgment, an injunction, and appropriate ancillary relief").

(n11)Footnote 11. *See, e.g., Catucci v. Ouellette, 592 A.2d 962, 963 (Conn. Ct. App. 1991)* ; *Cohon v. Oscar, 149 N.E.2d 472* ; *see also Aurigemma v. Arco Petroleum Prods. Co., 734 F. Supp. 1025, 1033 (D. Conn. 1990)* (actual damages language in statute would permit order of restitution, but it was not appropriate under circumstances of case); *Gour v. Daray Motor Co., 373 So. 2d 571, 578 (La. Ct. App. 1979)* (actual damages language of statute permits order of restitution); *Gross-Haentjens v. Leckenby, 589 P.2d 1209, 1210 (Or. Ct. App. 1979)* (purpose of private enforcement

provision is to provide consumers restitution).

(n12)Footnote 12. *Catucci v. Ouellette, 25 Conn. App. 56, 592 A.2d 962 (1991)* .

(n13)Footnote 13. *Jersild v. Aker, 775 F. Supp. 1198 (E.D. Wis. 1991)* ; *Haddad v. Gonzalez, 410 Mass. 855, 576 N.E.2d 658 (1991)* ; *Hale v. Basin Motor Co., 110 N.M. 314, 795 P.2d 1006 (1990)* ; *Sing v. John L. Scott, Inc., 920 P.2d 589 (Wash. Ct. App. 1996)* . *But see Schauer v. Morse Operations, Inc., 5 So. 3d 2 (Fla. Dist. Ct. App. 2009)* (Florida UDAP statute limits damages those attributable to diminished value of the goods or services received and excludes recovery of consequential damages).

(n14)Footnote 14. *International Totalizing Sys., Inc. v. Pepsico, Inc., 29 Mass. App. Ct. 424, 560 N.E.2d 749 (1990)* (loss of business opportunity was a foreseeable consequence of defendant's deception).

(n15)Footnote 15. *See Fort Lauderdale Lincoln Mercury v. Corgnati, 715 So. 2d 311 (Fla. Dist. Ct. App. 1998)* .

(n16)Footnote 16. *Jersild v. Aker, 775 F. Supp. 1198 (E.D. Wis. 1991)* ; *Antle v. Reynolds, 15 S.W.3d 762 (Mo. Ct. App. 2000)* .

(n17)Footnote 17. *Jersild v. Aker, 775 F. Supp. 1198 (E.D. Wis. 1991)* .

(n18)Footnote 18. *York v. InTrust Bank, N.A., 265 Kan. 271, 962 P.2d 405 (1998)* .

(n19)Footnote 19. *Hale v. Basin Motor Co., 110 N.M. 314, 795 P.2d 1006 (1990)* . *See Zanakis-Pico v. Cutter Dodge, Inc., 47 P.3d 1222 (Haw. 2002)* (out-of-pocket costs such as gasoline and parking incurred to respond to a deceptive ad are compensable even if the consumer declined to make the purchase).

(n20)Footnote 20. *Zanakis-Pico v. Cutter Dodge, Inc., 47 P.3d 1222 (Haw. 2002)* .

(n21)Footnote 21. *See Boat Superstore, Inc. v. Haner, 877 S.W.2d 376 (Tex. App. 1994)* . *See also Levine v. First Nat'l Bank, 917 So. 2d 1235 (La. Ct. App. 2005)* (citing damage to credit rating as factor in upholding $300,000 UDAP award for humiliation, embarrassment, and mental anguish due to wrongful foreclosure); *rev'd on other grounds*, *948 So. 2d 1051 (La. 2006)* (bank's actions were proper, so no substantive basis for UDAP claim)**;** *Connell Chevrolet Co. v. Leak, 967 S.W.2d 888, 892 (Tex. App. 1998)* (affirming award of UDAP damages for injury to credit rating).

(n22)Footnote 22. *Provident Am. Ins. Co. v. Castaneda, 988 S.W.2d 189 (Tex. 1999)* , *reh'g of cause overruled,* (Apr. 29, 1999) (disallowing UDAP claim where property damage arose from automobile accident that caused personal injury).

(n23)Footnote 23. *Nationwide Mut. Ins. Co. v. Holmes, 842 S.W.2d 335 (Tex. Ct. App. 1992)* . *Accord Columbia Chiropractic Group v. Trust Ins. Co., 430 Mass. 60, 712 N.E.2d 93 (1999)* (UDAP damages can include fees for defense of lawsuit that was filed to collect unreasonable and unnecessary charges).

(n24)Footnote 24. *Blowers v. Eli Lilly & Co., 100 F. Supp. 2d 1265 (D. Haw. 2000)* ; *Hart v. GMAC Mortgage Corp. (In re Hart), 246 B.R. 709 (Bankr. D. Mass. 2000)* (requiring proof of elements of intentional infliction of emotional distress in order to recover UDAP damages for emotional distress); *State Farm Life Ins. Co. v. Beaston, 907 S.W.2d 430 (Tex. 1995)* (case involving deception violating Insurance Code); *Woodlands Land Dev. Co., L.P. v. Jenkins, 48 S.W.3d 415 (Tex. App. 2001)* (testimony that a consumer had "shut down," cried "a lot," and endured "extreme hardship" was insufficient to show mental anguish); *Latham v. Castillo, 972 S.W.2d 66 (Tex. 1998)* , *reh'g overruled,* (Aug. 25, 1998); *American Nat'l Ins. Co. v. Paul, 927 S.W.2d 239 (Tex. App. 1996)* ; *Laurents v. Lousiana Mobile Homes, Inc., 689 So. 2d 536 (La. App. 1997)* (upholding award of mental anguish damages where seller delivered defective mobile home); *American Bankers' Ins. Co. v. Wells, 819 So. 2d 1196 (Miss. 2001)* (emotional distress damages are recoverable for ordinary negligence only if there is physical manifestation of injury or

demonstrable physical harm). *But see Wenrich v. Robert E. Cole, P.C., 2000 U.S. Dist. LEXIS 18687* (E.D. Pa. Dec. 22, 2000) (emotional distress damages probably not available for Pennsylvania UDAP violation). *See also* National Consumer Law Center, Consumer Warranty Law § 10.5.3.3 (3d ed. 2006) (mental anguish damages on warranty claims).

(n25)Footnote 25. *Barnette v. Brook Road, Inc., 429 F. Supp. 2d 741, 751 (E.D. Va. 2006)* . *Hill v. Sisters of St. Francis Health Servs., 2006 U.S. Dist. LEXIS 92874* (N.D. Ill. Dec. 20, 2006) (emotional distress qualifies as "actual damage" as required by the Illinois Consumer Fraud Act). In 2006, in *Whitaker v. M.T. Automotive, Inc., 855 N.E.2d 825 (Ohio 2006)* , the Ohio Supreme Court held that emotional distress damages are "actual damages" that are fully recoverable under the state UDAP statute. However, after this decision, the state legislature amended the UDAP statute to cap non-economic damages at $5000. *Ohio Rev. Code § 1345.09(B). See also Morris v. Harvey Cycle & Camper, Inc., 911 N.E.2d 1049 (Ill. App. Ct. 2009)* (once consumer shows economic loss, can recover damages for emotional distress, inconvenience, and aggravation).

(n26)Footnote 26. *Craig & Bishop, Inc. v. Piles, 247 S.W.3d 897 (Ky. 2008)* .

(n27)Footnote 27. *Roche v. Fireside Chrysler-Plymouth, 600 N.E.2d 1218 (Ill. App. Ct. 1992)* (affirming award of $750 for aggravation and inconvenience). *Cf. Fogle v. William Chevrolet/GEO, Inc., 2000 WL 1129983,* at *6 (N.D. Ill. Aug. 9, 2000) (consumer may recover for aggravation and inconvenience, but not shown here).

(n28)Footnote 28. *Griffin-Amiel v. Frank Terris Orchestras, 178 Misc. 2d 71, 677 N.Y.S.2d 908 (City Ct. 1998)* (awarding $500 for disappointment, humiliation, and annoyance suffered when defendant sent a different singer to the plaintiff's wedding than the one for whom she had contracted).

(n29)Footnote 29. *Becker v. Montgomery, Lynch, 2003 U.S. Dist. LEXIS 24992* (N.D. Ohio Feb. 26, 2003) (frustration, aggravation, humiliation, embarrassment, inconvenience, humiliation, and upset).

(n30)Footnote 30. *Brashears v. Sight N Sound Appliance Centers, Inc., 981 P.2d 1270 (Okla. Ct. App. 1999)* ; *Fuller v. Sight N Sound Appliance Centers, Inc., 982 P.2d 528 (Okla. Ct. App. 1999) . But see Hedrick v. Spear, 138 Or. App. 53, 907 P.2d 1123 (1995)* (damages cannot include work time lost to attend trial).

(n31)Footnote 31. *Mirandy v. Allstate Ins. Co., 151 F.3d 1029 (4th Cir. 1998)* (table, text available at *1998 U.S. App. LEXIS 10915*). *See also* National Consumer Law Center, Consumer Warranty Law § 10.5.3.3 (3d ed. 2006 and Supp.) (mental anguish damages in warranty actions).

(n32)Footnote 32. *See also Zanakis-Pico v. Cutter Dodge, Inc., 47 P.3d 1222 (Haw. 2002)* (travel expenses compensable).

(n33)Footnote 33. *See Standard Register Co. v. Bolton-Emerson, Inc., 38 Mass. App. Ct. 545, 649 N.E.2d 791 (1995)* (contractual limitation on damages has no effect on tort-type UDAP claim, but may apply where UDAP claim is merely an alternative theory of recovery under a contract).

(n34)Footnote 34. *Cambridge Plating Co. v. NAPCO, Inc., 85 F.3d 752 (1st Cir. 1996)* ; *Gunn Infiniti v. O'Byrne, 996 S.W.2d 854 (Tex. 1999)* (common law mitigation duties apply to UDAP claim).

(n35)Footnote 35. *York v. InTrust Bank, N.A., 265 Kan. 271, 962 P.2d 405 (1998)* (defendant's proof insufficient); *Pierce v. Drees, 607 N.E.2d 726 (Ind. Ct. App. 1993)* .

(n36)Footnote 36. *See, e.g., Maberry v. Said, 927 F. Supp. 1456 (D. Kan. 1996) . See also Carter v. Lachance, 766 A.2d 717 (N.H. 2001)* (statutory damages are required even without proof of actual damages); *Dantzig v. Sloe, 115 Ohio App. 3d 64, 684 N.E.2d 715 (1996)* (statutory damages required even if consumer proves no damages).

(n37)Footnote 37. *Dantzig v. Sloe, 115 Ohio App. 3d 64, 684 N.E.2d 715 (1996)* ; *Page & Wirtz Constr. Co. v. Solomon, 110 N.M. 206, 794 P.2d 349 (1990)* . *But see Shurtliff v. N.W. Pools, Inc., 120 Idaho 263, 815 P.2d 461 (Ct. App. 1991)* (no statutory damages where no actual damages). *See also Aspinall v. Philip Morris Cos., 813 N.E.2d 476, 491 /-/92* (Mass. 2004) (statutory minimum damages can be awarded as long as consumer has suffered injury; purchasing product that was deceptively advertised is sufficient injury). *See also White v. Mock, 104 P.3d 356 (Idaho 2004)* (awarding statutory minimum damages even though consumers failed to prove actual damages). *Mulford v. Altria Group, Inc., 242 F.R.D. 615, 2007 U.S. Dist. LEXIS 29149* (D.N.M. Mar. 22, 2007) (statutory damages available in individual actions without proof of actual damages); *Chambers v. General Trailer Mfg., 2006 U.S. Dist. LEXIS 45199* (E.D. Mich. July 5, 2006) (where product did not fulfill plaintiff's expectations, statutory damages are available even if actual damages are not proven); *Gadula v. Gen. Motors Corp., 2001 Mich. App. LEXIS 692* (Jan. 5, 2001) (disappointed expectations sufficient to allow jury to award statutory damages, even if actual damages are not proven) (unpublished). *But cf. Hershenow v. Enterprise Rent-A-Car Co., 840 N.E.2d 526, 533 n.18 (Mass. 2006)* (must show that UDAP violation caused cognizable loss, but need not quantify that loss).

(n38)Footnote 38. *Fenn v. Noah, 133 P.3d 1240, 1244 (Idaho 2006)* .

(n39)Footnote 39. Upadhyay v. Anderson, Clearinghouse No. 49,148 (Va. Dist. Ct. Apr. 2, 1993). *See also Griffin v. Bank of Am., 971 F. Supp. 492 (D. Kan. 1997)* (jury could award multiple statutory damage awards for the nine violations alleged even though Kansas UDAP statute allows court to award statutory damages up to $5000 for each claim); *Baker v. Tri-County Harley Davidson, Inc., 1999 Ohio App. LEXIS 5353* (Ohio Ct. App. Nov. 15, 1999) ($200 statutory damages awarded for each of three violations); *Smith v. Stacy, 2001 Ohio App. LEXIS 3202* (Ohio Ct. App. June 19, 2001) (statutory damages of $200 available for each of four UDAP violations, but actual damages are greater so are awarded instead); *In re Wiggins, 273 B.R. 839 (Bankr. D. Idaho 2001)* ($1000 statutory damages for each of 6 violations in single transaction). *But see Ferrari v. Howard, 2002 Ohio App. LEXIS 3632* (Ohio Ct. App. July 11, 2002) (unpublished, citation limited) (only one statutory damage award possible for multiple violations in same transaction).

(n40)Footnote 40. *Sign-O-Life Signs, Inc. v. Delaurenti Florists, Inc., 825 P.2d 714 (Wash. Ct. App. 1992)* .

(n41)Footnote 41. *See, e.g., Veranda Beach Club v. W. Sur. Co., 936 F.2d 1364 (1st Cir. 1991)* (Massachusetts law) (court doubles UDAP award of $2 million).

(n42)Footnote 42. *Davis v. Sellers, 443 S.E.2d 879 (N.C. Ct. App. 1994)* ; *Armour v. Klecker, 169 Wis. 2d 692, 486 N.W.2d 563 (Ct. App. 1992)* . *See Williams v. First Gov't Mortgage & Investors Corp., 225 F.3d 738 (D.C. Cir. 2000)* (District of Columbia UDAP statute interpreted to allow treble damages without any additional findings by the court); *Stultz v. Artistic Pools, Inc., 2001 Ohio 1420 (Ohio Ct. App. 2001)* (good faith, the fact that the consumer has already been adequately compensated, and equitable considerations are not grounds for denying treble damages).

(n43)Footnote 43. *Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co., 991 F.2d 141 (4th Cir. 1993)* (N.C. law).

(n44)Footnote 44. *See, e.g., Vista Resorts, Inc. v. Goodyear Tire & Rubber Co., 117 P.3d 60 (Colo. App. 2004)* .

(n45)Footnote 45. *Rini v. United Van Lines, Inc., 903 F. Supp. 224 (D. Mass. 1995)* (willfulness shown); *Oswego Laborers' Local 214 Pension Fund v. Marine Midland Bank, 85 N.Y.2d 20, 647 N.E.2d 741 (1995)* (proof of scienter necessary); *Top Value Homes, Inc. v. Harden, 460 S.E.2d 427 (S.C. Ct. App. 1995)* (treble damages properly denied where consumers did not prove willful or knowing violation). *See also Cambridge Plating Co. v. NAPCO, Inc., 85 F.3d 752 (1st Cir. 1996)* (Massachusetts law) (defendant's acts did not rise to the level of callousness or meretriciousness that would justify multiple damages). A defendant's UDAP violation may be found willful or knowing, thereby justifying multiple damages, even though the jury found in the defendant's favor on a companion fraud count. *Shah v. Racetrac Petroleum Co., 2005 WL 2417059* (E.D. Tenn., September 30, 2005).

(n46)Footnote 46. *Whelihan v. Markowski, 37 Mass. App. 209, 638 N.E.2d 927 (1994)* .

(n47)Footnote 47. *Stultz v. Artistic Pools, Inc., 2001 Ohio App. LEXIS 4561* (Ohio Ct. App. Oct. 10, 2001) .

(n48)Footnote 48. *Maryland Ins. Co. v. Head Indus. Coatings & Servs., Inc., 906 S.W.2d 218 (Tex. App. 1995)* .

(n49)Footnote 49. *Whelihan v. Markowski, 37 Mass. App. 209, 638 N.E.2d 927 (1994)* .

(n50)Footnote 50. *Lewis v. ACB Bus. Servs., 911 F. Supp. 290 (S.D. Ohio 1996)* (to justify treble damages, defendant's actions must be similar to specific conduct determined to be UDAP violation by prior court); *Dotson v. Brondes Motor Sales, 90 Ohio App. 3d 206, 628 N.E.2d 137 (1993)* (no treble damages where no showing that seller violated UDAP rule or prior court decision); *Gross v. Bildex, Inc., 647 N.E.2d 573 (Ohio Mun. Ct. 1994)* (damages trebled where contractor's acts violated decisions made available for public inspection). *Heindel v. Pfizer Inc., 381 F. Supp. 2d 364 (D.N.J. 2004)* (New Jersey makes treble damages mandatory but in Pennsylvania they are discretionary).

(n51)Footnote 51. *Votto v. American Car Rental, Inc., 273 Conn. 478, 871 A. 2d 981 (2005)* ; *Gargano v. Heyman, 203 Conn. 616, 525 A.2d 1343 (1987)* .

(n52)Footnote 52. *Votto v. American Car Rental, Inc., 273 Conn. 478, 871 A.2d 981 (Conn. 2005)* .

(n53)Footnote 53. *Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987)* . *See generally* National Consumer Law Center, Consumer Arbitration Agreements Ch. 4 (2d ed. 2002). *Byrd v. Jackson, 902 A.2d 778 (D.C. 2006)* (affirming award of both treble damages and punitive damages under UDAP law).

(n54)Footnote 54. *Stehli v. Action Custom Homes, 1999 Ohio App. LEXIS 4464* (Ohio Ct. App. Sept. 24, 1999) . *See also Broughton v. CIGNA Healthplans, 21 Cal. 4th 1066, 90 Cal. Rptr. 2d 334, 988 P.2d 67 (1999)* (striking down a limitation on a state statutory remedy as against public policy); *Derrickson v. Circuit City Stores, Inc., 1999 U.S. Dist. LEXIS 21100, 81 Fair Empl. Prac. Cas. (BNA) 1533, 1538* (D. Md. Mar. 19, 1999) , *aff'd sub nom. Johnson v. Circuit City Stores, Inc., 203 F.3d 821* (4th Cir.) , *cert. denied, 530 U.S. 1276, 120 S. Ct. 2744, 147 L.Ed. 2d 1008 (2000)* . *Cf. In re Managed Care Litig., 132 F. Supp. 2d 989* (S.D. Fla. Dec. 11, 2000) (refusing to enforce arbitration clauses that did not permit a plaintiff to obtain exemplary or punitive damages), *aff'd sub nom. Price Plaintiffs v. Humana Ins. Co. (In re Humana Inc. Managed Care Litig.), 285 F.3d 971 (11th Cir. 2002)* ; *Armendariz v. Foundation Health Psychcare Servs., Inc., 24 Cal. 4th 83, 99 Cal. Rptr. 2d 745, 6 P.3d 669 (2000)* (arbitration agreement may not limit statutorily imposed remedies such as punitive damages).

(n55)Footnote 55. *LaBarre v. Shepard, 84 F.3d 496 (1st Cir. 1996)* ; *Lexton-Ancira Real Estate Fund, 1972 v. Heller, 826 P.2d 819 (Colo. 1992)* ; *Han v. Yang, 84 Haw. 162, 931 P.2d 604 (Ct. App. 1997)* ; *Waite Hill Servs. v. World Class Metal Works, 959 S.W.2d 182 (Tex. 1998)* . *See Cremeans v. Robbins, 2000 Ohio App. LEXIS 2753* (Ohio Ct. App. June 12, 2000) (where remedy plaintiff sought was basically cancellation of the transaction and return of money paid, this was a prayer for rescission so she could not get treble damages).

(n56)Footnote 56. *Blankenship v. Town & Country Ford, Inc., 622 S.E.2d 638 (N.C. Ct. App. 2005)* .

(n57)Footnote 57. *Cambridge Plating Co. v. NAPCO, Inc., 890 F. Supp. 55 (D. Mass. 1995)* (plaintiff allowed to recover compensatory damages on non-UDAP count, plus the portion of UDAP damages that resulted from doubling); *Conseco Fin. Servicing Corp. v. Hill, 556 S.E.2d 468 (Ga. App. 2001)* (consumers may be able to recover both treble damages and exemplary damages for the same UDAP violation under the Georgia statute), *recons. denied,* (Dec. 5, 2001). *See Jackson v. Byrd, 902 A.2d 778 (D.C. Super. 2004)* (trial court awarded both treble damages and punitive damages for the same UDAP violations by a fraudulent homesaver).

(n58)Footnote 58. *Heller v. Lexton-Ancira Real Estate Fund, Ltd., 809 P.2d 1016 (Colo. Ct. App. 1990)* ; *Winkle Chevy-Olds-Pontiac v. Condon, 830 S.W.2d 740 (Tex. Ct. App. 1992)* . *Compare Cherick Distribs., Inc. v. Polar Corp., 41 Mass. App. Ct. 125, 669 N.E.2d 218* , *rev. denied, 423 Mass. 1109, 672 N.E.2d 538 (1996)* (where UDAP claim derived from same wrongful acts as non-UDAP claim, only single award of damages should have been trebled).

(n59)Footnote 59. *Cal. Civ. Code § 3345. See Novick v. UNUM Life Ins. Co., 570 F. Supp. 2d 1207 (C.D. Cal. 2008)* (punitive damages under Consumers Legal Remedies Act may be trebled).

(n60)Footnote 60. *Davis v. Wholesale Motors, 86 Haw. 405, 949 P.2d 1026 (Ct. App. 1997)* ; *Tosi v. Adams, 424 Mass. 1001, 673 N.E.2d 1224 (1997)* ; *Brown v. LeClair, 20 Mass. App. 976, 482 N.E.2d 870 (1985)* ; *Pierce v. Norwick, 550 N.W.2d 451 (Wis. Ct. App. 1996)* .

(n61)Footnote 61. *Edmondson v. American Motorcycle Ass'n, 2001 U.S. App. LEXIS 1506* (4th Cir. Feb. 2, 2001) (unpublished, citation limited) (N.C. law); *Cremeans v. Robbins, 2000 Ohio App. LEXIS 2753* (Ohio Ct. App. June 12, 2000) .

(n62)Footnote 62. *Cannon v. Cherry Hill Toyota, Inc., 161 F. Supp. 2d 362 (D.N.J. 2001) . But see Stuart v. Weisflog's Showroom Gallery, Inc., 293 Wis. 2d 668 (2006)* (where the consumer entered into a transaction because of the defendant's deception, the multiple damage award should be based on all the damage resulting from the transaction, even if the defendant's negligence in performing the contract was the primary cause of some of the damages.).

(n63)Footnote 63. *Stuart v. Weisflog's Showroom Gallery, Inc., 746 N.W.2d 762, 770* /-/771 (Wis. 2008).

(n64)Footnote 64. *See City Coal Co. v. Noonan, 434 Mass. 709 (2001)* (prejudgment interest runs only on the untrebled compensatory portion of the award). *Compare Roberts v. Grande, 868 S.W.2d 956 (Tex. Ct. App. 1994)* (interest not trebled), *with Vairo v. Clayden, 153 Ariz. 13, 734 P.2d 110 (Ct. App. 1987)* (interest trebled in state RICO action). *See also Murphy v. National Union Fire Ins. Co., 438 Mass. 529, 781 N.E.2d 1232, 1236 (2003)* (treble damages may be awarded based on delay in payment of arbitration award).

(n65)Footnote 65. *Schwartz v. Rose, 418 Mass. 41, 634 N.E.2d 105 (1994)* .

(n66)Footnote 66. *Custom Molders, Inc. v. American Yard Prods., Inc., 463 S.E.2d 199 (N.C. 1995)* .

(n67)Footnote 67. *Green Tree Acceptance, Inc. v. Holmes, 803 S.W.2d 458 (Tex. Ct. App. 1991)* .

(n68)Footnote 68. *Cal. Civ. Code § 1780*; Conn. Gen. Stat. § 42-110(g); *D.C. Code Ann. § 28-3901*; *Ga. Code Ann. § 10-1-399*; *Idaho Code § 48-608*; *Ky. Rev. Stat. § 367.220*; *Mo. Rev. Stat. § 407.025*; *Or. Rev. Stat. § 646.638*; *R.I. Gen. Laws § 6-13.1-5.2*; *Vt. Stat. Ann. tit. 9, § 2461* (exemplary damages capped at treble the consideration that consumer provides the merchant). *See Parrott v. Carr Chevrolet, Inc., 331 Or. 537, 17 P.3d 473 (2001)* (reinstating $1 million punitive damage award on UDAP claim), *reconsideration denied, 2001 Ore. LEXIS 223* (Mar. 27, 2001) . *See, e.g., Nielsen v. Wisniewski, 32 Conn. App. 133, 628 A.2d 25 (1993)* (punitive damages against landlord of substandard housing); *Billy Cain Ford Lincoln Mercury v. Kaminski, 230 Ga. App. 598, 496 S.E.2d 521 (1998) , cert. denied, 1998 Ga. LEXIS 589* (Ga. May 29, 1998) . *See also Cohen v. Express Financial Servs., Inc., 145 S.W.3d 857 (Mo. App. 2004)* (affirming award of $25,000 punitive damages against dealership and $1000 against salesperson for failure to disclose vehicle's prior wreck damage). *But cf. Thomas v. Brooks, 2007 WL 1378510* (Ky. Ct. App. May 11, 2007) (unpublished) (UDAP statute does not expand availability of punitive damages; not available where UDAP claim is based on breach of construction contract); *Ford Motor Co. v. Mayes, 575 S.W.2d 480, 482 (Ky. Ct. App. 1978)* (UDAP statute merely preserves any preexisting right to claim punitive damages, but does not make punitive damages more widely available; not available where UDAP claim was based on breach of contract).

(n69)Footnote 69. *Minn. Stat. § 549.20* ("upon clear and convincing evidence that the acts of the defendant show deliberate disregard for the rights or safety of others"). *See also Wexler v. Brothers Entertainment Group, Inc., 457 N.W.2d 218 (Minn. Ct. App. 1990)* ; *Yost v. Millhouse, 373 N.W.2d 826 (Minn. Ct. App. 1985) . But see In re Lutheran Brotherhood Variable Ins. Prods. Co. Sales Practices Litig., 2004 U.S. Dist. LEXIS 7789* (D. Minn. Apr. 28, 2004) (stating that Minn. Consumer Fraud Act and Private Attorney General statute do not authorize punitive damages; court does not mention *Minn. Stat. § 549.20*).

(n70)Footnote 70. Ark. Stat. Ann. § 4-88-204.

(n71)Footnote 71. Ill. Comp. Stat. Ann. § 505/10a.*See Kirkpatrick v. Strosberg, 2008 Ill. App. LEXIS 358* (Ill. App. Ct. Apr. 16, 2008) ; *Kleczek v. Jorgensen, 328 Ill. App. 3d 1012, 767 N.E.2d 913 (2002)* (upholding trial court's discretion in denying punitive damages).

(n72)Footnote 72. *Societa Bario E Derivati v. Kaystone Chem., Inc., 1998 U.S. Dist. LEXIS 23066* (D. Conn. Apr. 15, 1998) (Connecticut UDAP statute adopts common law standards for punitive damages but expands their nature to serve both compensatory and deterrent purposes); *Aronson v. Creditrust Corp., 7 F. Supp. 2d 589, 594 (W.D. Pa. 1998)* (construing language authorizing "such additional relief as [the court] deems necessary or proper" to allow punitive damages); *Martin v. Heinold Commodities, Inc., 163 Ill. 2d 33, 643 N.E.2d 734 (1994)* (punitive damages awarded in suit alleging UDAP violations and breach of fiduciary duty). *But see Wyman v. Terry Schulte Chevrolet, 584 N.W.2d 103, 1998 S.D. 96 (1998)* (punitive damages not available on UDAP claim).

(n73)Footnote 73. *Nielsen v. Wisniewski, 32 Conn. App. 133, 628 A.2d 25 (1993)* (reckless indifference to rights of others or an intentional and wanton violation of those rights); *Leonard & Harral Packing Co. v. Ward, 971 S.W.2d 671 (Tex. App. 1998) . See also Cohen v. Express Financial Servs., Inc., 145 S.W.3d 857 (Mo. App. 2004)* (punitive damages allowable where defendant's conduct is outrageous because of evil motive or reckless indifference to rights of others); *Votto v. Am. Car Rental, Inc., 871 A.2d 981 (Conn. 2005)* (upholding punitive damage award where defendant's overcharge was reprehensible, not an isolated incident, and exacerbated by directing consumer to address complaint to a phony legal department).

(n74)Footnote 74. *See Bristol Tech. v. Microsoft Corp., 114 F. Supp. 2d 59 (D. Conn. 2000)* (awarding $1 million in punitive damages against Microsoft even though jury awarded $1 in actual damages), *vacated, 250 F.3d 152 (2d Cir. 2001)* (vacating judgment pursuant to settlement agreement; expressing doubt about whether district court had jurisdiction to consider punitive damages issues); *Conway v. American Excavating, Inc., 41 Conn. App. 437, 676 A.2d 881 (1996) . But see Twin City Fire Ins. Co. v. Davis, 904 S.W.2d 663 (Tex. 1995) .*

(n75)Footnote 75. *Mastrobuono v. Shearson Lehman Hutton, 514 U.S. 52, 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995) . See generally* National Consumer Law Center, Consumer Arbitration Agreements (2d ed. 2002).

(n76)Footnote 76. *TXO Prod. Corp. v. Alliance Res. Corp., 509 U.S. 443, 113 S. Ct. 2711, 125 L. Ed. 2d 366 (1993) . See also BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 116 S. Ct. 1589, 134 L. Ed. 2d 809 (1996) .*

(n77)Footnote 77. *See Grabinski v. Blue Springs Ford Sales, Inc., 203 F.3d 1024 (8th Cir. 2000)* (upholding punitive damage awards ranging from five to ninety-nine times actual damages; also discusses how to calculate punitive-to-actual damage ratios), *reh'g, en banc, denied, 2000 U.S. App. LEXIS 4660* (8th Cir. Mar. 21, 2000) , *cert. denied, 531 U.S. 825, 121 S. Ct. 70, 148 L.Ed. 2d 35 (2000)* ; *Sheffield v. Andrews, 679 So. 2d 1052 (Ala. 1996)* (upholding $1 million in punitive damages where actual damages $10) (the Alabama Supreme Court denied a motion for rehearing on this case even after *Gore* was issued); *Waltson v. Monumental Life Ins. Co., 923 P.2d 456 (Idaho 1996)* (ratio greater than 25 to 1); *Schaffer v. Edward D. Jones & Co., 552 N.W.2d 801 (S.D. 1996)* ; *Romanski v. Detroit Entertainment, L.L.C., 428 F.3d 629 (6th Cir. 2005)* (upholding $600,000 of jury's $875,000 punitive damage award on compensatory damages of $279.05, a 2750-to-1 ratio); *Action Marine, Inc. v. Continental Carbon, Inc., 2006 U.S. Dist. LEXIS 4907* (M.D. Ala. Jan. 23, 2006) (taking risk of physical harm from defendant's environmental pollution into account even though plaintiffs did not claim personal injury); *CGB Occupational Therapy, Inc. v. RHA Pa. Nursing Homes, 2005 U.S. Dist. LEXIS 13516* (E.D. Pa. July 5, 2005) (upholding $2 million of jury's $30 million punitive damages on compensatory damages of $109,000, a 19-to-1 ratio; court notes that plaintiff probably suffered damages that are not reflected in the compensatory award).

(n78)Footnote 78. *Tingley Sys., Inc. v. Norse Sys., Inc., 49 F.3d 93 (2d Cir. 1995) .*

(n79)Footnote 79. *See Neibel v. Trans World Assurance Co., 108 F.3d 1123 (9th Cir. 1997)* ; *Life Ins. Co. of*

Georgia v. Johnson, 701 So. 2d 524 (Ala. 1997) (intentional sale of unnecessary supplemental Medicare insurance policy to Medicaid recipient was particularly reprehensible given that victim was elderly and poor, and supported a ratio of punitive to compensatory damages of 12 to 1); *Williams v. ITT Fin. Servs., 1997 Ohio App. LEXIS 2721* (Ohio Ct. App. June 25, 1997) (home repair loan scam perpetrated on elderly victim supported punitive to compensatory damages ratio of 100 to 1), *aff'd sub nom. Williams v. Aetna Fin. Co., 83 Ohio St. 3d 464, 700 N.E.2d 859 (1998)* , *cert. denied, 526 U.S. 1051, 119 S. Ct. 1357, 143 L. Ed. 2d 518 (1999)* . *Cf. Dean v. Olibas, 129 F.3d 1001 (8th Cir. 1997)* (punitive damages 14 times actuals not excessive for malicious prosecution action against bail bondsman); *Parsons v. First Invs. Corp., 122 F.3d 525 (8th Cir. 1997)* (punitive damages award over 11 times the actual damages not excessive in investors' action for fraudulently inducing them to invest in junk bond mutual funds); *Hampton v. Dillard Dep't Stores, Inc., 18 F. Supp. 2d 1256 (D. Kan. 1998)* ($1,100,000 punitive damage award, at a 20-to-1 ratio to the $56,000 compensatory award, was justified due to the reprehensible pattern of discriminatory behavior against minorities); *United States v. Oak Manor Apartments, 11 F. Supp. 2d 1047 (W.D. Ark. 1998)* (punitive damages 100 times the compensatory award not excessive for housing discrimination claim); *McDermott v. Party City Corp., 11 F. Supp. 2d 612 (E.D. Pa. 1998)* (upholding 9 to 1 ration where breach of fiduciary duties); *Scribner v. Waffle House, Inc., 976 F. Supp. 439 (N.D. Tex. 1997)* , *vacated, 62 F. Supp. 2d 1186 (N.D. Tex. 1999)* (punitive damages 13 times the actual damages awarded to employee in a sexual harassment case warranted due to egregious harassment over an extended period of time); *Rush v. Scott Specialty Gases, Inc., 930 F. Supp. 194 (E.D. Pa. 1996)* ($2,700,000 punitive damages in employment discrimination case), *costs/fees proceeding, 934 F. Supp. 152 (E.D. Pa. 1996)* , *clarified, 940 F. Supp. 814 (E.D. Pa. 1996)* , *rev'd, in part, remanded, 1997 U.S. App. LEXIS 11102 (3d Cir. 1997)* , *reh'g denied, 1997 U.S. App. LEXIS 18415* (3d Cir. Juy 16, 1997) . *But cf. FDIC v. Hamilton, 122 F.3d 854 (10th Cir. 1997)* (punitive damages award 27 times the compensatory damages award excessive for action against landlord for falsely promising to make substantial repairs, and reduced to 6 times compensatory damages). *See Stevens v. Owens-Corning Fiberglas Corp., 57 Cal. Rptr. 2d 525 (Ct. App. 1996)* (upholding $2 million punitive damage award); *Owens-Corning Fiberglas Corp. v. Rivera, 683 So. 2d 154 (Fla. Dist. Ct. App. 1996)* (upholding $1.5 million punitive damage award); *Owens-Corning Fiberglas Corp. v. Wasiak, 917 S.W.2d 883 (Tex. Ct. App. 1996)* (applying Alabama law and upholding $3.7 million punitive damage award).

(n80)Footnote 80. *538 U.S. 408, 123 S. Ct. 1513, 155 L. Ed. 2d 585 (2003)* .

(n81)Footnote 81. *538 U.S. 408, 419, 123 S. Ct. 1513, 1521, 155 L. Ed. 2d 585, 602 (2003)* .

(n82)Footnote 82. Restatement (Second) of Torts § 909; Restatement (Second) of Agency, 217C; *Preston v. Income Producing Mgmt. Co., 871 F. Supp. 411 (D. Kan. 1994)* ; *Dahl v. Sittner, 474 N.W.2d 897 (S.D. 1991)* .

(n83)Footnote 83. *Williams v. Aetna Fin. Co., 83 Ohio St. 3d 464, 700 N.E.2d 859 (1998)* , *cert. denied, 526 U.S. 1051, 119 S. Ct. 1357, 143 L. Ed. 2d 518 (1999)* (Aetna is ITT's new corporate name).

(n84)Footnote 84. *Crawford v. Bill Swad Chevrolet, Inc., 2000 Ohio App. LEXIS 4221* (Sept. 19, 2000) (allowing both punitive damages for fraud plus treble damages for UDAP violations); *United Labs. v. Kuykendall, 335 N.C. 183, 437 S.E.2d 374 (1993)* ; *Winkle Chevy-Olds-Pontiac v. Condon, 830 S.W.2d 740 (Tex. Ct. App. 1992)* ; *Conseco Fin. Serv. Corp. v. Hill, 556 S.E.2d 468 (Ga. App. 2001)* (treble and punitive damages may be allowed for same UDAP violation if intentional); *Scott v. Blue Springs Ford Sales, Inc., 176 S.W.3d 140 (Mo. 2005)* (punitive damages under UDAP statute are not inconsistent with punitive damages for fraud, so consumer may seek both; after verdict judge should determine the extent to which the awards merge). *See also Hess v. Chase Manhattan Bank, 2006 Mo. App. LEXIS 350* (Mo. Ct. App. Mar. 28, 2006) (fraud and UDAP theories of recovery are not inconsistent, so consumer need not choose between them prior to submitting case to jury; after verdict, court must ensure that there is no double recovery).

(n85)Footnote 85. *See Lexton-Ancira Real Estate Fund, 1972 v. Heller, 826 P.2d 819 (Colo. 1992)* ; *Cieri v. Leticia Query Realty, Inc., 905 P.2d 29 (Hawaii 1995)* (consumer must elect between treble damages and attorney fees on a UDAP claim or punitive damages on a fraud claim).

(n86)Footnote 86. *Cieri v. Leticia Query Realty, Inc., 905 P.2d 29 (Hawaii 1995)* (consumer must choose larger award; in determining which is larger, attorney fees are included in UDAP award); *Hale v. Basin Motor Co., 110 N.M. 314, 795 P.2d 1006 (1990) . See also Inman v. Imperial Chrysler-Plymouth, Inc., 397 S.E.2d 774 (S.C. App. 1990) . But see Concrete Spaces, Inc. v. Sender, 1998 Tenn. App. LEXIS 525* (Tenn. Ct. App. July 31, 1998) (plaintiff must make election before amount of punitive damages is awarded), *vacated, remanded, 2 S.W.3d 901 (Tenn. 1999)* .

(n87)Footnote 87. Consumer class action practice issues are treated in National Consumer Law Center, Consumer Class Actions: A Practical Litigation Guide (6th ed. 2006).

(n88)Footnote 88. *Piccicuto v. Dwyer, 32 Mass. App. 137, 586 N.E.2d 38 (1992)* .

(n89)Footnote 89. *Carroll v. Cellco P'ship, 313 N.J. Super. 488, 713 A.2d 509 (App. Div. 1998)* ("This preference for class certification applies especially for adjudication of multiple consumer-fraud claims.").

(n90)Footnote 90. Whether an arbitration proceeding can go forward as a class is dealt with in detail in National National Consumer Law Center, Consumer Arbitration Agreements, Ch. 10 (5th ed. 2007 and Supp.).

(n91)Footnote 91. *55 F.3d 269 (7th Cir. 1995) . See also Thompson v. Illinois Title Loans, Inc., 2000 Dist. LEXIS 232* (N.D. Ill. Jan. 6, 2000) ; *Furgason v. McKenzie Check Advance of Ind., Inc., 2001 U.S. Dist. LEXIS 2725* (S.D. Ind. Jan. 6, 2001) ; *Gammaro v. Thorp Consumer Disc. Co., 828 F. Supp. 673, 674 (D. Minn. 1993)* , *overruled in part, Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000)* ; *Stein v. Geonerco, Inc., 105 Wash. App. 41, 17 P.3d 1266, 1271 (2001)* .

(n92)Footnote 92. *See, e.g., Idaho Code § 48-608*; *Kan. Stat. Ann. § 50-634. See also Delahunt v. Cytodyne Techs., 241 F. Supp. 2d 827 (S.D. Ohio 2003)* (finding that proposed class action meets Ohio's requirement that practice have been determined by a rule or court decision to be a violation). *See also Aspinall v. Philip Morris Cos., 813 N.E.2d 476, 485 (Mass. 2004)* (traditional technicalities are not to be read into UDAP statute's class action procedure); *Park v. Ford Motor Co., 2004 R.I. Super. LEXIS 181* (R.I. Super. Oct. 7, 2004) (UDAP statute's class action procedures override those of court rules); *Iowa Code § 714H.7* (private UDAP class action complaint must be approved by attorney general before it can be filed; attorney general must approve it unless it is frivolous).

(n93)Footnote 93. *See Ga. Code Ann. § 10-1-390*; *Miss. Code Ann. § 75-24-15*; *Tenn. Code Ann. § 47-18-109* (section that creates private cause of action allows consumer to bring suit individually). *See also Landreneau v. Fleet Fin. Group, 197 F. Supp. 2d 551 (M.D. La. 2002)* ; *Durant v. ServiceMaster Co., 208 F.R.D. 228 (E.D. Mich. 2002)* (Tennessee UDAP statute only allows individual actions).

(n94)Footnote 94. *Faralli v. Hair Today, Gone Tomorrow, 2007 U.S. Dist. LEXIS 1977* (N.D. Ohio Jan. 10, 2007) (UDAP class cannot be certified based on FTC decision that was not in public inspection file); *Pettrey v. Enterprise Title Agency, Inc., 241 F.R.D. 268 (N.D. Ohio 2006)* (class certification of Ohio UDAP claim cannot be based on HUD regulations); *Delahunt v. Cytodyne Technologies, 241 F. Supp. 2d 827 (S.D. Ohio 2003)* (finding that proposed class action meets Ohio's requirement that practice have been determined by a rule or court decision to be a violation); *Marrone v. Philip Morris USA, Inc., 850 N.E.2d 31 (Ohio 2006)* (UDAP class can be certified only if prior determination orattorney general rule relates to acts that are substantially similar to defendant's; general rule prohibiting representations without reasonable basis in fact, and prior determinations about different industries, are insufficient); *Dunkelman v. Cincinnati Bengals, 866 N.E.2d 576 (Ohio Ct. App. 2006)* (class certification of Ohio UDAP claim improper when plaintiffs did not allege that defendant violated a rule or a prior decision).

(n95)Footnote 95. *Arenson v. Whitehall Convalescent & Nursing Home, 164 F.R.D. 659 (N.D. Ill. 1996)* (small amount at stake for each individual militates in favor of class action); *Carroll v. Cellco P'ship, 313 N.J. Super. 488, 713 A.2d 509 (App. Div. 1998)* .

(n96)Footnote 96. *Piccicuto v. Dwyer, 32 Mass. App. 137, 586 N.E.2d 38 (1992)* .

(n97)Footnote 97. *See Martin v. Dahlberg, Inc., 156 F.R.D. 207 (N.D. Cal. 1994)* .

(n98)Footnote 98. *See Arenson v. Whitehall Convalescent & Nursing Home, 164 F.R.D. 659 (N.D. Ill. 1996)* (no need to show reliance in Illinois UDAP class action); *Latman v. Costa Cruise Lines, N.V., 758 So. 2d 699 (Fla. Dist. Ct. App. 2000)* ; *Pickett v. Holland Am. Line-Westours, Inc., 101 Wash. App. 901, 6 P.3d 63 (2000)* (same), *rev'd on other grounds, 35 P.3d 351 (Wash. 2001)* . *See also Chisolm v. TranSouth Fin. Corp., 194 F.R.D. 538 (E.D. Va. 2000)* (reliance can be proven in RICO claim by consumers' payment of bill). *But see In re Woodward & Lothrop Holdings, Inc., 205 B.R. 365 (Bankr. S.D.N.Y. 1997)* .

(n99)Footnote 99. Duffy v. Jerry's Chevrolet, Inc., Clearinghouse No. 54555 (Md. Cir. Ct. Aug. 27, 2001).

(n100)Footnote 100. *Arenson v. Whitehall Convalescent & Nursing Home, 164 F.R.D. 659 (N.D. Ill. 1996)* .

(n101)Footnote 101. *See Fielder v. Credit Acceptance Corp., 175 F.R.D. 313 (W.D. Mo. 1997)* , *vacated, remanded, mot. denied, 188 F.3d 1031 (8th Cir. 1999)* . *Latham v. Residential Loan Centers of Am., Inc., 2004 U.S. Dist. LEXIS 7993* (N.D. Ill. May 6, 2004) (refusing to dismiss class action UDAP claim based on presentation of deceptive documents at loan closings).

(n102)Footnote 102. *Strawn v. Canuso, 140 N.J. 43, 657 A.2d 420 (1995)* (failure to disclose existence of landfill near homes that were being sold).

(n103)Footnote 103. *Shields v. Lefta, Inc., 888 F. Supp. 891 (N.D. Ill. 1995)* (class certified on claim that standard contract falsely represented that cost disclosed for extended warranty was actually paid to warranty company).

(n104)Footnote 104. *Bloyed v. GMC, 881 S.W.2d 442 (Tex. App. 1994)* . *See generally* National Consumer Law Center, Consumer Class Actions: A Practical Litigation Guide (6th ed. 2006 and Supp.).

(n105)Footnote 105. Delaware; Georgia; Hawaii; Illinois; Maine; Minnesota; Nebraska; New Mexico; Ohio; Oklahoma; and Oregon.

(n106)Footnote 106. *Del. Code Ann. tit. 6, § 2531*; *Ga. Code Ann. § 10-1-370*; Haw. Rev. Stat. § 481A; *815 Ill. Comp. Stat. 510/1 et seq.* ; *Me. Rev. Stat. Ann. tit. 10, § 1211*; *Minn. Stat. Ann. § 325D.43*; *Neb. Rev. Stat. § 87-301*; Ohio Rev. Code Ann. § 4165 (Baldwin); *Okla. Stat. Ann. tit. 78, § 51* (West).

(n107)Footnote 107. *Del. Code Ann. tit. 6, § 2511*; *Ga. Code Ann. § 10-1-390*; Haw. Rev. Stat. § 481; *815 Ill. Comp. Stat. 505/1 et seq.* ; *Me. Rev. Stat. Ann. tit. 5, § 206*; *Minn. Stat. Ann. § 8.31*; *Neb. Rev. Stat. § 59-1601*; *Ohio Rev. Code Ann. § 1345.01* (Baldwin); *Okla. Stat. Ann. tit. 15, § 751* (West). *See Greenberg v. United Airlines, 206 Ill. App. 3d 40, 563 N.E.2d 1031 (1990)* (comparison of the two statutes).

(n108)Footnote 108. *Ala. Code § 8-19-10*; *Cal. Civ. Code § 1780*; *Cal. Bus. & Prof. Code §§ 17203*, *17204*; Conn. Gen. Stat. § 42-110(g); *D.C. Code Ann. § 28-3905(k)*; *Fla. Stat. Ann. § 501.211(1)*; *Ga. Code Ann. § 10-1-399*; *Haw. Rev. Stat. § 480-13*; *Idaho Code § 48-608*; *815 Ill. Comp. Stat. 505/10a*; *Kan. Stat. Ann. § 50-634*; *Me. Rev. Stat. Ann. tit. 5, § 213*; *Mass. Gen. Laws Ann. ch. 93A, § 9*; *Mich. Comp. Laws § 445.911*; *Neb. Rev. Stat. § 59-1609*; *N.H. Rev. Stat. Ann. § 358-A:10*; *N.Y. Gen. Bus. Law § 349*; *Ohio Rev. Code Ann. § 1345.09*; *R.I. Gen. Laws § 6-13.1-5.2*; *Tenn. Code Ann. § 47-18-109*; Tex. Bus. &Com. Code Ann. tit. 2, § 17.50(b); *Utah Code Ann. § 13-11-19*; *Wash. Rev. Code § 19.86.090*.

(n109)Footnote 109. *Mo. Ann. Stat. §§ 407.025*.

(n110)Footnote 110. *Scott v. Blue Springs Ford Sales, Inc., 215 S.W.3d 145 (Mo. Ct. App. 2006)* .

(n111)Footnote 111. *See Weinberg v. Sprint Corp., 173 N.J. 233, 801 A.2d 281, 293 (2002)* (consumer can obtain injunction where statute authorizes "any other appropriate legal or equitable relief"; must establish ascertainable loss of

money or property sufficient to withstand summary judgment); *Medical Soc. of N.J. v. Amerihealth HMO, Inc., 376 N.J. Super. 48, 868 A.2d 1162, 1168 (App. Div. 2005)* .

(n112)Footnote 112. *Cf. Dialogo, L.L.C. v. Santiago-Bauza, 425 F.3d 1 (1st Cir. 2005)* (private plaintiff must show irreparable injury to obtain injunction under Mass. UDAP statute).

(n113)Footnote 113. *See Frey v. Vin Devers, Inc., 80 Ohio App. 3d 1, 608 N.E.2d 796 (1992)* . *See also Wenneman v. Sperano, 2001 Ohio App. LEXIS 1970* (May 3, 2001) (must elect between rescission and damages).

(n114)Footnote 114. *Smith v. Scott Lewis Chevrolet, Inc., 843 S.W.2d 9 (Tenn. Ct. App. 1992)* .

(n115)Footnote 115. *See, e.g., David McDavid Pontiac, Inc. v. Nix, 681 S.W.2d 831 (Tex. Ct. App. 1984)* . *See also Ponzo v. Affordable Homes of Rochester, L.L.C., 2005 Minn. App. Unpub. LEXIS 122* (Minn. Ct. App. Aug. 2, 2005) (consumer must act promptly after discovering the basis for rescission).

(n116)Footnote 116. *Davis v. Wholesale Motors, Inc., 86 Haw. 405, 949 P.2d 1026 (Ct. App. 1997)* .

(n117)Footnote 117. *Chattin v. Cape May Greene, Inc., 243 N.J. Super. 590, 581 A.2d 91 (1990)* . *See also Showpiece Homes Corp. v. Assurance Co. of Am., 38 P.3d 47 (Colo. 2001)* (purposes are to provide remedy and promote enforcement), *modified and reh'g denied, en banc, 2002 Colo. LEXIS 57* (Colo. Jan. 14, 2002) . *Presidential Leasing, Inc. v. Krout, 896 So. 2d 938 (Fla. Dist. Ct. App. 2005)* ; *Furst v. Einstein Moomjy, Inc., 860 A.2d 435, 446, 448 (N.J. 2004)* ; *Miller v. United Automax, 166 S.W.3d 692 (Tenn. 2005)* (purpose is to make prosecution of UDAP claims economically feasible). *Killingsworth v. Ted Russell Ford, Inc., 205 S.W.3d 406, 410 (Tenn. 2006)* (potential award of fees is intended to make UDAP claims economically viable). *Accord: Krautsack v. Anderson, 861 N.E.2d 633, 645 (Ill. 2006)* (because individual consumer fraud claims are frequently small, attorney fee provision ensures that defrauded consumers will be able to exercise their rights).

(n118)Footnote 118. *Jordan v. Transnational Motors, Inc., 537 N.W.2d 471 (Mich. Ct. App. 1995)* .

(n119)Footnote 119. *In re Bryant, 111 B.R. 474 (Bankr. E.D. Pa. 1990)* ; *In re Wernly, 91 B.R. 702 (Bankr. E.D. Pa. 1988)* ; *In re Stewart, 93 B.R. 878 (Bankr. E.D. Pa. 1988)* ; *Andrews v. Fleet Real Estate Funding Corp., 78 B.R. 78 (Bankr. E.D. Pa. 1987)* ; *Jungkurth v. E. Fin. Servs., Inc., 74 B.R. 323 (Bankr. E.D. Pa. 1987)* , *aff'd on other grounds*, *87 B.R. 333 (Bankr. E.D. Pa. 1988)* (while the reviewing district court acknowledged the argument for UDAP attorney fees as "additional relief," it did not expressly affirm this part of the bankruptcy court's ruling). *See also Hines v. Chrysler Corp., 971 F. Supp. 212 (E.D. Pa. 1997)* .

(n120)Footnote 120. *Steiger v. J.S. Builders, Inc., 39 Conn. App. 32, 663 A.2d 432 (1995)* (even if trial court has discretion whether to award fees, it must apply the correct legal standard in setting the amount of fees). *See Dobosz v. Barrington Dodge, Inc., 2002 U.S. Dist. LEXIS 18970* (N.D. Ill. Oct. 7, 2002) (fee award is discretionary; listing relevant factors in determining award).

(n121)Footnote 121. *Knight v. Snap-On Tools Corp., 3 F.3d 1398 (10th Cir. 1993)* (New Mexico law); *Stocker v. Keith, 178 Or. App. 544, 38 P.3d 283 (2002)* (Oregon plaintiffs who obtained a judgment on one UDAP claim were held to have prevailed even though they lost on other UDAP claims). *See also Brown v. King, 601 S.E.2d 296 (N.C. App. 2004)* ; *Miller v. United Automax, 166 S.W.3d 692* (Tenn. June 24, 2005) (consumer who elects to receive punitive damages awarded on fraud count rather than treble damages awarded on UDAP count can still recover UDAP attorney fees).

(n122)Footnote 122. *Thomas v. Olson, 220 S.W.3d 627 (2005)* ; *Singh v. I.D.J. Construction & Elec., Inc., 2006 WL 1492475* (N.J. Super. Ct. App. Div. June 1, 2006) (unpublished).

(n123)Footnote 123. *Midstate Siding & Window Co. v. Rogers, 309 Ill. App. 3d 610, 722 N.E.2d 1156 (1999)*

(construing both state UDAP statute and state credit repair organizations statute to allow award of fees for appellate work), *review granted, 731 N.E.2d 765 (Ill. 2000)* ; *Sing v. John L. Scott, Inc., 920 P.2d 589 (Wash. Ct. App. 1996)* . *But see Parker v. I&F Insulation Co., 89 Ohio St. 3d 261, 730 N.E.2d 972 (2000)* (consumer not entitled to fees for seller's appeal in which seller won 63% reduction of trial court's UDAP award).

(n124)Footnote 124. *532 U.S. 598, 121 S. Ct. 1835, 149 L. Ed. 2d 855 (2001)* .

(n125)Footnote 125. *Id. at 604* .

(n126)Footnote 126. *Id.*

(n127)Footnote 127. *Id. at 605*

(n128)Footnote 128. *Id., 121 S. Ct. at 1838, 1839 n. 4* ("Numerous federal statutes allow courts to award attorney's fees and costs to the 'prevailing party.' The question presented here is whether this term includes a party that has failed to secure a judgment on the merits or a court-ordered consent decree ... .") (citing various fee-shifting statutes, referring to list of additional statutes in *Marek v. Chesny, 473 U.S. 1, 105 S. Ct. 3012, 87 L. Ed. 2d 1 (1985)* , and saying that all are interpreted consistently).

(n129)Footnote 129. *See, e.g., Wallerstein v. Stew Leonard's Dairy, 258 Conn. 299, 780 A.2d 916 (2001)* (judgment entered under Connecticut equivalent of Rule 68 made plaintiff the prevailing party). *But see Graham v. DaimlerChrysler Corp., 101 P.3d 140 (Cal. 2004)* (rejecting *Buckhannon* and adhering to catalyst theory).

(n130)Footnote 130. *Brandon K. v. New Lenox Sch. Dist., 2001 U.S. Dist. LEXIS 19138* (Nov. 21, 2001) , *reprinted as amended, 2001 U.S. Dist. LEXIS 19138* (N.D. Ill. Nov. 30, 2001) ; *Jose Luis R. v. Joliet Township H.S. Dist. 204, 2001 U.S. Dist. LEXIS 13951* (N.D. Ill. Aug. 27, 2001) , *costs/fees proceedins, summ. judgment granted, summ. judgment denied, 2002 U.S. Dist. LEXIS 13951* (N.D. Ill. Jan. 14, 2001) . *But see Thayer v. Principi, 15 Vet. App. 204 (2001)* (plaintiff not prevailing party where government sought remand to administrative agency, which then issued favorable appeal, and then court dismissed appeal as moot).

(n131)Footnote 131. *Dorfsman v. Law Sch. Admission Council, 2001 U.S. Dist. LEXIS 24044* (E.D. Pa. Nov. 28, 2001) .

(n132)Footnote 132. A federal court does not have jurisdiction to enforce a settlement agreement once a case is dismissed, unless the dismissal entry embodies the settlement agreement or retains jurisdiction to enforce it. *Kokkonen v. Guardian Life Ins. Co., 511 U.S. 375, 114 S. Ct. 1673, 128 L. Ed. 2d 391 (1994)* (stating that district court can enforce settlement agreement if it is embodied in dismissal order or if order states that court retains jurisdiction to enforce it). For further discussion of this topic, see National Consumer Law Center, Consumer Warranty Law, § 2.7.6.6 (3d ed. 2006 and Supp.).

(n133)Footnote 133. *Jacques All Trades Corp. v. Brown, 42 Conn. App. 124, 679 A.2d 27 (1996)* ; *Totz v. Continental DuPage Acura, 602 N.E.2d 1374 (Ill. App. Ct. 1992)* (attorney fee award that was 40 times greater than actual damage award is not excessive); *Jordan v. Transnational Motors, Inc., 537 N.W.2d 471 (Mich. Ct. App. 1995)* ; *Jones v. General Motors Corp., 124 N.M. 606, 953 P.2d 1104 (Ct. App. 1998)* (attorney fees awarded even though plaintiff recovered only statutory damages); *Bittner v. Tri-County Toyota, Inc., 58 Ohio St. 3d 143, 569 N.E.2d 464 (1991)* . *See, e.g., Paschal v. Bristol Window & Door, Inc., 2001 Mich. App. LEXIS 1131* (Mich. Ct. App. Mar. 16, 2001) (unpublished, limited precedent) (affirming fee award of $11,000 where damages were $5000). *See also Peterson v. Boat Sales, Inc., 2004 Mich. App. LEXIS 3502* (Mich. App. Dec. 21, 2004) (unpublished, citation limited) (reversing award of fees as too low; trial court should have considered remedial nature of UDAP statute and the reasons negotiations were unsuccessful). *See also Barbara Parmenter Living Trust v. Lemon, 194 P.3d 796 (Or. 2008)* (requiring proportionality would frustrate purpose of landlord-tenant fee-shifting statute of removing barriers to litigation of small but legitimate claims).

(n134)Footnote 134. *See Fabri v. United Techs. Int'l, Inc., 193 F. Supp. 2d 480 (D. Conn. 2002)* ; *Societa Bario E Derivati v. Kaystone Chem., Inc., 1998 U.S. Dist. LEXIS 23066* (D. Conn. Apr. 15, 1998) (applying lodestar to Connecticut UDAP case). *See also Florida Patient's Comp. Fund v. Rowe, 472 So. 2d 1145 (Fla. 1985)* (adopting lodestar approach in non-UDAP case and listing 8 factors to determine reasonableness of fees); *General Motors Acceptance Corp. v. Laesser, 791 So. 2d 517 (Fla. Dist. Ct. App. 2001)* (using lodestar calculation for fees awarded to prevailing seller under prior version of statute). *Cf. Stuart v. Weisflog's Showroom Gallery, Inc., 293 Wis. 2d 668 (2006)* (court should start with reasonable number of hours multiplied by reasonable hourly rate, and then make adjustments based on bar disciplinary rule).

(n135)Footnote 135. *Williams v. First Gov't Mortgage & Investors Corp., 225 F.3d 738 (D.C. Cir. 2000)* (fees should cover time spent on unsuccessful claims unless they are distinctly different in all respects from the UDAP claims); *Ciampi v. Ogden Chrysler Plymouth, Inc., 634 N.E.2d 448 (Ill. App. Ct. 1994)* (court affirms awards of fees for all work on case where evidence was same for UDAP and non-UDAP counts); *Fit'N' Fun Pools, Inc. v. Shelly, 2001 Ohio App. LEXIS 3* (Jan. 3, 2001) .

(n136)Footnote 136. *Sing v. John L. Scott, Inc., 920 P.2d 589 (Wash. Ct. App. 1996) . FMC Corp. v. Helton, 360 Ark. 465 (2005)* (attorney fees are available to parties prevailing on a UDAP claim, however, the fees may be awarded only for work on the UDAP claim even if the party prevails on other claims if those claims do not provide for attorney fees). *But see Advanced Construction Corp. v. Pilecki, 901 A.2d 189 (Me. 2006)* (when UDAP and non-UDAP claims are intertwined and arise from same facts, and consumer prevails on UDAP claim, trial court need not apportion the fee award); *Mayer v. Sto Indus., Inc., 132 P.3d 115 (Wash. 2006)* (fees appropriate for all work on case where UDAP claims are so closely related to other claims that time cannot reasonably be segregated); *Stuart v. Weisflog's Showroom Gallery, Inc., 293 Wis. 2d 668 (2006)* (fact that defendant's negligence was one of causes of plaintiff's losses is no basis for reducing UDAP fees).

(n137)Footnote 137. *Cruz v. Northwestern Chrysler Plymouth Sales, 179 Ill. 2d 271, 688 N.E.2d 653 (1997) .*

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 4 Unfair and Deceptive Credit Practices

1-4 Consumer Credit Law Manual § 4.07

§ 4.07 Federal Racketeering Statute

[1] RICO Described; Scope

Federal and state n1 RICO statutes provide important alternatives to state UDAP remedies in cases of abusive consumer credit practices. The private remedies authorized by RICO n2--have assumed great importance in diverse fields of civil litigation. Although RICO was primarily devised as a weapon against organized crime, its broad provisions for criminal and civil liability were deliberately drawn to encompass types of business-related misconduct which are not peculiar to gangsters. n3

Civil RICO creates a federal civil action for damages (and, arguably, for private injunctive relief) n4 based on the existence of a pattern of enumerated federal and state crimes, n5 and, most importantly, RICO provides prevailing plaintiffs with treble damages plus attorney fees n6 and costs, where other state and federal law might have provided only compensatory damages or no damages at all.

By its own terms, RICO "shall be liberally construed to effectuate its remedial purposes," and the Supreme Court has rebuffed several lower court efforts to limit its scope, supporting an expansive construction of the statute. n7 It has done this despite acknowledging the fact that civil RICO has been used far more often against "legitimate" businesses than against "the archetypal, intimidating gangster." n8 It should be noted, however, that the expansive use of civil RICO against "legitimate" businesses has aroused widespread criticism and occasioned various proposals for amendments to restrict its scope. n9 However, the United States Supreme Court in *Humana Inc. v. Forsyth* n10 has ruled that the McCarran-Ferguson Act n11 does not prevent the federal RICO statute from applying to the business of insurance. Prior to this decision, insurance fraud litigation generally had to be brought in state court on a UDAP, breach of contract, or bad faith tort claim.

Specific statutes may be found to bar or preempt RICO claims. Some defendants, such as school boards, n12 the Internal Revenue Service, tribal councils, n13 legislators, n14 municipalities, n15 and the FDIC, n16 have been found to be immune from RICO.

The RICO statute is complex and important ambiguities remain to be resolved by the courts. The law is in flux, the volume of civil RICO litigation is high, and it is especially important to keep abreast of recent developments. n17

[2] The Structure of RICO

To recover on a RICO count, the plaintiff must show the defendant engaged in at least one of the four prohibited activities spelled out in section 1962, subsections (a) through (d):

> "(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt ... to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce...
>
> "(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.
>
> "(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.
>
> "(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsections (a), (b), or (c) of this section." n18

These four prohibited practices are triggered by either a pattern of racketeering activity or the "collection of an unlawful debt."

"Racketeering activity" is defined in the statute as including eight generic state crimes and a longer list of specified federal offenses, such as bribery, extortion, narcotics, and obstruction of justice. n19 The crimes are called predicate offenses, and only the enumerated crimes can be used to show racketeering activity. Mail fraud n20 and wire fraud n21 are the most significant predicate offenses, especially for consumer plaintiffs. n22

To prevail on a RICO claim, one must show not only racketeering activity, but a "pattern" of racketeering activity, which requires at least two acts of "racketeering activity" within ten years of each other, at least one of which took place after the statute took effect in 1970. n23

"Collection of an unlawful debt" is defined as either gambling debts or usury, under state or federal law, at a rate at least twice the enforceable rate. n24 For a violation based on collection of an unlawful debt, there need be no racketeering activity and no pattern of abuse, just one instance of collection of a debt at twice the enforceable rate. n25

RICO is somewhat confusing to deal with, partly because RICO does not prohibit racketeering activity directly. Rather, its provisions deal more with the peripheral aspects of racketeering--use of money made through racketeering, control of businesses affecting interstate commerce by racketeers, and conspiracy to do either.

Violators of RICO are subject to criminal penalties, n26 to forfeiture of their interest in the enterprise, n27 and to other sanctions. n28 RICO also provides private litigants with federal court jurisdiction for actions seeking treble damages plus attorney fees. n29

[3] Elements of the Civil RICO Action

[a] Overview

The essential elements of a civil RICO action depend upon which of the four subsections of section 1962 is alleged to have been violated. The elements common to any civil RICO cause of action are:

- The existence of an enterprise;
- The enterprise is engaged in or affects interstate or foreign commerce (utilizing the interstate mails or wires or where supplies are shipped through interstate commerce);
- That the defendant has engaged in one or more of the four prohibited activities enumerated in section 1962; and
- That the prohibited conduct causes injury to the plaintiff's business or property.

Subsection 1962(c) is so far the most commonly used basis for alleging activities prohibited by RICO. Its particular elements, in addition to the elements of all RICO claims, are:

- The defendant is either employed by, or associated with, the enterprise;
- The defendant conducted or participated in, directly or indirectly, the conduct of the enterprise's affairs; and
- The participation was through a pattern of racketeering activity (or collection of an unlawful debt).

The prohibited activities on which civil RICO liability is based involve conduct with reference to an "enterprise": n30 "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." n31 Most circuit courts have held that for a RICO count based on section 1962(c), the "person" conducting or participating in an enterprise's affairs cannot also be the "enterprise" itself. n32 However, such persons can themselves be an association-in-fact enterprise, that is, the enterprise can consist of no one other than multiple defendants each of whom is involved in the scheme. n33 Sections 1962(a), (b), and (d) generally do not require a distinct enterprise.

[b] Liability of Outside Professionals Under Section 1962(c)

The Supreme Court in the *Reves* case n34 held that in order for outside accountants to be held liable under RICO for their fraudulent audits, they had to have participated in the operation or management of the enterprise, thus severely limiting the liability of outside professionals for RICO violations of enterprises with which they do business. Since *Reves*, plaintiffs have not had great success with claims against outside professionals. n35 Another possible approach is to argue that the defendant is liable under RICO for aiding and abetting the RICO violation. Since the Supreme Court's decision in *Central Bank v. First Interstate Bank*, n36 courts have split over whether aider and abetter liability is available under RICO. n37

[c] "Pattern" of Racketeering Activity

A pattern of racketeering activity "requires at least two acts of racketeering activity" n38--one is not enough. The Supreme Court in *H.J. Inc. v. Northwestern Bell Telephone Co.* n39 specifically stated that, while a pattern of racketeering need not involve organized crime, it can not be shown merely by proving two predicate acts. The acts alleged, however, need not be part of separate illegal schemes. The Court specifically found that RICO is applicable only to long-term criminal activity.

Following these decisions, the lower courts adopt a flexible test of whether the acts alleged are sufficiently related and continuous enough to evidence a pattern. n40 The factors to be looked at include the number of victims, the number of participants, the purpose of the activity, the result of the activity, the method of commission, the number of transactions, whether the scheme is ongoing and open-ended, and the duration of activity. Consumer cases that involve a scheme that, by its nature, projects into the future, a "recidivist" scheme, may well meet the requirements of an "open-ended" type pattern. For example, homeowners who pled that they had been victimized by a scheme through a which a finance company illegally diverted loan proceeds successfully argued that the scheme, which took place over just nine months, satisfied the pattern requirement by virtue of being "open-ended." n41 Some courts hold that multiple acts arising from one criminal episode can form a pattern.

[d] Conspiracy

Section 1962(d) declares it unlawful for any person to conspire to violate any of the provisions of subsections (a), (b), or (c) of section 1962. *Salinas v. United States* n42 resolved a split in the circuits as to the requirements of section 1962(d) by choosing the broader reading. Relying on traditional conspiracy law which provides that, so long as they share a common purpose, conspirators are liable for the acts of their co-conspirators, the Court ruled that RICO does not require that the defendant must commit or agree to commit two or more predicate acts in order to violate section 1962(d). n43 Rather, the conspirator need only "intend to further an endeavor which, if completed, would satisfy all of the elements of a substantive criminal offense... [I]t suffices that he adopt the goal of furthering or facilitating the criminal endeavor." n44 While the commission of two predicate acts may prove this intent, it is not the only means of proving it. n45 Based on this holding, the Court affirmed the conviction of a sheriff's deputy who knew about and agreed to facilitate a bribery scheme but who had not accepted or agreed to accept two bribes.

Lower court decisions since *Salinas* have held that the plaintiff or prosecutor need only show that the defendant agreed that predicate acts would be committed on behalf of the conspiracy. n46 The Eleventh Circuit has taken the expansive view that such an agreement can be shown by proving an agreement on an overall objective, which in turn can be proven by circumstantial evidence that each defendant must reasonably have known that others were also conspiring to participate in the same enterprise through a pattern of racketeering activity. n47

[e] Collection of an Unlawful Debt

There is an alternative in RICO to proof of a pattern of racketeering. The statute provides that it is illegal to do various things *either* from a pattern of racketeering activity or through collection of an unlawful debt. n48 An unlawful debt is defined to include a usurious debt which is unenforceable in whole or in part as to interest or principal, and where the interest rate is at least twice the enforceable rate.

Virtually all usury laws specify that usurious loans are unenforceable, at least as to the portion of interest exceeding the enforceable rate. Consequently, the key to proving a RICO violation based on collection of an unlawful debt is showing that a creditor collected a debt where the interest rate exceeded twice the enforceable rate.

It is not enough if a creditor violates laws relating to loans or the collection of loans--the laws must set a maximum amount of interest that can be charged for the type of loan in question and the interest actually charged must be more than twice that rate. No pattern need be proven here, n49 however, some courts have expressly or implicitly held that the scope of RICO does not extend to occasional usurious transactions by one not in the business of loan sharking. n50 However, other courts have given a less strict reading to the unlawful debt element, finding that it can apply to an occasional instance of loansharking. n51

[f] The "Injury" Element

"Any person injured in his business or property" may sue for treble damages under RICO. n52 In *Holmes v. Securities*

Investor Protection Corp., n53 the United States Supreme Court held that a RICO plaintiff may not recover unless the plaintiff can demonstrate that the injuries were directly and proximately caused by a defendant's racketeering activity. n54 The Supreme Court resoundingly reaffirmed the proximate cause rule of *Holmes* in *Anza v. Ideal Steel Supply Corp*., n55 in which business owners sued a competitor that had failed to charge its customers sales tax and had submitted fraudulent tax returns to the state. The Court rejected the plaintiffs' argument that the practice allowed the defendant to charge lower prices, and that those lower prices cost the plaintiffs sales. n56 The injury alleged, the Court reasoned, was too attenuated from the violating act, the tax fraud. n57 The fact that a competitor commits tax fraud does not mean that it will charge lower prices, nor are a business's lost sales necessarily the product of a competitor's lower prices. n58 The decision signals the Court's commitment to close conformity to RICO's proximate cause requirement, and attorneys should be cautious in relying on plaintiff-favorable rulings on the issue that pre-date *Anza*.

[g] Rejected Limitations on Liability

The Supreme Court has rejected many attempted limitations on liability and has endorsed the position that RICO is to be given a broad construction in order to further its remedial purposes. n59

[4] Predicate Offenses: Mail Fraud and Wire Fraud

To recover on a RICO count, the plaintiff must either show collection of an unlawful debt or a pattern of "racketeering activity." Racketeering activity is defined as violation of one of a list of enumerated state and federal statutes--what are referred to as predicate offenses. n60 Two of the most often used RICO predicate offenses are also two of the broadest federal criminal statutes, the mail fraud and wire fraud statutes.

[a] Mail Fraud

The mail fraud statute does not, of itself, create a civil cause of action, but, as the basis of racketeering claims, it accounts for a major share of the vast scope of civil RICO liability. For the consumer plaintiff, especially, mail fraud predicate offenses are the usual foundation of a RICO civil action; it is almost impossible for a business to carry out a fraudulent scheme without making some use of the mails. n61

The elements of mail fraud are two: (1) a scheme to defraud, and (2) a mailing made for the purpose of executing the scheme. The mail and wire fraud statutes address a broader scope of fraud than common law fraud does. n62 It is not necessary that anyone actually be defrauded. Nevertheless, as always under RICO, the plaintiff must have suffered injury to business or property "by reason of" the RICO violation. n63

A scheme to defraud is very broad and encompasses almost anything designed to defraud through misrepresentations of the truth. It can include the assertion of "half-truths," the concealment of material facts, n64 or misappropriation of confidential information. n65

Mail fraud requires the specific intent to defraud. n66 Intent is not shown, though, where the claims are based on negligent or unintentional conduct. The defendant's good faith belief in even an impractical or "somewhat visionary" scheme is a defense; however, this is not determined by a purely subjective standard of sincerity. Honest belief does not justify baseless, false, or reckless representations or promises. Thus, mail fraud includes more than common law fraud, but probably somewhat less than the UDAP "deception" standard.

The mailing need not be made by the defendant so long as he or she causes it to be made. Nor need the mailing contain the fraudulent representation itself; it is enough if the mailing somehow aids in the execution of the fraudulent scheme, although it must be more than just confirmatory in nature. n67

Under the mail fraud statute, each mailing in furtherance of a scheme to defraud is a separate offense, separately

punishable. And multiple mailings in furtherance of a single scheme to defraud provide multiple RICO predicate offenses.

In 2008 the Supreme Court resolved a circuit split to hold in *Bridge v. Phoenix Bond & Indemnity Co.*, that a RICO plaintiff asserting mail or wire fraud need not claim first party reliance. n68 Accordingly, the plaintiffs, who were participants in a county's auction of tax liens that the county had acquired on the property of delinquent taxpayers, could base a RICO claim on misrepresentations made to the county, rather than to the participants themselves. n69

[b] Wire Fraud

Insofar as RICO is concerned, wire fraud n70 and mail fraud are treated in virtually identical fashion. The only difference is that wire fraud requires an interstate communication, typically by telephone.

[5] RICO Pleading and Procedure

[a] Pleading the Claim

A RICO claim should not be omitted if there is a good faith basis for it at the time the complaint is filed, but attorneys should reevaluate the RICO claim as the case progresses. n71 Courts have imposed Rule 11 sanctions for failure to dismiss a RICO claim when it was clear after discovery that the claim was not valid. n72

Most courts have held that, for purposes of RICO, the Federal Rules of Civil Procedure apply, requiring that fraud be pleaded with particularity. n73 Some courts now require that all predicate acts--not just those based on fraud--be pled with equal particularity. n74 Courts require a RICO plaintiff to plead the time, place, and particular context of the false representations, as well as the identity of the party making the representations and the consequences of making them. n75 For consumer purposes, mail fraud, wire fraud, and collection of an unlawful debt are the most likely predicate acts.

In alleging mail fraud, the plaintiff should outline the fraud by delineating the sender and recipient, the location of mailing and receipt, the contents of the mailings, and the consequences of the mailings.

In the case of wire fraud, the plaintiff must give similarly detailed information, and also must allege an interstate telephone call or other interstate wire communication in furtherance of the fraudulent scheme. n76 Where the predicate offense is collection of an unlawful debt, the plaintiff must, in addition to specifying the details of the transaction, specify the prescribed interest rate which the defendant has violated.

It is clear that fraud cannot be pleaded simply on information and belief without some elaboration of the facts supporting that belief, or if the "information and belief" pertains to information from a pending criminal complaint. n77 The safest approach is to draft a civil RICO complaint so as to resemble, as closely as possible, a criminal indictment. n78

[b] Pleading the Relief Sought

The Supreme Court has declined to establish the measure of damages available in RICO claims. n79 But it is clear that personal injury--whether manifested by physical injury or emotional distress--is neither directly nor indirectly compensable, n80 nor are pecuniary losses connected with physical injury or emotional distress.

The attorney fees awarded need not be in proportion to the amount of damages. n81 The fees will often be calculated by the court after it asks for an affidavit of counsel as to the fees incurred. Costs may also be awarded.

A successful RICO claimant will be awarded treble damages. The jury will not normally be told about either the triple damages provision or the attorney fee provision. n82 The courts are divided as to availability of punitive damages. n83

The district courts have jurisdiction to prevent and restrain RICO violations by means including, but not limited to, the compelled divestiture of interests in an enterprise, reasonable restrictions on a person's future activities or investments, and even the dissolution or reorganization of an enterprise. n84 The United States Attorney General is expressly authorized to seek such relief, n85 but whether private civil litigants may obtain it is a question which has divided the courts. Some inclination to avoid the issue is discernible.

To prevent the dissipation of assets by the defendant during litigation, lawyers can ask the court to freeze assets of the defendant for the pendency of the litigation; however, the courts are split on this question. n86 The Supreme Court recently declined to resolve the circuits' split on the issue. n87

[c] Local Requirements for Case Statements

Because of the popularity and complexity of RICO claims, some courts have instituted special procedures, primarily a case statement in some form. n88

[d] Service of Process and Venue

Most courts have construed RICO as having a nationwide service of process provision, so that suit can be brought in a convenient forum without concern for whether the defendant has minimum contacts with the state. n89 However, circuit courts of appeals cases are split as to whether the nationwide service of process provision itself provides a sufficient basis for personal jurisdiction, n90 or whether a plaintiff must first establish personal jurisdiction over one of the defendants before relying on RICO's nationwide service of process provision to obtain personal jurisdiction over other defendants. n91

Circuits also split on whether, in assessing personal jurisdiction, a defendant need only have minimum contacts with the United States, n92 or whether the *Fifth Amendment* requires a court to consider issues of fairness and reasonableness after the defendant has shown that litigating in the plaintiff's chosen forum will implicate the liberty interests of the defendant. n93 RICO does not authorize international service. n94

As for venue, the section 1965(a) provision, that RICO venue is proper in any district in which the defendant resides, is found, has an agent, or transacts his affairs, does not nullify general venue provisions, so the court will weigh all relevant factors.

[e] RICO Standard of Proof

Federal courts have generally ruled that civil RICO claims need only be established by a preponderance of the evidence.

[f] RICO Concurrent Jurisdiction

The United States Supreme Court has ruled that state courts have concurrent jurisdiction with federal courts over civil RICO claims. n95

Since there is no express statutory prohibition on removal of RICO claims, defendants may remove them to federal court. n96

[g] RICO Statute of Limitations

The Supreme Court has ruled that the statute of limitations in RICO cases is four years. n97 When the statute of limitations begins to run remains a question answered differently in different jurisdictions using one of the following tests:

- Under the "discovery" rule, the claim arises when the plaintiff knew or should have known of the injury caused by the defendant's pattern of behavior. n98

- Under the "separate accrual" rule, discovery of each separate RICO violation triggers a new limitations period. n99

- Under the "conspiracy" rule, the limitation period runs from the date of the last predicate act. n100

- The Sixth Circuit "compromise rule": an action accrues no later than when the plaintiff discovers or reasonably should have discovered both the existence and source of his injury and that the injury is part of a pattern. n101

To raise equitable tolling as a statute of limitations defense, the plaintiff must be prepared to plead and prove the elements of fraudulent concealment: (1) the use of fraudulent means by the party raising the statute of limitations; (2) successful concealment from the injured party; and (3) that the party claiming fraudulent concealment did not know or by the exercise of due diligence could not have known that he might have a cause of action. n102

[h] Offensive and Defensive Collateral Estoppel

The RICO statute does not specifically allow private parties to use offensive collateral estoppel in civil suits following criminal convictions, but some courts have allowed its use. If offensive collateral estoppel is available, the private plaintiff (1) must allege that issues in the subsequent civil case were actually litigated and necessary to the outcome of the first criminal case; and (2) must show that, under the doctrine of *Parklane Hosiery*, use of offensive collateral estoppel would not involve any of four unfair situations for the defendant. n103

Conversely, plaintiffs may also find that collateral estoppel may be used defensively against them if fraud or related causes of action were not raised as defenses in earlier actions brought against them.

[6] RICO Consumer Cases in the Courts

There are quite a few reported consumer cases involving RICO claims. Decisions that are more or less favorable to consumer civil RICO plaintiffs or potentially of value to them include the following:

- The Seventh Circuit reversed the dismissal of RICO claims by loan applicants against a lender. The loan applicant alleged that the lender fraudulently induced her to refinance her existing personal loan at exorbitant rates. There was no allegation that Truth-in-Lending requirements or other statutory requirements were violated, but the lender did not make clear that it would be less expensive to take out a new loan than to refinance the old one. The Seventh Circuit noted that a careful reading of the Truth-in-Lending statement would have shown that the refinancing was not a good deal, but noted that not everyone is capable of being a careful reader. It summarized the allegation as being that the complainant belonged to a class of borrowers who are not competent interpreters of Truth-in-Lending forms and that the lender took advantage of that fact. n104

- The Fourth Circuit twice reversed the district court's dismissal of RICO claims by a class of used car buyers against a car wholesaler and a related finance company. The consumer alleged that the defendants had engaged in a fraudulent "churning" scheme to sell cars at inflated rates, repossess them, conduct sham repossession sales, and bill consumers for alleged deficiencies. n105

- A RICO class action against a lender that charged interest rates between 179% and 557% and used threats in the collection process withstood a motion to dismiss. n106

- A criminal conviction was upheld under a state RICO statute against parties engaged in an automobile brokerage scam in which a company "took over" car loans or leases, reselling the cars to other parties, without first paying off the lessor or creditor. n107

- A plaintiff brought a class action against a finance company which financed her automobile, claiming that there should have been a provision in the loan documents that would allow her to raise seller-related defenses to any attempt to collect the loan. The court refused to dismiss the case, finding that the plaintiff had alleged a sufficient pattern. n108

- A First Circuit panel upheld a lower court's decision that refused to dismiss a class action RICO conspiracy claim by plaintiff home buyers against several realty-related corporations. The plaintiffs alleged that the corporations had conspired with another defendant, a developer, to induce the plaintiffs to purchase homes they could not afford, by using fraudulent financial incentives. On appeal, the court held that the plaintiffs need not show that the defendant corporations committed a substantive violation of RICO, but only that the defendant knowingly agreed to assist a scheme that included the operation or management of a RICO enterprise. n109

- A Tennessee district court ruled that plaintiffs, victims of a predatory lending scheme, successfully alleged a RICO enterprise consisting of a title company, a mortgage lender, and other participants in the scheme. n110

- A California district court ruled that a plaintiff, who had been induced to buy an annuity, successfully alleged a RICO enterprise consisting of insurance companies that allegedly schemed to convince annuity purchasers to buy annuities inappropriate for them. n111

[7] State RICO Statutes

Approximately half the states have enacted legislation similar to RICO. n112 These statutes have been upheld against a variety of constitutional challenges. All but a few of these statutes create a private civil cause of action.

State RICO statutes differ from federal RICO, and each other in various respects. State RICO statutes do not require a nexus between racketeering activity and interstate commerce. State RICO statutes typically require the plaintiff to have suffered an injury as a condition of a private cause of action. n113

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawPrivate ActionsRacketeer Influenced & Corrupt OrganizationsGeneral OverviewCriminal Law & ProcedureCriminal OffensesRacketeeringRacketeer Influenced & Corrupt OrganizationsGeneral OverviewSecurities LawLiabilityRICO ActionsGeneral Overview

FOOTNOTES:
(n1)Footnote 1. For discussion of state RICO statutes, see National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 14.3 (7th ed. 2008 and supp.).

(n2)Footnote 2. *18 U.S.C. §§ 1961-1968*, *reprinted in* Vol. 1B *infra*.

(n3)Footnote 3. For the legislative history of RICO, see 115 Cong. Rec. 6994-6995, 9567 (1969); 1970

U.S.C.C.A.N. 4007, 4032-4036; Blakey, *The RICO Civil Fraud Action in Context: Reflections on Bennett v. Berg, 58 Notre Dame L. Rev. 237 (1982) (Prof. G. Robert Blakey, the author of this article, was principal draftsman of RICO); and sources cited in Strafer, Massumi & Skolnick, Civil RICO in the Public Interest: "Everybody's Darling,"* Civil RICO *19 Am. Crim. L. Rev. 655, 680 n.193 (1982).* Reflections on Bennett v. Berg, *58 Notre Dame L. Rev. 237 (1982)* Civil RICO

(n4)Footnote 4. *See § 4.07[3] infra.*

(n5)Footnote 5. *18 U.S.C. § 1961(1).*

(n6)Footnote 6. *18 U.S.C. § 1964(c).*

(n7)Footnote 7. *See Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 497-99, 105 S. Ct. 3275, 87 L. Ed. 2d 346 (1985)* ; *United States v. Turkette, 452 U.S. 576, 586-87, 101 S. Ct. 2524, 69 L. Ed. 2d 246 (1981)* .

(n8)Footnote 8. *Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 499, 105 S. Ct. 3275, 87 L. Ed. 2d 346 (1985)* .

(n9)Footnote 9. *See, e.g.,* Bradley, *Long Arm of the Rackets Law Draws Fire From White-Collar Targets*, Christian Science Monitor, Feb. 7, 1986, at 21, col. 1; Zimroth, *Legislative Proposals to Amend the Civil RICO Statute,* Practicing Law Institute, 1985 Civil RICO at 427-44.

(n10)Footnote 10. *525 U.S. 299, 119 S. Ct. 710, 142 L. Ed. 2d 753 (1999)* ("When federal law does not directly conflict with state regulation, and when application of the federal law would not frustrate any declared state policy or interfere with a State's administrative regime, the McCarran-Ferguson Act does not preclude its application."). State insurance statutes rarely provide for a private right of action and, in some states, the state insurance regulation may even be seen as preventing a private UDAP or bad faith tort claim. A federal RICO claim now provides an alternative, allowing federal court jurisdiction, mandatory treble damages, and attorney fees, that is not preempted by state insurance regulation unless it impairs that regulation.

(n11)Footnote 11. *15 U.S.C. § 1012(b).*

(n12)Footnote 12. *Dammon v. W.L. Folse, 846 F. Supp. 36 (E.D. La. 1994) . See also Doe v. Board of Trustees of Univ. of Ill., 429 F. Supp. 2d 930, 941 (N.D. Ill. 2006)* (suit barred by state sovereign immunity statute).

(n13)Footnote 13. *Smith v. Babbitt, 875 F. Supp. 1353 (D. Minn. 1995)* .

(n14)Footnote 14. *Chappell v. Robbins, 73 F.3d 918 (9th Cir. 1995)* .

(n15)Footnote 15. *Frooks v. Town of Cortlandt, 997 F. Supp. 438 (S.D.N.Y. 1998) , aff'd, 182 F.3d 899 (2d Cir. 1999)* .

(n16)Footnote 16. *McNeily v. United States, 6 F.3d 343 (5th Cir. 1993)* .

(n17)Footnote 17. Three reporting services, RICO L. Rep., Civil RICO Rep. (BNA), and RICO Business Disputes Guide (CCH), are devoted exclusively to RICO. RICO cases are regularly featured in bar journals and the legal press.

(n18)Footnote 18. *18 U.S.C. § 1962.*

(n19)Footnote 19. *18 U.S.C. § 1961(1).*

(n20)Footnote 20. *18 U.S.C. § 1341.*

(n21)Footnote 21. *18 U.S.C. § 1343.*

(n22)Footnote 22. Prior to 1995, securities' fraud was often cited as a RICO predicate act, but under the Private Securities Litigation Reform Act of 1995 [hereinafter PSLRA], civil RICO was amended to exclude as an underlying predicate "any conduct that would have been actionable as fraud in the purchase or sale of securities." The Third and Ninth Circuits have held that the PSLRA did not retroactively bar previously existing RICO claims. *Mathews v. Kidder, Peabody & Co., 161 F.3d 156 (3d Cir. 1998)* , *cert. denied, 526 U.S. 1067, 119 S. Ct. 1460, 143 L. Ed. 2d 546 (1999)* ; *Scott v. Boos, 215 F.3d 940 (9th Cir. 2000)* .

(n23)Footnote 23. *18 U.S.C. § 1961(5).*

(n24)Footnote 24. *18 U.S.C. § 1961(6).*

(n25)Footnote 25. *18 U.S.C. §§ 1961(6), 1962(c)* (pattern of racketeering or collection of unlawful debt); *cf. Durante Bros. & Sons, Inc. v. Flushing Nat'l Bank, 755 F.2d 239* (2d Cir.) , *cert. denied, 473 U.S. 906, 105 S. Ct. 3530, 87 L. Ed. 2d 654 (1985)* . One state case, *Bandas v. Citizens State Bank of Silver Lake, 412 N.W.2d 818 (Minn. Ct. App. 1987)* , *remanded on other grounds sub nom. VanderWeyst v. First State Bank, 425 N.W.2d 803* (Minn.) , *cert. denied, 488 U.S. 943, 109 S. Ct. 369, 102 L. Ed. 2d 359 (1988)* , reached the opposite conclusion, that a pattern of unlawful debts must be shown. This holding is clearly wrong, and the Minnesota Supreme Court in dicta on appeal made a special effort to point out the error of the holding in *Bandas*. However, in doing so, *VanderWeyst* dicta may have suggested another route to a similar requirement by noting that the bank was not alleged to be "in the business" of lending money at usurious rates. *425 N.W.2d 803, 812 (Minn. 1988)* . (*Cf. 18 U.S.C. § 1961(6)* (definition of unlawful debt)).

(n26)Footnote 26. *18 U.S.C. § 1963.*

(n27)Footnote 27. *18 U.S.C. §§ 1963, 1964(a). See* U.S. Dept. of Justice, Criminal Division, Criminal Forfeitures Under the RICO and Continuing Enterprise Statutes (1980).

(n28)Footnote 28. *E.g., 18 U.S.C. § 1964(a)* (court-ordered restrictions on future business activities, dissolution or reorganization of any enterprise, etc.).

(n29)Footnote 29. *18 U.S.C. § 1962(c)*; *Odishelidze v. Aetna Life, 853 F.2d 21 (1st Cir. 1988)* ; *United States v. Feldman, 853 F.2d 648 (9th Cir. 1988)* .

(n30)Footnote 30. *18 U.S.C. § 1962(a), (b), (c).*

(n31)Footnote 31. *18 U.S.C. § 1961(4). See Manhattan Telecomms. Corp. v. DialAmerica Mktg., 156 F. Supp. 2d 376, 381-82 (S.D.N.Y. 2001)* (RICO enterprise must have structural continuity that incorporates a mechanism for directing the group's affairs on a continuing basis); *Eva v. Midwest Nat'l Mortgage Banc, Inc., 143 F. Supp. 2d 862, 875 (N.D. Ohio 2001)* (plaintiff sufficiently alleged ongoing, coordinated behavior by members of the association-in-fact). *See also Handeen v. Lemaire, 112 F.3d 1339, 1351 (8th Cir. 1997)* ; *Progressive Northern Ins. Co. v. Alivio Chiropractic Clinic, Inc., 2005 U.S. Dist. LEXIS 39912* (D. Minn. Dec. 22, 2005) (holding that plaintiff adequately alleged an association in fact enterprise in case alleging that the defendant participated in insurance fraud).

(n32)Footnote 32. *See Guidry v. Bank of LaPlace, 954 F.2d 278 (5th Cir. 1992)* (unincorporated sole proprietorship through which operator ran fraudulent scheme was not RICO "enterprise" distinct from RICO "person"). *See also Cedric Kushner Promotions Ltd. v. King, 533 U.S. 158, 121 S. Ct. 2087, 150 L. Ed. 2d 198 (2001)* (distinctness requirement is satisfied where the person and the corporation are distinctly different legal entities, even though they may be connected); *Riverwoods Chappaqua Corp. v. Marine Midland Bank, N.A., 30 F.3d 339, 344 (2d Cir. 1994)* ("a section 1962(c) claim may be sustained where there is only a partial overlap between the RICO person and the RICO enterprise, ... and that a defendant may be a RICO 'person' and one of a number of members of the RICO 'enterprise' "); *In re Mastercard Int'l Inc., 132 F. Supp. 2d 468 (E.D. La. 2001)* (finding distinctness satisfied where defendant bank and charge card company were alleged to be both the RICO defendants and part of an association-in-fact enterprise

along with casinos that contracted for the charge card services); *Living Designs, Inc. v. E.I. Dupont de Nemours and Co., 431 F.3d 353, 361-62 (9th Cir. 2005)* (defendant was distinct from enterprise consisting of defendant and its legal defense team); *Jones v. Deutsche Bank AG, 2005 U.S. Dist. LEXIS 21468* (N.D. Cal. July 19, 2005) (denying defendant's motion to dismiss where defendants alleged to be part of the enterprise each had its own legal existence, separate from the racketeering activity).

(n33)Footnote 33. *See Boyle v. United States, 129 S. Ct. 2237 (2009)* (Supreme Court loosened the definition of an association-in-fact enterprise, holding that it must have a structure, and then looking to common dictionary definitions of "structure": "In the sense relevant here, the term 'structure' means '[t]he way in which parts are arranged or put together to form a whole' and '[t]he interrelation or arrangement of parts in a complex entity.'" To satisfy this definition of structure, an association-in-fact enterprise must have three structural features: (1) a purpose; (2) relationships among those associated with the enterprise; and (3) longevity sufficient to permit these associates to pursue the enterprise's purposes. *St. Paul Mercury Ins. Co. v. Williamson, 224 F.3d 425, 447 (5th Cir. 2000)* (reversing summary judgment in favor of three individual defendants who were also alleged to be the RICO enterprise; holding that plaintiff properly alleged an enterprise comprising banks and individual defendants by alleging activity showing ongoing, coordinated behavior among the members in a scheme to charge excessive fees and interest rates on loans); *Stewart v. Associates Consumer Disc. Co., 1 F. Supp. 2d 469 (E.D. Pa. 1998)* (in class action by borrowers against a debt consolidation company and its affiliated insurance and financial services companies, the plaintiff successfully pled that each of the three defendant corporations had a different role in an enterprise that consisted of an association-in-fact of the three). *See also United States v. Cianci, 210 F. Supp. 2d 71, 73-75 (D.R.I. 2002)* (a legitimate organization, such as a city agency, may be a non-culpable member of a RICO association-in-fact enterprise operated by a defendant for criminal purposes). *But see, e.g., VanDenBroeck v. CommonPoint Mortgage Co., 210 F.3d 696, 700 (6th Cir. 2000)* (that mortgage lender had business relationship with secondary lenders to whom it sold loans did not establish an association-in-fact enterprise); *In re Mastercard Int'l Inc., 132 F. Supp. 2d 468 (E.D. La. 2001)* (contractual arrangements among credit card companies, their issuing banks, and on-line casinos demonstrated nothing more than ordinary business relationships); 800537 *Ont., Inc. v. Auto Enters., 113 F. Supp. 2d 1116 (E.D. Mich. 2000)* ; *Jubelirer v. Mastercard Int'l, 68 F. Supp. 2d 1049, 1053 (W.D. Wis. 1999)* ; *Williams v. Ford Motor Co., 11 F. Supp. 2d 983, 986 (N.D. Ill. 1998)* (in suit alleging dealer and Ford misrepresented extended service warranty, mere allegation of association in fact of Ford and its affiliated dealers and servicers did not sufficiently fulfil requirements of structure, continuity, and common course of conduct to be an enterprise).

(n34)Footnote 34. *Reves v. Ernst & Young, 507 U.S. 170, 113 S. Ct. 1163, 122 L. Ed. 2d 525 (1993)* .

(n35)Footnote 35. *See, e.g., Azrielli v. Cohen Law Offices, 21 F.3d 512 (2d Cir. 1994)* (attorneys); *McNew v. People's Bank of Ewing, 999 F.2d 540 (6th Cir. 1993)* (bank); *United States v. Quintanilla, 25 F.3d 694 (7th Cir. 1993)* (attorneys); *Nolte v. Pearson, 994 F.2d 1311 (8th Cir. 1993)* (preparer of opinion letters); *Baumer v. Pachl, 8 F.3d 1341 (9th Cir. 1993)* (attorney). *But see Thomas v. Ross & Hardies, 9 F. Supp. 2d 547 (D. Md. 1998)* (*Reves* did not limit liability of attorney who allegedly persuaded homeowners to obtain mortgages and then diverted proceeds to enterprise instead of paying prior mortgages, as agreed); *Mruz v. Caring, Inc., 991 F. Supp. 701 (D.N.J. 1998)* (plaintiffs, whistleblower employees, overcame *Reves* by alleging that attorneys seized power and control of enterprise for purposes of dissuading plaintiffs from revealing fraud and to defame and intimidate them; alleged behavior was more than the mere provision of legal services).

(n36)Footnote 36. *511 U.S. 164, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (1994)* .

(n37)Footnote 37. *Compare Crowe v. Henry, 43 F.3d 198 (5th Cir. 1995)* , *with In re Lake States Commodities, Inc., 936 F. Supp. 1461 (N.D. Ill 1996)* (no aiding and abetting liability under § 1962(c)), *and Rosenheck v. Rieber, 932 F. Supp. 626 (S.D.N.Y. 1996)* .

(n38)Footnote 38. *18 U.S.C. § 1961(5)*; *Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 105 S. Ct. 3275, 87 L. Ed. 2d 346 (1985)* . *See, e.g., Pizzo v. Bekin Van Lines Co., 258 F.3d 629, 633 (7th Cir. 2001)* (consumer who received

substandard furniture could not demonstrate pattern of fraud by store with evidence of only one other dissatisfied customer); *GE Inv. Private Placement Partners II v. Parker, 247 F.3d 543, 550 (4th Cir. 2001)* (two years insufficient, in light of other circumstances); *First Capital Asset Mgmt. v. Brickelbush, Inc., 150 F. Supp. 2d 624, 635* (less than a year insufficient), *recons. granted, in part, 2001 U.S. Dist. LEXIS 13396* (S.D.N.Y. Aug. 23, 2001) ; *Dempsey v. Sanders, 132 F. Supp. 2d 222, 228 (S.D.N.Y. 2001) . But see Wilson v. De Angelis, 156 F. Supp. 2d 1335, 1339 (S.D. Fla. 2001)* (refusing to dismiss RICO claim based on ten acts over ten months).

(n39)Footnote 39. *492 U.S. 229, 109 S. Ct. 2893, 106 L. Ed. 2d 195 (1989) .*

(n40)Footnote 40. *Allwaste, Inc. v. Hecht, 65 F.3d 1523 (9th Cir. 1995)* (flexible test; Ninth Circuit refused to adopt specific time period). *See, e.g., Mathon v. Marine Midland Bank, N.A., 875 F. Supp. 986 (E.D.N.Y. 1985)* (no continuity). *See also Hobson v. Lincoln Ins. Agency, Inc., 2000 U.S. Dist. LEXIS 13314* (N.D. Ill. Sept. 7, 2000) (plaintiff's allegations of ten payments made over a ten month period as part of a single, allegedly fraudulent, insurance transaction do not constitute a "pattern"); *Midwest Heritage Bank, F.S.B. v. Northway, 576 N.W.2d 588 (Iowa 1998)* (in suit by borrower alleging scheme by bank to defraud in connection with a FmHA loan, the three alleged predicate acts were insufficiently related where they did not have a common purpose, only common participants and a common victim; claim also lacked showing of continuity since borrower did not offer evidence that the predicate acts were part of the bank's regular way of doing business).

(n41)Footnote 41. *Thomas v. Ross & Hardies, 9 F. Supp. 2d 547 (D. Md. 1998)* (the principals targeted minority homeowners, convinced them to mortgage their homes for the maximum amount possible in return for paying off prior mortgages and extending a line of credit, then failed to pay off the prior loans). *See also GE Inv. Private Placement Partners II v. Parker, 247 F.3d 543, 549 (4th Cir. 2001)* ; *Jordan (Berm.) Inv. Co. v. Hunter Green Invs. Ltd., 154 F. Supp. 2d 682, 694 (2001) , complaint dismissed, 205 F. Supp. 2d 243 (S.D.N.Y. 2002)* ; *First Capital Asset Mgmt. v. Brickelbush, Inc., 150 F. Supp. 2d 624, 633-34 , recons. granted, in part, 2001 U.S. Dist. LEXIS 13396* (S.D.N.Y. Aug. 23, 2001) . *See also AT&T Corp. v. Schroeder, 2006 U.S. Dist. LEXIS 45832* (W.D. Wash. June 28, 2006) (granting summary judgment to plaintiff after holding that it had shown open-ended continuity).

(n42)Footnote 42. *522 U.S. 52, 118 S. Ct. 469, 139 L. Ed. 2d 352 (1997) .*

(n43)Footnote 43. *118 S. Ct. at 478* ("The interplay between subsections (c) and (d) does not permit us to excuse from the reach of the conspiracy provision an actor who does not himself commit or agree to commit the two or more predicate acts requisite to the underlying offense.").

(n44)Footnote 44. *118 S. Ct. at 477 . See also Beck v. Prupis, 529 U.S. 494, 120 S. Ct. 1608, 146 L. Ed. 2d 561 (2000)* ; *Smith v. Berg, 247 F.3d 532 (3d Cir. 2001)* (defendant alleged to have conspired to violate § 1962(c) did not have to commit or agree to commit predicate acts to be liable for conspiracy under § 1962(d), so long as he knowingly agreed to facilitate a scheme which included operation or management of a RICO enterprise).

(n45)Footnote 45. *118 S. Ct. at 478 .*

(n46)Footnote 46. *Goren v. New Vision Int'l, Inc., 156 F.3d 721 (7th Cir. 1998)* (defendant must agree that someone would commit two predicate acts on behalf of the enterprise); *United States v. Conghau Huu To, 144 F.3d 737 (11th Cir. 1998)* ; *American Auto. Accessories, Inc. v. Fishman, 991 F. Supp. 995 (N.D. Ill. 1998) .*

(n47)Footnote 47. *United States v. Conghau Huu To, 144 F.3d 737 (11th Cir. 1998) .* Alternatively, a violation of § 1962(d) can be shown by proving the defendant agreed to commit two predicate acts. *Id.*

(n48)Footnote 48. *18 U.S.C. § 1962.*

(n49)Footnote 49. *See United States v. Oreto, 37 F.3d 739 (1st Cir. 1994)* (unlawful debt section does not require pattern--that does not render the statute unconstitutional); *Ballen v. Prudential Bache Secs., 23 F.3d 335 (10th Cir.*

1994) ; *United States v. Weiner, 3 F.3d 17 (1st Cir. 1993)* ; *Davis v. Mutual Life Ins. Co. of N.Y., 6 F.3d 367 (6th Cir. 1993)* , *cert. denied, 510 U.S. 1193, 114 S. Ct. 1298, 127 L. Ed. 2d 650 (1994)* ; *United States v. Giovanelli, 945 F.2d 479 (2d Cir. 1991)* (only single collection of unlawful debt need be proved).

(n50)Footnote 50. *Wright v. Sheppard, 919 F.2d 665 (11th Cir. 1990)* ; *Weisel v. Pischel, 197 F.R.D. 231 (E.D.N.Y. 2000)* . The *Weisel* court granted summary judgment to defendants on this basis, reasoning that RICO's legislative history justified limiting the statute to loansharkers, not ordinary businessmen who might make a usurious loan: "[t]he requirement that the loan have been incurred in connection with 'the business of' making usurious loans is aimed at ... 'the exclusion from the scope of the statute of occasional usurious transactions by one not in the business of loan sharking.' " *Weisel v. Pischel, 197 F.R.D. 231, 241 (E.D.N.Y. 2000)* (quoting S. Rep. No. 91-617, at 158 (1969)).

(n51)Footnote 51. *See Robidoux v. Conti, 741 F. Supp. 1019 (D.R.I. 1990)* ; *Vander Weyst v. First State Bank, 425 N.W.2d 803* (Minn.) , *cert. denied, 488 U.S. 943, 109 S.Ct. 369, 102 L.Ed. 2d 359 (1988)* . *But see Cashback Catalog Sales, Inc. v. Price, 102 F. Supp. 2d 1375 (S.D. Ga. 2000)* (denying summary judgment on RICO claim).

(n52)Footnote 52. *18 U.S.C. § 1962(c)*. The injury need not be direct, but it must satisfy the traditional "but for" analysis. *Ocean Energy II, Inc. v. Alexander & Alexander, Inc., 868 F.2d 740 (5th Cir. 1989)* . The injury must also be concrete. For example, the loss of *potential* business does not satisfy RICO's injury requirement. *Imagineering, Inc. v. Kiewit Pac. Co., 976 F.2d 1303 (9th Cir. 1992)* . Likewise, the possibility of a future injury is not a present injury compensable under RICO. Calobrace v. American Nat'l Can Co., No. 93 C 0999 (N.D. Ill. Jan. 25, 1995). Lost opportunity does not qualify as a RICO injury. *In re Taxable Mun. Bond Secs. Litig., 51 F.3d 518 (5th Cir. 1995)* . *See also Kaplan v. Prolife Action League, 475 S.E.2d 247 (N.C. Ct. App. 1996)* (loss of use of property is not an injury to property under North Carolina RICO). Payment of lawyers' fees incurred by a judgment creditor as a result of allegedly fraudulent claims made by the debtor was considered an injury to business or property by one court. *Handeen v. Lemaire, 112 F.3d 1339 (8th Cir. 1997)* . *See also In re Managed Care Litig., 185 F. Supp. 2d 1310* (plaintiffs who alleged that they were injured by paying more for insurance coverage than they would have absent the defendants' alleged omissions and misrepresentations established RICO standing), *recons. denied, 2002 U.S. Dist. LEXIS 11809* (S.D. Fla. June 10, 2002) ; *Corley v. Rosewood Care Ctr., Inc., 152 F. Supp. 2d 1099, 1112 (C.D. Ill. 2001)* (though defendant nursing home company's representations regarding continuing care might have formed a pattern of racketeering activity, plaintiff failed to show requisite injury because the guaranty neither factored in decision to place mother in home nor was tested by need for such aid). *But see Ove v. Gwinn, 264 F.3d 817, 825 (9th Cir. 2001)* (deprivation of "honest services" that does not constitute concrete financial loss was not a RICO injury). *See Living Designs, Inc. v. E.I. Dupont de Nemours and Co., 431 F.3d 353, 361-362 (9th Cir. 2005)* (looking to state law to determine whether a particular harm is a loss of property, and holding that the plaintiffs' claim that the defendant's fraudulent inducement led to them settling their claims for less damages than they would have otherwise received satisfied RICO's standing requirement).

(n53)Footnote 53. *503 U.S. 258, 112 S. Ct. 1311, 117 L. Ed. 2d 532 (1992)* .

(n54)Footnote 54. *See Bonilla v. Volvo Car Corp., 150 F.3d 62 (1st Cir. 1998)* (defendant's excise fraud, which presumably lowered the cost of cars purchased by plaintiffs, could not support a RICO claim because plaintiffs were not injured by reason of the fraud); *Price v. Pinnacle Brands, Inc., 138 F.3d 602 (5th Cir. 1998)* , *reh'g denied, 1998 U.S. App. LEXIS 13676* (5th Cir. Tex. May 27, 1998) (no RICO injury where plaintiffs, purchasers of trading cards packages manufactured by defendant, alleged that defendant's practice of randomly inserting limited edition cards in packages was illegal gambling; plaintiffs had mere expectancy interests, not tangible property interests, declining to follow *Schwartz v. Upper Deck Co., 967 F. Supp. 405 (S.D. Cal. 1997))* ; *Line v. Astro Mfg. Co., 993 F. Supp. 1033 (E.D. Ky. 1998)* (plaintiff who had paid no more than fair market value for manufactured home did not suffer an injury from the manufacturer's alleged concealment of the fire hazards of such homes); *Medgar Evers Houses Tenants Ass'n v. Medgar Evers Houses Assocs., LP, 25 F. Supp. 2d 116 (E.D.N.Y. 1998)* (plaintiffs who alleged that housing management company made fraudulent statements to HUD had not suffered an injury proximately caused by the fraud; plaintiffs must show that their injuries are the "preconceived purpose," "specifically intended consequence," "necessary result," or

"foreseeable consequences" of the racketeering); *Skeete v. IVF Am., Inc., 972 F. Supp. 206 (S.D.N.Y. 1997)* (no standing where injury did not arise from claimed predicate acts); *Moore v. Painewebber, Inc., 1997 U.S. Dist. LEXIS 13884 (S.D.N.Y. 1997)* (investor who sued brokerage firm alleging misrepresentation could not proceed without alleging either "transaction causation" (would not have purchased but for the misrepresentations) or "loss causation" (misrepresentations were the reason the transaction turned out to be a losing one)); *First Nationwide Bank v. Gelt Funding Corp., 27 F.3d 763 (2d Cir. 1994)* ; *Red Ball Interior Demolition Corp. v. Palmadessa, 874 F. Supp. 576 (S.D.N.Y. 1995)* (plaintiff must show direct relationship between plaintiff's injury and defendant's conduct). *See also Corley v. Rosewood Care Ctr., Inc., 152 F. Supp. 2d 1099, 1112 (C.D. Ill. 2001)* (though defendant nursing home company's representations regarding continuing care might have formed a pattern of racketeering activity, plaintiff failed to show requisite injury because the guaranty neither factored in decision to place mother in home nor was tested by need for such aid).

(n55)Footnote 55. *126 S. Ct. 1991, 1993 (2006)* .

(n56)Footnote 56. *Id. at 1997* .

(n57)Footnote 57. *Id.*

(n58)Footnote 58. *Id.*

(n59)Footnote 59. *Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 496-99, 105 S. Ct. 3275, 87 L. Ed. 2d 346 (1985)* ; *United States v. Turkette, 452 U.S. 576, 586-87, 101 S. Ct. 2524, 69 L. Ed. 2d 246 (1981)* .

(n60)Footnote 60. *18 U.S.C. § 1961(1).*

(n61)Footnote 61. Note, however, that the mailings must show intent to defraud; innocuous business communications cannot be RICO predicates. *O'Malley v. New York Transit Auth., 896 F.2d 704 (2d Cir. 1990)* .

(n62)Footnote 62. *Regency Communications v. Cleartel Communications, Inc., 160 F. Supp. 2d 36, 44 (2001)* (breach of contract accompanied by use of mail to deceive plaintiffs could fulfill mail fraud statute's requirements) (citing *McEvoy Travel Bureau, Inc. v. Heritage Travel, Inc., 904 F.2d 786 (1st Cir. 1990)* , *cert. denied, 498 U.S. 992 (1990))* , *recons. denied, 212 F. Supp. 2d 1 (D.D.C. 2002)* . *See also Royal Indem. Co. v. Pepper Hamilton LLP, 479 F. Supp. 2d 419, 428-429 (D. Del. 2007)* (denying the defendants' motion to dismiss); *United States v. Philip Morris USA, Inc., 449 F. Supp. 2d 1 (D.D.C. 2006)* (holding that the plaintiff had sufficiently established mail fraud, stating that "[t]he individual components must be viewed not independently but in context of the entire scheme to defraud ... [i]t is sufficient to prove by the totality of the circumstances that the defendant devised a scheme intended to defraud which included one or more of the individual component schemes alleged").

(n63)Footnote 63. *18 U.S.C. § 1962(c).*

(n64)Footnote 64. *Emery v. American Gen. Fin., Inc., 71 F.3d 1343 (7th Cir. 1995)* (omission or concealment of loan information can constitute mail fraud).

(n65)Footnote 65. *United States v. Cherif, 943 F.2d 692 (7th Cir. 1991)* .

(n66)Footnote 66. *Blu-J, Inc. v. Kemper C.P.A. Group, 916 F.2d 637 (11th Cir. 1990)* .

(n67)Footnote 67. *Schmuck v. United States, 489 U.S. 705, 109 S. Ct. 1443, 103 L. Ed. 2d 734 (1989)* (mailing incidental to fraudulent scheme sufficient); *Bennett Silvershein Assocs. v. Fruman, 1997 U.S. Dist. LEXIS 12909* (S.D.N.Y. filed Aug. 28, 1997) (mailings may constitute mail fraud even if they occur after the fraud is completed). The mail fraud must also have a pecuniary goal. *First Pac. Bancorp, Inc. v. Bro, 847 F.2d 542 (9th Cir. 1988)* ; *Garrick-Aug Assocs. Store Leasing, Inc. v. Hirshfeld, 652 F. Supp. 905 (S.D.N.Y. 1986)* .

(n68)Footnote 68. *128 S. Ct. 2131, 2145 (2008)* , *abrogating VanDenBroeck v. CommonPoint Mortgage Co., 210 F.3d 696 (6th Cir. 2000)* and *Sikes v. Teleline, Inc., 281 F.3d 1350 (11th Cir. 2002)* .

(n69)Footnote 69. *Id.* at 2138 , 2145.

(n70)Footnote 70. *18 U.S.C. § 1343*.

(n71)Footnote 71. *See Byrne v. Nezhat, 261 F.3d 1075, 1116 (11th Cir. 2001)* ("any doubt" as to meritlessness of state RICO claim dissolved when state court dismissed similar action brought on behalf of a different client against same defendants; affirming sanctions against attorney who nonetheless continued to pursue claim); *Smith v. Our Lady of the Lake Hosp., Inc., 960 F.2d 439 (5th Cir. 1992)* (while attorney's Rule 11 duty is particularly strong in RICO cases, sanctions for withdrawn RICO claim were inappropriate because law was not clear when complaint was filed in good faith); *Lodal, Inc. v. Great Am. Ins. Cos., 2001 U.S. Dist. LEXIS 22123,* at *28 (W.D. Mich. Sept. 19, 2001) (awarding sanctions against attorney for RICO claims that "lacked any reasonable factual or legal basis and were asserted for an improper purpose" in case arising from dispute between manufacturer and two insurers over coverage of policies).

(n72)Footnote 72. *See Andersen v. Smithfield Foods, Inc., 209 F. Supp. 2d 1278, 1281 (S.D. Fla. 2002)* (imposing sanctions for failing to make a "reasonable inquiry" before filing second amended complaint after previous two complaints had been dismissed); *Miller v. Norfolk S. Rwy. Co., 208 F. Supp. 2d 851, 852 (N.D. Ohio 2002)* (ordering reprimand against attorney who filed motion to reconsider that contained no new facts or legal theories); *Martinez v. Martinez, 207 F. Supp. 2d 1303, 1309 (D.N.M. 2002)* (imposing sanctions where attorney failed to follow court's explicit warnings upon dismissing initial complaint, but rather filed amended complaint that still failed to properly allege RICO claim); *Divot Golf Corp. v. Citizens Bank of Mass., 2003 U.S. Dist. LEXIS 187* (D. Mass. Jan. 8, 2003) (imposing sanctions, noting that plaintiffs repeated factual misstatements and failed to properly allege pattern even after put on notice of complaint's deficiencies by defendants). *See also Byrne v. Nezhat, 261 F.3d 1075, 1116 (11th Cir. 2001)* ("any doubt" as to merit of state RICO claim dissolved when state court dismissed similar action brought on behalf of a different client against same defendants; affirming sanctions against attorney who nonetheless continued to pursue claim).

(n73)Footnote 73. *Murr Plumbing Inc. v. Scherer Bros. Fin. Servs. Co., 48 F.3d 1066 (8th Cir. 1995)* (while mail and wire fraud statutes do not require proof of a misrepresentation of fact, still must have specificity regarding the elements of the statutory fraud); *Mills v. Polar Molecular Corp., 12 F.3d 1170 (2d Cir. 1993)* ; *Farlow v. Peat, Marwick, Mitchell & Co., 956 F.2d 982 (10th Cir. 1992)* ; *Brown v. Coleman Invs., Inc., 993 F. Supp. 416 (M.D. La. 1998)* (in case against assignee of retail installment sales contract, plaintiff's complaint failed to adequately plead fraud where it alleged only that defendant knew assignor had inflated fees but did not allege that defendant had specific intent).

(n74)Footnote 74. *See Brooks v. Bank of Boulder, 891 F. Supp. 1469 (D. Colo. 1995)* ("a charge of racketeering should not be easier to make than an allegation of fraud").

(n75)Footnote 75. *E.g., Emery v. American Gen. Fin., Inc., 134 F.3d 1321* (7th Cir.) , *cert. denied, 525 U.S. 818, 119 S. Ct. 57, 142 L. Ed. 2d 44 (1998)* ; *Murr Plumbing Inc. v. Scherer Bros. Fin. Servs. Co., 48 F.3d 1066 (8th Cir. 1995)* .

(n76)Footnote 76. *DeLorean v. Cork Gully, 118 B.R. 932 (E.D. Mich. 1990)* .

(n77)Footnote 77. *Epstein v. Haas Secs. Corp., 731 F. Supp. 1166 (S.D.N.Y. 1990)* .

(n78)Footnote 78. Blakey, *How to Tell If You Have a RICO Case*, 5 Law. Alert, Oct. 28, 1985, at 28; Harris, *A Framework for Pleading Civil RICO* Civil RICO, Practicing Law Institute, 1985 Civil RICO, at 165. Five examples of RICO civilcomplaints and criminal indictments are reproduced in Harris, *A Framework for Pleading Civil RICO* Civil

RICO, Practicing Law Institute, 1985 Civil RICO, at 189-318.

(n79)Footnote 79. *Fleischhauer v. Feltner, 879 F.2d 1290 (6th Cir. 1989)* , *cert. denied, 494 U.S. 1027, 110 S. Ct. 1473, 108 L. Ed. 2d 611 (1990)* .

(n80)Footnote 80. *Maio v. Aetna Inc., 221 F.3d 472, 482 (3d Cir. 2000)* ; *Genty v. Resolution Trust Corp., 937 F.2d 899 (3d Cir. 1991)* ; *Berg v. First State Ins. Co., 915 F.2d 40 (9th Cir. 1990)* ; *Fleischhauer v. Feltner, 879 F.2d 1290 (6th Cir. 1989)* , *cert. denied, 494 U.S. 1027, 110 S. Ct. 1473, 108 L. Ed. 2d 611 (1990)* ; *Grogan v. Platt, 835 F.2d 844* (11th Cir.) , *cert. denied, 488 U.S. 982, 109 S. Ct. 531, 102 L. Ed. 2d 562 (1988)* .

(n81)Footnote 81. *Rosario v. Livaditis, 963 F.2d 1013 (7th Cir. 1992)* .

(n82)Footnote 82. *HBE Leasing Corp. v. Frank, 22 F.3d 41 (2d Cir. 1994)* .

(n83)Footnote 83. *Compare Com-Tech Assocs. v. Computer Assocs. Int'l, Inc., 753 F. Supp. 1078 (2d Cir. 1991)* (declining to strike a claim for punitive damages "at the pleading stage"), *with Mylan Labs., Inc. v. Akzo, N.V., 770 F. Supp. 1053 (D. Md. 1991)* (striking RICO punitive damages claim).

(n84)Footnote 84. *18 U.S.C. § 1964(a)*.

(n85)Footnote 85. *18 U.S.C. § 1964(b)*.

(n86)Footnote 86. *Rosen v. Cascade Int'l, Inc., 21 F.3d 1520 (11th Cir. 1994)* . The Eleventh Circuit stated that prejudgment attachment could accomplish the same result, and if a forum state does not allow prejudgment attachment, the federal court should not circumvent that rule by issuing an injunction.

(n87)Footnote 87. *Scheidler v. NOW, 537 U.S. 393, 123 S. Ct. 1057, 154 L. Ed. 2d 991 (2003)* (finding that ruling on Hobbs Act that reversed judgment against petitioners rendered decision on the injunction issue unnecessary).

(n88)Footnote 88. *Marriott Bros. v. Gage, 911 F.2d 1105 (5th Cir. 1990)* ; *Figueroa-Ruiz v. Alegria, 905 F.2d 545 (1st Cir. 1990)* . *See Commercial Cleaning Servs., L.L.C. v. Colin Serv. Sys., Inc., 271 F.3d 374 (2d Cir. 2001)* (complaint's failure to allege an essential element of the RICO predicate offense was not fatal, allowing plaintiff to cure by repleading). *See, e.g., Greer v. Stulp, 2002 U.S. Dist. LEXIS 1482* (N.D. Ill. Feb. 1, 2002) (listing elements of required case statement). *See, e.g., McDonald v. Heaton, 2006 U.S. Dist. LEXIS 40396* (W.D. Okla. June 16, 2006) (directing plaintiff to file a RICO case statement). *See, e.g., Barsekian v. First Am. Loanstar Trustee. Servs., 2009 U.S. Dist. LEXIS 2884* (C.D. Cal. Jan. 6, 2009) (requiring plaintiff to supply RICO case statement and designating the form to be supplied). *See also Cruz v. Cinram Int'l, Inc., 574 F. Supp. 2d 1227, 1235 (N.D. Ala. 2008)* (while plaintiff need not file a separate RICO case statement, plaintiff must file a more definite statement in that form).

(n89)Footnote 89. *ESAB Group, Inc. v. Centricut, Inc., 126 F.3d 617 (4th Cir. 1997)* , *cert. denied, 523 U.S. 1048, 118 S. Ct. 1364 (1998)* ; *Monarch Normandy Square Partners v. Normandy Square Assocs. Ltd. P'ship, 817 F. Supp. 896 (D. Kan. 1993)* . *But see* 800537 *Ontario, Inc. v. Auto Enters., 113 F. Supp. 2d 1116, 1128 (E.D. Mich. 2000)* (Section 1965 authorizes nationwide service of process only when plaintiff shows court has personal jurisdiction over at least one of the defendants).

(n90)Footnote 90. Republic of Panama v. BCCI Holdings (Luxembourg)*S.A., 119 F.3d 935, 942* ((11th Cir. 1997) ; *ESAB Group, Inc. v. Centricut, Inc., 126 F.3d 617, 626* /-/627 (4th Cir. 1997).

(n91)Footnote 91. *FC Inv. Group LC v. IFX Markets, Ltd., 529 F.3d 1087, 1100 (D.C. Cir. 2008)* ; *PT United Can Co. Ltd. v. Crown Cork & Seal Co., 138 F.3d 65, 70 (2d Cir. 1998)* ; *Butcher's Union Local No. 498 v. SDC Inv. Inc., 788 F.2d 535, 538 (9th Cir. 1986)* .

(n92)Footnote 92. *See, e.g., Cory v. Aztec Steel Bldg., Inc., 468 F.3d 1226, 1229 (10th Cir. 2006)* ; *Busch v.*

Buchman, Buchman & O'Brien, Law Firm, 11 F.3d 1255, 1258 (4th Cir. 1994) ; *United States v. Tillem, 906 F.2d 814 (2d Cir. 1990)* ; *Go-Video, Inc. v. Akai Elec. Co., 885 F.2d 1406, 1416 (9th Cir. 1989)* ; *Lisak v. Mercantile Bancorp, Inc., 834 F.2d 668, 671 (7th Cir. 1987)* (RICO); *BankAtlantic v. Coast to Coast Contractors, Inc., 947 F. Supp. 480 (S.D. Fla. 1996)* ; *Headwear, U.S.A., Inc. v. Stange, 166 F.R.D. 36 (D. Kan. 1996)* . *See also FC Inv. Group LC v. IFX Markets, Ltd., 529 F.3d 1087, 1099* /-/1100 (D.C. Cir. 2008) (affirming dismissal of RICO action against foreign currency broker on the grounds that the court could not obtain personal jurisdiction over the defendant, and rejecting argument that the nationwide service of process provision conferred jurisdiction without minimum contacts).However, notwithstanding the nationwide service provisions, a court will most likely not exercise jurisdiction over a potential RICO claim involving an Indian intra-tribal dispute.

(n93)Footnote 93. *See, e.g., Republic of Panama v. BCCI Holdings (Luxembourg) S.A., 119 F.3d 935, 945, 946 (11th Cir. 1997)* .

(n94)Footnote 94. *Forbes v. Eagleson, 1996 U.S. Dist. LEXIS 10582* (E.D. Pa. July 23, 1996) .

(n95)Footnote 95. *Tafflin v. Levitt, 493 U.S. 455, 110 S. Ct. 792, 107 L. Ed. 2d 887 (1990)* .

(n96)Footnote 96. *Lichtenberger v. Prudential-Bache Secs., Inc., 737 F. Supp. 43 (S.D. Tex. 1990)* .

(n97)Footnote 97. *Agency Holding v. Malley-Duff, 483 U.S. 143, 107 S. Ct. 2759, 2764, 97 L. Ed. 2d 121 (1987)* . *See Mathews v. Kidder, Peabody & Co., 260 F.3d 239, 247 (3d Cir. 2001)* (RICO injury from overpriced securities occurs at time of purchase).

(n98)Footnote 98. *Forbes v. Eagleson, 228 F.3d 471, 482 (3d Cir. 2000)* , *cert. denied, 533 U.S. 929, 121 S. Ct. 2551, 150 L.Ed. 2d 718 (2001)* ; *Graves v. Combined Ins. Co., 95 F.3d 1154 (7th Cir. 1996)* (accrual when plaintiff discovers or should have discovered, his injury); *Granite Falls Bank v. Henrikson, 924 F.2d 150 (8th Cir. 1991)* ; *Bath v. Bushkin, Gaims, Gaines, & Jonas, 913 F.2d 817 (10th Cir. 1990)* ; *Rodriguez v. Banco Cent., 917 F.2d 664 (1st Cir. 1990)* . *See also Allstate Ins. Co. v. Valley Physical Medicine & Rehabilitation, P.C., 475 F. Supp. 2d 213, 228* /-/231 (E.D.N.Y. 2007). (applying injury discovery rule to bar recovery for some of the plaintiff's claims).

(n99)Footnote 99. *Bingham v. Zolt, 66 F.3d 553 (2d Cir. 1995)* ; *McCool v. Strata Oil Co., 972 F.2d 1452 (7th Cir. 1992)* .

(n100)Footnote 100. *Charter Oak Fire Ins. Co. v. Domberg, 1987 U.S. Dist. LEXIS 7153* (N.D. Ill. Aug. 3, 1987) ; *Citicorp Sav. of Ill. v. Streit, 1987 U.S. Dist. LEXIS 2860* (N.D. Ill. Apr. 6, 1987) ; *Carlstead v. Holiday Inns, In c., 1987 U.S. Dist. LEXIS 2546* (N.D. Ill. Mar. 26, 1987) . The Sixth Circuit rejected the last predicate act rule in *Agristor Fin'l Corp. v. Van Sickle, 967 F.2d 233 (6th Cir. 1992)* , and the Seventh Circuit rejected it in *McCool v. Strata Oil Co., 972 F.2d 1452 (7th Cir. 1992)* .

(n101)Footnote 101. *Strassman v. Almahurst, Inc., 25 F.3d 1050 (6th Cir. 1994)* .

(n102)Footnote 102. *Klehr v. A.O. Smith Corp., 65 U.S.L.W. 4514* (June 17, 1997) (requiring exercise of due diligence); *see also Ballen v. Prudential Bache Secs., 23 F.3d 335 (10th Cir. 1994)* . *See, e.g., Love v. National Med. Enters., 230 F.3d 765, 780 (5th Cir. 2000)* (finding material fact as to issue of fraudulent concealment). *See also Shapo v. O'Shaugnessy, 246 F. Supp. 2d 935 (N.D. Ill. 2002)* (recognizing tolling doctrine); *G-I Holdings, Inc. v. Baron & Budd, 238 F. Supp. 2d 521 (S.D.N.Y. 2002)* (standard tolling exceptions apply to civil RICO claims).

(n103)Footnote 103. *Parklane Hosiery Co. v. Shore, 439 U.S. 322, 330, 99 S. Ct. 645, 58 L. Ed. 2d 552 (1979)* .

(n104)Footnote 104. *Emery v. American Gen. Fin., 71 F.3d 1343 (7th Cir. 1995)* .

(n105)Footnote 105. *Chisolm v. TranSouth Fin. Corp., 95 F.3d 331 (4th Cir. 1996)* , *appeal after remand, 164*

F.3d 623 (4th Cir. 1998) (table, full text at *1998 U.S. App. LEXIS 24632*), *on remand, 184 F.R.D. 556 (E.D. Va. 1999)* (certifying class), *later op. at 194 F.R.D. 538 (E.D. Va. 2000)* (defining subclasses and ruling on trial plans).

(n106)Footnote 106. *Brown v. C.I.L., Inc., 1996 U.S. Dist. LEXIS 4053* (N.D. Ill. Mar. 29, 1996) .

(n107)Footnote 107. *Thompson v. State, 211 Ga. App. 887, 440 S.E.2d 670 (1994)* , *cert. denied, 1994 Ga. LEXIS 514* (Mar. 25, 1994) .

(n108)Footnote 108. *Brown v. LaSalle N.W. Nat'l Bank, 820 F. Supp. 1078 (N.D. Ill. 1993)* .

(n109)Footnote 109. *Smith v. Berg, 247 F.3d 532, 538 (3d Cir. 2001)* . The trial court later declined to certify the class of homebuyers, but on other grounds. *Smith v. Berg, 2001 U.S. Dist. LEXIS 15814* (E.D. Pa. Oct. 1, 2001) .

(n110)Footnote 110. *Carr v. Home Tech Co., Inc., 476 F. Supp. 2d 859, 863-865 (W.D. Tenn. 2007)* (referring to prior order of the court).

(n111)Footnote 111. *In re Nat'l Western Life Ins. Deferred Annuities Litig., 467 F. Supp. 2d 1071, 1085-1086 (S.D. Cal. 2006)* .

(n112)Footnote 112. *See e.g. Ariz. Rev. Stat. Ann. §§ 13-2301 to 13-2318*; *Colo. Rev. Stat. §§ 18-17-101 to 18-17-109*; *Iowa Code Ann. §§ 706A.1 to 706A.5*; *N.J. Stat. Ann. §§ 2C:41-1 to 2C:41-6.2*. *See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 14.3 (7th ed. 2008 and supp.), and App. C.2 for summaries of state statutes.

(n113)Footnote 113. *See, e.g., Ford Motor Co. v. Edgewood Props., Inc., 2009 U.S. Dist. LEXIS 4172* (D.N.J. Jan. 20, 2009) , *on reconsideration in part, 2009 U.S. Dist. LEXIS 70953* (D.N.J. Aug. 11, 2009) (allowing RICO claim to go forward); *Weaver v. Aetna Life Ins. Co., 2008 U.S. Dist. LEXIS 93658* (D. Nev. Nov. 4, 2008) (dismissing suit because of insufficient showing of injury; taking an extremely cramped reading of this requirement).

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CHAPTER 4 Unfair and Deceptive Credit Practices

1-4 Consumer Credit Law Manual § 4.08

§ 4.08 State Civil Theft Laws

A few states have civil theft laws that offer a cause of action that is similar to but less complex than a state RICO claim. These statutes also usually cover a greater range of fraud and theft offenses.

In Indiana, a person who has suffered a pecuniary loss as a result of a theft or fraud crime, or certain other types of crimes, may sue for treble damages, costs, attorney fees, certain travel expenses and court costs, and collection costs. n1 Ohio offers a private cause of action for damages, attorney fees, costs, and, in certain cases, punitive damages to anyone injured in person or property by a criminal act. n2 The statute also provides for treble damages and statutory damages in some circumstances n3 if the defendant does not respond properly to a thirty-day demand letter. n4 Rhode Island provides a private cause of action for damages to any person who suffers injury to the person, reputation, or estate by reason of the commission of any crime or offense, and specifies that it is not a defense that no criminal complaint has been filed. n5

Legal Topics:

For related research and practice materials, see the following legal topics:
Criminal Law & ProcedureCriminal OffensesCrimes Against PersonsRobberyGeneral OverviewCriminal Law & ProcedureCriminal OffensesFraudGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *Ind. Code § 34-24-3-1.*

(n2)Footnote 2. *Ohio Rev. Code Ann. § 2307.60.*

(n3)Footnote 3. *Ohio Rev. Code Ann. § 2307.61.*

(n4)Footnote 4. *See Buckeye Check Cashing, Inc. v. Proctor, 1999 Ohio App. LEXIS 2678* (Ohio Ct. App. June 15, 1999) (interpreting ambiguous statutory language).

(n5)Footnote 5. *R.I. Gen. Laws § 9-1-2.*

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§ 4.09 Unjust Enrichment, Restitution, and Similar Equitable Theories

Another alternative remedy to state UDAP remedies in cases of consumer fraud is unjust enrichment. Unjust enrichment is an equitable doctrine that provides a remedy--restitution--when a party receives benefits that would be unjust for that party to retain under the circumstances. Unjust enrichment is the source of the liability, and restitution is the consequence of--or remedy for--the liability. n1

A claim for restitution may be a useful approach when a seller or lender collects funds that it is not entitled to. For example:

- A car dealer may assess a license fee but fail to disclose that the dealer will remit only a portion of the fee to the state, retaining the excess as profit;

- A mortgage lender may assess a fee labeled as a recording tax when in fact the actual tax due to the state is only a fraction of the item;

- A seller may line item a fee for a federal excise tax that is not due;

- A mobile home park lessor may demand a fee for the sale of a home in the park, notwithstanding that state law prohibits such a fee;

- A merchant may disclose and collect a fee that the merchant does not have the authority to collect, for example, an unlicensed real estate broker is not entitled to command and keep a commission;

- A seller may overcharge a consumer for a product, by assessing a higher price than agreed to or allowed by law.

In some jurisdictions, "unjust enrichment" is a cause of action in and of itself, sounding in equity, that has distinct elements to prove and results in an award of restitution. n2 In other jurisdictions, unjust enrichment serves as the basis for imposing liability through another cause of action, and it must be proven as an element of the overriding claim. Typically such a claim is labeled restitution, n3 "money had and received," n4 *assumpsit*, n5 or recoupment. n6

In general, the elements of a claim of unjust enrichment include the following:

- The defendant received a benefit;
- The defendant's failure to pay was to the plaintiff's detriment; and
- The circumstances are such that it would be unjust for the defendant to fail to return the benefit to the plaintiff. n7

Jurisdictions that have a more conservative approach to the doctrine may also require a plaintiff to show not just that the defendant obtained a benefit, but that the defendant obtained the benefit by fraud, duress, or the taking of an undue advantage. n8

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawRemediesEquitable ReliefGeneral Overview

FOOTNOTES:
(n1)Footnote 1. Restatement (Third) of Restitution & Unjust Enrichment § 1 provides: "A person who is unjustly enriched at the expense of another is liable in restitution to the other."

(n2)Footnote 2. Restatement (Third) of Restitution & Unjust Enrichment § 1 cmt. a. The Restatement carefully circumscribes the situations of unjust enrichment that will yield restitution, providing as follows:

(1) Liability in restitution is based on and measured by the receipt of a benefit, but the receipt of a benefit does not of itself make the recipient liable in restitution.

(2) The transactions that give rise to a liability in restitution are primarily nonconsensual. They take place outside the framework of an enforceable contract, or otherwise without the effective consent of one or both parties.

(3) The fact that a person has received or obtained a benefit without paying for it does not of itself establish that the recipient has been unjustly enriched.

(4) There is no liability in restitution in respect of a benefit intentionally conferred by the claimant on the recipient, unless the circumstances of the transaction are such as to excuse the claimant from the necessity of basing a claim to payment on a contract with the recipient.

(n3)Footnote 3. *Kowalski v. Cedars of Portsmouth Condo. Ass'n, 769 A.2d 344, 346 (N.H. 2001)* ; *Oxford Fin. Cos. v. Velez, 807 S.W.2d 460, 465 (Tex. Ct. App. 1991)* (while unjust enrichment is not an independent cause of action, an action for restitution based on unjust enrichment will lie to recover money that it would be unconscionable for the defendant to retain); *see also Century Bank v. Hymans, 905 P.2d 722, 726, 727 (N.M. Ct. App. 1995)* (allowing restitution claim based on mortgagee's overpayment to mortgagor).

(n4)Footnote 4. *See, e.g., Lonergan v. A.J.'s Wrecker Serv. of Dallas, Inc., 1999 U.S. Dist. LEXIS 10494* (N.D. Tex. July 6, 1999) (describing claim for money had and received as an equitable doctrine used to prevent unjust enrichment).

(n5)Footnote 5. *See, e.g., Cohon v. Oscar L. Paris Co., 149 N.E.2d 472, 475 (Ill. App. Ct. 1958)* (the action of *assumpsit*, under the common counts for money had and received, is an appropriate remedy to enforce the equitable obligation arising from the receipt of money by one person which belongs to another and which in equity and justice should be returned).

(n6)Footnote 6. *See Pension Benefit Guar. Corp. v. White Consol. Indus. Inc., 72 F. Supp. 2d 547, 550 (W.D. Pa. 1999)* .

(n7)Footnote 7. *See, e.g., White v. Smith & Wesson Corp., 97 F. Supp. 2d 816 (N.D. Ohio 2000)* ; *Steinmetz v. Toyota Motor Credit Corp., 963 F. Supp. 1294, 1307 (E.D.N.Y. 1997)* (interest earned on lessee's security deposits could be basis of claim for unjust enrichment against lessor); *Gary v. D. Agustini & Asociados, S.A., 865 F. Supp. 818 (S.D. Fla. 1994)* ; *Fitzpatrick v. Scalzi, 806 A.2d 593 (Conn. App. Ct. 2002)* ; *Dominiack Mech., Inc. v. Dunbar, 757 N.E.2d 186, 190 (Ind. Ct. App. 2001)* .

(n8)Footnote 8. *Lonergan v. A.J.'s Wrecker Serv. of Dallas, Inc., 1999 U.S. Dist. LEXIS 10494* (N.D. Tex. July 6, 1999) (fees paid to defendant's towing companies, for the nonconsensual towing and storage of vehicles, sufficed as payment of money under duress); *Friar v. Vanguard Holding Corp., 434 N.Y.S.2d 698, 702 (App. Div. 1980)* (action for money had and received arises when money was paid by mistake, upon consideration that failed, or under duress). *See* Restatement (Third) of Restitution & Unjust Enrichment § 2 cmt. a ("the concern of restitution is with nonconsensual transactions and not (for example) with the fairness of a valid contractual exchange"). For further discussion of unjust enrichment, see National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 9.7.2 (6th ed. 2006 and Supp.).

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§ 5.01 Introduction

[1] Overview

Credit discrimination is a pervasive and pernicious problem in American society. n1 Minorities and other protected groups face difficulties obtaining market-rate first and second mortgages and other forms of credit; many banks do not even open branches in minority neighborhoods. Creditors discriminate as to which customers they solicit for credit, to whom they grant credit, or how their credit customers are treated in subsequent stages of the credit transaction, such as in loan servicing and debt collection. Consumers cannot be sure if they are even eligible for credit or do not understand why they are turned down for credit.

This chapter considers a number of different credit discrimination statutes. n2 The Equal Credit Opportunity Act ("ECOA"), *15 U.S.C. sections 1691-1691f*, n3 is the primary statute treated, in part because it has the broadest application and most detailed standards. The Fair Housing Act ("FHA") n4 is covered because it more directly prohibits discrimination in residential leases and sale of residences, as well as applying to first and second mortgages and unsecured loans used to improve or maintain a dwelling.

42 U.S.C sections 1981 and *1982* of the Civil Rights Acts are also considered, but in less detail. These statutes, like the FHA, are broader in some respects than the ECOA. In these statutes, any aggrieved party (and not just an applicant) may bring an action; they clearly apply to all types of leases and even to sales not involving credit; and they are not limited in the amount of punitive damages. This makes them important particularly when the FHA does not apply--that is, where the transaction is not related to a dwelling. The Civil Rights Acts may also be useful where the two-year ECOA and FHA limitations period has run.

This chapter also briefly covers state credit discrimination laws. A final category of laws mentioned in this chapter are state UDAP statutes; that is, state consumer protection statutes of general applicability prohibiting unfair and deceptive practices. n5

Federal and state credit discrimination laws do not prohibit discrimination generally. They do not prevent creditors from making reasonable distinctions between applicants, denying credit or offering less advantageous terms to higher risks. These credit discrimination laws generally do not even require that creditors act reasonably.

Instead, credit discrimination laws prohibit creditors from utilizing certain factors (race, sex, etc.) as the *basis* for the credit discrimination. Whether or not a credit determination is reasonable, it is prohibited if the determination is based upon a prohibited distinction, except for special credit programs restricted to those discriminated against.

A practice can involve illegal discrimination even when the creditor does not intend to discriminate on a prohibited basis. A practice can be illegal if it has the *effect* of discriminating on a prohibited basis. This "effects test" provides an alternative approach when it is impossible to prove that the creditor intended to treat applicants differently.

The credit discrimination statutes prohibit discrimination at all stages of a credit transaction and reach more than just transactions with stated interest charges, but apply to leases, utility service, certain medical treatments, and other transactions where the consumer's obligation to pay is deferred until after receipt of the goods or services. Credit discrimination laws may even apply to differential treatment as to the cash price of the goods or services related to the credit.

[2] Terminology and Acronyms

This chapter commonly uses the following abbreviations and shorthand:

- ECOA for Equal Credit Opportunity Act;
- FRB for Federal Reserve Board;
- HUD for the United States Department of Housing and Urban Development;
- Civil Rights Acts for *42 U.S.C. sections 1981* and *1982*;
- UDAP for general state consumer protection statutes that prohibit unfair and deceptive acts and practices.
- Clearinghouse is the National Clearinghouse for Legal Services. n6

[3] The ECOA

The ECOA has two important aspects. First, it sets out a general rule that creditors cannot discriminate in any way against any applicant in any stage of a credit transaction on any of the following bases:

- Race,
- Color,
- Religion,
- National origin,
- Sex,
- Marital status,
- Age,

- Public assistance income,
- Exercise of rights under the Consumer Credit Protection Act. n7

Second, the ECOA sets out various specific actions that creditors must or must not take, factors that may not be considered in determining creditworthiness (such as certain types of income an applicant may receive), when an existing account may be closed, and ways in which information is reported to credit reporting agencies concerning spouses.

Both the general rule against discrimination and the more specific requirements have a broad scope (with certain itemized exceptions). Any individual applying for credit or obligated to pay on a loan may bring actions against any creditor, which includes those arranging and participating in loans. The ECOA also applies not only to transactions with multiple installments or a finance charge, but to any deferral of payment, such as payment for services a week after the services were provided. The ECOA also applies not just to consumer, but also to business and other forms of credit. Special purpose credit programs are largely exempt, and certain narrow exceptions apply to incidental consumer credit, utility credit, business credit, and securities credit.

ECOA provides private remedies for actual and punitive damages (up to a maximum of $10,000 in an individual action), equitable relief, and attorney fees. Actions may be brought in federal or state court, and may be brought as individual or class actions. Creditor defenses are limited. Various federal agencies also have enforcement authority over ECOA violations.

In 1996, the ECOA was amended as part of the Omnibus Consolidated Appropriations Act of 1996. n8 Incentives for self-testing and self-correcting were added, providing that reports or results of self-tests are privileged information under specified conditions. The FRB (in consultation with HUD) developed regulations dealing with these issues.

The amendment did not take effect until the regulations were final, and the regulations did not take effect until thirty days after they became final. n9 In 1999, the FRB issued an extensive set of proposed revisions to Regulation B and the Official Staff Commentary. The FRB issued its final rule and revisions to the Official Staff Commentary almost four years later, in March 2003. n10 The changes made by the final rule were significantly more limited in scope than the proposed rule.

[4] The Fair Housing Act

The Fair Housing Act, *42 U.S.C. sections 3601-3631*, contains several different provisions dealing with credit discrimination: one prohibits discrimination in residential real estate-related transactions, which primarily means any loan where a dwelling is taken as collateral or where the proceeds will go to purchase, improve, or maintain residential property. Another deals more with housing discrimination, in that it prohibits discrimination in the rental or sale of real estate. A third prevents threats, coercion, or interference with the enjoyment of rights protected by the Fair Housing Act.

The provisions prohibit discrimination on the basis of race, color, religion, national origin, sex, familial status, and handicap. Thus, there is considerable overlap with the ECOA, but only the Fair Housing Act prohibits familial status and handicap discrimination, while only the ECOA prohibits discrimination on age, marital status, public assistance status, and exercise of rights under the Consumer Credit Protection Act. The Fair Housing Act also does not contain any specific credit limitations such as those found throughout the ECOA.

Private actions may seek actual damages, punitive damages, equitable relief, and attorney fees. The Fair Housing Act

provides for both administrative and judicial proceedings for violations. Plaintiffs may pursue either approach or both simultaneously (up until the time one of the proceedings goes to actual trial).

On September 30, 1996, the FHA was amended as part of the Omnibus Consolidated Appropriations Act of 1996. n11 Incentives for self-testing and self-correcting were added, providing that reports or results of self-tests are privileged information under specified conditions. The Department of Housing and Urban Development (in cooperation with the FRB) developed regulations dealing with these issues.

The amendment did not take effect until the regulations were final, and the regulations did not take effect until thirty days after they became final. n12

There is an extensive body of caselaw under the Fair Housing Act in the rental and zoning contexts, much of which is used by courts as a source of precedent in credit discrimination cases brought under both the FHA and ECOA. n13 Some of these cases are discussed in this chapter when relevant to the applicable section. However, for a more extensive discussion of fair housing caselaw, advocates are advised to consult available fair housing treatises and other resources. n14

[5] Other Civil Rights Acts

This chapter also briefly treats two other federal statutes with some importance to credit discrimination, *42 U.S.C sections 1981* and *1982*, part of the Civil Rights Acts.

These statutes clearly apply to many aspects of credit transactions, n15 and also apply to many transactions beyond the scope of the ECOA and the FHA. They are particularly useful in challenging discrimination in leasing and selling of personal property.

The Civil Rights Acts generally apply only to racial discrimination, but the Supreme Court has expanded on this to include certain types of ethnic discrimination. In addition, section 1981 may be able to reach discrimination against noncitizens. On the other hand, section 1982 does not provide rights to noncitizens.

The Civil Rights Acts provide for private actions for actual and punitive damages, equitable relief and attorney fees. Like the FHA, but unlike the ECOA, there is no statutory cap on the amount of punitive damages. Unlike the FHA and the ECOA, the Civil Rights Acts *only apply to cases of intentional discrimination*, and do not apply to cases of disparate impact--that is, the "effects test" is not available for violations of the Civil Rights Acts. n16 The limitations period for the Civil Rights Acts are determined by state law, so that they may be longer than or shorter than the FHA and ECOA's two year period.

The Civil Rights Act of 1991 amended section 1981 by re-designating the prior text as subsection (a) and adding subsections (b) and (c). n17 Subsection (b) added a definition for the phrase "make and enforce contracts," stating that it extends to both the "making, performance, modification, and termination of contracts" as well as the "enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship." n18 Subsection (c) added a provision making clear that the protections of section 1981 extend to both "non-governmental discrimination and impairment under color of State law." n19 The limitations period for the federal Civil Rights Acts is somewhat complicated. The limitations period for a cause of action that could be brought under provisions of the Act that existed prior to the 1991 Amendments is determined by state law, so the period may be longer or shorter than the Fair Housing Act's and the ECOA's two-year limitations periods. To the extent, however, that a cause of action is made possible by the provisions added by the 1991 Amendments, they are subject to the four-year "catch-all" federal statute of limitations at *28 U.S.C. § 1658(a)*. n20

In addition to credit discrimination and housing discrimination cases, many courts have relied on the extensive body of

law in the employment discrimination area as a source of precedent. For example, courts often turn to employment discrimination law when analyzing a disparate impact claim in a credit discrimination case. n21 In addition, some (but not all) federal courts have used the three-part, burden-shifting analysis developed by the Supreme Court for employment law cases in the *McDonnell-Douglas* case. n22 Also, advocates can use employment discrimination law theories to develop novel legal theories in credit discrimination cases. For example, one commentator has suggested tackling the problem of discrimination by creditors when issuing pre-screened credit offers by using the analysis developed in cases challenging discrimination in employment recruitment. n23

However, there are some differences between the two areas of law. For example, ECOA prohibits creditors from offering joint accounts to married couples, but not unmarried couples. n24 In contrast, several courts have held that state employment laws which forbid marital status discrimination do not prohibit employers from discriminating against unmarried couples. n25

[6] The Community Reinvestment Act (CRA)

The Community Reinvestment Act ("CRA") requires federal bank supervisors to monitor and evaluate how banks serve the credit needs of entire communities, including low and moderate-income neighborhoods. n26 It is distinct from the FHA and the ECOA in that it addresses inequalities in the distribution of credit among geographic areas, rather than discrimination against particular protected groups. However, commentators have noted that, for a number of reasons, CRA issues often become inescapably intertwined with addressing racial disparities in lending. n27 It applies to all institutions whose deposits are covered by federal deposit insurance.

The basic premise of the CRA is that banks and savings institutions, although privately capitalized, have an underlying obligation to serve their local communities. This obligation is generally considered to be in exchange for government backing, such as federal deposit insurance, that banks need to survive. Although it does not provide a civil cause of action, the CRA does require regulatory agencies to publicly disclose certain findings and conclusions regarding lending institutions, including whether an institution is meeting community needs. n28 Most importantly for advocates, banks have a strong incentive to maintain a positive CRA rating as federal bank regulatory agencies may deny merger or expansion applications from institutions with low ratings. The CRA in a sense grants implicit standing to neighborhood groups and other advocates to intervene in lender expansion application proceedings. n29 In addition, regulators are permitted to impose sanctions on lenders with weak records. n30

In general, the CRA is not aggressively enforced by regulatory agencies, n31 although some advocates have been able to use it effectively to address unfair and discriminatory lending practices. n32 Without a civil right of action, it may not be directly relevant for individual litigation. However, as part of an overall advocacy plan, it can be an effective tool for change.

[7] State Credit Laws

State equal credit laws are generally patterned after the ECOA. State fair housing laws are generally patterned after the Federal Fair Housing Act. In the wake of the 1988 Amendments to the federal statute, many states have been amending their fair housing statutes to include familial status and disability to the list of protected classes, to increase the statute of limitations from one to two years, and to eliminate the ceilings for punitive damage awards.

Sometimes recent amendments to the state fair housing acts offer broader protections than are found in the federal statute, and then such statutes are particularly relevant to a credit discrimination case. For example, several states explicitly mention individuals with AIDS as a protected class or prohibit discrimination based upon sexual orientation, political affiliation, or creed.

[8] State UDAP (Unfair or Deceptive Acts and Practices) Statutes

Every state has a general statute prohibiting deceptive and often unfair marketplace conduct. Thus, violations of a credit discrimination statute can also be a state UDAP violation, providing treble damages and/or minimum statutory damages and relatively long limitations periods in some states. More importantly, credit discrimination on a basis not prohibited by a credit discrimination statute could still be an unfair practice under a state UDAP statute. n33

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityGeneral OverviewBanking LawFederal ActsFair Housing & National Housing ActsCivil Rights LawContractual Relations & HousingFair Housing RightsCredit & Mortgage LawsPublic Health & Welfare LawHousing & Public BuildingsFair HousingReal Property LawFinancingRedlining

FOOTNOTES:
(n1)Footnote 1. For example, in 2000, mortgage lenders rejected nearly half of all African-American applicants and more than one-third of Hispanic applicants for conventional mortgages, as compared to less than one-quarter of white applicants. Ass'n of Community Organizations for Reform Now [hereinafter ACORN], The Great Divide: An Analysis of Racial and Economic Disparities in Home Purchase Mortgage Lending Nationally and in Sixty Metropolitan Areas 1 (2001), *available at* www.acorn.org.

(n2)Footnote 2. For an overview of all aspects of credit discrimination cases, see National Consumer Law Center, Credit Discrimination, Ch. 1 (5th ed. 2009).

(n3)Footnote 3. The Equal Credit Opportunity Act [hereinafter ECOA] is reprinted in Vol. 1A *infra*.

(n4)Footnote 4. The Fair Housing Act [hereinafter FHA] is reprinted in Vol. 1A *infra*.

(n5)Footnote 5. *See* Ch. 4 *supra*.

(n6)Footnote 6. Certain unreported cases and other documents are referred to herein with a "Clearinghouse" number. These documents may be ordered from the Sargent Shriver National Center on Poverty law (formerly known as the National Clearinghouse for Legal Services) by writing to: 111 N. Wabash St. Suite 500, Chicago, IL 60602, by calling (800) 621-3256 or (312) 263 3830, by sending a fax to (312) 263-3846 or by sending an e-mail to admin@povertylaw.org. Many documents are available on the organization's website, www.pvertylaw.org. There is a $60.00 annual access charge, plus $10,00 per copy plus shipping for hard copies. Non-subscribers can order individual documents for $10.00 plus shipping. As of early 2006, anyone whether a subscriber or not will be able to read abstracts and download case documents from their website.

For a more thorough presentation of the ideas in this chapter, plus a comprehensive appendix of relevant federal and state laws and court decisions, refer to National Consumer Law Center, Credit Discrimination (3rd ed. 2002 and Supp.).

(n7)Footnote 7. Regulation B, found at *12 C.F.R. §§ 202.1 et seq.* , is the official FRB implementing and interpreting regulation for the ECOA. It includes sample forms. Further explanation of the FRB rules and position is found in the Official Staff Commentary on Regulation B, found as a supplement to 12 C.F.R. pt. 202. The FRB issued a set of proposed revisions to Regulation B in August 1999, and issued final rules in March 2003. The text of the final rules can be found at *68 Fed. Reg. 13,144* (Mar. 18, 2003) . The new rules became effective on April 15, 2003, and mandatory compliance began on April 15, 2004.

(n8)Footnote 8. Pub. L. No. 104-208 (Sept. 30, 1996).

(n9)Footnote 9. Final regulations were promulgated as of mid-December 1997. *See 62 Fed. Reg. 66,412* (Dec. 18, 1997) . The regulations are effective as of Jan. 30, 1998.

(n10)Footnote 10. *68 Fed. Reg. 13,144* (Mar. 18, 2003) .

(n11)Footnote 11. Pub. L. No. 104-208 (Sept. 30, 1996).

(n12)Footnote 12. Final regulations were promulgated as of mid-December 1997. *See 62 Fed. Reg. 66,424* (Dec. 18, 1997) . The regulations are effective as of Jan. 30, 1998.

(n13)Footnote 13. *See, e.g., Coleman v. GMAC, 196 F.R.D. 315, 325, n. 21 (M.D. Tenn. 2000)* (applying FHA caselaw in a non-housing finance ECOA case).

(n14)Footnote 14. *See., e.g.,* J. Kushner, *Fair Housing: Discrimination in Real Estate, Community Development and Revitalization* (2d ed. 1995); R. Schwemm, *Housing Discrimination: Law and Litigation*(1990).

(n15)Footnote 15. *See, e.g., Hargraves v. Capital City Mortgage Corp., 140 F. Supp. 2d 7 (2000)* (predatory lending/reverse redlining case brought under both §§ 1981 and 1982), *recons. granted in part, denied in part, 147 F. Supp. 2d 1 (D.D.C. 2001)* (§ 1981 claim dismissed for lack of standing, but not § 1982 claim), *inj. denied sub nom. FTC v. Chevy Chase Bank, 2002 U.S. Dist. LEXIS 2199* (D.D.C. Feb. 7, 2002) ; *Johnson v. Equicredit Corp., 2002 U.S. Dist. LEXIS 4817* (N.D. Ill. Mar. 21, 2002) (predatory lending/reserve redlining case brought pursuant to § 1981); *Doane v. National Westminster Bank, 938 F. Supp. 149 (E.D.N.Y. 1996)* (mortgage redlining case brought under §§ 1981 and 1982).

(n16)Footnote 16. *Davis v. Strata Corp., 242 F. Supp. 2d 643 (D.N.D. 2003)* (credit discrimination case brought under § 1981; no liability without proof of intentional or purposeful discrimination).

(n17)Footnote 17. Pub. L. No. 102-166, *105 Stat. 1071 (1991).*

(n18)Footnote 18. *42 U.S.C. § 1981(b).*

(n19)Footnote 19. *42 U.S.C. § 1981(c).*

(n20)Footnote 20. *Jones v. Donnelley, 124 S. Ct. 1836 (2004)* .

(n21)Footnote 21. *Bhandari v. First Nat'l Bank of Commerce, 808 F.2d 1082, 1101 (5th Cir. 1987)* , *rev'd in part on other grounds, 829 F.2d 1343 (5th Cir. 1987)* (en banc), *vacated and remanded, 492 U.S. 901* , *reinstated, 887 F.2d 609 (5th Cir. 1989)* , *cert. denied, 494 U.S. 1061 (1990)* ; *Coleman v. GMAC, 196 F.R.D. 315, 325-326 (M.D. Tenn. 2000)* ; *Buycks-Roberson v. Citibank Fed. Sav. Bank, 162 F.R.D. 322 (N.D. Ill. 1995)* .

(n22)Footnote 22. *McDonnell-Douglas Corp. v. Green, 411 U.S. 792, 93 S.Ct. 1817, 36 L. Ed. 2d 668 (1973)* . The *McDonnell-Douglas* test is used by the First Circuit and Fifth Circuit, but has been rejected by the Seventh Circuit. See National Consumer Law Center, Credit Discrimination § 9.4.3.1, for a description of the McDonnell-Douglas test and the split amongst federal courts as to whether it should be applied in credit discrimination cases.

(n23)Footnote 23. Timothy J. Lambert, *Fair Marketing: Challenging Pre-Application Lending Practices, 87 Geo. L.J. 2181 (1999).* The Equal Opportunity Commission's website is a good resource on federal employment anti-discrimination law, and includes relevant statutes, regulations and the EEOC's enforcement guidance, which is its interpretations of current issues in the law. *See* www.eeoc.gov. Other employment anti-discrimination law resources include B. Lindemann and P. Grossman, Employment Discrimination Law (3d ed. 1996).

(n24)Footnote 24. Official Staff Commentary § 202.6(b)(1)-1; *Markham v. Colonial Mortgage Serv. Co., 605 F.2d 566 (D.C. Cir. 1979)* ; *Diaz v. Virginia Hous. Dev. Auth., 101 F.Supp. 2d 415, 419-20 (E.D.Va. 2000)* .

(n25)Footnote 25. *Parker-Bigback v. St. Labre Sch., 7 P.3d 361 (Mont. 2000)* , *cert. denied, 531 U.S. 1076, 121 S. Ct. 772, 148 L. Ed. 2d 671 (2001)* ; *Waggoner v. Ace Hardware Corp., 953 P.2d 88 (Wash. 1998)* . Note that Title VII

of the federal Civil Rights Act, which is the federal anti-discrimination employment law, does not prohibit marital status discrimination. *42 U.S.C. § 2000e-2(a)(1)*. Several states have enacted fair employment and fair housing laws prohibiting marital status discrimination. These states are split as to whether such provisions also protect unmarried couples. *See* John C. Beattie, *Prohibiting Marital Status Discrimination: A Proposal for the Protection of Unmarried Couples*, *42 Hastings L.J. 1415 (1991)*.

(n26)Footnote 26. *12 U.S.C. § 2903*.

(n27)Footnote 27. Patricia A. McCoy, *Banking Law Manual §§ 8.03 [1][a]*, *8.04[3]* (2d ed. 2001); Keith N. Hylton & Vincent D. Rougeau, *Lending Discrimination: Economic Theory, Econometric Evidence, and the Community Reinvestment Act, 85 Geo. L.J. 237 (1996)*. In addition, the CRA regulations state that federal regulators will consider evidence of lending discrimination in assigning a CRA rating. *12 C.F.R. § 228.28*.

(n28)Footnote 28. *12 U.S.C. § 2906(b)(2)*.

(n29)Footnote 29. *See generally* Allen Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works, but Strengthened Federal Enforcement Is Needed*, *20 Fordham Urb. L.J. 293 (1993)*.

(n30)Footnote 30. *12 U.S.C. § 2903*.

(n31)Footnote 31. These agencies have a tendency to engage in "grade inflations." For example, in 1996, 98 percent of all banks and thrifts examined received either outstanding or satisfactory CRA ratings. *Activists: Examiners are Too Soft on Banks,* Banking Rep. (BNA), (Sept. 8, 1997), at 358.

(n32)Footnote 32. *See generally* Allen Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works, but Strengthened Federal Enforcement Is Needed*, *20 Fordham Urb. L.J. 293 (1993)*.

(n33)Footnote 33. UDAP statutes are treated in Ch. 4 *supra* , and in National Consumer Law Center, Unfair and Deceptive Acts and Practices (7th ed. 2008 and supp.)

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

1-5 Consumer Credit Law Manual § 5.02

§ 5.02 Scope of the Laws Protecting Consumers From Discrimination

[1] Scope of the ECOA

[a] General

To determine if the ECOA applies, one must consider three preliminary questions:

- Has there been an extension of "credit" covered by the ECOA? If so, is the transaction fully subject to the requirements of the ECOA, or has the FRB exempted the transaction from certain Regulation B requirements?

- Is the debtor an "applicant" who can invoke the statute's protection and recover under its remedy provisions?

- Is the party being sued a "creditor" under the ECOA definition, and, therefore, subject to the statute's requirements and liable for damages?

If the answer to all three of these initial issues is yes, the ECOA may apply.

[b] The ECOA Applies to "Credit" Transactions

The ECOA generally only applies to credit transactions. For ECOA purposes, credit is the right granted by a creditor to:

- Defer payment of a debt;

- Incur debt and defer its payment; or

- Purchase property or services and defer payment. n1

ECOA's definition is intentionally broader than that found under the federal Truth in Lending Act ("TILA") and covers transactions excluded from TILA. n2 The ECOA definition of credit is the same as

that found in the Uniform Consumer Credit *Code, section 1-301*.

Because credit under the ECOA involves any simple deferral of payment, even if there are no finance charges or installments, the ECOA applies to many transactions where the consumer pays after receiving the goods or services, such as doctor and hospital bills, bills from repair persons and other workers, and even a local store where a customer runs up a tab.

The ECOA's coverage (unlike the TILA) includes not only consumer, but also commercial credit, n3 such as credit for business, agricultural or investment purposes. Whenever the creditor grants a deferral of this obligation to pay, there is credit. This obligation can arise by contract, by oral agreement, or by conduct.

[c] Examples of ECOA Coverage

First, if a lease is really a disguised credit sale, it should certainly fall within the ECOA's definition of credit. n4 In cases of discrimination on the basis of race, national origin, religion, or sex in residential leases, the FHA will clearly apply.

Rent-to-own transactions (such as those involving televisions, stereos, and appliances) may be covered. If the transaction is viewed as a disguised credit sale, or if there is a deferral of payment, the ECOA applies. n5 Utility service involves credit for purposes of the ECOA, although the FRB has exempted most forms of utility service from a few particular ECOA provisions.

Denial of an automated teller ("ATM") card which merely accessed a savings account, without any accompanying overdraft privileges, has been found not to involve the right to defer payment of debt, and so not to involve "credit." n6 Accepting payment by check, rather than cash, may not involve credit. n7 "Pay as You Go" arrangements are not covered. Allegations of discriminatory valuations of property in a government lease/buyback program were also held not to involve a "credit transaction." n8

A transaction also might be subject to the ECOA when it is so designated by the creditor, even if it would not otherwise be within the statutory definition. A creditor may contract to subject itself to ECOA. n9

[d] ECOA Prohibits Discrimination Against "Applicants."

Only "applicants" are protected under most ECOA provisions. n10 The statute defines an "applicant" as "any person who applies to a creditor directly for an extension, renewal, or continuation of credit or applies to a creditor indirectly by use of an existing credit plan for an amount exceeding a previously established credit limit." n11 Regulation B defines an applicant as including "any person who requests or who has received an extension of credit" and "any person who is or may become contractually liable regarding an extension of credit." Thus, a cosigner is an applicant. n12

To be an applicant, one need not submit a full application to a creditor. n13 Applicants are not restricted to persons attempting to open a new account, but could be a person who requests credit, a person who submits an actual application, a person whose application is approved and who opens an account, a person whose application is approved but who decides not to accept the credit offered, a person who requests an increase of an existing credit limit, or a person who just has existing credit with a creditor. n14

In its Advanced Notice of Proposed Rulemaking, the FRB solicited comment on whether it should further clarify the distinction between an inquiry about credit and an application for credit. n15 The Board was motivated by the growth of new delivery channels for loan products information, such as the Internet, and growth in credit counseling and prequalification programs, resulting in consumers asking for information about credit products and their creditworthiness before ever submitting an application. n16 Many industry commentators reported that they were

unclear about when inquiries about credit rose to the level of an "application" requiring a formal denial if credit was rejected.

Based on the various responses to the FRB, including the industry comments noted above, the FRB proposed adding has proposed adding that the definition of "application" includes a request for preapproval under procedures in which a creditor will issue to a creditworthy person a written commitment, even if conditional, for credit up to a specified amount that is valid for a period of time. n17 The Official Commentary would be amended to reflect this change and to further explain when an inquiry or prequalification request becomes an application. n18 However, the Board declined to extend the ECOA to cover prescreened credit solicitations. n19

The Board, in 2003, decided to adopt the proposed language on pre- approvals. n20 However, the changes were not added to the regulation as proposed but only to the Official Staff Commentary. n21 The amendments to the Commentary distinguish between inquiries and pre-qualification requests, on the one hand, and certain pre-approval requests, on the other, for purposes of determining whether an application exists. The Commentary now clarifies that pre-qualification requests are subject to the same test applicable to inquiries. n22

In general, a request or inquiry will become an application for purposes of the ECOA if the creditor responds not only by providing information but also by evaluating information about the consumer. The Board changed the term "applicant" to "consumers" in the Commentary to emphasize that an application may exist for purposes of the ECOA even if the consumer has not actually submitted an application. n23 The Board explained that using the term "applicant" presumes that an application exists, while the point of the comment is that, in the case of an inquiry or pre-qualification request, an application may or may not exist depending upon the circumstances. n24

[e] Creditors and Related Parties Subject to the ECOA

The ECOA applies to any person who:

1) "regularly" extends, renews, or continues credit. n25 If a transaction represents more than an "isolated," "incidental" occurrence, n26 then the creditor regularly extends credit.

2) regularly arranges for credit or refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made. This includes certain real estate brokers, loan brokers, or car dealers, who may not provide credit, but whose discrimination may prevent applicants from receiving credit.

3) in the ordinary course of business, regularly participates in the decision whether to extend credit, such as a creditor's assignee (with knowledge of the violation), transferee, or subrogee. n27

Regulation B defines "creditor" as a person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of the credit. Previously, Regulation B defined creditors as those persons who regularly participate in the decision of whether or not to extend credit. The Board stated that the new language was intended to clarify that the definition includes entities that make the credit decisions as well as those that negotiate and set the terms of the credit. n28

[f] Exclusions From Definition of Creditor

There are two exclusions from the definition of creditor. A person whose only participation in a credit transaction involves honoring a credit card is not a creditor. In addition, where a transaction involves more than one creditor, and one creditor violated the ECOA, the other creditors in a transaction are not liable for the violation to the extent that they lacked "reasonable notice" of the violation *before* becoming involved in the transaction. n29 It has also been held that co-guarantors are not "creditors" vis-a-vis one another, and that one co-guarantor cannot assert an ECOA violation

against a second co-guarantor as a defense to a contribution action. n30

[g] The Government as Creditor

Transactions in which credit is extended *by* a government or a governmental subdivision, agency, or instrumentality are subject to the provisions of the ECOA and Regulation B, except that no action can be brought against governmental creditors for the recovery of punitive damages. n31 Some government agencies extend credit directly to consumer or business applicants, and the ECOA applies to those transactions. n32

In 1999, a consent decree was approved and entered against the U.S. Department of Agriculture in a class action case alleging systemic discrimination against African-American farmers. n33 The class included approximately 20,000 members. Among other charges, the class alleged that the Farm Service Agency, an agency within the USDA, routinely discouraged applications from some farmers, delayed processing their applications, or denied applications for credit and benefits on a discriminatory basis. n34

[h] Transactions Partially Exempted by the FRB

The FRB has created *partial* exemptions from ECOA coverage for five classes of credit: public utility credit, incidental consumer credit, business credit, securities credit and credit extended to the government. It is important to realize that these are *partial* exemptions dealing with specific, itemized ECOA requirements, and that these partially exempt forms of credit must still comply with *all* other ECOA requirements. In every case, the general rule prohibiting discrimination against applicants on a prohibited basis applies to these five special forms of credit. n35 The general rule prohibiting discrimination against applicants on a prohibited basis still applies to these five special forms of credit.

Previously, regulated public utilities granting credit for utility service may ask the marital status of applicants, but are not required to report credit information in both spouses' names or to retain records of credit applications; all other provisions of Regulation B apply. In 1999, the Board proposed to eliminate two of the three public utility exemptions, the exemption from collection of marital status information and from reporting credit information in the names of both spouses. n36 Only the record retention exemption would have remained under this proposal. In the final rules announced in 2003, the Board modified its proposal and decided to eliminate the exemption only for reporting of credit information in the names of both spouses. n37 In response to commentator concerns, the Board reiterated that the reporting requirement applies only to creditors that furnish information to reporting agencies. In these circumstances, utilities will now be required to furnish information that reflects the participation of both spouses. n38

The FRB provides a limited exemption for "incidental consumer credit," defined as: n39

- Primarily for personal, family, or household purposes;
- Not involving public utilities or securities credit;
- Not made pursuant to the terms of a credit card account;
- Not subject to any finance charge or interest; and
- Not payable by agreement in more than four installments. n40

The FRB proposed extending the definition of incidental credit to include incidental business credit as well, but in the final rules announced in 2003, the Board decided not to adopt this proposal. n41 Currently, business credit is subject to different procedures in a few areas, and the requirement that the reporting of credit information be in the name of both spouses applies only to consumer, and not

business, credit. In deciding whether something is business or consumer credit, the primary purpose of the application controls.

Business credit is subject to different procedures in a few areas, and the requirement that the reporting of credit information be in the name of both spouses applies only to consumer, and not business, credit. In deciding whether something is business or consumer credit, the primary purpose of the application controls.

A partial exemption from Regulation B is provided for extensions of credit subject to regulation through the Securities Exchange Act of 1934 or offered by a broker or dealer under that Act. The FRB has largely exempted from ECOA coverage transactions in which credit is extended *to* (not by) governments or governmental subdivisions, agencies, or instrumentalities.

[2] Scope of the Fair Housing Act

One section of the FHA prohibits discrimination in "residential real estate-related transactions," n42 and it is this section that has the most relevance to credit discrimination. The Federal FHA applies to any loan used to purchase, build, improve, repair, or maintain a dwelling. A dwelling includes a home, a mobile home, a condominium, a cooperative, a time share, a mobile home park, trailer courts, a multi-family building, a house boat, or any other structure used as a residence.

The FHA also applies to any loan secured by residential real estate. The loan proceeds do not have to be used in any way related to a dwelling, so long as the residential real estate is taken as collateral for the loan, such as home equity loans. The FHA applies to loan brokers, financial consultants, or anyone else providing financial assistance related to a loan covered by the FHA and to those who buy mortgages and other loan paper from the originating lender, as long as the loans themselves are covered by the FHA. n43 The FHA applies to the activities of real estate agents and appraisers.

The FHA prohibits discrimination in the sale, rental, or advertising of "dwellings" n44 with the following two exemptions. The Fair Housing Act (except for the discriminatory advertising section) does not apply to the sale or rental of a single family house by an owner as long as the owner has an interest only in three or fewer homes, and as long as the owner does not use an agent or broker or other person in the business of selling or renting dwellings. n45 With the noted exception of the discriminatory advertising section, the Act also does not apply to rentals of units in an owner-occupied four-family or smaller home. n46 The FHA also makes it illegal to coerce, intimidate, threaten or interfere in any way with any person exercising rights protected under the FHA. n47 HUD regulations set out the types of conduct considered to be unlawful under this section. n48 With respect to housing for seniors, the FHA has been held to cover (1) all types of "independent living" units, including condominiums, cooperatives, mobile home parks and various other age-restrictive residences; n49 (2) all types of "assisted living" units, including those in age-restricted communities; and (3) all types of residential units in age-restricted retirement communities, including cottages, townhouses, and apartments. n50 The issue is less clear with respect to nursing homes, although a number of courts have applied the FHA to these facilities. n51

[3] Summary of Key ECOA and FHA Provisions

An advocate will often have to choose whether to bring claims under the ECOA or FHA. Claims under both laws are not viable in some cases because of a provision in the ECOA that no person aggrieved by an ECOA violation and, in the same transaction, by a violation of the FHA's prohibitions concerning residential real estate-related discrimination can recover under both the ECOA and the FHA. n52

Key advantages and disadvantages of each law are discussed below.

- *Scope*. ECOA coverage extends to all types of credit transactions. The FHA applies only to housing. Advocates challenging discrimination in car financing, for example, do not have the option of proceeding under the FHA.

- *Protected Classes*. Race and color, religion, national origin, and sex or gender are prohibited bases of discrimination under both laws. The ECOA prohibits discrimination based on marital status, while the FHA prohibits discrimination based on familial status. The ECOA has three additional protected classes that are not covered by the FHA. These are age, public assistance status, and good faith exercise of legal rights under the consumer credit protection act. The FHA, but not the ECOA, includes disability or handicap as a prohibited basis for discrimination.

- *Standing*. FHA has broader standing provisions, including standing for testers and organizational plaintiffs. The ECOA limits causes of action to "applicants."

- *Extended Liability*. Provisions for extended liability vary somewhat. The FHA explicitly applies to loan purchasers. This means that lenders who participate in the original loan decision are covered, as are lenders who do not participate before the fact but whose decision as to which loans to purchase involves discrimination on a prohibited basis. The ECOA, in contrast, requires in some cases that loan purchasers have knowledge or reasonable notice of the discriminatory actions of the primary lenders. This possible limitation to extended liability in the ECOA is critical only if the loan purchaser is not considered to be a direct creditor in the transaction. Loan purchasers that create financing policies and set credit terms should be held directly liable as creditors for any ECOA violations committed by the primary lenders or others.

- *Relief*. Relief under both laws is similar with one major difference. Only the ECOA places a cap on punitive damages. Class actions are available under both statutes, but again, the ECOA places a cap on punitive damages in both class and individual cases. Punitive damages are not awarded for FHA administrative claims.

- FHA gives plaintiffs a choice of an administrative or judicial forum.

- Disparate impact should be available as a theory under either law.

- Both laws have two-year statutes of limitations for affirmative claims and both allow defensive actions (recoupment) in certain circumstances. Extending the statute of limitations through the "continuing violation theory" is more established in FHA case law, but this theory should arguably apply to the ECOA as well.

- The ECOA explicitly lists certain creditor defenses.

- Only the ECOA requires creditors to meet certain procedural requirements, such as providing notices of adverse actions and retaining certain records. Violations of these provisions can be raised even in cases where discrimination is not alleged.

[4] Scope of the Federal Civil Rights Acts

The Federal Civil Rights Acts apply to all types of contracts, all types of borrowers or related individuals, and any type of creditor or other type of merchant. n53 *42 U.S.C. section 1982* applies to a loan in any way used to purchase or rent property. The statute applies to discrimination engaged in by both state and private action. n54 Section 1982, like the ECOA, does not require that a credit application be denied and may apply if the application was approved but on discriminatory terms or was withdrawn due to discrimination. n55 However, § 1981 only protects persons who have (or sought) rights under a contractual relationship that has been impaired, including parties to the contract and, potentially, third-party beneficiaries of the contract. n56 Unless the person has or would have had some rights under that contract, § 1981 does not provide a remedy, even if the person is the target of discrimination and loses benefits as a result of the contract impairment. Section 1982 plaintiffs must identify injuries flowing from a racially motivated breach of their

own--and not of someone else's--contractual relationship. n57

Courts have found that proof of discrimination by disparate impact is not available in federal civil rights cases. Thus, proof of intentional discrimination, whether by direct or circumstantial evidence, is required in these cases. n58

[5] Scope of State Credit Discrimination Statutes

By and large the scope of state credit discrimination statutes follows the scope of the federal statute they are modeled after. Nevertheless, sometimes the scope of a state statute will be broader than the scope of the analogous federal statute and it may prove particularly valuable in those situations.

Because of significant state variations, readers are referred to their applicable state statute to determine the scope of the state credit discrimination statute. Particularly because states continue to make changes to bring their state statutes more in line with the current version of the federal Fair Housing Act and other federal statutes, it is important to examine the most recent version of the state statute. n59

[6] Scope of State UDAP Statutes

Occasionally, a state statute generally prohibiting unfair or deceptive acts or practices (a UDAP statute) may be used to challenge credit discrimination not prohibited by any other statute or a UDAP claim may be useful if a discrimination statute does not provide a sufficient remedy. Nevertheless, various scope issues may limit the applicability of a state UDAP statute to credit discrimination.

State UDAP statutes vary significantly, and this variation is most pronounced concerning scope issues. n60

Some UDAP statutes apply only to the sale of goods and services and there will be an issue as to whether credit (related or unrelated to a sale) involves the sale of goods and services. n61 In other states, the statute applies to trade or commerce, and credit should clearly fall within the statute's coverage. n62

Certain state UDAP statutes do not apply to banks or other creditors regulated by state agencies. n63 There may also be an issue as to whether a UDAP statute applies to debt collection practices (which may be the subject of a credit discrimination action), n64 or offers protections to loan guarantors n65 or businesses. n66

It is important to note that each of these issues applies only to certain UDAP statutes and not to most state UDAP laws. Nevertheless, it is always important before bringing any UDAP claim to review carefully the particular state statute's scope.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityDiscriminatory ActsBanking LawFederal ActsFair Housing & National Housing ActsCivil Rights LawContractual Relations & HousingFair Housing RightsCredit & Mortgage LawsPublic Health & Welfare LawHousing & Public BuildingsFair HousingReal Property LawFinancingRedlining

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1691a(d)*; Reg. B, *12 C.F.R. § 202.2(j)*.

(n2)Footnote 2. Official Staff Commentary § 202.1(a)-1.

(n3)Footnote 3. Official Staff Commentary § 202.1(a)-1. *See* Official Staff Commentary § 202.2(j)-1. *See also Hargraves v. City Mortgage Corp., 147 F. Supp. 2d 1 (D.D.C. 2001)* (claims of individual plaintiffs who did not receive

or apply for credit as individuals, but rather were involved in obtaining the loan for their church, dismissed; the ECOA provides a cause of action for the church, but individuals cannot assert the church's legal interest; § 1981 claims also dismissed because the church, not the individual plaintiffs, was party to the loan contract); *Church of Zion Christian Ctr., Inc. v. Southtrust Bank, 1997 U.S. Dist. LEXIS 12425* (S.D. Ala. July 30, 1997) (individual plaintiffs held not to have standing to bring an ECOA action when loan application was made on behalf of a corporation and plaintiffs never entered into any oral or written agreement with defendants).

(n4)Footnote 4. *See Brothers v. First Leasing, 724 F.2d 789* (9th Cir.) , *cert. denied, 469 U.S. 832, 105 S. Ct. 121, 83 L. Ed. 2d 63 (1984)* (ECOA applies to personal property leases covered by the Consumer Leasing Act [hereinafter CLA]). *But see Liberty Leasing Co. v. Machamer, 6 F. Supp. 2d 714 (S.D. Ohio 1998)* (equipment lease under which contemporaneous payments were made in exchange for possession of leased equipment was not credit transaction within the scope of ECOA).

(n5)Footnote 5. *See generally Fogie v. Thorn Ams., Inc., 95 F.3d 645 (8th Cir. 1996)* ; *Miller v. Colortyme, Inc., 518 N.W.2d 544 (Minn. 1994)* .

(n6)Footnote 6. *Dunn v. American Express Co., 529 F. Supp. 633 (D. Colo. 1982)* .

(n7)Footnote 7. *Roberts v. Walmart Stores, Inc., 736 F. Supp. 1527 (E.D. Mo. 1990)* .

(n8)Footnote 8. *Robinson v. Veneman, 124 Fed. Appx. 893 (5th Cir. 2005)* .

(n9)Footnote 9. *Mack Fin. Corp. v. Crossley, 209 Conn. 163, 550 A.2d 303 (1988)* ; *First N.W. Nat'l Bank v. Crouch, 287 N.W.2d 151 (Iowa 1980)* ; *Farmers State Bank v. Haflich, 699 P.2d 553, 557 (Kan. 1985)* ; *U.C.C. §§ 1-102(3), 1-105(2).*

(n10)Footnote 10. *15 U.S.C. § 1691(a), (d), (e)*; Reg. B, *12 C.F.R. §§ 202.4, 202.5* (also applies to prospective applicants), 202.6, 202.7, 202.9.

(n11)Footnote 11. *15 U.S.C. § 1691a(b).*

(n12)Footnote 12. Reg. B, *12 C.F.R. § 202.7(c). See also* Official Staff Commentary §§ 202.7(c)(1)-1; 202.7(c)(2)-1. *Cf. Miller v. American Express Co., 688 F.2d 1235 (9th Cir. 1982)* .

(n13)Footnote 13. *Cragin v. First Fed. Sav. & Loan Ass'n, 498 F. Supp. 379 (D. Nev. 1980)* .

(n14)Footnote 14. *15 U.S.C. § 1691a(b)*; Reg. B, *12 C.F.R. § 202.2(e).*

(n15)Footnote 15. *63 Fed. Reg. 12,326* (Mar. 12, 1998) .

(n16)Footnote 16. *64 Fed. Reg. 44,589* (Aug. 16, 1999) .

(n17)Footnote 17. *64 Fed. Reg. 44,594* (proposed Aug. 16, 1999) (proposing to amend *12 C.F.R. § 202.2(f)*).

(n18)Footnote 18. *64 Fed. Reg. 44,619* (proposed Aug. 16, 1999) (proposing to amend Official Staff Commentary § 202.2(f)).

(n19)Footnote 19. *64 Fed. Reg. 44,584-44,585* (Aug. 16, 1999) .

(n20)Footnote 20. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) .

(n21)Footnote 21. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) , *amending* Official Staff Commentary *12 C.F.R. § 202.2(f)-5.*

(n22)Footnote 22. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) . Comment 2(f)-3.

(n23)Footnote 23. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) .

(n24)Footnote 24. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) .

(n25)Footnote 25. *15 U.S.C. § 1691a(e)*. The FRB has proposed amending the definition of creditor to make it clear that it also includes one who regularly participates in setting terms of credit, not just in the decision of whether to extend or deny credit.

The final rule adopted this proposal with a few modifications. *68 Fed. Reg. 13,144, 13,145* (Mar. 18, 2003) . The former definition of a creditor was a "person, who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit." The new definition defines a creditor as a person who "regularly participates in a credit decision, including setting the terms of the credit." The new definition was effective April 15, 2003, although the mandatory compliance date was April 15, 2004. *68 Fed. Reg. 13,144* (Mar. 18, 2003) . *See, e.g., Logsdon v. Dennison Corp., 2007 U.S. Dist. LEXIS 41501* (C.D. Ill. June 7, 2007) (granting summary judgment for dealer on ECOA claim; court found that "record is devoid of evidence" indicating that the dealer participated in the credit decision although borrower alleged that dealer regularly referred applicants to lenders and because it reviewed credit reports and decided which assignees should receive retail installment contracts"); *Barnette v. Brook Road Inc., 457 F. Supp. 2d 647 (E.D. Va. 2006) . See also Stegvilas v. Evergreen Motors, Inc., 2007 U.S. Dist. LEXIS 35303* (N.D. Ill. May 11, 2007) .

(n26)Footnote 26. *See, e.g., Eby v. Reb Realty, Inc., 495 F.2d 646 (9th Cir. 1974)* .

(n27)Footnote 27. Reg. B, *12 C.F.R. § 202.2(l)*. *See also* Official Staff Commentary § 202.2(*l*)-1. The FRB has proposed amending the Official Staff Commentary to Reg. B to expressly provide that arrangers can include automobile dealers, home builders, and home improvement contractors, and those who solely accept applications. *See 64 Fed. Reg. 44,620* (proposed Aug. 16, 1999).

The Board adopted these changes. *68 Fed. Reg. 13,144, 13,188* (Mar. 18, 2003) . In the final rules effective April 15, 2003 (mandatory compliance beginning April 15, 2004), the Board changed the description of credit arrangers in the Commentary, from those "who do not participate in credit decisions but who *regularly refer applicants* to creditors or who select or offer to select creditors to whom credit requests can be made" to those "who do not participate in credit decisions but who *only accept applications and refer applicants* to creditors, or select or offer to select creditors to whom credit requests can be made." The key changes are emphasized. *68 Fed. Reg. 13,144, 13,145* (Mar. 18, 2003) , *amending* Official Staff Commentary *12 C.F.R. § 202.2(l)-2*.

The Board illustrated the distinction between credit arrangers and "full" creditors subject to all ECOA provisions. The Board explained that an automobile dealer may accept and refer applications for credit or it may accept applications, perform underwriting, and make decisions regarding the extension of credit. When the dealer only accepts applications for credit and refers those applications to another creditor who makes the credit decisions, the dealer is subject only to the limited provisions of the ECOA listed above. *68 Fed. Reg. 13,155* . A dealer that participates in setting the terms of credit and makes credit decisions is subject to all ECOA provisions.

The Board also expanded the illustrative list of actors that might be considered credit arrangers under this section. Previously, the Commentary mentioned only real estate brokers in this category. Official Staff Commentary *12 C.F.R. § 202.2*(*l*)-2. The Commentary now lists real estate brokers, automobile dealers, home builders, and home improvement contractors. *68 Fed. Reg. 13,144, 13,188* (Mar. 18, 2003) , *amending* Official Staff Commentary *12 C.F.R. § 202.2*(*l*)-2

In a case brought not under the ECOA but under § 1981 of the Civil Rights Act, the Truth In Lending Act, and various other federal and state statutes, a car dealer misrepresented that it would find customers the best available credit. The

dealer then referred customers to a lender who, unbeknownst to the customers, paid some of the interest it collected back to the dealer. *Fairman v. Schaumberg Toyota, 1996 U.S. Dist. LEXIS 9669* (N.D. Ill. July 10, 1996) . The defendants unsuccessfully argued that the ECOA should shield them from liability because the statute did not require them to disclose the pay-back scheme. *Id.*; *see also Johnson v. Equicredit Corp. of Am., 2002 U.S. Dist. LEXIS 4817* (N.D. Ill. Mar. 21, 2002) (plaintiff presented sufficient evidence to state a claim against a mortgage origination company; company could be considered an arranger of credit). *See also Jones v. Ford Motor Credit Co., 2002 U.S. Dist. LEXIS 1098* (Jan. 18, 2002) (in denying defendant's motion to dismiss, court held that defendant was a creditor under the ECOA because defendant participated in the credit decision-making process by arriving at an objective credit score for customers and then authorizing the dealers to subjectively mark it up), *claim dismissed, 2002 U.S. Dist. LEXIS 190902* (June 14, 2002) , *later proceeding, 2002 U.S. Dist. LEXIS 10903* (S.D.N.Y. June 18, 2002) . *See also Cochran v. Northeast Mortg., LLC, 2007 U.S. Dist. LEXIS 61125* (D. Conn. Aug. 21, 2007) (holding that mortgage broker that did not submit plaintiff's loan application to any lenders participated in a credit decision and was a creditor under the ECOA).

(n28)Footnote 28. *See 64 Fed. Reg. 44,582, 44,594* (Aug. 16, 1999) ; *68 Fed. Reg. 13,144, 13,145* (Mar. 18, 2003) . *See Kivel v. Wealthspring Mortgage Corp., 398 F. Supp. 2d 1049 (D. Minn. 2005)* (mortgage broker who participated in setting the terms of the credit arrangements and determined the loan type, loan terms, and interest rate and actively solicited consumers to refinance their property was held to be a "regular" creditor under the ECOA.)

(n29)Footnote 29. Reg. B, *12 C.F.R. § 202.2(l)*. Note that the FRB recently considered, but rejected, changes to this rule. *See 64 Fed. Reg. 44,590* (proposed Aug. 16, 1999).

(n30)Footnote 30. *Spottiswoode v. Levine, 1999 Me. 79, 730 A.2d 166 (1999)* .

(n31)Footnote 31. *15 U.S.C. § 1691e(b)*.

(n32)Footnote 32. *See, e.g., Robinson v. Schafer, 2008 U.S. Dist. LEXIS 36900* (M.D. Ga. May 6, 2008) (the ECOA applies to the federal government through the definition of creditor); *Chiang v. Schafer, 2008 U.S. Dist. LEXIS 64654* (D. V.I. Aug. 20, 2008) (United States Dep't of Agric. is a creditor under the ECOA).

(n33)Footnote 33. *Pigford v. Glickman, 185 F.R.D. 82 (D.D.C. 1999)* (consent decree), *aff'd, 206 F.3d 1212, 340 U.S. App. D.C. 420 (2000)* . It is estimated that the United States is likely to provide $2 billion in debt relief and monetary payments in consideration for the dismissal of the class complaint. This settlement was challenged by non-African-American farmers in *Green v. Veneman, 159 F. Supp. 2d 360 (S.D. Miss. 2001)* , *aff'd, in part, 46 Fed. Appx. 731 (5th Cir. 2002)* . The court in *Green* upheld the *Pigford* settlement on the basis that the non-African-American farmers were not similarly situated to the *Pigford* class members. The consent decree in *Pigford* allowed class members to choose between two claims procedures. Track A awarded $50,000 to farmers able to meet only minimal burdens of proof of discriminatory treatment or damages. Track B imposed no cap on damages but, after limited discovery, required farmers to prove claims by a preponderance of evidence in one-day mini-trials before an arbitrator. *See Pigford v. Veneman, 292 F.3d 918 (D.C. Cir. 2002)* . Similar cases alleging discrimination in the USDA farm lending program have also been filed on behalf of Latino farmers, *Garcia v. Veneman, No. 00-2445 (D.D.C. filed October 13, 2000), Garcia v. Veneman, 211 F.R.D. 15 (D.D.C. 2002)* ; female and other farmers, Love v. Veneman, No. 00-2502 (D.D.C. filed October 19, 2000); Native American farmers, *Keepseagle v. Veneman, No. 99-3119 (D.D.C. 2001), In re Veneman, 309 F.3d 789 (D.C. Cir. 2002)* (petition for review of District Court's decision to grant class certification for equitable relief only denied); and older farmers, *Jones v. Glickman, 42 Fed. Appx. 292 (10th Cir. Kan. 2002)* (an individual claim against the USDA based on alleged age discrimination was found to be untimely).

(n34)Footnote 34. *See generally* Stephen Carpenter, *Discrimination in Agricultural Lending, 33 Clearinghouse Rev. 166* (July/Aug. 1999) (includes information on who is eligible for class relief).

(n35)Footnote 35. Official Staff Commentary, 12 C.F.R. § 202.3-1. For a more complete discussion of these

exemptions, see National Consumer Law Center, Credit Discrimination, § 2.2.6 (5th ed. 2009).

(n36)Footnote 36. *64 Fed. Reg. 44,582, 44,595* (Aug. 16, 1999) .

(n37)Footnote 37. *68 Fed. Reg. 13,144, 13,145, 13,146* (Mar. 18, 2003) .

(n38)Footnote 38. *68 Fed. Reg. 13,144, 13,145, 13,146* (Mar. 18, 2003) .

(n39)Footnote 39. Reg. B, *12 C.F.R. § 202.3(c). See also* Reg. B, *12 C.F.R. § 202.2(b)*; Official Staff Commentary § 202.3(c).

See, e.g., Mays v. Buckeye Rural Elec. Coop., Inc., 277 F.3d 873 (6th Cir. 2002) (finding no public utilities credit when rural electric cooperative was not required to file rates with any government entity; however, transaction was considered incidental credit and therefore exempt from certain ECOA provisions).

(n40)Footnote 40. *See Williams v. AT&T Wireless Servs., Inc., 5 F. Supp. 2d 1142 (W.D. Wash. 1998)* (application for cellular telephone service is a credit transaction, but qualifies for the incidental credit exemption to the ECOA notice requirement because it does not involve a credit card account, a finance charge, or installment payments).

(n41)Footnote 41. *64 Fed. Reg. 44,595* (proposed Aug. 16, 1999). The Board decided not to adopt this proposal in the final rules announced in 2003. *68 Fed. Reg. 13,144, 13,146* (Mar. 18, 2003) . In explaining this decision, the Board cited concerns about possible discrimination against minority-owned businesses.

(n42)Footnote 42. *42 U.S.C. § 3605*; *24 C.F.R. § 100.115(a). See, e.g., Nationwide Mut. Ins. Co. v. Cisneros, 52 F.3d 1351, 1357 (1995)* (§ 3604 applies to property insurance), *reh'g, en banc, denied, 1995 U.S. App. LEXIS 21068* (6th Cir. Aug. 4, 1995) , *mot. granted, cert. denied, 516 U.S. 1140 (1996)* ; *United States v. Yonkers Bd. of Educ., 837 F.2d 1181 (2d Cir. 1987)* (applying § 3604 to exclusionary zoning), *cert. denied, 486 U.S. 1055 (1988)* ; *Hanson v. Veterans Admin., 800 F.2d 1381 (5th Cir. 1986)* (applying § 3604 to discriminatory appraisals); *Laufman v. Oakley Bldg. & Loan Co., 408 F. Supp. 489 (S.D. Ohio 1976)* (court agreed with plaintiffs that § 3604(a) not only prohibits conduct constituting a refusal to sell or rent, but also conduct that otherwise makes dwellings unavailable; applied in this case to mortgage redlining), *later proceeding, 72 F.R.D. 116 (S.D. Ohio 1976) . But see Matthews v. New Century Mortgage Corp., 185 F. Supp. 2d 874 (S.D. Ohio 2002)* (transactions involving financial assistance for improving, repairing, or maintaining a dwelling that the owner had previously acquired fall outside the scope of § 3604); *Eva v. Midwest Nat'l Mortgage Banc Inc., 143 F. Supp. 2d 862 (N.D. Ohio 2001)* (courts have generally stretched § 3604 to address insurance issues; although § 3604 applies beyond the literal sale or rental of housing, not applicable in case involving discrimination based on gender in refinancing loans; court granted creditors' motion to dismiss § 3604 claims, but denied motion to dismiss § 3605 claims); *Thomas v. First Fed. Sav. Bank of Ind., 653 F. Supp. 1330 (N.D. Ind. 1987)* (redlining practices which affect the availability of housing are actionable under § 3604, redlining practices which affect the availability of financing are more properly brought under § 3605).

(n43)Footnote 43. 24 C.F.R. § l00.125(a). A 2003 U.S. Supreme Court decision addressed the issue of vicarious liability under the FHA. *See Meyer v. Holley, 537 U.S. 280, 123 S. Ct. 824, 154 L. Ed. 2d 753 (2003)* . Implications of this decision for holding individuals and corporations liable in credit discrimination cases are discussed in National Consumer Law Center, Credit Discrimination, § 11.3 (4th ed. 2005 and Supp.).

(n44)Footnote 44. *42 U.S.C. § 3604*. This includes steering prospective buyers away from particular properties on a prohibited basis. *See, e.g., Gladstone Realtors v. Vill. of Bellwood, 441 U.S. 91, 99 S. Ct. 1601 (1979)* ; *Tillery v. The Darby-Rogers Co., 2006 U.S. Dist. LEXIS 839* (M.D. Fla. Jan. 5, 2006) . *See also Lakeside Resort Enters., L.P. v. Board of Supervisors of Palmyra Twp., 455 F.3d 154, 158 (3d Cir. 2006)* (describing factors that determine whether a facility is a dwelling for purposes of the Fair Housing Act). *But see JAT, Inc. v. National City Bank of Midwest, 460 F. Supp. 2d 812, 819 (E.D. Mich. 2006)* (dismissing Fair Housing Act claim when loan transaction did not involve a dwelling).

(n45)Footnote 45. *24 C.F.R. § 100.10(c)(1).*

(n46)Footnote 46. *24 C.F.R. § 100.10(c)(2).*

(n47)Footnote 47. *42 U.S.C. § 3617.*

(n48)Footnote 48. *24 C.F.R. § 100.400.*

(n49)Footnote 49. *See, e.g., Lapid-Laurel, L.L.C. v. Zoning Bd. Of Adjustment, 284 F.3d 442 (3d Cir. 2002)* (parties agreed that ninety-five-bed care facility for the elderly is a "dwelling" under the FHA); *Smith & Lee Assocs, Inc. v. Taylor, Mich., 102 F.3d 781 (6th Cir. 1996)* ; *Town & Country Adult Living, Inc. v. Mt. Kisco, 2003 U.S. Dist. LEXIS 8519* (S.D.N.Y. May 21, 2003) (assuming the FHA applies to assisted-living residence for disabled senior citizens); *U.S. v. Lorantffy Care Ctr., 999 F. Supp. 1037 (N.D. Ohio 1998)* .

(n50)Footnote 50. *See, e.g.*, Fair Hous. in *Huntington v. Huntington, 316 F.3d 357 (2d Cir. 2003)* ; *E. Paralyzed Veterans v. Lazarus-Burman Assocs., 133 F. Supp. 2d 203 (E.D.N.Y. 2001)* ; *U.S. v. Hillhaven Corp., 960 F. Supp. 259 (D. Utah 1997)* ; *U.S. v. Forest Dale, Inc., 818 F. Supp. 954 (N.D. Tex. 1993)* . *See generally* Robert G. Schwemm & Michael Allen, *For the Rest of Their Lives: Seniors and the Fair Housing Act, 90 Iowa L. Rev. 121 (Oct. 2004)* (noting that, even though it would seem to be clear that all assisted-living and retirement communities are covered by the FHA, there is a good deal of evidence that providers of such housing often behave as if they are exempt).

(n51)Footnote 51. *See, e.g., Lapid-Laurel L.L.C. v. Zoning Bd. Of Adjustment, 284 F.3d 442 (3d Cir. 2002)* (parties agreed that a nursing home for the elderly was a "dwelling"); *Hovsons, Inc. v. Brick, N.J., 89 F.3d 1096 (3d Cir. 1996)* ; *Caron v. Pawtucket, 307 F. Supp. 2d 364 (D.R.I. 2004)* ; *U.S. v. Puerto Rico, 764 F. Supp. 220 (D. P.R. 1991)* . *See generally* Robert G. Schwemm & Michael Allen, *For the Rest of Their Lives: Seniors and the Fair Housing Act, 90 Iowa L. Rev. 121 (Oct. 2004).*

(n52)Footnote 52. *15 U.S.C § 1691e(i). See* National Consumer Law Center, Credit Discrimination § 11.5.2 (5th ed. 2009). For further discussion of differences between the ECOA and the FHA, see National Consumer Law Center, Credit Discrimination § 2.7 (5th ed. 2009).

(n53)Footnote 53. *42 U.S.C. § 1981(c). See Graham v. Richardson, 403 U.S. 365, 91 S. Ct. 1848, 29 L. Ed. 2d 534 (1971)* .

(n54)Footnote 54. *Jones v. Alfred H. Mayer Co., 392 U.S. 409, 88 S. Ct. 2186, 20 L. Ed. 2d 1189, 47 Ohio Op. 2d 43 (1968)* .

(n55)Footnote 55. *See JAT, Inc. v. National City Bank of the Midwest, 460 F. Supp. 2d 812 (E.D. Mich. 2006)* .

(n56)Footnote 56. *See Domino's Pizza, Inc. v. McDonald, 126 S. Ct. 1246 (2006)* ; *id. at 1249 n.3* (declining to affirm or exclude the possibility that third-party intended beneficiaries of a contract have rights under § 1981).

(n57)Footnote 57. *See id.*

(n58)Footnote 58. *See, e.g., Gen. Bldg. Contractors Ass'n v. Penn., 458 U.S. 375 (1982)* ; *Duran v. Cmty. First Bankshares, Inc., 92 Fed. Appx. 756,* (10th Cir. 2004) ; *Guides, Ltd. V. Yarmouth Group Prop. Mgmt., Inc., 295 F.3d 1065 (10th Cir. 2002)* ; *Jiang v. Allstate Ins. Co., 199 F.R.D. 267 (N.D. Ill. 2001)* (a case for disparate impact discrimination under § 1981 and § 1982 will not lie).

(n59)Footnote 59. *See also* National Consumer Law Center, Credit Discrimination, App. F (5th ed. 2009) for summary of state credit discrimination statutes.

(n60)Footnote 60. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices (7th ed. 2008 and

supp.). A general analysis of UDAP scope issues is found in Ch. 4 *supra* . This section briefly lists only some of the possible scope problems found in *some* state UDAP statutes.

(n61)Footnote 61. *See* Ch. *4.04 supra* ; National Consumer Law Center, Unfair and Deceptive Acts and Practices § 2.2.1.2 (7th ed. 2008 and supp.).

(n62)Footnote 62. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 2.2.1.4 (7th ed. 2008 and supp.).

(n63)Footnote 63. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 2.2.1.3 (7th ed. 2008 and supp.).

(n64)Footnote 64. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 2.2.2 (7th ed. 2008 and supp.).

(n65)Footnote 65. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 2.4.3 (7th ed. 2008 and supp.).

(n66)Footnote 66. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 2.4.5 (7th ed. 2008 and supp.).

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

1-5 Consumer Credit Law Manual § 5.03

§ 5.03 Prohibited Bases for Discrimination

[1] When Is Discrimination on a Prohibited Basis?

Discrimination is prohibited if there is a linkage between the discrimination and the prohibited basis, so that the creditor's decision-making process results in individuals being treated differently because of a prohibited basis. This is called "disparate treatment."

Of course, in practice, it is often difficult to prove that a decision was made on a prohibited basis and not based on some other permissible factor. The creditor will almost always present a legitimate business justification for its actions. The disparate treatment case will then center on whether the stated reason for the creditor's adverse action was the real basis, or was it a mere pretext for discrimination on a prohibited basis.

The issue in a disparate treatment case is not whether the stated reason for the creditor's conduct is a compelling one or even one that makes any sense at all. The issue is whether it is the real reason. If it is the real reason, there is no disparate treatment. If the creditor's actions in practice were not based on the stated reason, but on a prohibited basis, there is disparate treatment, no matter how essential the stated reason is to the creditor's business.

The plaintiff need not prove the creditor used a prohibited basis knowingly, only that the prohibited basis in fact was a factor in the creditor's conduct--that the stated business justification was not the real or sole reason.

Sometimes the plaintiff will have direct evidence that the real reason is on a prohibited basis. Other times, the plaintiff will have to present circumstantial evidence. The plaintiff could show, for example, that the creditor did not apply the same standards to other similarly situated applicants--that the supposed business justification was applied differently to other applicants.

If a creditor does not engage in disparate treatment, the creditor's conduct can still be challenged under the ECOA and FHA for its disparate impact. If the stated business justification for a practice is, in fact, the real basis for the creditor's conduct, this may still be illegal if the business justification has a disparate impact on protected groups.

[2] The Effects Test

The effects test is a judicial doctrine that was developed in a series of employment cases decided by the Supreme Court under Title VII of the Civil Rights Act of 1964. n1 The test is not available to litigants using federal civil rights claims under *42 U.S.C sections 1981* or *1982* (which require a showing of intentional discrimination), but it is for actions under the Federal FHA.

Moreover, the FRB has explicitly held that Congress intended to apply the "effects test" used in Title VII employment discrimination cases to the ECOA. n2 Most federal courts have reached a similar conclusion. n3 The Seventh Circuit, without referring to the FRB's authoritative position, has rejected the effects test in favor of traditional methods of proof. n4 Courts should use the "effects test" in any action under a state statute patterned after the FHA or the ECOA.

The effects test prohibits even unintentional discrimination if the practice has the effect of discriminating on a prohibited basis. In disparate impact cases, the business justification is taken as a given, and the issue is whether this is a sufficient reason for an adverse action where the application of the business justification has the side-effect of treating protected classes adversely.

The first element of the effects test is that the business justification have a disproportionately negative disparate impact on a protected class. If this can be shown, then the case will be decided by the legitimate business necessity for the practice and whether alternatives with less disparate impact are available to achieve the legitimate business purpose.

[3] The Prohibited Bases

[a] Race and Color

Race and color are prohibited bases under the ECOA, the FHA, the Federal Civil Rights Acts, and most state credit discrimination legislation. n5 Native Americans (Indians) are a protected race. n6 Discrimination against whites violates the ECOA as well. n7 Racial discrimination may be against Caucasian groups, such as Arabs, Jews, and Hispanics. n8 Members of other ethnic groups, such as Italian-Americans, have also successfully asserted claims. n9

[b] Religion, Creed, Political Affiliation

Religion is a prohibited basis for discrimination under the ECOA, the Federal FHA, and most state credit discrimination statutes. The only exception under the ECOA is that creditors may favor applicants of a particular religion only when offering a special purpose credit program meeting the standards set out in Regulation B. n10 While the Federal Civil Right Acts do not prohibit discrimination on the basis of religion, they have been interpreted by the U.S. Supreme Court as prohibiting discrimination on the basis of such ethnic groups as Arabs and Jews. n11

Creed might be a broader standard than religion because a creed could be a set of fundamental beliefs, not necessarily religious beliefs. While federal discrimination laws do not list creed as a prohibited basis, a number of state credit discrimination statutes do, n12 and at least one state (Iowa) lists political affiliation as a prohibited basis.

[c] National Origin

National origin is a prohibited basis under the ECOA, n13 the Federal FHA, n14 and most state credit discrimination statutes. While the Federal Civil Right Acts do not explicitly prohibit discrimination on the basis of national origin, they have been interpreted by the U.S. Supreme Court as prohibiting discrimination on the basis of such ethnic groups as Arabs and Jews. Nevertheless, only citizens are given rights to utilize *42 U.S.C. section 1982*. On the other hand, noncitizens are protected by *42 U.S.C. section 1981*, n15 so that noncitizens could bring actions under that statute for discrimination based on their ethnic origin.

The prohibition prevents discrimination because an individual comes from a particular country, n16 because an individual was born outside of the United States, or because an individual does not speak English. n17 In 1999, the

Justice Department ("DOJ") sued Associates National Bank ("ANB") for alleged discrimination against Hispanics in its credit card operations. n18 The DOJ alleged that ANB coded Spanish-language applications as "Hispanic" and maintained those accounts in a separate sub-file. The complaint alleged further that ANB lowered the credit score cutoff level and increased the credit lines for English-language applicants, but did not adopt those changes for Spanish-language applicants. As a result, some Spanish language applicants were denied credit and others were given low credit limits.

Granting credit on less preferable terms on the basis of language ability may also constitute discrimination or "reverse redlining" on the basis of national origin. n19 For example, the DOJ sued one bank for allegedly using stricter underwriting standards, resulting in less favorable credit terms to applicants who submitted credit card applications in Spanish. n20 Creditors who exploit the vulnerability of limited-English speakers, targeting them for abusive credit terms, may be liable for claims of discrimination as well as claims for unfair or deceptive trade practices. n21

[d] Immigration Status

For purposes of the ECOA, a denial of credit to a non-United States citizen is not *per se* discrimination. A creditor may consider the applicant's residency status in the United States, the applicant's immigration status, and other information necessary to determine the creditor's rights and remedies in case of default. n22

Section 1981 of the Federal Civil Rights Acts should apply to discrimination against aliens. The Supreme Court has ruled that section 1981 applies not only to discrimination based on race, but also to discrimination based on an individual not being a United States citizen. n23

Credit discrimination against immigrants occurs frequently and often overtly, especially in mortgage lending. n24 Non-citizens who are not lawful permanent residents generally may be subject to heightened requirements to obtain mortgage loans, such as higher down payments and additional documentation requirements. n25 They may be unable to obtain loans that conform to secondary market requirements and required to pay higher interest rates. n26

Addressing credit discrimination against immigrants under the ECOA and FHA is complicated. A more promising alternative may be an action under the Federal Civil Rights Act.

[e] Sex

An applicant's sex is a prohibited basis for credit discrimination under the ECOA, the Federal FHA, and many state credit discrimination statutes, but not the Federal Civil Rights Acts. n27

The FHA prohibits discrimination on the basis of familial status, and this includes discrimination against someone who is pregnant. Similarly, the ECOA provides certain specific protections for women against creditor inquiries or credit decisions based on an individual's child bearing or rearing intentions, including intentions as to maternity leave. The ECOA also prohibits creditors from considering whether a telephone is listed in the applicant's name.

Prohibited sex discrimination may also be based on differential treatment of income sources traditionally associated with women. Sex discrimination may also take the form of discrimination based on sexually-defined occupations.

Sex discrimination may also take the form of discrimination against applicants who do not conform to gender-specific stereotypes or behave in gender-specific ways. For example, a sex discrimination claim under the ECOA was allowed to proceed against a bank that refused to allow a man who dressed in "feminine" clothing to apply for credit. n28 Thus, the prohibition against sex discrimination may also cover discrimination based on sexual orientation or transgender identity if the animus is based upon the applicant's failing to appear or act "like a man/woman." n29 Rhode Island prohibits discrimination based upon an applicant's gender identity or expression. n30

[f] Familial Status

The FHA lists familial status as a prohibited basis for credit discrimination. n31 This basis is not found in the ECOA or Federal Civil Rights Acts or most state credit discrimination legislation, although a number of state statutes do list familial status (or being pregnant) as a prohibited basis. Some forms of familial status discrimination may be challenged under the ECOA as discrimination based on sex or marital status.

Generally, the FHA prohibition on discrimination based on familial status prohibits creditors from discriminating against those with or without children or who are pregnant or who become legal custodians of children. The FHA regulations define familial status as a parent, legal custodian, or designee of such person having one or more children under the age of 18 domiciled with them. n32

Familial status also includes being pregnant or in the process of gaining legal custody of a child under 18 years of age. n33 Thus, discrimination against a family that takes in foster children should be discrimination under the FHA. n34 This prohibition does not apply to certain housing for the elderly. n35

[g] Marital Status

Marital status is a prohibited basis under the ECOA n36 and many state credit discrimination statutes, n37 but not under the FHA (which includes "familial status" as a prohibited basis) or the Federal Civil Rights Acts. Creditors are required to treat married and unmarried applicants using the same standards unless otherwise permitted or required by law. n38 Generally, marital status as a prohibited basis includes any discrimination against an individual because that individual is single, divorced, separated, married, or widowed. The prohibition against marital status discrimination prevents creditors from favoring married couples over unmarried couples in evaluating applicants for joint credit. n39 However, a government-authorized special purpose credit program is permitted to favor married couples over unmarried couples. n40 In addition, a creditor is permitted to consider whether alimony or another protected source of income has been consistently paid. n41

Creditors are required to treat married and unmarried applicants using the same standards unless otherwise permitted or required by law. n42 Some of the exceptions permitted by law are discussed at the end of this chapter.

The prohibition against marital status discrimination prevents creditors from favoring married couples over unmarried couples in evaluating applicants for joint credit. n43 However, a government-authorized special purpose credit program is permitted to favor married couples over unmarried couples. n44

In recent years, the FTC has had two large settlements involving marital status discrimination and violations of the notice provisions of the ECOA. In United States v. Franklin Acceptance Corp., the DOJ simultaneously filed a complaint and consent decree pursuant to the FTC's negotiation of an $800,000 settlement, the largest civil penalty settlement obtained up to that time for alleged violations of the ECOA. n45

The FTC alleged that Franklin violated the ECOA by discriminating against applicants: 1) on the basis of sex and marital status by failing to consider child support payments as part of the applicant's income; 2) on the basis of marital status by failing to combine the income of unmarried co-applicants while combining the incomes of married co-applicants; 3) on the basis of marital status by requiring a married applicant to have his/her spouse and not any other person co-sign a loan when required; and 4) when the applicant's income was derived from public assistance, by failing to consider the public assistance as income. The complaint also alleged that Franklin did not provide the adverse action notice required by the ECOA and the Fair Credit Reporting Act ("FCRA"). In addition to paying $800,000 in civil penalties, Franklin was enjoined from violating provisions of the ECOA and FCRA in the future.

In the second case, the FTC settled with Ford Motor Credit Co., the auto financing subsidiary of Ford Motor Company,

for $650,000 in December 1999. n46 The FTC alleged that from May 1994 to August 1995, Ford violated the ECOA by combining incomes for married applicants but not for unmarried joint applicants, resulting in unmarried applicants obtaining credit on less favorable terms compared to their married counterparts.

[h] Sexual Orientation

None of the federal credit discrimination statutes mention sexual orientation as a prohibited basis. In some cases, discrimination based on sexual orientation may be challenged as discrimination based on marital or familial status. More importantly, several state credit discrimination statutes specifically list sexual orientation as a prohibited basis, n47 and there seems to be a trend toward state credit discrimination statutes being amended to list such a prohibited basis. On May 15, 2001, Maryland enacted a new law adding sexual orientation as prohibited basis in its fair housing and public accommodations laws (but not its credit discrimination statute). n48 The law takes effect October 1, 2001. There are also a number of municipalities that have included sexual orientation in their credit discrimination ordinances. The Lambda Legal Defense and Education Fund has a list of these municipalities on its website at www.lambdalegal.org.

Regulation B prohibits creditors from favoring married couples over unmarried couples in evaluating applicants for joint credit, which should protect same-sex joint applications. In states that permit same-sex marriage, there could be a potential argument that discrimination against same-sex couples is gender discrimination. If a creditor will grant a loan to a married couple consisting of a man and a woman but not a couple consisting of a man and a man, then the creditor is denying the loan because one of the applicants is not a woman.

[i] Age

The ECOA n49 and a number of state credit discrimination laws n50 list age as a prohibited basis; the FHA and Civil Rights Acts do not. While the ECOA lists age as a prohibited basis, in practice, the ECOA mainly prohibits discrimination against the elderly.

There are several important exceptions to the general rule against discrimination on the basis of age. First, the creditor may consider the applicant's age to determine if the applicant is too young under state law to enter into a binding contract. n51 Second, a creditor may consider the age of an applicant 62 years old or older in order to give favorable treatment or more favorable credit terms to that applicant. n52

[j] Handicapped Status

The ECOA does not list handicapped status as a prohibited basis for discrimination, although, in some cases, the protections for an applicant's age and public assistance status may prove helpful. The Federal Civil Rights Acts also do not list handicapped status as a prohibited basis. The FHA, on the other hand, and many state credit discrimination statutes n53 directly prohibit credit discrimination based on an applicant's handicapped status, some using the phrase "disability" rather than handicapped.

Handicap is defined in HUD's Fair Housing regulations as a physical or mental impairment which substantially limits one or more major life activities, having a record of such impairment, or being considered as having such an impairment. n54

It is not enough to have an impairment. The handicap also must substantially limit one or more major life activities, such as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, or working. n55

The Americans with Disabilities Act (ADA) provides another avenue to combat credit discrimination involving

applicants with disabilities or handicaps, especially for non-housing financing cases. n56 Title III of the ADA prohibits discrimination on the basis of disability by places of public accommodation, n57 which are defined to include banks, retailers, and other service establishments. n58

Furthermore, credit transactions should be covered under the scope of Title III of the ADA. Title III prohibits discrimination on the basis of disability in the full enjoyment of "goods, services, facilities, or privileges." n59 Most of the courts that have considered whether the ADA applies to credit transactions have held that it does. n60

The ADA prohibits the imposition or application of eligibility criteria that screen out or tend to screen out individuals with disabilities and prevent them from fully and equally enjoying any goods, services, facilities, or privileges, unless such criteria can be shown to be necessary for the provision of the goods, services, facilities, or privileges being offered. n61 Another provision requires places of public accommodation to provide auxiliary devices to ensure effective communication with the public. n62 The ADA also prohibits unnecessary inquiries about disabilities. n63

The remedies for private plaintiffs under the ADA are limited to injunctive relief and attorney fees. Congress did not provide for compensatory relief in private rights of actions for violations of Title III of the ADA. n64 However, private plaintiffs might be able to seek monetary relief under certain state UDAP statutes, that is, statutes prohibiting unfair or deceptive marketplace conduct. n65

In addition to directly prohibiting discrimination on the basis of disability, the FHA also provides that a refusal to make a reasonable accommodation for a disabled person is a form of discrimination. n66 Reasonable accommodation can involve either physical access modifications or accommodations in rules, policies, practices or services. n67 Thus, a lender could be required to make an exception to its rules or policies in order to reasonably accommodate a disabled applicant. n68

Several state Fair Housing Acts and the Americans with Disabilities Act ("ADA") consider persons with AIDS or with HIV to be disabled or handicapped. n69 Another possible avenue to deal with credit discrimination involving handicapped applicants involves the ADA. n70

[k] Public Assistance Status

The ECOA lists as a prohibited basis that "all or part of the applicant's income derives from any public assistance program." n71 This is not found in the Federal FHA or in Civil Rights Acts, and is only infrequently found as a basis in state credit legislation. n72 The DOJ recently sued a credit card lender for, among other things, discouraging applicants who received public assistance income and offering them less favorable terms than similarly qualified applicants who do not receive public assistance income. n73

[l] Good Faith Exercise of Consumer Credit Protection Act, Other Legal Rights

A prohibited basis under the ECOA is the applicant's good faith exercise of Consumer Credit Protection Act ("CCPA") rights. n74 One court has held that to make out a prima facie case of retaliation, a consumer must allege facts sufficient to show that he or she engaged in a statutorily protected activity and suffered an adverse credit action, and that there is a causal connection between the two (a retaliatory motive). n75 Another Court of Appeals characterized the prima facie test as requiring plaintiffs to show that they (1) exercised in good faith (2) a right under the Consumer Credit Protection Act and (3) as a result, the creditor discriminated against them with respect to the credit transaction. n76 This basis is not available under either the Fair Housing or Civil Rights Acts or under state credit discrimination legislation. A few state statutes list exercise of rights under state credit legislation as a prohibited basis, n77 and the FHA prohibits retaliating against any person because that person has made a complaint, testified, assisted, or participated in any manner in a proceeding under the FHA. n78 Exercise of rights could also potentially include an applicant's refusal to agree to an arbitration clause that would deprive the applicant of certain rights and remedies provisions by various

CCPA statutes, such as the right to file a case in District Court or to seek class relief under ECOA or TILA. n79

Several of the statutes that comprise the CCPA create good faith or bona fide error defenses for creditors. n80 Cases interpreting these provisions are not likely to provide useful guidance in interpreting the ECOA's standard of good faith exercise of CCPA rights, however. First, the context is very different. In addition, these statutory defenses include specific elements that the creditor must establish, such as the maintenance of reasonable procedures to prevent errors, that are irrelevant to the question whether a consumer asserted CCPA rights in good faith.

[m] Other Prohibited Bases

If discrimination does not involve one of these listed prohibited bases, the consumer has three other strategies to show the discrimination to be actionable. First, does the basis for credit discrimination have a disparate impact on a protected class? For example, if credit is based on the income level of the applicant's zip code, does this have a disparate impact on minorities, even though the income level of the zip code is not itself a prohibited basis?

Second, look to other, usually specialized state or federal legislation that may prohibit discrimination on the basis utilized. n81 Finally, even if no state or federal statute prohibits a form of credit discrimination, the discrimination may still be actionable under a state UDAP statute, particularly a statute that prohibits unfair or unconscionable, and not just deceptive, practices.

[n] Discrimination and the Digital Divide

A growing practice that is sure to have a disparate impact on protected classes is the offering of preferential or exclusive credit terms to consumers who apply on-line. n82 A recent report by the Department of Commerce indicates that the so-called "digital divide," i.e., the gap between individuals who have Internet access and those without access, is even greater for most racial and ethnic minorities, the elderly, the disabled, and low income individuals. n83 Therefore, a creditor who offers "Internet-only" deals is disproportionately excluding racial and ethnic minorities, the elderly, the disabled, and probably public assistance recipients. n84

Such practices could be challenged under Regulation B's prohibition against advertising that discourages prospective applicants on a prohibited basis. n85 For housing finance, such practices could also be challenged under the FHA. n86 In particular, the FHA could be used to challenge housing finance programs on the Internet that exclude the disabled, given the FHA's requirement of reasonable accommodation. n87 For example, an "Internet-only" mortgage program might effectively exclude all visually impaired prospective applicants. n88

[4] ECOA Prohibited Bases Do Not Apply to Special Purpose Credit Programs

ECOA Regulation B sets out an exception to the general rule prohibiting discrimination on these prohibited bases for "special purpose credit programs," which may require that program participants share a common characteristic, such as race, national origin, or sex. n89 This exception does not apply to a FHA claim or a Federal Civil Rights Act claim.

A creditor does not violate the ECOA by denying credit solely because the applicant fails to qualify under the requirements of a "special purpose" credit program, provided that the program was not established for the purpose of evading the ECOA and that it fits into one of the following categories: n90

- A credit assistance program offered to benefit an economically disadvantaged class.

- A credit assistance program administered by a not-for-profit organization (as defined by I.R.S. *Code section 501(c)*) for its members or for an economically disadvantaged class; or

- A special purpose credit program offered by a for-profit organization to meet "special social needs." n91

A special purpose credit program is exempt only to the extent necessary to carry out the program. n92 For non-governmental special credit programs, a creditor may only require applicants to share those factors inextricably tied to the need being addressed. n93 For non-governmental special credit purpose programs, the most important limitation is that once the program is set up, it must not discriminate on a prohibited basis within that group. n94

[5] Protected Characteristics May Apply to Those Associated With Applicant

Prohibited credit discrimination under the ECOA may be based not only on the characteristics of the applicant, but also may extend to discrimination based on the characteristics of the applicant's partners, its officers, in the case of a corporate applicant, and the individuals with whom the applicant affiliates or with whom an applicant associates. n95 Thus, the ECOA prevents discrimination in the offering of credit based on race, religion, sex, or other characteristics of those with whom the applicant deals or those who will benefit if the applicant obtains the credit.

The same rule applies in FHA and Civil Rights Act cases. The plaintiff need not be a member of a protected class as long as consideration of a prohibited basis injured the plaintiff. In fact, the FHA scope is broader than the ECOA, and anyone in any way aggrieved by discriminatory credit practices can bring an action. n96 The plaintiff need not even be a credit applicant.

Under the ECOA, on the other hand, the extension for discrimination based on characteristics of those affiliated or related to the applicant is not unlimited. The ECOA does not provide a basis for a plaintiff associated with the applicant to challenge the discrimination suffered by the applicant, but not by the plaintiff. The ECOA generally only provides remedies to those who *apply* for credit, not those affiliated with those who apply. For example, the ECOA would only provide a remedy for the landlord and not black tenants, where the landlord was denied a loan to fix up the apartment because of the tenants' race.

The general ECOA rule that a creditor may not discriminate against an applicant because of individuals the applicant is related to is at least true where the discrimination is based on the race, color, religion, national origin, sex, marital status, or age of those with whom the applicant deals. It is unclear whether this "associational" protection extends to the remaining two categories--receipt of public assistance and good faith exercise of rights under the Consumer Credit Protection Act.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityGeneral OverviewCivil Rights LawContractual Relations & HousingEqual Rights Under the Law (sec. 1981)Protected PartiesCivil Rights LawContractual Relations & HousingFair Housing RightsCredit & Mortgage LawsReal Property LawFinancingRedlining

FOOTNOTES:
(n1)Footnote 1. *42 U.S.C. §§ 2000e et seq.*

(n2)Footnote 2. Reg. B, *12 C.F.R. § 202.6(a)* n.2. Specific cases which served as models for the effects test were *Griggs v. Duke Power Co., 401 U.S. 424, 91 S. Ct. 849, 28 L. Ed. 2d 158 (1971)* , and *Albemarle Paper Co. v. Moody, 422 U.S. 405, 95 S. Ct. 2362, 45 L. Ed. 2d 280 (1975)* .

(n3)Footnote 3. *See Mercado-Garcia v. Ponce Fed. Bank, 979 F.2d 890 (1st Cir. 1992)* ; *Bhandari v. First Nat'l Bank of Commerce, 808 F.2d 1082 (5th Cir. 1987)* , *rev'd in part on other grounds*, *829 F.2d 1343 (5th Cir. 1987)* (*en banc*), *vacated and remanded*, *492 U.S. 901, 109 S. Ct. 3207, 106 L. Ed. 2d 558* , *reinstated*, *887 F.2d 609 (5th Cir.*

1989) , *cert. denied*, *494 U.S. 1061, 110 S. Ct. 1539, 108 L. Ed. 2d 778 (1990)* ; *Buycks-Roberson v. Citibank Fed. Sav. Bank, 162 F.R.D. 322 (N.D. Ill. 1995)* ; *Moore v. United States Dep't of Agric., 857 F. Supp. 507 (W.D. La. 1994)* ; *Gross v. United States Small Bus. Admin., 669 F. Supp. 50 (N.D.N.Y. 1987)* , *aff'd per curiam*, *867 F.2d 1423 (2d Cir. 1988)* ; *Williams v. First Fed. Sav. & Loan Ass'n, 554 F. Supp. 447 (N.D.N.Y. 1981)* , *aff'd per curiam*, *697 F.2d 302 (2d Cir. 1982)* ; *Cherry v. Amoco Oil Co., 490 F. Supp. 1026 (N.D. Ga. 1980)* .

(n4)Footnote 4. *Latimore v. Citibank F.S.B., 151 F.3d 712 (7th Cir. 1998)* .

(n5)Footnote 5. Reg. B, *12 C.F.R. § 202.2(z)*; *24 C.F.R. § 100.110(b)*; *42 U.S.C. §§ 1981*, *1982*. In its 2003 revisions, the FRB decided not to lift the ban on inquiring about an applicant's race, color, religion, national origin, or sex, as it had proposed. Instead, the Board created a new exception for collection of this information for the purpose of conducting a self-test under § 202.15. *68 Fed. Reg. 13,144, 13,149* (Mar. 18, 2003) . The Board did adopt new § 202.6(b)(9) emphasizing that, except as otherwise permitted or required by law, a creditor may not consider race, color, religion, national origin, or sex (or an applicant's decision not to provide such information) in any aspect of a credit transaction. *68 Fed. Reg. 13,150* .

(n6)Footnote 6. *Stuart v. First Sec. Bank, 15 P.3d 1198 (Mont. 2000)* ; *Davis v. Strata Corp., 242 F. Supp. 2d 643 (D.N.D. 2003)* .

(n7)Footnote 7. *Moore v. United States Dep't of Agric., ex rel. Farmer's Home Admin., 993 F.2d 1222 (5th Cir. 1993)* .

(n8)Footnote 8. *Rodriguez v. Beechmont Bus Serv., 173 F. Supp. 2d 139 (S.D.N.Y. 2001)* (Hispanic employee allowed to bring racial discrimination claim, but not national origin discrimination claim, under § 1981); *Cantu v. Nocona Hills Owners Ass'n, 2001 U.S. Dist. LEXIS 11010* (N.D. Tex. July 30, 2001) (Mexican-American plaintiff permitted to bring § 1981 claim as a racial minority), *summ. judg. granted, dismissed, 2002 U.S. Dist. LEXIS 580* (N.D. Tex. Jan. 10, 2002) . The FRB proposed adding § 202.6(b)(9) to emphasize that a creditor may not consider race, color, religion, national origin, or sex to determine an applicant's creditworthiness, except as permitted by law, nor may a creditor consider an applicant's decision not to provide the information. *64 Fed. Reg. 44,597* (proposed Aug. 16, 1999). The FRB also proposed adding § 202.5(a)(4), which would prohibit a creditor from requiring an applicant to supply information about race, color, religion, national origin, or sex unless otherwise permitted or allowed by law, and would require a creditor who seeks such information to disclose to the applicant that providing the information is voluntary, and that neither the information nor the decision not to provide the information will be taken into account in any aspect of the credit transaction. *Id.* The provision would conform to the FRB's proposal to lift the ban on inquiring about such characteristics. *See* Reg. B, *12 C.F.R. § 202.2(z)*; *24 C.F.R. § 100.110(b)*; *42 U.S.C. §§ 1981*, *1982*. In addition, the FRB proposed a new § 202.4(d) that would require this disclosure, and some others required by Reg. B, to be in writing, in a clear and conspicuous manner, and in a form the applicant can retain. *Id.* In its 2003 revisions, the FRB decided not to lift the ban on inquiring about an applicant's race, color, religion, national origin, or sex, as it had proposed. Instead, the Board created a new exception for collection of this information for the purpose of conducting a self-test under § 202.15. *68 Fed. Reg. 13,144, 13,149* (Mar. 18, 2003) . The Board did adopt new § 202.6(b)(9) emphasizing that, except as otherwise permitted or required by law, a creditor may not consider race, color, religion, national origin, or sex (or an applicant's decision not to provide such information) in any aspect of a credit transaction. *68 Fed. Reg. 13,150* (Mar. 18, 2003) .

(n9)Footnote 9. *See, e.g., Bisciglia v. Kenosha Unified Sch. Dist. No. 1, 45 F.3d 223 (7th Cir. 1995)* (Italian-Americans may state § 1981 claim as they may be considered members of a race protected against discrimination); *Donaire v. NME Hosp., 27 F.3d 507 (11th Cir. 1994)* (Filipino-Americans considered a protected class under § 1981). *But see King v. Township of E. Lampeter, 17 F. Supp. 2d 394 (E.D. Pa. 1998)* , *aff'd per curiam, 182 F.3d 903* (3d Cir.) , *cert. denied, 528 U.S. 951, 120 S. Ct. 373, 145 L. Ed. 2d 291 (1999)* (Amish are not a protected group under § 1981 as they are a religious, and not an ethnic, group).

(n10)Footnote 10. In its 2003 revisions, the Board decided not to lift the ban on inquiring about an applicant's race, color, religion, national origin, or sex. Instead, the Board created a new exception for collection of this information for the purpose of conducting a self-test under § 202.15. *68 Fed. Reg. 13,144, 13,149* (Mar. 18, 2003) . *See* note 5 *supra*. See also National Consumer Law Center, Credit Discrimination § 5.5.4 (3d ed. and Supp.), for a summary of the changes as adopted by the Board.

(n11)Footnote 11. *Shaare Tefila Congregation v. Cobb, 481 U.S. 615, 107 S. Ct. 2019, 95 L. Ed. 2d 594 (1987)* .

(n12)Footnote 12. *See, e.g., Colo. Rev. Stat. § 24-34-502* (housing financing); *Del. Code Ann. tit. 6, § 4604* (fair housing act); *Iowa Code Ann. § 216.8A* (housing financing); *La. Rev. Stat. § 51:2254* (real estate financing); *Md. Com. Law Code Ann. § 12-113*; *Md. Com. Law. Code Ann. § 12-305*; Md. Ann. Code Art. 49B, § 22 (housing financing). For a more complete list of these state statutes, see National Consumer Law Center, Credit Discrimination § 3.5.2 National Consumer Law Center, Credit Discrimination § 3.3.2 (3d ed).

(n13)Footnote 13. *15 U.S.C. § 1691(a)(1)*; Reg. B, *12 C.F.R. § 202.2(z)*.

(n14)Footnote 14. *24 C.F.R. § 100.110(b)*.

(n15)Footnote 15. *See Graham v. Richardson, 403 U.S. 365, 91 S. Ct. 1848, 29 L. Ed. 2d 534 (1971)* .

(n16)Footnote 16. Official Staff Commentary § 202.2(z)-2.

(n17)Footnote 17. *12 C.F.R. § 571.24(c)(2)*. Note that the Equal Employment Opportunity Commission's [hereinafter EEOC] guidelines also state that a blanket English-only workplace rule may constitute national origin discrimination. *29 C.F.R. § 1606.7*. However, the EEOC has received mixed reactions amongst the federal courts to this guideline. *Compare EEOC v. Premier Operator Servs., 113 F. Supp. 2d 1066 (N.D. Tex. 2000)* (upholding EEOC guideline) *with Garcia v. Spun Steak Co., 998 F.2d 1480 (9th Cir. 1993)* (rejecting EEOC guidelines and holding that an English-only rule does not create adverse impact prohibited by Title VII), *cert. denied, 512 U.S. 1228, 114 S. Ct. 2726, 129 L. Ed. 2d 849 (1994)* .

(n18)Footnote 18. United States v. Associates Nat'l Bank, Civ. No. 99-196 (D. Del. Mar. 29, 1999) *(available at* http://www.usdoj.gov [complaint]). Associates National Bank [hereinafter ANB] settled this lawsuit in January 2001 by agreeing to establish a $1.5 million fund to compensate Hispanic applicants and cardholders affected by the allegedly discriminatory practices. The settlement did not contain any injunctive relief. United States. v. Associates Nat'l Bank, No. 99-196 (D.Del. 2001) (settlement agreement), *available at* www.usdoj.gov (March 2001). The DOJ also sued a credit card lender for, among other things, having a policy of denying credit to applicants based on inability to read and understand English. U.S. v. Fidelity Fed. Bank, Civ. Action No. 02-CV-03906 (E.D.N.Y. complaint and consent decree filed July 8, 2002), *available at* www.usdoj.gov.

(n19)Footnote 19. See generally National Consumer Law Center, Credit Discrimination, Chapter 8 (5th ed. 2009) for a discussion of reverse redlining.

(n20)Footnote 20. U.S. v. Assocs. Nat'l Bank, Clearinghouse No. 53,524, Civ. No. 99-196 (D. Del. Jan. 8, 2001), *available at* www.usdoj.gov. This lawsuit was settled with Associates National Bank agreeing to establish a $1.5 million fund to compensate Hispanic applicants and cardholders affected by the allegedly discriminatory practices. *Id*.

(n21)Footnote 21. *See, e.g., Gallegos v. Rizza Chevrolet, 2003 U.S. Dist. LEXIS 18060* (N.D. Ill. Oct. 9, 2003) (Hispanic consumer alleged ECOA violation by auto dealer who took advantage of consumer's limited English abilities by intentionally deceiving him into signing a lease agreement instead of a retail installment contract; motion to dismiss denied); Complaint, Hua Bai v. Bob Wondries Assoc., Case No. BC286661 (Cal. Super. Ct. complaint filed Dec. 10, 2002) (monolingual Chinese speakers targeted for predatory auto loans; complaint alleges violation of California consumer protection and discrimination laws). *See generally,* National Consumer Law Center, Unfair and Deceptive

Acts and Practices § 5.2.1 (5th ed. 2001 and Supp.).

(n22)Footnote 22. Reg. B, *12 C.F.R. § 202.6(b)(7). See also Bhandari v. First Nat'l Bank of Commerce, 808 F.2d 1082 (5th Cir. 1987)* (denial of credit to all aliens not an ECOA violation), *rev'd in part on other grounds*, *829 F.2d 1343 (5th Cir. 1987)* (*en banc*), *vacated and remanded*, *492 U.S. 901, 109 S. Ct. 3207, 106 L. Ed. 2d 558* , *reinstated*, *887 F.2d 609 (5th Cir. 1989)* , *cert. denied*, *494 U.S. 1061, 110 S. Ct. 1539, 108 L. Ed. 2d 778 (1990)* ; *Hanna v. Security Pac. Bus. Credit, 281 Cal. Rptr. 857 (Ct. App. 1991)* (credit refusal based on lack of citizenship is not national origin discrimination).

(n23)Footnote 23. *Takahashi v. Fish & Game Comm'n, 334 U.S. 410, 68 S. Ct. 1138, 92 L. Ed. 1478 (1948)* .

(n24)Footnote 24. *See generally* Charu A. Chandrasekhar, *Can New Americans Achieve the American Dream? Promoting Homeownership in Immigrant Communities*, 39 Harvard C.R.-C.L. L. Rev. 169 (2004).

(n25)Footnote 25. *See, e.g.*, Jennifer S. Cowley, *More Paperwork, Higher Interest: Nonpermanent Residents Face Stricter Mortgage Requirements*, Tierra Grande, Oct. 2000, *available at* http://recenter.tamu.edu/pdf/1430.pdf (describing examples of mortgage requirements for non-permanent resident immigrants).

(n26)Footnote 26. *Id.*

(n27)Footnote 27. *15 U.S.C. § 1691(a)(1)*; Reg. B, *12 C.F.R. §§ 202.4*, *202.2(z)*.

The FRB has proposed adding § 202.6(b)(9) to emphasize that a creditor may not consider race, color, religion, national origin or sex to determine an applicant's creditworthiness, except as permitted by law, nor may a creditor consider an applicant's decision not to provide the information. *64 Fed. Reg. 44,597* (proposed Aug. 16, 1999). The FRB also proposed adding § 202.5(a)(4), which would prohibit a creditor from requiring an applicant to supply information about race, color, religion, national origin, or sex unless otherwise permitted or allowed by law, and would require a creditor who seeks such information to disclose to the applicant that providing the information is voluntary, and that neither the information nor the decision not to provide the information will be taken into account in any aspect of the credit transaction. *Id.* The provision would conform with the FRB's proposal to lift the ban on inquiring about such characteristics. In addition, the FRB has proposed a new § 202.4(d) that would require that disclosure, and some others required by Reg. B, to be in writing, in a clear and conspicuous manner, and in a form the applicant can retain. *Id.* In its 2003 revisions, the Board decided not to lift the ban on inquiring about an applicant's race, color, religion, national origin, or sex. Instead the Board created a new exception for collection of this information for the purpose of conducting a self-test under § 202.15. *68 Fed. Reg. 13,144, 13,149* (Mar. 18, 2003) . *See* note 5 *supra*. See also National Consumer Law Center, Credit Discrimination § 5.5.4 (3d ed. and Supp.), for a summary of the changes as adopted by the Board.

(n28)Footnote 28. *Rosa v. Park W. Bank & Trust, 214 F.3d 213, 216 (1st Cir. 2000)* (noting that stereotyped remarks about dressing in a more feminine or masculine manner can be evidence of gender bias).

(n29)Footnote 29. *See Centola v. Potter, 2002 U.S. Dist. LEXIS 1504* (D. Mass. Jan. 29, 2002) ; *Enriquez v. West Jersey Health Sys., 777 A.2d 365 (N.J. Super. Ct. App. Div. 2001)* , *certification denied, 170 N.J. 211 (2001)* .

(n30)Footnote 30. *R.I. Gen. Laws §§ 34-37-4(b)* (housing financing), § 34-37-4.3.

(n31)Footnote 31. *24 C.F.R. § 100.110(b)*.

(n32)Footnote 32. *24 C.F.R. § 100.20*; *see* Glover v. Crestwood Lake Section 1 Holding Corp., 746 F. Supp. 301 (S.D.N.Y. 1990) . Note that the FHA contains an exemption which states that occupancy limits per se do not violate the FHA. *42 U.S.C. § 3607(b)(1)*. However, this exemption is to be narrowly construed, and occupancy limits cannot be based upon the familial relationships (or lack thereof) of the occupants. *City of Edmonds v. Oxford House, 514 U.S.*

725, 115 S. Ct. 1776, 131 L. Ed. 2d 801 (1995) . For example, an occupancy limit which applies only to unrelated persons is not permitted under the FHA. *Id.* Occupancy limits based upon the number of children also are prohibited. *State Civ. Rights Comm'n v. County Line Park, Inc., 738 N.E.2d 1044 (Ind. 2000)* ; *see also Kelly v. Secretary, U.S. HUD, 3 F.3d 951, 952 (6th Cir. 1993)* .

(n33)Footnote 33. *24 C.F.R. § 100.20.*

(n34)Footnote 34. *See Gorski v. Troy, 929 F.2d 1183 (7th Cir. 1991)* . However, familial status does not include a group home consisting solely of children unless the caretakers of the children actually live with them in the home. *Keys Youth Servs. v. City of Olathe, 248 F.3d 1267 (10th Cir. 2001)* .

(n35)Footnote 35. *See 24 C.F.R. § 100.300. See, e.g., Massaro v. Mainlands Section 1 & 2 Civic Ass'n, 3 F.3d 1472 (11th Cir 1993)* , *cert. denied, 513 U.S. 808, 115 S. Ct. 56, 130 L. Ed. 2d 15 (1994)* .

(n36)Footnote 36. Reg. B, *12 C.F.R. § 202.2(z).*

(n37)Footnote 37. *See, e.g., Alaska Stat. § 18.80.240*; *Alaska Stat. § 18.80.250*; Ark. Stat. Ann. §§ 4-87-101 *et seq.*; *Cal. Civil Code § 1812.30*; Cal. §§ 35800 *et seq.*(Health & Safety Code); Colo. Rev. Stat. § 5-1-109 (Colorado Consumer Credit Code).

(n38)Footnote 38. 12 C.F.R. § 202.(b)(6)(8), added by *68 Fed. Reg. 13,144, 13,150* (Mar. 18, 2003) .

(n39)Footnote 39. Reg. B, 12 C.F.R. § 202.(b)(6)(8), added by *68 Fed. Reg. 13,144, 13,165* (Mar. 18, 2003) . *See also* Official Staff Commentary *12 C.F.R. § 202.7(a)-2*. Note that states which prohibit marital status discrimination are split as to whether these provisions prohibit discrimination against unmarried couples. *Levin v. Yeshiva Univ., 754 N.E.2d 1099 (N.Y. 2001)* ; *Hoy v. Mercado, 266 A.D.2d 803 (N.Y. App. Div. 1999)* . *See generally* Jason C Long, *Housing Discrimination and the Status of Unmarried Cohabitants--Living with* McCready v. Hoffus, *76 U. Det. Mercy L. Rev. 99 (1998)*. New Mexico's credit discrimination law has substituted "spousal affiliation" for "marital status" as a prohibited basis. *N.M. Stat. Ann. § 28-1-1.*

(n40)Footnote 40. *Diaz v. Virginia Hous. Dev. Auth., 101 F. Supp. 2d 415* , *subs. proc. at 117 F.Supp. 2d 500 (E.D. Va. 2000)* ; see National Consumer Law Center, Credit Discrimination § 3.9 (5th ed. 2009) (discussion of special purpose credit programs).

(n41)Footnote 41. Official Staff Commentary § 202.6(b)(5)-2; *Sallion v. Suntrust Bank, 87 F. Supp. 2d 1323 (N.D. Ga 2000)* .

(n42)Footnote 42. *12 C.F.R. § 202.6(b)(8)*, added by *68 Fed. Reg. 13,144, 13,150* (Mar. 18, 2003) .

(n43)Footnote 43. Regulation B, *12 C.F.R. § 202.6(b)(8)*, added by *68 Fed. Reg. 13,144, 13,165* (Mar. 18, 2003) . *See also* Official Staff Commentary *12 C.F.R. § 202.7(a)-2*. Note that states which prohibit marital status discrimination are split as to whether these provisions prohibit discrimination against unmarried couples. *Levin v. Yeshiva Univ., 754 N.E.2d 1099 (N.Y. 2001)* ; *Hoy v. Mercado, 266 A.D.2d 803 (N.Y. App. Div. 1999)* .

(n44)Footnote 44. *Diaz v. Virginia Hous. Dev. Auth., 101 F. Supp. 2d 415* , *subs. proc. at 117 F. Supp. 2d 500 (E.D. Va. 2000)* .

(n45)Footnote 45. United States v. Franklin Acceptance Corp., Civ. No. 99-CV-2435 (E.D. Pa. 1999) (consent decree). The decree is also available at http://www.ftc.gov.

(n46)Footnote 46. United States v. Ford Motor Credit Co., No. 99-75887 (E.D. Mich. Dec. 14, 1999) (consent decree) (*available at* http://www.ftc.gov).

(n47)Footnote 47. *See, e.g., Cal. Gov't Code § 12955*; *Conn. Gen. Stat. §§ 46a-66*; 46a-82; 46a-98; D.C. Code § 1-2515 (human rights); *Mass. Gen. Laws ch. 151B, §§ 4(3B)*, *4(14)(4)*; 1993 Minn. Laws ch. 22; *N.H. Rev. Stat. Ann. § 354-A:10*; *N.J. Stat. Ann. § 10:5-12(i)*; *N.M. Stat. Ann. § 28-1-7* (human rights) (also includes gender identity as a prohibited basis); *N.Y. Exec. Law § 296-a* (McKinney) (credit transactions); *N.Y. Exec. Law § 296(5)(a)-(c)* (McKinney) (housing transactions); *R.I. Gen. Laws §§ 34-37-4(b)*, *34-37-4.3*, *34-37-5.4*; Vt. Stat. Ann. tit. 8, §§ 1211, 1302; *Vt. Stat. Ann. tit. 9, §§ 2362*, *2410*, *4503(a)(6)*; Wis. Stat. Ann. § 101.22 (housing financing) (sexual orientation, as defined); *Wis. Stat. Ann. § 440.77* (certain housing financing) (sexual orientation, as defined); *Haw. Rev. Stat § 515-1 to 515-20* (housing); Me. Rev. Stat. Ann. tit. 5 §§ 4595-4598 (credit transactions); Me. Rev. Stat. Ann. tit. 5 §§ 4451-4632 and 4581-4583 (housing transactions).

(n48)Footnote 48. Antidiscrimination Act of 2001, 2001 Md. Laws 340.

(n49)Footnote 49. *15 U.S.C. § 1691(a)(1)*; Reg. B, *12 C.F.R. §§ 202.4*, *202.2(z)*.

(n50)Footnote 50. *See, e.g.,* D.C. Code Ann. § 1-2515; *775 Ill. Comp. Stat. §§ 5/1-102*, *5/4-102*; Ill. Comp. Stat. § 140/1a (bars age discrimination regarding credit cards); *Ohio Rev. Code Ann. §§ 4112.021 et seq.* (Baldwin's); *Okla. Stat. Ann. tit. 25, § 1452(A)(7)-(9)* (housing financing); *43 Pa. Cons. Stat. Ann. § 955(h)* (housing financing); *R.I. Gen. Laws §§ 34-37-4.1*, *34-37-4.2*; *Tex. Fin. Code Ann. § 341.401*; Vt. Stat. Ann. tit. 8, § 1211; *Vt. Stat. Ann. tit. 9, § 2410*; *Va. Code §§ 59.1-21.19 et seq.* ; *Wis. Stat. Ann. §§ 106.04*, *224.77(1)(o)* (certain housing financing).

(n51)Footnote 51. Reg. B, *12 C.F.R. § 202.6(b)(2)*.

(n52)Footnote 52. *15 U.S.C. § 1691(b)(4)*; Reg. B, *12 C.F.R. § 202.6(b)(2)(iv)*; 202.2(o).

(n53)Footnote 53. *See, e.g.,* Iowa Code Ann. § 601A.10 (civil rights act); *Ky. Rev. Stat. Ann. § 344.370* (state housing financing); *La. Rev. Stat § 46:2254(G)* and *(I)* (housing financing for handicapped); Me. Rev. Ann. tit. 5, § 4582 (housing financing); *Md. Com. Law Code Ann. § 12-113*; Md. Ann. Code Art. 49B, § 22 (housing financing); Mich. Stat. Ann. § 3.550(504) (housing financing); *N.M. Stat. § 28-1-7(H)*; *Wis. Stat. Ann. § 138.20*; *Wis. Stat. Ann. § 440.77* (certain housing financing).

(n54)Footnote 54. *24 C.F.R. § 100.201*.

(n55)Footnote 55. *See Toyota Motor Mfg. v. Williams, 534 U.S. 184, 198, 122 S. Ct. 681, 691, 151 L. Ed. 2d 615, 631 (2002)* (in this employment discrimination case a unanimous Supreme Court ruled that "to be substantially limited in performing manual tasks, an individual must have an impairment that prevents or severely restricts the individual from doing activities that are of central importance to most people's daily lives, and the impairment must be permanent or long-term").

(n56)Footnote 56. *42 U.S.C. § 12101, et seq.*

(n57)Footnote 57. *42 U.S.C. § 12182(a)* ("No individual shall be discriminated against on the basis of disability in the full and equal enjoyment of the goods, services, facilities, privileges, advantages, or accommodations of any place of public accommodation by any person who owns, leases (or leases to), or operates a place of public accommodation.").

(n58)Footnote 58. *42 U.S.C. § 12181(7)(F)*.

(n59)Footnote 59. *42 U.S.C. § 12182(a)*.

(n60)Footnote 60. *42 U.S.C. § 12182(a)*. Credit is considered a "service" under this provision. *Webster Bank v. Oakley, 830 A.2d 139 (Conn. 2003)* .

(n61)Footnote 61. *Gaona v. Town & Country Cr., 324 F.3d 1050 (8th Cir. 2003)* ; *Webster Bank v. Oakley, 830*

A.2d 139 (Conn. 2003) . The one case to date which has held that the ADA does not apply to credit transactions is *Kloth v. Citibank, 33 F. Supp. 2d 115 (D. Conn. 1998)* . In this case, which was brought by a pro se plaintiff, the court dismissed the public accommodations claim by rather oddly citing only the ADA section concerning discrimination in employment while ignoring Title III.

(n62)Footnote 62. *See* U.S. Dep't of Justice, ADA Title III Technical Assistance Manual, *available at* www.usdoj.gov/crt/ada/taman3.html.

(n63)Footnote 63. *Id.*

(n64)Footnote 64. *42 U.S.C. § 12188(a)*; *AR v. Kogan, 964 F. Supp. 269, 271 (N.D. Ill. 1997)* . In contrast, U.S. Attorneys can seek monetary relief for the victims of discrimination, as well as injunctive relief and civil penalties. *42 U.S.C. § 12188(b)(2).*

(n65)Footnote 65. *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 3.2.7 (7th ed. 2008 and supp.).

(n66)Footnote 66. *42 U.S.C. § 3604(f)(3).*

(n67)Footnote 67. *42 U.S.C. § 3604(f)(3)(A)* and *41 U.S.C. § 3604*(f)(3)(B).

(n68)Footnote 68. Note that the FHA's requirement of reasonable accommodation for disabled persons is a more stringent burden than the "reasonable accommodation" standards for religious practices under Title VII (but appears to be the same standard as set forth in the Americans with Disabilities Act). *Shapiro v. Cadman Towers, Inc., 51 F.3d 328, 334 (2nd Cir. 1995) . But see Scherer v. Mission Bank, 34 Fed. Appx. 656, 2002 U.S. App. LEXIS 8098* (10th Cir. May 1, 2002) (lender not required to make exception to its underwriting inquiry for disabled applicant as a reasonable accommodation).

(n69)Footnote 69. *See Fla. Stat. § 760.25*; *Haw. Rev. Stat. § 515-5*; *N.J. Stat. Ann. § 10:5-12(i). See also Bragdon v. Abbott, 524 U.S. 624, 118 S. Ct. 2196, 141 L. Ed. 2d 540 (1998) .*

(n70)Footnote 70. *42 U.S.C. § 12101.* For more information on the American with Disabilities Act [hereinafter ADA], the DOJ's website includes an ADA home page with a detailed description of the statute, answers to frequently asked questions, and a wealth of guidance and other information. Go to www.usdoj.gov/crt/ada/adahom1.html (July 2001).

(n71)Footnote 71. *15 U.S.C. § 1691(a)(2)*; Reg. B, *12 C.F.R. § 202.2(z). See also* United States v. Franklin Acceptance Corp., Civ. No. 99-CV-2435 (E.D. Pa. 1999) (consent decree) (FTC alleged that Franklin violated the ECOA by failing to consider applicants' income derived from public assistance as income). The decree is available at http://www.ftc.gov.

(n72)Footnote 72. *See, e.g., Conn. Gen Stat. § 46a-64c* (housing finance) (source of income); *815 Ill. Comp. Stat. Ann. § 120/3* (Fairness in Lending Act); *Mass. Gen. Laws ch. 151B, § 4(10)*; *N.J. Stat. Ann. § 10:5-4* (source of income); *Or. Rev. Stat. § 659A.421* (source of income); *Tex. Fin. Code § 341.401* (social security and SSI income only); *Wis. Stat. Ann. § 106.04* (housing finance) (source of income); *Wis. Stat. Ann. § 224.77* (certain housing finance) (source of income). Note that the FRB's proposed revisions to Official Staff Commentary § 202.2(z)-3 would reflect the change in name of the Aid to Families with Dependent Children program to Temporary Aid to Needy Families [hereinafter TANF].

(n73)Footnote 73. U.S. v. Fidelity Fed. Bank, Civ. Action No. 02-CV-03906 (E.D.N.Y. complaint and consent decree filed July 8, 2002), *available at* www.usdoj.gov.

(n74)Footnote 74. Exercise of rights under any of the following statutes triggers the protection of the ECOA for credit applicants: Truth in Lending Act; Fair Credit Billing Act; Consumer Leasing Act; Federal Garnishment Act; Fair Credit Reporting Act; Fair Debt Collection Practices Act; Electronic Funds Transfer Act; and Equal Credit Opportunity Act itself.

(n75)Footnote 75. *Lewis v. ACB Bus. Servs., Inc., 135 F.3d 389 (6th Cir. 1998)* , *reh'g, en banc, denied, 1998 U.S. App. LEXIS 7698* (6th Cir. Mar. 17, 1998) .

(n76)Footnote 76. *Bowen v. First Family Fin. Servs., Inc., 233 F.3d 1331 (11th Cir. 2000)* . *See also Kivel v. Wealthspring Mortgage Corp., 398 F. Supp. 2d 1049 (D. Minn. 2005)* (rejecting plaintiff's claim of discrimination based on exercising of right to receive ECOA adverse action notice because plaintiffs failed to establish that they were entitled to the notice).

(n77)Footnote 77. *See, e.g.,* Iowa Code § 537-3311; *Mo. Ann. Stat. § 408.550* (Vernon).

(n78)Footnote 78. *24 C.F.R. § 100.400(c)(5).*

(n79)Footnote 79. See generally National Consumer Law Center, Credit Discrimination, § 11.5.3 (5th ed. 2009), regarding ECOA and mandatory arbitration.

(n80)Footnote 80. *See, e.g.*, Truth in Lending Act, *15 U.S.C. § 1640(c)* (bona fide error), (f) (good faith compliance with rule, regulation, or interpretation); Fair Debt Collection Practices Act, *15 U.S.C. § 1692k(c)* (bona fide error defense). *See generally* National Consumer Law Center, Truth in Lending §§ 7.4.2, 7.4.4 (6th ed. 2007 and Supp.); National Consumer Law Center, Fair Debt Collection § 7.2 (6th ed. 2008).

(n81)Footnote 81. For example, a New York statute prohibits discrimination on the basis of military status. *N.Y. Exec. Law § 296-a* (McKinney) (credit transactions); *N.Y. Exec. Law § 296(5)(a)-(c)* (McKinney) (housing transactions).

(n82)Footnote 82. C. Lee, *Cyberbanking: A New Frontier for Discrimination?, 26 Rutgers Computer & Tech. L.J. 277 (2000).*

(n83)Footnote 83. U.S. Department of Commerce, Economic and Statistics Administration & National Telecommunications and Information Administration, *Falling Through the Net: Toward Digital Inclusion,* October, 2000, *available at* www.digitaldivide.gov (July 2001). *See also* U.S. Department of Commerce, Economic & Statistics Administration and National Telecommunications & Information Administration, *A Nation Online: How Americans are Expanding Their Use of the Internet,* Feb. 2002, *available at* www.ntia.doc.gov. The Department of Commerce's report states that only about 40% of African-Americans and 32% of Hispanics use the Internet (whether from home or another location, such as work or school), as compared to nearly 60% of whites. As for older Americans, about 37% of persons over the age of 50 use the Internet, in comparison to 53.9% of the overall U.S. population. Persons with a disability are about half as likely as the non-disabled to use the Internet. Although this study did not focus on public assistance recipients, it did report that only 25% of households with incomes of less than $15,000 use the Internet.

(n84)Footnote 84. A related issue in electronic transactions is whether a creditor has met the consumer consent requirements of the Electronic Signatures in Global and National Commerce Act. *15 U.S.C. §§ 7001 et seq.* See *§ 6.09[1][a][i][G]* and *§ 10.03[9][c] infra* , and National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 9.2.10 (3d ed. 2005 and Supp.), for a more detailed discussion of these requirements.

(n85)Footnote 85. Reg. B., *12 C.F.R. § 202.5.*

(n86)Footnote 86. In one Internet-related advertising case, a lender was sued for operating a web page that steered

potential homebuyers to areas in which the buyer's race predominated. The District Court initially permitted the plaintiffs to bring a claim under the *FHA. Isaac v. Norwest Mortgage, 153 F. Supp. 2d 900 (N.D. Tex. 2001)* . However, the court ultimately held that the plaintiffs lacked standing, because they failed to show that their communities had actually been injured by the lender's practices. *Isaac v. Norwest Mortgage, 2002 U.S.Dist. LEXIS 9354* (N.D. Tex. May 23, 2002) , *aff'd without opinion, 58 Fed. Appx. 595, 2003 U.S. App. LEXIS 2558* (5th Cir. Jan. 15, 2003) . Thus, the ability to establish standing may be an issue in "cyber-discrimination" cases. In addition to steering, Norwest's web site contained a number of offensive and stereotyped descriptions of minority and low-income neighborhoods. *Id.*

(n87)Footnote 87. *42 U.S.C. § 3604(f)(3).* Recall that ECOA does not include a prohibition against discrimination on the basis of disability.

(n88)Footnote 88. In the case of non-mortgage lending, such discrimination might violate the public accommodations section of the ADA, *42 U.S.C. § 12182 (a).*

(n89)Footnote 89. Reg. B, *12 C.F.R. § 202.8.*

(n90)Footnote 90. *15 U.S.C. § 1691(c)*; Reg. B, *12 C.F.R. § 202.8(b)(2).* See also Official Staff Commentary § 202.8, which gives numerous examples of allowable programs and credit-granting procedures.

(n91)Footnote 91. The FRB has proposed deleting the phrase "to meet special social needs" from the requirements of qualifying special purpose credit programs listed in § 202.8. *64 Fed. Reg. 44,598* (proposed Aug. 16, 1999).

The Board did not adopt this proposal out of concern that, by removing the phrase, a creditor might not understand that a program must meet special social needs and because the ECOA itself uses the phrase. *68 Fed. Reg. 13,144, 13,151* (Mar. 18, 2003) .

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

(n92)Footnote 92. The FRB has proposed revising Official Staff Commentary § 202.8(a)-5 to clarify how creditors can determine the need for a special purpose credit program by providing additional examples of analyses that can be used to determine such need. *64 Fed. Reg. 44,625* (proposed Aug. 16, 1999). The Board adopted this revision as proposed in the final rules issued in 2003. *68 Fed. Reg. 13,144, 13,156* (Mar. 18, 2003) .

(n93)Footnote 93. *United States v. American Future Sys., Inc., 743 F.2d 169 (3rd Cir. 1984)* . On the other hand, a governmental special credit purpose program, i.e. a program expressly established pursuant to federal or state law, has more flexibility to establish eligibility requirements. *Diaz v. Virginia Hous. Dev. Auth., 101 F. Supp. 2d 415 (E.D.Va. 2000)* .

(n94)Footnote 94. *See* Reg. B, *12 C.F.R. § 202.8(b)(2).*

(n95)Footnote 95. Official Staff Commentary § 202.2(z)-1.

(n96)Footnote 96. *See Simms v. First Gibraltar Bank, 83 F.3d 1546 (5th Cir. 1996)* .

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

1-5 Consumer Credit Law Manual § 5.04

§ 5.04 Types of Discrimination

[1] General Standards

The ECOA prohibits any discrimination in any aspect of a credit transaction on a prohibited basis. Likewise for the FHA, at every stage of a transaction involving the sale, rental, or financing related to a dwelling and the Civil Rights Acts as to intentional discrimination based on race, color, ethnic origin, and perhaps citizenship.

[a] Must Discrimination Be by a "Creditor"?

To be actionable under the ECOA, the discrimination must be by a "creditor." n1 Under the FHA, the discrimination must be by entities whose business includes engaging in residential real estate-related transactions, meaning the making of loans, offering other financial assistance, or the selling, brokering or appraising of residential real property. n2 Discrimination is not limited to a creditor under the Federal Civil Rights Acts.

[b] What Is Discrimination?

To "discriminate" is defined under the ECOA as treating an applicant less favorably than other applicants. n3 Consequently, the ECOA prohibits any treatment of an applicant on a prohibited basis less favorably than other applicants at any stage of the credit transaction, from application procedures to terms of the transaction to subsequent handling of defaults.

The Fair Housing Act also uses the term "to discriminate," but, unlike the ECOA, does not define the term. Most likely, it will be considered as having the same meaning as found under the ECOA. Similarly, the Federal Civil Rights Acts require that individuals be treated the "same" as white citizens, indicating a similar standard to that found under the ECOA.

[2] Discrimination in Different Stages of the Credit Transaction

The ECOA prohibits creditors from, on a prohibited basis, utilizing different approaches to encouraging credit applications. n4 Creditor actions which discourage applications include creditor practices at its place of business, such as sending minorities to different locations to apply, encouraging potential applicants to apply at other banks, and

indicating it would take a long time to have an application processed. The prohibition against acts to discourage applicants in no way prevents creditors from encouraging applications from disadvantaged groups. The Commentary specifically states: "A creditor may affirmatively solicit or encourage members of traditionally disadvantaged groups to apply for credit, especially groups that might not normally seek credit from that creditor." n5

For example, the Federal Reserve Board gave approval to a California statute that requires creditors to provide Spanish-speaking applicants with the opportunity to obtain an unexecuted Spanish language contract. n6 The Board reasoned that the statute made contract terms more understandable to applicants of one national origin without interfering with the interests of any other group and therefore did not frustrate the intent of the ECOA. n7 Furthermore, not only whether credit should be extended, but the amount of credit to be extended, is also subject to the general rule against discrimination. Although creditors may decide whether to allow authorized users on an account, they may not decide on a prohibited basis which individuals can be authorized users. n8 Unreasonably delaying the applications of members of protected groups may also be discriminatory. n9

A creditor may not discriminate on a prohibited basis as to what type of collateral or other protection it demands on a loan. Creditors may not discriminate under the ECOA on a prohibited basis concerning credit terms, n10 such as the rate of interest it charges, the length of loans it offers, n11 the timing of payments, the number of points, or other fees or charges it assesses. Similarly, the creditor should not be able to discriminate under the ECOA based on down payment amounts n12 or security deposits. A creditor also cannot discriminate as to how many payments it must receive before it will deliver the goods sold. n13 At least one court has agreed that the ECOA may be used to challenge predatory lending. n14 The court in Hargraves v. Capital City Mortgage noted that the plain language of the ECOA prohibits discrimination in any aspect of a credit transaction and is therefore not limited to the denial of credit. n15 The Court also found support for ECOA's application to reverse redlining on the basis of regulations that include investigations procedures, terms of credit, collections procedures, and other matters in the definition of credit. n16

The FHA prohibits discrimination concerning the type of loan, the amount of the loan, the interest rate, duration, or other terms of the loan. n17 The FHA should thus apply to any aspect of a loan's credit terms.

The Commentary explicitly states that it is *not* a violation of Regulation B for a creditor to discriminate as to the availability, rates, and other terms on which credit-related casualty insurance or credit life, health, accident, or disability insurance are provided an applicant. n18 The probable reason for this exception is the FRB's deference to state insurance laws dealing with discrimination.

The FHA and the regulations explicitly prohibit discrimination concerning the sale of property or hazard insurance. n19 The FHA applies not only when redlining involves higher insurance premiums, but also applies when decisions are made involving renewal of property insurance policies. n20 The Federal Civil Rights Acts should apply to discrimination in the sale of any form of insurance since insurance is a contract. n21

Differences in credit terms on a prohibited basis is illegal. A creditor should not discriminate on a prohibited basis concerning ease of payment, willingness to restructure or postpone payments, or provision of information about account balances. Under the FHA, such discrimination is likely to violate the prohibition on discrimination concerning the "terms and conditions" of a loan. n22

To the extent that a credit discrimination statute reaches discrimination concerning the sale price of property or a service, it should also reach discrimination concerning compliance with warranties and other post-sale performance.

The general rule against discrimination applies not only to the granting of credit initially, but to any changes in an account, such as raising credit limits, changing credit terms, renewing accounts, or terminating credit. n23 Changes in the "terms or conditions" of a residential real estate-related transaction also fall under the scope of the FHA. n24 Thus, that federal statute should apply as well to changes in credit limits or terms or termination of accounts.

Under the ECOA, creditors may not treat debtors differently post-default based on a prohibited basis. n25 The FHA also prohibits discrimination concerning treatment of defaults. The statute has been interpreted to bar discrimination in mortgage foreclosures, on the basis that this constitutes one of the "terms or conditions" of a loan. n26 Reporting a default or other credit information to a credit bureau is another part of the credit transaction, and creditors may not discriminate on a prohibited basis here as well.

[3] Application to Utilities

Utilities are an important area of ECOA coverage. Utility service is not available on a cash or pay as you go basis. Utility service by its very nature usually involves delayed billing for service already provided, and if a utility refuses to accept a credit risk, this is equivalent to the denial of service. Thus, every aspect of a utility transaction, from the initial security deposit and connection to collection procedures and disconnect practices, must comply with the general rule against discrimination on a prohibited basis. n27

Utilities may not ask for a larger security deposit on a prohibited basis. n28 Late charges, collection fees, collection practices for slow payers, and repayment arrangements may not differentiate on a prohibited basis.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityGeneral OverviewCivil Rights LawContractual Relations & HousingFair Housing RightsCredit & Mortgage LawsPublic Health & Welfare LawHousing & Public BuildingsFair HousingReal Property LawFinancingRedlining

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1691a(e)*; Reg. B, *12 C.F.R. § 202.2(l)*. The FRB has proposed revisions to Reg. B that would amend § 202.2(*l*) to clarify that creditors include those who regularly participate in setting terms of credit decisions, not just in the decision to extend or deny credit. *64 Fed. Reg. 44,594* (proposed Aug. 16, 1999).

The final rule adopted this proposal with a few modifications. *68 Fed. Reg. 13,144, 13,145* (Mar. 18, 2003) . The former definition of a creditor was a "person, who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit." The new definition defines a creditor as a person who "regularly participates in a credit decision, including setting the terms of the credit." The new definition was effective April 15, 2003, although the mandatory compliance date was April 15, 2004. *68 Fed. Reg. 13,144* (Mar. 18, 2003) .

(n2)Footnote 2. *42 U.S.C. § 3605*; *24 C.F.R. §§ 100.110*, *100.115*.

(n3)Footnote 3. Reg. B, *12 C.F.R. § 202.2(n)*.

(n4)Footnote 4. Reg B, *12 C.F.R. § 202.5(a)*. Reg. B, *12 C.F.R. § 202.5(a)* has been redesignated as § 202.4(b) without substantive change as part of the FRB's revision of Regulation B issued in March 2003. *68 Fed. Reg. 13,144, 13,146* (Mar. 18, 2003) .

The FRB has implicitly recognized that targeting minority applicants for subprime loans while marketing prime products to white applicants may be discrimination in violation of the ECOA. As part of its revision of Regulation B in March 2003, the Board added one aspect of this practice as an additional example of disparate treatment in the Official Staff Commentary. Official Staff Commentary, *12 C.F.R. § 202.4(A)-2(i)(A)*, stating that disparate treatment includes "provid[ing] information only on 'subprime' and similar products to minority applicants who request information about the creditor's credit mortgage products, but provid[ing] information on a wider variety of mortgage products to similarly situated nonminority applicants."

(n5)Footnote 5. Official Staff Commentary, *12 C.F.R. § 202.5(a)-2*.

(n6)Footnote 6. *Cal. Civ. Code § 1632*. The FRB has also recently issued an amendment to Regulation B that specifically permits creditors to provide ECOA notices in a language other than English as long as it is available in English upon request. Reg. B, *12 C.F.R. § 202.4(b)*. This provision was added as part of the Board's interim final rule issued March 30, 2001, concerning electronic disclosures. *66 Fed. Reg. 17,779-17,786* (Apr. 4, 2001) .

(n7)Footnote 7. FRB, Official Board Interpretation § 202.1102, *42 Fed. Reg. 22,861* (May 5, 1977). This interpretation was not included in the 1985 Official Commentary to Regulation B. However, the FRB chose not to include in the Official Commentary any interpretation which did not preempt state law and so, presumably, the California statute remains acceptable. Moreover, § 202.1102 is an official board interpretation, not a staff interpretation, and should therefore not be superseded by staff commentary.

(n8)Footnote 8. Official Staff Commentary § 202.7(a)-1.

(n9)Footnote 9. *Thompson v. Marine Midland Bank, 1999 U.S. App. LEXIS 22960* (2d Cir. Sept. 16, 1999) .

(n10)Footnote 10. Reg. B, *12 C.F.R. § 202.2(m)* defines credit terms as part of a credit transaction, and Reg. B, *12 C.F.R. § 202.4* prohibits discrimination concerning any aspect of a credit transaction.

(n11)Footnote 11. *See* United States v. General Motors Acceptance Corp., Clearinghouse No. 38,902 (D.N.M. 1984) (consent decree based on allegations that the creditor sometimes required Native American applicants to agree to shorter than customary contract terms).

(n12)Footnote 12. *See* United States v. General Motors Acceptance Corp., Clearinghouse No. 38,902 (D.N.M. 1984) (consent decree based on allegations that the creditor sometimes required Native American applicants to agree to larger than customary down payments).

(n13)Footnote 13. *United States v. American Future Sys., Inc., 743 F.2d 169 (3d Cir. 1984)* .

(n14)Footnote 14. *Hargraves v. Capital City Mortgage Corp., 140 F. Supp. 2d 7 (D.D.C. 2000)* (some individual ECOA and § 1981 claims dismissed for lack of standing).

(n15)Footnote 15. *140 F. Supp. 2d 7 (D.D.C. 2000)* , *citing 15 U.S.C. § 1691(a)*.

(n16)Footnote 16. *140 F. Supp. 2d 7 (D.D.C. 2000)* , *citing 12 C.F.R. § 202.2(m)*.

(n17)Footnote 17. *42 U.S.C. § 3605(a)*; *24 C.F.R. § 100.130(b)(2)*.

(n18)Footnote 18. Official Staff Commentary § 202.7(e)-1.

(n19)Footnote 19. *24 C.F.R. § 100.70(d)(4)*.

(n20)Footnote 20. *Lindsey v. Allstate Ins. Co., 34 F. Supp. 2d 636 (W.D. Tenn. 1999)* . For a discussion of redlining in the insurance industry, see National Consumer Law Center, Credit Discrimination § 7.3 (5th ed. 2009); for a discussion of redlining in the mortgage industry, see *Id.* § 7.2 (5th ed. 2009).

(n21)Footnote 21. *See 42 U.S.C. § 1981*.

(n22)Footnote 22. *24 C.F.R. §§ 100.110(b)*, *100.130(a)*.

(n23)Footnote 23. Reg. B, *12 C.F.R. § 202.2(m)* defines this as part of a credit transaction, and Reg. B, *12 C.F.R. § 202.4* prohibits discrimination concerning any aspect of a credit transaction.

(n24)Footnote 24. *24 C.F.R. § 100.110(b)*.

(n25)Footnote 25. Reg. B, *12 C.F.R. § 202.2(m)*; Official Staff Commentary § 202.4-1. The FRB has proposed redesignating Official Staff Commentary § 202.4-1 as 202.4(a)-1 and -2 to clarify the Commentary and to provide additional examples of disparate treatment. *64 Fed. Reg. 44,621* (proposed Aug. 16, 1999).

(n26)Footnote 26. *Harper v. Union Sav. Ass'n, 429 F. Supp. 1254 (N.D. Ohio 1977)* ; *Lindsey v. Modern Am. Mortgage Corp., 383 F. Supp. 293 (N.D. Tex. 1974)* ; *cf. Little Earth of United Tribes v. United States Dept. of Housing & Urban Dev., 675 F. Supp. 497 (D. Minn. 1987)* , *aff'd*, *878 F.2d 236 (8th Cir. 1989)* (foreclosure decisions by HUD fully justified and no violation of FHA).

(n27)Footnote 27. *See generally* National Consumer Law Center, Access to Utility Service (2d ed. and Supp.). *See McGee v. Eastern Ohio Gas Co., 111 F. Supp. 2d 979 (S.D. Ohio 2000)* (ECOA prohibits utility from refusing credit to one spouse on the basis of a delinquency owed by the other spouse to the same utility), *class certification granted*, *200 F.R.D. 382 (S.D. Ohio 2001)* ; *In re Brazil, 21 B.R. 333 (Bankr. N.D. Ohio 1982)* (a public utility company discriminated against a bankruptcy petitioner on the basis of marital status by refusing to accept her application for service while her husband was still residing in their home and there was an outstanding bill in his name). *But see Haynes v. Bank of Wedowee, 634 F.2d 266 (5th Cir. 1981)* (no discrimination on basis of marital status shown when bank accelerated wife's loan due to husband's bankruptcy filing and bank had relied on existence of a joint account in original credit extension); *Haynsworth v. South Carolina Elec. & Gas Co., 488 F. Supp. 565 (D.S.C. 1979)* (no unlawful discrimination when a utility company refused to open an account in a woman's name because of an outstanding bill at the same residence in the name of her separated husband); *Vander Missen v. Kellogg-Citizens Nat'l Bank, 481 F. Supp. 742 (E.D. Wis. 1979)* ; *Cherry v. Hughes Supply Co., 539 S.E.2d 536 (Ga. Ct. App. 2000)* (holding that a creditor does not violate the ECOA by requiring applicant to pay spouse's delinquency to that same creditor before granting new credit when the creditor justifiably believes that the applicant is liable for the spouse's delinquency).

(n28)Footnote 28. Official Staff Commentary § 202.3(a)-2 (utility security deposit is subject to ECOA).

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

1-5 Consumer Credit Law Manual § 5.05

§ 5.05 Application Procedures and Signature Requirements

[1] Introduction

The ECOA has special requirements that creditors must follow in the various stages of a credit transaction. For ECOA purposes, there are four major stages in a credit transaction: the application for credit and other initial procedures; the creditor's evaluation of that application and decision to grant or to deny credit; notification to the applicant of the creditor's decision; and the various activities which follow the decision to grant credit.

[2] Discouraging Applications

Creditors may not make any statement, oral or written, in advertising or otherwise, which would, on a prohibited basis, discourage a reasonable person from making or pursuing an application. n1 The prohibition against acts to discourage applicants in no way prevents creditors from encouraging applications from disadvantaged groups. n2 Unreasonably delaying the processing of applications from members of protected groups may also be discriminatory. n3

The Fair Housing Act explicitly prohibits discrimination in advertising with respect to the sale or rental of a dwelling. n4 This prohibition applies to any written and oral notices or statements n5 and thus should apply to marketing discrimination. The FHA regulations give examples of discriminatory advertising, including selecting media or locations for advertising that deny housing information to prospective buyers on a prohibited basis. n6 There are also non-binding HUD guidelines on non-discriminatory advertising, which are referenced in the FHA regulations. n7

Furthermore, the FHA regulations contain a separate set of prohibitions against discrimination in the marketing of loans in connection with residential real-estate-related transactions. The regulations prohibit creditors from failing to provide information regarding the availability of loans because of a prohibited basis. n8 A Federal Financial Institutions Examination Council (FFIEC) guidance document suggests that steering (which occurs when a loan officer refers potential applicants away from one type of product or market) on a prohibited basis violates Regulation B and that indicators of discriminatory steering include the following scenarios: n9

- If a lender has a subprime mortgage subsidiary, any significant differences, by loan product, in the percentage of applicants from a protected group for the lender versus the subprime subsidiary

- Lack of clear objective standards for i) referring applicants to subsidiaries or affiliates, ii) classifying applicants as "prime" or "subprime" borrowers, or iii) deciding what kinds of alternative loan products should be offered or recommended to applicants

- For a lender that makes both prime and subprime loans for the same purpose, difference in the percentage of applicants from a protected group in each of the alternative loan product categories

- A lender with a subprime subsidiary integrates its loan application processing for both entities, such that steering between the prime and subprime products can occur almost seamlessly (that is, a single loan processor could simultaneously attempt to qualify any applicant to the bank or the mortgage company under either the bank's prime criteria or the mortgage company's subprime criteria)

Steering sometimes occurs when lenders offer government-backed mortgages as well as conventional mortgage. The FFIEC guidance addresses steering of minorities to government-backed mortgages, as indicated by the following scenarios: n10

- For a lender that makes both conventional and FHA mortgages, any significant differences in the percentages of prohibited-basis-group applicants in each of these two loan products, particularly with respect to loan amounts of $100,000 or more

- Loan officers having broad discretion regarding whether to promote conventional or FHA loans or both to applicants, and the lender has not issued guidelines regarding the exercise of this discretion. FHA regulations also prohibit providing information that is different from that provided to others because of a prohibited basis. n11 These regulations are not limited to applicants but apply to a creditor's provision of information to any "persons." n12 Thus, they could be used to challenge certain types of advertising and marketing discrimination in the provision of housing-related credit.

[3] Prohibited Requests for Information

[a] General

Except under a court order, other federal law, or in connection with specially targeted credit programs, a creditor may not request the race, color, religion, or national origin of the applicant or any other person in connection with a credit transaction. However, a creditor may inquire about an applicant's permanent residence and immigration status. n13

The limitations on a creditor's requests for information do not apply when federal law requires the creditor to seek this information for monitoring purposes. n14 Thus, otherwise prohibited information may be sought in the following situations:

- Certain applications for credit primarily for the purchase or refinancing of a principal residence. n15

- Applications where Regulation C interpreting the Home Mortgage Disclosure Act ("HMDA") requires (or allows) creditors to collect information. This includes certain home improvement loans and home purchase loans not covered immediately above. n16

- Information collected by loan brokers or others to provide information to creditors that are required to collect that data under HMDA or another statute or regulation requiring such data collection. n17

In these situations, the creditor must ask the applicant to provide information voluntarily on race, national origin, sex, marital status, and age, so that the creditor compliance with the ECOA and other

statutes can be monitored. n18 This information may be used only for monitoring; it may not be used to discriminate against the applicant. n19

It is important to note, however, that in one of the most significant changes in the 1999 proposed revisions, the FRB proposed to remove the prohibition on seeking information about an applicant's race, color, religion, national origin, and sex for non-mortgage credit products. n20 This proposed change was made in response to comments from the Department of Justice and other federal financial enforcement agencies that the enhanced ability to obtain data on race and ethnicity would aid fair lending enforcement, particularly with respect to small business lending. n21 The Board recognized the obvious concern, that removing the prohibition would give loan officers access to information on applicant characteristics that would aid discrimination, but found in favor of allowing the collection of that information. n22

In March 2003, the FRB issued final rules in which the Board decided not to remove the prohibition against seeking information about an applicant's race, color, religion, national origin, and sex. n23 Instead of lifting the ban, the Board created a new exception for collection of this information for the purpose of conducting a self-test under section 202.15. n24

The Board's stated rationale was that it believed retaining the prohibition was the best way to reduce and/or avoid discrimination. n25 The Board believed that the existing prohibition restricted creditors' access to information about applicants' personal characteristics, thus reducing or avoiding discrimination. n26

An additional rationale expressed by the Board was its concern that lifting the prohibition would create some risk that the data gathering itself would be discriminatory, that is, creditors would selectively inquire or note information about prohibited characteristics for certain applicants. n27 In general, the Board felt that the reliability of voluntarily collected data was questionable. n28

One interesting issue is whether a creditor's request for documents to establish an applicant's identity, which would also reveal prohibited information such as race and gender, violates the ECOA. For example, the Department of Justice sued a credit card company for retaining photographic identification of applicants that showed the applicant's race and gender. n29 This issue is complicated by the Treasury Department's recent promulgation of customer identification regulations, as required by the U.S. PATRIOT ACT. n30 These regulations require financial institutions to verify the identity of all customers, n31 including loan applicants. n32 The creditor may verify the applicant's identity using documentary or non-documentary methods. n33 If a creditor uses documentary methods, the regulations suggest use of government-issued identification with photograph or a similar safeguard. n34 Thus, a creditor that requires applicants to provide photographic identification is complying with these customer identification regulations, yet this request also indirectly seeks the applicants' race and gender. n35

[b] Sex; Optional Use of Courtesy Titles

A creditor generally may not request the sex of the applicant as required information. n36 There are five exceptions. A creditor may inquire into the applicant's gender where (1) securities credit is involved; (2) where incidental consumer credit is involved, but only to the extent necessary for medical records or similar purposes; (3) to determine eligibility and premium rates for insurance; (4) where information is required for monitoring purposes; and (5) when a special purpose credit program is involved.

The applicant may be asked, but not required, to designate a courtesy title for the account (Ms., Miss, Mrs., or Mr.), n37 and the application form must "appropriately" indicate that selection of such a designation is optional. All other terms used on the application must be sex-neutral.

A creditor may not request any information about the applicant's birth control practices, intention or capacity to bear

children, or intention to rear children. n38 A creditor, however, may request information about the applicant's present dependents (such as the number of dependents and their age) and related financial obligations for these present dependents, as long as this information is not just requested from a group protected by the statute.

The FRB recently proposed removing the prohibition against inquiring about sex (as well as color, race, religion, and national origin). n39 While this allows creditors to ask applicants about their gender, they would still be prohibited from discriminating against applicants on prohibited bases. Furthermore, the Regulation, as proposed, would require creditors who request information on sex to disclose at the time of the request that providing the information is optional, and that the creditor will not take the information, or the applicant's decision not to provide the information, into account in any aspect of the credit transaction. n40 The disclosure must be in writing, in a clear and conspicuous manner, and in a form the applicant can retain. n41 Finally, the FRB proposed adding a new section to Reg. B to emphasize that a creditor may not consider race, color, religion, national origin or sex to determine an applicant's creditworthiness, except as permitted by law, nor may a creditor consider an applicant's decision not to provide the information. n42 The FRB included a proposed model notice in its revisions to Appendix C. n43 In March 2003, the Federal Reserve Board issued final rules in which the Board decided not to remove the prohibition against seeking information about an applicant's race, color, religion, national origin, and sex. Instead, the Board created a new exception for the collection of this information for the purpose of conducting a self-test under § 202.15. n44

[c] Marital Status

Whether a creditor may seek an applicant's marital status will depend on the type of credit account being sought. If an account is joint between husband and wife, or if the credit account is secured by property, the creditor may seek information about the applicant's marital status. n45

But a creditor must allow a married applicant to apply for an individual account if the applicant so desires. n46 If the applicant seeks an individual, unsecured account, a creditor is severely restricted as to when it can seek marital status information. The creditor in that situation may *not* ask the applicant's marital status unless:

- The applicant resides in a community property state or is relying on any property located in such a state to establish creditworthiness;
- The credit involves a regulated utility company, incidental consumer credit, or securities credit;
- The creditor seeks the information solely to determine eligibility and premium rates for insurance;
- The information is required for monitoring purposes; or
- The creditor seeks the information solely to determine eligibility for a special purpose credit program.

Unless the transaction involves only incidental consumer credit, the creditor also must make "appropriate" disclosure to the applicant that income from alimony, child support, or separate maintenance payments need not be revealed unless the applicant wants it to be considered in evaluating the application. n47

If the applicant does not want alimony, child support or separate maintenance income to be considered, then the creditor is prohibited from making any inquiries about this source of income. The creditor instead evaluates the application based on the applicant's other income sources.

In situations where creditors may request an applicant's marital status, creditors may categorize the

applicant only as "unmarried" (which includes single, divorced, and widowed persons), "married," or "separated." n48 These terms are to be defined by applicable state law.

One court has held that a creditor who asked a female applicant if she anticipated getting married did not violate the ECOA, as the questions were posed in the context of a discussion of the applicant's financial troubles and her need for a guarantor. n49

[d] Information About Spouse or Former Spouse

A creditor may request information about the applicant's spouse or former spouse *only* if:

- The spouse will be permitted to use the account;
- The spouse will be contractually liable on the account;
- The applicant is relying on the spouse's income for repayment of the credit;
- The applicant resides in a community property state, or is relying on property for repayment which is located in such a state;
- The applicant is relying on alimony, child support, or separate maintenance payments from a spouse or former spouse for repayment of the credit; or
- The transaction involves incidental consumer or securities credit. n50

[e] Public Assistance Status

Except to comply with other federal laws or a court order or in connection with a specially focused credit program, a creditor is limited in the information it may seek about an applicant's public assistance status.

If a creditor is using a "judgmental system," they may ask whether an applicant's income derives from public assistance payments to determine the amount and probable continuance of the payments, the applicant's credit history, and other "pertinent elements of creditworthiness." n51

[f] Exceptions to Restrictions on Requested Information

[i] The Home Mortgage Monitoring Requirements

The major exception to the ECOA's prohibitions on prohibited inquiries is in the area of home mortgages. Both Regulation B and the Home Mortgage Disclosure Act ("HMDA") n52 require lenders to collect certain information regarding the residential real estate-related loans that they make. The HMDA requires lenders to collect information including the race, sex, and income of each applicant for a home mortgage, as well information about the location of the property securing the loan. n53 Regulation B requires lenders to collect information including race, national origin, sex, marital status, and age so that creditor compliance with the ECOA and other statutes can be monitored. n54

Although the creditor is required to seek this information, the applicant is not required to provide it. Under Regulation B, if the applicant does not provide the required information or any part of it, the creditor must note that fact on its form(s) and, to the extent possible, also note the applicant's race or national origin and sex on the basis of visual observation or surname. This information may be used only for monitoring; it may not be used to discriminate against the applicant. n55

Creditors are required to seek out information on race, national origin, and gender (and marital status and age if the Regulation B monitoring requirements apply) in the following situations:

- Under both Regulation B and the HDMA/Regulation C: Applications for credit n56 primarily for the purchase or refinancing of a dwelling; n57 Regulation B's requirements only apply to dwellings occupied by the applicant as a principal residence when the dwelling will be collateral for the loan; n58 dwelling means residential structure, whether or not the structure is attached to real property, including condominiums, cooperatives, and mobile homes; n59

- Under the HDMA/Regulation C: Applications for certain home improvement loans and open-ended home equity loans; n60

- Regulation B also provides that loan brokers do not violate the ECOA when they collect information otherwise prohibited for purposes of providing it to creditors that are required to collect that data under the HMDA or another statute or regulation requiring such data collection. n61

[ii] Information Required By Any Other Federal or State Statute or By Court Order For Monitoring Purposes

In addition to the home mortgage exception, creditors may make requests for information otherwise prohibited by Regulation B if any other federal or state statute or regulation requires collection of the information. n62

Perhaps the biggest exception, then, to the prohibition on requesting information on prohibited bases is the Treasury Department's customer identification regulation pursuant to the U.S. PATRIOT ACT. n63 The Patriot Act regulation requires financial institutions to verify the identity of all customers n64 and, in particular, suggests the use of government-issued identification containing a photograph or similar safeguard. n65 Yet a creditor that requests applicants to provide photographic identification also indirectly seeks the applicants' race and gender. For example, the Department of Justice sued a credit card company for retaining photographic identification of applicants that showed the applicants' race and gender. n66

While the request for photographic identification pursuant to the Patriot Act regulation qualifies for the exception allowing information requests required by "other" federal and state laws, *retention* of the identification will not qualify. The Patriot Act regulation does not require creditors to *retain* a copy of identification documents--a description of the document will suffice. n67 Ironically, the Treasury Department had originally proposed a retention requirement; however, this requirement was modified in part due to concerns by creditors that "requiring banks to keep copies of documents that have pictures, such as driver's licenses, could expose the bank to allegations of unlawful discrimination, even if the retention of this information were not prohibited under ECOA." n68

Apart from the photo identification issue, the Treasury Department specifically noted that the collection and retention of a customer's date of birth, which is required by the regulation, does not relieve the creditor of its obligations to comply with laws prohibiting age discrimination such as the ECOA. n69 Creditors may also make otherwise forbidden inquiries if required to by an order or agreement issued by, or entered into with, a court or an enforcement agency. n70 The most common example of such an order would be one issued in an ECOA or Fair Housing lawsuit in which a creditor's future performance is to be monitored by a government enforcement agency.

[iii] Special Purpose Credit Programs

Regulation B creates special rules for special purpose credit programs, which are programs that address the credit needs of economically disadvantaged groups. n71 If participants in such a program are required to possess one or more common characteristics (such as race, national origin or sex), a creditor may request information regarding those

common characteristics. n72 For example, if an energy conservation program is created to assist the elderly, the creditor may ask the applicant's age. A creditor may also inquire about the applicant's minority status when offering credit under a Minority Enterprise Small Business Investment Corporation program. n73

If financial need is one of the criteria for the special purpose credit program, the creditor may also request information about marital status, alimony, child support, separate maintenance income, and the spouse's or parents' financial resources. n74 Examples of such programs are subsidized housing programs for low to moderate income households and student loan programs based on the family's financial need. n75

[4] Oral Applications for Credit

Regulation B permits creditors to take either oral or written applications for credit, except that applications must be in writing where credit is used to purchase or refinance the applicant's principal residence, and where the residence is taken as security on the loan. n76 When a creditor does conduct the application process orally, it still must maintain written records of the process and of its reasons for action taken on the application. n77

[5] Cosignature of Spouse or Other Person

The general rule against discrimination prevents a creditor from seeking a spouse or other person to cosign or guaranty a loan on a prohibited basis. n78 Regulation B specifies that state laws prohibiting the individual extension of consumer credit to both parties to a marriage if each spouse individually and voluntarily applies for such credit are inconsistent with the ECOA, and, therefore, are preempted by it. n79

A creditor may not require the signature on a credit instrument of a spouse or any other additional person if the applicant has requested an individual account, no jointly held or community property is involved, and the applicant individually meets the creditor's standards for creditworthiness for the amount and terms of credit requested. n80 If jointly owned property or community property is used as security or as evidence of creditworthiness, then requiring such a signature on the security agreement would be allowed. n81 However, the FRB's 2003 revisions to Regulation B amend *12 C.F.R. section 202.7(d)(1)* to expressly prohibit a creditor from deeming the submission of a joint financial statement or other evidence of jointly held assets as an application for joint credit. n82 Likewise when a joint, rather than an individual, application for credit is made voluntarily, the creditor obviously has the right to ask for the signature of both persons involved. n83 However, in order for an account to be truly joint and thus avoid ECOA cosigne limitations, the cosigner must have voluntarily entered into the loan. The Commentary states that a joint applicant "refers to someone who applies contemporaneously with the applicant for shared or joint credit. It does not refer to someone whose signature is required by the creditor as a condition for granting the credit requested." n84

Determining whether applicants voluntarily entered into a joint account, or were required or convinced to do so by the creditor, can be complicated. The distinction hinges on the intent of the applicants at the time of the application n85 and is generally a question of fact. n86

The creditor may condition the designation of an authorized user by the account holder on the authorized user's becoming contractually liable for the account, as long as the creditor does not differentiate on any prohibited basis in imposing this requirement. n87 The rules limiting a creditor's ability to require the signature of an applicant's spouse apply as well to a creditor's attempt to obtain the signature not only of a guarantor, but also a guarantor's spouse. n88

[6] Creditors May Not Refuse to Open Accounts in a Married Woman's Own Name

The creditor may not prohibit the applicant from opening (or maintaining) an account under any of the following names:

- Birth-given first name (e.g., Jane Applicant, rather than Mrs. John Applicant);

- Birth-given surname (e.g., Jane Birthname);
- Spouse's surname (e.g., Jane Marriedname); or
- A combined surname (e.g., Jane Birthname-Marriedname). n89

A creditor may require, however, that joint applicants on an account designate a single name for purposes of administering the account and that a single name be embossed on any credit cards issued on the account. But the creditor may not require that the name be the husband's name.

[7] Collateral, Security Deposits, Sureties, Other Forms of Creditor Protection

[a] Discriminatory Practices

In addition to the ECOA's co-signature rules, a creditor may not discriminate on a prohibited basis as to the type of protection it demands on a loan, including collateral or security.

Lenders often offer both secured and unsecured loans and may offer lower interest rates for the secured loans. Nevertheless, if a creditor offers only secured loans to applicants of certain races, even if the interest is lower, this practice is discriminatory if other applicants are given the choice between higher-rate unsecured loans and lower-rate secured loans.

The general rule against discrimination applies not only to collateral but also to cosigners, security deposits and other forms of protection. For example, under the ECOA, a security deposit or cosigner may not be sought from public assistance recipients if it is not sought from others. n90

If all a merchant requires as security is a credit card in the consumer's name or a telephone number listed under the consumer's own name, even this requirement may be discriminatory if the creditor does not accept a credit card or telephone number that is in the name of the consumer's spouse. n91 This practice may be viewed as having the effect of discriminating against married, separated, or divorced women who, for historical reasons, never obtained a separate listing under their own name.

[b] Injury Caused By Such Discrimination

Merely requiring extra security may not seem injurious to a consumer, but such discrimination can often cause the consumer financial damage *even* if the loan never goes into default, and these damages should be recoverable under the ECOA. If a consumer must put up personal property as collateral, the creditor may require the consumer to purchase property insurance on that collateral. Using a home as security may require various closing costs. There may be additional damages if the loan goes into default.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityDiscriminatory ActsCivil Rights LawContractual Relations & HousingFair Housing RightsCredit & Mortgage LawsReal Property LawFinancingRedlining

FOOTNOTES:
(n1)Footnote 1. Reg. B, *12 C.F.R. § 202.5(a)*. Reg. B, *12 C.F.R. § 202.5(a)* has been redesignated as § 202.4(b) without substantive change as part of the FRB's revision of Regulation B issued in March 2003. *68 Fed. Reg. 13,144, 13,146* (Mar. 18, 2003) . *See, e.g., Ragin v. Harry Macklowe Real Estate Co., 6 F.3d 898 (2d Cir. 1993) . See also Gregory v.*

Dillard's, Inc., 494 F.3d 694 (8th Cir. 2007) (fact that store patrons left in frustration after allegedly being denied service or being harassed did not preclude finding of "protected activity" element of patrons' § 1981 action against store owner, i.e., did not preclude contractual interest), *rehearing en banc granted, judgment vacated* (8th Cir. Sept. 20, 2007); *JAT, Inc. v. National City Bank of the Midwest, 460 F. Supp. 2d 812 (E.D. Mich. 2006)* (plaintiffs who withdrew loan application due to delay, and who were granted loans on allegedly more restrictive terms, could state claim under § 1981).

(n2)Footnote 2. Official Staff Commentary § 202.5(a)-2. Comment 202.5(a)-2 has been redesignated as comment 4(b)-2 without substantive change as part of the FRB's revision of Regulation B issued in March 2003. *68 Fed. Reg. 13,144, 13,155* (Mar. 18, 2003) .

(n3)Footnote 3. *See Thompson v. Marine Midland Bank, 1999 U.S. App. LEXIS 22960* (2d Cir. Sept. 16, 1999) (although plaintiffs' allegations of delay in processing of applications may have constituted disparate treatment, the court found that defendant provided a legitimate, non-discriminatory reason for the delay; therefore, a prima facie case of discrimination was not established).

(n4)Footnote 4. *42 U.S.C. § 3604(c).*

(n5)Footnote 5. 100 C.F.R. § 100.75(b).

(n6)Footnote 6. 100 C.F.R. § 100.75(c)(3).

(n7)Footnote 7. These guidelines were formerly codified at 24 C.F.R. Part 109, and the FHA regulations still cite them as such. *24 C.F.R. § 100.75(d).* However, the guidelines were removed from the Code of Federal Regulations as part of a regulatory streamlining in 1996. *61 Fed. Reg. 14,378* (Apr. 1, 1996) . The guidelines are available at *54 Fed. Reg. 3,308-3,310* (Jan. 23, 1989) . The guidelines provided further guidance and examples of potentially discriminatory advertising.

(n8)Footnote 8. 100 C.F.R. § 100.120(b).

(n9)Footnote 9. Fed. Fin. Insts. Examination Council, Interagency Fair Lending Examination Procedures Guide 21, Clearinghouse No. 53,526 (1999), *available at* www.ffiec.gov/PDF/fairlend/pdf.

(n10)Footnote 10. *Id.*

(n11)Footnote 11. *Id.*

(n12)Footnote 12. *Id.*

(n13)Footnote 13. Reg. B, *12 C.F.R. § 202.5(d)(5).*

(n14)Footnote 14. Reg. B, *12 C.F.R. § 202.5(B)(2).*

(n15)Footnote 15. Reg. B, *12 C.F.R. § 202.13(a).*

(n16)Footnote 16. Official Staff Commentary § 202.5(b)(2)-2.

(n17)Footnote 17. Official Staff Commentary § 202.5(b)(2)-3.

(n18)Footnote 18. Reg. B, *12 C.F.R. § 202.13.*

(n19)Footnote 19. Reg. B, *12 C.F.R. §§ 202.13(c), 202.6(a).*

(n20)Footnote 20. *64 Fed. Reg. 44,596* (proposed Aug. 16, 1999) (amending *12 C.F.R. § 202.5*).

(n21)Footnote 21. *64 Fed. Reg. 44,586* (proposed Aug. 16, 1999).

(n22)Footnote 22. *64 Fed. Reg. 44,586* (proposed Aug. 16, 1999).

(n23)Footnote 23. *68 Fed. Reg. 13,144, 13,147* (Mar. 18, 2003) .

(n24)Footnote 24. *68 Fed. Reg. 13,144, 13,147* (Mar. 18, 2003) . The new exception is codified at § 202.5(b)(l).

(n25)Footnote 25. *68 Fed. Reg. 13,144, 13,148* (Mar. 18, 2003) .

(n26)Footnote 26. *68 Fed. Reg. 13,144, 13,148* (Mar. 18, 2003) .

(n27)Footnote 27. *68 Fed. Reg. 13,144, 13,148* (Mar. 18, 2003) .

(n28)Footnote 28. *68 Fed. Reg. 13,144, 13,148* (Mar. 18, 2003) .

(n29)Footnote 29. United States v. Fidelity Fed. Bank, Civ. Action No. 02-CV-03906 (E.D.N.Y. complaint and consent decree filed July 8, 2002), *available at* www.usdoj.gov.

(n30)Footnote 30. 31 C.F.R. § 101.121.

(n31)Footnote 31. 31 C.F.R. § 101.121(b)(2).

(n32)Footnote 32. 31 C.F.R. § 101.121(a)(1)(i).

(n33)Footnote 33. 31 C.F.R. § 101.121(b)(2)(ii).

(n34)Footnote 34. 31 C.F.R. § 101.121(b)(2)(ii)(A)(1).

(n35)Footnote 35. Note, however, that the customer identification regulations do not require creditors to *retain* a copy of identification documents--a description of the document will suffice. 31 C.F.R. § 101.121 (b)(3)(i)(B).

(n36)Footnote 36. Reg. B, *12 C.F.R. § 202.5(d)(3)*. The FRB recently proposed amending Reg. B to allow creditors to seek information about an applicant's sex (as well as race, color, religion, and national origin). In March 2003, the Federal Reserve Board issued final rules in which the Board decided not to remove the prohibition against seeking information about an applicant's race, color, religion, national origin, and sex. Instead, the Board created a new exception for collection of this information for the purpose of conducting a self-test under § 202.15. *68 Fed. Reg. 13,144, 13,147* (Mar. 18, 2003) .

See § 5.05[3][b] supra.

(n37)Footnote 37. Reg. B, *12 C.F.R. § 202.5(d)(3)*.

(n38)Footnote 38. Reg. B, *12 C.F.R. § 202.5(d)(4)*.

(n39)Footnote 39. *64 Fed. Reg. 44,585, 44,596* (proposed Aug. 16, 1999).

(n40)Footnote 40. *64 Fed. Reg. 44,596* (proposing *12 C.F.R. § 202.5(a)(4)*).

(n41)Footnote 41. *64 Fed. Reg. 44,596* (proposing *12 C.F.R. § 202.4(d)*).

(n42)Footnote 42. *64 Fed. Reg. 44,597* (proposed Aug. 16, 1999) (proposing *12 C.F.R. § 202.6(b)(9)*).

(n43)Footnote 43. *64 Fed. Reg. 44,631* (proposed Aug. 16, 1999).

(n44)Footnote 44. *68 Fed. Reg. 13,144, 13,147* (Mar. 18, 2003) .

(n45)Footnote 45. Reg. B § 202.5(d)(1).

(n46)Footnote 46. *15 U.S.C. § 1691d(c)*; Reg. B, *12 C.F.R. § 202.7(a)*. The statute explicitly overrides any state laws prohibiting the separate extension of consumer credit to spouses.

(n47)Footnote 47. Reg. B, *12 C.F.R. § 202.5(d)(2)*.

(n48)Footnote 48. Reg. B, *12 C.F.R. §§ 202.5(d)(1)*, *202.2(u)*.

(n49)Footnote 49. *Para v. United Carolina Bank, 1998 U.S. Dist. LEXIS 16843* (E.D.N.C. Aug. 25, 1998) .

(n50)Footnote 50. Reg. B, *12 C.F.R. § 202.5(c)(1)*, *(2)*. A creditor was sued by the DOJ for, *inter alia*, obtaining credit reports on non-applicant spouses. U.S. v. Fidelity Fed. Bank, Civ. Action No. 02-CV-03906 (E.D.N.Y. complaint and consent decree filed on July 8, 2002), *available at* www.usdoj.gov.

(n51)Footnote 51. Reg. B, *12 C.F.R. § 202.2(y)*; Official Staff Commentary § 202.6(b)(2)-5.

(n52)Footnote 52. *12 U.S.C. §§ 2801-2810*. For more on the HDMA and its implementing regulation, Regulation C, see *§ 5.09 infra*; *see also* National Consumer Law Center, Credit Discrimination § 4.4.5 (3d ed.).

(n53)Footnote 53. *12 C.F.R. § 203.4(a)*. Beginning in January 2004, lenders will also be required to disclose whether the loan is a high cost loan subject to the Home Ownership Equity Protection Act, and information about loan pricing for certain loans. *67 Fed. Reg. 7222, 7230* (Feb. 15, 2002) (adding *12 C.F.R. § 203.4(a)(12)*, *(13)*). Creditors will also be required to distinguish which loans are secured by first liens, subordinate liens, or unsecured, for applications and originations but not for loans that they purchase. *67 Fed. Reg. 43,218, 43,219* (June 27, 2002) . *See* National Consumer Law Center, Credit Discrimination § 4.4.5.3.2.

(n54)Footnote 54. Reg. B, *12 C.F.R. § 202.13*. The Federal Reserve Board has made technical revisions to § 202.13(a). The Board reorganized the numbering structure of the subsection and revised the racial and ethnic categories in what is now § 202.13(a)(l)(i) to conform to directives from the Office of Management and Budget. *68 Fed. Reg. 13,144, 13,153* (Mar. 18, 2003) .

(n55)Footnote 55. Reg. B, *12 C.F.R. §§ 202.13(c)*, *202.6(a)*. *12 C.F.R. § 202.13(c)* provides that the creditor must inform the applicant that the information is being requested for the purpose of monitoring compliance with federal anti-discrimination statutes and that, if the applicant chooses not to provide the information, the creditor is required to note the race or national origin and sex on the basis of visual observation or surname. The Federal Reserve Board has proposed requiring that this information be clear and conspicuous and in a form the applicant can retain. *64 Fed. Reg. 44,582, 44,596* (Aug. 16, 1999) (proposing to add 12 C.F.R. § 204(d)).

The Board adopted the proposed changes requiring clear and conspicuous written disclosures but modified the proposal by clarifying that this standard applies only when the ECOA otherwise requires written disclosures or the creditor chooses to make disclosures in writing. *68 Fed. Reg. 13,144, 13,146, 13,147* (Mar. 18, 2003) . Thus, the disclosures under § 202.13(c) need not be made in writing, but if the creditor chooses to make them in writing, they must be clear and conspicuous. The Board also exempted § 202.13(c) disclosures from the new retainability requirement of new § 202.4(d). *68 Fed. Reg. 13,144, 13,146, 13,147* (Mar. 18, 2003) .

(n56)Footnote 56. Regulation B's requirements only apply to applications by natural persons. Official Staff Commentary, *12 C.F.R. § 202.13(a)-1*.

(n57)Footnote 57. Reg. C, *12 C.F.R. § 203.4(a)*; Reg. B, *12 C.F.R. § 202.13(a)*.

(n58)Footnote 58. Reg. B, *12 C.F.R. § 202.13(a)*. A dwelling is a principal residence if the applicant intends to make the dwelling his or her principal residence within one year of completion of construction. Official Staff Commentary, *12 C.F.R. § 202.13(a)-2*. Principal residence does not include a vacation home or a rental unit. Official Staff Commentary, *12 C.F.R. § 202.13(a)-2*. An application for temporary financing to construct a dwelling is not covered, and neither are loans not obtained to purchase the residence but rather obtained for home improvements, debt consolidations, or home equity lines of credit. Official Staff Commentary, *12 C.F.R. §§ 202.13(a)-3*, *202.13(a)-5*.

(n59)Footnote 59. Reg. C, *12 C.F.R. § 203.2(d)*; Reg. B, *12 C.F.R. § 202.13(a)*. Regulation B's definition of dwelling includes multi-family structures of two to four units, if the applicant intends to occupy one of the units as a principal residence. Official Staff Commentary, *12 C.F.R. § 202.13(a)-2*.

(n60)Footnote 60. Reg. C, *12 C.F.R. 203.4(a)*; *see also* Official Staff Commentary, *12 C.F.R. § 202.5(b)(2)-2*. The FRB's proposed revisions to the Official Staff Commentary would delete § 202.5(b)(2)-2 in accordance with proposed changes to *12 C.F.R. § 202.5* that would allow creditors to request information about an applicant's race, color, religion, national origin, or sex. *64 Fed. Reg. 44,582, 44,622* (Aug. 16, 1999) . The Board did not delete comment 5(b)(2)-2 in the final rules issued in March 2003, since it did not lift the prohibition against inquiring about prohibited bases. Instead, comment 5(b)(2)-2 has been redesignated as comment 5(a)(2)-2 without substantive change. *68 Fed. Reg. 13,144, 13,155* (Mar. 18, 2003) .

(n61)Footnote 61. Official Staff Commentary, *12 C.F.R. § 202.5(b)(2)-3*. The FRB's proposed revisions to the Official Staff Commentary delete § 202.5(b)(2)-3 in accordance with proposed changes to *12 C.F.R. § 202.5* that would allow creditors to request information about an applicant's race, color, religion, national origin, or sex. *64 Fed. Reg. 44,582, 44,622* (Aug. 16, 1999) . The Board did not delete comment 5(b)(2) final rules issued in Mar. 2003, since it did not lift the prohibition against inquiring about prohibited bases. Instead, comment 5(b)(2)-2 has been redesignated as comment 5(a)(2)-2 without substantive change. *68 Fed. Reg. 13,144, 13,155* (Mar. 18, 2003) .

(n62)Footnote 62. Reg. B, *12 C.F.R. § 202.5(b)(2)*. Reg. B, *12 C.F.R. § 202.5(b)(2)* has been redesignated as § 202.5(a)(2) as part of the FRB's revision of Regulation B issued in March 2003. *68 Fed. Reg. 13,144, 13,149* (Mar. 18, 2003) .

(n63)Footnote 63. *31 C.F.R. § 103.121*.

(n64)Footnote 64. *31 C.F.R. § 103.121 (b)(2)*.

(n65)Footnote 65. *31 C.F.R. § 103.121(b)(2)(ii)(A)(1)*.

(n66)Footnote 66. U.S. v. Fid. Fed. Bank, Civ. Action No. 02-CV-03906 (E.D.N.Y. complaint and consent decree filed July 8, 2002), *available at* www.usdoj.gov [reproduced on the CD-ROM accompanying this volume].

(n67)Footnote 67. *31 C.F.R. § 103.121 (b)(3)(i)(B)*. The creditor must retain the identification information required under the customer identification regulation for five years after the account is closed or, for credit cards, when the account becomes dormant or is closed. *Id*. § 103.121 (b)(3)(ii).

(n68)Footnote 68. *68 Fed. Reg. 25,090, 25,102* (May 9, 2003) .

(n69)Footnote 69. *Id. at 25,097* .

(n70)Footnote 70. Reg. B, *12 C.F.R. § 202.5(b)(2)*. Reg. B, *12 C.F.R. § 202.5(b)(2)* has been redesignated as § 202.5(a)(2) as part of the FRB's revision of Regulation B issued in March 2003. *68 Fed. Reg. 13,144, 13,149* (Mar. 18, 2003) .

(n71)Footnote 71. Reg. B, *12 C.F.R. § 202.8*; *see § 5.03[4] supra* (a description of the requirements for a special

purpose credit program).

(n72)Footnote 72. Reg. B, *12 C.F.R. § 202.8(c)*.

(n73)Footnote 73. Official Staff Commentary, *12 C.F.R. § 202.8(c)-2*.

(n74)Footnote 74. Reg. B, *12 C.F.R. § 202.8(d)*.

(n75)Footnote 75. Official Staff Commentary, *12 C.F.R. § 202.8(d)-2*.

(n76)Footnote 76. Reg. B, *12 C.F.R. § 202.5(e)*.

(n77)Footnote 77. Reg. B, *12 C.F.R. § 202.12(b)*. The FRB has proposed extending the record retention requirement for applications pertaining to businesses with $1 million or less in gross revenues from 12 months to 25. Larger businesses would remain subject to the shorter 60-day period allowed by *12 C.F.R. § 202.12(b)(5). 64 Fed. Reg. 44,600-44,601* (proposed Aug. 16, 1999). The Board did not adopt this change. The final rule retains the current record retention period of twelve months for business credit. *68 Fed. Reg. 13,144, 13,152* (Mar. 18, 2003) .

(n78)Footnote 78. As part of its revisions to Regulation B issued in March 2003, the Federal Reserve Board added a new Official Staff Commentary § 202.7(d)(l)-1 to emphasize that a creditor may not require an applicant who is individually creditworthy to provide a cosigner even if the creditor applies the requirement without regard to sex, marital status, or any other prohibited basis. *68 Fed. Reg. 13,144, 13,156* (Mar. 18, 2003) . *But see Boyd v. United States Bank Nat'l Ass'n, 2007 U.S. Dist. LEXIS 72455* (D. Kan. Sept. 26, 2007) (creditor required spouse of borrower for small business loan; court found genuine issue of material fact regarding whether creditor actually determined that borrower was not creditworthy before requiring his wife's guaranty and whether the wife's guaranty violated the rules under *12 C.F.R. § 202.7(d)*).

(n79)Footnote 79. Reg. B, *12 C.F.R. § 202.11(b)(1)(ii)*.

(n80)Footnote 80. Reg. B, *12 C.F.R. § 202.7(d)(1). See also Marine Am. State Bank v. Lincoln, 433 N.W.2d 709 (Iowa 1988)* (bank violated ECOA by requiring spouse's signature when applicant was qualified individually). *But see First Fid. Bank v. Best Petroleum, Inc., 757 F. Supp. 293 (S.D.N.Y. 1991)* (bank could ask owner to cosign for corporation even if corporation was creditworthy; owner did not claim to be member of protected class). However, one court has held that a blanket policy of requiring spousal signatures regardless of creditworthiness of the applicant does not violate the ECOA if the applicant and spouse presented themselves as joint applicants. *Southwestern Pa. Reg'l Council v. Gentile, 776 A.2d 276 (Pa. Super. Ct. 2001)* . Note that this provision of Reg. B prohibits the creditor from requiring the signature not only of the applicant's spouse, *but of any other person* if the applicant seeks individual credit and is creditworthy. Reg. B., *12 C.F.R. § 202.7(d)(1)*. The DOJ has sued one credit card lender for having a policy of requiring all members of a household to sign an application. U.S. v. Fidelity Fed. Bank, Civ. Action No. 02-CV-03906 (E.D.N.Y. complaint and consent decree filed July 8, 2002), *available at* www.usdoj.gov.

(n81)Footnote 81. In the context of loans for small businesses, the spouse is often listed as a partner or principal in the business, and the creditor may in those instances require the spouse's signature. *Taylor v. Albina Cmty. Bank, 2001 U.S. Dist. LEXIS 21519* (Nov. 23, 2001) , *mot. granted, in part, mot. denied, in part, 2002 U.S. Dist. LEXIS 20367* (May 23, 2002) , *costs/fees proceeding, 2002 U.S. Dist. LEXIS 25580* (D. Or. Oct. 2, 2002) ; *Cherry v. Hughes Supply Co., 539 S.E.2d 536 (Ga. Ct. App. 2000)* .

(n82)Footnote 82. *68 Fed. Reg. 13,144, 13,150* (Mar. 18, 2003) .

See also Bolduc v. Beal Bank, 994 F. Supp. 82 (D.N.H. 1998) (ECOA violation where wife was required to cosign credit instrument despite husband being independently creditworthy), *remanded, 167 F.3d 667 (1st Cir. 1999)* .

(n83)Footnote 83. *Cf. United States v. Meadors, 753 F.2d 590 (7th Cir. 1985)* (signature voluntary where creditor did not provide signature block for applicant's spouse and creditor was not present when applicant's spouse added signature).

(n84)Footnote 84. Official Staff Commentary § 202.7(d)(l)-2, *redesignated by 68 Fed. Reg. 13,144, 13,191* (Mar. 18, 2003) . *Cf. United States v. Meadors, 753 F.2d 590 (7th Cir. 1985)* (signature voluntary where creditor did not provide signature block for applicant's spouse and creditor was not present when applicant's spouse added signature); *Baybank v. Bornhofft, 694 N.E.2d 854 (Mass. 1998)* (combination of contemporaneous application for credit and shared ownership interest in the collateral makes the defendant a joint applicant). *But see Southwestern Pa. Reg'l Council v. Gentile, 776 A.2d 276 (Pa. Super Ct. 2001)* (not a violation of ECOA for lender to require spouse's signature under a blanket policy of requiring spousal guarantees regardless of creditworthiness, if the applicant and spouse presented themselves as joint applicants).

(n85)Footnote 85. Official Staff Commentary § 202.7(d)(l)-3, *added by 68 Fed. Reg. 13,144, 13,156* (Mar. 18, 2003) ("A person's intent to be a joint applicant must be evidenced at the time of application.")

(n86)Footnote 86. Thus, the issue of whether the cosigner signature is voluntary should enable the debtor to withstand a morion for summary judgment. *See, e.g., Cadle Co. v. Newhouse, 300 A.D.2d 526 (N.Y. App. Div. 2002)* .

(n87)Footnote 87. Official Staff Commentary § 202.7(a)-1.

(n88)Footnote 88. Official Staff Commentary § 202.7(d)(6)-1. *See Riggs Nat'l Bank v. Linch, 36 F.3d 370 (4th Cir. 1994)* (no ECOA violation under special circumstances where wife required to sign as co-guarantor).

(n89)Footnote 89. Reg. B, *12 C.F.R. § 202.7(b)*.

(n90)Footnote 90. *See, e.g.*, Reed v. Northwestern Bell Tel., Clearinghouse No. 27,524 (D. Minn. 1981).

(n91)Footnote 91. *See* Reg. B, *12 C.F.R. § 202.6(b)(4)* (can only require telephone listing at applicant's residence, not in applicant's name); FTC, Informal Staff Opinion, Clearinghouse No. 37,084 (May 26, 1983) (ECOA violation when car rental agency required that a customer without a major credit card have a telephone listing in their own name).

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

1-5 Consumer Credit Law Manual § 5.06

§ 5.06 Special ECOA Rules Concerning Credit Evaluation

Creditors cannot discriminate on a prohibited basis in the evaluation of credit applications. Examples of credit evaluation practices that violate the general rule include: applying different credit standards to applicants on a prohibited basis; using different investigation procedures on a prohibited basis; using different appraisal practices because of a prohibited basis; failing to combine joint applicant income on the basis of marital status; requiring immediate payment when the creditor does not normally do so; discrimination in setting credit limits; or denying credit for exercise of rights under the consumer credit protection act. Such discrimination would run afoul of not only the ECOA, but also the Federal Fair Housing Act and Civil Rights Acts, and state credit discrimination statutes.

[1] Understanding Credit Evaluation Systems

[a] Types of Systems Used

Creditors base their method of evaluating credit applications on the assumption that past history of bill payment is the best predictor of how obligations will be handled in the future. Some creditors look only at the credit history and present financial situation of an individual applicant when deciding whether or not to extend credit to that person. Others look both at the applicant's history of making payments, and at how the applicant compares to an "ideal" credit applicant on such factors as length of employment and whether residence is owned or rented. Applicants seeking credit from the latter type of creditor may be rejected despite their good credit histories, merely because they vary too much from the characteristics of the ideal applicant. n1

Creditors use one of three different credit evaluation systems--a credit scoring system, a judgmental system, or a combined system, sharing aspects of both of the other systems.

[i] Credit Scoring Systems

A credit scoring system assigns a particular number of points to various applicant characteristics, such as length of employment, types of credit already held, and income level. n2 If the total exceeds a certain number, the applicant is granted credit. The number of points the applicant receives also may determine the amount of credit granted.

These systems are constructed by compiling and comparing characteristics of past applicants who have proven to be

creditworthy with those who have not, and then measuring each new applicant against an ideal applicant. The underlying assumption is that the applicants most likely to repay their obligations are those most like the ideal applicant.

Credit scoring systems thus use only selected information from an application. The characteristics which would seem to be the most important predictors of creditworthiness--income level and payment of past obligations--are not necessarily weighted most heavily.

The leading creator of credit scoring models is Fair, Isaac & Co. ("Fair Isaac"), also known as FICO; hence, a credit score is sometimes referred to as a "FICO score." Fair Isaac has developed credit scoring models for each of the three major credit bureaus (Trans Union, Experian, and Equifax). These models take data from a consumer's file and generate a number. Depending on the model used, a generic credit score will fall within a range, from a low of 300 to 400 to a high of 800 to 900. The higher the score, the better. A borrower with a score of 660 or greater is generally considered to be less of a risk for the lender, n3 although some lenders are now using a cut-off of 720 for their best rates. n4 A score of 620 or lower is considered a poor risk. n5

Fair Isaac has also developed a newer scoring model called "NextGen," the scores for which range from 150 to 950. n6

FICO products return a score along with reason codes explaining why the consumer's score deviated from the optimal score. Fair Isaac has a list of over one hundred reason codes, n7 which may be used by lenders when preparing adverse action notices pursuant to the ECOA or the Fair Credit Reporting Act. n8

[A] Special Issues Concerning Credit Scoring Systems

Credit scoring systems that appear scientific or validly derived may still discriminate on a prohibited basis. Many systems predating the ECOA arbitrarily denied credit to what are now protected classes of applicants, such as public assistance recipients and divorced women. As a result, the pool of past credit recipients on which the credit evaluation system is based often contains a disproportionately low number of persons protected by the ECOA. A system borrowed from another source is even more likely to contain this flaw, since the creditor does not know the details of the borrowed system's workings or the assumptions on which the system is based, and may not examine it for discriminatory impact before using it.

Auto loan borrowers have alleged that companies may manipulate a supposedly "color blind" credit scoring system by setting systems up differently for different dealerships. In one case, plaintiffs alleged that dealerships in predominantly minority neighborhoods may even be required to submit to creditors all credit applications for manual review. In this case, plaintiffs suggested that this type of individualized assessment demonstrates both the potential for and sanctioning of "redlining" loan applications that come from dealerships located in these areas. n9

Regulation B provides that a credit scoring system must be "developed and validated using accepted statistical principles and methodology" in terms of its ability to separate creditworthy and noncreditworthy applicants. n10 Further, the system must be reviewed and revalidated based on the creditor's own data periodically and adjusted accordingly. n11 Moreover, there are minimal sanctions to a creditor if a system does not meet the Regulation B standards for a credit scoring system.

[1] Dramatic Increase in the Use of Credit Scores

The use of credit scores to determine whether to extend consumer credit, and on what terms to extend credit, has grown dramatically, particularly in the home mortgage business. One reason for the growth in the use of credit scores is that Freddie Mac and Fannie Mae--which, together, dominate the secondary market for home mortgages--have recommended that mortgage lenders use credit scores in deciding whether to grant mortgage requests and whether to charge higher interest rates and fees. While Freddie Mac and Fannie Mae state that they caution their lenders not to

exclude borrowers solely on the basis of their credit scores, both have urged lenders to use their automated underwriting systems, which factor in credit history scores in determining creditworthiness. n12

Credit scores are also increasingly being used for purposes that extend well beyond the initial question of whether to grant loans. For example, scoring systems are used to prescreen and preselect consumers for the purposes of direct marketing, to determine interest rates and credit limits, to collect on mortgage loans, and in the sale of loans to Wall Street and secondary market purchasers. Some credit card issuers have begun periodically reviewing card holders' credit scores to reset rates for lower-scoring holders.

[2] Lack of Information and Regulation of Credit Scores

The Fair and Accurate Credit Transactions (FACT) Act of 2003 n13 amended the FCRA, however, to require disclosure of credit scores, which were previously exempt from disclosure. The FACT Act requires that, upon the request of a consumer, credit bureaus must disclose the following, *inter alia*:

- The current credit score of the consumer or most recent credit score that was previously calculated by the credit reporting agency related to the extension of credit. n14

- A statement indicating that the information and credit scoring model may be different than the credit score used by a lender n15

- The range of credit scores of the model used to generate the disclosed credit score n16

- The key factors that adversely affected the credit score of the consumer, listed in order of impact. n17

The credit reporting agency may charge a fee for the credit score, to be determined by the Federal Trade Commission. n18

In addition, the FACT Act requires mortgage lenders who use credit scores in connection with an application for residential real-estate secured credit to provide, free of charge, the credit score and accompanying information that is either obtained from a credit bureau or was developed and used by the lender. n19 Mortgage lenders must also give a prescribed notice to the consumers. n20

Finally, state laws regarding disclosure of credit scores are preempted except for several existing state laws that are grandfathered in. n21

For many years, Fair Isaac and the three major credit reporting agencies refused to provide consumers with their own credit scores. Recently, the industry began to provide access to credit scores for a fee. If consumers wish to obtain their credit scores, they have the following options:

- Fair Isaac offers a number of different FICO score products to consumers. Consumers can purchase a copy of their FICO score based on their Equifax, Experian or TransUnion files from www.myfico.com. For a range of prices, consumers can also get a variety of other credit scoring products from the FICO website. As part of each product, consumers receive charts, details, and a list of the main reasons that determined their score.

- TransUnion has its own version of a credit score, which is included with any credit report ordered from the company for the regular credit report price. TransUnion credit reports and scores can be ordered from www.transunion.com, by calling 800-888-4213, or by writing Trans Union, Consumer Disclosure Center, P.O. Box 1000, Chester, PA 19022.

- Experian currently offers a product called Experian Scorecard for a fee, which entitles the purchaser to both their credit report and credit score from Experian. The Experian Scorecard is available at www.experian.com.

There may be significant variations in the credit scores provided by the three credit reporting agencies.

[3] How a Credit Score Is Calculated: The Black Box

Another reason for the controversy over credit scores is that, even with their availability to consumers, the method by which they are calculated is not known to consumers, advocates, or even regulators. The process by which a credit score is calculated has been likened to a "black box."

Freddie Mac and Fair Isaac have disclosed a list of general factors they use to generate credit scores and the general level of importance they attach to each factor. n22 However, critical information is still lacking from the industry's new disclosures. For example, Fair Isaac failed to identify all the factors that go into scoring an applicant and has not identified which of these factors help and which hinder the borrower. Furthermore, they have not revealed the algorithms or mathematical models used to calculate the credit scores.

Fair Isaac has stated that the following factors are used to derive FICO scores (a weighting of each factor is given in parentheses):

- Payment History (35%);
- Amounts Owed (30%);
- Length of Credit History (15%);
- New Credit (10%); and
- Types of Credit in Use (10%). n23

On its website, Freddie Mac lists the factors used in its automated underwriting system, Loan Prospector. Freddie Mac has not revealed the relative weight or importance given to each factor:

- Collateral;
- Credit history and credit bureau score;
- Capacity (debt ratios, salaried versus self-employed borrower, and cash reserves); and
- Loan type and purpose. n24

[ii] Judgmental Systems

A judgmental system is defined by Regulation B as any credit evaluation system other than a "demonstrably and statistically sound, empirically derived credit system"; that is, a system other than a credit scoring system. n25 A judgmental system generally involves a subjective examination of the overall application--often a general search of the application for "acceptable" characteristics based on past experience. In contrast, a credit scoring system measures specific characteristics of the applicant against those of an ideal applicant, usually through point values.

At times, a judgmental system may operate much like a credit scoring system because the judgmental creditor may favorably consider certain characteristics, such as home ownership, which also are high-point items in a credit scoring system. But unlike the credit scoring system, the judgmental system may grant or deny credit based on a general overview of the application rather than on a list of specific factors. The decision to grant or deny credit can be based on a single factor which overshadows the rest of the application. Thus, the outcome often is less predictable under a judgmental system. Judgmental systems have great potential for producing discriminatory results, since Regulation B does not provide adequate standards for their use.

[iii] Combination Systems

The FRB allows combination systems of credit evaluation--systems that require applicants to pass both a credit scoring and judgmental evaluation. This combination has the potential to allow any credit scoring system to be transformed into a combination system whenever an applicant has a passing score, but still is an undesirable applicant in the creditor's eyes. A combination system could subject applicants to additional judgmental tests which increase the risk of rejection.

[b] Discovery of How Creditor Utilizes Scoring System

People asking about details of these scoring systems probably will be told initially by the creditor that the decision was "made by a computer" or is a "trade secret." This "trade secret" obstacle to obtaining information on credit scoring systems can be overcome via discovery pursuant to *Rule 26(c), Federal Rules of Civil Procedure* ("FRCP"). The ECOA itself indicates that nothing in the statute shall be construed to prohibit discovery of a creditor's credit granting standards under appropriate discovery procedures. n26

[2] Types of Prohibited Discrimination (Beyond the Prohibited Bases)

[a] Protected Income Sources

[i] General

The ECOA protects applicants from a creditor's inappropriate consideration of certain sources of the applicant's income called "protected income." Protected income includes income derived from part-time employment, alimony, child support, separate maintenance, retirement benefits, or public assistance. n27 These sources of income are related to age, sex, marital status, and public assistance status, and the FRB thus believes it important to prevent discrimination concerning these sources of income that could have a disparate impact on prohibited bases.

The ECOA does not guarantee that every applicant with such income will be granted credit. A creditor need not consider income at all in evaluating creditworthiness. If the creditor does consider income, there are several acceptable methods of evaluating income. n28

A creditor may consider the total amount of income stated by the applicant without taking any steps to evaluate the different sources or components of that income. Alternatively, the creditor may review *every* component of income separately, placing every component in one of two categories--reliable income and unreliable income. The creditor can then disregard *all* the unreliable income or evaluate the applicant based on these two total numbers--reliable and unreliable income. If the creditor does not evaluate each component for reliability (e.g., it evaluates some components for reliability, but not others), then it must automatically treat all "protected income" as reliable.

[ii] Individual Evaluation of Protected Income

If the creditor is using the second approach and evaluating every component of the applicant's income for reliability, the creditor may not discount or exclude from consideration the income of an applicant or the spouse of an applicant

because of a prohibited basis. n29 In addition, the creditor may not automatically discount or exclude from consideration *any* protected income. The discount or exclusion must be based on the applicant's actual circumstances. n30

Creditors may not use blanket rules which automatically deem a certain type of protected income to be unreliable. The decision must be made on an individual basis, and not be based on aggregate statistical relationships such as those underlying credit scoring models.

Creditors may not treat negatively that an applicant's only earned income is derived from a part-time job, or that income is an annuity, pension, or other retirement benefit. The creditor instead may only consider for this individual case the amount and probable continuity of the income. Similarly, alimony, child support, or separate maintenance payments must be considered as income to the extent to which they will be consistently made in the individual applicant's case. n31

[iii] Income From Multiple Sources

Creditors may not take into account the *number* of sources for protected income (such as alimony, child support, and Social Security). Further, they may not treat negatively the fact that the sole source of *earned* income is from a part-time job.

However, creditors may take into account the fact that the applicant has more than one source of *earned* income, even if one such source is the otherwise protected source category of part-time employment. n32 In other words, Regulation B allows consideration of the fact that income is derived from two part-time jobs or from one full-time and one part-time job. n33 The creditor may also treat income earned from an applicant's primary job differently than income from an applicant's second job. n34 These standards apply to both credit scoring and judgmental evaluation systems. n35

[iv] Income Sources Associated With Older Applicants

A creditor may not automatically exclude from consideration, or consider only a portion of, income of an applicant or applicant's spouse derived from part-time employment, annuities, pensions, or other retirement benefits. Evaluation of protected income from sources such as Social Security or retirement income must be made on an individual basis, and not be based on aggregate statistical relationships such as those underlying credit scoring models. Creditors may not use blanket rules which automatically deem a certain type of protected income to be unreliable, and, therefore, to predict adverse credit performance.

[v] Income Sources Associated With Women Applicants

Regulation B prohibits creditors from discounting income from certain sources historically associated with women, such as part-time employment. Other sources of income traditionally available primarily to women, when an applicant is relying on such income to support the application, such as alimony, child support, and separate maintenance payments, also may not be discounted automatically, although they may be evaluated on an individual basis for reliability and probable continuity.

[b] Credit History

[i] Supplementing a Minimal Credit History

Regulation B requires creditors who consider the credit history of applicants to consider the credit history, when available, of accounts designated as accounts that both the applicant and spouse are permitted to use, or for which both are contractually liable. Such a creditor also must consider, on the applicant's request, the credit history, when available, of any account reported in the name of the applicant's spouse or former spouse which the applicant can demonstrate

accurately reflects the applicant's own creditworthiness. n36

The burden is placed on the applicant to present information on these other accounts, without any affirmative duty on the creditor to request the information. The applicant carries the further burden of demonstrating that these other accounts "accurately reflect" the applicant's own creditworthiness.

A creditor may restrict the types of credit history and credit references that it will consider, provided that the restrictions are applied to all credit applicants without regard to sex, marital status, or any other prohibited basis. n37 The provisions concerning credit history apply only to the extent that the creditor considers credit history in evaluating the creditworthiness of "similarly qualified applicants for a similar type and amount of credit." n38 However, on the applicant's request, a creditor must consider credit information not reported through a credit reporting agency when the information relates to the same types of credit references and history that the creditor would consider if reported through a credit reporting agency. n39

Note that an inadvertent error by the creditor is not a violation of the above requirements. n40 Inadvertent errors include clerical mistakes, calculation errors, computer malfunctions, and printing errors. An error of legal judgment is not an inadvertent error. n41

[ii] Avoiding a Spouse's Bad Credit History

On the applicant's request, the creditor must consider any information that the applicant presents "tending to indicate" that the credit history being considered by the creditor does not accurately reflect the applicant's creditworthiness. n42

[iii] Inadvertent Error Defense

An inadvertent error by the creditor is not a violation of these credit history requirements. n43 Inadvertent errors include clerical mistakes, calculation errors, computer malfunctions, and printing errors. An error of legal judgment is not an inadvertent error. n44

[c] Telephone Listing

A creditor may not consider whether there is a telephone listing in the applicant's name as a factor relevant to creditworthiness, but it may consider the existence of a telephone at the applicant's residence as such a factor. n45 This provision is primarily designed to protect married women, who often do not have telephone listings in their own names.

[d] Likelihood of Bearing or Rearing Children

In evaluating an applicant's creditworthiness, a creditor may not make assumptions or use aggregate statistics concerning the likelihood that the income of any group of persons will be interrupted or diminished at a future time because those persons will bear or rear children. n46

[e] Availability of Credit Insurance

A creditor may not refuse to extend credit or terminate an account merely because the applicant's age makes him or her ineligible for credit life, health, accident, or disability insurance. n47

[3] Allowable Discrimination on a Prohibited Basis

[a] Age

The general rule applying to any type of system is that age may not be taken into consideration at all unless as provided

by the regulation. n48 So to use age at all in either a credit scoring or judgmental system, the creditor must show the application of one of the specific exceptions to the general rule.

The creditor can consider the applicant's age to determine if the applicant has the legal capacity to enter into a binding contract. n49 Legal capacity refers primarily to the legal age of majority.

The second exception--which also applies whether the creditor is using a credit scoring system or a judgmental system--is that a creditor may consider the age of an applicant 62 years old or older in order to give *favorable* treatment to that applicant. n50

When a creditor uses a credit scoring system, it may use the age of applicants as a predictor of creditworthiness. n51 However, creditors may not attach a negative factor or value when the applicant is 62 years of age or older.

When a creditor uses a judgmental system, it may consider age only to determine a "pertinent element of creditworthiness." n52

State laws addressing credit discrimination are preempted to the extent that they are inconsistent with the ECOA and Regulation B. n53 As described above, Regulation B allows credit discrimination in favor of elderly applicants and Regulation B specifically preempts state laws that prohibit creditors from asking or considering an applicant's age in order to favor an elderly applicant. n54

Somewhat more confusing is a related Regulation B preemption of state laws dealing with age discrimination. Regulation B allows creditors using a credit scoring system to utilize age as a predictive factor, but only allows other systems to use age as a "pertinent element of creditworthiness." Regulation B preempts state laws that prohibit *credit scoring systems* from using age as a pertinent element of creditworthiness. n55 In other words, a state statute can prohibit creditors using a judgmental system from considering age at all, except to favor those over the age of sixty-two. The state statute could only limit a credit scoring system's use of age as a pertinent element of creditworthiness.

The ECOA does not preempt state laws which establish an age of majority for various purposes, such as an age below which a person may not enter into an enforceable contract. n56 Nor does it preempt state laws which set a different age of majority for married and unmarried persons. n57

[b] Public Assistance Status

A creditor may not consider whether an applicant's income is derived from any public assistance program, except as expressly permitted by Regulation B. n58 Credit scoring systems cannot use the fact that income derives from a public assistance program.

When the creditor uses a judgmental system, it may consider whether the applicant's income is derived from a public assistance program, but only to determine a "pertinent element of creditworthiness." n59

According to Regulation B, a pertinent element of creditworthiness is "any information about applicants that a creditor obtains and considers and that has a demonstrable relationship to a determination of creditworthiness." n60

Several examples of information displaying this "demonstrable relationship" are listed in the Commentary: n61

- The length of time an applicant will likely remain eligible to receive such income;

- Whether the applicant will continue to qualify for benefits based on the status of the applicant's dependents (for instance, the age of the applicant's children may affect future Temporary Assistance to

Needy Families payments or Social Security payments to a minor);

- Whether the creditor can attach or garnish the income to assure payment of the debt in the event of default (this exception, if followed, would nullify the general rule--most public benefits are exempt from execution; the Commentary example would in effect nullify the statutory protections granted to recipients of public assistance, placing the validity of this Commentary provision in doubt).

The prohibition against discriminatory treatment of public assistance income also requires creditors who consider gross income in credit evaluation to upwardly adjust the amount of public assistance income which is nontaxable to make it comparable to taxable income. n62

[c] Marital Status

A creditor may not consider an applicant's marital status to determine the applicant's creditworthiness, except as otherwise permitted or required by law. n63 In evaluating joint applications, a creditor can not treat applicants differently based on the existence, absence, or likelihood of a marital relationship between the parties. n64

The exception "as permitted or required by law" allows a creditor to consider marital status for purposes of ascertaining the rights and remedies applicable to the particular extension of credit. n65 For example, in a secured transaction involving real estate, a creditor may take into account whether state law gives the applicant's spouse an interest in the property being offered as collateral. n66

[d] Immigration Status

Under the ECOA, a creditor may consider the applicant's residency status in the United States, the applicant's immigration status, and other information necessary to determine its rights and remedies in case of default. A denial of credit to a non-United States citizen is not per se discrimination. n67

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityDiscriminatory ActsBanking LawConsumer ProtectionFair Credit ReportingConsumer ReportsCivil Rights LawContractual Relations & HousingFair Housing RightsCredit & Mortgage LawsReal Property LawFinancingRedlining

FOOTNOTES:
(n1)Footnote 1. *See, e.g., Cherry v. Amoco Oil Co., 490 F. Supp. 1026 (N.D. Ga. 1980)* (applicant denied credit because creditor had experienced poor payments on accounts of customers in applicant's zip code area).

(n2)Footnote 2. Additional information on credit scoring is available in National Consumer Law Center, Fair Credit Reporting Ch. 14 (6th ed. 2006 and Supp.).

(n3)Footnote 3. Freddie Mac, *Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families* 25 (Sept. 1996), *available at* www.freddiemac.com/corporate/reports/moseley/mosehome.htm.

(n4)Footnote 4. For example, the Fair Isaac website (www.myfico.com) lists sample mortgage rates, with the best rates requiring a credit score of 720 or higher.

(n5)Footnote 5. Freddie Mac, *Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families* 25 (Sep. 1996), *available at* www.freddiemac.com/corporate/reports/moseley/mosehome.htm.

(n6)Footnote 6. Nathalie Mainland & Julia Wooding, *NextGen FICO Risk Score Conversion FAQ* 2 (Apr. 2002),

available at www.fairisaac.com/fairisaac/images/images_viewpoints/july2002/nextgenfaq.pdf.

(n7)Footnote 7. Fair Isaac, *Fair Isaac US Credit Bureau Risk Score Reason Codes*(May 2000). For further description of FICO scores, *see* National Consumer Law Center, Credit Discrimination, § 6.3.2 (5th ed. 2009).

(n8)Footnote 8. Fair Isaac, *Understanding Your Credit Score* 15 (Nov. 2003).

(n9)Footnote 9. *Coburn v. DaimlerChrysler Servs. N. America, 2005 U.S. Dist. LEXIS 6276* (N.D. Ill. Mar. 31, 2005) (granting summary judgment in part and denying in part).

(n10)Footnote 10. Reg. B, *12 C.F.R. § 202.2(p)(1). See also* Official Staff Commentary § 202.2(p).

(n11)Footnote 11. Reg. B, *12 C.F.R. § 202.2(p)(1)(iv). See also* Official Staff Commentary, *12 C.F.R. § 202.2(p)-2*, which gives some guidance on revalidation procedures.

(n12)Footnote 12. Loretta J. Mester, *What's the Point of Credit Scoring?*, Bus. Rev.-Fed. Reserve Bank of Philadelphia, Sept./Oct. 1997, at 6. Fannie Mae's automated underwriting system is known as "Desktop Underwriter" while Freddie Mac's is known as "Loan Prospector." In September 2002, a lawsuit was filed against Fannie Mae alleging that Fannie Mae had violated ECOA in that its use of credit scores in its Desktop Underwriter system had a disparate impact on African Americans. Rahmaan v. Federal Nat'l Mortgage Assoc., Clearinghouse No. 54,573, No. 1:02CV01822 (D.D.C. Sept. 13, 2002).

(n13)Footnote 13. Pub. L. No. 108-159 (2003).

(n14)Footnote 14. Fair Credit Reporting Act § 609(f)(1)(A), added by Pub. L. No. 108-159, § 212 (2003).

(n15)Footnote 15. *See id.* § 609(f)(1), added by Pub. L. No. 108-159, § 212 (2003).

(n16)Footnote 16. *See id.* § 609(f)(1)(B), added by Pub. L. No. 108-159, § 212 (2003).

(n17)Footnote 17. *See id.* § 609(f)(1)(C), 609(f)(2)(B), added by Pub. L. No. 108-159, § 212 (2003). For credit scores using Fair Isaac scoring models, the key factors are probably the "reason codes" provided by FICO.

(n18)Footnote 18. *See id.* § 609(f)(8), added by Pub. L. No. 108-159, § 212 (2003).

(n19)Footnote 19. *See id.* § 609(g)(1)(A), added by Pub. L. No. 108-159, § 212 (2003) (requiring disclosure of the same information identified in Fair Credit Reporting Act § 609(f), that is, the information described in the bullet list in this section).

(n20)Footnote 20. *See id.* § 609(g)(1)(D), added by Pub. L. No. 108-159, § 212 (2003).

(n21)Footnote 21. *See id.* § 625(b)(3), as amended by Pub. L. No. 108-159, § 212 (2003).

(n22)Footnote 22. *See* Press Release, Freddie Mac, Freddie Mac Releases Automated Underwriting Factors Used by Loan Prospector (June 7, 2000), *available at* www.freddiemac.com; Press Release, Fair, Isaac & Co., Fair Isaac 'Demystifies' FICO Scores with List of Score Factors, Web-based Explanation Service (June 8, 2000), *available at* www.fairisaac.com.

(n23)Footnote 23. Press Release, Fair, Isaac & Co., Fair, Isaac 'Demystifies' FICO Scores with List of Score Factors, Web-based Explanation Service (June 8, 2000), *available at* www.fairisaac.com.

(n24)Footnote 24. Press Release, Freddie Mac, Freddie Mac Releases Automated Underwriting Factors Used by Loan Prospector (June 7, 2000), *available at* www.freddiemac.com.

(n25)Footnote 25. Reg. B, *12 C.F.R. § 202.2(t)*.

(n26)Footnote 26. *15 U.S.C. § 1691e(j)*.

(n27)Footnote 27. Official Staff Commentary § 202.6(b)(5)-1.

(n28)Footnote 28. Official Staff Commentary § 202.6(b)(5)-3. The FRB has made minor clarifying revisions to §§ 202.6(b)(5)-1, -3, and -4 of the Official Staff Commentary and removed the phrase "protected income." *68 Fed. Reg. 13,144, 13,156* (Mar. 18, 2003) .

(n29)Footnote 29. Reg. B, *12 C.F.R. § 202.6(b)(5)*.

(n30)Footnote 30. Official Staff Commentary, *12 C.F.R. § 202.6(b)(5)-3*. The FRB has made minor clarifying revisions to §§ 202.6(b)(5)-1, -3, and -4 of the Official Staff Commentary and removed the phrase "protected income." *68 Fed. Reg. 13,144, 13,156* (Mar. 18, 2003) .

(n31)Footnote 31. Reg. B, *12 C.F.R. § 202.6(b)(5)*.

(n32)Footnote 32. Official Staff Commentary § 202.6(b)(5)-4.

(n33)Footnote 33. Official Staff Commentary, *12 C.F.R. § 202.6(b)(5)-4*.

(n34)Footnote 34. Official Staff Commentary, *12 C.F.R. § 202.6(b)(5)-4*.

(n35)Footnote 35. United States v. Aristar, Inc., Clearinghouse No. 37,083 (S.D. Fla. Apr. 7, 1983).

(n36)Footnote 36. Reg. B, *12 C.F.R. § 202.6(b)(6)*.

(n37)Footnote 37. Official Staff Commentary, *12 C.F.R. § 202.6(b)(6)-1*.

(n38)Footnote 38. Reg. B, *12 C.F.R. § 202.6(b)(6)*.

(n39)Footnote 39. Official Staff Commentary, *12 C.F.R. § 202.6(b)(6)-1*.

(n40)Footnote 40. Reg. B, *12 C.F.R. § 202.14(c)*; *see also Sayers v. General Motors Acceptance Corp., 522 F. Supp. 835 (W.D. Mo. 1981)* (no ECOA violation when credit denial was based on an inadvertent misinterpretation of the credit history; however, creditor's subsequent willful refusal to comply with notification requirements after being informed of its error did constitute an ECOA violation).

(n41)Footnote 41. Official Staff Commentary, *12 C.F.R. § 202.14(c)-1*.

(n42)Footnote 42. Reg. B, *12 C.F.R. § 202.6(b)(6)(ii)*. For instance, an applicant could show that she was unemployed at a time when a joint account went into default and had no way to ensure that her then-spouse, who was employed, would make payments.

(n43)Footnote 43. Reg. B, *12 C.F.R. § 202.14(c). See also Sayers v. General Motors Acceptance Corp., 522 F. Supp. 835 (W.D. Mo. 1981)* (no ECOA violation where credit denial was based on an inadvertent misinterpretation of the credit history; however, creditor's subsequent willful refusal to comply with notification requirements after being informed of its error did constitute an ECOA violation).

(n44)Footnote 44. Official Staff Commentary § 202.14(c)-1.

(n45)Footnote 45. Reg. B, *12 C.F.R. § 202.6(b)(4)*.

(n46)Footnote 46. Reg. B, *12 C.F.R. § 202.6(b)(3)*.

(n47)Footnote 47. Reg. B, *12 C.F.R. § 202.7(e)*.

(n48)Footnote 48. Reg. B, *12 C.F.R. § 202.6(b)(1)*.

(n49)Footnote 49. Reg. B, *12 C.F.R. § 202.6(b)(2)*.

(n50)Footnote 50. *15 U.S.C. § 1691(b)(4)*; Reg. B, *12 C.F.R. §§ 202.6(b)(2)(iv)*, *202.2*(*o*).

(n51)Footnote 51. Reg. B, *12 C.F.R. § 202.6(b)(2)(ii)*.

(n52)Footnote 52. Reg. B, *12 C.F.R. §§ 202.6(b)(2)(iii)*, *202.2(y)*.

(n53)Footnote 53. *15 U.S.C. § 1691d(f)*; Reg. B, *12 C.F.R. § 202.11(a)*.

(n54)Footnote 54. Reg. B, *12 C.F.R. § 202.11(b)(1)(iv)*.

(n55)Footnote 55. Reg. B, *12 C.F.R. § 202.11(b)(iv)*.

(n56)Footnote 56. FRB, Official Board Interpretation § 202.1103, *42 Fed. Reg. 36,810* (July 18, 1977), *as modified by 42 Fed. Reg. 39,368* (Aug. 4, 1977) . Interpretation § 202.1103 was not included in the Official Staff Commentary because the FRB did not include any interpretations which did not preempt state laws. The reasoning of this interpretation thus apparently is still valid. Moreover, § 202.1103 is an Official Board Interpretation, not a staff interpretation, and thus should not be superseded by a staff commentary.

(n57)Footnote 57. FRB, Official Board Interpretation § 202.1103, *42 Fed. Reg. 36,810* (July 18, 1977), *as modified by 42 Fed. Reg. 39,368* (Aug. 4, 1977) . Interpretation § 202.1103 was not included in the Official Staff Commentary because the FRB did not include any interpretations which did not preempt state laws. The reasoning of this interpretation thus apparently is still valid. Moreover, § 202.1103 is an Official Board Interpretation, not a staff interpretation, and thus should not be superseded by a staff commentary.

(n58)Footnote 58. Reg. B, *12 C.F.R. § 202.6(b)(2)-5*.

(n59)Footnote 59. Reg. B, *12 C.F.R. § 202.2(y)*.

(n60)Footnote 60. Reg. B, *12 C.F.R. § 202.2(y)*.

(n61)Footnote 61. Official Staff Commentary, *12 C.F.R. § 202.6(b)(2)-6*. The FRB has proposed revisions to Official Staff Commentary, *12 C.F.R. § 202.6(b)(2)-6* that would reflect the change in name of the Aid to Families with Dependent Children program. The Board adopted these changes as proposed in final rules issued in 2003. *68 Fed. Reg. 13,144, 13,156* (Mar. 18, 2003) .

(n62)Footnote 62. U.S. v. Fidelity Fed. Bank, Civ. Action No. 02-CV-03906 (E.D.N.Y. complaint and consent decree filed on July 8, 2002), *available at* www.usdoj.gov.

(n63)Footnote 63. *12 C.F.R. § 202.6(b)(8)*.

(n64)Footnote 64. *Id*

(n65)Footnote 65. Official Staff Commentary, *12 C.F.R. § 202.6(b)(8)-1*. The Board has specifically noted that this exception allows creditors to consider state property laws. *68 Fed. Reg. 13,144, 13,150* (Mar. 18, 2003) .

(n66)Footnote 66. *Id*. *Segaline v. Bank of Am., 2003 U.S. Dist. LEXIS 8349* (W.D. Tex. Apr. 18, 2003) (no ECOA

violation when creditor denied loan to husband and wife upon learning the couple had divorced; loan was to be secured by the couple's home, and the fact of the divorce affected homestead rights under Texas law).

(n67)Footnote 67. Official Staff Commentary § 202.6(b)(7)-2.

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

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Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

1-5 Consumer Credit Law Manual § 5.07

§ 5.07 Notification of Action Taken on an Application or on an Existing Account

[1] Introduction

The ECOA requires creditors to notify applicants of action taken on their application within a specified time frame. Creditors also have to provide applicants with the specific reasons for any unfavorable action taken.

The ECOA notice provisions as to the action taken on an application do not apply to incidental consumer credit n1 or to business credit. However, incidental creditors are required to comply with the general prohibition against discrimination, among other ECOA provisions. n2 Other federal and state statutes may have notice provisions similar to those found in the ECOA. For example, the Fair Credit Reporting Act requires notice when a credit report forms the basis of a credit denial. n3 The Fair Credit Reporting (FCRA) defines "adverse action" to have the same meaning as in the ECOA. n4 Despite this shared definition, there are some important distinctions between the ECOA and FCRA notice requirements. One important difference is that the ECOA notice must be given within thirty days of a credit application n5 The FCRA notice should be sent at the same time as the denial, but there is no requirement that the denial meet any time deadlines. The FCRA notice may be required even when an ECOA notice is not. For example, the ECOA states that there is no "adverse action" when the creditor presents a counteroffer and the consumer accepts it. n6 The FCRA notice requirement is not limited in this way. n7 The ECOA notice must state the reasons for denial. The FCRA notice, in contrast, will only indicate that a consumer report was involved in the denial. In addition, the ECOA notice need only be given to the primary applicant. n8 The FCRA notice, on the other hand, requires that notice be given to "any consumer" whenever an adverse action is taken that is based in whole or in part on information contained in a credit report. n9 Another distinction, according to one court, is that the ECOA covers actions by all potential creditors in a case whereas the FCRA is more circumscribed to ensure that consumer reporting agencies, not all creditors, exercise care and adopt reasonable procedures for meeting the needs of commerce for consumer credit. n10 The FRB has provided creditors with model forms that combine both the FCRA notice and the ECOA notice separately on the same disclosure. n11 Proper use of the model forms will satisfy the ECOA notice requirement. n12 Compliance with just the FCRA notice requirements will ordinarily not comply with the ECOA requirement. n13

[2] Notification Requirement for Approved Applications

A creditor must notify an applicant of its decision to approve an application within 30 days after receiving the completed application. n14 This notification may be either express or implicit. Implicit notification is given when the

applicant receives, for example, a credit card, money, property, or services in accordance with the application.

Notification need not be given each time a consumer uses a line of credit, a credit card or other open-end account.

[3] Notification Requirement Where Creditor Makes a Counteroffer

Sometimes the creditor's response to a completed application will be an offer to extend credit, but in substantially different terms or amounts than those requested by the applicant. Regulation B requires that a creditor notify an applicant of any counteroffer to the credit requested within 30 days after receiving an application. n15 The practice of a creditor responding to a consumer's application with a counteroffer, but failing to give the required counteroffer notice, is especially common, and the procedural provisions of the ECOA can provide powerful remedies. n16

The counteroffer provision, in particular, is critical in alerting a borrower to differences between the loan presented to her at closing and the loan she had applied for. For example, borrowers often come to a lender with a specific loan amount in mind to pay for home improvements or other uses. The lender will often inflate that amount, bringing a loan to the table that is significantly different in amount and/or terms than what the borrower initially requested. The ECOA notice of counteroffer can raise a red flag and possibly help convince the borrower to reconsider signing for a bad loan.

If the applicant does not expressly accept or use the counteroffered credit, the creditor then must make a determination whether to accept or reject the applicant's original credit request. In that case, the creditor, within 90 days of its counteroffer, must notify the applicant of the action it has then taken on the original application.

The creditor may also combine a counteroffer with a notice of adverse action (notice of adverse actions are described in the next section). Then the creditor need not send a second notice of the action it has taken if the applicant does not accept the counteroffer.

The FRB proposed amending the Official Staff Commentary to clarify that when a consumer receives a solicitation request for a specific amount and the creditor subsequently offers a different amount, the creditor's action constitutes a counteroffer. n17 The Board decided not to adopt this change, stating instead that this interpretation will be reviewed and reissued for additional public comment. n18

[4] ECOA Notice Requirements and Automobile Fraud

Car dealers, particularly used car dealers, routinely engage in deceptive tactics aimed at confusing prospective buyers and hiding the true cost of the credit being offered. A wide range of state and federal laws can be used to challenge these practices, including state UDAP statutes, odometer statutes, and federal Truth in Lending ("TIL"). n19 The ECOA's procedural and substantive requirements are an often overlooked, yet powerful, addition to this array of consumer protections.

ECOA notice requirements are triggered whenever a creditor denies an application and/or makes a counteroffer. Many dealers violate these notice requirements because they do not want to call attention to changes in credit terms or changes from sales to leases.

For example, dealers who engage in the deceptive practice of spot delivery (also known as "yo-yo," "take-back" or "gimme-back" sales) frequently do not comply with the ECOA. Spot delivery occurs when a dealer supposedly finalizes an installment sale of a car, gives the consumer possession of the car "on the spot," even transfers title to the consumer, and then later tells the consumer to return the car because the financing has fallen through. n20 This practice leads to either the consumer agreeing to rewrite the loan at higher payments or repossession or both.

Dealers will often fail to provide the ECOA notice of credit denial in these situations. The mere failure to provide these

written notices should be a violation of the ECOA even in the absence of actual damages and may be enough to meet the standard for punitive damages. n21

Dealers may argue that a denial notice was not required because they did not actually deny credit but, rather, made a counteroffer. If the dealer truly made a counteroffer, they must have provided the required written ECOA notice of a counteroffer within thirty days after receiving the application. n22 A counteroffer occurs if the dealer/creditor offers credit on substantially different terms or in substantially different amounts than those requested by the applicant. n23 At that point, the consumer may accept the counteroffered credit. Even if the consumer accepted the "new deal," she should still have received notice of the counteroffer. The failure to provide this notice may arguably be an ECOA violation. Advocates should also confirm in these cases that the consumer truly accepted the counteroffer.

If instead the consumer rejected the counteroffer, the creditor must then have made a determination whether to accept or reject the applicant's original credit request. In that situation, within ninety days of the counteroffer, the creditor must notify the applicant of the action it has taken on the original application. n24 An ECOA violation may also occur when the creditor denies a credit application in a consumer's name but approves the application in a co-signer's name. n25

It is also a common practice for dealers to deny an application to buy a car and then offer to lease the car to the consumer. An immediate offer of lease terms may also be considered a counteroffer, triggering ECOA notice requirements. Even if the same credit application is used, there are two separate transactions in these circumstances. The first action by the dealer in denying credit for a sale should trigger ECOA notice requirements. Dealers may also attempt to avoid ECOA requirements by arguing that they do not fit within the ECOA definition of creditor. Dealers should fit the definition either as persons that regularly extend, renew or continue credit, or as persons who regularly arrange for credit. n26 It is preferable to argue that dealers regularly extend credit rather than arrange for credit because the ECOA limits the liability of arrangers. n27

The dealer may also argue that because they assigned the financing immediately after purchase, it is the assignee and not the dealer who is responsible for sending the ECOA notices. The borrower's response should be that the dealer is the original creditor and therefore is required to give ECOA notices. In the spot delivery context, the dealer may have agreed to finance the purchase, thereby creating an account. An assignee's subsequent denial of the credit terms should be considered an adverse action on an existing account, also requiring notice. n28 On the other hand, the ECOA only requires one party to provide notice of adverse action. If the assignee has already provided that notice to the consumer, there is no requirement that the dealer do so as well. n29

If only one credit agency is used and the credit agency, not the dealer, notifies the applicant in writing and states the reasons for the denial, the ECOA reporting requirement is met. n30 Alternatively, the applicant or a third party acting on the applicant's behalf may submit applications to several creditors. If the applicant expressly accepts or uses the credit offered by any one creditor, no notice of adverse action need be provided by any other creditor that may have rejected the application. n31 If, on the other hand, no credit is offered by any creditor, or the applicant does not expressly accept or use any credit offered, each creditor that took adverse action must comply with Regulation B's adverse action notification requirements, either directly or through a third party. n32

A third party or one of the creditors may provide the notice on behalf of all of the creditors, identifying each creditor that took adverse action. n33

[5] Notification Requirement for Adverse Actions; Applications vs. Inquiries

[a] General

The creditor must notify applicants when an adverse action is taken after the creditor receives an "application." n34 The FRB proposed amending Regulation B to broaden the definition of "application" to include a request for preapproval

under procedures in which a creditor will issue to creditworthy persons a written commitment, even if conditional, for credit up to a specified amount that is valid for a period of time. n35 The Official Commentary would be amended to reflect this change, and to further explain when an inquiry or prequalification request becomes an application. n36 However, the Board declined to extend the ECOA to cover prescreened credit solicitation. n37

The Board, in 2003, decided to adopt the proposed language on preapprovals. n38 However, the changes were not added to the regulation as proposed but only to the Official Staff Commentary. n39 The amendments to the Commentary distinguish between inquiries and prequalification requests, on the one hand, and certain preapproval requests, on the other, for purposes of determining whether an application exists. The Commentary now clarifies that prequalification requests are subject to the same test applicable to inquiries. n40

In general, a request or inquiry will become an application for purposes of the ECOA if the creditor responds not only by providing information but also by evaluating information about the consumer. The Board changed the term "applicant" to "consumers" in the Commentary to emphasize that an application may exist for purposes of the ECOA even if the consumer has not actually submitted an application. n41 The Board explained that using the term "applicant" presumes that an application exists, while the point of the comment is that, in the case of an inquiry or prequalification request, an application may or may not exist depending upon the circumstances. n42

Applications are different from inquiries. If the creditor evaluates information about the applicant and decides to decline the request, and communicates this to the applicant, the inquiry must be treated as an application, and the creditor must notify the potential applicant of the adverse decision. n43

If a creditor discourages a particular applicant or indicates that that particular applicant may not obtain credit, then an application *has* been made, and the creditor must notify the consumer of the adverse action. n44

In its Advanced Notice of Proposed Rulemaking, the FRB solicited comment on whether it should further clarify the distinction between an inquiry about credit and an application for credit. n45 The Board was motivated by the growth of new delivery channels for loan products information, such as the Internet, and growth in credit counseling and prequalification programs, resulting in consumers asking for information about credit products and their creditworthiness before ever submitting an application. n46

Application is defined in Regulation B as "an oral or written request for an extension of credit that is made in accordance with procedures established by a creditor for the type of credit requested." n47 This gives creditors flexibility to establish the type of process it decides to use. The commentary, however, encourages creditors to provide consumers with information needed to shop for credit. Many industry commentators reported that they were unclear about when inquiries about credit rose to the level of an "application" requiring a formal denial if credit was rejected.

Based on the various responses to the FRB, including the industry comments noted above, the FRB has proposed adding that the definition of "application" includes a request for preapproval under procedures in which a creditor will issue to creditworthy persons a written commitment, even if conditional, for credit up to a specified amount that is valid for a period of time. n48 The Official Commentary would be amended to reflect this change and to further explain when an inquiry or prequalification requests becomes an application. n49 However, the Board declined to extend the ECOA to cover prescreened credit solicitation. n50 The Board, in 2003, decided to adopt the proposed language on pre-approvals. n51 However, the changes were not added to the regulation as proposed but only to the Official Staff Commentary. n52 The amendments to the Commentary distinguish between inquiries and pre-qualification requests, on the one hand, and certain pre- approval requests, on the other, for purposes of determining whether an application exists. The Commentary now clarifies that pre-qualification requests are subject to the same test applicable to inquiries. n53

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"applicant" to "consumers" in the Commentary to emphasize that an application may exist for purposes of the ECOA even if the consumer has not actually submitted an application. n54 The Board explained that using the term "applicant" presumes that an application exists, while the point of the comment is that, in the case of an inquiry or pre-qualification request, an application may or may not exist depending upon the circumstances. n55

[b] What Is an Adverse Action?

[i] Adverse Actions Involving New Credit Accounts

The creditor must notify an applicant of an "adverse action." n56 The FRB has proposed amending *12 C.F.R. section 202.9(a)(3)(ii)* to require that creditors disclose, to businesses with gross revenues in excess of $1 million in the preceding fiscal year, the right to a written statement of reasons for adverse actions if requested within 60 days of being notified of an adverse action. n57 Conversely, if Regulation B does not treat an action as adverse, Regulation B does not require the creditor to notify the applicant of the action (although the failure to disclose the action taken may be a deceptive trade practice).

When an applicant is applying for new credit, an adverse action is defined as any refusal to grant credit "in substantially the amount or on substantially the terms requested in an application, unless the creditor makes a counteroffer (to grant credit in a different amount or on other terms) and the applicant uses or expressly accepts the credit offered." n58 A creditor's request for a larger down payment and a co-signer when none was previously requested constituted an adverse action. n58.1 Regulation B contains a list in § 202.2(c)(1) of actions that are considered adverse actions and, in § (c)(2), a list of actions that are not adverse. An action that falls within the definitions of both (c)(1) and (c)(2) is governed by (c)(2) and is not an adverse action. n58.2

Nevertheless, an adverse action is not involved where applicable law prohibits the creditor from extending the credit requested or where the creditor does not offer the type of credit or credit plan requested.

[ii] Adverse Actions Involving Existing Accounts

Termination of an account or an unfavorable change in the terms of an account that does not affect all or a substantial portion of a class of the creditor's accounts is an adverse action. n59 In its proposed revisions to Regulation B, the FRB has suggested replacing the phrase "substantial portion" with "substantially all" to emphasize that "a creditor's action must affect the overwhelming majority of accounts in a class to be excluded from the definition of adverse action." n60

Similarly, a telephone company's requirement that only certain existing customers pay a $100 deposit would constitute adverse action and entitle the consumers to a statement of specific reasons. n61 In contrast, an increase in the interest rate on all credit cards issued by the creditor would not be an adverse action. Refusal to increase the amount of credit available to an applicant who has made an application for an increase is an adverse action.

On the other hand, the following would not be adverse actions concerning existing accounts:

- A change in the terms of an account expressly agreed to by the borrower; n62

- Any action or forbearance relating to an account taken in connection with inactivity, default, or delinquency on that account. n63 It is not an adverse action, for example, to repossess collateral, accelerate a defaulted loan, or to request the return of a credit card when the consumer has overrun the credit line. n64

- A refusal or failure to authorize an account transaction at a point of sale or loan. Similarly, there is no adverse action where credit is refused where it appears fraud is involved, the card authorization

process is not working, or billing statements have been returned for lack of a forwarding address. n65

- A mortgagor's sale of property where the mortgagee accelerates the mortgage loan; notice need not be sent to the mortgagor or to the property purchaser. n66

[c] Complying With Another Required Notice Does Not Satisfy ECOA Requirement

Other statutes require certain notifications to credit applicants. For example, the FCRA requires notice when a credit report forms the basis of a credit denial. n67 Similarly, HUD or other government programs may require notice of action taken on an application. But these requirements are in addition to, and do not absolve the creditor from complying with, the ECOA notice requirement. n68

[d] Timing of Notice of Adverse Action

A creditor must notify an applicant of any adverse action taken on an application or an existing account within prescribed time periods, as follows:

- The creditor must send notification of adverse action taken on a completed application for credit within 30 days after receiving the application. The application is considered complete once a creditor has obtained all the information it normally considers in making a credit decision; n69

- The creditor must send notification of adverse action taken regarding an incomplete application or on an existing account within 30 days after taking the adverse action; and

- The creditor must send notification of adverse action taken within 90 days after notifying the applicant of a counteroffer, if the applicant has not expressly accepted or used the proffered credit. n70

A written notification of adverse action satisfies the regulation when it is delivered or mailed to the applicant's last known address. An oral notification is considered complete when the creditor "communicates" with the applicant. n71

The ECOA obligates the creditor to provide timely notice but does not expressly require actual notice. n72

[e] Form of the Notification

Most creditors must give the applicant *written* notification. n73 The FRB has adopted "rules" requiring clear and conspicuous written disclosures in a form that the applicant can retain, but modified the proposal by clarifying that this standard applies only when the ECOA otherwise requires it or the creditor chooses to make disclosures in writing. The Board also exempted certain disclosures, even if provided in writing, from the retainability requirement. n74 In December 2003, the FRB published a proposed rule to define more precisely the standard for providing "clear and conspicuous" disclosures and to provide a more uniform standard among the Board's regulations. n75 The proposed rule relies mainly on the Board's Regulation P (Privacy of Consumer Financial Information), which defines the "clear and conspicuous" standard to mean that disclosure is "reasonably understandable and designed to call attention to the nature and significance of the information" in the disclosure. n76 The Board proposed to adopt this same definition for Regulation B. The ECOA notification may appear on the front or back or on both sides of a form or letter. Creditors that have acted on one hundred and fifty or fewer applications during the preceding calendar year may notify the applicant orally. n77 The notification can be made in a language other than English, so long as it is available in English upon request. n78

[f] Electronic Disclosures

In September 1999, the FRB published a proposed rule permitting creditors to use electronic disclosures in some circumstances to fulfill the requirements of ECOA. n79 Subsequently, the FRB placed the rule on hold in order to re-examine it in light of the passage of the Electronic Signatures in Global and National Commerce Act ("E-Sign Act"). n80 The E-Sign Act, effective October 1, 2000, allows creditors, among others, to replace written disclosures with electronic documents if:

(a) certain disclosures are made to the consumer n81

(b) the consumer consents electronically, or confirms his or her consent electronically, in a manner that reasonably indicates that he or she can access information electronically in the format used by the provider of the information, n82 and

(c) the electronic document is in a form that is capable of being retained and accurately reproduced for later reference by all parties or persons who are entitled to retain it. n83

These requirements apply when a lender wants to use an electronic document to replace a document that ECOA requires to be in writing. n84 This includes the notice of adverse action and the notice of right to the statement of reasons (or the statement itself). n85 However, these requirements do not apply to the notice of the right to a copy of the appraisal n86 and the request for monitoring information. n87

[i] The Interim Final Rule

On April 4, 2001, the FRB published an interim final rule amending Regulation B to provide for electronic disclosures. n88 The interim final rules make some significant interpretations of the requirements of the E-Sign Act for purposes of ECOA, as well as addressing issues not covered by the E-Sign Act, such as the format of electronic disclosures. The FRB also issued a Supplement to the Official Staff Commentary, which discusses the interim final rule. n89

The interim final rule permits ECOA disclosures to be made using "electronic communication" so long as the creditor complies with the consumer consent provisions of the E-Sign Act. n90 The rule defines "electronic communication" as a message transmitted electronically that can be displayed as visual text on equipment. n91

The interim final rule imposes a new clear and conspicuous standard for electronic disclosures. n92 This standard only applies for electronic disclosures. There is no similar standard for paper ECOA notifications. The FRB has stated that it is permissible to place other text, including advertisements, on the same screen as the ECOA disclosures, so long as the clear and conspicuous standard is met.

The interim final rule permits creditors to provide ECOA disclosures electronically by either sending them via e-mail, n93 or posting them on the creditor's website. n94 If a creditor provides disclosures by posting them on its website, the creditor must also send a notice to consumers informing them of the availability of the disclosures ("alert notice"). The creditor has the option of sending this alert notice by e-mail or by postal mail. n95 The interim rule requires notices posted on the creditor's website be retained on the website for ninety days. n96 This ninety-day retention requirement may contradict the E-Sign Act's requirement that an electronic document be "capable of being retained and accurately reproduced for later reference *by all parties*." n97

The interim final rule does not impose any requirements, such as an electronic return receipt, verifying that a consumer has actually received a disclosure.

The consumer consent requirements of the E-Sign Act are intended to protect consumers by ensuring that they *affirmatively* consent to receiving important documents in electronic format, and that they have the ability to access and

retain those electronic documents. n98 The potential pitfalls lie in attempts by overbearing creditors to entice or coerce consumers into consenting to electronic disclosures when the consumers do not actually have real Internet access.

[g] Content of Notice

The notification should include a statement of the action taken, the creditor's name and address; the name and address of the federal agency with enforcement authority concerning the transaction; and a statement of specific reasons for the action taken; or a disclosure of the applicant's right to request a statement of such reasons within 60 days, with the name, address, and telephone number of the person or office from which the statement of reasons can be obtained. n99 Courts generally agree that long, detailed statements are not required, but some go to the other extreme, requiring mere "transparency." n100 Courts have, for example, approved notices that were ambiguous and required some interpretation by the consumer. n101 The notification must also include a specific notice of the applicant's rights. n102

When providing the reason for the adverse action, the creditor must list the specific reasons for the adverse action and the reasons listed must be the real ones used to make the credit decision. n103 Listing only one of several reasons is not sufficient. If credit is denied, the adverse action reasons must come from both the credit scoring component and the judgmental component of the system, if both are used. n104

If an application is incomplete, the creditor may either deny the application or notify the applicant that information is missing. In the case of a denial, the incompleteness may not be the reason for the adverse action; the creditor must provide a different reason. n105

The reasons given must be the ones utilized by the creditor and the reasons cannot violate the ECOA, but the reasons do not have to be good ones.

[6] Incomplete Applications for Credit

Whenever an application does not contain all of the information that the creditor "regularly obtains and considers" in evaluating applications (including credit reports and other reports or approvals necessary to guarantee the credit), it is considered an incomplete application for credit subject to special notification procedures. n106 The creditor, nevertheless, must act with reasonable diligence to collect information needed to complete the application.

The creditor must take one of two actions within thirty days after receiving an incomplete application: (1) notify the applicant of action taken on the application; or (2) notify the applicant that further information is needed. n107 There is often confusion with respect to whether an application is complete. According to one court, loan documents generally use qualifying language in the earlier stages of the process that is often susceptible to misinterpretation. Examples include noting that a loan application is "conditionally pre-approved" or that the borrower is "conditionally pre-qualified." n107.1

If the applicant does not respond within the designated reasonable period of time to a written notice, the creditor does not need to take further action. n108 Creditors that have acted on one hundred fifty or fewer applications during the preceding calendar year may notify the applicant orally of these facts. n109

[7] Withdrawn Applications for Credit

Where an applicant expressly withdraws an application for credit, the creditor need not comply with the notification requirements. n110 The creditor must still comply with the record retention requirements.

[8] Multiple Applicants and Creditors

When there is more than one applicant for credit, the required notification need be given to only one applicant--the

primary applicant, if one is apparent. n111

If an applicant accepts or uses the credit offered by any one creditor in connection with an application to multiple creditors submitted through a third party, no notice of adverse action need be provided by any other creditor that may have rejected the application. n112

[9] Creditor's Inadvertent Error

An inadvertent error by the creditor is not a violation of the notification requirements, provided that the creditor corrects the error as soon as possible after discovering it. n113 Inadvertent errors include clerical mistakes, calculation errors, computer malfunctions, and printing errors. An error of legal judgment is not an inadvertent error.

[10] Right to Copy of Appraisal

A 1991 Amendment to the ECOA n114 requires that creditors provide applicants with notice of their right to receive a copy of any appraisal report of a residence securing the loan obligation being sought. n115 The statute also specifies that the creditor may require reimbursement from the applicant for the cost of the appraisal. The applicant must request the appraisal within 90 days and it must be provided within 30 days. Violations of this requirement should entitle a consumer to relief. n116

[11] Exceptions to Notice Requirements: Incidental Consumer Credit

The ECOA notice requirements do not apply to incidental consumer credit. n117 Incidental consumer credit is defined as:

- Primarily for personal, family, or household purposes;
- Not made pursuant to the terms of a credit card account;
- Not subject to any finance charge or interest; and
- Not payable by agreement in more than four installments. n118

Examples of incidental consumer credit may include (as long as there is no finance charge and no more than four installments) deferment of payment by doctors, home oil companies, hospitals, and some small retailers.

Even though courts have found these types of transactions to be "credit" transactions under the ECOA, the incidental credit exception allows the creditors to avoid complying with important ECOA requirements, including the notice requirements. n119 However, incidental creditors are required to comply with the general prohibition against discrimination, among other ECOA provisions. n120

There are two main legal theories why a consumer is entitled to some notification of the denial of incidental consumer credit. One possible, but not very practical, approach is to challenge the FRB's authority to make this exception.

However, even if a challenge to the regulatory exclusion were successful, the consumer would obtain only prospective relief and perhaps attorney fees, because the creditor will assert the ECOA defense of good faith compliance with FRB regulations. n121

A state UDAP claim is a more direct way to challenge the failure to notify the consumer of denial of incidental consumer credit. n122 The creditor's failure to disclose the action taken is an unfair and deceptive act because it is

deceptive to fail to disclose an important part of a sales transaction, in this case that the creditor will not defer payment. n123 Nevertheless, it is more difficult to prove a UDAP violation when the creditor has notified the consumer of the denial of credit, but has not disclosed the reason for the denial.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer ReportsBanking LawConsumer ProtectionTruth in LendingDisclosureCivil Rights LawContractual Relations & HousingFair Housing RightsCredit & Mortgage LawsReal Property LawFinancingMortgages & Other Security InstrumentsGeneral Overview

FOOTNOTES:
(n1)Footnote 1. Reg. B, *12 C.F.R. § 202.3(c)(2)(vi)*. Incidental consumer credit is defined as: primarily for personal, family, or household purposes; not made pursuant to the terms of a credit card account; not subject to any finance charge or interest; and not payable by agreement in more than four installments.

(n2)Footnote 2. Official Staff Commentary 12 C.F.R. § 202.3-1.

(n3)Footnote 3. *15 U.S.C. § 1681m(a)*. *See also* National Consumer Law Center, Fair Credit Reporting, § 8.2.6 (6th ed. 2006 and Supp.).

(n4)Footnote 4. *15 U.S.C. § 1681a(k)*. *See generally* National Consumer Law Center, Fair Credit Reporting, § 8.2.6.4.2 (6th ed. 2006 and Supp.).

(n5)Footnote 5. Reg. B, *12 C.F.R. § 202.9(a)(1)(i)*.

(n6)Footnote 6. Reg. B, *12 C.F.R. § 202.9(a)(1)(iv)*.

(n7)Footnote 7. *See* National Consumer Law Center, Fair Credit Reporting, § 8.2.6.4 (6th ed. 2006 and Supp.).

(n8)Footnote 8. Reg. B, *12 C.F.R. § 202.9(f)*.

(n9)Footnote 9. *15 U.S.C. § 1681m(a)*. *See also* Stinneford, FTC Informal Staff Opinion Letter, July 14, 2000 (FCRA notice must be given to a co-applicant, but not to a guarantor), *reprinted in* National Consumer Law Center, Fair Credit Reporting, Appendix D (6th ed. 2006 and Supp.).

(n10)Footnote 10. *Davis v. Reg'l Acceptance Corp., 2003 WL 22946190 (E.D. Va. 2003)*. *See generally* National Consumer Law Center, Fair Credit Reporting, Ch. 8 (6th ed. 2006 and Supp.).

(n11)Footnote 11. Reg. B, 12 C.F.R. § 202 App. C.

(n12)Footnote 12. *Id*.

(n13)Footnote 13. FTC Official Staff Commentary § 615 item 1, *reprinted in* National Consumer Law Center, Fair Credit Reporting, Appendix D (6th ed. 2006 and Supp.).

(n14)Footnote 14. Reg. B, *12 C.F.R. § 202.9(a)(1)(i)*.

(n15)Footnote 15. Reg. B, *12 C.F.R. § 202.9(a)(1)(i)*. *See Newton v. United Cos. Fin. Corp., 24 F. Supp. 2d 444 (E.D. Pa. 1998)* (lender violated ECOA when, without giving notice that it was making a counteroffer, it extended credit in significantly higher amounts than the borrower had applied for).

(n16)Footnote 16. *See Newton v. United Cos. Fin. Corp., 24 F. Supp. 2d 444 (E.D. Pa. 1998) . But see Diaz v. Va. Hous. Dev. Auth., 117 F. Supp. 2d 500 (E.D. Va. 2000)* (written notice of counteroffer not required). *See also Madrigal v. Kline Oldsmobile, Inc., 423 F.3d 819 (8th Cir. 2005)* (no adverse action when creditor kept applicant orally informed of status of application, because oral notification is sufficient when the action being taken is not adverse); *Diaz v. Paragon Motors of Woodside, Inc., 424 F. Supp. 2d 519 (E.D.N.Y. 2006)* (requiring written notice of an accepted counteroffer would be contrary to well-established rules of statutory interpretation). *See also In re Ameriquest Mortg. Co. Mortg. Lending Practices Litig., 2006 U.S. Dist. LEXIS 81498* (N.D. Ill. Nov. 7, 2006) (consumer's acceptance of a loan where the terms changed between application and closing is not clearly acceptance of a counteroffer because of the surreptitious nature of the bait and switch).

(n17)Footnote 17. *64 Fed. Reg. 44,582, 44,588-89* (Aug. 16, 1999) ; *see also Newton v. United Cos. Fin. Corp., 24 F. Supp. 2d 444 (E.D. Pa. 1998)* .

(n18)Footnote 18. *68 Fed. Reg. 13,144, 13,154* (Mar. 18, 2003) .

(n19)Footnote 19. *See generally* National Consumer Law Center, Automobile Fraud (3d ed. 2007).

(n20)Footnote 20. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices (7th ed. 2008 and supp.).

(n21)Footnote 21. *See Williams v. Thomas Pontiac-GMC-Nissan-Hyundai, 1999 U.S. Dist. LEXIS 15045* (N.D. Ill. Sept. 22, 1999) (denial of motion to dismiss); *Pinkett v. Payday Today Loans, LLC, 1999 U.S. Dist. LEXIS 12098* (N.D. Ill. July 22, 1999) (denial of motion to dismiss); *Davis v. Regional Acceptance Corp., 2002 U.S. Dist. LEXIS 16775 (E.D. Va. 2002)* (titling the car in plaintiff's name, refusing to accept payments, attempting to undo the contract, obtaining a subsequent credit report and then repossessing the car could all be construed as facts sufficiently alleging denial or termination of credit and constituting an adverse action under the ECOA).

(n22)Footnote 22. Reg. B, *12 C.F.R. § 202.9(a)(1)(i).*

(n23)Footnote 23. Reg. B, *12 C.F.R. § 202.2(c)(1)(i).*

(n24)Footnote 24. Reg. B, *12 C.F.R. § 202.9(a)(1)(iv).*

(n25)Footnote 25. *See Mungia v. Tony Rizza Oldsmobile Inc., 2002 U.S. Dist. LEXIS 6624 (N.D. Ill. 2002)* (summary judgment granted to plaintiff when creditor relied on co-signer to inform plaintiff that her credit application had been denied).

(n26)Footnote 26. Reg. B, *12 C.F.R. § 202.2(l)*; *see Burns v. Elmhurst Auto Mall, Inc., 2001 U.S. Dist. LEXIS 6385* (N.D. Ill. May 16, 2001) (dealer who regularly refers applicants to creditors and selects creditors to whom applications can be made is a creditor within meaning of the ECOA); *Hudson v. Richfield Mitsubishi, 1997 U.S. Dist. LEXIS 23674* (D. Minn. July 11, 1997) (denial of defendant's argument in summary judgment motion that it was not covered by the ECOA).

(n27)Footnote 27. The FRB has proposed amending the ECOA definition of creditor to clarify that it also includes one who regularly participates in setting terms of credit, not just in the decision of whether to extend or deny credit. *64 Fed. Reg. 44,582, 44,594* (Aug. 16, 1999) . The FRB has also proposed amending the Official Staff Commentary to expressly provide that arrangers can include automobile dealers, home builders and home improvement contractors, and those who solely accept applications. Official Staff Commentary, 12 C.F.R. § 202.2-1, *64 Fed. Reg. at 44,620* .

The Board adopted the proposed change to the regulatory definition of "creditor," with a few modifications. *68 Fed. Reg. 13,144, 13,145* (Mar. 18, 2003) . The former definition of a creditor was a "person, who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit." The new definition defines a creditor

as a person who "regularly participates in a credit decision, including setting the terms of the credit." The new definition was effective April 15, 2003, although the mandatory compliance date was April 15, 2004. *68 Fed. Reg. 13,144* (Mar. 18, 2003) . The Board also changed the description of creditors in the Commentary from those "who do not participate in credit decisions but who *regularly refer applicants* to creditors or who select or offer to select creditors to whom credit requests can be made" to those "who do not participate in credit decisions but who *only accept applications and refer applicants to* creditors, or select or offer to select creditors to whom credit requests can be made." The key changes are emphasized. *See 68 Fed. Reg. 13,145* , *amending* Official Staff Commentary *12 C.F.R. § 202.2*(*l*)-2. Persons that only accept applications and refer applicants to creditors still meet the definition of "creditor," but only for purposes of the prohibition against discrimination and discouragement. *68 Fed. Reg. 13,144, 13,155* (Mar. 13, 2003) . The prohibitions against discrimination and discouragement are codified at *12 C.F.R. § 202.4(a)* and *(b)*. The Board also expanded the illustrative list of actors that might be considered creditors under this section. Previously, the Commentary mentioned only real estate brokers in this category. Official Staff Commentary, *12 C.F.R. § 202.2*(*l*)-2. The Commentary now lists real estate brokers, automobile dealers, home builders, and home improvement contractors. *See 68 Fed. Reg. 13,188* , *amending* Official Staff Commentary, *12 C.F.R. § 202.2*(*l*)-2

(n28)Footnote 28. Reg. B, *12 C.F.R. § 202.2(c)(1)(ii)*.

(n29)Footnote 29. *See Burns v. Elmhurst Auto Mall, Inc., 2001 U.S. Dist. LEXIS 6385* (N.D. Ill. May 16, 2001) (Regulation B foresees that multiple entities may be involved, but only requires one notice to applicant); *Leguillou v. Lynch Ford, Inc., 2000 U.S. Dist. LEXIS 1668* (N.D. Ill. Feb. 10, 2000) (granting motion to dismiss). Even though the assignee is not the original creditor, it may still be directly liable for ECOA violations. *See Najieb v. Chrysler-Plymouth, 2002 U.S. Dist. LEXIS 24927* (N.D. Ill. December 31, 2002) (ECOA requires that, when a third party asks a creditor to extend credit to an individual, the notice may be made directly by such creditor or indirectly through the third party), *motion to reconsider denied*, *Najieb v. Chrysler-Plymouth, 2003 U.S. Dist. LEXIS 7933* (N.D. Ill. May 9, 2003) . At least one court held that, for a consumer to state a cause of action in these circumstances, she must show that she did not receive a notice from either the dealer or the proposed assignee, since either source may give notice. *See Brand v. Rohr-Ville Motors, Inc., 2003 U.S. Dist. LEXIS 8026* (N.D. Ill. May 9, 2003) .

(n30)Footnote 30. *Burns v. Elmhurst Auto Mall, Inc., 2001 U.S. Dist. LEXIS 6385 (N.D. Ill. 2001)* ; *see also Najieb v. Chrysler-Plymouth, 2002 U.S. Dist. LEXIS 24927* (N.D. Ill. Dec. 30, 2002) .

(n31)Footnote 31. Reg. B, *12 C.F.R. § 202.9(g)*; *see also Thompson v. Galles Chevrolet Co., 807 F.2d 163 (10th Cir. 1986)* (when truck purchasers submitted two credit applications to the same finance company through two different dealers, and credit was approved on the second application, there was no need for written notification that the creditor had stopped considering the first application).

(n32)Footnote 32. Reg B., *12 C.F.R. § 202.9(g)*.

(n33)Footnote 33. Reg. B, *12 C.F.R. § 202.9(g)*; Official Staff Commentary, *12 C.F.R. § 202.9(g)-1*.

(n34)Footnote 34. Reg. B, *12 C.F.R. § 202.9(a)*. "Application" is defined in Regulation B as "an oral or written request for an extension of credit that is made in accordance with procedures established by a creditor for the type of credit requested." Reg. B, *12 C.F.R. § 202.2(f)*. This term is not defined in the statute. *See also* Official Staff Commentary § 202.2(f).

(n35)Footnote 35. *64 Fed. Reg. 44,594* (proposed Aug. 16, 1999) (proposing to amend *12 C.F.R. § 202.2(f)*).

(n36)Footnote 36. *64 Fed. Reg. 44,619* (proposed Aug. 16, 1999) (proposing to amend Official Staff Commentary § 202.2(f)).

(n37)Footnote 37. *64 Fed. Reg. 44,584-44,585* (proposed Aug. 16, 1999).

(n38)Footnote 38. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) .

(n39)Footnote 39. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) , *amending* Official Staff Commentary, *12 C.F.R. § 202.2(f)-5*.

(n40)Footnote 40. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) ; Official Staff Commentary 2(f)-3.

(n41)Footnote 41. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) .

(n42)Footnote 42. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) .

(n43)Footnote 43. Official Staff Commentary § 202.9(a)(1)-7.

(n44)Footnote 44. Official Staff Commentary § 202.2(f)-3.

(n45)Footnote 45. *63 Fed. Reg. 12,326* (Mar. 12, 1998) .

(n46)Footnote 46. *64 Fed. Reg. 44,589* (Aug. 16, 1999) .

(n47)Footnote 47. Reg. B, *12 C.F.R. § 202.2(f)*. Application is not defined in the statute. *See also* Official Staff Commentary, *12 C.F.R. § 202.2(f)*.

(n48)Footnote 48. *64 Fed. Reg. 44,594* (proposed Aug. 16, 1999) (proposing to amend *12 C.F.R. § 202.2(f)*).

(n49)Footnote 49. *64 Fed. Reg. 44,619* (proposed Aug. 16, 1999) (proposing to amend Official Staff Commentary § 202.2(f)).

(n50)Footnote 50. *64 Fed. Reg. 44,584-44,585* (Aug. 16, 1999) .

(n51)Footnote 51. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) .

(n52)Footnote 52. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) , *amending* Official Staff Commentary *12 C.F.R. § 202.2(f)-5*.

(n53)Footnote 53. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) . Comment 2(0)-3.

(n54)Footnote 54. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) .

(n55)Footnote 55. *68 Fed. Reg. 13,144, 13,145, 13,154, 13,155* (Mar. 18, 2003) .

(n56)Footnote 56. Reg. B, *12 C.F.R. § 202.9(a)*.

(n57)Footnote 57. *64 Fed. Reg. 44,599* (proposed Aug. 16, 1999).

(n58)Footnote 58. Reg. B, *12 C.F.R. § 202.2(c)(1)(i)*. At least one court found that an adverse action occurred when all parties involved in a car finance transaction understood that the consumer had applied for credit at a certain rate even though the credit application did not specify a rate. *Bayard v. Behlmann Auto. Servs., 292 F. Supp. 2d 1181 (E.D. Mo. 2003)* . Instead, the application stated that the consumer sought credit at the "lowest rate available." *See id.*

(n59)Footnote 58.1. *Love v. O'Connor Chevrolet, Inc., 2006 U.S. Dist. LEXIS 68246* (N.D. Ill. Aug. 21, 2006) .

(n60)Footnote 58.2. Reg. B, *12 C.F.R. § 202.2(c)(3). See, e.g., Southern v. Golden Gate Auto Sales, 487 F. Supp. 2d 951* (N.D. Ill. Dec. 5, 2006) .

(n61)Footnote 59. Reg. B, *12 C.F.R. § 202.2(c)(1)(ii). See also Pierce v. Citibank (South Dakota), 843 F. Supp. 646 (D. Or. 1994)* (automatic termination of wife's accounts when husband's separate account terminated improper where independently established trustworthiness for each).

(n62)Footnote 60. *64 Fed. Reg. 44,583, 44,593-44,594* (proposed Aug. 16, 1999) (proposing to amend *12 C.F.R. § 202.2(c)(1)(ii)*). The FRB has also proposed adding Official Staff Commentary § 202.2(c)(1)(ii)-1 to explain the proposed revisions and to clarify that while "class of accounts" is a broad category, "it does not include a category of accounts designated according to characteristics of customers, such as by their credit scores." *64 Fed. Reg. 44,619* (proposed Aug. 16, 1999). The Board adopted this change to the definition. *68 Fed. Reg. 13,144* (Mar. 18, 2003) .

(n63)Footnote 61. *See O'Dowd v. South Cent. Bell, 729 F.2d 347 (5th Cir. 1984)* .

(n64)Footnote 62. Reg. B, *12 C.F.R. § 202.2(c)(2)(i)*.

(n65)Footnote 63. Reg. B, *12 C.F.R. § 202.2(c)(2)(ii)*. Note that the FRB has proposed revising Official Staff Commentary § 202.2(c)(2)(ii) to clarify that an adverse action does not include another action or a termination on an account due to a current delinquency or default on that account. *64 Fed. Reg. 44,619* (proposed Aug. 16, 1999).

The Board decided not to adopt these proposed changes in final rules published in March 2003, stating instead that the interpretations will be reviewed and reissued for additional public comment. *68 Fed. Reg. 13,144, 13,154* (Mar. 18, 2003) .

(n66)Footnote 64. *See Haynes v. Bank of Wedowee, 634 F.2d 266 (5th Cir. 1981)* (consumer was in default when the creditor accelerated the loan, and, hence, the acceleration did not constitute adverse action under the exception of Reg. B, *12 C.F.R. § 202.2(c)(ii)*). *See also Harara v. ConocoPhillips Co., 377 F. Supp. 2d 779 (N.D. Cal. 2005)* (no ECOA notice violation when credit denial was based on plaintiff's default); *Southern v. Golden Gate Auto Sales, 487 F. Supp. 2d 951* (N.D. Ill. Dec. 5, 2006) (repossession and any continued action against the vehicle were taken in connection with delinquency); *Baker v. Capital One Bank, 2006 U.S. Dist. LEXIS 2625* (D. Ariz. Jan. 24, 2006) (reduction in a consumer's credit limit based on account inactivity is not an "adverse action" although creditor withdrew motion for summary judgment on question whether reinstatement of credit limit to an amount lower than borrower requested is an adverse action).

(n67)Footnote 65. Official Staff Commentary § 202.2(c)(2)(iii).

(n68)Footnote 66. Official Staff Commentary § 202.2(c)(2)(ii)-1.

(n69)Footnote 67. *15 U.S.C. § 1681m(a)*; *see also § 16.03 infra*.

(n70)Footnote 68. Official Staff Commentary § 202.9(b)(2)-9.

(n71)Footnote 69. Reg. B, *12 C.F.R. 202.9(a)(1)(i). See Saldana v. Citibank, 1996 U.S. Dist. LEXIS 8327* (N.D. Ill. June 12, 1996) (because Citibank regularly obtains and considers appraisals to complete an application, plaintiff's application was not complete until creditor received appraisal. Although not the case here, court stated that there may be an impermissible motive where creditor deliberately delays obtaining the information necessary to complete an application). *See Schwab v. Kids' Fin., Inc., 2008 U.S. Dist. LEXIS 9199* (D. Colo. Feb. 7, 2008) (issue of material fact about a whether application was complete when denial was sent, since defendant had asked for plaintiff's pay stub and alleged that it had not received it when it sent the denial).

(n72)Footnote 70. Reg. B, *12 C.F.R. §§ 202.9(a)(1)(i), (ii), (iv)*; Official Staff Commentary § 202.9(a)(1)-1.

(n73)Footnote 71. Official Staff Commentary § 202.9-3.

(n74)Footnote 72. *See Davis v. U.S. Bancorp., 2003 U.S. Dist. LEXIS 12930* (D. Minn. July 23, 2003) (plaintiff did not present evidence to rebut presumption that a properly mailed document is received).

(n75)Footnote 73. Reg. B, *12 C.F.R. § 202.9(a)(2)*; Official Staff Commentary § 202.9-4. *See, e.g., Curley v. JP Morgan Chase Bank NA, 2007 U.S. Dist. LEXIS 33395* (W.D. La. May 7, 2007) (oral notice sufficient when defendant orally informed agent of applicant and also said "I'm sorry" when returning the application file to applicant).

(n76)Footnote 74. *68 Fed. Reg. 13,144, 13,146, 13,147* (Mar. 18, 2003) (exempting disclosures under §§ 202.5 and 202.13 from the retainability requirement).

(n77)Footnote 75. *68 Fed. Reg. 68786* (Dec. 10, 2003) . The proposed rule would add a "clear and conspicuous" definition to Regulation B at § 202.2(bb). The staff commentary would also be revised to add comments 2(bb)-1 and -2. Other FRB regulations affected include Regulation Z (Truth in Lending), Regulation M (Consumer Leasing Act), Regulation P (Privacy of Consumer Financial Information), and Regulation DD (Truth in Savings).

(n78)Footnote 76. *Id., citing 12 C.F.R. § 216.3(b)(1).* Regulation P also provides examples of how to satisfy the standard. *12 C.F.R. § 216.3(b)(2).*

(n79)Footnote 77. Reg. B, *12 C.F.R. § 202.9(d).*

(n80)Footnote 78. *12 C.F.R. § 202.4(b).* This section was added as part of the FRB's interim final rule issued March 30, 2001 concerning electronic disclosures. *66 Fed. Register 17779-17786* (April 4, 2001) .

(n81)Footnote 79. *64 Fed. Reg. 49,688* (Sept. 14, 1999) .

(n82)Footnote 80. Pub. L. No. 106-229, *114 Stat. 464* (June 30, 2000), *codified at 15 U.S.C. §§ 7001 et seq. See also § 6.09[1][a][i][G]* and *§ 10.03[9][c], supra* .

(n83)Footnote 81. *15 U.S.C. § 7001(c)(1)(B), (C)(1).* See National Consumer Law Center, the Cost of Credit: Regulation and Legal Challenges, § 9.2.10 (4th ed. 2009), for a more detailed discussion of these requirements.

(n84)Footnote 82. *15 U.S.C. § 7001(c)(1)(C)(ii). See* National Consumer Law Center, the Cost of Credit: Regulation and Legal Challenges, § 9.2.10 (4th ed. 2009), for a further discussion of this requirement.

(n85)Footnote 83. *15 U.S.C. § 7001(e).*

(n86)Footnote 84. *15 U.S.C. § 7002* allows states to supersede E-Sign's effect on state law by passing the Uniform Electronic Transactions Act or a similar statute that is consistent with E-Sign. A state's enactment of superseding legislation would not, however, affect the application of E-Sign to federal statutes such as ECOA. See National Consumer Law Center, the Cost of Credit: Regulation and Legal Challenges, § 9.2.10 (2004 Supplement), for a further discussion of this issue.

(n87)Footnote 85. *15 U.S.C. § 1691(d)*; Reg. B, *12 C.F.R. § 202.9(a)* and *(b).*

(n88)Footnote 86. *15 U.S.C. § 1691(e)*; Reg. B, 12 C.F.R. § 202.5a.

(n89)Footnote 87. Reg. B, *12 C.F.R. § 202.13(a).*

(n90)Footnote 88. *66 Fed. Reg. 17,779-17,786* (April 4, 2001) . In August 2001, the FRB rescinded the October 1, 2001 deadline for compliance with the interim final rule. *66 Fed. Reg. 41,439* (Aug. 8, 2001) .

As part of the FRB's revision of Regulation B issued in March 2003, the Board redesignated the interim final rule from § 202.17 to § 202.16. *68 Fed. Reg. 13,144, 13,154* (Mar. 18, 2003) . However, the Board did not set a new date

for mandatory compliance with the interim final rule. *68 Fed. Reg. 13,144, 13,154* (Mar. 18, 2003) . Instead the Board stated that any substantive revisions to the interim final rule would be made at a future date.

(n91)Footnote 89. *66 Fed. Reg. 17,786* (April 4, 2001) .

(n92)Footnote 90. *12 C.F.R. § 202.17(b)*. The interim final rule also allows third parties who provide ECOA disclosures on behalf of creditors to do so electronically. *12 C.F.R. § 202.9(h)*. See note 71 *supra,* regarding revision of Regulation B.

(n93)Footnote 91. *12 C.F.R. § 202.17(a)*. See note 71 *supra,* regarding revision of Regulation B.

(n94)Footnote 92. *12 C.F.R. § 202.17(b)*. See note 71 *supra,* regarding revision of Regulation B.

(n95)Footnote 93. *12 C.F.R. § 202.17(d)(1)*. The Official Staff Commentary prohibits creditors from sending electronic disclosures to an e-mail address that is limited solely to receiving communications from the creditor. Official Staff Commentary § 202.17(d)(1)-1. See note 71 *supra,* regarding revision of Regulation B.

(n96)Footnote 94. *12 C.F.R. § 202.17(d)(2)*. See note 71 *supra,* regarding revision of Regulation B.

(n97)Footnote 95. *12 C.F.R. § 202.17(d)(2)(i)*. Creditors are not required to send an alert notice when making a request for monitoring information required by *12 C.F.R. § 202.13(a). 12 C.F.R. § 202.17(d)(3)*. See note 71 *supra,* regarding revision of Regulation B.

(n98)Footnote 96. *15 U.S.C. § 7001(e)* (emphasis added). The interim rule also has its own requirement that electronic notifications be "in a form that the applicant may retain." *12 C.F.R. § 202.17(b)*.

(n99)Footnote 97. *12 C.F.R. 202.12(b)*. The rules contained in § 202.17 have been redesignated as § 202.16 as part of the FRB's revision of Regulation B issued in March 2003. *68 Fed. Reg. 13,144, 13,154* (Mar. 18, 2003) .

(n100)Footnote 98. See National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 9.2.10 (4th ed. 2009), for a further discussion of this issue. *See also* National Consumer Law Center, Credit Discrimination, § 10.6.2.2 (5th ed. 2009).

(n101)Footnote 99. Reg. B, *12 C.F.R. § 202.9(a)(2). See Aikens v. Northwestern Dodge, Inc., 2006 U.S. Dist. LEXIS 1339* (N.D. Ill. Jan. 5, 2006) (ECOA does not require creditor to utilize the exact language in the sample forms).

(n102)Footnote 100. *See, e.g., Pettineo v. Harleysville Nat'l Bank & Trust Co., 2006 U.S. Dist. LEXIS 3858* (E.D. Pa. Jan. 31, 2006) (ECOA notice that included reasons for denial that did apply to plaintiff's situation *and* reasons that did not apply was not in violation of ECOA; the ECOA notice provisions require general transparency only).

(n103)Footnote 101. *See, e.g., Aikens v. Northwestern Dodge, Inc., 2006 U.S. Dist. LEXIS 1339* (N.D. Ill. Jan 5, 2006) (it is irrelevant whether the applicant actually finds the notice educational or helpful); *Higgins v. J.C. Penny, Inc., 630 F. Supp. 722 (E.D. Mo. 1986)* (notice was sufficient to enable the plaintiff to focus her efforts in a particular area and to investigate the proprietary of the company's decision).

(n104)Footnote 102. Reg. B, *12 C.F.R. § 202.9(b)(1)*.

(n105)Footnote 103. Reg. B, *12 C.F.R. § 202.9(b)(2)*; *see* Official Staff Commentary § 202.9(b)(2)-2.

(n106)Footnote 104. *68 Fed. Reg. 13,144, 13,156* (Mar. 18, 2003) ; *15 U.S.C. § 1681g(g)(1)(D). See generally* National Consumer Law Center, Fair Credit Reporting § 8.2.6 (6th ed. 2006 and Supp.).

(n107)Footnote 105. Official Staff Commentary § 202.9(a)(1)-3.

(n108)Footnote 106. Reg. B, *12 C.F.R. §§ 202.9(c), 202.2(f)*; Official Staff Commentary §§ 202.2(f)-5, 202.9(c). Proposed and final changes to Regulation B's definition of application, found at *12 C.F.R. § 202.9(f)*, are discussed at *§ 5.07[5][a] supra*.

(n109)Footnote 107. Reg. B, *12 C.F.R. § 202.9*. *See Johnson v. Grossinger Motorcorp., Inc., 753 N.E.2d 431 (Ill. App. 1st Dist. 2001)* (when car dealer provided consumer with written list of documents required to obtain financing and consumer failed to fully respond, court held written list satisfied ECOA's written notice requirement); *Payne v. Diepholz Ford Lincoln Mercury, 2004 U.S. Dist. LEXIS 19* (N.D. Ill. Jan. 6, 2004) (summary judgment granted for plaintiff consumer when dealer did not provide a written denial or a written explanation of why application was incomplete).

(n110)Footnote 107.1. *Jefferson v. Briner, Inc., 2006 U.S. Dist. LEXIS 41423* (E.D. Va. June 21, 2006) .

(n111)Footnote 108. *See* Reg. B, *12 C.F.R. §§ 202.9(c), 202.2(f)*. *See also Cartwright v. Am. Sav. & Loan Ass'n, 880 F.2d 912 (7th Cir. 1989)* (mortgage lender did not violate ECOA when it placed application on indefinite hold after requesting that applicant herself provide information on comparable housing prices in a largely minority neighborhood; nor was lender required to provide notice of adverse action, because none had occurred).

(n112)Footnote 109. Reg. B, *12 C.F.R. § 202.9(d)*.

(n113)Footnote 110. Official Staff Commentary § 202.9-2. *See also Thompson v. Galles Chevrolet Co., 807 F.2d 163 (10th Cir. 1986)* (where truck purchasers submitted two credit applications to the same finance company through two different dealers and credit was approved on the second application, there was no need for written notification that the creditor had stopped considering the first application, which was incomplete and arguably withdrawn); *Johnson v. Grossinger Motorcorp., Inc., 753 N.E. 2d 431 (Ill. App. Ct. 2001)* (no ECOA notice violation when plaintiff failed to provide creditor with requested documentation prior to repossession and withdrew his application after repossession).

(n114)Footnote 111. Reg. B, *12 C.F.R. § 202.9(f)*. *See Mungia v. Tony Rizza Oldsmobile, Inc., 2002 U.S. Dist. LEXIS 6624* (N.D. Ill. Apr. 12, 2002) (summary judgment granted for plaintiff who applied for credit in her name and was not given notice of denial; creditor relied on the co-signer to inform plaintiff that her credit application had been denied).

(n115)Footnote 112. Reg. B, *12 C.F.R. § 202.9(g)*.

(n116)Footnote 113. Reg. B, *12 C.F.R. § 202.14(c)*; Official Staff Commentary § 202.14(c)-1. *See also Sayers v. General Motors Acceptance Corp., 522 F. Supp. 835 (W.D. Mo. 1981)* .

(n117)Footnote 114. The Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, *105 Stat. 2300, 2306* (Dec. 19, 1991) (adding *15 U.S.C. § 1691(e)*).

(n118)Footnote 115. The FRB proposed requiring this notice to be clear and conspicuous and in a form the applicant can retain. *64 Fed. Reg. 44,596* (proposed Aug. 16, 1999) (proposing to add 12 C.F.R. § 204(d)). The Board adopted these proposed changes requiring clear and conspicuous written disclosures in a form that the applicant can retain but modified the proposal by clarifying that this standard applies only when the ECOA otherwise requires it or the creditor chooses to make disclosures in writing. The Board also exempted certain disclosures from the retainability requirement. In addition, based on changes published in March 2003, the rules on providing appraisal reports will now appear as § 202.14. *68 Fed. Reg. 13,144, 13,146, 13,147* (Mar. 18, 2003) .

(n119)Footnote 116. *15 U.S.C. § 1691e*. *But see Wiltshire v. Dhanraj, 421 F. Supp. 2d 544 (E.D.N.Y. 2005)* (the plain language of § 1691e notwithstanding, plaintiffs have cited no authority and the court's research has revealed none, which indicates that a cause of action exists under the ECOA based on a creditor's failure to furnish an appraisal report; court did not reach a conclusion on the issue, however, because of deficiencies in plaintiff's ECOA claims).

(n120)Footnote 117. Reg. B, *12 C.F.R. § 202.3(c)(2)(vi)*.

(n121)Footnote 118. Reg. B, *12 C.F.R. § 202.3(c)*; *see also* Official Staff Commentary, *12 C.F.R. § 202.3(c)*.

(n122)Footnote 119. *See, e.g., Mays v. Buckeye Rural Elec. Coop. Inc., 277 F.3d 873 (6th Cir. 2002)* ; *Williams v. AT&T Wireless Servs., Inc., 5 F. Supp. 2d 1142 (W.D. Wash. 1998)* (application for cellular phone service held to be incidental credit and creditor exempted from notice requirements.).

(n123)Footnote 120. Official Staff Commentary, 12 C.F.R. § 202.3-1.

(n124)Footnote 121. *15 U.S.C. § 1691e(e)*.

(n125)Footnote 122. *See § 5.01[8] supra* (discussion of state UDAP statutes).

(n126)Footnote 123. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 4.2.14 (7th ed. 2008 and supp.).

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

1-5 Consumer Credit Law Manual § 5.08

§ 5.08 ECOA Procedures Subsequent to the Granting of Credit

[1] Creditor Actions Triggered by Borrower's Increased Age or Change in Name or Marital Status

A creditor may not require reapplication, change the terms, or terminate an *open-end* account such as a credit card merely because account holders reach a certain age, retire, or change their name or marital status. n1 The creditor may take such actions only if there is evidence of the account holder's inability or unwillingness to repay or the credit was granted to both spouses and one has now repudiated further responsibility.

[2] Refusal to Improve Account Terms

Refusal to increase the amount of credit available to an applicant who has made an application for an increase is an adverse action requiring the same notice as if the refusal had been to the initial credit application.

[3] Are Authorized Users Entitled to Notification?

Authorized users are clearly entitled to notification of adverse action if they are contractually obligated. Typically, language on a charge slip or elsewhere may contractually obligate an authorized user for charges for which that user signs, so these users must receive notice of an adverse action.

[4] Credit Reporting; Scope of Requirement

Regulation B establishes procedures which creditors must follow when they furnish information about certain accounts to credit reporting agencies. n2 A creditor that furnishes credit information must designate any new account to reflect the participation of both spouses, if the applicant's spouse is permitted to use or is contractually liable on the account.

These requirements apply only to creditors that furnish credit information to credit bureaus or to other creditors. There is no requirement that a creditor furnish credit information on its accounts. Currently, these procedural requirements do not apply to public utility credit, incidental consumer credit, business credit, or securities credit. n3 The FRB expanded the requirements to public utility credit in the final rules issued in 2003. n4 In response to commentator concerns, the Board reiterated that the reporting requirement applies only to creditors that furnish information to reporting agencies. In these circumstances, utilities will now be required to furnish information that reflects the participation of both

spouses.

The Board has noted that creditors are considering public utility payments more frequently, and that it would be helpful to consumers if public utility companies that furnish credit payment information were subject to the same reporting requirements as the other creditors covered by the ECOA. n5

[5] Record Retention

Creditors generally must retain records of credit transactions for approximately as long as the ECOA statute of limitations. Exempt from this rule are public utilities, creditors dealing in securities credit, incidental consumer creditors, and creditors extending credit to governments or governmental subunits and agencies. n6 A creditor must retain the original or a copy of each of the following for 25 months following the date of notification to an applicant of the action taken on an application (or on an incomplete application): n7

- Any application form that the creditor receives;
- Information obtained for monitoring purposes;
- Any other written or recorded information used in evaluating the application and not returned to the applicant upon request;
- Written notification to the applicant of the action taken on the application, or notes concerning oral notification;
- Written notification to the applicant of the specific reasons for adverse action, or notes concerning oral notification; and
- Any written statement submitted by the applicant alleging a violation of the ECOA or Regulation B.

Written copies need not be retained by creditors using a computerized system providing that the information can be timely regenerated.

In its proposed revisions to Regulation B, the FRB has submitted that creditors who solicit potential customers for credit be required to retain any preapproved credit solicitation, the list of criteria the creditor used to select the recipients of the solicitation, any correspondence related to complaints about the solicitation, and any component of any marketing plan related to the solicitation. n8 The creditor would be required to keep the information for 25 months, or 12 months for certain business credit. n9 In final rules published in March 2003, the Board decided to adopt the proposal requiring creditors to retain records related to the text of the solicitation, the criteria used to select potential customers for pre-screened solicitations, and correspondence related to consumer complaints. n10 However, the Board did not adopt the proposed requirement for creditors to identify and retain the component of the marketing plan to which the solicitation relates. The Board clarified that nothing in the final rule requires creditors to establish a separate database or set of files for correspondence relating to complaints about pre-screened solicitations. n11

When adverse action has been taken on a credit transaction outside of the application process, such as when the creditor has terminated or changed terms on an existing account, the creditor also must preserve the following records for 25 months after notification to the applicant of the adverse action:

- Any written or recorded information concerning the adverse action; and

- Any written statement submitted by the applicant, claiming a violation of the ECOA or Regulation B.

Currently, creditors dealing with business credit applicants have shorter retention periods. The FRB has proposed extending the record retention period for small business applicants to 25 months, believing that technical advances have alleviated concerns that such storage would be too costly and time-consuming. n12 Creditors notified that they are under investigation for ECOA violations must retain all records until the case is closed. The Board did not adopt this change. The final rules, published in March 2003, preserve the current record retention period of twelve months for business credit. n13

[a] Retention of Prohibited Information

The ECOA and Regulation B prohibit creditors from requesting certain types of information. n14 However, creditors may retain any information in their files, even if use of it would violate the ECOA or Regulation B, provided that the information was obtained:

- From any source prior to March 23, 1977;
- At any time, from consumer reporting agencies or others without the specific request of the creditor;
- At any time, from the applicant if the creditor did not specifically request the information; or
- At any time, if required for federal or state monitoring. n15

Thus, creditors may retain in their files the type of information which was the basis of much past credit discrimination. For example, they may retain information on birth control and childbearing; information about marital status even when it is irrelevant to creditworthiness; or references to the race of the applicant or the ethnic makeup of the applicant's neighborhood, provided the information was obtained either voluntarily from the applicant or from a third party such as a neighbor or a credit reporting agency. However, creditors may not use prohibited information in evaluating credit applications unless expressly permitted to do so. n16

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingGeneral Overview

FOOTNOTES:
(n1)Footnote 1. Reg. B, *12 C.F.R. §§ 202.7(c)(1), (2)*; Official Staff Commentary § 202.7(c).

(n2)Footnote 2. Readers unfamiliar with credit reporting procedures should refer generally to Ch. 16 *infra* .

(n3)Footnote 3. Reg. B, *12 C.F.R. §§ 202.3(a)(2), (b)(2), (c)(2).*

(n4)Footnote 4. *68 Fed. Reg. 13,144, 13,145, 13,146* (Mar. 18, 2003) .

(n5)Footnote 5. *64 Fed. Reg. 44,583* (proposed Aug. 16, 1999).

(n6)Footnote 6. Reg. B, *12 C.F.R. § 202.3*.

(n7)Footnote 7. Reg. B, *12 C.F.R. § 202.12(b)*. The final rule retains the current record retention period of twelve months for business credit. *68 Fed. Reg. 13,144, 13,152* (Mar. 18, 2003) .

(n8)Footnote 8. *64 Fed. Reg. 44,601* (proposed Aug. 16, 1999) (proposing to add *12 C.F.R. § 202.12(b)(7)*).

(n9)Footnote 9. *64 Fed. Reg. 44,601* (proposed Aug. 16, 1999) (proposing to add *12 C.F.R. § 202.12(b)(7)*). The Board opted for this requirement, believing the information would allow review and analysis of creditors' possible use of prohibited bases in their preapproved credit solicitations, rather than extending the ECOA to prescreened credit solicitations. *See 64 Fed. Reg. 44,584-44,585* (proposed Aug. 16, 1999).

(n10)Footnote 10. *68 Fed. Reg. 13,144, 13,153* (Mar. 18, 2003) .

(n11)Footnote 11. *68 Fed. Reg. 13,144, 13,153* (Mar. 18, 2003) .

(n12)Footnote 12. *64 Fed. Reg. 44,558, 44,601* (proposed Aug. 16, 1999).

(n13)Footnote 13. *68 Fed. Reg. 13,144, 13,152* (Mar. 18, 2003) .

(n14)Footnote 14. *See § 5.05[3] supra* (prohibited requests for information). Note that the FRB proposed revisions to Regulation B would allow creditors to make requests for this information with certain safeguards. *64 Fed. Reg. 44,582, 44,594* (Aug. 16, 1999) . In 2003, the Board decided not to remove the prohibition against requesting this information. Instead of lifting the ban, the Board created a new exception for collection of this information for the purpose of conducting a self-test under § 202.15. *68 Fed. Reg. 13,144, 13,147-13,150* (Mar. 18, 2003) .

(n15)Footnote 15. Reg. B, *12 C.F.R. § 202.12(a)*.

(n16)Footnote 16. Official Staff Commentary, *12 C.F.R. § 202.12(a)-2*.

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

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§ 5.09 Proving Credit Discrimination

[1] HMDA and Other Monitoring Data

[a] HMDA Data

The Home Mortgage Disclosure Act ("HMDA") n1 and FRB Regulation C n2 require that lenders collect certain data on loan applicants, and that the Federal Financial Institutions Examination Council prepare disclosure statements and produce various reports on the practices of these individual lenders. For each metropolitan statistical area, each lender's disclosure statement shows lending patterns by location, age of housing stock, income level, sex, and racial characteristics. In addition to disclosures for each lender, the Council also produces aggregate reports for each metropolitan statistical area for all lenders, broken down by census tract. Plaintiffs can then compare a particular lender's experience with that of the aggregate lenders for the same geographic area.

The disclosure statement, aggregate data, and other reports are available after July 1 of the following year to the public at central data depositories in each metropolitan area; a listing of such depositories can be obtained from the Federal Financial Institutions Examination Council, Washington, D.C. 20006. n3

Strong statistical evidence is particularly critical in proving disparate impact claims, and HMDA data is one of the most effective and accessible sources of data. Although there are limits to HMDA data, advocates bringing reverse redlining claims and credit discrimination cases will almost always want to examine HMDA data and, in many situations, base their cases on it. n4

The HMDA requirements only apply to federally insured or regulated lenders, or where the loan is insured by a federal agency or the lender intends to sell the loan to Fannie Mae or Freddie Mac, and even then does not apply to smaller institutions or those that do not do business in a metropolitan area. Institutions not falling within this definition must still keep information for monitoring purposes pursuant to the ECOA.

In addition, certain for-profit institutions (other than banks, saving institutions, or credit unions) are covered by HMDA requirements. In order to be covered, these institutions must have originated home purchase loans (including refinancings) that equaled at least 10% of the institution's loan-origination volume or home purchase loans (including refinancing) that equaled at least $25 million and have a home or branch office in an MSA and either have total assets

of more than $10 million or originated at least 100 home purchase loans, including refinancings. n5

HMDA though is broader in scope than the ECOA in that lenders not only have to obtain monitoring data for loans to purchase or refinance a principal residence, but also for home improvement loans. n6 Covered lenders must keep the following data for each covered loan:

(1) an identifying number for the loan or loan application, and the date the application was received;

(2) the type of loan or application;

(3) the purpose of the loan or application;

(4) whether the application is a request for pre-approval and whether it resulted in a denial or in an origination; n7

(5) the property type to which the loan or application relates; n8

(6) the owner-occupancy status of the property to which the loan or application relates;

(7) the amount of the loan or the amount applied for;

(8) the type of action taken, and the date;

(9) the location of the property to which the loan or application relates, by MSA or by metropolitan division, by state, by county, and by census tract, if the institution has a home of branch office in that MSA or metropolitan division;

(10) the ethnicity, race, and sex of the applicant or borrower, and the gross annual income relied on in processing the application; n9

(11) the type of entity purchasing a loan that the institution originates or purchases and then sells within the same calendar year;

(12) for originated loans subject to Regulation Z, 12 C.F.R. § 226 (Truth in Lending), the difference between the loan's annual percentage rate (APR) and the yield on Treasury securities having comparable periods of maturity, if that difference is equal to or greater than three percentage points for loans secured by a first lien on a dwelling or equal to or greater than five percentage points for loans secured by a subordinate lien on a dwelling;

(13) whether the loan is subject to the Home Ownership and Equity Protection Act of 1994, and

(14) the lien status of the loan or application. n10

[i] Changes to HMDA Effective January 2004 n11

In January 2002, the FRB announced changes in Regulation C intended to provide more consistent and comprehensive information about mortgage lending activity and to aid in fair lending enforcement. These changes are summarized below.

A number of changes relate to the reporting of subprime loans. The first is a new requirement that lenders designate on their HMDA reports which of the loans they originate are high-cost loans, subject to the provisions of the Home Ownership Equity Protection Act ("HOEPA"). n12

The second predatory lending-related change requires additional reporting on loan pricing. The Board rejected a proposal to require reporting of annual percentage rates ("APRs"), instead adopting a scheme based on the difference between the APR on the loan and the yield on a comparable security issued by the U.S. Treasury. The Board set out tentative thresholds for reporting these spreads. n13 These proposed thresholds were later adopted. n14 For first lien loans, if that spread is more than three percentage points, lenders will have to report how big the spread is. For junior lien loans, lenders will have to report the spread if it is more than five percentage points. n15 This regulation is limited to originations of home purchase loans, secured home improvement loans, and refinancings. n16

The FRB also made changes intended to expand the scope of lenders that must maintain HMDA data. Currently, nondepository for-profit lenders must maintain and report HMDA data only if they have assets above $10 million, originated at least one hundred home purchase or refinance loans in the previous calendar year, and their mortgage lending activity constituted 10% or more of their total loan volume (measured in dollars). n17 The Board added a requirement that nondepository lenders whose mortgage lending activity amounted to $25 million in the previous calendar year must report HMDA data, even if this lending constituted less than 10% of the institutions' total loan volume. n18

Among other important changes the FRB made is a requirement that lenders indicate which applications are for manufactured homes. n19 The new rule also changes the definition of a refinancing loan that must be reported under the HMDA. The new definition covers loans that pay off and replace an existing loan, when both loans are secured by a lien on the dwelling. n20 Previously, lenders could choose from among four scenarios in deciding which refinancing loans to report, leading to inconsistent data. n21

A third change that relates to subprime lending is the requirement that lenders distinguish which loans are unsecured or secured by first liens or subordinate liens. The final rule requires lenders to report lien status on applications and originations but not for loans that they purchase. n22

These changes take effect for data collected under the HMDA beginning January 1, 2004.

[B] Monitoring Data Required by the ECOA

In addition to the HMDA requirements, the ECOA also requires creditors to retain certain information for monitoring purposes. This is significant for two reasons. First, certain smaller institutions, institutions that do not do business within a metropolitan area, and lenders with no federal connection need not comply with the HMDA requirements, while the ECOA requirements will apply to all "creditors," thus including every mortgage lender. n23 (Nevertheless, the ECOA requirement only applies whenever a consumer seeks a loan to purchase or refinance a principal residence, and does not apply to home improvement loans.)

Second, the ECOA requires the creditor to obtain certain information also required by HMDA (the applicant's race or national origin, and sex), but the ECOA also requires information on marital status (married, unmarried, or separated) and age. The ECOA data is not routinely compiled into reports like the HMDA data, and the data is not generally open for inspection. Nevertheless, the relevant enforcement agency may have requested the data, and may have compiled it in some fashion.

[c] Data Not Related to Mortgages

While statistical data relating to home mortgage and home improvement loan applicants are readily available, the same is not the case for other types of credit. In fact, the ECOA prohibits creditors from asking information about an applicant's race, religion, national origin, sex, or other factors except in certain very narrow situations. HMDA and ECOA mortgage data needed for monitoring is one of the few exceptions to this rule.

Thus, except for HMDA and ECOA mortgage data, a creditor legally should not have statistics as to the racial, sexual or other breakdown of those denied or approved for credit. The FRB has created a new exception for collection of this information, however, for the purpose of conducting a self-test under § 202.15. n24 The self-test exception allows creditors that wish to monitor and ensure compliance with the ECOA to inquire and note information about non-mortgage credit applicants' personal characteristics. Creditors that collect this information must disclose at the time the information is requested that the applicant will not be required to provide the information, that the creditor is requesting the information to monitor its compliance with the federal Equal Credit Opportunity Act, that federal law prohibits the creditor from discriminating on the basis of this information or on the basis of an applicant's decision not to furnish the information and if applicable, that certain information will be collected based on visual observation or surname if not provided by the applicant or other person. n25

In order to avail itself of the self-test exception, a creditor must meet the requirements for conducting a self-test under Regulation B, *12 C.F.R. 202.15*.

[2] Sources of Evidence

Plaintiffs litigating credit discrimination cases have numerous sources of information and evidence. The best of these are their own records, the creditor's files, credit reporting agencies, using testers, and checking data required to be maintained by federal law or court order. n26

Investigations involving testers recently led to settlements with five mortgage lenders in the Fort Worth and Dallas areas of Texas. The Fort Worth Human Relations Commission used testers to study fair lending practices in the pre-application stage of the mortgage loan process. One hundred white and minority testers assisted in the study of twenty-eight lenders. Eight of the twenty-eight showed disparities in the way minority and white testers were treated.

As a result of these studies, five mortgage lenders entered into agreements with HUD and the Fort Worth Human Relations Commission committing themselves collectively to invest approximately $3.5 billion to assist minority and low-income mortgage borrowers. The lenders are: Temple-Inland Mortgage Corporation, Banc One Mortgage Corporation, Overton Bank and Trust, SFM Mortgage Corporation, and AccuBanc Mortgage Corporation. n27 In addition to the monetary commitments, each lender also agreed to make changes in their training and outreach efforts, to develop and implement standardized pre-application policy and procedures to be applied equally to all prospective applicants, and to apply flexible underwriting standards to the extent allowed by purchasers of their loans in the secondary market.

[3] Proving Disparate Treatment

[a] Introduction

Fair Housing Act and ECOA claims can allege either disparate treatment or disparate impact. Actions under the Federal Civil Rights Acts can only allege disparate treatment. This section describes how to prove disparate treatment, and the next discusses disparate impact.

To prove disparate treatment, plaintiff must show (1) membership in a protected class; (2) application for credit for which the plaintiff was qualified; (3) rejection despite qualification; and (4) defendant continued to approve credit for similarly qualified applicants. n28 The burden then shifts to the creditor to articulate a legitimate non-discriminatory basis for the adverse action. If defendant does so, plaintiff must show the "legitimate" reasons were merely a pretext for discrimination. n29 It may be relatively easy to show that a creditor discriminated against an individual, that is, that it treated that individual differently than other applicants. The difficult part of a disparate treatment case is to show that the creditor acted on a prohibited basis in treating applicants differently.

It is not enough to show that the applicant denied credit was black, a woman, or had some other characteristic protected by credit discrimination legislation. n30 The plaintiff must show that the credit decision was at least in part based on this characteristic. The creditor will typically claim that the credit denial was not based on such a protected characteristic, but was based on objective standards of creditworthiness. n31

Since most applicants have some kind of blemish on their credit record, their employment history, or income potential, it is relatively easy for a creditor to point to a specific legitimate reason to deny credit to an applicant. The plaintiff will have to show that this is not the real reason for the creditor action, that the real reason was because of the applicant's race, sex, or some other special characteristic. n32

If the creditor's business justification is a mere pretext for the real reason, which is a prohibited basis, then it is irrelevant how good a business justification the creditor has presented. Even if the justification is an absolute business necessity, if the real reason for its actions was a prohibited basis, then there is disparate treatment. The Civil Rights Act of 1991 recently reaffirmed this principle in the employment discrimination context, indicating unequivocally that business necessity is no defense against a claim of intentional discrimination. n33

Conversely, if the business justification is the real reason, it is irrelevant that the justification is not a good one or that there are other ways of accomplishing the same business goal with a narrower impact on a prohibited basis. n34 Instead, such a case should be brought for its disparate impact, not disparate treatment.

[b] Direct Evidence of Disparate Treatment

There are two ways to prove that the creditor really used a prohibited basis to make a credit decision--either through direct or circumstantial evidence. Clearly, direct evidence of disparate treatment on a prohibited basis will constitute a *prima facie* violation of a credit discrimination statute. n35 Sometimes, a creditor will actually admit that its credit decision was based on public assistance status--"We do not handle Medicare or Medicaid patients, or we do not rent to those on public assistance"--or based on familial or marital status or age. It is less likely that a creditor will admit to acting on an individual's race, religion, or national origin.

Nevertheless, direct evidence of an intent to discriminate on a prohibited basis sometimes can be obtained from former employees of the creditor, from those with whom the creditor communicated, or from notations in the creditor's records.

[c] Circumstantial Evidence

[i] General

If the plaintiff does not have direct evidence of disparate treatment, a prima facie case may be established through circumstantial evidence. To prove disparate treatment using circumstantial evidence, most courts will require that a plaintiff first establish a prima facie case of discrimination by showing: 1) membership in a protected class; 2) application for credit for which the plaintiff was qualified; 3) rejection despite qualification; and 4) that defendant continued to approve credit for similarly qualified applicants. n36 In a typical predatory lending case, a prima facie case would require showing that the plaintiff: 1) is a member of a protected class; 2) applied for and was qualified for a loan; 3) was given grossly unfavorable terms; and 4) that the lender continues to provide loans to other applicants with similar qualifications, but on significantly more favorable terms. n37 There should be an alternative to the fourth prong if plaintiffs can present direct evidence that the lender intentionally targeted them on a prohibited basis. At a minimum, in that case, the plaintiff should not have to show that the lender makes loans on more favorable terms to others. n38

This analysis is derived from a Supreme Court employment discrimination case, *McDonnell-Douglas Corp. v. Green*. n39 With certain exceptions, most courts use this test for claims brought under the ECOA, the FHA, and the federal Civil Rights Acts.

The lender may then rebut the prima facie case by showing a legitimate, nondiscriminatory business justification for the denial of credit. n40 If the lender meets its burden, the plaintiff must prove that the alleged justification is merely a pretext for discrimination. n41

[ii] Where Denial Is Based on Credit Scoring System

When a creditor uses a credit scoring or similar system, the circumstantial evidence might merely indicate that the applicant is a member of a protected class, received a passing grade under the creditor's objective system, but was still denied credit.

Disparate treatment can also be shown even if the applicant failed to obtain a passing grade on the creditor's test. The issue is whether other applicants received the same failing grade but still were offered credit.

Another possibility of disparate treatment even when an applicant failed objective tests is to determine if there is discrimination as to how the tests are applied. A good example is the real estate appraisal process. If appraisals on comparable property are lower for blacks than whites, this would cause blacks to fail the loan-to-value ratio more often.

Differences in appraisal practices are also specifically prohibited by the Fair Housing Act, and should violate the ECOA and the Civil Rights Acts as well. Look to see if a creditor uses only white appraisers, for example, even when black appraisers are available who might be more familiar with predominantly black neighborhoods.

One method of discovering discrimination in appraisal practices is to ask the creditor to appraise the same residence a second time, under a different name, where the fictitious applicant has different characteristics than the original applicant.

The Justice Department has begun to look more closely at credit scoring biases in its enforcement actions. In 1999, the DOJ filed a suit against Deposit Guaranty National Bank ("DGNB"), alleging violations of the FHA and ECOA based on intentional discrimination against African-Americans in its underwriting of applications for home improvement loans. n42 The complaint alleged that DGNB did not strictly adhere to its stated credit scoring decision-making process or to its written underwriting guidelines for credit scoring and loan approval. DGNB loan officers allegedly had broad discretion to override decisions for credit-scored loan applications and a high level of this decision-making was inconsistent with the credit scores of individual applicants. The purpose and effect, according to the complaint, was to grant credit less frequently to African-American loan applicants in violation of the FHA and ECOA.

A settlement agreement was filed simultaneously with the filing of the complaint. Under the terms of the settlement agreement, a $3 million fund was to be created to compensate African-American applicants who were denied home improvement loans under DGNB's prior underwriting system. In addition, DGNB agreed to adopt new underwriting policies which include a second level of review for all applications initially recommended for rejection, a limited number of bank officials who have the authority to override a credit score, and frequent reviews of all underwriting decisions for consistency with the ECOA and FHA. n43

In a case against ANB also filed in 1999, the DOJ alleged that ANB implemented different standards for English language applicants than for Spanish language applicants. n44 The DOJ alleged that ANB coded Spanish language applications as "Hispanic" and maintained those accounts in a separate sub-file. According to the complaint, ANB then lowered the credit score cutoff and increased the credit lines for English language applicants, but did not adopt those changes for Spanish language applicants. As a result, the denial rate of credit cards for Spanish speaking applicants was higher and others were given lower credit limits. The case was settled in January 2001. The settlement agreement provided for a $1.5 million fund to compensate Hispanic applicants and cardholders affected by the allegedly discriminatory practices. The settlement did not contain any injunctive relief. n45

[iii] Denial Based on a Judgmental System

Many creditors use a judgmental system. In this situation, it is useful to consider the stated reason for the creditor rejecting the applicant.

If the stated reason for denial of credit is a mere pretext for the real reason which is on a prohibited basis, the plaintiff should be able to prove disparate treatment. The plaintiff will also have proven a violation of the ECOA requirement that the notice of adverse action contain the real reason for credit denial.

[iv] Disparate Efforts to Encourage Applicants

In some cases, the discrimination can be even more subtle, involving discrimination not in handling applications, but in how applications are encouraged or discouraged. This might be circumstantial evidence of the creditor's intent in dealing with the applicant. That is, if a creditor takes direct steps to discourage black applicants, and then denies credit to a black who still applies, the general discouragement of black applicants is evidence of the creditor's intent in denying credit to the black who does apply.

[v] Use of Statistics

Credit discrimination can be shown by demonstrating a statistical disparity between persons whose applications were accepted and those who were rejected. n46 General statistics which do not relate to the discriminatory policy alleged do not satisfy the plaintiff's burden.

[4] Proving Disparate Impact

[a] Introduction

An alternative under the FHA and the ECOA to proving disparate treatment is proving disparate impact. That is, although the creditor may not be treating applicants differently on a prohibited basis, the *effect* of the creditor's practices is to adversely impact a particular protected class. Proof of disparate impact is very different than proof of disparate treatment. Where disparate treatment on a prohibited basis cannot be proved, the plaintiff can attempt to prove discrimination based on the effect of the creditor's practices. Disparate impact and disparate treatment are not mutually exclusive claims, but rather different methods of proof. n47

To prove disparate impact, the applicant must show how a specifically identified policy, practice, or procedure has a significantly greater impact on members of a protected class.

Although the U.S. Supreme Court has not directly ruled on the issue, n48 it is widely accepted that proof of discriminatory impact or effect can lead to a violation of the credit discrimination provisions of the Fair Housing Act and the ECOA. Nevertheless, most cases describing the precise standards as to whether a practice has a discriminatory impact are in the employment or housing areas, and do not involve credit discrimination. n49 This requires the plaintiff to make extra efforts in proving disparate impact until the standards are more routinized.

[b] The ECOA Commentary Standards

The most important standards for credit discrimination cases are those set out in the FRB's Official Staff Commentary to ECOA Regulation B. FRB interpretations of the ECOA are afforded great deference by the courts, n50 particularly considering the limited court precedent available. n51 Courts will not overturn the Commentary standards unless the standards are demonstrably irrational or conflict with the statute, or are beyond the FRB's authority.

The Official Staff Commentary states:

> "The act and regulation may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact." n52

[c] The Fair Housing Act Standard

Effects test standards under the FHA in housing discrimination cases are similar to those found in the ECOA Commentary. n53

[d] Burdens of Proof

The plaintiff has the burden of proving the creditor's practices have a disparate impact on a protected class. n54 Generally, this requires proof that (1) plaintiff is a member of a protected class; (2) plaintiff applied for credit; (3) plaintiff was qualified for the loan; and (4) plaintiff was denied credit. The burden of proof then shifts to the creditor. n55

[e] Redlining

Probably the most frequently considered example of a credit factor with a disparate impact on minorities is geographical redlining. Redlining refers to the practice of separating out certain neighborhoods for disparate treatment as to mortgage or other types of lending. n56

Government enforcement actions have also focused on redlining. For example, in *United States v. Albank*, n57 the DOJ alleged that Albank refused to fund mortgage loans secured by residential properties located in certain areas in Connecticut and in Westchester County, New York, where significant populations of African-Americans and Hispanics lived. Although Albank made exceptions to its policies, the exceptions were predominately for white borrowers. Albank entered into a consent decree, which required the bank to adopt a remedial special mortgage lending program which provides homebuyer counseling and marketing tailored to the communities it previously refused to serve and to provide $55 million in loans at below market rates to those areas.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityDiscriminatory ActsCivil Rights LawContractual Relations & HousingEqual Rights Under the Law (sec. 1981)Proof of DiscriminationCivil Rights LawContractual Relations & HousingFair Housing RightsFair Housing ActReal Property LawFinancingRedlining

FOOTNOTES:
(n1)Footnote 1. *12 U.S.C. § 2801.*

(n2)Footnote 2. 12 C.F.R. § 203.

(n3)Footnote 3. The FRB releases HMDA data on CD-Rom annually, usually in August. It is also available online. To obtain more information by phone, call 202-452-2016 (HMDA Assistance Line); online, visit www.ffiec.gov/hmda. Data obtained in this way is designed to allow users to look up one lender at a time. To do more in-depth analysis, users will need to import the data into statistical software or a database manager. *See generally* Jo Craven McGinty, Home Mortgage Lending: How To Detect Disparities (Investigative Reporters & Editors, Inc. 2000). A number of websites have information about analyzing and obtaining access to HMDA data, including: The Center for Community Change (www.communitychange.org); Inner City Press (www.innercitypress.org); and National Fair Housing Advocate

(www.fairhousing.com).

(n4)Footnote 4. *See, e.g, Paschal v. Flagstar Bank, 295 F.3d 565 (6th Cir. 2002)* (HMDA data, along with tester results and testimony, considered sufficient evidence to support jury's finding of racial discrimination).

(n5)Footnote 5. *12 C.F.R. § 203.2(e)(2)*. Prior to the 2002 amendments, for-profit lenders were exempt unless they had assets over $10 million and originated more than one hundred home purchase or refinance loans in the preceding year and their lending activity constituted 10% or more of their total loan volume measured in dollars. The Board changed this requirement in response to concerns that a number of large consumer finance companies that are active mortgage lenders apparently were not required to report HMDA data because they did not reach the 10% volume level. Rather than eliminating the 10% requirement, the Board added a requirement that non-depository lenders whose mortgage-lending activity amounted to $25 million in the previous calendar year must report HMDA data, even if this lending constituted less than 10% of the institutions' total loan volume. *67 Fed. Reg. 7222* (Feb. 15, 2002) .

(n6)Footnote 6. *12 C.F.R. § 203.4(a)*.

(n7)Footnote 7. Pre-approval programs are defined as programs under which, after a comprehensive analysis of the creditworthiness of the applicant, the lender issues a written commitment to lend borrowers up to a specific amount for a specific period of time, subject only to limited conditions, such as finding a suitable property. *12 C.F.R. § 203.2(b)(2)*.

(n8)Footnote 8. In the 2002 final rules, the Board decided to require lenders to specify when loans involve manufactured housing. *67 Fed. Reg. 7222* (Feb. 15, 2003) . The Board adopted the definition of "manufactured housing" found in HUD regulations. *12 C.F.R. § 203.2(i)*, citing the HUD regulation at *24 C.F.R. § 3280.2*.

(n9)Footnote 9. In 2002, the Board published rules that changed the way that race and ethnicity are reported to allow borrowers to designate more than one race or ethnicity. This change is in conformance with other government standards. *67 Fed. Reg. 7222* (Feb. 15, 2002) .

(n10)Footnote 10. *12 C.F.R. § 203.4(a)*.

(n11)Footnote 11. On May 2, 2002, the FRB announced a delay in the effective date of these changes from January 1, 2003 to January 1, 2004. *67 Fed. Reg. 30,771* (May 8, 2002). There are two exceptions to the January 1, 2004, effective date. First, the new requirement that lenders taking applications by phone must ask for an applicant's ethnicity, race, and sex is effective January 1, 2003. *67 Fed. Reg. 43,217* (June 27, 2002). Second, beginning in 2003, lenders must use the census tract numbers and corresponding geographic areas from the 2000 census when reporting on all applications and loans. *67 Fed. Reg. 30,771* (May 8, 2002). In March 2003, the Board published proposed rules to address the collection and reporting of certain data for applications received before January 1, 2004, for which final action is taken on or after January 1, 2004. *68 Fed. Reg. 11,010* (Mar. 7, 2003). Under the proposed transition rules, lenders would not have to indicate whether an application or loan involved a request for preapproval or is related to a manufactured home and could at their option, continue to apply the current definitions of a home improvement loan and of refinancing. *Id*.

(n12)Footnote 12. *67 Fed. Reg. 7222, 7230* (Feb. 15, 2002) (amending *12 C.F.R. § 203.4(a)(13)*). *See generally* National Consumer Law Center, Truth In Lending Ch. 10 (4th ed. 1999 and Supp.) (HOEPA); Center for Community Change, Home Mortgage Disclosure Act: Fed Announces New Mortgage Disclosure Rules--More Info on Subprime Lending, *available at* www.communitychange.org (last visited April 2002). This change, effective January 1, 2004, should expand the information available on HOEPA loans. However, it will not capture the large numbers of loans that lenders fail, intentionally or not, to categorize as high-rate HOEPA loans.

(n13)Footnote 13. In the February 2002 final rules, the Board solicited additional comment on the thresholds. Final thresholds should be available in mid-2002.

(n14)Footnote 14. *67 Fed. Reg. 43,218* (June 27, 2002) .

(n15)Footnote 15. *67 Fed. Reg. 7222, 7228* (Feb. 15, 2002) (amending *12 C.F.R. § 203.4(a)(12)* and *(13)*).

(n16)Footnote 16. *67 Fed. Reg. 7222, 7228* (Feb. 15, 2002) .

(n17)Footnote 17. *12 C.F.R. § 203.3(a)(2), § 203.2(e).*

(n18)Footnote 18. *67 Fed. Reg. 7222, 7224* (Feb. 15, 2002) .

(n19)Footnote 19. *67 Fed. Reg. 7222, 7226* (Feb. 15, 2002) (amending *12 C.F.R. § 203.2(i)*).

(n20)Footnote 20. *67 Fed. Reg. 7222, 7226* (Feb. 15, 2002) (amending *12 C.F.R. § 203.2(k)*).

(n21)Footnote 21. *67 Fed. Reg. 7222, 7226* (Feb. 15, 2002) .

(n22)Footnote 22. *67 Fed. Reg. 43,218,43,219* (June 27, 2002) .

(n23)Footnote 23. Reg. B, *12 C.F.R. § 202.13(a).*

(n24)Footnote 24. *Id.* The new exception is codified at § 202.5(b)(1).

(n25)Footnote 25. *12 C.F.R. § 202.5(b)(1).*

(n26)Footnote 26. For discussion of various sources of evidence of discrimination and of credit scoring systems used by creditors, see National Consumer Law Center, Credit Discrimination, § 4.4 (4th ed. 2005 and Supp.).

(n27)Footnote 27. *See Fort Worth Human Relations Commission Study Leads to $1.375 Billion Fair Lending Settlement,* National Fair Housing Advocate 1 (Apr. 1998); Michael Janofsky, *Texas Lenders Pledge $1.4 Billion in Housing Case*, N.Y. Times (Mar. 10, 1998); *HUD Settles With Texas Mortgage Lender Charged With Fair Housing Act Violations,* 70 BNA Banking Report 688 (Apr. 27, 1998). See generally National Consumer Law Center, Credit Discrimination § 4.4.4 (3d ed. 2002 and Supp.), for further discussion of use of testers. *See also* Stella J. Adams, Testing and Investigating for Fair Housing Violations: Designing an Appropriate Test in Lending and Predatory Practices Cases (Apr. 12, 2002) (prepared for the John Marshall Law School, "Testing and Investigating for Fair Housing Violations" seminar, April 12 and 13, 2002) (available from the John Marshall Law School); Office of Policy Development and Research, United States HUD, *All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions, Final Report*(Apr. 2002).

(n28)Footnote 28. *A.B. & S. Auto Serv., Inc. v South Shore Bank, 962 F. Supp. 1056 (N.D. Ill. 1997) .*

(n29)Footnote 29. *Simms v. First Gibraltar Bank, 83 F.3d 1546 (5th Cir. 1996) , reh'g denied, 95 F.3d 56 , cert. denied, 519 U.S. 1041, 117 S. Ct. 610, 136 L. Ed. 2d 535 (1996) .*

(n30)Footnote 30. *See O'Dowd v. South Cent. Bell, 729 F.2d 347 (5th Cir. 1984)* (court rejected white couple's claim that telephone company discriminated in requiring a deposit, because of their exchange's racial composition, where couple had history of late payments and deposits were required of all such customers); *Gross v. United States Small Bus. Admin., 669 F. Supp. 50 (N.D.N.Y. 1987) , aff'd per curiam, 867 F,2d 1423 (2d Cir. 1988)* (no ECOA violation based on sex or marital status discrimination, since applicant was rejected due to past delinquent loan with same agency).

(n31)Footnote 31. *See Cartwright v. American Sav. & Loan Ass'n, 880 F.2d 912, 923 (7th Cir. 1989)* ; *Sassower v. Field, 752 F. Supp. 1182, 1188 (S.D.N.Y. 1990) .*

(n32)Footnote 32. *St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 113 S. Ct. 1550, 123 L. Ed. 2d 211 (1993)* (burden of persuasion remains with plaintiff to show defendant's stated reason were pretext to discriminate); *Soules v. United States Dep't of Housing & Urban Dev., 967 F.2d 817, 822 (2d Cir. 1992)* .

(n33)Footnote 33. *42 U.S.C. § 2000e-2(k)(2).*

(n34)Footnote 34. *See Texas Dep't of Cmty. Affairs v. Burdine, 450 U.S. 248, 101 S. Ct. 1089, 67 L. Ed. 2d 207 (1981)* (employment case); *McDonnell-Douglas Corp. v. Green, 411 U.S. 792, 93 S. Ct. 1817, 36 L. Ed. 2d 668 (1973)* (employment discrimination case). *See, e.g., Hu v. Cantwell, 2007 U.S. Dist. LEXIS 23884* (N.D. Ill. Mar. 29, 2007) (conclusory allegations of racial discrimination sufficed for purpose of surviving a motion to dismiss a Fair Housing Act claim). *But see Campbell v. Robb, 162 Fed. Appx. 460, 2006 U.S. App. LEXIS 622* (6th Cir. Jan. 9, 2006) (unpublished decision) (for prima facie case under § 1981, unlike Title VII, plaintiff must show that she was qualified to rent apartment even if plaintiff has direct evidence of discrimination). *Cf. Hallmark Developers, Inc. v. Fulton County, 466 F.3d 1276, 1284 (11th Cir. 2006)* (ruling that plaintiff had failed to make a prima facie case under the Fair Housing Act of disparate treatment by zoning authority).

(n35)Footnote 35. *See Pinchback v. Armistead Homes Corp., 907 F.2d 1447, 1452-53* (4th Cir.) , *cert. denied, 498 U.S. 983, 111 S. Ct. 515, 112 L. Ed. 2d 527 (1990) . See, e.g., Faulkner v. Glickman, 172 F. Supp. 2d 732 (D. Md. 2001)* (to constitute direct proof of discriminatory intent statements in question must be more than stray or isolated remarks) (citing *O'Connor v. Consolidated Coin Caterers Corp., 56 F.3d 542, 549 (4th Cir. 1995)* , *rev'd on other grounds, 517 U.S. 308 (1996)) . See, e.g., Tribett v. BNC Mortg., 2008 U.S. Dist. LEXIS 3573* (N.D. Ill. Jan. 17, 2008) (although stating that vague allegations of discrimination will not suffice to state an FHA claim, permitting the plaintiffs to amend their complaint to allege that either the defendant or its brokers disproportionately targeted African-American and Hispanic communities for loans and that the defendant continued to pay yield spread premiums despite knowing of price disparities in subprime loans that were due to race).

(n36)Footnote 36. *See, e.g., Simms v. First Gibralter Bank, 83 F.3d 1546 (5th Cir. 1996)* , *reh'g, en banc, denied, 95 F.3d 56* , *cert. denied, 519 U.S. 1041, 117 S. Ct. 610 (1996)* ; *Saldana v. Citibank, 1996 U.S. Dist. LEXIS 8327* (N.D. Ill. Jun. 13, 1996) ; *Farris v. Jefferson Bank, 194 B.R. 931 (Bankr. E.D. Pa. 1996)* .

(n37)Footnote 37. *See* Frank Lopez, *Using the Fair Housing Act to Combat Predatory Lending*, 6 Geo. J. on Poverty L. & Pol'y 73 (1999).

(n38)Footnote 38. *See, e.g., Wiltshire v. Dhanraj, 421 F. Supp. 2d 544 (E.D.N.Y. 2005)* (plaintiffs have alternative to fourth prong if they present direct evidence that the lender intentionally targeted them for unfair loans on a protected basis). The court in *Hargraves v. Capital City Mortgage Corp., 140 F. Supp. 2d 7 (D.D.C. 2000)* , noted that plaintiffs in reverse-redlining cases do not need to show that defendants made loans on more favorable terms to anyone other than the targeted class as long as they show that the terms of the loans are unfair and predatory. However, the *Hargraves* court was not explicitly examining the revised *McDonnell-Douglas* test.

(n39)Footnote 39. *McDonnell-Douglas Corp. v. Green, 411 U.S. 792, 93 S. Ct. 1817, 36 L. Ed. 2d 668 (1973)* . For a contrary holding, see *Latimore v. Citibank, 151 F.3d 712, 714 (7th Cir. 1998) . See generally* National Consumer Law Center, Credit Discrimination, § 4.2.3 (5th ed. 2009) for further discussion of these issues.

(n40)Footnote 40. *See Cartwright v. American Sav. & Loan Ass'n, 880 F.2d 912, 923 (7th Cir. 1989)* ; *Graham v. Chevron Credit Bank, N.A., 1997 U.S. Dist. LEXIS 17122* (N.D. Cal. Oct. 22, 1997) ; *Sassower v. Field, 752 F. Supp. 1182, 1188 (S.D.N.Y. 1990)* , *aff'd in part, vacated in part, remanded on other grounds, 973 F.2d 75 (2d Cir. 1992)* , *cert. denied, 507 U.S. 1043, 113 S. Ct. 1879, 123 L. Ed. 2d 497 (1993)* .

(n41)Footnote 41. *Soules v. United States Dep't of Hous. & Urban Dev., 967 F.2d 817, 822 (2d Cir. 1992)* ; *Latimore v. Citibank, F.S.B., 151 F.3d 712 (7th Cir. 1998)* (civil rights, Fair Housing Act, and ECOA case). *See Matthiesen v. Banc One Mortgage Corp., 173 F.3d 1242 (10th Cir. 1999)* ; *Massey v. First Greensboro Home Equity,*

Inc., 1998 U.S. Dist. LEXIS 6575 (M.D. Fla. Apr. 27, 1998) . *See, e.g., Nicholson v. Johanns, 2007 U.S. Dist. LEXIS 83909* (S.D. Ala. Nov. 13, 2007) . *See also Martinez v. Freedom Mortg. Team, Inc., 527 F. Supp. 2d 827 (N.D. Ill. 2007)* (refusing to dismiss FHA claim based on allegations that the defendants put more pressure on applicants of Hispanic origin to accept higher rates than on white applicants, rejecting the defendants' argument that the plaintiff must show that he was denied credit to state a claim); *Dismuke v. Connor, 2007 U.S. Dist. LEXIS 91912* (W.D. Ark. Dec. 14, 2007) (defendant in farm loan case showed legitimate non-discriminatory reasons for delay of loan decision where loan application was incomplete, borrower requested an increase in loan amount after initial application, and outside agency was hired to complete title work and do appraisal; plaintiff did not contend these arguments were pretextual).

(n42)Footnote 42. *See* United States v. Deposit Guar. Nat'l Bank, Civ. Action No. 3:99CV67OLN (S.D. Miss. 1999) (*available at* http://www.usdoj.gov).

(n43)Footnote 43. *See* United States v. Deposit Guar. Nat'l Bank, Civ. Action No. 3:99CV67OLN (S.D. Miss. 1999) (*available at* http://www.usdoj.gov).

(n44)Footnote 44. United States v. Associates Nat'l Bank, Civ. No. 99-196 (D. Del. Mar. 29, 1999) (*available at* http://www.usdoj.gov).

(n45)Footnote 45. United States. v. Associates Nat'l Bank, No. 99-196 (D.Del. 2001) (settlement agreement), also available at www.usdoj.gov (March 2001).

(n46)Footnote 46. *See International Brotherhood of Teamsters v. United States, 431 U.S. 324, 97 S. Ct. 1843, 52 L. Ed. 2d 396 (1977)* (prima facie case of employment discrimination found).

(n47)Footnote 47. *Watson v. Forth Worth Bank & Trust, 487 U.S. 977, 987, 108 S. Ct. 2777, 2785, 101 L. Ed. 2d 827, 840 (1988)* (in Title VII employment case, court stated that the factual issues that typically dominate in disparate impact cases do not imply that the ultimate issues are different than in cases where disparate treatment analysis is used).

(n48)Footnote 48. *See Town of Huntington v. Huntington Branch, NAACP, 488 U.S. 15, 16, 109 S. Ct. 276, 102 L. Ed. 2d 180 (1988)* (while the Supreme Court did not reach the question of which standard to utilize as to disparate impact, because the defendant had not challenged the application of one particular test, the Court did comment that it was "satisfied on this record that disparate impact was shown, and that the sole justification proffered to rebut the prima facie case was inadequate"). However, in 2005, the Supreme Court held in *Smith v. City of Jackson, 125 S. Ct. 1536 (2005)* , that the ADEA provides a cause of action for disparate impact. The Court noted that the ADEA, like Title VII, contains express language prohibiting conditions that "adversely affect" employment status on account of age. The ECOA does not contain such language. However, the majority also noted favorably that the EEOC had interpreted the statute to permit disparate impact claims. Justice Scalia based his concurrence on this argument. Focusing on the regulatory agency's approval of the disparate impact test bolsters the argument that disparate impact is available under the ECOA since the FRB has maintained that the ECOA allows such claims. *Zamudio v. HSBC N. Am. Holdings, Inc., 2008 U.S. Dist. LEXIS 13952* (N.D. Ill. Feb. 20, 2008) (it is well established that there is a disparate impact claim under the ECOA and FHA; case involves claim that racially discriminatory assumptions are embedded in statistical formulas used to analyze credit information and underwrite loans).

(n49)Footnote 49. One of the few cases under the Fair Housing Act to deal with credit discrimination is Briceno v. United Guar. Residential Ins. Co., No. 3:89, CV 7325, 5 Fair Hous.--Fair Lending Rep. (P-H) P 9.9 (N.D. Ohio dismissed Sept. 18, 1989). *Compare Latimore v. Citibank, F.S.B., 151 F.3d 712 (7th Cir. 1998)* (civil rights, FHA, and ECOA case in which court compares prima facie case under FHA followed generally with test used in Northern District of Ohio). With respect to the ECOA, there is support indicating that a disparate impact theory can be used. *See Coleman v. GMAC, 196 F.R.D. 315, 325 (M.D. Tenn. 2000)* (Granting plaintiff's motion for class certification and denying defendant's motion for summary judgment in part), *vacated and remanded on unrelated grounds, 296 F.3d 443 (6th Cir. 2002)* . (The legislative history of the ECOA indicates that the Congress intended an "effects test" concept, as outlined

in the employment field in the Supreme Court in the cases of *Griggs v. Duke Power Co., 401 U.S. 424, 91 S. Ct. 849, 28 L. Ed. 2d 158 (1971)* and *Albemarle Paper Co. v. Moody, 422 U.S. 405, 95 S. Ct. 2362, 45 L. Ed. 2d 280 (1975)* and citing *12 C.F.R. § 202.6(a)* n.2 and pt. 202, Supp. I., § 202.6(a)(2), Official Staff Commentary on Regulation B); *Haynes v. Bank of Wedowee 634 F. 2d 266 (5th Cir. 1981)* (noting use of disparate impact standard in ECOA case); *A.B. & S Auto Serv. v. South Shore Bank, 962 F. Supp. 1056 (N.D. Ill. 1997)* .

(n50)Footnote 50. *Ford Motor Credit Co. v. Milhollin, 444 U.S. 555, 100 S. Ct. 790, 63 L. Ed. 2d 22 (1980)* .

(n51)Footnote 51. However, without referring to the FRB's interpretation that the effects test applies, the Seventh Circuit recently rejected the effects test in an ECOA case. *Latimore v. Citibank F.S.B., 151 F.3d 712 (7th Cir. 1998)* .

(n52)Footnote 52. Official Staff Commentary § 202.6(a)-2.

(n53)Footnote 53. *See* National Consumer Law Center, Credit Discrimination, § 4.3.2.4 (5th ed. 2009).

(n54)Footnote 54. *See* National Consumer Law Center, Credit Discrimination, § 4.3.2 (5th ed. 2009).

(n55)Footnote 55. *Matthiesen v. Banc One Mortgage Corp., 173 F.3d 1242 (10th Cir. 1999)* ; *Coleman v. GMAC, 196 F.R.D. 315 (M.D. Tenn. 2000)* (plaintiffs presented statistical evidence showing that African Americans were 203% more likely to be charged an interest rate mark-up than similarly situated whites, paying an average of $315.35 more than white customers).

(n56)Footnote 56. *See* National Consumer Law Center, Credit Discrimination, Ch. 7 (5th ed. 2009). *See also* Jonathan Brown, Racial Redlining: A Study of Racial Discrimination by Bankers and Mortgage Companies in the United States (1993) (In 2001, available on-line at http://www.essential.org).

(n57)Footnote 57. United States v. Albank, Clearinghouse No. 52,054, Civ. No. 97-1206 (N.D.N.Y. Aug. 13, 1997) (complaint and consent decree).

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

1-5 Consumer Credit Law Manual § 5.10

§ 5.10 Litigating a Credit Discrimination Case

[1] The Plaintiff

[a] The Plaintiff Must Be Aggrieved

Under any of the credit discrimination statutes, it is important that the plaintiff be "aggrieved" by the statutory violation. Otherwise, the plaintiff may not have standing under U.S. Constitution Article III. Moreover, both the ECOA and the Fair Housing Act provide private remedies only for "aggrieved" persons. n1 There must also be some linkage between the relief sought and why the plaintiff is aggrieved.

"Aggrieved person" is defined in Fair Housing regulations as any person who claims to be injured by a discriminatory practice or believes he or she will be injured by a discriminatory practice that is about to occur. n2

The aggrieved individual bringing an ECOA, Fair Housing or Civil Rights Act suit need not be a member of the group being discriminated against, as long as the individual is injured by the discrimination. For example, a white can bring an action under any of the credit discrimination laws if denied credit because he or she lives in a predominantly black neighborhood or associates with blacks. n3 Courts may allow an association to bring ECOA claims on behalf of its members as long as Article III standing requirements are met. n4 To make this determination, a court will determine: a) whether the association's members would otherwise have standing to sue in their own right; b) whether the interests the association seeks to protect are germane to the organization's purpose; and c) that neither the claims asserted nor the relief requested requires the participation of the association's individual members in the lawsuit. n5

Increasingly, consumers are facing the possibility that their claims against creditors may not be resolved by either a judicial or an administrative process. A growing problem for consumers seeking to assert their statutory rights has been the insertion of mandatory arbitration clauses into consumer credit agreements. It is not an issue that has arisen much in the credit discrimination context, but should be anticipated as arbitration clauses become commonplace in consumer contracts. n6

[b] Other Preconditions for Plaintiffs

Under the ECOA, only "applicants," those who seek credit, those who have been extended credit, and others obligated

on the debt can bring actions. It will be more difficult for an organization representing applicants to bring an ECOA action than a FHA case.

If an action is brought under section 1982, the plaintiff must be a United States citizen. The same requirement does not apply for section 1981, the ECOA, or the FHA.

[c] Class Actions

Class actions are available under all the credit discrimination statutes, and the same issues arise in such class actions as with any other type of consumer class action. n7 Several unique issues also arise in deciding whether to bring a discrimination suit as an individual or class action. Under the ECOA, if a creditor has a net worth less than $1 million, then maximum class action punitive damages are *less* than the punitive damages available in an individual action. In addition, since there are no limits to the size of punitive damages under the FHA and Civil Rights Acts, there may be no need to bring a class action if punitive damages are the major relief sought, since an individual action may produce a large punitive damages award that would deter future misconduct. Despite differences in damage amounts and other variations among individual members of a class, it is possible to certify class actions in discrimination cases. For example, in a case challenging a car financing company's allegedly discriminatory mark-up policies, courts have certified classes even though there are individual questions of fact involved and variations in consumers' interactions with specific dealers. n8

In addition, there may be significant differences in damages among class members. For example, in a redlining case, potential class members may all live in the designated geographic area or be members of a protected group but will differ as to individual qualifications for credit. In this case, courts may certify the class for injunctive relief only and require individual claims for damages to proceed separately. n9

[2] The Defendant

Most credit discrimination cases are brought against the creditor extending or refusing to extend the credit. Very few such creditors are exempt from the credit discrimination laws. Those who arranged the loan application and parties that might eventually purchase a loan as well as the credit extenders may also be sued. n10 ECOA remedies are limited where a government entity is the creditor, and the ECOA and FHA may not apply to an individual who only makes one or two isolated loans.

Corporate principals may also be individually responsible for the acts of the corporation's agent. n11 Holding the principals responsible for the acts of the corporation and its agents can be critical to collecting on a judgment at the end of the day. n12 Corporations and other entities that are wholly owned by one or a few individuals may be merely a shell to protect the individuals from liability. The individuals may, in reality, be the deep pockets. Informal investigation before the filing of a case can clarify the corporate and/or familiar relationships and agency ties that form the web of a fraudulent scheme.

[3] Selecting the Forum

[a] General

Credit discrimination cases can be brought either in federal district court, without regard to the amount of damages involved, or in state court. n13 Relevant factors include court schedules, fees, different discovery rules, class notification requirements, etc.

If federal court is the preferred forum, then at least one claim must be under the federal credit discrimination laws--the ECOA, the FHA, or the Federal Civil Rights Acts. If the plaintiff prefers a state forum, the plaintiff must anticipate that the defendant will prefer a federal forum. If the plaintiff's complaint includes a claim under a federal discrimination law,

the defendant may be able to remove the case to federal court pursuant to *28 U.S.C. section 1441*.

If the plaintiff wants to stay in state court, the safest course will be to plead an action solely under a state credit discrimination or other state claim.

A consumer may wish to bring a federal credit discrimination law claim by way of counterclaim to a creditor's state court collection action. This will generally not provide a basis to remove an action to federal court because the federal question must appear in the complaint.

[b] Deciding Whether to Select an Administrative Determination

There are two ways to make a claim under the FHA. The aggrieved party may file an administrative complaint with HUD n14 or commence a private civil action. n15 These two procedures are not mutually exclusive and may be pursued contemporaneously or sequentially. There is no requirement that the administrative remedies be exhausted prior to instituting a private action. n16 The only restriction is that trial of the private action may not be commenced once the actual administrative hearing has begun n17 and an administrative hearing may not go forward if a civil trial has begun. n18

The administrative complaint procedure will, in many cases, offer a satisfactory method of redress at a substantially lower cost than a private action. The greatest advantage of the administrative route is this low cost to the complainant since the government bears the burden of investigating and proving the case even after it is removed to federal court. The complainant need not have an attorney or pay any filing fees. The complainant, nevertheless, has the right to intervene in the administrative proceeding and conduct an independent investigation.

There are drawbacks to the administrative option: loss of control over the case, delay, and no punitive damages. Given all of these factors, the wisest course is probably to commence both an administrative and judicial proceeding simultaneously. This strategy prevents the respondent from using its right to remove as a delaying tactic, allows the aggrieved party to conduct discovery and early motion practice in the private proceeding, putting pressure on the respondent to settle as it is forced to spend money, and prevents delay if HUD finds no reasonable cause to prosecute the administrative complaint.

[c] How the Administrative Procedure Works

If an individual files a complaint with HUD, HUD is required to refer the complaint to the state or local agency in whose jurisdiction the alleged discrimination occurred, if that agency is "certified" as having a law comparable to the Federal FHA. n19 The list of certified states is updated annually.

The state or local agency is given 30 days to commence a proceeding. n20 If the agency fails to do so, the complaint reverts back to HUD. n21

After the complaint is filed, or reverts back due to the inaction of a state or local agency, HUD has 100 days in which to conduct an investigation. n22 If the investigation leads to a finding of reasonable cause, the government initiates an action.

Either the respondent or the complainant has the right at this stage to elect that the case be removed to federal district court. n23 The purpose of this provision is to assure that the statute does not violate the respondent's constitutional right to a jury trial. If no election to remove the case is made, the case is heard by an administrative law judge.

[d] Mandatory Arbitration

Mandatory arbitration clauses are now appearing more frequently in consumer contracts. If enforced, these clauses often place consumers at a great disadvantage to their adversaries. n24

[i] Problems of Pre-Dispute Arbitration Clauses

Discovery is limited in arbitration proceedings, which benefits creditors who have automatic access to consumer information collected in their own files. Hearing fees are often beyond consumers' means. Erroneous interpretations of the law cannot be appealed. Punitive damages may be precluded. Arbitrators may be more sympathetic to defendant companies who appear before them frequently than to unfamiliar plaintiff consumers. n25

Consumer class actions may be explicitly barred or limited in arbitration clauses. Although they may work to undermine the deterrent function of civil rights laws, the Supreme Court has ruled that mandatory arbitration clauses are enforceable as applied to statutory civil rights claims unless plaintiff can show that Congress, in enacting the particular statute at issue, intended to preclude waiver of a judicial forum. n26

[ii] Applicability to Credit Discrimination Claims

Most of the cases dealing with the application of pre-dispute arbitration clauses to civil rights litigation concern employment discrimination claims. The majority rule is that such agreements should be analyzed under standard contract law principles. n27 It is hoped that, in doing so, courts will consider the pro-civil rights concerns underlying civil rights statutes, and not permit the federal policy favoring arbitration to trump the federal policy of protecting those concerns. There should, at a minimum, be an inquiry into whether the consumer has knowingly waived her right to a jury trial in order for a pre-dispute arbitration clause to be deemed enforceable. n28

[4] Statute of Limitations

[a] Affirmative Actions--ECOA Claims

The ECOA statute of limitations is two years from the date of the occurrence of the violation. n29 The statute of limitations runs from the date the violation occurs and not the date the credit is applied for or the date the credit is granted. One court has stated that the date of the violation is the date by which the creditor was required to provide notice of its adverse action. n30 If an ECOA enforcement agency n31 or the U.S. Attorney General n32 has commenced an ECOA proceeding or civil action within two years of the occurrence, a victim of discrimination may bring a private action up to one year after the commencement of that proceeding or civil action. In some extraordinary cases, Congress may waive the statute of limitations. This occurred in 1999 when Congress passed special legislation to waive the ECOA two-year limit for a class of African-American farmers alleging discrimination by the USDA in its agricultural credit programs. n33 The extension of time applied to African-American farmers who had a discrimination complaint unrelated to employment filed between 1981 and 1997. n34

[b] Fair Housing Act Claims

The statute of limitations for a private cause of action arising under the Fair Housing Act is two years after the occurrence or termination of the discriminatory practice. n35 Thus, if a practice is ongoing, the two year period does not begin to run until the practice ceases.

The Sixth Circuit has developed a three-part test to determine whether a continuing violation exists. n36 First, the defendant's wrongful conduct must continue after the precipitating event that began the pattern. Second, injury to the plaintiff must continue to accrue after that event. Finally, further injury to the plaintiff must have been avoidable if the defendant had at any time ceased its wrongful conduct. n37

An administrative complaint may be filed within one year of the occurrence. n38 The two year period is tolled while

any administrative action is proceeding. n39 The statute of limitations should also be tolled for fraudulent concealment; courts will probably rely on state law standards as to fraudulent concealment.

Courts will frequently follow the discovery rule in FHA cases. n40 The key question in cases involving a question of plaintiff's capacity is whether the plaintiff had the awareness or ability to comprehend the original action. Thus, a borrower who suffered from advanced Alzheimer's Disease when the loan was consummated was held to lack the ability to comprehend her injury. n41 Unlike under the ECOA, the continuing violation theory is well established in FHA cases. The continuing violation doctrine allows plaintiffs to recover for incidents outside of the statutory time limit if at least one instance of the alleged practice occurred within the period and the earlier acts are part of a continuing pattern of discrimination. n42

One district court confronting this issue in a credit discrimination case noted the difficulty in comparing credit discrimination cases to employment discrimination cases. n43 In this case, plaintiffs challenged automobile-finance mark-up policies that they alleged constituted an over-arching pattern of discrimination that persists today. The court found that the ruling in *Havens Realty Corp. v. Coleman* n44 could save otherwise time-barred claims, provided they are found to be part of the over-arching illegal policy. n45 The court found that the plaintiff's claims in this case were more analogous to the hostile work environment claims than discrete discriminatory acts, noting that "[t]he ongoing discrimination plaintiffs allege could only manifest itself after a critical mass of similarly situated people experience it, so as to bring an over-arching pattern to light ... Cumulation is necessary to demonstrate an otherwise concealed policy, and plaintiffs alleged that GMAC and the dealers acted pursuant to a specific, racially discriminatory policy." n46

[c] Federal Civil Rights Act Claims

Neither *42 U.S.C. section 1981* nor *section 1982* contains a specific statute of limitations. Courts entertaining such claims must look to analogous state limitations periods. n47

[d] Limitations Period for Credit Discrimination Claims When Responding to a Creditor's Lawsuit

Even though the statute of limitations may have run for an affirmative credit discrimination claim against the creditor, such claims usually can be brought by way of recoupment (i.e., as a defense) to the creditor's collection action. Although the consumer cannot recover an amount in actual and punitive damages in excess of the debt upon which the creditor is seeking collection, the limitations period will not apply to a recoupment claim.

The majority of reported ECOA cases which have addressed the issue of recoupment have permitted recoupment claims after the limitations period has run. n48 While most courts agree that the ECOA may be employed to defend against nonpayment of a promissory note, courts disagree as to whether the setoff or recoupment claim should be asserted as a counterclaim for damages or as a special defense of illegality. n49

[5] Creditor Defenses

[a] Business Justification Defense

[i] General

The business justification defense is only relevant where the plaintiff alleges a violation of the general rule against discrimination, based either on disparate treatment or disparate impact. The nature of the business justification defense is very different depending on whether a case involves disparate treatment or impact. There will be no business justification defense where the creditor violates a specific ECOA requirement, such as failing to send notice of an adverse action or seeking information not permitted.

[ii] Disparate Treatment Cases

In a disparate treatment case, the business justification for the discrimination cannot justify disparate treatment on a prohibited basis. Instead, the creditor will have to argue that it did not treat individuals differently on a prohibited basis; its *sole* basis for discrimination was a legitimate business basis.

In other words, there is no business justification for discrimination on the basis of race, religion, national origin, and other such bases. Congress has ruled that such discrimination is prohibited.

Instead, the creditor may only offer the business justification as the *sole* reason for its actions, and that the prohibited basis did not affect the creditor's actions. Then the issue at trial for the finder of fact will be what was the real basis of the creditor's actions, the prohibited basis or the business justification.

It is important to note that the issue is not whether the creditor knowingly discriminated on a prohibited basis. The issue is whether the prohibited basis was, in fact, the cause of the discrimination.

[iii] Disparate Impact

In a disparate impact case, the business justification defense is very different. The plaintiff might not even challenge the existence of a business justification or that this was, in fact, the basis for the creditor's actions. Instead, the plaintiff will allege that use of this business justification has a disparate impact on a prohibited basis, that the effect of using this legitimate business factor is to disproportionately deny credit to minorities or other protected groups.

The issue then becomes whether the disparate impact is so great as to outweigh the business justification. Under the ECOA and FHA, the rule is that a creditor practice with a disproportionately negative impact on a prohibited basis is illegal unless the practice meets a legitimate business need that cannot be reasonably achieved as well by means that are less disparate in their impact. In a disparate impact case, the issue is not whether there is a business justification or whether this was the real reason for the creditor's actions. The issue will be how great is the business justification and whether the same need may otherwise be met by some other approach.

[b] Special ECOA Defenses

[i] Good Faith Compliance

The ECOA states that a creditor is not liable for any act done or omitted in good faith in conformity with Regulation B or with the Official Staff Commentary, even if the regulation or commentary is amended or determined to be invalid. n50 The conduct must not only conform to the regulation, but must have been in good faith conformity.

[ii] The Inadvertent Error Defense

Regulation B sets out an inadvertent error defense for ECOA actions. n51 This defense is limited in scope. First, the inadvertent error defense excuses the creditor only from liability for violations of five specified Regulation B provisions--those dealing with review of credit history of a spouse's account, notification of action taken on an application, furnishing of credit information to reporting agencies, record retention, and information for monitoring purposes. The defense does not apply to actions based on the general rule against discrimination, cosigner requirements, application procedures, credit evaluation systems, or many other specific ECOA provisions.

Even when dealing with the five specified provisions, the creditor must show its actions fall within the Regulation's definition of inadvertent error. An inadvertent error is defined by Regulation B as a mechanical, electronic, or clerical error that a creditor demonstrates was not intentional and occurred notwithstanding the maintenance of procedures reasonably adapted to avoid such errors. n52

To make use of this shield from liability, the creditor thus has to overcome a number of burdens. It must show that an error was mechanical, electronic or clerical. n53

The creditor also has the burden of demonstrating that the error was not intentional and that it occurred despite the maintenance of procedures "reasonably adapted" to avoid such errors.

Moreover, on discovery of an error dealing with furnishing of credit information to reporting agencies or notification of an action taken on an application, the creditor must correct the error as soon as possible. Thus, the defense should not be available if the inadvertent error is known to the creditor before the applicant brings the ECOA claim.

[iii] Creditor's Reasonable Notice of Violation

Where a transaction involves more than one creditor, and one creditor violates the ECOA, the other creditors in a transaction are not liable for the violation to the extent that they lacked "reasonable notice" of the violation *before* becoming involved in the transaction. n54 Note, however, that the FRB proposed revisions to Regulation B that would amend section 202.2(*l*) to clarify that "creditor" includes those who regularly participate in making a credit decision by setting terms, not just the decision to extend or deny credit. n55 The final rule adopted this proposal with a few modifications. n56 The current definition of a creditor is a "person, who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit." The new definition defines a creditor as a person who "regularly participates in a credit decision, including setting the terms of the credit." The new definition was effective April 15, 2003, although the mandatory compliance date was April 15, 2004. n57

[c] Defenses to Fair Housing Act and Civil Rights Act Claims

The FHA and the Civil Rights Acts do not provide for any special defenses. The Fair Housing regulations provide a defense where an entity purchases loans. Such an entity may consider factors justified by business necessity, such as considerations employed in normal and prudent transactions. n58 Of course, business justification is an issue in any disparate treatment or impact case, as well.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityDiscriminatory ActsCivil Rights LawContractual Relations & HousingEqual Rights Under the Law (sec. 1981)Proof of DiscriminationCivil Rights LawContractual Relations & HousingFair Housing RightsEnforcementReal Property LawFinancingFederal ProgramsU.S. Department of Housing & Urban Development Programs

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1691e*; *42 U.S.C. § 3613*.

(n2)Footnote 2. *24 C.F.R. § 100.20*; *NAACP v. American Family Mut. Ins. Co., 978 F.2d 287 (7th Cir. 1992)* , *cert. denied*, *508 U.S. 907, 113 S. Ct. 2335, 124 L. Ed. 2d 247 (1993)* . *See also KB2S, Inc. v. City of San Diego, 2007 U.S. Dist. LEXIS 3673* (S.D. Cal. Jan. 17, 2007) ("conjectural" injury from alleged Fair Housing Act violation did not suffice to establish Article III standing); *Vaughn v. Consumer Home Mortgage Co., 2006 U.S. Dist. LEXIS 54267* (E.D.N.Y. Aug. 3, 2006) (ruling that plaintiffs failed to establish Article III standing in a Fair Housing Act claim brought against the Department of Housing and Urban Development).

(n3)Footnote 3. *See, e.g., Simms v. First Gibraltar Bank, 83 F.3d 1546* (5th Cir.) , *reh'g denied*, *95 F.3d 56* , *cert. denied*, *519 U.S. 1041, 117 S. Ct. 610, 136 L. Ed. 2d 535 (1996)* (white owner of apartment complex in minority area).

(n4)Footnote 4. *See, e.g., Ceiba, Inc. v. Ford Motor Credit Co., 2003 U.S. Dist. LEXIS 18082* (E.D. Pa. Sep. 22,

2003) .

(n5)Footnote 5. *See id.* (*citing Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333 (1977))* . The *Ceiba* court found that the plaintiff failed to meet the first prong of the Hunt test because it did not allege that any of its members applied to defendants for credit.

(n6)Footnote 6. *See § 5.10[3][d] infra*. For detailed discussion of arbitration clauses and challenges thereto, see National Consumer Law Center, Credit Discrimination, § 11.5.3 (5th ed. 2009), and National Consumer Law Center, Consumer Arbitration Agreements (5th ed. 2007 and supp.).

(n7)Footnote 7. *See generally* National Consumer Law Center, Consumer Class Actions: A Practical Litigation Guide (6th ed. 2006).

(n8)Footnote 8. *See, e.g., Coleman v. Gen. Motors Acceptance Corp., 220 F.R.D. 64, 2004 U.S. Dist. LEXIS 1243* (M.D. Tenn. Jan. 14, 2004) ; *see also Simpson v. Flagstar Bank, 2003 U.S. Dist. LEXIS 17175* (S.D. Ind. Sept. 11, 2003) (in FHA case challenging compensation policy for loan officers, class certification upheld despite defendants' claims that plaintiffs' requests for emotional damages requires individual evaluation that would destroy the commonality, typicality, and predominance prongs of the class certification test); *Cason v. Nissan Motor Acceptance Corp., 212 F.R.D. 518, 2002 U.S. Dist. LEXIS 25792* (M.D. Tenn. Oct. 16, 2002) . *But see Rodriguez v. Ford Motor Credit Co., 2002 U.S. Dist. LEXIS 7280* (N.D. Ill. Apr. 19, 2002) (denying class certification under Rule 23(b)(2) and (b)(3) in auto financing case due to court concerns that individualized inquiry into the reasons for thousands of credit decisions would be required).

(n9)Footnote 9. *See Buycks-Roberson v. Citibank Fed. Sav. Bank, 162 F.R.D. 322 (N.D. Ill. 1995)* ; *Fischer v. Dallas Fed. Sav. & Loan Ass'n, 106 F.R.D. 465 (N.D. Tex. 1985)* , *aff'd, 835 F.2d 567 (5th Cir. 1988)* . *See also Cason v. Nissan Motor Acceptance Corp., 212 F.R.D. 518* (M.D. Tenn. Oct. 16, 2002) (granting class certification under Rule 23(b)(2) for injunctive and declaratory relief only in an ECOA disparate impact case and denying certification under Rule 23(b)(2) for plaintiffs' claim for disgorgement of unjust enrichment as an equitable remedy. Latter claim denied on the grounds that disgorgement was a request for money that would require individual determinations in order to distribute awards to class members). A memorandum on the issue of unjust enrichment under the ECOA can be found on the CD-Rom accompanying this volume. The case against Nissan Motor Acceptance Corp. settled in June 2003. The settlement in *Cason v. Nissan Motor Acceptance Corp.* is available at www.nclc.org/initiatives/cocounseling/content/settlement_agreement.pdf.

(n10)Footnote 10. The Seventh Circuit expressed displeasure at the plaintiff's inclusion of the appraiser as a defendant in an ECOA case. *Latimore v. Citibank F.S.B., 151 F.3d 712 (7th Cir. 1998)* .

(n11)Footnote 11. *See Hargraves v. Capital City Mortgage Corp., 140 F. Supp. 2d 7 (D.D.C. 2000)* (Memorandum Opinion and Order); FTC v. Capital City Mortgage Corp., No. 98-237, (D.D.C. January 29, 1998), *available at* www.ftc.gov (March 2001). The court denied summary judgment on the issue of individual liability. *FTC v. Capital City Mortgage Corp., 1998 U.S. Dist. LEXIS 22115* (D.D.C. July 13, 1998) . For purposes of ECOA, the court held that corporate principal could be liable as a "creditor" based upon the fact that Regulation B at *12 C.F.R. § 202.2(1)* qualifies the term "creditor" to include those who "regularly participates in the decision" to extend credit. The court ruled there was sufficient evidence to survive summary judgment based upon the FTC's allegations that principal directed and controlled Capital City's acts and practices.

(n12)Footnote 12. *See generally* National Consumer Law Center, Credit Discrimination, § 11. 3.2 (5th ed. 2009). However, a January 2003 U.S. Supreme Court decision expressly rejected the non-delegable doctrine, at least as long as it is characterized in those terms. In *Meyer v. Holley, 537 U.S. 280, 123 S. Ct. 824, 154 L. Ed. 2d 753 (2003)* , the Supreme Court examined whether the FHA imposes personal liability without fault upon an officer or owner of a residential real estate corporation for the unlawful actions of the corporation's employee or agent. The Court found that

the FHA imposes liability without fault in accordance with traditional agency principles, imposing vicarious liability upon the corporation but not its officers or owners. *537 U.S. 280, 123 S. Ct. 824, 154 L. Ed. 2d 753 (2003)* . *See also* Miles v. Century 21 Real Estate L.L.C., 2007 U.S. Dist. LEXIS 2334 (E.D. Ark. Jan. 11, 2007) (holding that, though plaintiff did not establish actual agency between franchisor and franchisee for purposes of Fair Housing Act liability, plaintiff could establish apparent agency). *But see Wright v. Castle Point Mortgage, 2006 U.S. Dist. LEXIS 32761* (D.N.J. May 22, 2006) (no liability under Fair Housing Act when defendant did not originate loan, and plaintiff's claim was based on discriminatory loan terms). *Coelho v. Alliance Mortg. Banking Corp., 2007 U.S. Dist. LEXIS 39633* (D.N.J. May 10, 2007) (refusing to dismiss FHA claim against a mortgage broker, rejecting the defendant's argument that "to arrange to make available" a transaction did not fall within the scope of to "make available" such a transaction); *Jackson v. Novastar Mortg., Inc., 2007 U.S. Dist. LEXIS 93584* (W.D. Tenn. Dec. 20, 2007) (refusing to dismiss the plaintiff's FHA claim against lender, rejecting the defendant's argument that the mortgage broker that arranged the loan was not the lender's agent but was rather an independent contractor).

(n13)Footnote 13. *15 U.S.C. § 1691e(f)*; *42 U.S.C. § 3613(a)(1)(A)*.

(n14)Footnote 14. *42 U.S.C. § 3610*.

(n15)Footnote 15. *42 U.S.C. § 3613*. See Kotkin, *The Fair Housing Amendments Act of 1988*: *New Strategies for New Procedures*, 17 NYU Rev. of L. & Soc. Change 755 (1989-90), for an excellent analysis of the relative merits of the two procedures.

(n16)Footnote 16. *42 U.S.C. § 3613(a)(2). See Bryant Woods Inn, Inc. v. Howard County, 124 F.3d 597 (4th Cir. 1997)* ; *Green v. Konover Residential Corp., 1997 U.S. Dist. LEXIS 18893* (D. Conn. Nov. 24, 1997) .

(n17)Footnote 17. *42 U.S.C. § 3613(a)(3)*.

(n18)Footnote 18. *42 U.S.C. § 3612(f)*.

(n19)Footnote 19. *42 U.S.C. § 3610(f)*.

(n20)Footnote 20. *42 U.S.C. § 3610(f)(2)(a)*.

(n21)Footnote 21. *24 C.F.R. § 103.110 (1989). See also United States v. Shanrie Co., 2006 U.S. Dist. LEXIS 5646* (S.D. Ill. Jan. 26, 2006) (rejecting company's argument that the government's alleged failure to adequately conciliate should result in a remand to HUD and further conciliation; the FHA procedural requirements are not intended to function as a barrier to federal district court jurisdiction).

(n22)Footnote 22. *24 C.F.R. § 103.225*.

(n23)Footnote 23. *42 U.S.C. § 3612(a)*.

(n24)Footnote 24. *See generally* National Consumer Law Center, *Consumer Arbitration Agreements* (5th ed. 2007)., for a discussion of the enforceability of these agreements; see National Consumer Law Center, *Credit Discrimination*, § 11.5.3 (5th ed. 2009)., for a discussion of arbitration of ECOA and FHA claims.

(n25)Footnote 25. *See generally* National Consumer Law Center, *Unfair and Deceptive Acts and Practices*, § 12.6.8 (7th ed. 2008). See generally National Consumer Law Center, Consumer Arbitration Agreements (5th ed. 2007), for discussion of enforceability of arbitration agreements in consumer cases.

(n26)Footnote 26. *Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 111 S. Ct. 1647, 114 L. Ed. 2d 26 (1991)* .

(n27)Footnote 27. *See generally* National Consumer Law Center, Credit Discrimination, § 11.5.3 (5th ed. 2009).

(n28)Footnote 28. *See generally* National Consumer Law Center, Credit Discrimination, § 11.5.3.2 (5th ed. 2009). For a critique of the Supreme Court's decisions on pre-dispute arbitration clauses, see Paul D. Carrington and Paul H. Haagen, *Contract and Jurisdiction, 1996 Sup. Ct. Rev. 331.*

(n29)Footnote 29. *15 U.S.C. § 1691e(f). See also Ramsdell v. Bowles, 64 F.3d 5 (1st Cir. 1995)* , *cert. denied sub nom. Ramsdell v. Machias Sav. Bank, 516 U.S. 1113, 116 S. Ct. 913, 133 L. Ed. 2d 844 (1996)* . For example, if the claim is in connection with loan servicing, treatment after default or account administration, the claim runs from the alleged discriminatory treatment.

(n30)Footnote 30. *Para v. United Carolina Bank, 1998 U.S. Dist. LEXIS 16843* (E.D.N.C. Aug. 25, 1998) .

(n31)Footnote 31. *See 15 U.S.C. § 1691c(a)*; Reg. B, 12 C.F.R. § 202 app. A (complete list of federal agencies with ECOA enforcement powers and the creditors subject to each agency's jurisdiction).

(n32)Footnote 32. *15 U.S.C. § 1691e(f).*

(n33)Footnote 33. *See* Agricultural, Rural Development, Food and Drug Administration, and Related Agencies Appropriation Act, *1999 Pub. L. 105-277* § 741, *112 Stat. 2681* (interim rule codified at *7 U.S.C. § 2297).*

(n34)Footnote 34. *See, e.g., Stovall v. Veneman, 394 F. Supp. 2d 21 (D.D.C. 2005)* (court rejected plaintiff African-American farmer's claim to extend ECOA statute of limitations because he did not file complaint until 2004 and his claims were based on events that occurred between 1999 and 2001).

(n35)Footnote 35. *42 U.S.C. § 3613(a)(1)(A).*

(n36)Footnote 36. *Paschal v. Flagstar Bank, 295 F.3d 565 (6th Cir. 2002)* , *citing Tolbert v. State of Ohio Dept. of Trans., 172 F.3d 934, 938 (6th Cir. 1999)* .

(n37)Footnote 37. *See, e.g., Paschal v. Flagstar Bank, 295 F.3d 565 (6th Cir. 2002)* (plaintiff's continuing violation theory rejected).

(n38)Footnote 38. *42 U.S.C. § 3610.*

(n39)Footnote 39. *42 U.S.C. § 3613(a)(1)(B).*

(n40)Footnote 40. *See, e.g., Jones v. Citibank, 844 F. Supp. 437, 440* /-/41 (N.D. Ill. 1994) (the statute in this case began to run on the date on which Citibank notified plaintiffs of its decision to deny their loan application because it is the date on which the plaintiffs alleged they discovered that they suffered an injury). *But see Mills v. Equicredit Corp., 294 F. Supp. 2d 903 (E.D. Mich. 2003)* (statute not tolled because any terms of the loan that could be deemed to be unfair or unaffordable were disclosed in the loan agreement and in documents signed by plaintiff). *See also Tillery v. Darby-Rogers Co., 2006 U.S. Dist. LEXIS 68584* (M.D. Fla. Sept. 25, 2006) (tolling limitations period for Fair Housing Act claim when plaintiffs could not have learned of violation within statutory period).

(n41)Footnote 41. *Estate of Henderson v. Meritage Mortgage Corp., 293 F. Supp. 2d 830 (N.D. Ill. 2003)* (analysis applied to RESPA, TIL, HOEPA, FHA, ECOA, and § 1981 claims).

(n42)Footnote 42. *See Havens Realty Corp. v. Coleman, 455 U.S. 363, 102 S. Ct. 1114, 1125, 71 L. Ed. 2d 214 (1982)* (when a plaintiff, pursuant to the FHA, challenges not just one incident of conduct violative of the Act, but an unlawful practice that continues into the limitation period, the complaint is timely when it is filed within the statute of limitations for the last asserted occurrence of that practice); *Spann v. Colonial Vill., Inc., 899 F.2d 24, 34, 34* /-/35 (D.C. Cir. 1990) (affirming finding of continuing violation when last of "long stream" of advertisements with white models occurred within statutory period); *Hargraves v. Capital City Mortgage Corp., 140 F. Supp. 2d 7 (D.D.C. 2000)* .

(n43)Footnote 43. *See Davis v. Gen. Motors Acceptance Corp., 406 F. Supp. 2d 698 (N.D. Miss. 2005)* . *See also Claybrooks v. Primus Auto. Fin. Servs., Inc., 363 F. Supp. 2d 969 (M.D. Tenn. 2005)* (plaintiffs must show overarching policy of discrimination as well as a specific, allegedly discriminatory act against them within the relevant limitations period).

(n44)Footnote 44. *455 U.S. 363, 102 S. Ct. 1114, 1125, 71 L. Ed. 2d 214 (1982)* .

(n45)Footnote 45. *Id.*

(n46)Footnote 46. *Id.*

(n47)Footnote 47. *See, e.g., Slack v. Carpenter, 7 F.3d 418 (5th Cir. 1993)* .

(n48)Footnote 48. *See, e.g., Silverman v. Eastrich Multiple Inv. Fund, L.P., 51 F.3d 28 (3d Cir. 1995)* (recoupment claims never barred by statute of limitations); *Bolduc v. Beal Bank, SSB, 994 F. Supp. 82 (D.N.H. 1998)* (the 2-year statute of limitations does not bar the assertion of an ECOA violation as an affirmative defense against a creditor); *Boone Nat'l S&L Assoc. v. Crouch, 2001 Mo. App. LEXIS 325* (Mo. Ct. App. Feb. 27, 2001) , *aff'd in part, rev'd in part, remanded, 47 S.W.3d 371 (Mo. 2001)* ; *Nowicki v. Green, 1999 U.S. Dist. LEXIS 7058* (E.D. Pa. May 12, 1999) ; *Sharp Elecs. Corp. v. Yoggev, 1995 U.S. Dist. LEXIS 5751* (E.D. Pa. Apr. 28, 1995) ; *FDIC v. Medmark, Inc., 897 F. Supp. 511 (D. Kan. 1995)* ; *Integra Bank v. Freeman, 839 F. Supp. 326 (E.D. Pa. 1993)* ; *Machias Sav. Bank v. Ramsdell, 689 A.2d 595 (Me. 1997)* ; *Mundaca Inv. Corp. v. Emery, 674 A.2d 923 (Me. 1996)* ; *FDIC v. Notis, 602 A.2d 1164 (Me. 1992)* ; *Norwest Bank Minn. FDIC, N.A. v. Midwestern Mach. Co., 481 N.W.2d 875 (Minn. Ct. App. 1992)* . *See, e.g., Associates Home Equity Servs., Inc. v. Troup, 778 A.2d 529, 539 (N.J. Super. Ct. App. Div. 2001)* .

(n49)Footnote 49. *See, e.g., CMF Va. Land, L.P. v. Brinson, 806 F. Supp. 90 (E.D. Va. 1992)* (counterclaim for damages); *American Sec. Bank, N.A. v. York, 1992 U.S. Dist. LEXIS 14309* (D.D.C. Sept. 1, 1992) (special defense of illegality); *Stewart Title Guar. Co. v. WKC Rests. Venture Co., 961 S.W.2d 874 (Mo. Ct. App. 1998)* , *modified, reh'g denied, transfer denied*, (Mar. 31, 1998) (a recoupment action can mitigate or extinguish the creditor's damages, but cannot result in an affirmative judgment for the debtor).

(n50)Footnote 50. *15 U.S.C. § 1691e(e). See also* Official Staff Commentary Introduction-1.

(n51)Footnote 51. Reg. B, *12 C.F.R. § 202.14(c).*

(n52)Footnote 52. Reg. B, *12 C.F.R. § 202.2(s).*

(n53)Footnote 53. *See Harbaugh v. Continental Ill. Nat'l Bank & Trust Co., 615 F.2d 1169, 1174 (7th Cir. 1980)* (apparently condoning "good faith computer programming deficiencies").

(n54)Footnote 54. Reg. B, *12 C.F.R. § 202.2(l)*. The FRB solicited comments in its Advance Notice of Proposed Rulemaking on whether it should modify the reasonable notice standard, but chose to retain the present standard, believing "that it is not possible to specify with particularity the circumstances under which a creditor may or may not be liable for a violation committed by another creditor." *63 Fed. Reg. 12,326 (Mar. 12, 1998), 64 Fed. Reg. 44,590* (Aug. 16, 1999) . However, the FRB stated that under some circumstances the "reasonable notice" standard may carry with it the need for a creditor to exercise some degree of diligence with respect to third parties' involvement in credit decisions. *Id.*

(n55)Footnote 55. *64 Fed. Reg. 44,594* (proposed Aug. 16, 1999).

(n56)Footnote 56. *68 Fed. Reg. 13,144, 13,145* (Mar. 18, 2003) .

(n57)Footnote 57. *68 Fed. Reg. 13,144* (Mar. 18, 2003) .

(n58)Footnote 58. *24 C.F.R. § 100.125(c)*.

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

1-5 Consumer Credit Law Manual § 5.11

§ 5.11 Private Remedies

[1] Actual Damages

[a] Tangible Injury

Actual, out-of-pocket expenses and other tangible injuries are recoverable as actual damages under the ECOA, the Federal FHA, the Federal Civil Rights Acts, and state credit discrimination statutes.

It is not necessary for a credit applicant to establish actual damages under the ECOA in order to take advantage of the other possible statutory remedies, such as punitive damages, equitable and declaratory relief, and attorney's fees. There are, however, other sound reasons for establishing the existence of actual damages and aggressively pursuing such damages.

Some courts faced with claims for punitive damages may be reluctant to penalize a creditor when no "real," measurable damage has been done to the client. It is important, therefore, to demonstrate whenever possible that actual harm is the basis for the punitive damages claim.

Moreover, it would be a tactical mistake not to submit evidence of actual damages, since the ECOA explicitly provides that an award of actual damages is one factor in measuring any award of punitive damages. n1 Also, although the ECOA places a strict limit on the amount of punitive damages which may be awarded, no such limit is placed on actual damages.

[b] Intangible Damages

Courts under all the federal discrimination statutes have been generous in providing for actual damages for pain and suffering, humiliation, or damage to credit rating.

Thus, courts award as actual damages injury caused for the "private, momentary and personal affront"; n2 loss of a credit card's convenience, increased purchasing power, and protection in case of emergency; embarrassment, humiliation and mental distress; n3 inconvenience; deprivation of constitutional rights; and harm to the applicant's reputation for or actual creditworthiness. Of course, none of these damages will be awarded automatically. It is good

practice to allege these specific damages in the complaint, and, of course, the plaintiff must prove that these injuries did in fact occur. n4

Actual damages for such injury are not in lieu of or a form of punitive damages, but are actual damages to be awarded in *addition* to punitive damages.

[2] Multiple and Minimum Statutory Damages

None of the federal discrimination statutes provide either multiple or minimum statutory damages. Instead, these statutes provide for actual and punitive damages. Nevertheless, some relevant state statutes do provide multiple and/or minimum statutory damages.

[3] Punitive Damages

[a] General

Punitive damages under the FHA and the Federal Civil Rights Acts are discretionary with the court. Generally, the standard for a punitive damages award will be reckless, wanton, or malicious disregard for the plaintiff's rights and/or an intentional violation of federal law. n5 Punitive damages under the FHA are only available if an action is brought before a judge, not an administrative law judge.

On the other hand, the ECOA contains language which appears to mandate an award of punitive damages. A non-complying creditor "shall be liable ... for punitive damages ... in addition to any actual damages" awarded. n6 The one statutory exception is that no punitive damages are available in actions brought against a creditor that is a government or a governmental subdivision, agency, or instrumentality.

Despite the statutory language, though, ECOA punitive damages may not be as mandatory as it first seems nor FHA punitives as discretionary as on first blush.

Plaintiff should both attempt to show the creditor's wantonness or recklessness (to establish punitive damages) and also the impact of the practice on the applicant (to establish actual damages for intangible injury).

[b] Limits on the Size of Punitive Damage Awards

There are no limits to the size of punitive damage awards under the Federal Civil Rights Acts or under the FHA.

The ECOA, on the other hand, does limit the size of a punitive damages award. For an individual action, the maximum punitive damages award is $10,000 in addition to any actual damages that are awarded. n7 For a class action, the limit on punitive damages is the lesser of $500,000 or 1% of the creditor's net worth. (Where a creditor's net worth is less than $1 million, higher total punitive damages are actually available in an individual action.)

This limit only applies to punitive damages, and there is no limit to the size of actual damages that may be recoverable in a class action. Thus, where the maximum punitive damages in a class action is relatively small, proof of actual damages becomes critical. n8

It appears that the $10,000 limit applies to each creditor, applicant, and violation involved in a case so that the total punitive damages in an ECOA case can be significantly more than $10,000.

The ECOA also provides a list of relevant factors to be considered by a court to determine the amount of punitive damages to be awarded. n9

[c] ECOA Standards for Determining the Size of a Punitive Damages Award

ECOA provides that the size of a punitive damages award should be based on a number of factors: size of the actual damages award; n10 frequency and persistence of the creditor's failure to comply (either against the same person or violations against others); the resources of the creditor, most likely meaning net worth; the number of persons adversely affected; "the extent to which the creditor's failure of compliance was intentional," triggered by wanton or reckless conduct; and any other relevant factors.

[4] Equitable and Declaratory Relief

[a] Prospective Relief

Equitable and declaratory relief is available under all the federal credit discrimination statutes. Not only is it clear that such relief is available for a violation of the Federal Civil Rights Acts, but the FHA specifically states that the court "may grant as relief, as the court deems appropriate, any permanent or temporary injunction, temporary restraining order, or other order ... " n11 Similarly, the ECOA states that an aggrieved credit applicant may obtain "such equitable and declaratory relief as is necessary to enforce the requirements" of the ECOA. n12

[b] Voiding an Individual's Obligation Under a Note or Security Agreement

Where creditors require cosigners or guarantors to sign a note or security agreement in violation of the ECOA, it is an attractive remedy to seek to void the cosigner or guarantor's liability under the note or security agreement.

The courts are divided whether an ECOA or related claim may void a note or security agreement or whether the plaintiff may only seek actual and punitive damages as a way of offsetting liability under an illegally obtained signature. n13 The best course is to seek both remedies--voiding of any illegally obtained signature and actual and punitive damages equal at least to all possible liability and other damage that may occur because of such signature.

[c] Restitution and Disgorgement

Absent a clear command by Congress that a statute providing for equitable relief excludes certain forms of such relief, a court should presume that it has the full scope of equitable powers available for the proper and complete vindication of the statutory purpose. n14

Restitution and disgorgement are part of a court's traditional equitable authority. n15 They are potentially powerful tools under the FHA and the ECOA. n16

To date, there have been no published opinions in which restitution or disgorgement have been ordered, or denied, as a remedy in an ECOA case. Such relief has been awarded, however, in FHA cases in order to prevent defendants from being allowed to retain funds that were obtained as a result of illegal and unconstitutional conduct. n17

[5] Attorney's Fees and Costs

[a] General Standards

All the federal discrimination laws provide for attorney fees for prevailing plaintiffs, but the language of the various statutes' attorney fee provisions are somewhat different. The ECOA states that the costs of the action together with a reasonable attorney's fee, as determined by the court, *shall* be awarded in the case of any successful action. n18 (The ECOA standard for attorney fees is virtually identical to that found in the TILA.) The FHA and the Federal Civil Rights Acts state that the court in its discretion may allow the prevailing party a reasonable attorney fee and costs. n19

Prevailing plaintiffs should recover "in all but special circumstances." n20 At the same time, prevailing defendants should not routinely recover fees, and should only do so where the plaintiff's claim was frivolous, unreasonable or without foundation. n21

[b] When Is an Action Successful?

As a general rule, prevailing on only one claim is sufficient as long as the result is a good one for the plaintiff. n22 But attorney fees sometimes will not be awarded where the plaintiff prevails in only a technical sense of receiving $1.00 in nominal damages, but having failed to obtain any of the more substantial relief sought. n23

If the consumer raises an ECOA counterclaim to a creditor's collection action, the action is successful even if the action results in a net recovery for the creditor. n24

An award of fees need not be predicated on litigating a claim to a final verdict. A default judgment is a successful action and, therefore, attorney fees should be awarded even if the creditor never responds to the complaint. n25 A consent decree, n26 injunctive relief, n27 or a settlement n28 also may be considered successful actions warranting fee awards.

However, a U.S. Supreme Court decision handed down in 2001 casts some doubt on whether a settlement that is not incorporated into a court order can be the basis for an award of attorney fees. n29 Prior to this decision, it was widely accepted that a voluntary change in practices or policies in response to a suit could qualify as a successful action, under the "catalyst theory."

In *Buckhannon*, the U.S. Supreme Court rejected the awarding of fees to plaintiffs as the prevailing parties under the catalyst theory. n30 Because the plaintiffs in that case had not obtained an enforceable judgment on the merits or a court-ordered consent decree, they were not entitled to an award of fees. The case construed the fee-shifting provisions of fair housing laws and the Americans with Disabilities Act, but the Supreme Court made it clear that it was announcing a general rule that applied to most, if not all, federal fee-shifting statutes. n31 Courts have since applied the ruling to the civil rights fee-shifting statute, n32 the Equal Access to Justice Act, n33 and the Individuals with Disabilities Education Act, n34 all of which, like the statute construed in *Buckhannon*, use the term "prevailing party." The most troubling aspect of *Buckhannon* is its apparent support for the argument that a settlement agreement may be insufficient to trigger the consumer's right to attorney fees because the consumer is not a prevailing party.

The full effects of *Buckhannon* are not yet clear. Courts interpreting state fee-shifting statutes may find *Buckhannon* persuasive n35 but are free to adopt their own views about the catalyst theory and the formal requirements of settlements. n36 Nonetheless, it is prudent to assume that state courts will impose the same requirements and to draft settlement documents accordingly. Note that because the court must approve the settlement of class actions, n37 the *Buckhannon* ruling should not pose any additional complications in class actions. n38

The FHA Act was one of the statutes at issue in the *Buckhannon* case. Thus, courts will likely continue to apply the *Buckhannon* reasoning to future FHA cases. The FHA specifically provides for attorney fees for prevailing parties. n39 The ECOA, in contrast, allows the awarding of attorney fees in successful actions. n40

[c] Fees for Legal Services, Pro Bono, Pro Se Attorneys

Attorney fees should be awarded to legal services attorneys or other pro bono attorneys, even though the client is not obligated to pay the attorney or even though a fee is not actually charged. n41

[d] Costs and Witness Fees

A successful plaintiff should recover costs under an ECOA, FHA, or Civil Rights Act claim. n42 This should include

filing fees, transcripts, deposition costs, and other court and litigation expenses not otherwise claimed as attorney's fees.

[6] Election of Remedies

When a particular act or omission by a creditor would constitute a violation of both state law and the ECOA, an action may be brought to recover money damages under only one of them, either the ECOA or state law. n43 No such election of remedies is necessary when the court action is for relief other than money damages (e.g., injunction or declaratory relief), or for administrative actions. n44

In addition, no person aggrieved by an ECOA violation and, in the same transaction, by a violation of the FHA's prohibitions concerning discrimination involving residential real estate-related transactions shall *recover* under both the ECOA and the FHA. n45

The election between the ECOA and state law, on the other hand, indicates that an "action may be brought" under either the ECOA or state law, but not both. Nevertheless, a federal court has ruled that the case should not be dismissed if the plaintiff fails to elect between federal and state remedies before bringing the complaint; rather, the plaintiff should be restricted to recovery under the federal statute because it appeared that the action was primarily pursued under that theory. n46

The ECOA rules do not require an election of remedies between an ECOA action and a Federal Civil Rights Act claim or between an ECOA action and a FHA claim not based on residential real estate-related transactions, but on discrimination in the sale, rental, or advertising of a dwelling. Moreover, nothing prevents the simultaneous recovery on a FHA claim, a Federal Civil Rights Act claim, and a state credit discrimination or UDAP claim. Of course, only one actual damage recovery can be had for the same injury.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionEqual Credit OpportunityLiabilityBanking LawConsumer ProtectionTruth in LendingGeneral OverviewCivil Rights LawContractual Relations & HousingFair Housing RightsCosts & Attorney FeesCivil Rights LawContractual Relations & HousingFair Housing RightsRemedies

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C § 1691e(b).*

(n2)Footnote 2. *Bhandari v. First Nat'l Bank of Commerce, 808 F.2d 1082 (5th Cir. 1987) , rev'd in part on other grounds, 829 F.2d 1343 (5th Cir. 1987) (en banc), vacated and remanded, 492 U.S. 901, 109 S. Ct. 3207, 106 L. Ed. 2d 558 , reinstated, 887 F.2d 609 (5th Cir. 1989) , cert. denied, 494 U.S. 1061, 110 S. Ct. 1539, 108 L. Ed. 2d 778 (1990) .*

(n3)Footnote 3. *See, e.g., Fischl v. General Motors Acceptance Corp., 708 F.2d 143 (5th Cir. 1983)* (ECOA actual damages may include mental anguish, humiliation or embarrassment); *Anderson v. United Fin. Co., 666 F.2d 1274 (9th Cir. 1982)* (same).

(n4)Footnote 4. *See Carey v. Piphus, 435 U.S. 247, 98 S. Ct. 1042, 55 L. Ed. 2d 252 (1978) .*

(n5)Footnote 5. *See 42 U.S.C. § 1981a(b)(1)* (codifying malice or reckless indifference standard for employment discrimination cases). *See also Williams v. Homestead Mgmt., 2005 WL 1118118* (W.D. Mich. May 11, 2005) (finding that punitive damages standard was met; illegality of the defendant's policy against renting a one-bedroom apartment to an adult and minor should have been apparent); *United States v. Space Hunters, Inc., 429 F.3d 416 (2d Cir. 2005)* (in case involving alleged illegal steering of prospective renters based on race and disability, district court's refusal to submit issue of FHA punitive damages to jury was error because the court overlooked ample evidence that defendants

acted with malice and reckless indifference). *See also Snyder v. Bazargani, 241 Fed. App'x 20, 23 (3d Cir. 2007)* (affirming award of punitive damages on FHA and state human relations act claims, ruling that the plaintiff did not need to demonstrate "wanton and reckless" misconduct in addition to demonstrating that the conduct was intentional).

(n6)Footnote 6. *15 U.S.C. § 1691e(b).*

(n7)Footnote 7. *15 U.S.C. § 1691e(b).*

(n8)Footnote 8. *See § 1.10[2], [4] supra.*

(n9)Footnote 9. *15 U.S.C. § 1691e(b).*

(n10)Footnote 10. *See Fischl v. General Motors Acceptance Corp., 708 F.2d 143 (5th Cir. 1983)* (punitive damages may be awarded, regardless of proof of actual damages, if the creditor's conduct is adjudged wanton, malicious, or oppressive, or if it is deemed to have acted in reckless disregard of the applicable law).

(n11)Footnote 11. *42 U.S.C. § 3613(c).*

(n12)Footnote 12. *15 U.S.C. § 1691e(c).*

(n13)Footnote 13. *FDIC v. Medmark, Inc., 897 F. Supp. 511 (D. Kan. 1995)* ; *American Sec. Bank, N.A. v. York, 1992 U.S. Dist. LEXIS 14309* (D.D.C. Sept. 1, 1992) ; GECC v. Pulsifer, Clearinghouse No. 46,778A (D. Me. 1991) (surety could prove that signature in violation of ECOA, thus invalidating the signature; if signed mortgage because signed note, then mortgage could also be invalidated); *Shammas v. Merchants Nat'l Bank, 1990 U.S. Dist. LEXIS 19934* (D. Mass. Nov. 9, 1990) (bank enjoined from foreclosing on Mrs. Shammas' residence since it appeared her guaranty was required in violation of ECOA); *FDIC v. Allen, 1988 U.S. Dist. LEXIS 17565* (W.D. Okla. Nov. 3, 1988) ; Bank of New York v. Route 312 Dev. Corp., 586 N.Y.S.2d 373 (App. Div. 1992) ; *Transamerica Commercial Fin. Corp. v. Naef, 842 P.2d 539 (Wyo. 1992)* ; *Bolduc v. Beal Bank, 994 F. Supp. 82 (D.N.H. 1998)* (bank's illegal requirement of wife's cosignature invalidates wife's obligation), *remanded, 167 F.3d 667 (1st Cir. 1999)* ; *Spottiswoode v. Levine, 1999 Me. 79, 730 A.2d 166 (1999) , judgment vacated and remanded on other grounds, 769 A. 2d 849 (2001)* (illegal requirement of spouse's signature does not render a credit instrument void); *Stewart Title Guar. Co. v. WKC Rests. Venture Co., 961 S.W.2d 874 (Mo. Ct. App. 1998) , modified, reh'g denied, transfer denied*, (Mar. 31, 1998).

(n14)Footnote 14. *See Porter v. Warner Holding Co., 328 U.S. 395, 398 (1946)* ("[u]nless otherwise provided by statute, all the inherent equitable powers of the District Court are available for the proper and complete exercise of that jurisdiction").

(n15)Footnote 15. *See Mertens v. Hewitt Assocs., 508 U.S. 248, 255 (1993)* . Restitution and disgorgement of profits are two separate equitable remedies. Restitution allows a victim to be monetarily compensated for losses resulting from a defendant's acts while disgorgement forces a defendant to give up the amount by which he was unjustly enriched without inquiring whether, or to what extent, identifiable private parties have been damaged.

(n16)Footnote 16. *See Silverman v. Eastrich, 51 F.3d 28, 33 (3d Cir. 1995) , citing Integra Bank v. Freeman, 839 F. Supp. 326 (E.D. PA 1993) .*

(n17)Footnote 17. *See Zuch v. Hussey, 394 F. Supp. 1028,1055 n.13 (E.D. Mich. 1975) , aff'd without opinion, 547 F.2d 1168 (6th Cir. 1977)* (proof of actual profits obtained from sales which are found to be in violation of the Fair Housing Act may, as an appropriate remedy, result in a court order that the defendants forfeit the profits and disgorge them in order to implement the goals of the Act); *see also United States v. J.C. Long, 537 F.2d 1151,1155 (4th Cir. 1975) .*

(n18)Footnote 18. *15 U.S.C. § 1691e(d).*

(n19)Footnote 19. *42 U.S.C. §§ 1988(b), 3613(c)(2).*

(n20)Footnote 20. *Christiansburg Garment Co. v. Equal Employment Opportunity Comm'n, 434 U.S. 412, 417, 98 S. Ct. 694, 54 L. Ed. 2d 648 (1978)* .

(n21)Footnote 21. *Christiansburg Garment Co. v. Equal Employment Opportunity Comm'n, 434 U.S. at 421* . *See Bryant Woods Inn, Inc. v. Howard County, 124 F.3d 597 (4th Cir. 1997)* ; *see also Deadwyler v. Volkswagen of Am., Inc., 748 F. Supp. 1146 (W.D.N.C. 1990)* ("may" award defendant attorney fees interpreted as requiring fees only when action frivolous).

(n22)Footnote 22. *See Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983)* ; *Postow v. OBA Fed. Sav. & Loan Ass'n, 627 F.2d 1370 (D.C. Cir. 1980)* (Truth in Lending case). *See Tenafly Eruv Ass'n, Inc. v. Borough of Tenafly, 195 Fed. Appx. 93, 98,* (3d Cir. Sept. 1, 2006) (when unsuccessful Fair Housing Act claim arose from same core facts as successful Free Exercise Clause claim, fees could be awarded based on both claims).

(n23)Footnote 23. *Farrar v. Hobby, 506 U.S. 103, 113 S. Ct. 566, 121 L. Ed. 2d 494 (1992)* ($1 nominal recovery where $12 million sought).

(n24)Footnote 24. *See Hayer v. National Bank, 619 P.2d 474 (Alaska 1980)* (TILA case).

(n25)Footnote 25. *See City Fin. Co. v. Boykin, 358 S.E.2d 83 (N.C. Ct. App. 1987)* (state deceptive practices act claim); *Rodriguez v. Holmstrom, 627 S.W.2d 198 (Tex. App. 1981)* (same).

(n26)Footnote 26. *Balark v. City of Chicago, 81 F.3d 658 (1996)* (§ 1988 case), *reh'g denied, 1996 U.S. App. LEXIS 10442* (May 2, 1996) , *cert. denied, 519 U.S. 1006, 117 S. Ct. 507, 136 L. Ed. 2d 398 (1996)* ; *LaRouche v. Kezer, 20 F.3d 68 (2d Cir. 1994)* (§ 1988 case).

(n27)Footnote 27. *LeBlanc-Sternberg v. Village of Airmont, 143 F.3d 765 (2d Cir. 1998)* (§ 1988 case); *Riley v. City of Jackson, 99 F.3d 757 (5th Cir. 1996)* (§ 1988 case), *on remand, mot. denied, 2 F. Supp. 2d 864 (S.D. Miss. 1997)* ; *cf. Bisciglia v. Kenosha Unified Sch. Dist. No. 1, 45 F.3d 223 (7th Cir. 1995)* (§ 1988 case) (temporary restraining order which merely preserves status quo and does not result in relief on the merits is insufficient).

(n28)Footnote 28. *Sablan v. Department of Fin., 856 F.2d 1317 (9th Cir. 1988)* (§ 1988 case); *Gram v. Bank of La., 691 F.2d 728 (5th Cir. 1982)* (TILA case); *Folsom v. Heartland Bank, 2000 U.S. Dist. LEXIS 7890* (D. Kan. May 18, 2000) (TILA case). *See generally* National Consumer Law Center, Truth in Lending § 8.9.2.1 (4th ed. 1999 and Supp.).

(n29)Footnote 29. *Buckhannon Bd. & Care Home v. West Virginia Dep't of Health & Human Res., 532 U.S. 598, 121 S. Ct. 1835, 149 L. Ed. 2d 855 (2001)* .

(n30)Footnote 30. *Id.* at 1838 .

(n31)Footnote 31. *42 U.S.C. § 1988*; *see Chambers v. Ohio Dep't of Human Services, 273 F.3d 690 (2001)* , *reh'g, en banc, denied, 2002 U.S. App. LEXIS 2509* (6th Cir. Jan. 28, 2002) ; National Coalition for Students with *Disabilities v. Bush, 173 F. Supp. 2d 1272 (N.D. Fla. 2001)* .

(n32)Footnote 32. *28 U.S.C. § 2412(d)(1)*; *see Former Employees of Motorola Ceramic Prods. v. U.S., 176 F. Supp. 2d 1370* (Ct. Int'l Trade 2001) ; *Sileikis v. Perryman, 2001 U.S. Dist. LEXIS 12737* (N.D. Ill. Aug. 20, 2001) .

(n33)Footnote 33. *20 U.S.C. § 1451(I)(3)*; *see Brandon K. v. New Lenox Sch. Dist., 2001 U.S. Dist. LEXIS 20006* (N.D. Ill. Nov. 30, 2001) ; *John T. v. Delaware County Intermediate Unit, 2001 U.S. Dist. LEXIS 18254* (E.D. Pa. Nov. 7, 2001) , *subs. appeal, 318 F.3d 545 (3d Cir. 2003)* ; *Jose Luis R. v. Joliet Township High Sch. Dist. 204, 2001 U.S. Dist. LEXIS 13951* (N.D. Ill. Aug. 27, 2001) , *costs/fees proceeding, summ. judg. granted, summ. judg. denied, 2002*

U.S. Dist. LEXIS 20916 (N.D. Ill. Jan. 14, 2002) .

(n34)Footnote 34. *See, e.g., Wallerstein v. Stew Leonard's Dairy, 258 Conn. 299, 780 A.2d 916 (2001)* (judgment entered under Connecticut equivalent of Rule 68 made plaintiff the prevailing party).

(n35)Footnote 35. *Pitchford v. Oakwood Mobile Homes, Inc., 212 F. Supp. 2d 613 (W.D. Va. 2002)* (adopting interpretation of Virginia UDAP fee award standard similar to *Buckhannon*); *Wallerstein v. Stew Leonard's Dairy, 258 Conn. 299, 780 A.2d 916 (2001)* (citing *Buckhannon* as authority that judgment entered under Connecticut equivalent of Rule 68 made plaintiff the prevailing party); *Melton v. Frigidaire, 346 Ill. App. 3d 331, 805 N.E.2d 322 (2004)* (following *Buckhannon* but interpreting it not to require judgment on the merits or court-ordered consent decree; retention of jurisdiction to enforce settlement is sufficient); *Chase v. DaimlerChrysler Corp., 587 S.E.2d 521 (Va. 2003)* (adopting interpretation of "successful" party similar to *Buckhannon*'s under Virginia lemon law). *See also Stenger v. L.L.C. Corp., 819 N.E.2d 480 (Ind. Ct. App. 2004)* (under state version of Rule 68, Magnuson-Moss plaintiff waived fees by accepting offer of judgment that was silent about fees).

(n36)Footnote 36. *Moedt v. Gen. Motors Corp., 60 P.3d 240 (Ariz. Ct. App. 2002)* (awarding fees for settlement of state lemon law claim even though *Buckhannon* might have precluded fees for federal claim); Graham v. DaimlerChrysler Corp., *21 Cal. Rptr. 3d 331, 101 P.3d 140 (Cal. 2004)* (preserving catalyst theory when lawsuit has some merit and plaintiff engaged in reasonable pre-litigation attempt to settle dispute). *See also Lavene v. Volkswagen of Am., Inc., 702 N.W.2d 652, 654 (Mich. Ct. App. 2005)* (party who obtains mutually agreeable settlement is prevailing party under Michigan rule).

(n37)Footnote 37. *Fed. R. Civ. P. 23(e).*

(n38)Footnote 38. *Buckhannon Board & Care Home v. West Virginia Dep't of Health & Human Resources, 532 U.S. 598, 121 S. Ct. 1835, 149 L. Ed. 2d 855 (2001)* . See generally National Consumer Law Center, Credit Discrimination § 11.6.6.2 (3d ed. 2002 and Supp.), for a discussion of various ways of settling a case that are likely to preserve entitlement to fees, in light of *Buckhannon*.

(n39)Footnote 39. *42 U.S.C. § 3613(c)(2).*

(n40)Footnote 40. *15 U.S.C. § 1691e(d). But see Crabill v. Trans Union, 259 F.3d 662 (7th Cir. 2001)* (applying *Buckhannon* to the Fair Credit Reporting Act, which uses the term "successful action," and concluding that attorney fees are not available unless the plaintiff wins "formal judicial relief").

(n41)Footnote 41. *Blanchard v. Bergeron, 489 U.S. 87, 109 S. Ct. 939, 103 L. Ed. 2d 67 (1989)* (lawyer taking case without compensation does not bar attorney fee award); *Blum v. Stenson, 465 U.S. 886, 104 S. Ct. 1541, 79 L. Ed. 2d 891 (1984)* (legal services attorneys entitled to market rates in U.S. civil rights cases).

(n42)Footnote 42. *15 U.S.C. § 1691e(d)*; *42 U.S.C. § 3613(c)(2)*; *42 U.S.C. § 1988(b).*

(n43)Footnote 43. *15 U.S.C. § 1691d(e).*

(n44)Footnote 44. *15 U.S.C. § 1691d(e).*

(n45)Footnote 45. *15 U.S.C. § 1691e(1).* The literal language in the statute is confusing. It provides that there cannot be recovery under both the ECOA and *42 U.S.C. § 3612* of the FHA. Section 3612 previously authorized a private right of action for damages and injunctive relief. The private relief section has been moved to § 3613 and § 3612 now deals with administrative enforcement of the FHA. The notes to § 1691e now clarify this change, referring to *42 U.S.C. § 3613* as the relevant statute.

(n46)Footnote 46. *Milton v. Bancplus Mortgage Corp., 1996 U.S. Dist. LEXIS 5166* (N.D. Ill. Apr. 19, 1996)

(federal claims adequately pleaded; state claims, based on "election of remedy" statute, dismissed). *See also Saldana v. Citibank, 1996 U.S. Dist. LEXIS 8327* (N.D. Ill. Jun. 13, 1996) ; *Fernandez v. Hull Coop. Bank, 1979 U.S. Dist. LEXIS 8657* (D. Mass. Nov. 8, 1979) .

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Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 5 Credit Discrimination *

1-5 Consumer Credit Law Manual § 5.12

§ 5.12 Government Enforcement

[1] ECOA Enforcement

[a] The U.S. Attorney General

The United States Attorney General may bring a civil action against a creditor for violations of the ECOA in one of two situations. Either a federal agency with ECOA enforcement authority refers a case to the Attorney General for prosecution or the Attorney General must have reason to believe that a creditor is engaging in a pattern or practice of ECOA violations. n1 The Attorney General may bring the action for actual and punitive damages and injunctive relief.

[b] Federal Trade Commission

Except to the extent that another federal agency has specific enforcement authority concerning a particular type of creditor, the Federal Trade Commission ("FTC") has overall enforcement authority for the ECOA. n2 The one major exception is that the FRB has been delegated the authority to issue regulations under the ECOA. n3 Thus, the FTC has overall enforcement responsibility for the FRB's Regulation B, and the FRB's enforcement authority of its own regulation is limited to violations by certain banks.

Any violation of the ECOA or Regulation B is thus a violation of the FTC Act and is remedied by the FTC's normal enforcement powers. This includes administrative proceedings that lead to a cease and desist order, and federal court actions for civil penalties, restitution, and injunctive relief. As a practical matter, most FTC actions end in consent agreements.

[c] Other Federal Agencies

The ECOA delegates specific enforcement authority to eleven different federal agencies, each having jurisdiction over a particular type of credit transaction. n4 Any transaction not covered by one of these eleven agencies is covered by the FTC. n5

In general, ECOA violations may be enforced with the same remedies and powers that these agencies possess for other matters. n6 If the agency cannot obtain compliance, the agency may refer the matter to the Department of Justice for

appropriate civil action. n7

In addition, the Comptroller of the Currency, the FRB, the FDIC, the Office of Thrift Supervision, and the National Credit Union Administration are *mandated* to refer a matter to the Attorney General whenever the agency has reason to believe that one or more creditors has engaged in a pattern or practice of denying credit applications on a prohibited basis. They are permitted to make such reference even in the absence of a pattern or practice. n8

Where a creditor's ECOA violation may also constitute a violation of the Fair Housing Act, n9 the appropriate enforcing agency must notify the Secretary of HUD if it does not notify the U.S. Attorney General; it must also notify the applicant of the referral to HUD and that the Fair Housing Act may provide a remedy. n10 In 2007, HUD announced the creation of a new Fair Lending Division to assess possible discriminatory home lending practices. In addition to investigating complaints, the division will also look for lenders that exhibit a pattern of discriminatory lending practices, even if no individual complaints are filed against it. Another role for the division will be in the area of fair lending oversight regarding housing government-sponsored enterprises Fannie Mae and Freddie Mac. n10.1

[d] Agency Enforcement Policy

The FRB plays the most important role in setting ECOA standards, in that it has the responsibility for promulgating general regulations to carry out the purposes of the ECOA, n11 which it has done through Regulation B. n12 The FRB also has issued an Official Staff Commentary which provides many examples of applications of Regulation B to specific situations.

Nevertheless, the FRB's authority to issue regulations under the ECOA does not impair the FTC or the other enforcing agencies from making rules respecting their own procedures in enforcing compliance with ECOA requirements. n13 That is, the FRB sets the regulations as to when a practice does or does not violate the ECOA, but the various enforcement agencies can set their own enforcement policies.

In 1999, the Federal Financial Institutions Examination Council issued Interagency Procedures on Fair Lending Examination. These Procedures established a uniform set of procedures for use by the Federal Reserve Board, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of Comptroller of the Currency, and Office of Thrift Supervision in their examinations for compliance with ECOA and the FHA. n14

In deciding not to remove the prohibition on seeking information about an applicant's personal characteristics in non-mortgage credit applications, the Board in 2003 created a new exception for collection of this information for purposes of creditor self-testing. n15 In previous proposals, the Board had indicated that the self-test privilege would not extend to collection of applicant characteristics on application forms or in the application process. n16 Many creditors responded that, if the prohibition were removed, they would likely not collect information about applicant's personal characteristics unless collection was subject to this privilege. The Board decided to accept the suggestion of expanding the privilege but without removing the general ban on collection of this information.

[e] Interagency Policy Statement on Fair Lending

In 1994, many of the above agencies joined in an interagency policy statement on fair lending answering thirteen oft-asked questions and explaining how they planned to proceed in the future. n17

[2] Civil Enforcement by the United States Attorney General

The United States Attorney General may on her own initiative bring an action in federal court for credit discrimination. n18 The case must involve a pattern or practice of discrimination or the discrimination must raise an issue of general public importance. n19

The Secretary may also elect not to follow the administrative procedure in a case and request the Attorney General to bring an action directly in federal court. Thus, the Attorney General could bring a discrimination case in federal court either because the Attorney General determines that there is a pattern or practice or because the Secretary requests the Attorney General to take a case. In either case, the court may award equitable relief, monetary damages to aggrieved parties, and a civil penalty not to exceed $50,000 for a first violation (or $100,000 for subsequent violations). n20

[3] Agency Referrals to Department of Justice or HUD

The ECOA and Regulation B authorize any agency responsible for enforcing the ECOA to refer to the Attorney General any matter for which it is unable to obtain compliance under the Act or Regulation, or which it has reason to believe is a violation of section 701(a) of the Actby one or more creditors. n21 In addition, whenever the FRB, Comptroller of the Currency, FDIC, Office of Thrift Supervision, or National Credit Union Administration has reason to believe that one or more creditors has engaged in a pattern or practice of discouraging or denying applications in violation of the Act or Regulation, it is required to refer such matter to the Attorney General. n22 The Attorney General, on referral or whenever she has reason to believe that one or more creditors engaged in a pattern or practice in violation of the Act or Regulation, may bring a civil action for damages or injunctive relief. n23

The Act and Regulation also require that the above five agencies, whenever there is reason to believe that a violation of the ECOA also violates the FHA but has not referred the matter to the Attorney General, must notify HUD. n24 The agency must also notify the applicant of its referral to HUD and that remedies may be available under the FHA.

Since September 1992, the U.S. Department of Justice has filed complaints against approximately a dozen separate financial institutions for alleged discriminatory lending practices and insurance companies for alleged insurance redlining. These cases together allege numerous illegal practices, ranging from the level of availability of credit services to different customers or communities, to differential marketing strategies and differential pricing issues. Most of these cases were filed with simultaneous settlement agreements or consent decrees which attempt to redress the individuals and communities that were affected by the alleged misconduct. n25 Many states are now stepping up their enforcement activities in the fair lending area as well.

In recent years, the FTC has had two large settlements involving marital status discrimination and violations of the notice provisions of the ECOA. In United States v. Franklin Acceptance Corp., the DOJ simultaneously filed a complaint and consent decree pursuant to the FTC's negotiation of an $800,000 settlement, the largest civil penalty settlement obtained up to that time for alleged violations of the ECOA. n26

The FTC alleged that Franklin violated the ECOA by discriminating against applicants 1) on the basis of sex and marital status by failing to consider child support payments as part of the applicant's income; 2) on the basis of marital status by failing to combine the income of unmarried co-applicants while combining the incomes of married co-applicants; 3) on the basis of marital status by requiring a married applicant to have their spouse and not any other person co-sign a loan when required; and 4) when the applicant's income was derived from public assistance, by failing to consider the public assistance as income.

The complaint also alleged that Franklin did not provide the adverse action notice required by the ECOA and the FCRA. In addition to paying $800,000 in civil penalties, the FTC obtained injunctive relief whereby Franklin was enjoined from violating provisions of the ECOA and FCRA in the future.

In the second case, the FTC settled a case with Ford Motor Credit Co., the auto financing subsidiary of Ford Motor Company, for $650,000 in December 1999. n27 The FTC alleged that from May 1994 to August 1995, Ford violated the ECOA by combining incomes for married applicants, but not for unmarried joint applicants, resulting in unmarried applicants obtaining credit on less favorable terms compared to their married counterparts. Under the terms of the

consent decree, a $650,000 settlement fund was created to compensate credit applicants who were adversely affected by Ford's practice.

In February 1997, the DOJ filed a complaint and proposed settlement agreement on behalf of the FTC against The Money Tree, Inc. and its president. n28 The complaint alleged that the Money Tree discriminated against applicants who received public assistance and against elderly applicants. Regarding the first allegation, the FTC claimed the Money Tree imposed stricter loan terms on applicants who received income from public assistance than on employed applicants and collected or attempted to collect payments from borrowers receiving public assistance before they were due. The complaint further alleged that elderly applicants were discouraged from applying for credit, were denied credit, or were offered credit on less favorable terms than younger applicants. The Money Tree agreed to pay $75,000 in civil penalties and to refrain from discriminating against applicants who receive public assistance and elderly applicants in the future.

In October 1997, in a case against Bonlar Loan Co., the FTC once again requested that the DOJ file a complaint and proposed consent decree on behalf of the FTC. n29 The FTC claimed that Bonlar violated the ECOA and Fair Credit Reporting Act in the way it accepted and processed consumer loan applications. The FTC alleged that the ECOA was violated by: Bonlar's practice of asking applicants for their marital status when such information was not necessary for evaluating the loan application; failing to provide adverse action notices; and failing to provide specific reasons for adverse action or inform the applicant of the right to request such reasons. Under the consent decree, Bonlar agreed to pay $40,000 in civil penalties and was enjoined from future violations of the ECOA.

In 2000, the DOJ filed an amicus brief in *Cason v. Nissan Motors Acceptance Corp.*, one of two class action cases against major automobile financing creditors for discriminatory charging of subjective overages or "markups." n30 The markups occurred when auto dealers, with the approval of NMAC (or GMAC), charged a higher interest rate than the minimum "buy rate" set by the auto finance company for different credit risk categories. The markup was split between the dealer and NMAC or GMAC. In both cases, the private plaintiffs alleged that African Americans were over 200% more likely to be charged a marked-up interest rate than similarly situated whites, and thus disproportionately impacted by the practice. Furthermore, African Americans were allegedly charged more per markup--an average of about $950 per markup compared with an average markup for whites of, respectively, $500 (NMAC) and $650 (GMAC). n31

Both NMAC and GMAC filed motions for summary judgment, arguing that they were not liable under ECOA because they were merely assignees. The plaintiffs argued that NMAC and GMAC could be held directly liable under ECOA as creditors who participated in credit decisions. In addition, the plaintiffs and the DOJ amicus brief argued that ECOA, like the Fair Housing Act, imposes a non-delegable duty not to discriminate.

The District Courts in both cases denied summary judgment and held that NMAC and GMAC could be held liable as direct creditors. n32 The Court in GMAC went further, holding that the company had a non-delegable duty not to discriminate. n33

In July 2002, pursuant to a 2001 referral from the Office of Thrift Supervision, the Justice Department filed a complaint and settlement agreement against Fidelity Federal Bank. n34 Among other allegations, the government charged that Fidelity Federal failed to ensure that its marketing service providers had policies in place which would ensure compliance with fair lending laws. For example, the bank entered into an agreement with American Direct Credit to market subprime credit cards through a network of dealer-distributors conducting in-home sales of various household products. Fidelity was the issuer and owner of the credit cards. Under the terms of the settlement agreement, Fidelity agreed to provide $1.6 million to compensate the victims of the violations and to fund a Consumer Education Program. The bank also agreed to implement a Compliance and Risk Management Program and to provide fair lending training for all employees engaged in credit card program activities. n35

In December 2002, a complaint and consent order against Mid America Bank was filed in the Northern District of

Illinois. n36 The complaint alleged that, in extending the scope of its business, the bank focused on meeting the lending and credit needs of predominantly white residential areas in Chicago and avoided serving the needs of majority African-American and combined African-American/Hispanic neighborhoods. n37 Although denying that it violated the FHA or ECOA, the bank agreed to make significant changes in marketing and in decisions regarding on branch locations. n38 In addition, the Bank agreed to invest an average of $2 million each year for the duration of the order to offer residents in the designated minority census tract real estate loan products at more advantageous interest rates and/or terms than would normally be provided. n39 In 2007, DOJ reached a settlement with Compass Bank in a case alleging that the bank charged higher interest rates to co-applicants for automobile loans who were not married to each other than to co-applicants who were married. The consent order prohibits the bank from discriminating on the basis of marital status in any aspect of its automobile lending. n40 Similarly, in 2007 DOJ simultaneously filed and settled two cases against Philadelphia-area car dealerships alleging that they violated the ECOA by charging African Americans higher dealer markups on car loan interest rates. n41

[4] Enforcement Activities at the State and Local Levels

State and local government agencies responsible for enforcement of their respective anti-discrimination laws have also been active in challenging credit discrimination practices. However, their ability to enforce federal or state credit discrimination laws against national banks has been put in question by a Second Circuit ruling that they are largely, perhaps completely, preempted from doing so. The ruling does not affect private enforcement, nor does it restrict state and local enforcement against entities other than national banks, though preemption may still be an issue in public enforcement efforts against other federal depositories. n42

In 2006, after the HMDA data showed disparities in high cost lending by several institutions, the New York Attorney General issued subpoenas to several banks. HSBC, JP Morgan Chase, and Wells Fargo refused to cooperate. Joined by the Office of the Comptroller of the Currency, they sued to enjoin the attorney general's investigative and enforcement efforts.

In *Clearinghouse Ass'n, L.L.C. v. Cuomo*, the Second Circuit upheld the OCC's position that any effort by the attorney general to investigate or enforce provisions of the ECOA or state credit discrimination laws against national banks or their operating subsidiaries was an unlawful exercise of visitorial powers preempted by the National Bank Act. n43 The court declined to decide whether state enforcement of the federal Fair Housing Act is similarly preempted. The attorney general contended that he had standing to enforce the FHA in a *parens patriae* capacity and that an FHA action falls within the NBA's exception for visitorial powers "authorized by Federal law." n44 That issue was not ripe for adjudication as New York had not yet filed suit under the FHA and the FHA does not contain a pre-enforcement mechanism similar to the broad investigative power under state law.

Prior to the ruling, Countrywide Home Loans, which did not join in the challenge to the New York subpoenas, reached a settlement with the state, the first settlement of a regulatory inquiry arising out of the disclosures made pursuant to recent HMDA regulations requiring lenders to disclose the race and ethnicity of consumers who received high-cost loans. Under the settlement, Countrywide agreed to compensate certain minority borrowers who were given improperly costly loans and to institute a $3 million consumer education program, among other commitments. n45

The *Clearinghouse* ruling means that states cannot enforce the ECOA or any state credit discrimination laws against national banks or their operating subsidiaries. The ruling does not exempt banks from compliance with those laws, but only the OCC has enforcement authority. The OCC's record on that point, however, does not provide much comfort. Because the laws themselves are not preempted, however, private enforcement is unaffected.

The ruling does not, however, preempt state enforcement against entities other than national banks. For example, in 2008, New York officials filed administrative charges against two tax preparation firms alleging that they targeted low-income African-American, Hispanic, and military families with high-cost refund anticipation loans, in violation of

state anti-discrimination laws. n46

In a case that may force the courts to resolve the question left open by the Second Circuit, in 2008 the City of Baltimore filed suit against Wells Fargo Bank alleging that the bank violated the Fair Housing Act. The City of Baltimore claimed that the bank targeted underserved and vulnerable minority neighborhoods for subprime loans, which in turn lead to a disproportionately high foreclosure rate in African-American neighborhoods. n47

Prior to the *Clearinghouse* decision, state and local government agencies responsible for enforcement of their respective anti-discrimination laws had been active in challenging credit discrimination practices. Not all of the following actions would be precluded by the Second Circuit decision.

A 2006 determination by the Pennsylvania Human Relations Commission is notable in that it found reverse redlining to be actionable under the state Human Relations Act and because it held brokers liable for the violations. n48

In response to an investigation by the Massachusetts Attorney General, Bank of America agreed to reopen three consumer bank accounts and to contribute $50,000 to create education materials in order to resolve allegations that the former Fleet Bank discriminated against individuals and institutions with Arabic names. Fleet had closed the accounts based on suspicion of terrorism or money laundering. The attorney general noted that the state's investigation did not show a pattern of discrimination. n49

In the wake of the landmark study by the Federal Reserve Bank of Boston, n50 the Massachusetts Attorney General reached a settlement with ten banks and with the Bankers' Association. Among other provisions, the settlement established an independent committee to review minority applications which were denied during 1990. The banks and Bankers' Association also established several initiatives to ensure that minority borrowers and minority neighborhoods have equal access to credit.

In Georgia, the Atlanta-based mortgage subsidiary of Fleet Financial Group, Inc. agreed to pay $100 million to settle an investigation by the state attorney general into possible loan bias. The state's investigation centered on allegations that Fleet "preyed on minority borrowers by charging high fees and interest rates" n51 in violation of the state's Fair Business Practices Act. Some had accused the company of sending agents (that is, brokers and home improvement contractors) roaming through poor, mostly African-American, neighborhoods to make these high-rate loans. n52

Fleet agreed to refund some of the high fees, prospectively reduce high interest rates on 1150 loans, give a fresh start and waiver of past-due interest to delinquent borrowers, make a small cash payment to all borrowers who had a loan on January 1, 1991, and complete, correct, or reimburse victims of shoddy contracting financed by Fleet loans. It also offered unspecified relief to those who lost their homes to foreclosure. Additionally, Fleet agreed to make $70 million dollars available for affordable loans to qualified low-income borrowers in Georgia.

In Arizona, Banc One Mortgage Corporation agreed to provide $5 million dollars in loans to low- and moderate-income home buyers to end a lending discrimination investigation by the Arizona Attorney General. The investigation stemmed from complaints by Hispanic applicants in Yuma County, Arizona, that they were denied home loans on the basis of their ethnicity. Banc One also agreed to employ a Spanish-speaking loan officer in Yuma County. n53

An example from the local level involves the Philadelphia Commission on Human Relations, which filed actions against four lending institutions for alleged violations of anti-discrimination provisions of the Philadelphia Code. n54 As a result, each institution entered into a consent decree agreeing to comply with the code's "fair practices" provisions on lending, cease giving false or misleading information regarding lending to potential borrowers based upon the potential borrower's race or color, and require that its employees receive training on fair lending laws from the Human Relations Commission. In addressing practices that were having a disparate impact, the four institutions agreed not to establish or maintain minimum loan amounts and to advertise their mortgage products on an equal opportunity basis.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawFederal Trade Commission ActU.S. Federal Trade CommissionBanking LawConsumer ProtectionEqual Credit OpportunityLiabilityBanking LawRegulatory AgenciesU.S. Office of the Comptroller of the CurrencyCivil Rights LawContractual Relations & HousingFair Housing RightsEnforcementReal Property LawFinancingFederal ProgramsU.S. Department of Housing & Urban Development Programs

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1691e(h).*

(n2)Footnote 2. *15 U.S.C. § 1691c(c).*

(n3)Footnote 3. *15 U.S.C. § 1691b(a)(1).*

(n4)Footnote 4. *See 15 U.S.C. § 1691c*; Reg. B, *12 C.F.R. § 202.14(a)* and app. A.

(n5)Footnote 5. These eleven agencies and their areas of responsibility are:

- Comptroller of the Currency for national banks and federal branches of foreign banks;
- The FRB for member banks of the Federal Reserve System (other than national banks) and foreign bank branches (other than foreign bank Federal and insured State branches);
- The FDIC for banks insured by the FDIC (other than member banks of the Federal Reserve System) and insured State branches of foreign banks;
- The Office of Thrift Supervision for savings associations insured by the FDI;
- The Federal Credit Union Administration for federal credit unions;
- The Secretary of Transportation for carriers regulated by the Surface Transportation Board;
- The Secretary of Transportation for regulated air carriers;
- The Secretary of Agriculture for activities related to the Packers and Stockyards Act;
- The Farm Credit Administration for federal land banks and associations, federal intermediate credit banks and production credit associations;
- The SEC for brokers and dealers; and
- The Small Business Administration for small business investment companies.

(n6)Footnote 6. *15 U.S.C. § 1691c(b).* The OCC has also taken action against a payday lender and its service provider for failing to safeguard loan files in accordance with ECOA's document retention requirements. According to the OCC, ACE Cash Express, a third-party service provider for payday loans booked by Goleta National Bank, failed to protect 641 loan files. ACE employees discarded the loan files in a dumpster in violation of ECOA's requirement that such documents be retained for twenty-five months. *In re* ACE Cash Express, Inc., AA-EC-02-19 (Oct. 25, 2002) (consent order), *available at* www.occ.treas.gov/02rellst.htm; *In re* Goleta Nat'l Bank, AA-EC-02-18 (Oct. 25, 2002)

(consent order), *available at* www.occ.treas.gov/02rellst.htm.

(n7)Footnote 7. *15 U.S.C. § 1691e(g)*.

(n8)Footnote 8. *15 U.S.C. § 1691e(g)*, *as amended by* Pub. L. No. 102-242, § 223 (1991).

(n9)Footnote 9. *42 U.S.C. § 3605*.

(n10)Footnote 10. *15 U.S.C. § 1691e(k)*, *as added by* Pub. L. No. 102-242, § 223 (1991). *See also* Memorandum of Understanding Between Department of Housing and Urban Development and the Federal Financial Institutions Examination Council (FFIEC) Member Agencies, Clearinghouse No. 49,127 (Nov. 1991).

(n11)Footnote 10.1. *See* U.S. Dep't of Housing & Urban Dev., News Release, HUD No. 07-103 (July 13, 2007).

(n12)Footnote 11. *15 U.S.C. § 1691b*.

(n13)Footnote 12. 12 C.F.R. § 202.

(n14)Footnote 13. *15 U.S.C. § 1691c(d)*.

(n15)Footnote 14. The Procedures are available as Clearinghouse No. FILL IN or on the Council website at www.ffiec.gov/PDF/fairlend/pdf (March 2001).

(n16)Footnote 15. *68 Fed. Reg. 13,144, 13,148* (Mar. 18, 2003) . The new exception is codified at *12 C.F.R. § 202.5(b)(l)*.

(n17)Footnote 16. *64 Fed. Reg. 44,582* (Aug, 16,1999) . *See generally* National Consumer Law Center, Credit Discrimination § 4.4.8 (3d ed. 2002 and Supp.).

(n18)Footnote 17. *59 Fed. Reg. 18,266* (Apr. 15, 1994) .

(n19)Footnote 18. *42 U.S.C. § 3614(a)*.

(n20)Footnote 19. *42 U.S.C. § 3614(a). See also U.S. v. Incorporated Vill. of Island Park, 888 F. Supp. 419, 449 (E.D.N.Y. 1995)* .

(n21)Footnote 20. *42 U.S.C. § 3614(d)*.

(n22)Footnote 21. Reg. B, *12 C.F.R. § 202.14(b)(3)*.

(n23)Footnote 22. The FRB may include statistics on its referrals to the Attorney General in its Annual Report to Congress. For example, in its 86th Annual Report for 1999, the FRB noted that it reviewed 19 potential referrals and referred two to the Attorney General. *See* the FRB's website at www.federalreserve.gov/publications.html (March 2001).

(n24)Footnote 23. Reg. B, *12 C.F.R. § 202.14(b)(4)*.

(n25)Footnote 24. *15 U.S.C. § 1691e(k)*; Reg. B, *12 C.F.R. § 202.14(b)(5)*.

(n26)Footnote 25. *See* National Consumer Law Center, § 12.4.1.3 (4th ed. and supp.), for discussion of significant recent settlement in U.S. v. Long Beach Mortgage Co., Clearinghouse No. 51, 944, Case No. CV 96-6159 (C.D. Cal., settlement agreement and order filed Sept. 5, 1996). In 2001 the DOJ settled a lawsuit against ANB, which resulted in a $1.5 million fund to compensate Hispanic applicants and cardholders affected by the allegedly discriminatory practices. The settlement did not contain any injunctive relief. United States. v. Associates Nat'l Bank, No. 99-196 (D.Del. 2001)

(settlement agreement), *available at* www.usdoj.gov (March 2001).

(n27)Footnote 26. United States v. Franklin Acceptance Corp., Civ. No. 99-CV-2435 (E.D. Pa. 1999) (consent decree).

(n28)Footnote 27. United States v. Ford Motor Credit Corp., Clearinghouse No. 53,016, No. 99-75887 (E.D. Mich. Dec. 14, 1999) (consent decree) (*available at* http://www.ftc.gov).

(n29)Footnote 28. United States v. Money Tree, Inc., Civ. No. 6:97-CV-7 (M.D. Ga. Feb. 4, 1997) (*available at* http://www.ftc.gov).

(n30)Footnote 29. United States v. Bonlar Loan Co., Civ. No. 97-C-7274 (N.D. Ill. Oct. 17, 1997) (consent decree) (*available at* http://www.ftc.gov.)

(n31)Footnote 30. Cason v. Nissan Motor Acceptance Corp., Civ. No. 3-98-0223 (M.D. Tenn. 2000) (fourth amended complaint). The other case is Coleman v. GMAC, Civ. No. 3-98-0211 (M.D. Tenn. 2000) (fourth amended complaint). The DOJ filed its amicus brief in July 2000, also available at www.usdoj.gov (March 2001). *See also Coleman v. GMAC, 196 F.R.D. 315 (M.D. Tenn. 2000)* . The National Consumer Law Center (NCLC) is co-counsel in both cases.

(n32)Footnote 31. Cason v. Nissan Motor Acceptance Corp., Clearinghouse No. 53037A, Civ. No. 3-98-0223 (M.D. Tenn. 2000) (fourth amended complaint); Coleman v. GMAC, Clearinghouse No. 53036B, Civ. No. 3-98-0211 (M.D. Tenn. 2000) (fourth amended complaint).

(n33)Footnote 32. *Coleman v. GMAC, 196 F.R.D. 315, 324-325 (M.D. Tenn. 2000)* . The Court in the NMAC case issued an oral decision on August 24, 2000.

(n34)Footnote 33. *Coleman v. GMAC, 196 F.R.D. 315, 325, n.21 (M.D. Tenn. 2000)* .

(n35)Footnote 34. U.S. v. Fidelity Fed. Bank, Civ. Action No. 02-CV-03906 (E.D.N.Y. complaint and consent decree filed on July 8, 2002), *available at* www.usdoj.gov.

(n36)Footnote 35. *See id.*

(n37)Footnote 36. United States v. Mid Am. Bank, Clearinghouse Nos. 55055A (complaint), 55055B (consent order), Civ. No. 02C 9458 (N.D. Ill. complaint and consent order filed Dec. 30, 2002).

(n38)Footnote 37. United States v. Mid Am. Bank, Clearinghouse Nos. 55055A (complaint), 55055B (consent order), Civ. No. 02C 9458 (N.D. Ill. complaint and consent order filed Dec. 30, 2002).

(n39)Footnote 38. United States v. Mid Am. Bank, Clearinghouse Nos. 55055A (complaint), 55055B (consent order), Civ. No. 02C 9458 (N.D. Ill. complaint and consent order filed Dec. 30, 2002).

(n40)Footnote 39. United States v. Mid Am. Bank, Clearinghouse Nos. 55055A (complaint), 55055B (consent order), Civ. No. 02C 9458 (N.D. Ill. complaint and consent order filed Dec. 30, 2002).

(n41)Footnote 40. *See* Press Release, U.S. Dep't of Justice, Justice Department Reaches Settlement with Compass Bank Regarding Alleged Discrimination in Lending (Jan. 12, 2007), *available at* www.usdoj.gov/opa/pr/2007/January/07_crt_016.html. A copy of the consent order is available at www.usdoj.gov/crt/housing.

(n42)Footnote 41. *See* United States v. Pacifico Ford (E.D. Pa. Aug. 21, 2007), *available at* www.usdoj.gov; United States v. Springfield Ford, Inc. (E.D. Pa. Aug. 21, 2007), *available at* www.usdoj.gov.

(n43)Footnote 42. *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses Ch. 3 (4th ed. 2009).

(n44)Footnote 43. *See Clearinghouse Ass'n, L.L.C. v. Cuomo, 510 F.3d 105 (2d Cir. 2007)* .

(n45)Footnote 44. *12 U.S.C. § 484(a)*.

(n46)Footnote 45. *See* Press Release, Office of the N.Y. State Att'y Gen., Countrywide Agrees to New Measures to Combat Racial & Ethnic Disparities in Mortgage Loan Pricing (Dec. 5, 2006), *available at* http://www.oag.state.ny.us/media_center/2006/dec/dec05a_06.html.

(n47)Footnote 46. *See* New York State, Division of Human Rights v. Jth Tax, Inc., No. 10122847 (NY Human Rights Division Jan. 17, 2008); New York State, Division of Human Rights v. Jackson Hewitt, Inc., No. 10122843 (NY Human Rights Division Jan. 17, 2008).

(n48)Footnote 47. Mayor & City Council of Baltimore v. Wells Fargo Bank, N.A., No. L08CV062 (D. Md. Jan. 8, 2008) (available on the website accompanying this manual).

(n49)Footnote 48. *See McGlawn v. Human Relations Comm'n, 891 A.2d 757 (Pa. Commw. Ct. 2006)* (state Human Rights Commission found mortgage broker violated state Human Relations Act by engaging in reverse redlining). The commission accepted testimony that the brokers were significantly involved in making the loans. For more on broker liability, see §§ 11.3.2.2, *supra*, and 12.4.1.5, *infra* (federal action against brokers).

(n50)Footnote 49. *See* Press Release, Office of the Mass. Att'y Gen., AG Reilly Reaches Agreement with Bank of America Resolving Arab-American Community Complaints About Fleet Account Closures (Apr. 12, 2006), *available at* www.ago.state.ma.us/sp.cfm?pageid=986&id=1650.

(n51)Footnote 50. *See* Fed. Reserve Bank of Boston, Alicia Munnell et al., Working Paper Series No. 92-7, Mortgage Lending in Boston: Interpreting HMDA Data (1992).

(n52)Footnote 51. Mitchell Zuckoff & Kimberly Blanton, *Fleet to Pay $100m Loan Bias Settlement*, Boston Globe, Dec. 16, 1993, at 1.

(n53)Footnote 52. Mitchell Zuckoff, *Georgia Probe Slams Fleet Loan Practices*, Boston Globe, Dec. 17, 1993, at 85.

(n54)Footnote 53. Memorandum of Understanding (and Addendum) Between Banc One Mortgage Corp. and the Arizona Attorney General, Clearinghouse No. 53,525 (Dec. 7, 1997) (memorandum), (Jan. 10, 2000) (addendum).

(n55)Footnote 54. Phila. Comm'n on Human Relations v. Boulevard Mortgage Co., Clearinghouse No. 49,139A, Docket No. 92110885 (Phila. Comm'n on Human Relations June 29, 1993) (consent order and decree); Phila. Comm'n on Human Relations v. St. Edmonds Sav. & Loan, Clearinghouse No. 49,140A, Docket No. 92120892 (Phila. Comm'n on Human Relations May 4, 1993) (consent order and decree); Phila. Comm'n on Human Relations v. Bank & Trust Co. of Old York Rd., Clearinghouse No. 49,141A, Docket No. 92110887 (Phila. Comm'n on Human Relations Apr. 7, 1993) (consent order and decree); Phila. Comm'n on Human Relations v. People's Mortgage Co., Clearinghouse No. 49,142A, Docket No. 92110886 (Phila. Comm'n on Human Relations Feb. 3, 1993) (consent order and decree).

* [**Editor's Note:** The Federal Reserve Board [hereinafter FRB] revised Regulation B and the Official Staff Commentary. *68 Fed. Reg. 13,144, 13,161* (Mar. 18, 2003, effective April 15, 2003). The mandatory compliance date for the revised version of Regulation B was April 15, 2004.

The texts of revised Regulation B and the Official Staff Commentary are reprinted in Vol. 1A *infra*.]

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PART I Consumer Credit
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PART I Consumer Credit
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§ 6.01 Introduction

Despite the recent policy trend toward deregulation of the marketplace, the sky is not the limit for consumer credit charges. There remain significant limitations on the right of creditors to exact any yield they wish from borrowers in the most typical consumer credit transactions. These remaining protections for consumers are the subject of this chapter.

The primary focus of this chapter is on the cost of credit. As such, the bulk of it is devoted to those state and federal statutes which restrict credit charges, either directly or indirectly, through substantive limitations on credit contract terms. Since most of them are usury statutes and their descendants, the "common law" n1 of usury is considered throughout.

However, there are other statutes and common law legal theories which also may come into play as a viable means to challenge deception, excess, or unfairness in the price of credit, and this chapter provides an overview of these as well. n2

The oldest of the statutes which limit the cost of credit are so-called "general" usury statutes which purport to set the maximum rate of interest that can be charged in any "loan" transaction in a jurisdiction. More recent and plentiful are the "special" usury laws, such as small loan laws, which are usually structured as exceptions to a general usury ceiling, and which govern interest charges only in connection with specified kinds of loans. Finally, there are numerous laws which regulate charges for credit, but which are not usually called "usury" laws. For example, retail installment sales acts technically limit charges assessed in connection with the sale of goods on credit rather than charges for "loans" covered by usury laws. Consumer Finance Acts or Consumer Loan Acts may or may not set a limit on the maximum allowable interest rate, but they usually have limitations on other terms which affect the cost of credit. A number of states have responded to the problems of second mortgages by adopting special usury laws which govern only second mortgages, home equity loans, or home improvement loans. n3

Similarly, banking regulations may restrict the kinds of charges which a bank may impose, such as prepayment penalties or various service charges, without specifically restricting the rate of interest that may be charged, as usury statutes traditionally have done.

Some part of the consumer credit market is "deregulated" to some extent in every state, whether by action of the state

legislature or by federal preemption. n4 Even those transactions, however, are subject to some standards, and throughout the chapter, an effort is made to highlight areas where overcharges are vulnerable to challenge whether there is a usury ceiling or not.

This chapter analyzes the substance and interpretation of usury and related statutes. However, it is also important for advocates to understand the mechanics of these transactions. n5

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionState LawGeneral OverviewBanking LawFederal ActsGeneral OverviewBanking LawNational BanksInterest & UsuryGeneral OverviewBanking LawNational BanksInterest & UsuryUsury LitigationContracts LawDebtor & Creditor Relations

FOOTNOTES:
(n1)Footnote 1. The term is somewhat misleading, as usury is a statutory concept. Nonetheless, since usury laws have been around a long time and are widespread, what can be termed a common law of usury has arisen.

(n2)Footnote 2. *See* Ch. 4, "Unfair and Deceptive Credit Practices," *supra*; Ch. 1, "Truth in Lending," *supra*; Ch. 5, "Credit Discrimination," *supra*. For a thorough and in depth treatment of usury law and the cost of credit, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses (3d ed. and supp.). Apart from NCLC's manual, probably the most comprehensive treatments of usury law are contained in the C.J.S., 47 C.J.S., *Interest & Usury*; Consumer Credit (West) and Am. Jur. 2d, 17 Am. Jur. 2d, *Consumer & Borrower Protections* (Lawyers Cooperative Publishing Co.); 45 Am. Jur. 2d, *Interest & Usury* (Lawyers Cooperative Publishing Co.).

(n3)Footnote 3. *See generally* Annot., *43 A.L.R.4th 675 (1986)* (construction and application of second mortgage statutes), National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 2.3.3.7 (3rd ed. and Supp.). *See also* N.C. Gen. Stat. § 24.1-1E (1999). See discussion below, in *§ 6.02*, however, of federal preemption of state regulation of structure of home equity and other loans.

(n4)Footnote 4. *See § 6.02 infra*.

(n5)Footnote 5. For a basic overview of credit math and making sense of the numbers and interest rates that will be discussed in this chapter, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, Ch. 4 (3rd ed. and Supp.).

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§ 6.02 Federal Preemption of State Laws Limiting Credit Charges

[1] Introduction

Determining the legal limitations on consumer credit costs is greatly complicated by the existence of numerous federal statutes and regulations that preempt state usury laws with respect to some, but not all lenders, transactions, and practices which might otherwise lead to illegal overcharges. n1

What follows is a cursory overview of the relevant federal preemption statutes, and a preemption checklist. There is no guarantee that this chapter can safely be skipped on the basis of the checklist, but it will point out when it definitely should be read.

To generalize somewhat, preemption of state usury law is authorized by eight different federal statutes. n2

First, the National Bank Act ("NBA") n3 sets the ceiling for interest rates that may be charged by federally chartered banks. Under this Act, federal banks are treated as "most favored lenders" and may charge the higher of: (1) the interest rate allowed lenders in the state where the bank is located; or (2) 1% above the discount rate on 90-day commercial paper in effect at the Federal Reserve Bank in the district where the bank is located. This "most favored lender" status may be transported across state lines under certain circumstances.

The second statute preempting state usury laws is the Home Owners' Loan Act ("HOLA") enacted in 1933. n4 This act authorizes the Office of Thrift Supervision to provide for the organization, incorporation, examination, and regulation of federal savings associations. Like the NBA, HOLA sets the ceiling for interest rates that may be charged by these federal associations. Federal savings associations are likewise treated as "most favored lenders" and may charge the greater of: (1) 1% above the discount rate on 90-day commercial paper in effect at the Federal Reserve bank in the district in which such savings association is located; or (2) the rate allowed by the laws of the state in which the savings association is located. n5 Like national banks, federal associations may export this most favored lender status across state lines.

The third statute preempting state usury law is the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA or DIDMCA). n6 This law appears to extend the "most favored lender" treatment regarding interest rates

for federally chartered banks to any federally *insured* commercial bank (including state-chartered federally-insured banks), savings association, or credit union. In the special case of loans secured by first mortgages on residential real estate or first liens on mobile homes, DIDA has essentially eliminated interest rate ceilings and has preempted state limitations on a lender's ability to assess "points," finance charges, or "other charges." States may "opt out" of the federal DIDA preemption through appropriate legislation, and at least fifteen states exercised this option to some extent. Many of these states, however, have repealed their opt-outs. Those that retain their opt-out can, however, deregulate their state usury caps as well.

Fourth, pursuant to the National Housing Act, housing loans insured by the Federal Housing Administration ("FHA") or the Veteran's Administration ("VA") are exempted from state interest ceilings. n7 Since the authority of the FHA to set its own ceiling has been revoked, n8 new FHA-insured housing loans have no interest ceiling even, arguably, in situations where DIDA does not apply, such as junior mortgages. In contrast, the VA continues to set interest ceilings on loans which it issues. States may opt out of the FHA/VA preemption, so this form of preemption consequently will not apply in all jurisdictions.

Fifth, the National Credit Union Administration (NCUA) allows federally-chartered credit unions to assess interest of up to 15% per annum or any higher temporary rate set by the National Credit Union Administration Board. n9 Using this discretion, the Board raised the federal credit union ceiling to 21% in 1980. Since May 14, 1987, the rate has been set at 18% and will revert to 15% after September 8, 2006 unless extended. n10 Beyond usury issues, the preemption rights of federal credit unions are narrower than those granted or claimed by national banks or federal savings association. n11

Sixth, pursuant to the National Housing Act, housing loans insured by the Federal Housing Administration (FHA) or the Veteran's Administration (VA) are exempted from state interest ceilings. n12 As the authority of the FHA to set its own ceiling has been revoked, n13 new FHA-insured housing loans have no interest ceiling even, arguably, in situations where DIDA does not apply, such as junior mortgages. Similarly, the parties to a VA-insured loan may agree to any interest rate. However, states may opt out of the FHA/VA preemption, so this form of preemption consequently will not apply in all jurisdictions.

Seventh, the Interstate Banking and Branching Efficiency Act of 1994 ("IBBEA"), n14 which allows banks to establish branch banks in other states, continues (but does not expand), the current preemption authorized by the NBA and DIDA. Congress took special pains to emphasize that state consumer protection and fair lending laws apply to the extent not preempted by federal law, which certainly is an unmistakable message that it has no intent to "occupy the field" of consumer protection, thus leaving states free to continue to do so except where the *other* traditional tests for preemption dictate. n15 Indeed, the conference report admonished the national bank regulator not to find federal preemption unless "the legal basis is compelling and the Federal policy is clear." n16 Further, the Act imposes publication requirements regarding the issuance of agency opinions addressing national bank preemption of certain types of state law. n17

Eighth, most recently, Congress enacted the Gramm-Leach-Bliley Act that largely focuses upon eliminating the barriers separating the banking, insurance, and securities industries. n18 One provision, though, should have an effect on the ability of a limited number of states (perhaps only Arkansas!) to regulate the interest rates of the banks chartered within their boundaries in certain circumstances. n19 In addition, the GLB Act eliminates some barriers to banks and their operating subsidiaries from engaging in credit insurance sales, solicitations, or cross-marketing activity.

Finally, some federal consumer protection legislation may preempt inconsistent or less protective state law. The Truth in Lending Act ("TILA") n20 created a very narrow preemption of the disclosure terminology which may be required by state usury laws. Generally, state consumer credit statutes may not define TILA credit terms differently than they are defined by federal regulation and may not require the use of a different term for an amount identically calculated under TILA. The preemption is limited, however, and normally will not, for example, prevent states from compelling more

extensive or detailed disclosure than that required under TILA. Likewise, the 1994 Home Ownership and Equity Protection Act ("HOEPA"), n21 which amends TILA, imposes substantive restrictions on some contract terms with respect to certain transactions. Less protective state laws are preempted. Similarly, the 1992 federal rebate law, which requires rebates in consumer credit transactions and limits the use of the cost-distorting Rule of 78, preempts contrary state law. n22

Insofar as usury law is concerned, national banks, national credit unions, and federal savings and loan associations are generally regulated by the Office of the Comptroller of the Currency ("OCC"), n23 the National Credit Union Administration ("NCUA"), n24 and the Office of Thrift Supervision ("OTS") n25 (since 1989, replacing the Federal Home Loan Bank Board ("FHLBB")), n26 respectively. The major exception to this rule of thumb for federal lenders is that all lenders, including federal banks and credit unions, which wish to take advantage of the removal of interest ceilings on first mortgage loans provided by DIDA, must follow OTS regulations, including the OTS consumer protection regulations governing mobile home sales. Preemption also may not apply where the federally chartered or related institution is merely an assignee of a note, rather than the originator. n27

[2] Does More Than One Statutory Preemption Regime Apply?

As will be evident in this chapter, there are preemption regimes that apply to a financial institution solely because of its status as a federal or state chartered depository. In addition, in the mortgage context, other federal statutes provide that state lending laws are trumped due to the *type* of the loan itself. For example, in the absence of state opt-out legislation, state usury laws do not apply to FHA-insured or VA-insured mortgage loans or to first lien mortgage loans for other lenders. In addition, the ability of states to regulate certain terms in "alternative" mortgage loans is restricted.

The result is that if one preemption regime does not apply, the analysis may not end there. For example, even though a mortgage loan is not insured by the FHA, the state usury or other laws, nevertheless, may not apply. If the lender is a depository institution, there may a preemption problem separate and independent from the FHA preemption privilege. The practitioner should carefully consider all of the statutes reviewed in this chapter to either rule in or rule out potential preemption landmines.

[3] Federal Preemption: The National Bank Act

[a] Overview

The National Bank Act ("NBA") n28 allows a national bank, when originating credit, n29 to charge the higher of the maximum rate allowed lenders under state law (the most favored lender doctrine) or an alternative federal rate based on the federal discount rate. A national bank lending intrastate can take advantage of this alternative federal rate whenever it exceeds the state's interest ceiling. In addition, as is discussed later, the NBA as currently interpreted allows national banks operating interstate from one state to take advantage of higher (or no) rate ceilings in that state in extending credit, such as credit cards to consumers in other states.

The alternative federal rate is 1% above the discount rate on 90-day commercial paper in effect at the federal reserve bank in the district where the national bank is located. n30 Probably the best way to find the federal discount rate in effect at the time and place of a transaction is to examine the then current Federal Reserve Bulletin, published monthly by the Board of Governors of the Federal Reserve System. n31 Note that the federal discount rate is not a true market rate but is a managed interest rate set by the Federal Reserve.

Once the discount rate formula has been used to calculate the alternative federal rate, this rate must be compared to the maximum interest rate allowed to state lenders under state law. A national bank will be able to charge the *higher* of the two rates. However, determining the maximum rate allowed under a state's law can be complex because state laws frequently set different rates for different classes of lenders and different classes of loans.

The current interpretation of the alternative reference to state law is that national banks have "most favored lender" status, giving national banks an edge over state banks in transactions where this doctrine applies. The balance has shifted more recently in that federally insured state banks among others have successfully convinced courts that DIDA bestowed upon them the "most favored lender" status afforded national banks.

However, most favored lender doctrine is not blanket authority for those with its status to browse through state statutes and charge the highest interest rate in them. n32 There are three major limitations on the most favored lender doctrine, each of which is discussed briefly below.

First, national banks which invoke the most favored lender doctrine cannot automatically claim the right to charge the highest interest rate that any lender is permitted to charge. Rather, the national bank may only claim the rate which competing lenders may use *when issuing the same type of loan*. n33

It is the legal authority, rather than the actual practice of the potentially "competing" state lenders, which will determine whether or not a state lender is a competitor for purposes of the most favored lender analysis. n34

The second limitation on the most favored lender doctrine is that national banks may only adopt the rates of competing *state* lenders and not those of other *federal* lenders with whom they compete in a state. n35

Finally, national banks must comply with any state restrictions on the relevant loan type which are "material" to determination of the interest rate on that type of loan. n36 For example, if state law permits finance companies to issue high interest loans, but restricts their associated loan fees, a national bank cannot adopt only the state interest rate without complying with the fee restrictions because these restrictions are "material" to the interest rate allowed on the loan.

[b] Interstate Banking: National Banks and Rate Exportation

A 1978 Supreme Court decision, *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, n37 gave national banks the right to take the most favored lender status from their home state across state lines, and preempt the law of the borrower's home state.

The full extent of the exportation right has not been fully determined although the picture is clearer. Two questions have been central to the hotly contested post-*Marquette* litigation: what charges and contract terms are encompassed in the term "interest rate," and thus may be exported; and whether DIDA grants entities other than national banks the right to export "it," however "it" is defined.

The position of the exporting lenders is that virtually any contract term which affects their ultimate yield is "material," can be considered as interest, and is, therefore, exportable. To date, they have been fairly successfully in convincing courts of this position. n38 Charges and contract terms which have been held to fall within the scope of "interest rate" for purposes of most favored lender status (and hence exportation rights) are: late charges, n39 credit card over the limit (OTL) fees, n40 cash advance fees, n41 methods of computing interest, n42 bonus or commissions paid to lenders, n43 and closing costs. n44

Currently, there is some questioning as to whether these decisions have gone too far. The OCC's 1996 interpretive ruling for the most part formalizes the latest position its staff took in the exportation debate. n45 The OCC's new definition of "interest" is any payment compensating a creditor or prospective creditor for extending credit or any default or breach by a borrower of a condition upon which credit was extended. It includes such fees as "numerical periodic rates, late fees, not sufficient funds fees (NSF fees), overlimit fees, annual fees, cash advance fees, and membership fees." Ordinarily *excluded* are "appraisal fees, premiums and commissions attributable to insurance

guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization or fees incurred to obtain credit reports." n46 However, if state law would not consider OCC's included fees to be interest, for example, for usury purposes, this federal definition would not disturb that.

For the moment, the Supreme Court has given deference to the OCC ruling and upheld its broad federal definition of interest. n47 Since the promulgation of the OCC ruling, the OCC's Chief Counsel has issued two interpretative letters which add specific charges into the "interest" side of the equation. First, in Interpretative Letter No. 744, the OCC opines that prepayment penalties constitute interest for purposes of Section 85 (and are exportable if the national bank's home state permits them). n48 The rationale offered is that prepayment penalties compensate the lender for risks incurred in connection with the lending of its money because the bank relinquishes its right to receive the anticipated earnings on the loan over its projected life. n49

The second letter determined that certain fees charged in connection with home equity open-end accounts were interest under the ruling. n50

There is one limitation on rate exportation that does seem clear. Courts have held that federal preemption rights granted to depositories apply only to credit *initiated* by the depository, not to that assigned to it. n51 In other words, a bank cannot purchase a pre-existing usurious note executed by parties in a low-rate state and then claim that the note is no longer usurious on the theory that the laws of the high rate state should control. Such an approach would render usury ceilings for lenders other than national banks completely unworkable and has no foundation in the purposes of the National Bank Act or its counterpart statutes affecting other types of depository institutions. Further, the parties to a contract have the right to expect that the contract terms and the laws governing them are fixed as of the time the contract is consummated. If a national bank can successfully argue that its preemption rights regarding the interpretation and legality of a loan contract attach even if it is only the assignee of the contract, the ability to contract with certainty is completely undermined.

The OCC has spoken to some extent on this issue. Where the bank originates or table-funds the loan, n52 the bank's preemption rights "attach" to the loan and conflicting state laws are preempted. n53 Where the loan is arranged by a broker and made by another type of entity not entitled to preemption, the state law is not preempted. n54 Where the bank is merely the trustee of a pool of loans and did not originate the loan and did not fund the loan at inception, state law applies. n55

Another interesting issue involves the ability of a state to regulate or establish conditions upon the location of ATMs within its boundaries. At least two states prohibit an out-of-state bank from locating an ATM within their boundaries unless the bank has a branch in those states and/or meets other requirements. n56 One such law is currently on federal appellate review: a threshold issue for the court is whether the Electronic Funds Transfer Act, n57 which addresses bank charges for use of ATMs and generally defers to state law, acts to trump the NBA on issues it specifically covers. n58 In an interpretive letter, the OCC recently opined that geographic restrictions on ATM placement are preempted by the National Banking Act. n59

[c] National Bank Act Preemption

[i] Conflict Preemption

It is clear that national banks, though federally created creatures, are also subject to state laws, "except where such legislation is in conflict with some Act of Congress, or where it tends to impair or destroy the utility of such banks, as agents of instrumentalities of the United States, or interferes with the purposes of their creation." n60 State law carries a presumption of validity n61 unless it conflicts with federal law. This type of "conflict" preemption involves a case-by-case determination of whether particular state laws impede, impair, or conflict with the purposes of the federal act or the powers of national banks. The OCC has not issued broad regulations preempting state law in particular

banking areas. Instead, the agency has addressed particular state laws and their impact on national banks through opinion letters that, until recently, have not been formally published. n62 In 2002, the agency published a list of activities that national banks may perform with citations to authority. n63

Through the Gramm-Leach-Bliley Act, Congress recently expanded the authority of banks to operate in disregard of state law in an area long considered a sacred cow of state regulation, the sale of insurance. n64 This preemption, however, is subject to thirteen exceptions that preserve the states' rights to regulate a bank's insurance sales under certain conditions.

[ii] OCC Opinion and Interpretative Letters

Traditionally, the Office of the Comptroller of the Currency has utilized opinion and interpretive letters to rule upon whether and the extent to which states can regulate national banks. Despite what sounds on paper to be lip-service to state authority to co-regulate national banks, in fact, the OCC has issued few letters over the last twenty years in which it opines that a particular state law in question is *not* preempted. For example, in 1992, the OCC confirmed the validity of an Arkansas constitutional usury cap when applied to a national bank located in Arkansas which sought to use the state's "most favored lender" rate. n65

On the other hand, the OCC has released scores of letters finding that a variety of state laws *are* preempted. Specifically regarding consumer credit statutes, the OCC has opined that provisions requiring national banks to obtain licenses, n66 to maintain and allow inspection of certain records, n67 to pay annual or other fees, n68 or to provide certain disclosures are preempted. n69

In the Interstate Banking and Branching Efficiency Act of 1994 (IBBEA), Congress took care to emphasize that state consumer protection and fair lending laws apply to the extent not preempted by federal law. n70 At this point in time, the precise definition of the term "consumer protection" is unclear. Certainly, limitations on the cost of consumer credit protect consumers. However, given the Supreme Court's acceptance of the OCC's expansive definition of interest, n71 it is difficult to know what constitutes "consumer protection," except for protections that have nothing to do with interest rates and fees. Several courts have confirmed, however, that consumers and state agencies can enforce state unfair and deceptive acts and practices laws against banks concerning a variety of types of misleading or fraudulent behavior. n72

Despite its resounding deference to the OCC's published interpretation regarding the definition of "interest," judicial deference to unpublished letters was criticized by the Supreme Court in *Smiley v. Citibank (South Dakota), N.A.* n73 The Court held that letters construing ambiguous provisions of the National Banking Act will be given deference only if the interpretations are "formal," directed to national banks generally, and "reasonable." Since the decision in *Smiley*, two courts have refused to give deference to OCC letters in other contexts. n74

The OCC may have absorbed the fact that its letters will have more authority if they are published. During 2000 and 2001, it published several Notices of Request for Preemption Determinations for comments and issued three preemption letters. For consumers, the most important request for a preemption determination relates to the ability of national banks headquartered in one state that wish to conduct motor vehicle sales financing in another state, without regard to the foreign state's retail installment sales act. n75 Specifically, an Ohio bank sought to conduct business "through" automobile dealers located in Michigan, with the Ohio bank prescribing the terms of the loans and funding them. The Michigan Financial Institutions Bureau opined that its motor vehicle sales finance act (MVSFA) would limit the ability of the bank to make loans in this manner. In its Preemption Determination, the OCC found that the application of Michigan's MVSFA frustrates the bank's ability to exercise its lending authority by restricting it use of agents, by prohibiting the bank from charging interest rates permitted by its home state, and by seeking to apply licensing requirements to a national bank. The agency decided that the state law is preempted. n76

In late 2003, the OCC published a preemption determination regarding the Georgia Fair Lending Act, an anti-predatory

mortgage lending law patterned on the federal Home Ownership and Equity Protection Act. n77 While not directly taking this course, the OCC ruled that the entire statute was preempted, even provisions typically found in state law, such as rights to cure, restrictions on brokers and home improvement contractors, assignee liability, and attorney fees. n78 This preemption determination will have far-reaching consequences for the attempts by states to curb predatory lending practices within their borders.

The OCC's positions articulated in the Georgia preemption determination foreshadowed the agency's next major step to mirror the broad preemption available to federal savings associations under the Home Owners' Loan Act.

In 2004, the OCC adopted four broad regulations that purport to preempt state laws in the areas of deposit-taking, non-mortgage lending, mortgage lending and, generally, the business of banking. n79 These rules declare that state laws are preempted if they "obstruct, impair, or condition a national bank's ability to fully exercise" its powers, either directly or through operating subsidiaries. n80

In addition, the two new lending regulations create an "ability to repay" standard that national banks must follow when originating loans. n81 The lending regulations also prohibit national banks from engaging in unfair or deceptive acts or practices within the meaning of the Federal Trade Commission Act.

The types of state laws that the two regulations pertaining to lending identify as automatically preempted include those that relate to:

- Licensing, registration, filings, or reports by creditors;
- The ability of a creditor to require or obtain insurance for collateral or other credit enhancement or risk mitigant;
- Loan-to-value ratios;
- The terms of credit, including the schedule for repayment of principal and interest, amortization of loans, balance, payments due, minimum payments, term to maturity of the loan, or the ability to call the loan due and payable upon the passage of time or a specified event external to the loan;
- Escrow or similar accounts;
- Security property;
- Access to and use of credit reports;
- Disclosure and advertising requirements in credit application forms, credit solicitations, billing statement, credit contracts, or other related documents;
- Disbursements and repayments; and
- Rates of interest.

For real-estate secured loans, additional state laws relating to the following subjects are preempted:

- The aggregate amount of funds that can be loaned upon the security of real estate;
- Processing, origination, servicing, sale, or purchase of, investment in, or participation in mortgages;

- Due on sale clauses, with some exceptions; and

- Covenants and restrictions that must be contained in a lease to make it qualify as acceptable security for a real estate loan. n82

Both lending rules then list the types of state laws that are *not* preempted *as long as* they only incidentally affect the exercise of national banks' lending powers. n83 They are: contract, tort, criminal, homestead, rights to collect debts, acquisition and transfer of property, taxation, and zoning laws. When applying the "incidentally effects" standard, several courts have held that the state law claim is not preempted. n83.1 The OCC reserves the right to declare state laws not contained in this list preempted if they have more than an incidental affect on the banks' business of lending. Since the effective date of these regulations, the OCC has released two interpretive letters agreeing that the Uniform Commercial Code n84 and state anti-discrimination laws are *not* preempted. n85

One court has held that a national bank which made student loans (retail installment loan for state retail installment sales act purposes) and cooperated with the trade school to channel business to the bank is subject to assignee liability under the state RISA. n86 The court found that the state law does no more than incidentally affect the business for at least two reasons. First, a mere burden is not enough. Second, the state law is applied generally. It encourages all lenders to take a closer look when purchasing promissory notes but does not prohibit lenders from purchasing on the secondary market.

In 2006, the OCC released a compilation of activities it has deemed permissible for a national bank over the years. n87 The document also contains a handy summary of presumably all of the OCC's preemption letters and citations to court decisions that support the OCC's preemption positions regarding a wide variety of laws. In 2004, the OCC also amended the regulation regarding its "visitorial" powers. n88 "Visitation" refers to "the act of a superior or superintending officer, who visits a corporation to examine into its manner [of] conducting business, and enforces an observance of its laws and regulation." The OCC claims to have exclusive visitorial powers over national banks and their operating subsidiaries under Section 484 of the NBA. n89

The OCC asserts that state or local governmental bodies have no right to take administrative action against or to sue national banks and their operating subsidiaries to enforce state laws that *do* apply to national banks.

[iii] Co-Extensive Rights of Operating Subsidiaries

Until 2001, neither Congress nor the OCC had conferred national bank preemption rights upon national bank subsidiaries. However, last year, following the example of the OTS, the OCC promulgated a very short and seemingly innocuous regulation: "Unless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank." n90 The agency justified its action by arguing that the Gramm-Leach-Bliley Act n91 permits national banks to own subsidiaries that solely engage in activities that national banks are permitted to engage in directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks. n92

It is clear is that the authorization in Gramm-Leach-Bliley to subsidiaries was confined to "financial" subsidiaries. A financial subsidiary can engage only in activities that are financial in nature or incidental to a financial activity and activities that are permitted for national banks to engage in directly (subject to the same terms and conditions that govern the conduct of the activities by a national bank). n93 However, nowhere has Congress explicitly addressed the extension of national bank preemption to financial subsidiaries.

At this point, the Second, Fourth, Sixth, and Ninth Circuit Courts of Appeals have affirmed the validity of this regulation as it applies to national banks' operating subsidiaries. n94 At issue were state laws regarding licensing and

examination. Of note, the Ninth Circuit limited its holding to the " *enforcement* of state visitation by *state officials,* subject to exceptions stated in § 484(a) itself." n94.1 This suggests that state officials arguably could enforce state law through litigation if the substance of the state law is not preempted by other provisions of the National Bank Act or OCC regulations. n94.2 The Supreme Court granted certiorari in the *Watters* case and recently upheld the applicability of OCC visitation to operating subsidiaries. n94.3

The Second and Ninth Circuits provided the most lengthy analyses. Both courts relied upon section 24 (Seventh) of the NBA and the incidental power clause to hold that national banks have the authority to conduct business through operating subsidiaries. The Ninth Circuit rejected the argument that silence in the NBA regarding operating subsidiaries means that national banks cannot create and perform banking functions through such entities. n95 Both courts then deferred to the OCC operating subsidiary preemption rule.

In February 2004, the OCC added a searchable list of many of the national bank subsidiaries that engage in consumer lending to its website. The list appears at www.occ.treas.gov/OpSublist.pdf. Or one can go to the OCC home page at www.occ.treas.gov and click on "Customer Assistance." This list does not indicate when a company became an operating subsidiary, or when it lost this status if it was sold or reorganized. This information is critical because loans originated before or after a company was bought up or reorganized into an operating subsidiary would not be entitled to preemption. Further, the list is not complete. The OCC hopes to augment the list over time.

[iv] Rent-a-Charter Controversy

A recent and disturbing trend in the payday loan industry has drawn the ire of state regulators and consumers. Payday lenders have courted both national and state chartered banks to act as conduits for loans in a blatant attempt to avoid the application of state usury caps through the exportation doctrine. n96 Discussed in *§ 6.02[2][b] supra*, this doctrine permits a bank chartered in a deregulated state to ignore the usury laws in the borrower's home state, undermining that state's ability to enforce its usury laws. In the payday lending context, this means that payday lenders can partner with banks, make loans for the bank at its local storefront, buy back the loan, and claim that the borrower's home state usury laws do not apply.

Consumers are challenging these partnerships, arguing that the payday lender is renting the bank charter. For example, a case filed in Florida state court alleges that Ace and Goleta National Bank of California entered into a master agreement in which Ace Cash Express offered Goleta loans through its retail site. n97 Under the agreement, Ace purchased from Goleta all of the bank loans made on the previous day, and the loan purchases entitled Ace to substantially all of the interest and all of the risk of non-payment. Consumers accessed the loan proceeds through the use of debit cards that bear the Ace or "Advance Cash Express" name. According to the complaint, the real purpose of the agreement between Goleta and Ace is to allow Ace to evade Florida usury laws by allowing Ace to utilize Goleta's name and national banking standing. The complaint seeks damages for usury violations and under the state's unfair and deceptive trade practices act. Consumers in Maryland and Texas have filed class action suits in both federal and state courts attacking this particular brand of partnership between Goleta National Bank and Ace Cash Express. n98 The two cases filed in federal court, both of which named the national bank, have been dismissed. n99 Of the two cases, the one relevant to this discussion is *Hudson v. Ace Cash Express, Inc*. There, the court refused to look behind the loan documents listing the bank as the lender--at least at the motion to dismiss stage--and the complaint failed to allege that the lender was Ace, not the bank.

Three states, Colorado, Ohio, and North Carolina, have filed enforcement actions against Ace Cash Express, arguing that it, not Goleta, is the true lender. These cases are currently pending. n100

In addition, in 2000, both the Office of the Comptroller of the Currency and the Office of Thrift Supervision issued letters warning national banks and thrifts of the potential credit, transaction, reputation, compliance, and legal risks involved with payday lending. n101 While the OCC did not prohibit or limit national banks from entering into these

partnerships, it created a set of guidelines that discourage rollovers and listed certain disclosures that banks "should" make. One of the most important statements of the OCC in its letter is the following: "Multiple renewals--particularly renewals without reduction in the principal balance, and renewals in which interest and fees are added to the principal balance, are an indication that a loan has been made without a reasonable expectation of repayment at maturity." This position can be used to support and unfair or deceptive practices or unconscionability claims by arguing that the lender knew the consumer did not have the ability to repay at the time of each rollover.

The OCC recently announced a consent order signed by a pay-day lender, Eagle National Bank, n102 which it stated had "rented out its national bank charter to a payday lender in order to facilitate that nonbank entity's evasion of the requirements of state law that would otherwise be applicable to it." n103 Eagle agreed to cease its payday lending business.

The OCC continued its tough stance on banks and their partners regarding payday lending during 2002. The OCC terminated the partnership between Goleta National Bank and Ace Cash Express, Inc., the subject of the numerous lawsuits and state enforcement actions discussed above. These entities agreed to cease all payday lending by December 31, 2002, though servicing and collecting on outstanding loans can continue. Ace agreed to be 100% responsible for outstanding loans and to pay a $250,000 civil penalty. Ace cannot partner with any other national banks without the permission of the OCC. Goleta consented to a $75,000 civil penalty. n104

The OCC also shut down the smaller scale payday lending arrangements between Advance America and Cash Advance Centers and Peoples National Bank of Paris, Texas as well as the partnership between Cash America and First National Bank in Brookings, South Dakota. n105

In another significant move, the OCC filed an *amicus* in the Colorado case, *State ex rel. Salazar v. Ace Cash Express, Inc.*, in support of Colorado's motion to remand, and arguing against preemption. n106

In 2003, certain state chartered depositories came under the primary jurisdiction of the Federal Deposit Insurance Corporation ("FDIC"), if they are FDIC-insured banks. The FDIC issued guidelines for payday lending. n107

During 2005, however, payday loan companies became unhappy with the FDIC's guidelines and signs that these bank partnerships were doomed began to appear. In stunning developments in late 2005 and early 2006, all but a handful of small South Dakota banks decided to pull out of their bank agency arrangements. County Bank of Delaware exited the business after the FDIC issued a cease and desist order. n107.1 Next, the FDIC apparently sent letters to other state-chartered banks in the payday lending business advising them to correct certain deficiencies. n107.2 As a result, First Bank of Delaware, Republic Bank in Kentucky, BankWest, Inc. of South Dakota, and Community State Bank of South Dakota announced they would cease their payday lending operations in 2006. n107.3 By the end of 2006, all other rent-a-bank payday loan operations had ceased due to this FDIC intervention. The payday companies undoubtedly will look for other avenues to make these lucrative loans. n107.4

Following the demise of these relationships between payday lenders and state-chartered banks, the FDIC issued Affordable Small Loan Guidelines in 2007. n107.5 These guidelines encourage banks to:

- Collect fees that bear a direct relationship to origination costs and avoid charges such as annual fees, membership fees, advance fees, and prepayment penalties;

- Offer small loan credit with APRs of no greater than 36 percent;

- Encourage principal reduction by structuring closed-end loans to provide for affordable and amortizing payments; open-end loans should require minimum payments that pay off principal;

- Avoid excessive renewals or the prolonged failure to reduce the outstanding balance;

- Utilize sound underwriting that focuses on a borrower's history with the institution and ability to repay within an acceptable timeframe, though for small loans, documenting the borrower's ability to repay could be streamlined to include basic information, such as proof of recurring income.

[4] The Home Owners' Loan Act

[a] Overview

In 1933, Congress enacted the HOLA which authorizes the OTS to provide for the organization, incorporation, examination, and regulation of federal savings and loan associations. n108

A product of the Great Depression of the 1930s, the Act was intended: "to provide emergency relief with respect to home mortgage indebtedness at a time when as many as half of all home loans in the country were in default" and when many local savings institutions had closed or discontinued making "long-term loans." n109

Like the National Bank Act, the HOLA grants federal savings associations "most favored lender" status by granting them the right to charge a federal interest rate or the interest rate allowed by the home state. n110 Thus, federal S&Ls may charge the greater of: (1) 1% above the discount rate on 90-day commercial paper in effect at the Federal Reserve bank in the district in which such savings association is located; or (2) the rate allowed by the laws of the state in which the savings association is located. Calculating the alternative federal interest rate and the scope of the most favored lender doctrine are discussed earlier regarding national banks. If a savings association violates these restrictions, the harmed person may bring an action seeking forfeiture of the entire amount of interest that the debt carries with it or that is agreed to be paid. n110.1 The analysis of these issues appearing in *section 6.02[2][a] supra* applies with equal validity to federal savings and loans.

Federal savings associations may also export interest rates across state lines, just like national banks. n111 However, the OTS has defined where an association is "located" more broadly than has the OCC for purposes of which state's usury law applies under the most favored lender doctrine. n112 In a letter issued in 2004, the OTS reiterated its position: that an association may export the most favored lender interest rate of its home office state, even when making loans to borrowers residing in a branch state *and* even if the loans are booked out of offices located in that branch state. n113 In this latter situation, the association need not demonstrate any special nexus between the loans and the association's home state. The association also may elect to use the most favored lender interest rate of the branch state when a loan is made in that branch state, regardless of whether the borrower resides in the branch state or a state in which the association is not located.

The same rule that applies to national banks regarding *when* preemption arises should apply equally to federal savings associations. n114 The National Bank Act applies only to credit initiated by a national bank, not to that assigned to it. n115

[b] HOLA and "Conflict" Preemption

Though Congress granted the Federal Home Loan Bank Board (and its successor, the Office of Thrift Supervision) broad authority to regulate the lending practices of federal savings associations, the analysis applied by the courts to determine if a state law is preempted by HOLA or an OTS regulation is the same as that used when national banks are involved, *i.e.*, "conflict" preemption analysis. n116 Where the OTS has issued regulations governing the behavior at issue which conflicts with state law on the same issue, the state law is preempted. n117

In 1996, the OTS issued new regulations in which it claims the authority to occupy the entire field of lending

regulations regarding federal savings associations. n118

These regulations list the types of state laws which are expressly preempted with respect to federal savings associations and those which are not. n119 On the other hand, both before and after the enactment of 12 C.F.R. section 560, the OTS has found that numerous other types of state laws are preempted, including loan disclosure laws, loan-related charges regulation (including pre-payment penalty prohibitions), certain state insurance laws, statutes governing the trust activities of thrifts, licensing laws, laws or ordinance restricting the ATM fees, and a host of others. n120

The OTS has determined that one type of state law not mentioned in the regulation is *not* preempted--state unfair and deceptive acts and practices laws that do not directly regulate credit transactions. n121 This opinion letter specifically addressed whether Indiana's unfair and deceptive acts and practices ("UDAP") statute was preempted. While Indiana's UDAP statute affects lending to the extent that it prohibits misleading statements and practices in loan transactions, the OTS found that there is no indication that the law is aimed at any state objective in conflict with the safe and sound regulation of federal savings associations. "In fact, because federal thrifts are presumed to interact with their borrowers in a truthful manner, Indiana's general prohibition on deception should have no measurable impact on their lending operations."

Both before and after the enactment of 12 C.F.R. § 560, the OTS has determined that numerous other types of state laws are preempted, including state anti-predatory mortgage lending (HOEPA-like) laws, loan disclosure laws, loan-related charges regulation (including pre-payment penalty prohibitions), certain state insurance laws, statutes governing the trust activities of thrifts, licensing laws, laws or ordinance restricting the ATM fees, and a host of others. n122 Additionally, in 2002, the OTS published a list of the powers of federal savings associations with supporting citations. n123 Practitioners should consult this list to determine the OTS's view on the nature and extent of the powers of federal thrifts before suing or defending this type of institution.

The ability to preempt certain state laws enjoyed by federal savings associations also applies, by regulation, to certain subsidiaries of these federal associations. n124

[5] Industrial Loan Companies/Industrial Loan Banks

[a] Overview

Industrial loan companies (ILCs) or industrial banks emerged from the Morris Plan banks of the early 20th century to provide small loans to low- and moderate-income workers secured by their deposits. n124.1 Most of these companies operated like finance companies: they made loans at higher interest rates to wage earners who could not otherwise obtain credit. ILCs did not receive deposits. Instead, they issued thrift certificates to customers who made the equivalent of deposits. These thrift certificates were not insured by the FDIC, although two states, California and Utah, created insurance funds to back the ILCs. n124.2 ILCs were not subject to supervision by any federal banking agency for decades.

In 1982, the Garn-St. Germain Depository Institutions Act authorized federal deposit insurance for the thrift certificates of ILCs. n124.3 If an ILC applies for and receives FDIC insurance, the FDIC becomes its primary federal supervisor. However, ILCs or industrial banks remain state chartered and state regulated financial institu tions. Seven states charter ILCs: California, Colorado, Hawaii, Indiana, Minnesota, Nevada, and Utah. n124.4

As of January 30, 2007, there were 58 federally-insured ILCs with assets totaling approximately $177 billion. n124.5 Among the ILCs are automotive lenders (GMAC and BMW), retailers (Target), several large stock brokerage firms (Merrill Lynch, Goldman Sachs, Morgan Stanley, Lehman Brothers), and credit card lenders (Advanta). n124.6 Unsurprisingly, given its relatively permissive attitude towards ILCs, Utah is home to the vast majority of the large industrial banks.

[b] Most Favored Lender Doctrine and Exportation

Since ILCs are creatures of state law, state law generally applies to most of their activities. In addition, the state in which they are chartered will determine whether or not ILCs are different from a bank in any functional manner. For most purposes, ILCs can function as banks. There is only one meaningful limitation on what an industrial loan company can do: industrial loan companies cannot offer business checking accounts without losing the benefits of limited regulation available under the ILC charter. n124.7 ILCs can be owned by any business corporate entity, including a limited liability corporation, n124.8 and there is generally no limitation on their ability to own subsidiaries.

If an ILC becomes federally insured by the FDIC, the ILC is entitled to the "most favored lender" status granted to other state-chartered banks in the Depository Institutions Deregulatory and Monetary Control Act of 1980.As a result, the ILC may charge the greater of: (1) one percent above the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the district in which such state bank is located or (2) the rate allowed by the laws of the state in which the state bank is located. n124.9

The FDIC has issued letters opining that federally-insured institutions can export their home state's interest when doing business with customers residing in other states. This means that Utah-chartered ILCs are able to export Utah's usury laws in consumer lending transactions anywhere in the country even without branches in other states. Since Utah has no interest rate caps, n124.10 a Utah ILC can lend money in any other state at whatever rate it chooses.

[6] Preemption: DIDA

[a] Overview

The DIDA n125 provided (1) alternate federal rate ceilings for various federally chartered or insured depository lenders, apparently extending most favored lender status to these lenders; n126 (2) completely removed interest ceilings for most first mortgages on residences and mobile homes; n127 and (3) temporarily permitted an alternate federal ceiling on most business and agricultural credit. n128

Presumably recognizing the intrusion into states rights, Congress built into the statute an opportunity for states to "opt out." This is a significant difference from the NBA where a state opt-out right would have completely defeated the original purpose of supporting the fledgling national banks.

DIDA further attempted to circumscribe the impact of "interest" rate preemption, at least as to the first mortgage preemption, by clarifying that state consumer protections, such as limitations on late charges, prepayment penalties and attorney fees, are not preempted. n129

However, the financial services industry, and, to date, the courts specifically addressing the issue have not viewed DIDA as so circumscribed. In particular, sections 521-523 are now interpreted to give additional lenders the full measure of most favored lender status formerly reserved to national banks. Therefore, as the courts have interpreted these sections to give other lenders "exportation" rights, DIDA joins with the NBA to threaten national deregulation by "sister-state preemption." A result of the exportation controversy has been to erode the will of legislatures in "consumer-friendly" states as local financial services providers have worked hard (and generally successfully) for the freedom to charge more and higher fees, claiming this freedom is necessary to compete with those lenders who have the cloak of preemption. Consumers have accordingly lost protection as fee caps have risen.

One of the other ironies that arises in the exportation context occurs when courts in far-flung states where credit card customers reside must resolve conflicts in the laws of the state where the bank was chartered. For example, an Illinois federal court found itself embroiled in a controversy over which provisions of Virginia usury law applied to regulate the allowable amount of late fees and the duration of the grace period. n130 The result was that a foreign court construed

conflict in another state's law before that state's own court ever had the opportunity to do so.

[b] DIDA and Federally Related Lenders

One significant, and controversial, effect of DIDA was the extension of the alternate federal interest ceiling, which was formerly available only to national banks, to other federally-related depository institutions. The following lenders can take advantage of the federal alternative rate ceilings:

1) State-chartered commercial banks using federal deposit insurance; n131

2) Federally-insured or federally-chartered savings and loan associations, including federal savings banks; n132

3) State mutual savings banks and savings and loan associations, if they are federally insured; n133 and

4) Federally insured credit unions. n134

Because the language in DIDA extending the alternate interest ceiling to these federally related lenders matches the most favored lender provision of the National Bank Act, n135 these lenders have argued that they have similarly been granted most favored lender status. The result of such an interpretation is that federally insured state banks, savings and loans, and credit unions may charge the higher of the rate established for such institutions under state law, the federal alternate rate, or the highest rate allowed to any lender (particularly finance companies or deregulated lenders) making similar loans in the state.

Whether DIDA was actually intended to extend most favored lender status is unclear. However, most authorities, both regulatory agencies n136 and courts, n137 support the extension.

[c] DIDA and Exportation

The industry has assumed, and, since the First Circuit's decision in *Greenwood Trust v. Massachusetts*, n138 the courts have as well, that DIDA gives federally related lenders exportation rights coextensive with the national banks.

Two of the issues raised by DIDA exportation are the same as those raised by national bank exportation, and the reader should refer to those earlier discussions: the scope of terms encompassed by the term "interest rate" which can be exported, n139 and the constitutionality of delegating federal preemptive authority to unaccountable state legislatures. n140

There is, however, an additional issue presented by exportation under DIDA which, like the constitutional question, raises fundamental questions of comity and federalism. It is also one which the courts have yet to seriously address. That is the existence of the opt-out right in DIDA. n141

Arguably, the very existence of this opt-out right should, as a matter of statutory construction, weigh against grafting the full exportation right under the National Bank Act onto DIDA, for otherwise the opt-out right is superfluous. n142 Nonetheless, two circuit courts have held that DIDA carries with it the exportation right. n143 However, both were to states which had not opted-out of the relevant portion of DIDA. To date, only one decision appears to have involved a state which did opt out. A Colorado intermediate appellate court held that the opt-out right applied only to loans "made" in the opting-out state. It made reference to a Colorado law, n144 which considered the contract made in Colorado if the lender received the agreement there. Hence, the court found the opt-out would apply only to intrastate loans. n145

There are also conflict of law principles to be considered in the exportation context. n146 In brief, while there is a

preference for adopting the law of the state that would uphold the contract, there are two limitations on that, both of which argue against adopting the law of the exporting state. The first is that invoking the preference should not undermine the public policy of the state whose laws are not followed. Public policy should be a critical component of a conflicts analysis in these cases since Congress specifically gave states the right to "just say no," and it must be assumed that they meant that others must respect that decision.

Another choice of laws principle relating to usury cases recognizes the distinction between general and special usury laws. Courts have recognized that commercial and consumer cases involve different public policy considerations, n147 another factor which should, in a conflicts analysis, tilt the balance in favor of the home state of the borrower whose only contact with the other state is to mail the application and payments there.

[d] DIDA's "First Mortgage" Preemption

DIDA section 501(a)(1) overrides state laws and state constitutional provisions which limit "the rate or amount of interest, discount points, finance charges, or other charges" on loans secured by first liens on either residential real estate or residential mobile homes. n148

Unlike the most favored lender preemption, which, through controversial agency and judicial interpretations, currently encompasses a wide variety of charges within the definition of "interest," n149 DIDA's first lien preemption covers only those limitations on costs that are included in the annual percentage rate. n150 It does not preempt state limitations designed to protect borrowers, such as prepayment charges, late charges, attorney's fees or similar limitations. n151 Nor does it preempt a state statute which prohibits negative amortization n152 or a state statute which prohibited the charging of an escrow waiver fee. n153

However, the law contains no express purchase money limitation and, therefore, the preemption extends to any loan provided that the lender obtains a first lien on the borrower's home as security. n154 This has enabled *de facto* second mortgage lenders to claim usury preemption by paying off cheaper senior liens with part of the proceeds of the second mortgage loan, thus obtaining first lien status.

Because the application of the DIDA first mortgage preemption to a home loan can devastate a consumer's usury claim even if the interest charged is absurdly high, counsel representing defaulting homeowners should examine each loan transaction carefully to determine whether it falls within the scope of the preemption. n155 Several questions should be considered. Did the lender really obtain a first lien on residential property at the requisite time? Does the lender itself qualify under DIDA?

With respect to determining whether the lender really obtained a first lien, the OTS (formerly the FHLBB), which is charged with interpreting DIDA, has defined "loans which are secured by a first lien on real estate" as loans secured by any instrument "of such a nature that, in the event of default, the real estate described in the instrument could be subjected to the satisfaction of the obligation with the same priority as a first mortgage of a first deed of trust in the jurisdiction where the real estate is located." n156 This definition clearly leaves some questions about the precise definition of "first lien" under DIDA, and state law determines the issue. n157 Liens created by state or federal government programs, such as deferred loans made for the purpose of rehabilitating residences, should destroy the "first lien" claim of a subsequent home equity loan and could subject that second loan to the state's second mortgage loan law. n158

A second question to be considered in determining whether state usury law has been preempted by DIDA's first mortgage provisions is whether the lender itself qualifies under DIDA. Generally, DIDA section 501(a)(1) applies to a loan or mobile home credit sale if:

a) The loan or sale is made by a federally insured depository lender; n159

b) The loan or sale is made, insured, or "assisted in any way" by the U.S. Department of Housing and Urban Development ("HUD"); n160

c) The lender is approved by the Secretary of HUD for participation in any National Housing Act mortgage insurance program; n161

d) The loan or sale is made by a "creditor" n162 who "makes or invests in" residential real estate loans or mobile home credit sales in excess of $1 million per year; n163

e) The loan is eligible for resale on the federal secondary mortgage market; n164

f) The mobile home seller is a "creditor" n165 who assigns all or part of its credit contracts to one of the above qualifying lenders; n166 or

g) The seller is the previous occupant of the property or mobile home who is taking back a mortgage. n167

Finally, an extremely important qualification to the mobile home preemption in DIDA section 501(a)(1) is that it only applies if the mobile home loan or credit sale complies with the OTS's consumer protection regulations. n168 Exactly what happens in the absence of creditor's compliance with the OTS regulations will depend on what law applies to that creditor in the absence of the section 501(a)(1) preemption. There are two possibilities: either the creditor will be saved by some other provision which preempts state usury law, or state usury law will apply.

[e] Opting Out of DIDA by State Legislation

Congress, as noted above, tempered DIDA's preemption by giving states the right to "opt-out" and reassert primary control over credit charges. n169 As a result, not all the DIDA preemptions apply in all states.

The requirements for opting out of the DIDA preemptions vary with the individual preemptions, and some states have been selective in opting out, so it is important to be precise about which of DIDA's preemptions is at issue.

To add to the confusion, there are two separate components to the first lien opt-out right, one of which expired in 1983, the other of which is continuing.

In order to opt out of the section 501 first mortgage *interest rate* preemption, a state must have passed legislation or held a referendum prior to April 1, 1983, which "explicitly and by its terms" rejected the preemption. n170 However, this three-year cut-off does *not* limit the states' abilities to reregulate the assessment of *points or "such other charges"* on first mortgage loans. n171 DIDA imposes no deadline for such action and, unlike the interest rate opt-out, does not require an express rejection of this preemption. Any legislation, after March 31, 1980, which amends or institutes limitations on points or charges other than the stated interest rate, arguably constitutes opt-out legislation. n172

As with the first lien interest rate preemption, explicit legislative action is required for states to reject DIDA's alternate interest ceiling (and most favored lender) provisions for federally insured depository lenders. n173 No deadline exists before which a state must exercise its right, under section 525, to opt-out of this portion of DIDA. n174

[7] Preemption: Loans Insured by the FHA or VA

[a] Overview

The FHA and the VA are authorized to insure loans for the purchase or improvement of houses and mobile homes, n175 and the state interest ceilings have been preempted for these loans. n176 Although the VA replaces these state ceilings with its own interest limitations on the loans which it insures, n177 FHA authority to do likewise was revoked by the National Housing Act Amendments of 1983, and borrowers and lenders may agree to any interest rate on FHA-insured loans issued after November 30, 1983. n178 Thus, in the absence of state opt-out legislation, n179 there is no interest ceiling on FHA-insured loans. However, regulations governing insurance, payment schedules, fees, and other charges associated with these FHA-insured loans do exist. n180

Note that the removal of state interest ceilings on mobile home loans insured by the FHA and VA has led to some conflict with the mobile home provisions of DIDA. n181

Another issue that arises with these preemptions is that the elimination of the federal ceiling on interest which could be charged on loans insured by the FHA may create *indirect* rate deregulation in certain state consumer credit statutes which were pegged to this ceiling. n182

[b] State Opt-Out of the FHA/VA Loan Preemption

States may opt-out of the FHA- and VA-insured loan preemptions, but, because several statutes are involved in the preemption, and because the opt-out language in these statutes is somewhat vague, the applicability of state law to any given insured loan can be a complicated question, the answer to which depends largely on the effective dates of the state opt-out statutes(s) and the transaction date. n183

Beyond the tangle of effective dates which must be examined to determine whether an FHA- or VA-insured loan is covered by state usury law, one must consider what language is required in state legislation for the legislation to constitute opt-out law. n184 Practitioners should examine any amendments or re-enactments of their state usury law which occurred after the effective date(s) of the relevant preemption statute(s) to determine whether their state may have wittingly or unwittingly opted-out of the FHA/VA preemption. Such a search of state law may instead reveal the express repeal of state usury and other state limitations on FHA- and VA-insured loans. n185

[8] National Credit Union Act Interest Rate Preemption

The Federal Credit Union Act of 1934 (FCUA) n186 regulates the operation of federally-chartered credit unions and sets the maximum interest rate that these credit unions may charge in the absence of a more specific statutory authority. n187 Since 1970, the primary regulator of federal credit unions has been the National Credit Union Administration (NCUA). n188

Like national banks and federal savings associations, the FCUA confers upon federal credit unions "most favored lender" status in particular circumstances. Section 1785 allows federal credit unions to charge a federal interest rate or the interest rate allowed by the home state for the particular type of loan *if* either of those rates exceeds the rate permitted by the NCUA (presently 18%). n189 This means that the federal credit union may charge the greater of: (1) one percent above the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the district in which such credit union is located; or (2) the rate allowed by the laws of the state in which the credit union is located, if either exceeds 18%. The NCUA extended the most favored lender status to state-chartered credit unions by issuing an "interpretation." n190 Calculating the alternative federal interest rate and the scope of the most favored lender doctrine are discussed earlier regarding national banks.

The preemption regime for federal credit unions, until recently, has been fairly narrow. It is clear that the Federal Credit Union Act preempts state usury law to the extent that state law conflicts with the Act, and that state usury statutes setting low interest ceilings create such a conflict. n191 However, the Act is not so comprehensive as to preempt all state regulation of federal credit unions. States retain regulatory authority in areas the Act does not address. n192 Thus,

one court held that a state law limiting the maximum attorney fees that a lender could recover from a defaulting debtor was not preempted, and applied to a federal credit union. n193

The NCUA defined the limited scope of federal credit union preemption by regulation. n194 The NCUA states that the FCUA grants it exclusive authority to regulate the "rates, terms or repayment and other condition of Federal credit union loans and lines of credit (including credit cards) to members." n195 The regulation identifies the specific types of state law that are preempted as laws purporting to limit or affect:

- Rates of interest and amounts of finance charges, including, terms related to variable rate loans and late charges;
- Closing costs, application, origination, or other fees;
- Terms of repayment, including, maturity of loans and lines of credit; the amount, uniformity, and frequency of payments; balloon payments; and prepayment limits;
- Conditions related to the amount or purpose of the loan or line of credit and the type or amount of security;
- The imposition and enforcement of liens on the shares (deposits) of borrowers and accommodating parties. n196

The NCUA intends that this list be exclusive. n197 State laws that do not affect rates, terms of repayment, and other conditions are *not* preempted. n198

[9] Preemption of State Non-Rate Mortgage Credit Regulation: The Alternative Mortgage Transactions Parity Act (AMTPA).

One of the most sweeping federal preemptions of state consumer credit laws became effective on October 15, 1982, in the 1982 Depository Institutions Act, also known as the "Garn/St. Germain Act." This Act revised federal lending authority extensively, granting many new powers to federal lenders, especially the savings and loan associations. It provided special aid to ailing lenders, preempted state law concerning due on sale clauses, and altered Truth in Lending as well as other matters not treated here.

The primary DIA consumer usury preemption is contained in the Alternative Mortgage Transactions Parity Act. n199 AMTPA was designed to extend federal mortgage regulations, which previously had covered only federally chartered lenders, to state lenders, and, thereby, to eliminate the "discriminatory" advantage which these liberal regulations may have given the federal institutions. n200 Practitioners should note both the substance and scope of this statute.

First, AMTPA does not affect interest ceilings on mortgage loans. Instead, it addresses the *structure* of mortgage loans by overriding state laws which restrict "creative finance," e.g., laws limiting variable interest rates, final "balloon" payments, or negative amortization. These state statutes are replaced, at the option of the state lender, n201 by federal regulations. However, the state lender must follow in their entirety either state laws or federal regulations, and cannot select and combine the most advantageous terms of each. n202

Second, AMTPA applies not only to state depository institutions, but to all "housing creditors" making "alternative mortgage transactions." n203 Housing creditors are broadly defined to include any depository lender, HUD-approved lender, or any lender who "regularly makes" loans or credit sales secured by residential realty or mobile homes, and any transferee of these lenders. Alternative mortgages include senior or junior residential mortgages or credit sales which have variable interest rates or maturity or other non-traditional terms such as shared equity.

Third, AMPTA only applies to "alternative mortgage transactions" as defined in the statute:

- loans in which the finance charge or interest rate may be adjusted or renegotiated n204 (for example, adjustable rate mortgages or mortgages where the rate decreases if the borrower pays on time); n205

- loans with fixed rates but which implicitly permit rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule n206 (for example, loans with balloon payments); n207

- loans involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions n208 (for example, loans that negatively amortize or those involving shared equity or appreciation). n209 Once the loan meets one of these definitions, then certain state laws may be preempted.

The broad scope of AMTPA is significant because it gives non-depository lenders much greater freedom. However, states retain some licensing authority over state lenders n210 and, perhaps more importantly, six states used their now-expired ability to "opt out" of AMTPA provisions. October 15, 1985 was the deadline. n211

Congress has since imposed a limited degree of reregulation in this area. Trying to narrowly target the reregulation to the segment of the market where the abuses occurred, some of these terms were prohibited or restricted in specified high-cost, closed-end home equity loans in 1994. n212 For loans covered by HOEPA, it, not AMTPA, will be the controlling statute to the extent they conflict. n213

States who wish to regulate abusive mortgages in a fashion similar to HOEPA may run into claims that AMPTA trumps any prohibitions related to balloon payments, negative amortization, or prepayment penalties. The lending industry has begun to challenge these laws on a variety of theories, this being but one. A federal court in Illinois granted summary judgment to the state and dismissed such a challenge on the grounds that HOEPA is the statute against which preemption ought to be measured, not AMPTA. n214

[10] Gramm-Leach-Bliley Act and Interstate Loan Pricing

In 1999, Congress enacted the Gramm-Leach-Bliley Act which largely focuses upon eliminating the barriers separating the banking, insurance, and securities industries. n215

One provision, though, should have a profound effect on the ability of a limited number of states (perhaps only one) to regulate the interest rates of the banks chartered within their boundaries in certain circumstances. n216 This subsection contains two important limitations. First, the provision, by its terms, applies only to states with a constitutional provision limiting the maximum lawful annual percentage rate of interest on a contract at not more than 5% above the discount rate for 90-day commercial paper in effect at the federal reserve bank for the federal reserve district in which such state is located. n217 This may limit the effect of this provision to only one state, Arkansas. n218 Second, the subsection does not affect the interest that any insured depository institution may charge or receive under the Depository Institutions Deregulation and Monetary Control Act, n219 the National Bank Act, n220 or the Federal Deposit Insurance Act. n221

If this part of the Act applies, a bank with FDIC insurance chartered in such a state may charge and collect interest, discount points, finance charges, or other similar charges as permitted by the home state of an out-of-state bank with a branch in that state or the maximum rate or amount of interest, discount points, finance charges, or other similar charges allowed in a similar transaction allowed a state insured depository institution chartered in that state (the state with the constitutional limitation) or a national bank or federal savings association whose main office is located in such state.

Essentially, if an interstate bank can charge a particular interest rate, then a local bank in the state into which the interstate bank has branched, may charge a rate comparable to that which the home state of the interstate bank allows. n222

[11] Federal Jurisdiction, Removal Issues, and Preemptive Effect of Federal Consumer Protection Statutes

The credit export industry, which has been so aggressive in pushing the limits of "most favored lender doctrine" under both the NBA and DIDA, has tried to keep state courts from ruling on questions concerning the scope of that doctrine. Ordinarily, a federal question n223 must appear on the face of a complaint before a state court action can be removed to federal court. That there may be a defense rooted in federal law is not grounds for removal. n224 There is an exception, though, "where Congress has 'so completely preempt[ed] a particular area that any civil complaint raising this select group of claims is necessarily federal in character'." n225 The industry argues that the scope of most favored lender and exportation rights under the NBA and DIDA fall within that exception. The majority of early cases held that removal was warranted. n226 However, the federal appellate courts are now divided and the Supreme Court has granted *certiorari*. n227 The Eleventh Circuit's decision in *Anderson* provides the most articulate and careful analysis of Supreme Court standards used to determine when complete preemption exists. The touchstone of the complete preemption doctrine is congressional intent. Reviewing the National Bank Act, the court did not find evidence of this intent. n228 The only appellate court to rule directly on the removal question as it relates to the current exportation debate held there was not complete preemption, and ordered remand to state court. n229 That decision was subsequently vacated. n230

Though this chapter has concentrated on those federal preemption statutes which override state limitations of credit cost terms, there are some federal consumer protection statutes which may preempt inconsistent or less protective state laws. Two of those, the federal rebate statute and the Home Ownership and Equity Protection Act, are discussed elsewhere in this book. n231

Truth in Lending ("TIL"), a federal disclosure statute, preempts inconsistent state laws. Except to the extent it is amended by HOEPA, TIL neither regulates credit charges nor preempts state laws which do. n232 Its preemption is narrow, and relates largely to the definition of consumer credit terms. n233

[12] Usury Deregulation by State Parity Laws

In the early 1980s, many states enacted "parity" statutes as amendments to their special usury statutes. On their face, parity statutes provide in simple terms that one type of state creditor, such as a state savings and loan, may extend consumer credit under the same rate ceiling as another type of creditor, such as a federal savings and loan. However, the effects of such laws may be extremely complex, leading to legal arguments that the "parity" deregulation extends to transactions and creditors in ways that were unlikely to have been foreseen by the legislature enacting the parity laws.

Usury analysis becomes even more complicated when a state "parity" statute is invoked by a federal lender under the "most favored lender doctrine." For example, a national bank cannot directly use a federal credit union rate ceiling of 15% under the most favored lender doctrine because the doctrine only gives the bank equality with the most favored state lender, n234 and a federal credit union is not a state lender. Yet the national bank may be able to achieve the 15% rate indirectly in some states with parity statutes. For example, a state-chartered credit union in Tennessee is entitled by virtue of a state "parity" statute to charge the same rate as federal credit unions. n235 The federal most favored lender doctrine allows the national bank to do business under the state credit union rate ceiling since the state credit union may prove to be the most favored lender under state law. Because the state credit union can invoke the federal credit union rate under the parity statute, so can the national bank under the most favored lender rule.

The fundamental problem with this approach is that neither Congress nor the state legislature intended it. The combination of state parity laws and the most favored lender doctrine may provide state as well as federal lending

institutions with bootstrapping opportunities to raise their rates. n236

Another example of potential bootstrapping is provided by the facts in *Minnett v. Commerce Bank, N.A.* n237 There, the court speculated, but did not decide, that if a state bank can do what a national bank can do in sister states and if the national bank can export that activity to New Jersey, then a national bank located in New Jersey can engage in the same activity, even though it is not permitted by New Jersey law.

[13] The Military Lending Act

Most recently, Congress enacted the Military Lending Act that imposes a 36% interest rate cap, bans mandatory arbitration, and imposes other restrictions on consumer credit, other than residential mortgages and purchase money loans. n238 This provision applies to credit extended after October 1, 2007 to active duty members of the military and their dependents. n239 The Department of Defense limited the applicability of these restrictions to fixed-term payday, auto title, and tax refund loans. This is the first time that Congress re-imposed a usury cap for certain types of credit since legislation responding to the Great Depression. n240

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawFederal ActsGeneral OverviewBanking LawFederal ActsDepository Institutions Deregulation & Monetary Control ActBanking LawFederal ActsGramm-Leach-Bliley ActBanking LawFederal ActsHome Owners' Loan ActContracts LawDebtor & Creditor Relations

FOOTNOTES:
(n1)Footnote 1. For further discussion of the various relevant statutes, as well as checklists for determining which statutory schemes apply, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, Ch. 3 (3rd ed. and Supp.).

(n2)Footnote 2. Some of these statutes are discussed in greater detail, *infra*. A few federal statutes have specifically been held not to preempt state usury laws. *See In re Seolas, 140 B.R. 266 (E.D. Cal. 1992)* (ERISA does not preempt Cal. general usury law, despite Cal. law exempting ERISA from state usury limits; court held latter statute was preempted by ERISA, and yes, court recognized this seems odd.). Federal regulations governing federally chartered depository institutions preempt state law to the extent of direct conflict but do not preempt the field. *See Departmento de Asuntos del Consumidor (DACO) v. Oriental Fed. Sav. Bank, 648 F. Supp. 1194 (D. P.R. 1986)* (Home Owner's Loan Act did not preclude state regulation of federal S&L's retail installment sales contracts). *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 3.9 (3rd ed. and Supp.).

(n3)Footnote 3. *12 U.S.C. §§ 85-86. See also 12 C.F.R. §§ 7.4001, 7.4002*; *61 Fed. Reg. 4,869* (Feb. 9, 1996) . *See § 6.02[2] infra*.

(n4)Footnote 4. *12 U.S.C. §§ 1461 et seq. See § 6.02[3] infra*.

(n5)Footnote 5. *12 U.S.C. § 1463(g)*.

(n6)Footnote 6. Pub. L. No. 96-221, *94 Stat. 161 (1980)* (codified throughout Title 12 of the U.S. Code, including *12 U.S.C. § 1831d(a)* (state commercial banks), *12 U.S.C. § 1463(g)* (savings and loans), *12 U.S.C. § 1785(g)* (federally insured credit unions), and *12 U.S.C. § 1735f-7a* (mortgages)).

(n7)Footnote 7. *12 U.S.C. § 1709-1a*; *38 U.S.C. § 3728. See § 6.02[5] infra*.

(n8)Footnote 8. *See 12 U.S.C. § 1709(b)(5)*.

(n9)Footnote 9. *See 12 U.S.C. § 1757(5)(A)(vi).*

(n10)Footnote 10. *See 12 C.F.R. § 701.21(c)(7)(ii)(C)*; *70 Fed. Reg. 3861* (Jan. 27, 2005) .

(n11)Footnote 11. *See 12 C.F.R. § 701.21(b)(2).*

(n12)Footnote 12. *12 U.S.C. § 1709-1a*; *38 U.S.C. § 3728.*

(n13)Footnote 13. *See 12 U.S.C. § 1709(b)(5).*

(n14)Footnote 14. *12 U.S.C. § 36.*

(n15)Footnote 15. H.R. Conf. Rep. No. 103-651, at 53-55 (1994), *reprinted in* 1994 U.S.C.C.A.N. 2068, 2074-76 [hereinafter H.R. Conf. Rep. 651]. There are three traditional preemption tests: is the state law in direct conflict with federal law; is federal law so comprehensive as to evidence a Congressional intent to "occupy the field," or does the state law stand as an obstacle to achieving the purpose of the federal law. Where possible, statute should be construed to avoid finding a conflict. *See generally Pennsylvania v. Nelson, 350 U.S. 497 (1957)* ; 16 Am. Jur. 2d *Constitutional Law* § 291; H.R. Conf. Rep. 651, at 53. Some courts have recently found "complete preemption" sufficient to turn state consumer protection claims into federal questions, warranting removal of state legal challenges under consumer protection laws to federal court. This legislation arguably should lead to a reexamination of that issue.

(n16)Footnote 16. H.R. Conf. Rep. No. 103-651, at 54-55 (1994), *reprinted in* 1994 U.S.C.C.A.N. 2068, 2074-2076. *See generally Pennsylvania v. Nelson, 350 U.S. 497 (1956)* ; 16 Am. Jur. 2d *Constitutional Law* § 291.

(n17)Footnote 17. *12 U.S.C. § 43.*

(n18)Footnote 18. Pub. L. No. 106-102 (1999), *codified as 15 U.S.C. §§ 6701 et seq. , §§ 6801 et seq. , §§ 6901 et seq. , and amending 12 U.S.C. § 1831u. See § 6.02[8] infra.*

(n19)Footnote 19. Section 731, *amending 12 U.S.C. § 1831u(f).*

(n20)Footnote 20. *15 U.S.C. §§ 1601 et seq. , implemented by* 12 C.F.R. § 226 (Regulation Z). *See generally* National Consumer Law Center, Truth in Lending, § 2.6.2, 2.6.3 (5th ed. 2003 and Supp.).

(n21)Footnote 21. Home Ownership and Equity Protection Act, Subtitle B of Title I, Riegle Community Development and Regulatory Improvement Act of 1994 (H.R. 3474), Pub. L. No. 103-325, *108 Stat. 2160 (1994).*

(n22)Footnote 22. *15 U.S.C. § 1615.*

(n23)Footnote 23. *See* 12 C.F.R. pts. 1-34.

(n24)Footnote 24. *See* 12 C.F.R. pts. 700 See, e.g., *Crissey v. Alaska USA Fed. Credit Union, 811 P.2d 1057 (Alaska 1991)* (federally chartered credit unions subject to NCUA regulations which specifically preempt state laws on interest rates and late charges, *12 C.F.R. § 701.21(b)(1)*).

(n25)Footnote 25. *See* 12 C.F.R. pts. 560 *et seq.* These regulations make clear that OTS occupies the entire field of lending regulation for federal savings associations. *12 C.F.R. § 560.2(a).* The agency lists examples of state laws preempted by its regulations preempted by its regulations, including disclosures, usury-related ceilings, terms of loans, loan-related fees, licensing requirements, loan-to-value rates, escrow accounts, etc. *12 C.F.R. § 560.2(b).* In addition, the regulation lists certain state laws and common law that are not preempted to the extent that they only incidentally affect the lending operations of the savings association or are not otherwise contrary to the purposes expressed in paragraph (a) of § 560.2. These enumerated state laws include contract and commercial law, tort law, and real property law. Significantly, other state laws may be exempt from preemption in certain circumstances. *12 C.F.R. § 560.2(c)*; see

preamble language in *61 Fed. Reg. 50,951* (Sept. 30, 1996) . Therefore, state unfair and deceptive trade practices are arguably exempt (and therefore apply to savings associations) under this provision. *See Albank, FSB v. Foland, 177 Misc. 2d 569, 676 N.Y.S.2d 461 (City Ct. 1998)* .

In interpreting this regulation in the credit card context, a New York court held that the OTS regulation trumped a state evidentiary law that prohibits a maker of a contract involving a consumer transaction from introducing the contract into evidence when the print is not clear and legible or is smaller than a certain type size. *Albank, FSB v. Foland, 177 Misc. 2d 569, 676 N.Y.S.2d 461 (City Ct. 1998)* . Specifically, the court found that the type size requirement was inconsistent with *12 C.F.R. § 560.2(a)* because that requirement would thwart the goal that there be a uniform set of federal lending regulations.

Cases decided prior to the promulgation of § 560.2, holding that Congress did not intend to occupy the field of lending regulation for federal savings associations, are no longer viable except to the extent that they concern state laws that fell into the preemption exception in § 560.2(c).

(n26)Footnote 26. In the wake of the S&L crisis, the Federal Home Loan Bank Board was abolished and its functions transferred to the newly created OTS as of August 9, 1989. Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, *103 Stat. 183* (FIRREA). Many of the relevant FHLBB rules were republished by OTS with only technical changes. *54 Fed. Reg. 49,411* (Nov. 30, 1989) .

(n27)Footnote 27. "Federally related" loans is a catch-all term referring to those issued by lenders qualifying for DIDA's first lien preemption and AMTPA's "housing-creditors." *See generally 12 C.F.R. § 590.2.*

(n28)Footnote 28. *12 U.S.C. § 85.*

(n29)Footnote 29. Note that the NBA does not apply to credit initiated by another lender, such as a finance company, which is later assigned to a national bank. *See FDIC v. Lattimore Land Corp., 656 F.2d 139 (5th Cir. 1981)* . In the credit card context, a recent decision by the Eighth Circuit highlights a national bank's rights after it acquires credit card accounts and becomes the originator of credit. *Krispin v. May Dep't Stores Co., 218 F.3d 919 (8th Cir. 2000)* (consumer opened a revolving credit card account with the store located in Missouri sometime before 1996; in 1996, the store sold all of its accounts to May National Bank, not chartered in Missouri; all new accounts were also opened directly in the bank's name; bank increased the late fees; court found that the bank, and not the store, issued credit to the customers and thus was entitled to preempt Missouri late fee limits; central question was whether the case should be remanded to state court). *Cf. In re Harrington, 6 B.R. 655 (Bankr. D.R.I. 1980)* (assignment did not revive void note); *St. Paul Bank for Coops. v. Ohman, 402 N.W.2d 235 (Minn. Ct. App. 1987) . But see Saul v. Midlantic Nat'l Bank/South, 240 N.J. Super. 62, 572 A.2d 650 (App. Div. 1990)* (court applied most favored lender doctrine of NBA to transaction in which an installment sale contract with a car dealer was assigned to a national bank; however, the decision does not discuss the distinction between a national bank's status as assignee and as originator, and the point was apparently not raised). *Cf. Garrison v. First Fed. Sav. & Loan Ass'n of S.C., 402 S.E.2d 25 (Va. 1991)* (federal savings and loan as assignee of mortgage company originated loan not entitled to preemption even though loan was one of large pool sold to the savings and loan).

(n30)Footnote 30. *See 12 U.S.C. § 85.*

(n31)Footnote 31. The Federal Reserve Bulletin is available in many public libraries. It is also available by subscription for $25.00 per year or $2.50 per copy from: Publications Services, Board of Governors of the Federal Reserve System, Washington, DC 20551.

(n32)Footnote 32. When state law puts no limit on the interest rate a state bank may charge, *12 U.S.C. § 85* appears to assume a 7% discount per annum. However, the courts have essentially ignored this provision and have held that, in the absence of a state ceiling on state institutions, federal banks are similarly unlimited under the most favored lender

doctrine. *See, e.g., Hiatt v. San Francisco Nat'l Bank, 361 F.2d 504 (9th Cir. 1966)* .

(n33)Footnote 33. *See United Mo. Bank v. Danforth, 394 F. Supp. 774 (W.D. Mo. 1975)* ; *Attorney General v. Equitable Trust Co., 294 Md. 385, 450 A.2d 1273 (1982)* . *See also Saul v. Midlantic Nat'l Bank/South, 572 A.2d 650 (N.J. Super. App. Div. 1990)* .

(n34)Footnote 34. *See, e.g., United Mo. Bank v. Danforth, 394 F. Supp. 774 (W.D. Mo. 1985)* ; *VanderWeyst v. First State Bank of Benson, 425 N.W.2d 803 (Minn. 1988)* , *cert. denied, 488 U.S. 943, 109 S. Ct. 369, 102 L. Ed. 2d 359 (1988)* .

(n35)Footnote 35. OCC Letter, Consumer Cred. Guide (CCH) P 96,744 (Jan. 19, 1983); *see generally* Comment, *Federal Credit Unions--Competing Lenders For Purposes of the "Most Favored Lender" Doctrine*, 5 Annual Review of Banking Law 349 (1986) (criticizing OCC position).

(n36)Footnote 36. *12 C.F.R. § 7.4001(b)(c), 61 Fed. Reg. 4,869* (Feb. 9, 1996) (OCC interpretive ruling). For an interesting discussion of the OCC's vacillation on how materiality plays out in practice, see *Sherman v. Citibank (South Dakota), N.A., 668 A.2d 1036 (N.J. 1995)* , *vacated and remanded, 517 U.S. 1241, 116 S. Ct. 2493, 135 L. Ed. 2d 186 (1996)* (in light of *Smiley*). *See In re Beck, 248 B.R. 229 (Bankr. W.D.N.Y. 2000)* (national bank cannot have its cake and eat it too, says the court in dictum; bank chartered in Arizona may not claim applicability of its home state law regarding the creation of a security interest and that of the consumer's residence, New York, by inserting a clause in the contract indicating that New York law applies regarding the security interest; no discussion of what are "material" state restrictions).

(n37)Footnote 37. *439 U.S. 299, 99 S. Ct. 540, 58 L. Ed. 2d 534 (1978)* .

(n38)Footnote 38. But in a different context, one court noted that such an argument proves far too much. "The flaw in [this] argument may be demonstrated by asking whether a state's truth-in-lending statute would be preempted because it potentially reduces the return a [lending plan] may get on its loans by restricting its ability to cheat." *In re Seolas, 140 B.R. 266, 273 (E.D. Cal. 1992)* (discussing whether ERISA preempts state usury laws, and concluding it does not).

(n39)Footnote 39. *See, e.g., Goehl v. Mellon Bank (Del.), 825 F. Supp. 1239 (E.D. Pa. 1993)* ; *Nelson v. Citibank (S.D.), N.A., 794 F. Supp. 312 (D. Minn. 1992)* ; *Tikkanen v. Citibank (S.D.), N.A., 801 F. Supp. 270 (D. Minn. 1992)* ; *Smiley v. Citibank (S.D.), N.A., 11 Cal. 4th 138, 44 Cal. Rptr. 2d 441, 900 P.2d 690 (1995)* , *aff'd, 517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996)* ; *Copeland v. MBNA Am. Bank, N.A., 907 P.2d 87 (Colo. 1995)* ; *see also Greenwood Trust Co. v. Massachusetts, 971 F.2d 818 (1st Cir. 1992)* (late charges are interest for purposes of most favored lender status expanded to state banks under DIDA); *Hill v. Chem. Bank, 799 F. Supp. 948 (D. Minn. 1992)* (same); *Stoorman v. Greenwood Trust Co., 908 P.2d 133 (Colo. 1995)* (same).

(n40)Footnote 40. *See, e.g., Watson v. First Union Nat'l Bank, 837 F. Supp. 146 (D.S.C. 1993)* (NBA); *Tikkanen v. Citibank (S.D.), N.A., 801 F. Supp. 270 (D. Minn. 1992)* ; *Hill v. Chem. Bank, 799 F. Supp. 948 (D. Minn. 1992)* (DIDA).

(n41)Footnote 41. *Fisher v. First Nat'l Bank, 548 F.2d 255 (8th Cir. 1977)* .

(n42)Footnote 42. *See* First Nat'l Bank in *Mena v. Nowlin, 509 F.2d 872 (8th Cir. 1975)* (discount interest prohibited for national banks, as it was for all state lenders). *But cf. Grunbeck v. Dime Sav. Bank, 74 F.3d 331 (1st Cir. 1996)* (DIDA does not preempt state simple interest statute [lender made negatively amortizing mortgage loans]).

(n43)Footnote 43. *See, e.g., Cronkleton v. Hall, 66 F.2d 384 (8th Cir.1933)* (NBA §§ 85, 86).

(n44)Footnote 44. *See, e.g., Northway Lanes v. Hackley Union Nat'l Bank & Trust, 464 F.2d 855 (6th Cir. 1972)* (NBA § 85*)*.

(n45)Footnote 45. *60 Fed. Reg. 11,924* (Mar. 3, 1995) .

(n46)Footnote 46. *12 C.F.R. § 7.4001(a), 61 Fed. Reg. 4,869* (Feb. 9, 1996). In 2001, the OCC clarified the definition of an NSF fee. *66 Fed. Reg. 34,784* (July 2, 2001) . If the bank imposes a fee when a borrower tenders payment on a debt with a check drawn on insufficient funds, that fee constitutes "interest" for purposes of this rule. Revised *12 C.F.R. § 7.4001(a)*. Fees that a bank charges for its deposit account services, including overdraft and returned check charges, are not "interest." *66 Fed. Reg. 34,786. See also Video Trax, Inc. v. NationsBank, N.A., 33 F. Supp. 2d 1041 , aff'd without opinion, 205 F.3d 1358* (11th Cir.) , *cert. denied, 121 S. Ct. 66 (2000)* (honoring checks on an overdrawn account is not an extension of credit and fees related to honoring such checks do not constitute interest).

(n47)Footnote 47. *Smiley v. Citibank, 517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996)* .

(n48)Footnote 48. OCC Interpretative Letter No. 744 (Aug. 21, 1996). Summaries of OCC letters dealing with the preemption of state law and related topics can be found in National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges, App. D.1.2. Interpretive letters issued since 1996 also can be obtained from the Internet at www.occ.treas.gov. Select "regulatory information" from the menu.

(n49)Footnote 49. The products described in the Letter were home equity loans in which the customers could choose to pay a lower interest rate in a loan that included a prepayment penalty or pay a higher interest rate and avoid a prepayment penalty provision.

(n50)Footnote 50. OCC Interpretive Letter No. 803 (Oct. 7, 1997).

(n51)Footnote 51. *See Fed. Deposit Ins. Corp. v. Lattimore Land Corp., 656 F.2d 139 (5th Cir. 1981) Miller v. Pacific Shore Funding, 224 F. Supp. 2d 977 (D. Md. 2002) , aff'd on other grounds, 92 Fed. Appx. 933 (4th Cir. 2004)* (assignees stand in the shoes of the assignors and are subject to the same claims and defenses unless the holder-in-due-course defense applies); *Fed. Nat'l Mortgage Ass'n v. Lefkowitz, 390 F. Supp. 1364 (S.D.N.Y. 1975)* (where state law applies at loan origination, it continues to apply to the loan purchaser); *In re Harrington, 6 B.R. 655 (Bankr. D.R.I. 1980)* (assignment does not revive void note); *Spitz v. Goldome Realty Credit Corp., 569 N.E.2d 43 (Ill. App. Ct. 1991) , aff'd, 600 N.E.2d 1185 (Ill. 1992)* (mortgage originated by lender which is a servicing corporation second-tier subsidiary of a federal savings bank was subject to state mortgage escrow account act; the preemption applicable to its parent did not extend to it); *Viereck v. Peoples Sav. & Loan Ass'n, 343 N.W.2d 30 (Minn. 1984)* (due-on-sale clauses contained in mortgage were not valid under applicable state law; as the originating lenders were not entitled to preemption, the federal savings association assignee was not entitled to preemption either); *St. Paul Bank for Cooperatives v. Ohman, 402 N.W.2d 235 (Minn. Ct. App. 1987)* (interest preemption in *12 U.S.C. § 2205* relating to loans from institutions of the Farm Credit System did not apply to an assigned contract); *Garrison v. First Fed. Sav. & Loan Ass'n of S.C., 402 S.E.2d 25 (Va. 1991)* (federal savings and loan as assignee of mortgage company originated loan not entitled to preemption even though loan was one of large pool sold to the savings and loan). *Cf. Adkison v. First Plus Bank, 143 S.W.3d 29 (Mo. App. Ct. 2004)* (the bank was the lender since it was listed on the documents; court implies disapproval of the claim that the table-funding "lender," technically the assignee, is the lender). *See Phipps v. FDIC, 417 F.3d 1006, 1013 (8th Cir. 2005)* ("Courts must look at 'the originating entity (the bank), and not the ongoing assignee ... in determining whether the NBA applies.' " (quoting *Krispin*)). *Cf. In Re Community Bank of No. Va., 418 F.3d 277 (3d Cir. 2005)* (finding that a non-depository company originated the mortgage loans at issue, not national or state banks, despite express language in the loan agreements to the effect that the loans were made by a national or state bank; court distinguished *Krispin* by stating that the national bank in that case originated the loans). *See also Discover Bank v. Vaden, 409 F. Supp. 2d 632 (D. Md. 2006)* (even though the servicing agent of the bank sued the borrower, the credit card agreement at issue was between the a national bank and the borrower; thus, preemption trumped the borrower's claims under state law). *But see Dannewitz v. Equicredit Corp. of America, 839 N.E.2d 1060 (Ill. App. Ct. 2005)* (loan made by a non-bank finance company and later bought by bank operating subsidiary; court held that state law claims prepayment penalty claims were preempted); *Citibank (South Dakota), N.A. v. Martin, 807 N.Y.S.2d 284 (N.Y. Civ. Ct. 2005)* .

(n52)Footnote 52. A table-funded transaction is one where a nominal lender is actually originating the loan for an entity whose money is used to fund the loan. The loan is transferred immediately to the table-funding lender.

(n53)Footnote 53. OCC Interpretive Letter No. 1000 (Apr. 2, 2004); OCC Interpretive Letter No. 1002 (May 13, 2004), *reprinted on* the CD-Rom accompanying this volume. *But cf. Adkison v. First Plus Bank, 143 S.W.3d 29 (Mo. App. Ct. 2004)* (the bank was the lender since it was listed on the documents; court implies disapproval of the claim that the table-funding "lender," technically the assignee, is the lender).

(n54)Footnote 54. *Id.*

(n55)Footnote 55. OCC Letter to Private Attorneys regarding Wells Fargo Bank, Minnesota, N.A. v. Alberta Harris (Jan. 14, 2005), *reprinted on* the CD-Rom accompanying this volume. Securitization is described in National Consumer Law Center, Unfair and Deceptive Acts and Practices § 6.7.4 (6th ed. 2004 and Supp.), and in Kathleen C. Engel & Patricia A. McCoy, *Predatory Lending: What Does Wall Street Have to Do with It?*, 15 Housing Pol. J. 715, 717/-/718 (2004). One caveat in this OCC Letter is worth noting. The result may be different if the national bank purchases a loan as permitted by *12 C.F.R. § 34.4(a)(10)*. In that case, the preemption ought to be limited to state laws affecting purchase of the loan, not state laws affecting the origination. *Cf. Abel v. Keybank USA, N.A., 313 F. Supp. 2d 720 (N.D. Ohio 2004)* (a provision embedded in a state usury law that creates assignee liability and trumps the holder-in-due-course doctrine in the U.C.C. is preempted). *See also* Bryant v. Rosslare Funding, Inc., No. 3:05-ap-01038 (Aug. 26, 2005) (court remands case to state court because the state usury claim is not preempted where the bank is sued as the trustee of a trust of loans). *Cf. Blanco v. KeyBank USA, N.A., 2005 U.S. Dist. LEXIS 31768* (N.D. Ohio Sept. 30, 2005) (court held that national bank which made student loans (retail installment loan for state retail installment sales act purposes) and cooperated with the trade school to channel business to the bank is subject to assignee liability under the state RISA); *Dannewitz v. Equicredit Corp. of America, 839 N.E.2d 1060 (Ill. App. Ct. 2005)* .

(n56)Footnote 56. *Conn. Gen. Stat. Ann. § 36a-158*; *Iowa Code §§ 527.3-5*.

(n57)Footnote 57. *Bank One, N.A. v. Guttau, 190 F.3d 844 (8th Cir. 1999)* , *cert. denied sub nom. Foster v. Bank One, 529 U.S. 1087, 120 S. Ct. 1718, 146 L. Ed. 2d 641 (2000)* .

(n58)Footnote 58. *Bank One, Utah v. Gattau, 19989 U.S. Dist. LEXIS 14830* (S.D. Iowa July 24, 1998), *rev'd, 190 F.3d 844 (8th Cir. 1999)* , *cert. denied sub nom. Foster v. Bank One, 529 U.S. 1087 (2000)* . *See also Bank of Am. v. City & County of San Francisco, 309 F.3d 551 (9th Cir. 2002)* (federal district court permanently enjoined the implementation of two California cities' ordinances prohibiting financial institutions from charging non-accountholders an ATM fee for the use of their machines, on the grounds that the NBA and HOLA preempt the municipalities right to regulate national banks and federal savings associations on this core issue; Ninth Circuit affirmed, agreeing with the Eighth Circuit on the EFTA issue, and in addition the court held that the regulation of ATM fees is not the type of consumer protection measure contemplated by the EFTA); *Wells Fargo Bank Tex., N.A. v. James, 321 F.3d 488 (5th Cir. 2003)* (court upholds injunction issued against the enforcement of a state law prohibiting banks from charging fees to non-account holders for cashing checks drawn on that bank); *Metrobank N.A. v. Foster, 193 F. Supp. 2d 1156 (S.D. Iowa 2001)* (state's anti-discrimination law, which when applied to national banks prevented them from charging fees to non-account holders when accessing ATM machines, is preempted).

(n59)Footnote 59. OCC Interpretive Letter No. 821 (March 1998). Interestingly, a federal court reviewing this issue as it related to a Connecticut law dismissed the case on jurisdictional grounds. *Fleet Bank, N.A. v. Burke, 160 F.3d 883 (2d Cir. 1998)* , *cert. denied*, *527 U.S. 1004, 119 S. Ct. 2340, 144 L. Ed. 2d 237 (1999)* . *See also* OCC Interpretive Letter No. 906 (Jan. 19, 2001). OCC Interpretive Letters issued since May 1996 can be obtained from the Internet at www.occ.treas.gov. Select "regulatory information" at the menu. Summaries of OCC letters dealing with the preemption of state law and related topics that have not been published in the Federal Register can be found at National Consumer Law Center, Fair Debt Collection, App. D.12.

(n60)Footnote 60. *Barnett Bank of Marion County v. Nelson, 517 U.S. 25, 32, 116 S. Ct. 1103, 1108, 134 L. Ed. 2d 237, 245 (1996)* ; *First Nat'l Bank of San Jose v. California, 262 U.S. 366, 43 S. Ct. 602, 67 L. Ed. 1030 (1923)* ; *Waite v. Dowley, 94 U.S. 527, 533, 24 L. Ed. 181, 182 (1877)* ; Association of Banks in *Ins. v. Duryee, 270 F.3d 397 (6th Cir. 2001)* ; *Video Trax, Inc v. NationsBank, N.A., 33 F. Supp. 2d 1041* , *aff'd without op., 205 F.3d 1358* (11th Cir.) , *cert. denied, 531 U.S. 822, 121 S. Ct. 66, 148 L. Ed. 2d 31 (2000)* ; *In re Hibernia Nat'l Bank, 21 S.W.3d 908 (Tex. App. 2000)* . *See also Kroske v. US Bank Corp., 432 F.3d 976 (2005)* , *amended on other grounds, 2006 U.S. App. LEXIS 3376* (9th Cir. Feb. 13, 2006) (court cites to *Barnett* standard with approval and holds that state anti-discrimination law prohibiting age discrimination is not preempted by section 24 (Fifth) of the NBA allowing banks to terminate certain bank officers "at pleasure," at least to the extent that the state act mirrors its federal counterpart; in reaching this conclusion, the court explicitly recognized the direct conflict between section 24 (Fifth) and the state law). *Charter One Mortgage v. Condra, 847 N.E.2d 207* (Ind. Ct. App.) , *removal granted, 860 N.E.2d 599 (Ind. 2006)* (table) (court applied the *Barnett* standard when holding that Indiana's unauthorized practice of law standards which permit a bank employee to fill in the blanks on mortgage documents as long as no fee is charged does not prevent or significantly interfere with the national bank's right to charge fees; Indiana only prescribes who performs the act if a fee is charged).

(n61)Footnote 61. *National State Bank v. Long, 630 F.2d 981 (3d Cir. 1980)* (state anti-redlining law does not frustrate federal banking system and is not preempted). A more recent decision disputes this proposition. *Bank of America v. City & Council of San Francisco, 309 F.3d 551, 559 (9th Cir. 2002)* . *Watters v. Wachovia, 127 S. Ct. 1559, 167 L. Ed. 2d 389, 2007 U.S. LEXIS 4336* (U.S. Apr. 17, 2007) ("national banks "are subject to state laws of general application in their daily business to the extent such laws do not conflict with the letter or general purposes of the NBA."); *Medtronic, Inc. v. Lohr, 518 U.S. 470, 485, 116 S. Ct. 2240, 135 L. Ed. 2d 700 (1996)* (state law generally carries a presumption of validity, unless it conflicts with federal law, where Congress has legislated in a field that the state has traditionally occupied; case dealt with the preemption of state tort law by the federal Medical Device Amendments).

(n62)Footnote 62. *See* Richard J. Hillman and Lynn H. Gibson, *Role of the Office of Thrift Supervision and Office of the Comptroller of the Currency in the Preemption of State Law*, General Accounting Office, OGC-00-51R (Feb. 7, 2000). Congress has decided that those agencies must now go through the process of publishing in the Federal Register for a thirty-day comment period any proposed opinion letter or interpretation that the National Bank Act preempts any state law regarding consumer protection, community reinvestment, fair lending, or the establishment of intrastate branches. *12 U.S.C. § 43*

(n63)Footnote 63. Activities Permissible for a National Bank, OCC (Feb. 2002), *available at* www.occ.treas.gov/corpapps/bankact.pdf.

(n64)Footnote 64. *15 U.S.C. § 6701*. The nature and extent of this preemption is discussed more fully in National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 8.4.1.5.2 (3rd ed. and Supp.).

(n65)Footnote 65. OCC Unpublished Letter (June 10, 1992). Interpretive Letters issued since May 1996 can be obtained from the Internet at www.occ.treas.gov./interp/monthly.htm. Summaries of OCC letters dealing with the preemption of state law and related topics that have *not* been published in the Federal Register can be found in National Consumer Law Center, Cost of Credit, App. D.1.2 (2d ed. and Supp.). More recently, a Texas regulation which prohibited banks from using any form of advertising that implied that a branch facility is a separate bank was held to be a valid exercise of state authority over a national bank. OCC Interpretive Letter No. 674 (June 9, 1995).

(n66)Footnote 66. OCC Unpublished Letter (Feb. 9, 1995) (reviewing Idaho Credit Code); OCC Interpretive Letter No. 644 (Mar. 24, 1994) (same) (reviewing Georgia's Residential Mortgage Act which required licensing of banks which do not maintain an office in that state); OCC Interpretive Letter No. 614 (Jan. 15, 1993) (same) (reviewing Idaho Credit Code which requires credit card issuers to obtain a license); OCC Unpublished Letter (Feb. 4, 1992) (same) (reviewing Iowa Lender Credit Card Act).

(n67)Footnote 67. OCC Unpublished Letter (Feb. 9, 1995) (states cannot exert "visitorial" powers over a national bank; "visitation" includes any act of a state official to inspect, regulate, or control the operation of a bank to enforce its law) (reviewing Idaho Credit Code); OCC Unpublished Letter (May 6, 1993) (same) (reviewing Idaho Consumer Credit Code); OCC Interpretive Letter No. 614 (Jan. 15, 1993) (same) (reviewing Wisconsin and Wyoming Credit Codes which require that lenders file notification with the state when a finance charge exceeding a certain percent and to file annual reports thereafter); OCC Unpublished Letter (Feb. 4, 1992) (same) (reviewing Iowa Lending Credit Card Act).

(n68)Footnote 68. OCC Unpublished Letter (Feb. 9, 1995) (while states can tax national banks to the same extent that they tax state banks, annual fees and the like are generally not "taxes" as they do not constitute general revenue, but, rather, are used for the purpose of funding a licensing or regulatory scheme; only the OCC can assess fees against national banks; reviewing Idaho Credit Code); OCC Interpretive Letter No. 644 (Mar. 24, 1994) (same) (reviewing Georgia's Residential Mortgage Act); OCC Unpublished Letter (May 6, 1993) (same) (reviewing Idaho Consumer Credit Code); OCC Unpublished Letter (Feb. 4, 1992) (same) (reviewing Iowa Lender Credit Card Act).

(n69)Footnote 69. *American Bankers Ass'n v. Lockyer, 239 F. Supp. 2d 1000 (E.D. Cal. 2002)* (California's minimum payment disclosure law for credit cards preempted). In this case, the OCC filed an amicus brief arguing preemption (rather than issuing a letter) and the court gave it deference.

(n70)Footnote 70. *12 U.S.C. § 36(f)(1).*

(n71)Footnote 71. *Smiley v. Citibank (S.D.), N.A., 517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996)* .

(n72)Footnote 72. *See Minnesota v. Fleet Mortg. Corp., 158 F. Supp. 2d 962 (D. Minn. 2001)* (claims under state consumer fraud, deceptive practices, and false statement in advertising act not preempted where claims arose from practice of disclosing customer information to other companies without customer's knowledge); *Black v. Financial Freedom Senior Funding Corp., 92 Cal. App. 4th 917, 112 Cal Rptr. 2d 445 (1st Dist. 2001)* , *review denied*, *2002 Cal. LEXIS 479* (Cal. Jan. 23, 2002) (allegations of false advertising and misleading transactional material in the sale of reverse mortgages raised under state consumer protection and unfair business practices not preempted). Note also that the Office of Thrift Supervision determined that state unfair and deceptive acts and practices laws which do not directly regulate credit transactions are *not* preempted. OTS Chief Counsel letter of 2/24/96.

(n73)Footnote 73. *517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996)* .

(n74)Footnote 74. *McQueen v. Williams, 177 F.3d 523 (6th Cir. 1999)* (court gave no deference to OCC letter in which agency opined that National Bank Act does not prevent relocation and merger plan of a bank); *Blackfleet Nat'l Bank v. Nelson, 171 F.3d 1237* (11th Cir.) , *cert. denied*, *528 U.S. 1004, 120 S. Ct. 497, 145 L. Ed. 2d 383 (1999)* (OCC letter allowing national bank to issue retirement certificates of deposit that guaranteed continuing stream of payments constituted an unreasonable expansion of the powers of national bank).

(n75)Footnote 75. *65 Fed. Reg. 63,917* (Oct. 25, 2000) .

(n76)Footnote 76. *66 Fed. Reg. 28,593* (May 23, 2001) .

(n77)Footnote 77. *Compare Ga. Code Ann. § 7-6A-1 et seq. with 15 U.S.C. §§ 1602(aa)*, *1639. See also Mayor of the City of New York v. The Am. Fin. Services Ass'n, 4 Misc. 3d 151 (N.Y. Sup. Ct. 2004)* .

(n78)Footnote 78. *68 Fed. Reg. 46,264* (Aug. 5, 2003) .

(n79)Footnote 79. *12 C.F.R. §§ 7.4007* (deposit-taking), 7.4008 (non-mortgage lending), 7.4009 (business of banking generally), 34.3 (mortgage lending), 34.4 (mortgage lending); *see 69 Fed. Reg. 1904* (Jan. 13, 2004) . These regulations became effective on February 12, 2004. In 2002, the OCC had adopted regulations governing the electronic activities of national banks. 12 C.F.R. § 7.500 et seq. These regulations contain a provision purporting to preempt state

laws affecting the electronic activities of national banks. *12 C.F.R. § 7.5002(c)*.

(n80)Footnote 80. *12 C.F.R. §§ 7.4007(b)*, *7.4008(d)*, *7.4009(b)*, *34.4(a)*.

(n81)Footnote 81. *12 C.F.R. §§ 7.4008(b)*, *34.3(b)*.

(n82)Footnote 82. *Compare 12 C.F.R. § 7.4008(d) with 12 C.F.R. § 34.4(a)*.

(n83)Footnote 83. *12 C.F.R. §§ 7.4008(e)*, *34.4(b)*.

(n84)Footnote 83.1. Hood v. Santa Barbara Bank & Trust, *49 Cal. Rptr. 3d 369 (Cal. Ct. App. 2006)* (UDAP claim that bank's change in terms notice violated Federal Regulation DD does not constitute a state limitation concerning disclosure; state UDAP act does no more than incidentally affect the bank's powers); Smith v. Wells Fargo Bank, N.A., *38 Cal. Rptr. 3d 653 (Cal. Ct. App. 2005)* (state UDAP claim does not obstruct, impair, or condition the bank's ability to exercise its powers and, therefore, does no more than incidentally affect the bank's business); *Charter One Mortgage v. Condra, 847 N.E.2d 207* (Ind. Ct. App.) , *removal granted*, *860 N.E.2d 599 (Ind. 2006)* (table) (Indiana's unauthorized practice of law standards which permit bank employee to fill in blanks on mortgage if no fee is charged does not more than incidentally affect bank's exercise of its right to charge fees; bank can hire an attorney or forego the $175 fee). *But see Austin v. Provident Bank, 2005 U.S. Dist. LEXIS 37113* (N.D. Miss. July 26, 2005) (predatory lending claims based on overpriced loans, inability to repay, excessive and fraudulent fees are preempted; these claims more than incidentally affect real estate lending powers of national banks).

(n85)Footnote 84. OCC Interpretive Letter No. 1005 (June 10, 2004).

(n86)Footnote 85. OCC Interpretive Letter No. 2004 (Mar. 9, 2004).

(n87)Footnote 86. *Blanco v. KeyBank USA, N.A., 2005 U.S. Dist. LEXIS 31768* (N.D. Ohio Sept. 30, 2005) .

(n88)Footnote 87. Comptroller of the Currency, Activities Permissible for a National Bank (Feb. 2006), *available at* www.occ.treas.gov/corpapps/BankAct.pdf.

(n89)Footnote 88. *69 Fed. Reg. 1895* (Jan. 13, 2004) .

(n90)Footnote 89. *12 C.F.R. § 7.4000*.

(n91)Footnote 90. *12 C.F.R. § 7.4006*; *66 Fed. Reg. 34,784, 34,788-89* (July 2, 2001) .

(n92)Footnote 91. Pub. L. No. 106-102, § 121, *codified at 12 U.S.C. § 24a(g)(3)*. For a discussion of this Act, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 8.4.1.5.2 (3rd ed. and Supp.). The OCC, by regulation, permitted national banks to own operating subsidiaries prior to the enactment of Gramm-Leach-Bliley. *See 12 C.F.R. § 5.34*. There is no explicit authority in the National Bank Act. However, the OCC relied upon *12 U.S.C. § 24* (seventh), which grants to national banks "incidental" powers necessary to carry on the business of banking.

(n93)Footnote 92. *66 Fed. Reg. 34,784, 34,788* (July 2, 2001) .

(n94)Footnote 93. *12 U.S.C. § 24a(a)(2)(A)*.

(n95)Footnote 94. *Nat'l City Bank of Indiana v. Turnbaugh, 463 F.3d 325 (4th Cir. 2006)* ; *Wachovia Bank, N.A. v. Burke, 414 F.3d 305 (2d Cir. 2005)* ; *Wachovia Bank, N.A. v. Watters, 431 F.3d 556* (6th Cir. 2005), *aff'd, 2007 U.S. LEXIS 4336* (U.S. Apr. 17, 2007) ; *Wells Fargo Bank, N.A. v. Boutris, 419 F.3d 949 (9th Cir. 2005)* .

(n96)Footnote 94.1. *Wells Fargo, 419 F.3d at 964* .

(n97)Footnote 94.2. *See* First Nat'l Bank in *St. Louis v. Missouri, 263 U.S. 640, 665* /-/66 (1924) (state branching statute does not conflict with the NBA and state attorney general can enforce it).

(n98)Footnote 94.3. *Watters v. Wachovia Bank, 2007 U.S. LEXIS 4336* (U.S. Apr. 17, 2007) . For a more in depth discussion of this decision, see National Consumer Law Center, Cost of Credit: Regulation, Preemption and Industry Abuse, § 3.4.6.4 (3d ed. and supp.).

(n99)Footnote 95. *But see* First Nat'l Bank in *St. Louis v. Missouri, 263 U.S. 640, 665-66 (1924)* (the dissent, arguing against the state enforcement at issue, stated: "And if [the laws of the United States] do not grant it, they in effect prohibit it, and no law of the state can strengthen or weaken the prohibition.").

(n100)Footnote 96. Indeed, this partnership scheme is the industry's action plan to avoid regulatory restrictions. *See* Stephens, Inc., Payday Advance--The Final Innings: Standardizing the Approach (2000).

(n101)Footnote 97. Long v. Ace Cash Express, Clearinghouse No. 53,504, Case No. 00-837CA (Clay County Cir. Ct., Fla.) (complaint). The case was removed to federal court which subsequently remanded it back to the state court. Clearinghouse No. 53,554 (remand order).

(n102)Footnote 98. *See* Johnson v. Ace Cash Express, Inc., Civil Action No. S-01-CV2299 (D. Md.) (nationwide class) (case voluntarily dismissed), Clearinghouse No. 53,545; Brown v. Ace Cash Express, Inc., Civil Action No. S01-2674 (Baltimore Cir. Ct., Md) (statewide class), Clearinghouse No. 53,547; Purdie v. Ace Cash Express, Inc., Civil Action No. 301-CV1754-X (N.D. Tex.) (nationwide class), Clearinghouse No. 53,546.

(n103)Footnote 99. *Hudson v. Ace Cash Express, Inc., 2002 U.S. Dist. LEXIS 11226* (S.D. Ind. May 30, 2002) , *amended complaint dismissed in 2002 U.S. Dist. LEXIS 19210* (S.D. Ind. Sept. 27, 2002) , *appeal pending*; *Purdie v. Ace Cash Express, Inc., 2002 U.S. Dist. LEXIS 20910* (N.D. Tex. Oct. 29, 2002) (case was filed under the federal RICO statute; court held that the plaintiff failed to adequately plead an association in fact under strict Fifth Circuit RICO standards).

(n104)Footnote 100. State *ex rel.* Salazar v. Ace Cash Express, Inc., (Colo. Dist. Ct. filed July 16, 2001), Complaint--Clearing house No. 53,544, Plaintiff's Motion to Remand--Clearinghouse No. 53,544, Order of Remand--Clearinghouse No. 53,557; Goleta Nat'l Bank v. O'Donnell, Case No. C2-01-971 (S.D. Ohio) (complaint) (memorandum in support of motion for preliminary injunction) (defendant's answer to motion) (defendant's motion to dismiss), Clearinghouse No. 53,550A-D; State *ex rel.* Cooper v. Ace Cash Express, Inc., Complaint, Clearinghouse No. 53,559 (N.C. Super. Ct. Jan. 2002).

(n105)Footnote 101. *See* OCC Advisory Letter No. AL 2000-10 (Nov. 27, 2000), *available at* www.occ.treas.gov/advlst00.htm; OTS Letter (Nov. 27, 2000), *available at* www.ots.treas.gov/docs/25132.pdf. *See also* OTS Letter P-2000-4 (Feb. 3, 2000) (OTS will conduct examinations of the thrift's partner in payday lending to the same extent as it will of the thrift).

(n106)Footnote 102. *See In re* Eagle Nat'l Bank, OCC #2001-104 (Dec. 18, 2001), *available at* www.occ.treas.gov/ftp/eas/ea2001-104.pdf.

(n107)Footnote 103. The Fact Sheet about the case is available at www.occ.treas.gov/ftp/release/2002-01a.txt.

(n108)Footnote 104. *In re* Goleta Nat'l Bank, EA #2002-93 (Oct. 25, 2002 consent order), *available at* www.occ.treas.gov/ftp/eas/ea2002-93.pdf; *In re* Ace Cash Express, Inc., EA #2002-92 (Oct. 25, 2002), *available at* www.occ.treas.gov/ftp/eas/ea2002-92.pdf.

(n109)Footnote 105. *In re* Advance Am., EA #2003-3 (Jan. 29, 2003 consent order), *available at* www.occ.treas.gov/ftp/eas/ea2003-3.pdf; *In re* Peoples Nat'l Bank, EA #2003-2 (Jan. 29, 2003), *available at*

www.occ.treas.gov/ftp/eas/ea2003-2.pdf; *In re* First Nat'l Bank in Brookings, EA #2003-1 (Jan. 17, 2003), *available at* www.occ.treas.gov/ftp/eas/ea2003-1.pdf.

(n110)Footnote 106. State *ex rel*. Salazar v. Ace Cash Express, Clearinghouse No. 53,556 (D. Colo. 2002) (order).

(n111)Footnote 107. The FDIC Guidelines for Payday Lending, issued July 2, 2003, are available on the FDIC's website at www.fdic.gov/regulations/safety/payday. For further discussion of this issue, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 3.13.3 (3rd ed. and Supp.)

(n112)Footnote 107.1. John Reosti, *First Delaware Getting Out of Payday Lending*, Am. Banker, Feb. 23, 2006.

(n113)Footnote 107.2. *Id*.

(n114)Footnote 107.3. *Id*.; Robert Schoenberger, *Republic to Get Out of Payday Loans; FDIC Urged Bank to Exit Business*, The Courier-Journal, Mar. 3, 2006; Republic Bancorp Inc, SEC Form 8-K (Feb. 24, 2006), *available at* www.sec.gov/Archives/edgar/data/921557/000110465906011951/a06-5812_18k.htm; Advance America, Cash Advance Centers, Inc., Form 8-K (Mar. 7, 2006), *available at* investors.advanceamerica.net/edgar.cfm; Press Release, West Virginia Attorney General's Office, Attorney General Darrell McGraw Reaches Agreement with West Virginia Last Payday Lender, First American Cash Advance (May 9, 2007) (mentioning that Community State Bank had broken off its relationship with First American Cash Advance in 2006), *available at* www.wvago.gov/press.cfm?ID=337&fx=more.

(n115)Footnote 107.4. Payday lenders may reconfigure themselves under state credit repair organizations acts, rent-a-finance company, or revert to using revolving credit in order to charge whatever fees they choose.

(n116)Footnote 107.5. Fed. Deposit Ins. Corp., FIL 50-2007: Affordable Small-Dollar Loan Guidelines (June 19, 2007) (available on the companion website to this volume).

(n117)Footnote 108. *12 U.S.C. §§ 1461, 1463*.

(n118)Footnote 109. *Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta, 458 U.S. 141, 159-60, 102 S. Ct. 3014, 3025-26, 73 L. Ed. 2d 664, 679 (1982)* .

(n119)Footnote 110. *12 U.S.C. § 1463(g)*. This provision first appeared at *12 U.S.C. § 1730(g)* when it was enacted as part of the Depository and Institutions Deregulation and Monetary Control Act of 1980. It was added later to HOLA. *See Gavey Props./762 v. First Fin. Sav. & Loan Ass'n, 845 F.2d 519 (5th Cir. 1988)* .

(n120)Footnote 110.1. *12 U.S.C. § 1463(g)(2)*.

(n121)Footnote 111. *See Gavey Props./762 v. First Fin. Sav. & Loan Ass'n, 845 F.2d 519 (5th Cir. 1988)* .

(n122)Footnote 112. *Compare* OTS Letter No. P-2004-8 (Sept. 17, 2004) *with* OCC Interpretive Letter No. 822 (Feb. 17, 1998).

(n123)Footnote 113. OTS Letter No. P-2004-8 (Sept. 17, 2004).

(n124)Footnote 114. *Viereck v. Peoples Sav. & Loan Ass'n, 343 N.W.2d 30 (Minn. 1984)* (due-on-sale clauses contained in mortgage were not valid under applicable state law; because the originating lenders were not entitled to preemption, the federal savings association assignee was not entitled to preemption); *Garrison v. First Fed. Sav. & Loan Ass'n of S.C., 402 S.E.2d 25 (Va. 1991)* (federal savings and loan, as assignee of mortgage company which originated loan, not entitled to preemption even though loan was one of large pool sold to the savings and loan).

(n125)Footnote 115. *Viereck v. Peoples Sav. & Loan Ass'n, 343 N.W.2d 30 (Minn. 1984)* (due-on-sale clauses

contained in mortgage were not valid under applicable state law; because the originating lenders were not entitled to preemption, the federal savings association assignee was not entitled to preemption); *Garrison v. First Fed. Sav. & Loan Ass'n of S.C., 402 S.E.2d 25 (Va. 1991)* (federal savings and loan, as assignee of mortgage company which originated loan, not entitled to preemption even though loan was one of large pool sold to the savings and loan). *See § 6.02[2][c][ii], supra.*

(n126)Footnote 116. *See Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta, 458 U.S. 141, 159 n.14, 102 S. Ct. 3014, 3025-26 n.14, 73 L. Ed. 2d 664, 679 n.14 (1982)* ("Because we find an actual conflict between federal and state law, we need not decide whether the HOLA or the Board's regulations occupy the field of due-on-sale law or the entire field of federal savings and loan regulation").

(n127)Footnote 117. *Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta, 458 U.S. 141, 102 S. Ct. 3014, 73 L. Ed. 2d 664 (1982)* (state court decision prohibiting lenders from exercising due-on-sale clauses in mortgages is preempted by explicit Board regulation); *Bank of America v. San Francisco, 2000 U.S. Dist. LEXIS 12587* (N.D. Cal. June 29, 2000) , *appeal pending* (city ordinance prohibiting the imposition of ATM fees on non-accountholders by financial institutions preempted by regulation generally permitting federal savings associations to use electronic means to provide any product or service).

(n128)Footnote 118. *12 C.F.R. § 560.2* (effective Jan. 1, 1997). *But see Konynenbelt v. Flagstar Bank, 617 N.W.2d 706, 713 (Mich. App. 2000)* (holding that these regulations "support the conclusion that Congress has not occupied the entire field").

(n129)Footnote 119. *Compare 12 C.F.R. § 560.2(b), with* § 560.2(c). *See, e.g., In re Ocwen Loan Serv., L.L.C. Mortgage Serv. Litig., 491 F.3d 638 (7th Cir. 2007)* (contract and commercial law generally not preempted, for example, breach of contract and breach of duty of good faith and fair dealing).

(n130)Footnote 120. OTS Letters discussing preemption issues are generally available on the OTS website: www.ots.treas.gov. *See also* National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges, D.3 (3d ed. and Supp.) for summary of OTS Letters regarding preemption.

(n131)Footnote 121. OTS Chief Counsel Letter of 2/24/96 (addressing whether Indiana's UDAP act was preempted). Several courts have recognized this principle when deciding whether state UDAP acts applied to the activities of savings associations. *See Lopez v. World Sav. & Loan Ass'n, 105 Cal. App. 4th 729 (2003)* (state law prohibition against charging for a payoff statement is within the field of lending regulation and is preempted; UDAP claims are not preempted to the extent that the behavior complained of is outside of the list of lending related activities; in this case, concurrent UDAP claim was preempted; breach of contract and fraud claims not preempted but failed due to court's reading of the contract provision); *Washington Mut. Bank v. Superior Ct. of L.A., 95 Cal. App. 4th 606 (Cal. Ct. App. 2002)* (charging one day's pre-closing interest affects the "terms of credit"; state law prohibiting the imposition of this charge is preempted; court noted that state UDAP act is within state's police power and is subject to heightened presumption against preemption); *Laskey v. Downey Sav. & Loan Ass'n., 2002 Cal. App. Unpub. LEXIS 11259* (Cal. Ct. App. Dec. 5, 2002) (same); *Kunert v. Bank of Am. Nat'l Trust & Sav. Ass'n, 2001 WL 1715929* (Cal. Super. Ct. Aug. 3, 2001) (interest rate upcharges in car financing is akin to a "loan-related fee" and state law prohibiting the charging of a secret upcharge is preempted; fraud claim is also preempted as it is based on the same "loan-related fee" issue); *Moskowitz v. Washington Mut. Bank, F.A., 768 N.E.2d 262 (Ill. App. Ct. 2002)* (breach of contract and UDAP claims based upon the bank's practice of charging a payoff statement fee, found to be a "loan-related fee" under the OTS regulations, preempted).

(n132)Footnote 122. The OTS decided that the anti-predatory lending laws of New York, New Mexico, New Jersey, and Georgia are preempted. OTS letters related to restrictions on ATM fees and requirements related to the disclosure of the estimated length of time necessary to pay off credit card balances have been upheld by the courts. *See Bank of Am. v. City & County of San Francisco, 309 F.3d 551 (9th Cir. 2002)* ; *Am. Bankers Ass'n v. Lockyer, 239 F.*

Supp. 2d 1000 (E.D. Cal. 2002) .

(n133)Footnote 123. Office of Thrift Supervision, Powers of Federal Savings Associations (Mar. 1, 2002).

(n134)Footnote 124. *12 C.F.R. § 559.3(h), (n). See also WFS Fin., Inc. v. Dean, 79 F. Supp. 2d 1024 (W.D. Wis. 1999)* ; *Chaires v. Chevy Chase Bank, F.S.B., 748 A.2d 34 (Md. App. 2000)* .

(n135)Footnote 124.1. FDIC, The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective (Summer 2004), *available at* www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/industrial_loans.html.

(n136)Footnote 124.2. FDIC, The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective (Summer 2004), *available at* www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/industrial_loans.html. ILC failures depleted these funds over time.

(n137)Footnote 124.3. Pub. L. No. 97-320, *96 Stat. 1469; 12 U.S.C. §§ 1815(a)* (any "depository institution" may apply for FDIC insurance), 1813(c)(1) (references the definition of "bank" at § 1813(a)(2) that includes ILCs).

(n138)Footnote 124.4. FDIC, The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective (Summer 2004), *available at* www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/industrial_loans.html.

(n139)Footnote 124.5. FDIC, Moratorium on Certain Industrial Bank Applications and Notices, *72 Fed. Reg. 5,290, 5,291* (Feb. 5, 2007) (Supplementary Information).

(n140)Footnote 124.6. All of these are chartered in Utah. A list of Utah-chartered industrial banks is available at www.dfi.utah.gov/IBSList.htm; a list by asset size as of December 2004 is in the Economic Development Corporation of Utah's report on industrial banks. Economic Development Corp. of Utah, Utah Industrial Banks Profile 4/-/6 (2007), *available at* www.edcutah.org/datacenter/publications/UtahIndustrialBanksIndustryProfile.pdf.pdf.

(n141)Footnote 124.7. *12 U.S.C. § 1841(c)(2)(H)(I)*. Technically, ILCs cannot offer any demand deposit accounts, but they may offer nonbusiness NOW (negotiable order of withdrawal) accounts--checking accounts that retain the legal right to require advance notice of the withdrawal. *12 U.S.C. § 1832*.

(n142)Footnote 124.8. *See, e.g., Utah Code Ann. § 7-8-3*.

(n143)Footnote 124.9. *12 U.S.C. § 1831d(a)*.

(n144)Footnote 124.10. *Utah Code Ann. § 15-1-1*. Utah law also does not limit the amount of late fees that may be charged by depository institutions, including ILCs. *Utah Code Ann. § 70C-2-102(1)(b)*.

(n145)Footnote 125. Pub. L. No. 96-221, *94 Stat. 164,* tit. V (Mar. 31, 1980).

(n146)Footnote 126. *See 12 U.S.C. § 1831d(a)* (state commercial banks); § 1463(g) (federal savings and loans); § 1785(g) (federal credit unions). To date, the courts have interpreted most favored lender issues under DIDA and the NBA consistently. *See, e.g., Gavey Props./762 v. First Fin. Sav. & Loan Ass'n, 845 F.2d 519 (5th Cir. 1988)* .

(n147)Footnote 127. *See 12 U.S.C. § 1735f-7a* (mobile home rate preemption is conditioned on compliance with consumer protections). The DIDA exemption can apply to a mobile home sale even if the sale includes other items. *Draper v. Castle Home Sales, Inc., 711 F. Supp. 1499 (E.D. Ark. 1989)* (refrigerator and range included in contract but not separately priced).

(n148)Footnote 128. *See 12 U.S.C. §§ 86a, 1831a* (expired) (allowed 5% over discount rate for nonconsumer loans of $1000 or more).

(n149)Footnote 129. *Cf.* S. Rep. No. 368, 96th Cong., 2d Sess. 19, *reprinted in* 1980 U.S.C.C.A.N. 236, 255 (first lien preemption of Title V, Part A does *not* preempt state consumer protections on residential mortgage loans such as "limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers"). Courts have differed on the relevance of that to interpreting Title V, Part C (most-favored-lender extension, §§ 521-523). *Cf. Hill v. Chemical Bank, 799 F. Supp. 948, 954 (D. Minn. 1992)* (not relevant), *with Sherman v. Citibank (South Dakota), N.A., 668 A.2d 1036 (N.J. 1995)* (finding it instructive), *vacated and remanded, 517 U.S. 1241, 116 S. Ct. 2493, 135 L. Ed. 2d 186 (1996)* .

(n150)Footnote 130. *Amaro v. Capital One Bank, 1998 U.S. Dist. LEXIS 8373* (N.D. Ill. May 19, 1998) (court opted for the position argued by the bank, i.e., that Virginia provision applying to revolving accounts which permitted banks to charge any "charges and fees" as agreed to by parties to the contract controlled). In some instances, if the case is filed in the federal courts sitting in the home state of the defendant bank, the federal court may dismiss the case on the grounds of lack of jurisdiction or certify the question of state law to the state's highest court. *See, e.g., Fleet Bank, N.A. v. Burke, 160 F.3d 883 (2d Cir. 1998)* .

(n151)Footnote 131. *12 U.S.C. § 1831d(a).*

(n152)Footnote 132. *12 U.S.C. § 1463(g)* (formerly codified at *12 U.S.C. § 1730g*).

(n153)Footnote 133. *12 U.S.C. § 1463(g), formerly codified at 12 U.S.C. § 1730g.*

(n154)Footnote 134. *12 U.S.C. § 1785(g).*

(n155)Footnote 135. *Compare 12 U.S.C. §§ 1436(g), 1785(g), 1831d(a), with 12 U.S.C. § 85.* The remedies also match. *Compare 12 U.S.C. § 86, with 12 U.S.C. § 1463(g)(2).*

(n156)Footnote 136. *E.g.,* FHLBB General Counsel Opinion #4 (Sept. 19, 1980) (FHLBB interpretation giving most favored lender status to an FSLIC-insured "thrift"); *Fed. Banking L. Rep. (CCH) P 81,635* and Consumer Cred. Guide (CCH) P 95,511 (FDIC opinion letter applying it to an FDIC-insured state chartered bank); Letter from Douglas H. Jones, Deputy Gen. Counsel, FDIC-93-27 (July 12, 1993); *45 Fed. Reg. 78,624-78,625 (1980)* as amended by IRPS 81-3, *46 Fed. Reg. 24,153* (NCUA opinion as to federally insured credit unions.).

(n157)Footnote 137. *See, e.g., VanderWeyst v. First State Bank of Benson, 425 N.W.2d 803 (Minn. 1988) , cert. denied, 488 U.S. 943, 109 S. Ct. 369, 102 L. Ed. 2d 359 (1988)* (federally insured state bank may invoke most favored lender doctrine; purpose of DIDA was to give state banks parity with national banks); *Dahl v. Lanesboro State Bank, 399 N.W.2d 621 (Minn. Ct. App. 1987)* .

(n158)Footnote 138. *971 F.2d 818 (1st Cir. 1992) . See also Hill v. Chem. Bank, 799 F. Supp. 948 (D. Minn. 1992)* ; Stoorman v. Greenwood Trust Co., No. 93CA0224 (Colo. Ct. App. Apr. 17, 1994). *Stoorman* was affirmed by the Colorado Supreme Court. *Stoorman v. Greenwood Trust Co., 908 P.2d 133 (Colo. 1995) , cert. denied, 517 U.S. 1244, 116 S. Ct. 2498, 135 L. Ed. 2d 190 (1996) . See also Venture Props., Inc. v. First S. Bank, 79 F.3d 90 (8th Cir. 1996)* .

(n159)Footnote 139. *See § 6.02[2][b] supra.*

(n160)Footnote 140. *See § 6.02[2][b] supra. Smiley v. Citibank (South Dakota), N.A., 11 Cal. 4th 138, 44 Cal. Rptr. 2d 441, 900 P.2d 690 (1995) , aff'd, 517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996)* .

(n161)Footnote 141. *See § 6.02[4][e] infra.*

(n162)Footnote 142. *Cf.* Singer, Sutherland Statutory Construction P 46.06 (5th ed.). *But see Stoorman v.*

Greenwood Trust Co., 888 P.2d 289 (Colo. Ct. App. 1994) , *aff'd on other grounds*, *908 P.2d 133 (Colo. 1995)* , *cert. denied, 517 U.S. 1244, 116 S. Ct. 2498, 135 L. Ed. 2d 190 (1996)* .

(n163)Footnote 143. *Greenwood Trust Co. v. Massachusetts, 971 F.2d 818 (1st Cir. 1992)* (Delaware-chartered bank may override Massachusetts' late charge limitation under § 521); *Gavey Props./762 v. First Fin. Sav. & Loan Ass'n, 845 F.2d 519 (5th Cir. 1988)* . *Accord Hill v. Chem. Bank, 799 F. Supp. 948 (D. Minn. 1992)* .

(n164)Footnote 144. *Colo. Rev. Stat. § 5-1-201(1).*

(n165)Footnote 145. *Stoorman v. Greenwood Trust Co., 908 P.2d 133 (Colo. 1995)* (the court mentioned, in passing, that § 525 had been repealed, which is an error).

(n166)Footnote 146. For a discussion of conflict of law principles in general, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 9.2.9 (3rd ed. and Supp.).

(n167)Footnote 147. *See, e.g.*, State *ex rel. Meierhenry v. Spiegel, Inc., 277 N.W. 2d 298 (S.D. 1979)* , *appeal dismissed*, *444 U.S. 804, 100 S. Ct. 25, 62 L. Ed. 2d 17 (1979)* .

(n168)Footnote 148. DIDA § 501(a)(1), *12 U.S.C. § 1735f-7a*. For a discussion of the "residential" nature of a mortgage, see *In re Lawson Square, Inc., 816 F.2d 1236 (8th Cir. 1987)* ; *Bank of New York v. Hoyt, 617 F. Supp. 1304 (D.R.I. 1985)* .

(n169)Footnote 149. *See § 6.02[2] supra. See Sweeney v. Savings First Mortgage, L.L.C., 879 A.2d 1037 (Md. 2005)* (broker fee is a finance charges and is included in the APR; therefore, the broker fee is "interest"). *See also Wells Fargo Bank, N.A. v. Boutris, 419 F.3d 949 (9th Cir. 2005)* (California's per diem law is not preempted; DIDA does not apply based upon the likely impact of the state law at issue, as long as there is no express limitation on interest rates or amounts; the per diem statute addresses only the time period for which interest may be assessed).

(n170)Footnote 150. S. Rep. No. 96-368, at 19, *reprinted in* 1980 U.S.C.C.A.N. 236.

(n171)Footnote 151. *12 C.F.R. § 590.3(c). See Veytia v. Seiter, 740 S.W.2d 64, 66 (Tex. App. 1987)* (quoting legislative history, § 501 would not protect usurious loan charges), *aff'd*, *756 S.W.2d 303 (Tex. 1988)* ; *Gonzalez v. Old Kent Mortg. Co., 2000 U.S. Dist. LEXIS 14530* (E.D. Pa. Sept. 19, 2000) (non-interest rate charges not subject to DIDMCA preemption); *Konynenbelt v. Flagstar Bank, 617 N.W.2d 706, 713 (Mich. App. 2000)* (mortgage release fees not a component of APR and, therefore, not subject to DIDMCA preemption).

(n172)Footnote 152. *See Grunbeck v. Dime Sav. Bank, 74 F.3d 331 (1st Cir. 1996)* .

(n173)Footnote 153. *Stern v. Norwest Mortgage, Inc., 284 Ill. App. 3d 506, 219 Ill. Dec. 788, 672 N.E.2d 296 (1996)* , *aff'd, 179 Ill. 2d 160, 227 Ill. Dec. 762, 688 N.E.2d 99 (1997)* .

(n174)Footnote 154. *See* DIDA § 501(a)(1), *12 U.S.C. § 1735f-7a*.

(n175)Footnote 155. For alternative theories to attack overreaching loans, see *§ 6.09 infra*.

(n176)Footnote 156. *See 12 C.F.R. § 590.2(c).*

(n177)Footnote 157. *See Brown v. Investors Mortgage Co., 121 F.3d 472 (9th Cir. 1997)* (lienholder of fixture lien arising from purchase of a furnace and water heater does not have same priority as a first mortgage holder under state law); *Mitchell v. Trustees of U.S. Mut. Real Estate Inv. Trust, 375 N.W.2d 424 (Mich. Ct. App. 1985)* ; FHLBB General Counsel Opinion Letter #S86 (May 11, 1984). *See also In re Russell, 72 B.R. 855 (Bankr.E.D. Pa. 1987)* (first lien issue discussed, but case decided on other grounds).

(n178)Footnote 158. *Chevy Chase Bank, F.S.B. v. Chaires, 350 Md. 716, 715 A.2d 199 (1998)* (state court held that lien on residential property created by a state shore erosion control fund prior to a later construction loan rendered the construction loan a "second lien" and therefore the state's secondary mortgage loan law applied).

(n179)Footnote 159. *12 U.S.C. § 1735f-5(b)*, incorporated by DIDA § 501(a)(1)(C). Note that the complete removal of ceilings under DIDA § 501(a)(1) takes priority over DIDA's alternative ceiling provisions, discussed in *§ 6.02[4][b] supra*, when federally related lenders issue first mortgage credit. *See In re Lawson Sq., 816 F.2d 1236 (8th Cir. 1987)* .

(n180)Footnote 160. *12 U.S.C. § 1735f-5(b)* incorporated by DIDA § 501(a)(1)(C).

(n181)Footnote 161. *See 12 U.S.C. § 1735f-7a* (DIDA § 501(a)(1)(C)(6)).

(n182)Footnote 162. The definition of creditor is taken from *15 U.S.C. § 1602(f)*, and includes persons who "regularly" extend consumer credit payable in four or more installments or involving a finance charge.

(n183)Footnote 163. *12 U.S.C. § 1735f-5(b)* incorporated by DIDA § 501(a)(1)(C). *See generally In re Russell, 72 B.R. 855 (Bankr. E.D. Pa. 1987)* (lender fails to carry burden of proof on $1,000,000 DIDA threshold).

(n184)Footnote 164. Generally, this means that the loan originator must have been approved by the Federal National Mortgage Association (Fannie Mae) or some other federal purchaser, and that the loan terms and structure must meet the federal purchaser's requirements.

(n185)Footnote 165. The definition of creditor is taken from *15 U.S.C. § 1602(f)*, and includes persons who "regularly" extend consumer credit payable in four or more installments or involving a finance charge.

(n186)Footnote 166. DIDA § 501(a)(1)(C)(v), *12 U.S.C. § 1735f-7a*.

(n187)Footnote 167. DIDA § 501(a)(1)(C)(vi), *12 U.S.C. § 1735f-7a*. This provision applies to sales on or after Oct. 8, 1980.

(n188)Footnote 168. DIDA § 501(c), *12 U.S.C. § 1735f-7a. Cf. Livingston v. Vanguard Fed. Sav. Bank, 563 A.2d 175, 180 (Pa. Super. Ct. 1989)* (court notes that mobile home lender's contract did not contain FHLBB's consumer safeguards, so regulations under DIDA were irrelevant to issue of whether Home Owner's Loan Act and regulations issued thereunder preempted state law prohibiting prepayment penalties on mobile home installment contracts).

(n189)Footnote 169. *See* Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, tit. V, §§ 501(b)(2), 501(b)(4), 525.

(n190)Footnote 170. *See* DIDA § 501(b)(2), *12 U.S.C. § 1735f-7a(b)(2). See also Veytia v. Seiter, 756 S.W.2d 303 (Tex. 1988) . See also Brown v. Investors Mortgage Co., 121 F.3d 472 (9th Cir. 1997)* (Washington's 1981 enactment of its general usury statute setting an annual interest rate ceiling at the higher of 12% or 4% above the yield on 26-week T-bills did not constitute an opt-out because it did not so state explicitly).

(n191)Footnote 171. *See* DIDA § 501(b)(4), *12 U.S.C. § 1735f-7a(b)(4)*.

(n192)Footnote 172. *Compare Doyle v. Southern Guar. Corp., 795 F.2d 907 (11th Cir. 1986)* (analogous language under FHA/VA preemption statutes), *cert. denied sub nom. Fort Wayne Mtg. Co. v. Wood, 484 U.S. 926, 108 S. Ct. 289, 98 L. Ed. 2d 249 (1987)* , *with* FHLBB General Counsel Opinion Letter #S50 (June 18, 1981) (citing *Green v. Decatur Fed. Sav. & Loan Ass'n, 143 Ga. App. 368, 238 S.E.2d 740 (1977)* (recodification)). *See also* FHLBB General Counsel Opinion Letter #S51 (Oct. 27, 1981) (amendment to North Carolina statute did not constitute opt-out of discount points preemption); *Autrey v. United Cos. Lending Corp., 872 F. Supp. 925 (S.D. Ala. 1995)* (Alabama passed a cap on points after March 31, 1980, which qualifies as an override of DIDA). *But see Baughman v. Mellon Mortgage Co., 621*

N.W.2d 776 (Minn. Ct. App. 2001) (re-enactment of a restriction on the charging of a fee for the administration of an escrow account and the addition of a clause prohibiting the charging of a fee for allowing the mortgagor to discontinue the escrow account in 1998 was not a "significant" change for purposes of qualifying for an opt-out of a state law DIDA-like preemption. *Note*: Minnesota opted out of DIDA but then enacted a state version of the DIDA rate, points, and fees preemption. *See U.S. Bank, N.A. v. Clark, 837 N.E.2d 74 (Ill. 2005)* (court applied state statutory interpretation rules to find that a state law restricting points and fees on mortgage loans with interest rates in excess of 8% was not repealed by a subsequent amendment. Since this provision was not reenacted after Congress passed DIDA, it is preempted).

(n193)Footnote 173. *See* DIDA § 525.

(n194)Footnote 174. *See* DIDA § 525.

(n195)Footnote 175. *See 12 U.S.C. § 1703*; *38 U.S.C. § 3703*.

(n196)Footnote 176. *See 12 U.S.C. § 1709-1a*; *38 U.S.C. § 3728*.

(n197)Footnote 177. *See 38 U.S.C. § 3745*; *38 C.F.R. §§ 36.4311-36.4312*.

(n198)Footnote 178. *See 12 U.S.C. § 1709(b)(5)*.

(n199)Footnote 179. *See § 6.02[4][b] infra*.

(n200)Footnote 180. *See generally* 24 C.F.R. §§ 201, 203.

(n201)Footnote 181. As was discussed earlier, DIDA preempts interest ceilings on first mobile home loans only on the condition that the mobile home lenders comply with OTS consumer protection regulations. *See 12 U.S.C. § 1735f-7a*; *12 C.F.R. § 590.4 (1985)*. However, the Eleventh Circuit in Doyle v. Southern Guaranty Corporation held that lenders making FHA or VA insured first mobile home loans need not comply with the FHLBB/OTS regulations because the state interest ceilings on their loans are independently preempted. *795 F.2d 907 (11th Cir. 1986)* . The Supreme Court denied certiorari in *Doyle*'s companion case, *Ft. Wayne Mtg. v. Wood, 484 U.S. 926, 108 S. Ct. 289, 98 L. Ed. 2d 249 (1987)* .

(n202)Footnote 182. The Pennsylvania Motor Vehicle Installment Sales Finance Act, 69 Pa. Stat. Ann. § 619F (1994), is an example.

(n203)Footnote 183. The first FHA/VA preemption law passed by Congress took effect on June 30, 1976 (*see 12 U.S.C. § 1709-1a*), and the second on Dec. 21, 1979 (*see 12 U.S.C. § 1735f-7*). State opt-out laws passed between those two dates would appear to cover only those loans issued after the effective date of the state opt-out law and prior to the second preemption in 1979. FHA and VA-insured loans issued after Dec. 21, 1979, would not be subject to state-imposed interest ceilings unless the relevant state passed its opt-out law after that date and prior to the loan transaction. That is, states which opted out of the 1976 preemption before or during most of 1979 would have to adopt a second opt-out law after Dec. 21, 1979, to reimpose the state exemption. Remember, however, that federally set interest ceilings were in effect on FHA loans until Nov. 30, 1983.

(n204)Footnote 184. *See Doyle v. Southern Guar. Corp., 795 F.2d 907 (11th Cir. 1986)* (state need only amend or reenact its usury law, and need not expressly reject the FHA/VA preemption to opt out of preemption). The Supreme Court denied certiorari in *Doyle*'s companion case, *Ft. Wayne Mortgage Co. v. Wood, 484 U.S. 926, 108 S. Ct. 289, 98 L. Ed. 2d 249 (1987)* .

(n205)Footnote 185. *Williams v. Norwest Fin. Ala., Inc., 1998 Ala. Civ. App. LEXIS 95* (Ala. Civ. App. Jan. 30, 1998) , *op. withdrawn, substituted op., mot. denied, 723 So. 2d 97 (Ala. Civ. App. 1998)* (state law expressly exempted

FHAA lenders from most of the provisions regulating consumer finance transactions, including a prohibition on prepayment penalties); *Burris v. First Fin. Corp., 928 F.2d 797* (8th Cir.) , *cert. denied, 502 U.S. 867, 112 S. Ct. 195, 116 L. Ed. 2d 155 (1991)* (court found such express statement in amendment to Arkansas state constitution limiting interest rates but explicitly excluding interest rates governed by federal law).

(n206)Footnote 186. *12 U.S.C. §§ 1751 et seq.*

(n207)Footnote 187. *12 U.S.C. § 1757(5)(A)(vi).*

(n208)Footnote 188. *See* Patricia A. McCoy, *Banking Law Manual § 2.08* (Lexis Pub. 2d ed. 2003).

(n209)Footnote 189. *12 U.S.C. § 1785(g).* This provision was enacted as part of the Depository and Institutions Deregulation and Monetary Control Act of 1980. *See* Appx. G.1.

(n210)Footnote 190. NCUA Statement of Interpretation and Policy (IRPS 81-31), *46 Fed. Reg. 24153* (Apr. 30, 1981), *amending*, IRPS 80-11, *45 Fed. Reg. 78624* (Nov. 26, 1980).

(n211)Footnote 191. *See, e.g., Ex parte Davis, 401 So. 2d 52 (Ala. 1981)* ; *Neal v. Redstone Fed. Credit Union, 447 So. 2d 805 (Ala. Civ. App. 1984)* ; *Christian v. Atlanta Army Depot Fed. Credit Union, 140 Ga. App. 277, 231 S.E.2d 7 (1976)* ; *Brooklyn Jenapo Fed. Credit Union v. Schucher, 41 Misc. 2d 368, 245 N.Y.S.2d 637 (Sup. Ct. 1963)* ; *McAnally v. Ideal Fed. Credit Union, 428 P.2d 322 (Okla. 1967)* .

(n212)Footnote 192. *See Ex parte Davis, 401 So. 2d 52 (Ala. 1981)* ; *see also McAnally v. Ideal Fed. Credit Union, 428 P.2d 322 (Okla. 1967)* .

(n213)Footnote 193. *Ex parte Davis, 401 So. 2d 52 (Ala. 1981)* .

(n214)Footnote 194. *12 C.F.R. § 701.21(b).*

(n215)Footnote 195. *12 C.F.R. § 701.21(b).*

(n216)Footnote 196. 12 C.F.R. 21 701.21(b)(1), *citing 12 U.S.C. § 1757(5).*

(n217)Footnote 197. *Id.*

(n218)Footnote 198. *12 C.F.R. § 701.21(b)(2).*

(n219)Footnote 199. *12 U.S.C. § 3800.* The regulations which apply to AMTPA lenders can be found at *12 C.F.R. § 560.220, § 560.33-560.35* (OTS regulations); 12 C.F.R. § 34 (OCC regulations); *12 C.F.R. § 701.21* (NCUA regulations).

(n220)Footnote 200. *See 12 U.S.C. § 3801.*

(n221)Footnote 201. *See 12 U.S.C. § 3803.*

(n222)Footnote 202. *E.g.,* Cooluris, *Variable Rates in Closed End Credit, reprinted in* P.L.I. Consumer Credit 1983, at 764 (1983). *See also* Rudolph, Schmeltzer & Weiner, *Federal Legislation Affecting Mortgage Credit, 38 Bus. Law. 1311, 1320 (May 1983).*

(n223)Footnote 203. *See 12 U.S.C. § 3802.*

(n224)Footnote 204. *12 U.S.C. § 3802(1)(A).*

(n225)Footnote 205. See examples of what constitute "alternative mortgage transactions" in the Supplementary

Information accompanying the revised OTS AMTPA rule. *67 Fed. Reg. 60,542, 60,549* (Sept. 26, 2002) .

(n226)Footnote 206. *12 U.S.C. § 3802(1)(B). See, e.g., Cabrejas v. Accredited Home Lender, Inc., 2007 U.S. Dist. LEXIS 51105* (D. Md. July 5, 2007) (fixed rate loan with balloon payment constitutes an alternative loan subject to AMTPA); *Patrick v. Shaw, 739 N.W.2d 365 (Mich. Ct. App. 2007)* (loan with a balloon payment is an alternative mortgage transaction).

(n227)Footnote 207. *67 Fed. Reg. 60,542, 60,549* (Sept. 26, 2002) .

(n228)Footnote 208. *12 U.S.C. § 3802(1)(C).*

(n229)Footnote 209. *67 Fed. Reg. 60,542, 60,549* (Sept. 26, 2002) .

(n230)Footnote 210. *See 12 U.S.C. § 3802.*

(n231)Footnote 211. *See 12 U.S.C. § 3804.* Arizona, Maine, Massachusetts, New York, South Carolina, and Wisconsin have opted out of all or part of AMTPA; *Mass. Gen. Laws ch.183, § 60* note. Me. Rev. Stat. Ann. tit. 9A, § 1-110 (1993 Supp.); 1984 S.C. Acts 355 § 1 (not codified); 1983 Wis. Acts 389 § 11(1) (non-statutory). *See generally* Consumer Cred. Guide (CCH) P 510.

The potential to control terms which fall within the scope of the statute, such as interest rates on variable rate home equity loans, is very limited in those states which failed to exercise their right to opt-out, however. *See* Opinion of the Tenn. Att'y Gen., No. 87-147, 5 Consumer Cred. Guide (CCH) P 95,916 (Sept. 15, 1987) (since Tennessee did not opt out of AMTPA, state law attempting to regulate rates charges on mortgages subject to AMTPA would be preempted).

(n232)Footnote 212. Home Ownership and Equity Protection Act (HOEPA), *15 U.S.C. § 1639.*

(n233)Footnote 213. *See* Ch. 2 *supra. See Williams v. Gelt Fin. Corp. (In re Williams), 232 B.R. 629* (Bankr. E.D. Pa.) , *aff'd, 237 B.R. 590 (E.D. Pa. 1999)* .

(n234)Footnote 214. *Illinois Ass'n of Mortg. Brokers v. Office of Banks & Real Estate, 174 F. Supp. 2d 815 (N.D. Ill. 2001)* , *vacated, remanded, 308 F.3d 762 (7th Cir. 2002)* .

(n235)Footnote 215. Pub. L. No. 106-102 (1999), *codified as 15 U.S.C. §§ 6701 et seq.* , *§§ 6801 et seq.* , *§§ 6901 et seq.* , *and amending 12 U.S.C. § 1831u.*

(n236)Footnote 216. Section 731, *amending 12 U.S.C. § 1831u(f).*

(n237)Footnote 217. Section 731, *amending 12 U.S.C. § 1831u(f).*

(n238)Footnote 218. *See Johnson v. Bank of Bentonville, 122 F. Supp. 2d 994 (W.D. Ark. 2000)* , *aff'd, 269 F.3d 894 (8th Cir. 2001)* (court indicates that Arkansas is the only state which has such a constitutional provision).

(n239)Footnote 219. *12 U.S.C. § 1831u(f)(2)*; no affect on *12 U.S.C. § 1735(f)-7(a).*

(n240)Footnote 220. *12 U.S.C. § 1831u(f)(2)*; no affect on *12 U.S.C. § 85.*

(n241)Footnote 221. *12 U.S.C. § 1831u(f)(2)*; no affect on *12 U.S.C. § 1831(d).*

(n242)Footnote 222. H.R. Rep. No. 106-434, p.184 (1999), *reprinted in* 1999 U.S.C.C.A.N. 245, 277; *Johnson v. Bank of Bentonville, 122 F. Supp. 2d 994, 999 (W.D. Ark. 2000)* , *aff'd, 269 F.3d 894 (8th Cir. 2001)* (Congress has power under *Commerce Clause* to enact this preemption provision; bank chartered in Arkansas permitted to charge interest in excess of constitutional cap).

(n243)Footnote 223. Federal jurisdiction is proper where a claim arises under the Constitution, laws or treaties of the United States. *28 U.S.C. § 1331*.

(n244)Footnote 224. *See, e.g., Hill v. Chem. Bank, 799 F. Supp. 948 (D. Minn. 1992)* .

(n245)Footnote 225. *Hill v. Chem. Bank, 799 F. Supp. 948, 950 (D. Minn. 1992)* .

(n246)Footnote 226. *Compare Copeland v. MBNA Am., N.A., 820 F. Supp. 537 (D. Colo. 1993)* (NBA: removal not warranted) *and Donald v. Golden Credit Union, 839 F. Supp. 1394 (E.D. Cal. 1993)* (DIDA: same) *with Goehl v. Mellon Bank (DE), 825 F. Supp. 1239 (E.D. Pa. 1993)* (NBA: removal granted); *Watson v. First Union Nat'l Bank, 837 F. Supp. 146 (D.S.C. 1993)* (same); *Nelson v. Citibank (S.D.), N.A., 794 F. Supp. 312 (D. Minn. 1992)* (NBA: removal granted); *Tikkanen v. Citibank (S.D.) N.A., 801 F. Supp. 270 (D. Minn. 1992)* (same); *Hill v. Chemical Bank, 799 F. Supp. 948 (D. Minn. 1992)* (DIDA § 521).

(n247)Footnote 227. *Compare Anderson v. H&R Block, Inc., 287 F.3d 1038 (11th Cir. 2002)* , *cert. granted*, *123 S. Ct. 990 (2003)* (finding of complete preemption is not warranted) *with M. Nahas & Co. v. First Nat'l Bank of Hot Springs, 930 F.2d 608 (8th Cir. 1991) and Krispin v. May Dep't Stores Co., 218 F.3d 919 (8th Cir. 2000) . See also Ansley v. Ameriquest Mortgage Co., 194 F. Supp. 2d 1062 (C.D. Cal. 2002)* (AMTPA; removal not proper because AMTPA does not preempt all state laws); West Virginia *ex rel. McGraw v. Parrish Auto. Training Co., 147 F. Supp. 2d 470 (N.D. W. Va. 2001)* (NBA; remand granted where the state sued car dealers and banks, as assignees, over a UDAP claim for failure to disclose the dealer interest rate hikes and the receipt of the yield spread premium from the banks); *Heaton v. Monogram Credit Card Bank of Georgia, 2001 U.S. Dist. LEXIS 325* (E.D. La. Jan. 5, 2001) (FDIA; no complete preemption, relying on *Jones v. BankBoston*), *subs. proc. at 297 F.3d 416 (5th Cir. 2002)* (FDIC permitted to intervene, thus creating federal court jurisdiction; remand reversed on these grounds); *Jones v. BankBoston, N.A., 115 F. Supp. 2d 1350 (S.D. Ala. 2000)* (NBA; removal not warranted).

(n248)Footnote 228. But see the dissent which looks to a completely different and earlier statute regarding federal court jurisdiction, the Judiciary Act of 1789. *Anderson v. H&R Block, 287 F.3d 1038, 1048-49 (11th Cir. 2002)* .

(n249)Footnote 229. *Spellman v. Meridian Bank, 1995 U.S. App. LEXIS 37149* (3d Cir. Dec. 29, 1995) (eleven consolidated cases; jurisdiction over only those few which had pled federal causes of action). *But see M. Nahas & Co. v. First Nat'l Bank, 930 F.2d 608 (8th Cir. 1991)* (case does not involve exportation as national bank was chartered in Arkansas where transaction took place; court denied removal on grounds that § 86 provides exclusive federal remedy in usury claim against a national bank).

(n250)Footnote 230. *Spellman v. Meridian Bank, 1996 U.S. App. LEXIS 2506* (3d Cir. Feb. 16, 1996) .

(n251)Footnote 231. *See § 6.03[7] infra* (federal rebate), and Ch. 2 *supra* (HOEPA).

(n252)Footnote 232. *15 U.S.C. §§ 1601 et seq.* ; *see generally* Ch. 1 *supra*, for TILA. The Truth in Lending Act is reprinted in Vol. 1B *infra*.

(n253)Footnote 233. TIL preemption is discussed in *§ 1.07[3] supra*.

(n254)Footnote 234. *See § 6.02[2] supra. See Begala v. PNC Bank, Ohio, N.A., 214 F.3d 776 (6th Cir. 2000)* , *cert. denied*, *531 U.S. 1145 (2001)* (national bank located in Ohio is entitled to use the interest rate allowed to building and loan associations and savings banks under most favored lender doctrine; payment holiday was not a new credit transaction and, therefore, was covered by this state law which allowed unlimited interest on "loans made").

(n255)Footnote 235. *Tenn. Code Ann. § 45-4-602(a)(2)*; *see also* Tenn. A.G. Op., Consumer Cred. Guide (CCH) P 96,966 (Dec. 7, 1981).

(n256)Footnote 236. *See, e.g., First Bank of Cadillac v. Miller, 131 Mich. App. 764, 347 N.W.2d 715 (1984) . See also Begala v. PNC Bank, Ohio, N.A., 214 F.3d 776 (6th Cir. 2000) .*

(n257)Footnote 237. *2005 WL 2447969* (N.J. Super. Ct. App. Div. Oct. 3, 2005).

(n258)Footnote 238. *10 U.S.C. § 987.*

(n259)Footnote 239. By contrast, the Service members Civil Relief Act applies to credit taken out before an individual enters the military.

(n260)Footnote 240. For example, the Home Owners Loan Act of 1933 originally contained a 6% rate cap on mortgage loans originated by savings associations. The National Housing Act of 1934 imposed a 5% rate cap on insured mortgage loans made under the auspices of the Federal Housing Administration. Patricia A. McCoy & Elizabeth Renuart, *The Legal Infrastructure of Subprime and Nontraditional Home Mortgages, in* Borrowing to Live 112 (Nicolas P. Retsinas & Eric S. Belsky, eds. 2008).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 6 The Cost of Credit

1-6 Consumer Credit Law Manual § 6.03

§ 6.03 The Cost of Early Termination

[1] Overview

A distinct form of overcharge often appears when credit is retired early by prepayment of the debt (including by refinancing) or when a debt matures early because of default and acceleration. Since the amount of interest due is in part a function of the time the credit is outstanding, shortening the time should, as a matter of logic and fairness, reduce the amount of interest the borrower pays. But that may not always happen. The creditor may impose hidden charges, consisting of any unearned amount of insurance premiums and precomputed interest that it retains upon the early termination of credit.

The windfall that a creditor would receive if it could retain unearned charges upon prepayment or acceleration of precomputed debt has been widely recognized, and almost all state consumer credit statutes have long required the rebate of unearned interest and insurance charges. Failure to give those rebates, or to calculate them correctly, gives rise to usury or overcharge claims. n1 As is discussed in this chapter, there are numerous exceptions and limitations to this policy. Even in the absence of a specific statute or contract provision requiring a rebate, a court may impose such a requirement based on an equitable principle that unearned interest must be deducted upon acceleration and payment of a debt prior to maturity. n1.1

[2] When Are Rebates Required?

[a] Precomputed Charges

One of the two key words in determining when rebates are necessary is "unearned." Issues about the proper rebate of *interest* should arise only with respect to *precomputed* credit, because, by definition, interest is added to the debt only as it is earned in an interest-bearing contract. n2 Thus, as a general rule, there is no unearned interest involved in interest-bearing credit, though, as is discussed below, that is not an absolute. A precomputed transaction, in contrast, folds into the borrower's legal obligation at the outset all the interest to be earned over the originally scheduled life of the loan. As payments are made, they are subtracted from the "total of payments" and not allocated between interest and principal, n3 so at any point prior to the scheduled maturity, the remaining debt (the sum of the remaining payments due) will include some interest not yet earned. It is primarily this context in which rebate issues arise.

However, rebate issues can also arise in interest-bearing transactions, as contract interest may not be the only type of charge imposed. Most commonly, both precomputed and interest-bearing loans may contain other charges which are priced in relation to time, such as credit insurance premiums. These will need to be rebated upon early termination. n4

The second key word in determining when a rebate is required is "early." For example, if a borrower defaulted on the last two payments of a loan, which was scheduled to mature on April 1, 1994, but the creditor did not file a collection action until June 1, 1994, there will be no rebate issues. Since the loan went to (and past) maturity, all the precomputed interest would have been fully earned, as would any credit insurance premiums. n5

Also related to the "early termination" prerequisite is how rebates are to be handled when the transaction is involuntarily terminated prior to scheduled maturity. In the event of default, the loan may mature early through acceleration. Involuntary early termination of a consumer credit transaction may trigger state and federal rebate requirements.

Finally, the federal law and most state laws typically do not require rebates for "partial prepayments." n6 These are early payments which are too small to retire the consumer's total debt.

Advocates representing borrowers who have made partial payments in precomputed transactions should check the language of both the state usury statutes and the credit contract to see how partial payments are treated. The federal act requires rebates only in the event of complete prepayment, but that is a minimum standard. It should not preempt more protective state laws, n6.1 and certainly parties can contract for a more favorable rule. n6.2

[3] What Charges Are Subject to Rebate?

In precomputed transactions, by definition, there will be unearned interest when the loan is prepaid and so a refund is necessary. In contrast, *generally* there is no unearned interest to rebate in an interest-bearing transaction when it is properly amortized. However, it is nonetheless necessary to check the creditor's accounting on interest-bearing loans, too.

As is discussed elsewhere in this volume, creditors usually charge debtors numerous fees in addition to the stated contract interest. n7 Creditors typically claim that these fees are earned at the consummation of the credit contract and need not be rebated because they are unrelated to the term of the credit. The validity of this argument depends on the particular type of fee which has been assessed and the language of the controlling statute.

The argument that a fee is earned at the outset of a credit transaction makes no sense in the case of fees that are clearly related to the term of credit. Credit insurance premiums, for example, usually vary with the term of credit, and the difference between a two-year premium and a one-year premium is unearned if prepayment occurs after one year. n8

The logical relationship between a fee and the term of credit is, however, only part of the rebate story. As with other usury issues, whatever fee the controlling statute says is rebatable is rebatable, and whatever fee the statute excuses from rebates need not be rebated, common sense notwithstanding.

One potential area of dispute is whether the federal or a relevant state law governing the transaction requires the rebate of points, service charges, origination charges, or other one-time fees charged at the time the loan is consummated. n9

State statutes differ on this issue, some deeming points or similar prepaid finance charges as "nonrefundable" or clearly stating that they are to be considered earned at consummation. Other statutes are silent on this matter. Where not expressly addressed, a mandate to rebate points may nevertheless follow directly from standard statutory rebate language.

In the absence of any controlling statute or case law, the need to rebate points may depend on the underlying economic

validity of the creditor's argument that they are earned at the time of loan consummation. n10 This argument depends on the existence of some separate service which the creditor provides at the beginning of a credit transaction and for which it may claim immediate compensation. Some courts considering the nature of points and similar fees have found no such separate service and have held instead that these fees merely constitute profit or compensation for overhead expense. n11 Additional authority for this proposition is found in generally accepted accounting principles, as well. n12

With respect to the rebate of points, a particularly interesting issue is whether points are "interest" for purpose of the federal rebate statute. It is by no means clear that TIL definitions do--or should--apply here, for the rebate statute is not part of TILA despite its location in the code books.

An argument can be made that, since the federal rebate statute is not part of TIL, the federal common law definition of "interest" should be the relevant one. Using this body of law as the relevant definition, then, would mean that a great many kinds of charges, such as points, would be "interest charges" subject to the federal rebate mandate. As with state laws, there remains the question of whether a given item in that broad category of charges is "unearned."

It is important to keep in mind other theories to attack abusive use of points as well. Where not explicitly sanctioned, a failure to rebate points might be argued as a prepayment penalty. n13 If the points are excessive, as some high-rolling mortgage lenders imposed in the mid-1980s (25 to 40 points), n14 borrowers might also challenge such nonrefundable fees as unconscionable, n15 particularly in the context of refinancings. n16

[4] Calculating Rebates

[a] Initial Steps in Calculating the Rebate

The first step in any rebate calculation is to determine the precise date as of which the rebate must be calculated. If a loan is prepaid, either directly by the borrower or through refinancing, the controlling date will be the date of prepayment, although as discussed subsequently, that date may be rounded to the nearest regular payment date preceding or following the actual date of prepayment. If a debt is matured through acceleration rather than voluntary prepayment, however, determining the date when a rebate must be credited is more complicated. n17

In some states, acceleration is simply treated as a form of prepayment and the controlling date for rebate calculations is the date on which the creditor accelerates the debt. n18 Some courts have held that rebates are required when a post-repossession sale is held. n19 In other states, however, acceleration is not viewed as terminating the credit, and the creditor continues to earn interest until some later date, such as the date the creditor files an action on the debt or the date of final judgment on the debt. n20 If the date of filing or the judgment date, as the case may be, is later than the date on which the debt was originally scheduled to terminate, the creditor will have earned all the interest due under the contract, and no rebate will be required.

The next complication in calculating the time that a precomputed loan has been outstanding is that contractually interest is "earned" and payments are due at specific intervals, usually monthly, during the term of the loan, but prepayments and accelerations generally do not occur exactly on a payment date. Rather than giving the borrower a partial rebate for the days remaining in the payment interval, n21 lenders have traditionally rounded up to the next payment date (rarely back to the previous payment date).

The practice of rounding payment intervals in a lender's favor has traditionally been sanctioned by state law. As consumers and regulators have become more sophisticated, however, more and more statutes have prohibited the rounding of intervals in the creditor's favor during the first fifteen days of the payment period, n22 and improper rounding has been challenged in court. n23 Specific statutory rounding rules, even if they still favor creditors, n24 provide clear standards against which a creditor's calculations may be measured. Creditors who claim excess interest through improper rounding will be charging illegal hidden interest. n25

[b] Rebate Formulae

[i] Determining Which Formula to Use

Once the particular charges that are subject to rebate are identified and the duration of the credit has been determined, the final step in computing the amount of the rebate is to apply to these figures one of the three rebate formulae which are generally used: the pro rata formula, the actuarial formula, or the Rule of 78.

For transactions consummated prior to September 30, 1993, the appropriate formula will be a question of state law. However, for consumer credit transactions with terms longer than 61 months consummated after that date, federal law now prohibits the use of the Rule of 78. It requires instead the use of a formula at least as favorable to the borrower as the actuarial method. n26 This federal law will preempt any contrary state law. After 1994, certain closed-end, high cost home equity loans are also subject to federal rebate rules. n27

But for transactions consummated prior to the effective date of these federal statutes, and for transactions not subject to it, the appropriate rebate formula remains a matter of state law. n28

[A] Pro Rata Rebates

The simplest but least used rebate formula is the pro rata method. This formula assumes that interest is earned in direct proportion to the time that a loan or credit has been outstanding. For example, if a prepayment occurs four months into the term of a precomputed loan that had been scheduled to be repaid in twelve months, the pro rata method proves that 4/12 of the interest has been earned. Consequently, the remaining 8/12 of the interest is unearned and must be rebated. If the total finance charge subject to rebate had been $1,000, then 8/12 x $1,000 = $666.67 should be rebated to the consumer.

The pro rata rebate method is simple to apply, but it is statistically very crude because it fails to consider the effect of a declining principal balance on the earning of interest.

Not because of its statistical inaccuracy, but because the pro rata method yields larger rebates for borrowers than other methods, it is rarely used. Statutes requiring pro rata rebates do, nevertheless, crop up at times, particularly for those rebates required when a creditor accelerates a debt because of default or some other contingency, n29 or in the event of a quick-flip on a loan. n30

[B] Rule of 78

The Rule of 78 is nothing more than a shorthand formula designed to *approximate* the results of an actual amortization with a single, simple five-step formula, which is all the more efficient because it can be applied to all transactions irrespective of term or interest rate. There is, however, a hitch in this shorthand approximation: It has an inherent bias in the creditor's favor. There will always be a smaller rebate to the consumer when the Rule of 78 is used than when the actuarial method is used, so the borrower always loses. n31

As discussed above, the use of the Rule now is prohibited in all precomputed consumer credit transactions with terms longer than 61 months consummated after September 30, 1993. n32

[C] Actuarial Rebates

The most accurate and the fairest way to balance creditor and debtor interests in a rebate calculation is to determine the actuarial interest that the creditor has earned at the time of prepayment and to refund to the borrower the difference between the total contract interest and this actuarially earned amount. n33 Generally accepted accounting principles consider this the economic reality. n34

A special rebate calculation issue arises under actuarial "split" rate usury statute, which apply one interest rate to part of the outstanding balance and another, usually a lower rate, to the rest. State law and regulations must be consulted to determine which actuarial rebate is correct. However, if the applicable statute does not specify the type of "actuarial" rebate, consumer advocates should argue that the very existence of the split rate statute constitutes a statutory specification that interest may only be earned in accordance with a split rate amortization pattern. n35

[5] Proving Rebate Violations Are Illegal Charges

[a] Usury Upon a Contingent Event

Until the 1960s, it was common for usury statutes to neglect the issue of rebates upon the early termination of precomputed debt. In essence, the courts reasoned that a contract which would not have been usurious if its anticipated payment schedule had been met could not be made usurious by some "contingency," such as the "voluntary" action of the debtor in prepaying or defaulting on the debt.

It is critical for consumer advocates to recognize that this rule against the existence of usury in contingencies is simply a rule of construction developed by courts interpreting statutes that were silent on the need for rebates. n36 If a statute specifically requires the rebate of unearned interest or premiums, as do almost all modern statutes regulating precomputed consumer credit, then the failure of the creditor to provide such rebates triggers whatever remedies that statute provides for in the event its terms regarding allowable charges are violated. The rule against usury through contingencies nevertheless continues to affect some consumer transactions.

[b] Intent to Collect Unearned Charges: What Constitutes "Charging," "Receiving," or "Contracting For" Unearned Charges?

Under some consumer credit statutes, specific remedies are authorized wherever finance charges (or simply charges) in excess of that allowed are charged, n37 or, more generally, where provisions of the act are violated. n38 Any time the statute provides for a specific remedy for imposing charges in excess of that allowed, a provision requiring rebates should be considered to be encompassed by that language. n39

In general, there are two ways in which a creditor may violate usury law rebate requirements: Either the creditor can provide a contract, which on its face fails to provide for the appropriate rebate, or it can neglect in actual practice to give a rebate which it is both contractually and statutorily required to give. Where intent is required, demonstrating a usury violation in the first situation may be considerably easier than in the second because the contract itself can show the creditor's intent. In many jurisdictions, it is usurious merely to "contract for" usurious payments.

If a credit contract properly provides for a rebate upon the early termination of a precomputed debt, the next question is whether, when the prepayment or acceleration finally occurs, the creditor actually gives the rebate properly. Statutorily, the issue is typically whether the creditor "charged" or "collected" usurious interest, and a significant number of cases have focused on this point.

[c] Special Issues Regarding Remedies for Violations of the Federal Rebate Statute

The federal rebate statute does not include any provisions for a specific remedy in the event a creditor violates it. Nonetheless, there are several viable theories which the consumer could assert in the event a creditor violated the statute.

[i] Truth in Lending

Irrespective of whether it is considered part of TIL or not, a violation of the federal rebate statute probably does *not*

directly lead to a viable claim for private TIL remedies. n40 It may, however, lead indirectly to a TIL violation. In brief, in the event the creditor n41 refinances the loan, and calculates the prior loan's payoff in violation of the statute, either by failing to give rebates or by using the Rule of 78 when the actuarial method is required, the new loan will include an "unearned portion of the old finance charge that is not credited to the obligation." n42 Under TIL rules, that is to be considered part of the finance charge in the new loan. n43 Thus, the disclosed amount financed, finance charge, and APR on the new loan all will be inaccurately disclosed, n44 and those violations, in turn, lead to TIL statutory damages as well as actual damages. n45

[ii] UDAP

Failure to comply with the rebate law should also state a UDAP claim, where the transaction and lender are subject to the statute: The amount of the improperly calculated rebate would be actual damages. n46

[iii] Contract Law

Common law contract principles may also be invoked to seek a remedy, as applicable law is an implied term of every contract. n47

[6] Prepayment Penalties

In its simplest form, a prepayment penalty is a fee that a borrower is contractually obligated to pay if he or she chooses to pay off a debt prior to its scheduled retirement date.

In the absence of statute or contract authorization, common law may prohibit prepayment of a debt. n48 However, in the consumer credit context, most state laws require that borrowers be allowed to prepay their debts and often limit or prohibit prepayment penalties. n49 Such statutory provisions are usually closely associated with the state's rebate requirements because the failure to provide a proper rebate upon the prepayment of a precomputed debt is essentially a form of prepayment penalty. n50

However, rebate requirements and prepayment penalty prohibitions are not interchangeable. The most obvious difference is that statutes prohibiting prepayment penalties typically are invoked when debt is retired through voluntary prepayment, while rebate requirements apply to precomputed debt regardless of whether it is prepaid, accelerated, or otherwise matured. n51

The new federal legislation regarding high rate mortgages addresses this issue of prepayment penalties. For most covered loans, n52 no prepayment penalties are permitted at all, and use of any method of rebate less favorable than the actuarial rule is specifically defined to constitute a prepayment penalty. n53 There is one very narrow, complex exception. n54

Finally, the laws of most states forbid prepayment penalties in consumer transactions, but borrowers' attorneys should be aware that these prepayment penalty prohibitions have been overridden in the case of some mortgage loans. n55 Specifically, if permitted by a loan contract, state and national banks may impose prepayment penalties on adjustable-rate mortgage loans, n56 and federally chartered savings and loan institutions may impose prepayment penalties on both fixed and variable rate mortgage loans. n57 Up until July 1, 2003, the Office of Thrift Supervision (OTS) allowed "housing creditors," defined as non-depository lenders who regularly make loans or credit sales secured by residential realty or mobile homes, to impose prepayment penalties in loans that fell under the Alternative Mortgage Transactions Parity Act. n58 Effective July 1, 2003, however, OTS amended its rules to no longer authorize these lenders to impose fees for prepayment. n59 As a result, these creditors are subject to any state restrictions on prepayment penalties. Further, non-depository lenders who regularly make loans or credit sales secured by residential realty or mobile homes may impose prepayment penalties in loans that fall under the Alternative Mortgage Parity Act.

n60 However, federal credit unions are specifically prohibited from receiving prepayment penalties, n61 as are any lenders making FHA-insured mortgage loans. n62 Another limitation is that OTS forbids collection of prepayment penalties by federal thrifts when they accelerate mortgage notes pursuant to due-on-sale clauses. n63 A creditor may attempt to evade a prohibition on prepayment penalties by creative labeling of the charge. For example, one bank waived the borrower's obligation to pay closing costs, as long as the borrower did not prepay the obligation for three years. Maryland's highest court held that, because the closing cost charge was imposed on the borrower only in the event of prepayment, it was a prepayment penalty no matter how it was labeled. n63.1

[7] Preemptive Effect of the New Federal Consumer Protection Statutes

In some cases, the federal rebate statute n64 and the high cost mortgage statute n65 will provide greater protections to borrowers than they would otherwise have under state or other federal law. In other states, though, state law may still provide greater protection.

The high cost mortgage statute is explicit about preemption. Even in the limited circumstances where a creditor is permitted to impose a prepayment penalty in a covered loan under that statute, it can only do so if otherwise applicable law also permits it. n66 Further, the new disclosure and substantive prohibitions do not affect state law "except to the extent that those State laws are inconsistent, and then only to the extent of the inconsistency," n67 by which Congress intended "to allow states to enact more protective provisions than those in this legislation."

The federal rebate statute included no specific preemption language. However, it, too, should not preempt state laws more protective of the consumer since consumer protection statutes are to be liberally construed to effectuate their purpose. n68

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawFederal ActsGeneral OverviewBanking LawNational BanksInterest & UsuryGeneral OverviewBanking LawNational BanksInterest & UsuryInterestBanking LawNational BanksInterest & UsuryUsury LitigationContracts LawDebtor & Creditor Relations

FOOTNOTES:
(n1)Footnote 1. *See, e.g., Circle v. Jim Walter Homes, Inc., 479 F. Supp. 39 (W.D. Okla. 1979) , aff'd, 654 F.2d 688 (10th Cir. 1981)* ; *Clyde v. Liberty Loan Co., 249 Ga. 78, 287 S.E.2d 551 (1982)* ; *G.A.C. Fin. Corp. v. Hardy, 232 Ga. 632, 208 S.E.2d 453 (1974)* .

(n2)Footnote 1.1. *See, e.g., Ala. Code §§ 5-18-15* (Rule of 78 for small loan prepayment), 5-19-4 (prepayment rebates by Rule of 78 for consumer credit transactions with original term less than sixty-one months, and any generally accepted actuarial method if greater than sixty-one months, except pro rata for refinancing within ninety days), 8-8-14 (pro rata refund of interest surcharge); *Alaska Stat. §§ 45.10.070* (Rule of 78 under state RISA), 06.40.120 (insurance premium finance), 06.40.150 (unearned insurance premiums); *Ariz. Rev. Stat. Ann. §§ 44-6002* (actuarial rebate required for RISA transactions), 44-1205 (actuarial rebate on loan transactions). *See also In re Coxson, 43 F.3d 189 (5th Cir. 1995)* (Texas follows equitable rule requiring surrender of unearned interest to obtain a foreclosure; rule invoked to avoid usurious construction of contract silent about rebate upon acceleration); *Aardwoolf Corp. v. Nelson Capital Corp., 861 F.2d 46 (2d Cir. 1988)* ; *Denley v. Peoples Bank of Indianola, 553 So. 2d 494 (Miss. 1989)* (even though statute was silent as to prepayment rebate method, use of Rule of 78 was usurious when it caused lender's yield to exceed statutory ceiling stated as actuarial rate; that implies a requirement of an actuarial rebate on precomputed loans).

(n3)Footnote 2. At any given time, the amount due on an interest-bearing contract is the unpaid principal balance plus accrued interest. *See, e.g., In re Curtis, 83 B.R. 853 (Bankr. S.D. Ga. 1988)* ; *Myles v. Resolution Trust Corp., 787 S.W.2d 616 (Tex. Ct. App. 1990)* (no usury contracted for in acceleration clause of interest-bearing contract).

(n4)Footnote 3. *See generally* James H. Hunt, *The Rule of 78: Hidden Penalty for Prepayment in Consumer Credit Transactions, 55 B.U. L. Rev. 331, 331 n.2 (1975).*

(n5)Footnote 4. *See § 6.03[3] infra.*

(n6)Footnote 5. There may be another issue, however, as to how the creditor calculated any interest due after maturity and before the legal action. Some contracts provide for lower post-maturity rates (though rarely these days), others provide for continuing at the original rate, and yet others provide for a higher "default" rate. Some predatory home equity lenders have contracted for default rates of 36% to 42% on fully secured loans. As a consequence, Congress limited default rates on high cost mortgages. Home Ownership and Equity Protection Act, codified at *15 U.S.C. § 1639(d).* Some state statutes may regulate default rates, as well. *See, e.g., Ala. Code § 5-18-15(j)* (small loan maximum interest reduced to 8% six months after maturity).

(n7)Footnote 6. *See, e.g., 15 U.S.C. § 1615(a)*; Neb. Rev. Stat. § 45-137(2)(c) (1988). *But see Cal. Fin. Code §§ 22480(a)(3), 24480(a)(3)* (West 1981 and Supp. 1994) (recomputation required for partial prepayment of three or more installments).

(n8)Footnote 6.1. *Toy Nat'l Bank v. McCarr, 286 N.W.2d 376 (Iowa 1979) . See also* National Consumer Law Center, Truth in Lending § 2.4.2.2 (6th ed. 2007 and Supp.) (standards for determining business purpose under Truth in Lending Act).

(n9)Footnote 6.2. *286 N.W.2d 376 (Iowa 1979) . Accord In re Stipetich, 294 B.R. 635 (Bankr. W.D. Pa. 2003)* (Md. law) (loan that refinanced business loan not consumer loan even though borrower obtained it to prevent foreclosure).

(n10)Footnote 7. *See § 6.05 infra.*

(n11)Footnote 8. *See Varner v. Century Fin. Co., 738 F.2d 1143 (11th Cir. 1984)* ; *Clyde v. Liberty Loan Co., 287 S.E.2d 551 (Ga. 1982)* (maintenance charges and credit insurance premiums must be rebated if unearned); *Brown v. Associates Fin. Servs. Corp., 346 S.E.2d 873 (Ga. Ct. App. 1986)* . But note that some types of credit may charge for credit insurance on a monthly installment basis, as is typically the case with credit cards.

(n12)Footnote 9. For a discussion of points as interest, see *§ 6.05[2][b] infra.*

(n13)Footnote 10. *Cf. In re Tucker, 74 B.R. 923 (Bankr. E.D. Pa. 1987)* (though persuasive authority and public policy suggest a "service charge" *should* be rebated, the controlling statute is clear that no such rebate is required).

(n14)Footnote 11. *See § 6.05[2][b] infra.*

(n15)Footnote 12. *See* FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated With Originating or Acquiring Loans and Initial Direct Costs of Leases (effective for fiscal years beginning after Dec. 15, 1987). *See generally* FASB Accounting Standards, § L20 (1993/94 ed.).

(n16)Footnote 13. *See § 6.03[6] infra. Cf. In re Jungkurth, 74 B.R. 323 (Bankr. E.D. Pa. 1987)* (absent statutory authorization, Rule of 78 is a prepayment penalty). Note that non-depository lenders who regularly make loans or credit sales secured by residential realty or mobile homes may impose prepayment penalties in loans that fall under the Alternate Mortgage Parity Act. *12 U.S.C. § 3801. See § 6.02[7] supra*; *National Home Equity Mortg. Ass'n v. Face, 239 F.3d 633 (4th Cir. 2001) , cert. denied, 534 U.S. 823, 122 S. Ct. 58, 151 L. Ed. 2d 26 (2001)* ; *McCarthy v. Option One Mortg. Corp., 2001 U.S. Dist. LEXIS 22711* (N.D. Ill. Feb. 11, 2001) (non-federally chartered housing creditor can charge prepayment penalty, but only if it complies with OTS regulations); *Shinn v. Encore Mortg. Servs., 96 F. Supp. 2d 419 (D.N.J. 2000)* (housing creditor that complied with OTS regulations could charge prepayment penalty notwithstanding state law restrictions).

(n17)Footnote 14. *E.g.*, First American Mortgage Company and Landbank Equity, two major multi-state lenders, both of which eventually went into bankruptcy, leaving their loans in the hands of other lenders which had purchased them on the secondary mortgage market.

(n18)Footnote 15. *See, e.g., Williams v. E.F. Hutton Mortg. Corp., 555 So. 2d 158 (Ala. 1989)* .

(n19)Footnote 16. *See § 6.04 infra*.

(n20)Footnote 17. Of course, accelerating an interest-bearing debt, instead of a precomputed debt, will not require any rebates, as there is no unearned interest to rebate. *See In re Curtis, 83 B.R. 853 (Bankr. S.D. Ga. 1988)* ; *Myles v. Resolution Trust Corp., 787 S.W.2d 616 (Tex. Ct. App. 1990)* (no usury contracted for in acceleration clause of interest-bearing contract).

(n21)Footnote 18. *See, e.g., Iowa Code Ann. § 537.2510(6)* (West 1987) (if judgment is obtained, rebate is calculated as of date of acceleration); *N.Y. Pers. Prop. Law § 408(6)* (McKinney 1992); *N.C. Gen. Stat. § 25A-32* (1986) (15 days after acceleration); Pa. Stat. Ann. tit. 69, § 622B (1994).

(n22)Footnote 19. *Union Trust Co. v. Tyndall, 428 A.2d 428 (Md. 1981)* ; *First Va. Bank v. Settles, 588 A.2d 803 (Md. Ct. App. 1991)* .

(n23)Footnote 20. For example, both the 1968 and 1974 versions of the Uniform Consumer Credit Code (UCCC) provide that "if the maturity is accelerated for any reason and judgment is entered, the consumer is entitled to the same rebate as if payment had been made on the date judgment is entered." UCCC §§ 2.210(8), 3.210(8) (1968); UCCC § 2.510(7) (1974). *See also* Hawaii Rev. Stat. § 408-15(f) (1985); Neb. Rev. Stat. § 45-137(2)(c) (1988); *W. Va. Code § 46A-3-111*.

(n24)Footnote 21. Such partial rebates may be required only for prepayments in the first 30 or 60 days of a loan. *See, e.g., Ohio Rev. Code Ann. §§ 1321.13* (Baldwin 1993) (small loans); 1321.57 (second mortgages) (if payment is made before first installment is due, lender may keep 1/30 of monthly finance charge per day loan was outstanding).

(n25)Footnote 22. *See, e.g., Ala. Code § 5-19-4* (1981 and Supp. 1993); Neb. Rev. Stat. § 45-137(2)(c) (1988); *Ohio Rev. Code Ann. §§ 1321.13, 1321.57* (1998); S.C. Dep't of Consumer Affairs 3.210-7609 Consumer Cred. Guide (CCH) P 98,318 (Oct. 21, 1976) (one day cannot be treated as one month for rebate purposes); *see also* Tex. Rev. Civ. Stat. Ann. § 5069-3.15(6)(b) (1987) (pro rata earnings for odd days when prepayment is not on installment date).

(n26)Footnote 23. *Compare Steele v. Ford Motor Credit Co., 783 F.2d 1016 (11th Cir. 1986)* (truth in lending case), *with In re Jones, 79 B.R. 233 (Bankr. E.D. Pa. 1987)* (state law permits use of Rule of 78 and rounding forward to allow a fraction of a month to be considered a full month). *See also Webster v. International Harvester Credit Corp., 51 Ohio App. 2d 192, 5 Ohio Op. 3d 332, 367 N.E.2d 924 (1977)* .

(n27)Footnote 24. For example, the Ohio RISA arbitrarily requires rounding in the borrower's favor only in the first ten days of the payment interval. *See Webster v. International Harvester Credit Corp., 51 Ohio App. 2d 192, 5 Ohio Op. 3d 332, 367 N.E.2d 924 (1977)* .

(n28)Footnote 25. *Cf. Steele v. Ford Motor Credit Co., 783 F.2d 1016 (11th Cir. 1986)* (hidden finance charge under Truth in Lending Act).

(n29)Footnote 26. *15 U.S.C. § 1615*. Consumer credit transactions have the same definition that they do in Truth in Lending, except that "creditor" includes any assignee. *15 U.S.C. § 1615(d)(3)*.

(n30)Footnote 27. Home Ownership and Equity Protection Act, *codified at 15 U.S.C. § 1639*. *See* Ch. 2 *supra*.

(n31)Footnote 28. *See, e.g., Zwayer v. Ford Motor Credit Co., 279 Ill. App. 3d 906, 216 Ill. Dec. 585, 665 N.E.2d*

843 (1996) (where court held that rebates computed by the Rule of 78s are not allowed where contract terms are ambiguous). Certain transactions may be subject to other federal law which may also prohibit the use of the Rule of 78, such as federally related loans secured by first liens on mobile homes. *See 12 C.F.R. § 590.4 (1994)*.

(n32)Footnote 29. *See, e.g., Walter E. Heller & Co. v. Mall, Inc., 267 F. Supp. 343 (E.D. La. 1967)* (pro rata refund of discount interest upon acceleration under Louisiana law); *Varner v. Century Fin. Corp., Inc., 253 Ga. 27, 317 S.E.2d 178 (1984)* (interpreting Off. Code Ga. Ann. § 7-4-2(b)(1) (effective Mar. 1, 1983)).

(n33)Footnote 30. *E.g., Ala. Code § 5-19-4(d)* (pro rata rebate if refinanced by same creditor or affiliate within 90 days).

(n34)Footnote 31. Bonker, *The Rule of 78,* XXXI Journal of Finance 877, 885 (No. 3, June 1976); Hunt, *The Rule of 78: Hidden Penalty for Prepayment in Consumer Credit Transactions, 55 B.U. L. Rev. 331 (1975). See § 6.03[3] supra*.

(n35)Footnote 32. *15 U.S.C. § 1615(d)*. Contrary state law will be preempted. For an explanation of how to calculate a Rule of 78 rebate, see National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges § 5.6.3.3.2 (2d ed. 2000).

(n36)Footnote 33. Even prior to the 1992 federal rebate statute, actuarial rebates were frequently required by state statutes and federal regulations, especially for contracts with longer terms and high principal amounts, because of the Rule of 78 inaccuracy for such transactions.

(n37)Footnote 34. James H. Hunt, *The Rule of 78: Hidden Penalty for Prepayment in Consumer Credit Transactions, 55 B.U. L. Rev. 331 (1975)*.

(n38)Footnote 35. For a discussion of how to calculate actuarial rebates, see National Consumer Law Center, The Cost of Credit, § 4.3.1 (4th ed. 2009).

(n39)Footnote 36. *See B.F. Saul Co. v. West End Park N., Inc., 250 Md. 707, 246 A.2d 591 (1968)* (distinguishing loans to which rebate statute applies).

(n40)Footnote 37. *E.g., Ala. Code § 5-19-19* (consumer credit code); *Iowa Code § 537.5201(2), (3)* (consumer credit code).

(n41)Footnote 38. *E.g., Mich. Comp. Laws § 445.868* (RISA).

(n42)Footnote 39. Since failure to rebate unearned interest results in excess charges, that should trigger any remedy authorized for excess charges. For such statutes, the question may be whether the excess was "charged," or whatever the operative verb in the statute is.

(n43)Footnote 40. Civil liability applies to violations of Parts B, D and E of TIL. *15 U.S.C. § 1640*. The rebate statute was codified in Part A, *15 U.S.C. § 1615*.

(n44)Footnote 41. The rebate statute defines creditor by reference to TIL's definition, but specifically includes assignees as creditors, as well. *15 U.S.C. § 1615(d)*.

(n45)Footnote 42. Reg. Z, *12 C.F.R. § 226.20(a). See, e.g., Steele v. Ford Motor Credit Co., 783 F.2d 1016 (11th Cir. 1986) . See generally* Ch. 1 *supra*. Note that this would also be the case when a creditor used the rule in violation of any other applicable statute. *See Steele, supra*.

(n46)Footnote 43. Reg. Z, *12 C.F.R. § 226.20(a). See, e.g., Steele v. Ford Motor Credit Co., 783 F.2d 1016 (11th Cir. 1986) . See generally* Ch. 1 *supra*. Note that this would also be the case when a creditor used the rule in violation of

any other applicable statute. *See Steele, supra*.

(n47)Footnote 44. That assumes, of course, that the creditor included the full payoff balance of the prior loan in the amount financed on the new loan. It is unlikely that a creditor would go to the trouble of separating out an illegal overcharge to properly account for it in its TIL calculations.

Even if it did so, arguably there is still a TIL violation. TIL requires that disclosures reflect the legal obligation, Reg. Z, *12 C.F.R. § 226.17(c)*. At least with respect to the finance charge, the legal obligation is to pay charges in accord with applicable law. Applicable law says that the consumer should not have to pay the excess charge at all, irrespective of whether denominated finance charge or amount financed, thus, all the financial disclosures would be skewed because the total loan should be less. *See In re Brown, 134 B.R. 134 (Bankr. E.D. Pa. 1991)* ; *see* Ch. 1, § 1.05[2][c], [e][ii] *supra*.

(n48)Footnote 45. *15 U.S.C. § 1640*; *see* Ch. 1, § 1.10[2], [3] *supra*; National Consumer Law Center, Truth in Lending §§ 8.5, 8.6 (6th ed. 2007 and supp.).

(n49)Footnote 46. For a discussion of scope issues under UDAP statutes, see National Consumer Law Center, Unfair and Deceptive Acts and Practices § 2.1.1 (7th ed. 2008 and supp.). For a discussion of UDAP damages, see *§ 4.06 supra*.

(n50)Footnote 47. 17A Am. Jur. 2d *Contracts* § 381.

(n51)Footnote 48. *E.g., C.C. Port, Ltd. v. Davis-Penn Mortgage Co., 61 F.3d 288 (5th Cir. 1995)* (Texas law); *Metropolitan Life Ins. Co. v. Strnad, 876 P.2d 1362 (Kan. 1994) . E.g., Norwest Bank v. Blair Road Assocs., 252 F. Supp. 2d 86, 97 (D.N.J. 2003)* ; *MONY Life Ins. Co. v. Paramus Parkway Bldg., Ltd., 834 A.2d 475 (N.J. Super. Ct. App. Div. 2003)* (commercial loan); *Westmark Commercial Mortgage Fund IV v. Teenform Assocs., 827 A.2d 1154 (N.J. Super. Ct. App. Div. 2003)* (commercial loan).

(n52)Footnote 49. *E.g., Del. Code tit. 6, § 4322* (RISA: right to prepay and receive rebate of unearned interest); *Md. Code Ann. Com. Law § 12-308* (consumer loan law); *Miss. Code § 63-19-47* (MVRISA: same); *Garver v. Brace, 47 Cal. App. 4th 995, 55 Cal. Rptr. 2d 220 (1996)* (prohibitions and limitations in *Cal. Civ. Code § 2954.9(b)* against prepayment penalty in mortgages on owner-occupied residential real property is extended to include the situation where the borrower builds a home on the property after the loan is executed, but before the prepayment fee is paid). *See also Nelson v. Associates Fin. Servs. Co., 253 Mich. App. 580, 659 N.W.2d 635 (Mich. Ct. App. 2002)* (construing *Mich. Comp. Laws §§ 438.31* and *438.31c* to place cap on prepayment penalties for certain deregulated first mortgage loans); *Glukowsky v. Equity One, Inc., 360 N.J. Super. 1, 821 A.2d 485 (App. Div. 2003)* (New Jersey law prohibits prepayment penalty; OTS regulation preempting state prepayment penalty laws is invalid as exceeding OTS's authority). *Cf. In re Curtis, 83 B.R. 853 (Bankr. S.D. Ga. 1988)* (Ga. Code Ann. § 57-101(6)(2) (1988 & Supp. 1993) prohibits prepayment penalties only in absence of contractual agreement for one; court validated express provision for prepayment penalty of 3 year's interest). *But compare George v. Fowler, 978 P.2d 565 (Wash. App. 1999)* (clause prohibiting prepayment is valid in absence of legislative ban on such clauses).

(n53)Footnote 50. Note that even if the statute does not spell out the right to prepay, that right is implicit in any statute which requires a rebate upon prepayment.

(n54)Footnote 51. The existence of a statute requiring rebates upon prepayment, in the absence of a statute compelling rebates upon default and acceleration, need not, however, be read as allowing the retention of unearned interest upon acceleration. *See* Glacier Lincoln-Mercury, Inc. v. Freeman, Consumer Cred. Guide (CCH) P 99,567 (Alaska Dist. Ct. 1970).

(n55)Footnote 52. See Ch. 2 *supra* for an explanation of the Act's scope. The background of this legislation, and the issues arising under it, are discussed more fully in National Consumer Law Center, *Truth in Lending* Chapter 9 (6th

ed. 2007).

(n56)Footnote 53. *15 U.S.C. § 1639(c)(1).*

(n57)Footnote 54. A prepayment penalty, including use of the Rule of 78 to calculate rebates in loans with terms of 60 months or less (use of the Rule in all consumer credit transactions with terms 61 months is prohibited in any event), may be imposed where *all* elements of a five-prong exception are met as set out in *15 U.S.C. §§ 1639(c)*

(n58)Footnote 55. For a general discussion of federal preemption of mortgage loan limitations, see *§§ 6.02[4] et seq. supra*. Note, however, that federal preemption of usury ceilings on first mortgage loans under § 501 of DIDA does not preempt state limitations on prepayment charges. *12 C.F.R. § 590.3(c). See also* S. Rep. No. 368, 96th Cong., 2d Sess. 19, *reprinted in* 1980 U.S.C.C.A.N. 236, 255. Further, state-chartered S&L's or other housing creditors may not invoke federal preemption under AMTPA to circumvent state restrictions on prepayment penalties. *12 C.F.R. §§ 560.34, 560.220 (1996).* Non-depository lenders who regularly make loans or credit sales secured by residential realty or mobile homes may impose prepayment penalties in loans that fall under the Alternative Mortgage Parity Act. *See 12 C.F.R. § 560.220* (allowing housing creditors to make alternative mortgage transactions, which under *12 C.F.R. § 560.34* may include prepayment penalties). *See National Home Equity Mortg. Ass'n v. Face, 239 F.3d 633 (4th Cir. 2001) , cert. denied, 534 U.S. 823, 122 S. Ct. 58, 151 L. Ed. 2d 26 (2001)* ; *McCarthy v. Option One Mortg. Corp., 2001 U.S. Dist. LEXIS 22711* (N.D. Ill. Feb. 11, 2001) (non-federally chartered housing creditor can charge prepayment penalty, but only if it complies with OTS regulations); *Shinn v. Encore Mortg. Servs., 96 F. Supp. 2d 419 (D.N.J. 2000)* (housing creditor that complied with OTS regulations could charge prepayment penalty notwithstanding state law restrictions).

(n59)Footnote 56. *See 12 C.F.R. §§ 34.23, 34.24 (1996)* (Regulations of the Comptroller of the Currency).

(n60)Footnote 57. Prepayment penalties must be disclosed under *12 C.F.R. § 560.210 (1996).*

(n61)Footnote 58. *12 C.F.R. § 560.220* (allowing housing creditors to make alternative mortgage transactions, which under *12 C.F.R. § 560.34* may include prepayment penalties). *See Nat'l Home Equity Mortg. Assn. v. Face, 239 F.3d 633 (4th Cir. 2001) .*

(n62)Footnote 59. *12 C.F.R. § 560.220* (as amended by *67 Fed. Reg. 60,542* (Sept. 26, 2002)) ; *see Nat'l Home Equity Mortgage Ass'n v. Office of Thrift Supervision, 271 F. Supp. 2d 264 (D.D.C. 2003)* (upholding amended regulation as within discretion of OTS).

(n63)Footnote 60. *12 C.F.R. § 560.220* (allowing housing creditors to make alternative mortgage transactions, which under *12 C.F.R. § 560.34* may include prepayment penalties). *See National Home Equity Mortgage Assn. v. Face, 239 F.3d 633 (4th Cir. 2001)* ; *McCarthy v. Option One Mortgage Corp., 2001 U.S. Dist. LEXIS 22711* (N.D. Ill. Feb. 11, 2001) (non-federally chartered housing creditor can charge prepayment penalty, but only if it complies with OTS regulations); *Shinn v. Encore Mortgage Servs., 96 F. Supp. 2d 419 (D.N.J. 2000)* (housing creditor that complied with OTS regulations could charge prepayment penalty notwithstanding state law restrictions).

(n64)Footnote 61. *See 12 C.F.R. § 701.21(c)(6) (1993).*

(n65)Footnote 62. *See 24 C.F.R. §§ 201.17, 203.22(b) (1993).*

(n66)Footnote 63. *12 C.F.R. § 591.5.*

(n67)Footnote 63.1. *Bednar v. Provident Bank, 937 A.2d 210 (Md. 2007) .*

(n68)Footnote 64. *15 U.S.C. § 1615.*

(n69)Footnote 65. *See* Home Ownership and Equity Protection Act, Ch. 2 *supra* .

(n70)Footnote 66. *15 U.S.C. § 1639(c)(2)(D).*

(n71)Footnote 67. Home Ownership & Equity Protection Act, at § 151(e)(2)(C), *amending 15 U.S.C. § 1610(b).* Effective October 1, 2009, the Federal Reserve Board has narrowed this exception in two ways: (1) a prepayment penalty is allowed only during the first two rather than five years of a covered loan; (2) prepayment penalties are prohibited for covered loans if the consumer's payments can change during the first four years after consummation. 26 C.F.R. § 226.32(d)(6), (7), *as amended by 73 Fed. Reg. 44,522, 44,511* /-/44,517, 44,603 (July 30, 2008).

In addition, effective October 1, 2009, the Board has extended many of these restrictions on prepayment penalties to a class of non-HOEPA "higher-priced mortgage loans" that carry rates a certain number of points above prime. 26 C.F.R. § 226.35, *as adopted by 73 Fed. Reg. 44,522, 44,511* /-/44,517, 44,603/-/44,604 (July 30, 2008).

(n72)Footnote 68. Singer, Sutherland Statutory Construction P 71.01 (5th ed.) *See § 6.07[2] infra*; *see also* National Consumer Law Center, Truth in Lending § 1.4.2.3 (6th ed. 2007 and supp.).

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PART I Consumer Credit
CHAPTER 6 The Cost of Credit

1-6 Consumer Credit Law Manual § 6.04

§ 6.04 The Cost of Refinancing: Calculation and Legal Issues

[1] Introduction

Refinancing, in the right circumstances, and with the right lender, is a good deal for both parties, but it is not always mutually beneficial. It can be a trap for unwary consumers, and it is on the hidden costs which can attend refinancing from some lenders that this chapter focuses.

At the outset, it may be helpful to define some of the terms which are used to describe different kinds of credit renewals. While "refinancing" is seldom statutorily defined, it means to "finance something new," usually after a renegotiation of credit terms. n1 On paper, a "refinancing" is a new loan, generally between an existing creditor and debtor, the proceeds of which are used to pay off the pre-existing debt.

"Consolidation" converts several debts into one new debt. The greatest abuse of consolidation occurs when several short-term, low-interest loans are consolidated into one very expensive loan, secured by the equity in the borrower's home. Consolidation may also occur when a pre-existing debt with the same lender is refinanced and a new advance is made. Whether the amount of a new advance is sufficient to change its character as refinanced debt may be important, for there are instances in which there are limits on the charges which can be imposed on a refinanced loan.

The term "flipping" may be used to describe refinancing in general, though it is sometimes used more restrictively to describe situations in which new credit is extended at a higher rate than the refinanced credit. This chapter generally uses the former, broader meaning.

[2] Usurious Taint in Refinanced Obligations

Because consumer debt is frequently refinanced, it is important to consider the extent to which the presence of usury in one obligation affects the validity of a subsequent agreement n2 that renews or extends the outstanding debt.

The rule followed by almost all courts is that once a debt is tainted by usury, the usury will follow the debt through any number of renewal transactions. n3 Depending on the state, the taint may invalidate the new obligation to the same extent that it invalidated the original transaction. n4

Despite the general rule against the purging of usury through renewal or replacement contracts, the courts do recognize circumstances under which the usury in one obligation will not taint a subsequent transaction between the parties. If the debt created by the first transaction forms no part of the consideration for the second obligation, then the two notes will be viewed as distinct, and usury in one note will not affect the legality of the other, unless the two are actually parts of a single usurious scheme. n5 This exception to the general rule of taint, however, is merely a statement that a second note between two parties will not be affected by usury in the prior note if, in fact, it is not a renewal of the previous note. Since refinancing transactions by definition involve the renewal of outstanding debt, this exception should seldom be of concern to advocates considering taint in refinanced obligations.

There is a more serious limitation to the rule that the taint of usury will follow a debt through a renewal transaction. It is widely recognized that a usurious obligation may be purged of its usury by a subsequent agreement between the parties through which the usurious contract is completely abandoned with the "full knowledge and consent" of the borrower, and "new or independent" consideration is provided for the new contract. n6 In other words, courts allow usury to be purged through a "novation," which they regard as distinct from a mere "renewal." Even so, few courts have provided much guidance for distinguishing the two transactions. The most logical rule for distinguishing between renewals and novations is that a refinancing may not be seen as a novation which purges a debt of usury unless the transaction in some manner credits the borrower with the amount of the usurious charges assessed in the previous transaction. n7

[3] The Cost of Refinancings: Evaluating the Calculations

This section outlines the basic steps for advocates in evaluating the various refinancing calculations. n8

The first step for the advocate is to check the regulatory statute applicable to a refinancing transaction to determine two things: the charges which must be rebated from the prior loan; n9 and the formula to be used in computing those rebates. n10 All states require that credit insurance be cancelled and rebates given upon refinancing. n11 Precomputed interest also must be rebated. n12 If refunds are not made or if the wrong formula is used--one which would result in a higher "earned" premium or interest figure than the prescribed formula--the transaction is subject to challenge for illegal overcharge. n13 Even a lender who uses the proper rebate formula may apply it improperly.

The calculation should then be checked to see whether, in determining the pay-off on the prior loan, the lender improperly compounded interest.

The general rule about compounding is that interest may be charged on accrued unpaid interest by an agreement made after the interest becomes due. n14 However, the applicable statute should be carefully reviewed.

Another red flag for advocates is the characterization of portions of the finance charge as non-rebatable fees, such as service charges or points of loan origination fees. Many statutes specifically authorize the imposition of service charges or points either in a prescribed amount or in a "reasonable" amount. To the extent the service charge imposed falls within the statutorily prescribed limit, the failure to rebate is probably legitimate. n15 (If they exceed the statutory limit, of course, they are subject to attack.) n16

Even absent a clear statutory prohibition, issues concerning the legality of such charges may arise where there is no affirmative authorization for them. The imposition of the charge itself may violate the statute. n17 Alternatively, if the points are "financed," their inclusion in the principal of the loan may give rise to illegal compounding. n18 Even if points are allowed and the *de facto* compounding that they involve is disregarded, it still is arguable that their effect in limiting rebates creates an illegal overcharge.

In addition, the advocate should examine the new refinancing transaction and check the legitimacy of any new charges imposed. For example, some regulatory statutes explicitly prohibit imposing any points, service charges, or administrative fees on loans which are refinanced within a specified amount of time, commonly six months to one year.

n19 In some cases, the rate increase on a new loan can be challenged. A few states explicitly restrict the right of a lender to raise the interest rate on a refinanced loan. n20

More common than such general rate restrictions on refinancings are provisions in Retail Installment Sales Acts ("RISAs"), which provide that refinanced sales contracts retain their character as sales contracts, subject to the terms of the RISA. n21 Many of the RISA statutes which have this restriction apply to all *holders* of retail sales contracts, not just to the original seller. n22 Requiring that refinanced contracts continue to be treated under the terms of the RISA when refinanced by a "holder" prevents the finance company from treating it as a loan regulated by the small loan law. (The same incentive to flip applies when the RISA is rate regulated, but a consumer loan is not.)

Finally, refinancing should be carefully considered as a useful option for borrowers facing foreclosure. Refinancing may prevent the loss of the home, or it may get the borrower deeper in debt. It is important for advocates to make a realistic assessment of a client's financial capabilities, examine the existing loan to determine what claims and defenses exist and examine both the existing and new mortgage extensions. n23

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawFederal ActsGeneral OverviewBanking LawNational BanksInterest & UsuryGeneral OverviewBanking LawNational BanksInterest & UsuryInterestBanking LawNational BanksInterest & UsuryUsury LitigationContracts LawDebtor & Creditor Relations

FOOTNOTES:
(n1)Footnote 1. *Springhill Lake Invs. Ltd. v. Prince George's County, 114 Md. App. 420, 690 A.2d 535 (1997)* (definition of refinancing was in context of imposition of transfer taxes by county recordation offices). *Bar Harbor Bank & Trust v. Superintendent of Bureau of Consumer Protection, 471 A.2d 292 (Me. 1984)* ; *Moore v. Canal Nat'l Bank, 409 A.2d 679, 684 (Me. 1979)* . The terms renewal and refinancing are generally used interchangeably. *See supra*, *Bar Harbor Bank & Trust, 471 A.2d at 295* .

(n2)Footnote 2. It is critical to note that this section on "taint" addresses the effect of subsequent *agreements between the same parties* on the continued existence of usury. There are two points here. First, some agreement is required before any purging of usury is possible. Unless expressly authorized by statute, a creditor cannot purge a debt of usury through its own unilateral action. *See, e.g., Duderwicz v. Sweetwater Sav. Ass'n, 595 F.2d 1008 (5th Cir. 1979)* ; *Davidson v. Commercial Credit Equip. Corp., 255 Ark. 127, 499 S.W.2d 68 (1973)* (subsequent disclaimer); *United-Bilt Homes, Inc. v. Teague, 245 Ark. 132, 432 S.W.2d 1 (1968)* (suit for legal interest only does not purge usury); *Yakutsk v. Alfino, 43 A.D. 2d 552, 349 N.Y.S.2d 718 (1973)* ; *Danziger v. San Jacinto Sav. Ass'n, 732 S.W.2d 300 (Tex. 1987)* ; *Financial Commerce, Inc. v. McLean, 73 Wash. 2d 52, 435 P.2d 932 (1968)* . Second, if a borrower pays off a usurious loan from one lender with the proceeds of a non-usurious loan from a second, *unrelated* lender, then the second note will generally not be tainted by the usury in the first.

(n3)Footnote 3. *See, e.g., Bowen v. Mt. Vernon Sav. Bank, 105 F.2d 796 (D.C. Cir. 1939)* ; *In re Feldman, 259 F. Supp. 218 (D. Conn. 1966)* ; *Family Fed. Sav. & Loan v. Davis (In re Davis), 172 B.R. 437 (Bankr. D.D.C. 1994)* ; *Lentino v. Cullen Ctr. Bank & Trust, 919 S.W.2d 743 (Tex. App. 1996)* ; *Sanders v. Barron, 291 Ala. 407, 282 So. 2d 237 (1973)* ; *American Sav. Life Ins. Co. v. Financial Affairs Mgmt. Co., 13 Ariz. App. 44, 474 P.2d 51 (1970)* . *See generally* 47 C.J.S. *Interest & Usury* §§ 183-188.

(n4)Footnote 4. *See, e.g., In re Feldman, 259 F. Supp. 218 (D. Conn. 1966)* (both principal and interest uncollectible); *Henson v. Dixie Fin. Corp. of Ga., 250 Ga. 132, 296 S.E.2d 593 (1982)* (interest and charges on original usurious loan forfeited, but lender may recover legal interest on new cash advanced upon refinancing).

(n5)Footnote 5. *Compare Brookshire v. Coffman, 287 Ark. 112, 696 S.W.2d 748 (1985)* (single usurious scheme),

and Johnson v. Ronamy Consumer Credit Corp., 515 A.2d 682 (Del. 1986) (second mortgage and collateral guarantees were parts of single unenforceable transaction), *with Thomas v. Estes, 139 Ga. App. 738, 229 S.E.2d 538 (1976)* (separate transactions). Similarly, a valid obligation will not be tainted by subsequent usurious agreements between the parties. *See Dichter v. Viking Office Prods., Inc., 501 N.Y.S.2d 420 (App. Div. 1986)* .

(n6)Footnote 6. *See American Sav. Life Ins. Co. v. Financial Affairs Mgmt. Co., 13 Ariz. App. 44, 474 P.2d 51 (1970)* (stating rule). For cases holding that a new agreement purged an outstanding debt of usury, see *Kogan v. Bergman, 244 Cal. App. 2d 613, 53 Cal. Rptr. 371 (1966)* ; *Ronen v. Teer, 94 Idaho 811, 498 P.2d 1284 (1972)* ; *Matter of Estate of Jackson, 508 N.Y.S.2d 671 (App. Div. 1986)* (borrower failed to meet his burden of proof).

(n7)Footnote 7. *See Bowen v. Mt. Vernon Sav. Bank, 105 F.2d 796 (D.C. Cir. 1939)* ; *Family Fed. Sav. & Loan v. Davis (In re Davis), 172 B.R. 437 (Bankr. D.D.C. 1994)* (lender not only did not purge original loan of usury, but condoned further unscrupulous activity by third parties in the process of settling litigation over the original loan); *In re Bishop, 79 B.R. 94 (Bankr. D.D.C. 1987)* ; *Whittemore Homes, Inc. v. Fleishman, 190 Cal. App. 2d 554, 12 Cal. Rptr. 235 (4th Dist. 1961)* ; *Henson v. Dixie Fin. Corp., 250 Ga. 132, 296 S.E.2d 593 (1982)* .

(n8)Footnote 8. The elements of refinancings that lead to additional costs can be complex. A number of case studies are discussed in National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 6.3 (4th ed. 2009).

(n9)Footnote 9. *See § 6.03[3] supra*.

(n10)Footnote 10. *See § 6.03[4][b] supra*.

(n11)Footnote 11. *See § 6.06[5] infra*. Usually, rebates of less than $1.00 need not be made.

(n12)Footnote 12. *See generally § 6.03 supra*.

(n13)Footnote 13. *See generally § 6.03 supra. See also In re Jungkurth, 74 B.R. 323 (Bankr. E.D. Pa. 1987)* ; *In re Tucker, 74 B.R. 923, 927 (Bankr. E.D. Pa. 1987)* ("[A]ny formula other than the 'actuarial method' of calculating rebates, unless such a formula is specifically authorized by state law, would constitute the imposition of a prepayment penalty and hence be usurious").

(n14)Footnote 14. *See, e.g., Smith v. MRCC P'ship, 792 S.W.2d 301 (Ark. 1990)* (not usury to add accrued, unpaid interest on antecedent debt to principal on new debt and write new contract with maximum legal rate of interest on whole amount).

(n15)Footnote 15. *In re Tucker, 74 B.R. 923 (Bankr. E.D. Pa. 1987)* (though persuasive authority and public policy suggest a service charge *should* be rebated, the controlling statute makes it clear that no such rebate is required).

(n16)Footnote 16. *E.g., Williams v. Seeley (In re Williams), 241 B.R. 387 (Bankr. E.D. Va. 1999)* , *rev'd in part, 2001 U.S. App. LEXIS 13246* (4th Cir. June 13, 2001) (points are not considered "paid" at outset of transaction when lender merely reserves them from the proceeds of the loan, so they could not be part of penalty under statutory formula); *Mayo v. Key Fin. Servs., Inc., 1994 Mass. Super. LEXIS 549* (Mass. Super. Ct. June 22, 1994) (implied private right of action for violation of statute limiting points; assertable by a suitable common law remedy; borrowers choose to assert common law restitution). If refinanced, the excess would taint the new loan, as well. *See § 6.04[2] supra*.

(n17)Footnote 17. Also, some statutes, such as small loan laws, for example, list the charges that a creditor is permitted to assess and prohibit the imposition of all "other charges." The imposition of an unauthorized charge violates the statute even if the effective interest rate charged is below the small loan ceiling. *See, e.g., Ex Parte New Fin. Ltd., 284 Ala. 374, 225 So. 2d 782, 784 (1969)* ; *see also Attorney Gen. of Md. v. Equitable Trust Co., 450 A.2d 1273, 1292 (Md. Ct. App. 1982)* .

(n18)Footnote 18. A counter argument to the claim of compounding is the notion that interest charges should be "spread" over the term of the loan when calculating the rate charged. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 4.6.6 (4th ed. 2009). However, spreading does not preclude the need for rebates of portions of the "up-front" fees merely because it assumes that fees are earned throughout the term of a loan.

(n19)Footnote 19. *E.g., Cal. Fin. Code § 18212.2* (West 1989) (Industrial Loan Act). *See also* Colo. Rev. Stat. § 5-3-206.5(2) (Supp. 1993).

(n20)Footnote 20. For example, in Iowa, if the rate on the original loan exceeded 18%, the rate cannot be increased on the refinancing of the unpaid balance. *Iowa Code Ann. § 537.2504* (West 1987 & Supp. 1994).

(n21)Footnote 21. *E.g., Cal. Civ. Code § 1807.2* (Supp. 1994); Mass. Gen. Laws Ann. 255D, § 17 (1988); *Mich. Comp. Laws Ann. § 445.861(d)(2)* (1989); *69 Pa. Stat. § 1702* (1994). Also, a number of RISA statutes provide protections regarding the right to refinance a balloon payment on a RISA contract. *See, e.g., Cal. Civ. Code § 1807.3* (1985).

(n22)Footnote 22. *E.g., Cal. Civ. Code § 1807.2* (Supp. 1994); Mass. Gen. Laws Ann. 255D, § 17 (1988); *Mich. Comp. Laws Ann. § 445.861(d)(2)* (1989); *69 Pa. Stat. § 1702* (1994). Also, a number of RISA statutes provide protections regarding the right to refinance a balloon payment on a RISA contract. *See, e.g., Cal. Civ. Code § 1807.3* (1985).

(n23)Footnote 23. For a general discussion of this topic and practice tips for evaluating refinancing as a way out of real estate mortgage foreclosure, see *§ 13.03[6] infra*. *See also* National Consumer Law Center, Foreclosures § 2.11(2d ed. 2007).

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PART I Consumer Credit
CHAPTER 6 The Cost of Credit

1-6 Consumer Credit Law Manual § 6.05

§ 6.05 Hidden Interest

[1] Overview

For as long as usury restrictions have existed, creditors have attempted to circumvent their limitations. These tactics are addressed in this section under the title of "hidden interest." For the purposes of this section, "hidden interest" refers to charges or other consideration paid in conjunction with a credit contract, which are classified as interest under state law regulating the transaction but which are not described as such, or are not described at all, in the contract, and which are consequently not included in the stated interest rate.

To use a simple example, if a lender charges the maximum interest rate on the face of a loan contract and, in addition, imposes a $100 "loan fee," that fee may constitute usurious hidden interest unless it is specifically allowed as a non-interest charge under state law.

[2] Payments for Lender Services: What Is Interest?

[a] Fees Based on the Creditor's Expenses

"Interest" can be defined as compensation paid to a lender for the use of money or the forbearance of a debt. n1 Broadly applied, such a definition would include any payment to a lender, regardless of whether the lender used the payment to cover expenses or instead attributed it to profit. However, in an attempt to circumvent the interest ceilings set by statute or agreement and to disguise the actual costs of a loan to the borrower, creditors have traditionally argued that certain specific expenses associated with a loan, such as closing costs or credit insurance, especially those costs attributable to third party services, n2 are not compensation for the loan and therefore not "interest."

This approach is widely accepted under state law even when the separate services primarily benefit the lender. n3 As a general rule, recognized lender fees may be excluded from interest if they compensate the lender for reasonable expenses actually incurred in connection with a particular loan. n4 Following the same approach, any charge which cannot be attributed to a specific loan-related expense is designed merely to cover the lender's overhead expenses or to contribute to its profit, and is interest on the loan unless a statute specifically says otherwise. n5

In the automobile financing context, dealers have begun to separately impose charges for specific "services." Fees

commonly added to the cost of a car include delivery and handling fees, and conveyance charges (imposed to register title to the vehicle with the state motor vehicle department). These fees may constitute interest when the dealer is the lender for a variety of reasons. The dealer may not perform the service, may inflate the actual cost, or may be reimbursed by a third party, such as the manufacturer, for the cost. Further, the state retail sales installment act may limit the types of fees which the lender may impose. Fees not specifically allowed should constitute interest and support an usury claim. Such fees may also be challenged under state UDAP acts n6 and the Truth in Lending Act. n7

Because the types and amounts of fees which may be excluded from interest vary widely from state to state and may, within any state, vary with the class of lender and loan, the first step to determine whether a lender has properly excluded specific fees from interest on a contract must be to check the relevant state code.

Loan document preparation fees present an interesting issue that other fees do not. In addition to the potential claim that these fees may not be authorized by state law and that they may be interest, advocates should explore whether the entity preparing the documents was engaged in the unauthorized practice of law. If the lender or other entity charged a fee for preparing or filling in the blanks on legal documents and this activity was incidental to the entity's business, the lender or entity may be engaged in the unauthorized practice of law. For example, in *Lawson v. First Union Mortgage Co.*, the Indiana Court of Appeals reversed the trial court's dismissal of a equitable claim for return of a document preparation fee, holding that while a lender's lay employees did not commit the unauthorized practice of law by preparing mortgage loan documents, the lender could not charge a separate fee for such documents. n8

[b] Points, Commitment Fees, and Other Percentage Fees

One type of ostensibly non-interest charge which has been increasingly used and misused by lenders in recent years is a fee calculated as a percentage of loan principal. Depending on the type of lender and loan involved, this fee may be variously described as an "origination fee," "commitment fee," "service charge," or "loan fee," but is perhaps best known as "points" or "discount points," with one point being a sum equal to one percent of the loan principal. n9

Points are essentially a "bonus": An additional incentive or inducement supposedly offered to the lender to convince it to issue a loan. As such, it is logically very difficult to characterize points as anything but interest. n10

When statutes do not address the issue, lenders carry the burden of demonstrating that points and other fees are justified by actual recognized costs associated with a loan, and are not merely extra profit or compensation for overhead expense. n11 In the case of points, it is a burden that lenders can seldom carry, and numerous courts have found points and similar fees to constitute hidden interest. n12

More commonly, the relevant state statute specifically permits the exclusion of points, often allowing one or two points to be excluded from interest. n13 Sometimes this exclusion is granted in lieu of permitting other charges to be passed on to borrowers. n14 In any event, the existence of such statutes is helpful to consumers in at least one way: by specifying how many points and other fees may be excluded from interest, these statutes clearly imply that any additional fees are to be treated as interest. n15

When statutes do not control this issue, a few courts have recognized the exclusion of a percentage fee from interest in one other situation: the commitment fee. Commitment fees are found mainly in commercial loans and are assessed when a lender agrees to hold open a line of credit for a certain time, at a given interest rate. Some courts have viewed commitment fees as proper non-interest compensation due to the lender for granting the borrower an ongoing option to borrow money, n16 although there is authority for the position that the fee must be reasonable to be excluded from "interest." n17 Other courts have held that commitment fees merely compensate the lender for normal overhead risk involved in lending and are, therefore, interest. n18

A variation on commitment fees is the "rate lock fee," which consumers pay to obtain a certain interest rate for a

mortgage. However, this fee is different in that it does not guarantee the option to borrow, but instead guarantees the price of borrowing if the loan is approved.

[c] Non-Cash Compensation and Side Agreements

Payments to a creditor under a contract may take forms other than the stated interest or the various cash fees, such as points and service charges. Non-cash bonuses may also be exacted by lenders in consideration for the extension of credit, and may constitute hidden interest in the same manner as cash payments. n19 For example, the borrower's agreement to guarantee or cosign a third party debt owed to the lender may be interest on the contract, n20 as may a sharing of rents from mortgaged property. n21

A major impediment to the claim that non-cash bonuses are hidden interest may be encountered if the benefit to the lender is contingent n22 or if the value of the bonus for some other reason cannot be quantified. This problem arises most frequently when a loan contract grants the lender a share of the profits from the borrower's business or investment in consideration for making the loan.

[d] Delinquency Charges

Late fees, like any other payments made to a lender, are a potential source of hidden interest and should be closely scrutinized. n23 A lender's ability to exclude late charges from interest on a contract varies widely from state to state, and reference to the relevant state's statutes and case law is essential to the analysis of any particular case. This section will examine the various general approaches taken by courts considering whether late fees should be classified as interest. n24

The general rule is that late fees are excluded from interest because the fees are avoidable or, more precisely, are contingent on the performance of the borrower. n25 The logic of this common law approach is questionable in many consumer credit cases because the late payment is often not so much a matter of the borrower's voluntary decision as one of economic necessity. n26

A second justification for the imposition of late fees is that such fees compensate creditors for expenses incurred when payments are made late, such as dunning costs n27 and loss of use of the principal which was due.

Statutes which govern late fees are generally more advantageous for consumers than this general common law rule. First, the limits of the permissible fees are often specified, and late fees will clearly be interest to the extent that they exceed the statutory limit. n28

Second, fees assessed prior to the expiration of statutory grace periods constitute interest. n29 Third, statutes governing late payment fees may contain other requirements in addition to capping the amount of the fee. Failure to meet those requirements may also give rise to a usury claim. A late fee may also be challengeable under contract or other theories. Finally, not all statutes which regulate lender fees permit any exclusion of late fees from interest. Courts in several states have determined that late fees fall within statutory definitions of interest in the absence of an express statutory exception. n30

This analysis may be clouded by recent developments regarding interstate banking and deregulation and rate exportation. To help the banks, the legislatures in states wanting to attract this industry have declared non-interest charges, including late fees, to be interest. n31 The cases considering late fees as interest in this context of interstate rate exportation and preemption have found them to be so, n32 as have bank regulatory agencies. n33

These cases have arisen in context of the laws of a deregulated state (the lender's home state) preempting the consumer protection laws of a regulated state (the borrower's home state), so it is the consumers who have lost by classifying late

fees as interest in these cases. n34

[3] Payments for Third Party Services

Third party payments may cover a myriad of services: brokers' fees, appraisal fees, recording fees, credit insurance, inspection fees, and attorneys' fees, to name but a few. Case law and statutes generally exclude reasonable, bona fide third party payments from interest on credit contracts. n35 Despite this general rule, hidden interest issues arise in several important situations.

One example of a third party payment which has frequently been revealed to be usurious hidden interest is the commission charged by a loan broker. Fees to bona fide third party brokers are valid third party expenses in most jurisdictions n36 and are expressly regulated in some states. n37 However, numerous courts have held that brokers' fees are interest on a loan when the broker is an agent of the lender and, hence, is not a bona fide third party. n38

Attorneys whose clients have been assessed brokers' fees should closely examine the transaction. As with other third party payments, fees which are collected when no third party exists, which are never forwarded to a third party, or which are kicked back to the lender, are interest. n39 Furthermore, illegal broker's fees exacted with the knowledge of the lender have been treated as interest. n40 When broker fees have been paid to apparently independent brokers, attorneys should examine the relationship between the broker and lender for a possible agency relationship. n41

Advocates should also note that the Real Estate Settlement Procedure Act ("RESPA"), now applicable to most home equity loans, has an anti-kickback provision which may be implicated in some broker-lender arrangements. n42

Another common third party payment is for attorneys' services. If the recovery is authorized by contract, most states allow creditors to obtain a judgment for the attorneys' fees that they incurred in collecting a debt from a defaulting debtor. n43 There are limits on the recovery but there seems to be general agreement that contractual provisions for the payment of attorneys' fee in the event of default are exempt from usury restrictions unless they are somehow used as a "cloak" for usury. n44

Charges for the services of an attorney in preparing loan papers or searching real estate title are quite different from charges associated with debt collection. Some courts have ruled that a creditor's charge for legal fees incurred in loan preparation are merely overhead expense and, as such, are interest subject to usury law. n45 Other courts have been more lenient with creditors and have ruled that such attorneys' fees, if paid to a bona fide third party attorney, n46 are valid third party expenses which may be charged to the borrower without being treated as interest. n47 As with other types of closing costs, applicable statutes may dictate the appropriate treatment of attorneys' fees for this type of service. n48

[4] Interest Hidden When Principal Amount Is Overstated

Another way of hiding interest is to exaggerate the amount of principal which a borrower has received. Undoubtedly the most common technique used to inflate loan principal is the inclusion of various fees in the face amount of the note signed by the borrower.

At least two usury issues are raised by such transactions. First, as discussed above, a consumer's attorney must question whether the fees assessed by the creditor fall within the definition of interest under state law.

In addition, if a lender finances hidden interest fees, this means that the face amount of the note signed by the borrower includes interest charges. Since the lender charges interest on the full face amount of the notice including the hidden interest, it will also be assessing interest on interest or compounding.

The presence of compounding raises issues beyond the legality of the effective interest rate charged by the lender. Courts traditionally frown upon the use of compound interest, and merely the presence of compounding may be treated as a contract overcharge in some jurisdictions, even when the usury ceiling has not been breached. n49

Also, if the insurance is required as part of the credit transaction, the fee may be illegal under state law for this reason. n50

A fairly novel transaction in which interest may be hidden by the exaggeration of the loan principal is the "wraparound" mortgage. A wraparound mortgage is defined as a junior mortgage which secures a promissory note, the face amount of which is equal to the sum of: (1) the principal balance remaining on the existing senior mortgage; and (2) any additional money advanced by the wraparound lender. n51 Wraparound mortgages may be structured either as purchase money mortgages or as mortgages executed for refinancing purposes. n52 Litigation testing the validity of wraparound mortgages under state usury laws is quite sparse. n53

In general, the validity of wraparound mortgages will probably be determined by the definitions of principal and interest in individual usury statutes. n54 Wraparounds have been expressly validated in some state codes, n55 but may be prohibited by the provisions of some second mortgage statutes. The terms of the individual statutes should be carefully examined to determine whether the lender may include any sum not actually advanced to the borrower in the principal of the note.

Interest can also be hidden in the price of goods purchased on credit. At least, in theory, the concealment of interest in an inflated cash price should cause a usury violation as well, if the true interest rate exceeds the statutory limit. However, several obstacles to an assertion of usury exist, including the traditional "time price" exception to the state usury laws, which means that a state has no usury ceiling for bona fide sales of goods and a seller can charge whatever time price it can extract, short of unconscionability.

A special method by which interest costs may be hidden in the sale price of goods or real estate is the use of "seller's points," which occur most frequently in real estate transactions when the real estate seller, typically a builder, pays points to a bank or other lender in return for the lender's commitment to issue "low-interest" loans to qualified buyers. Such an arrangement might appear to be a boon to buyers and, indeed, seller's points would not be deceptive or usurious if the seller did not recover its expense by raising the selling price of the real estate. In real life, however, seller's points are frequently, if not invariably, just a sales gimmick whose cost is passed on to the buyer in the form of an inflated sale price. n56

The main problem is that under the current version of Regulation Z, discounts for payments by cash instead of credit must be disclosed as finance charges for TILA purposes, n57 while seller's points need not be, even if the points are passed on to the buyer. n58

The open conflict between the seller's points loophole and the requirement that discounts for cash payment be disclosed as a finance charge has yet to be litigated. In light of this uncertainty, the validity of seller's points under state usury laws becomes a particularly important issue. n59

[5] Hidden Interest in "Non-Credit" Transactions

Perhaps the ultimate way to hide interest in a credit contract is to conceal the very fact that credit is being extended. This section presents a non-exhaustive discussion of common "non-credit" hidden interest transactions.

One of the egregious forms of hidden interest occurs when a debtor, seeking to obtain or refinance a mortgage, ends up selling his or her home instead. The courts have recognized that such "sales" with repurchase options may, in fact, be usurious loans and that the deeds at issue should be construed to be equitable mortgages. n60 A sale/repurchase or

sale/leaseback transaction involving personal property instead of real estate also may be a loan structured to evade usury laws. n61 If the sale/leaseback transaction contains a terminable at will clause, the deal may be covered by the state rent-to-own law which could raise claims and defenses if the lender did not comply with it.

Even if the transaction is a true sales/leaseback, state law may provide special protections. n62

A new phenomenon has surfaced in a growing number of states--the "car pawn." These transactions are really small loans which have been seen with effective (and, often undisclosed) APRs of as much as 900%. A good description of the scheme is contained in *Pendleton v. American Title Brokers, Inc.*, n63 the first case to consider it. In brief, the borrower pledged his or her car in exchange for a small loan, and at the same time, executed a leaseback for the pledged car, making weekly payments on both the loan and the lease. With credit insurance, and an undisclosed processing fee, the weekly payments resulted in an APR of 977%. The court found that Alabama's consumer credit code applied and that the transaction was subject to the Truth in Lending Act. n64

In the wake of adverse judicial rulings, the industry in some states sought a legislative stamp of approval for title pawns. n65 A few states have sought to limit auto title "pawns" by explicitly requiring that the "pawnbroker" take possession of the vehicle or by excluding pawns made solely against the title of a vehicle. n66 Some municipalities have responded to the growth of the auto title lending industry by enacting their own more protective regulation or through zoning actions. n67

In 2000, the Office of the Comptroller of the Currency issued a warning to national banks about safety and soundness and other risks associated with this type of lending as banks decide whether to partner with local entities to fund these loans. n68 The Letter advises banks to tread carefully given the potential for claims based on the fact that such loans may be based upon the value of the collateral and not on the consumer's ability to repay; lenders fail to rebate the net proceeds to the borrower upon the sale of the car; and some lenders fail to treat these transactions as loans, thus running afoul of the Truth in Lending Act.

A more common method of restructuring a credit transaction is to transform it into a lease. This is a common commercial practice, and a vast body of case law considers whether business transactions are secured credit sales or true leases. n69

In a consumer context, retailers have few reasons to structure credit sales as leases except to attempt to avoid the disclosures, interest ceilings, and repossession limitations imposed by the Federal Truth in Lending Act, state retail installment sales acts, and the Uniform Commercial Code, respectively. n70 Therefore, advocates who are examining purported leases under which ownership may ultimately be transferred to the consumer should be particularly suspicious of the possibility that violations of these statutes may exist.

Perhaps the most important example of the use of leases to conceal consumer credit sales is the "Rent-to-Own" (RTO) leasing industry.

In brief, RTO transactions attempt to circumvent numerous consumer protection statutes and, therefore, can be attacked on many different levels. Leases under which the lessee agrees to pay a sum equal to or exceeding the value of goods, and under which the lessee acquires an option to purchase for nominal consideration, may be credit sales requiring Truth in Lending disclosures. n71 Such leases may also constitute security interests under the UCC and may thus be subject to UCC repossession limitations. n72 Similarly, RTO transactions may be held to constitute security agreements rather than true leases under the Bankruptcy Code, thereby giving bankrupt consumers greater rights than normal lessees. n73 Last, but not least, RTO agreements may be subject to usury limitations under state installment sales acts. n74 Statutory definitions are very important in these cases, so advocates must parse the applicable language carefully in comparing it to their own statute and applying precedent from other states. n75

There is some indication that automobile dealers may structure car sales as rent-to-own deals. In this instance, the state RTO act and the motor vehicle installment sales act ("MVRISA") should be carefully reviewed. States may not have specifically exempted RTO deals from their MVRISAs which often cover leases. In those instances, it is likely that the MVRISA applies and was violated.

Somewhat surprisingly, consumers have met with only mixed success in challenging RTO contracts under most of these theories. The reason is that most consumer and commercial statutes were written to regulate sales transactions while recognizing the legitimacy of short term, true chattel leases as an independent class of transactions. However, this is not to say that RTO agreements are invariably beyond the reach of installment sales acts. n76

[6] Tax Refund Schemes as "Non-Credit" Transactions with Hidden Interest

[a] Background; Assignment of Tax Refunds as Disguised Credit

Another form of "non-credit" transaction that may be a disguised loan containing hidden interest is the assignment of a taxpayer's expected tax refund in return for an immediate cash payment; though this scheme has evolved into the now more prevalent Refund Anticipation Loans ("RALs"). n77 These RALs do not disguise their character as credit, though they frequently involve hidden interest. The assignments typically take the form of a power of attorney and, as with other disguised credit transactions, frequently conceal extremely high rates of interest. For example, the assignment of a $100 tax refund for a $60 cash payment produces a $40 profit in a relatively short period of time. Depending upon the precise length of time between the $60 payment and the lender's receipt of the refund, the effective annual interest rate may reach 1,700 percent.

Whether such a transaction is subject to usury law depends on whether it is viewed as the sale of a chose in action owned by the taxpayer or as a loan. Generally, it is permissible to sell notes or other obligations at a discount without the interference of usury ceilings, n78 so long as the seller is not the maker of the note. n79

The problem with the view of a tax refund assignment as a sale of a chose in action is that it ignores the basic obligation of a court in a usury case to look beyond the legal formalities of a transaction and to examine its substance. The substance of the tax refund transaction is that the taxpayer, who needs money immediately, obtains that money from another party such as a tax return preparer, and that the other party receives in return a larger payment at a later date. If that larger payment were made directly by the taxpayer, the transaction would be a textbook loan. To say that the transaction is not a loan because the later payment does not literally come from the taxpayer's pocket is to ignore the reality of the transaction.

Authorities that have been willing to look at the substance of assignment transactions have concluded that the transactions are loans which may violate usury laws. n80

Attorneys whose clients have been the victims of tax refund assignment schemes should closely examine the transaction for terms which reveal the true extension of credit. For example, if the taxpayer is in any way liable to the "assignee" if the refund is smaller than expected, the argument that the transaction is merely a sale of a chose in action would be rebutted. n81 Consumers' attorneys should also consider potential liability under disclosure statutes n82 or under statutes forbidding deceptive trade practices if the purported assignee in any way conceals the nature or terms of the transaction. n83

[b] Refund Anticipation Loans (RALs)

Some major lenders now offer "Refund Anticipation Loans," thus dropping the pretense that no credit is involved. n84 The refund is deposited directly into an "account" the borrower sets up as part of the transaction at a bank affiliated with the creditor. Commonly, the note is formally designated a demand note, and the creditor's compensation is a flat fee.

Since these loans typically are made through tax preparers, the consumer will pay a tax preparation fee, an electronic filing fee, and, often, a fee to cash the refund loan proceeds on top of the RAL fee to the lender. These fees can be substantial, as much as $267 per loan.

While there has been activity as to the Truth in Lending implications of this arrangement, n85 there has been little challenge under usury laws. Inasmuch as the effective interest rates on these short-term loans could be from 76% to 774%, exploration of the issue may be warranted, though usury claims against bank lenders have run into the federal preemption/exportation snag. n86

Several states have now addressed tax refund loans through legislation. Connecticut prohibits RAL facilitators (i.e., those who broker or process RALs) from facilitating a RAL over 60% APR and imposes a fine of $500 per violation. n87 Illinois regulates the tax preparer not the lender, but it only imposes limited disclosure requirements. n88 California added RAL regulation in 2006. n88.1 Among other things, these provisions address advertising, disclosure of fee schedules, non-English translations of the contracts, untying the tax preparation from getting a RAL, and information about the speed a customer can expect to get a refund without getting a RAL. Other states that impose disclosure rules include: Minnesota, Nevada, North Carolina, Oregon, Virginia, Washington, and Wisconsin. n88.2 New York City, San Antonio, and Seattle have passed ordinances dealing primarily with disclosure. n88.3

Aside from usury issues, borrowers can raise a myriad of other state law claims, particularly against the tax preparer, for example, breach of fiduciary duty, fraud, negligent misrepresentation, UDAP, breach of duty of good faith and fair dealing, civil conspiracy, and The Racketeer Influenced and Corrupt Organizations Act ("RICO"). n89 Courts have split on whether to dismiss or grant summary judgment on claims alleging breach of fiduciary duty and breach of duty of good faith and fair dealing. n90 A blow to class actions against H&R Block occurred when they were abruptly snuffed out by a controversial $25 million global settlement in *Zawikowski v. Beneficial National Bank*. n91 The Seventh Circuit, however, overturned the approval of the settlement. The court held that the district court judge abused his discretion in approving the settlement and sent the case back to the district court with the requirement that the case be assigned to a different judge. n92 On remand, the district court rejected the settlement on the basis that the class counsel who negotiated the settlement were inadequate representatives for the plaintiff class. n93 Subsequently, the district court permitted a nationwide class action to go forward on a RICO claim, plus a breach of contract claim against Household alone. n94 Active duty servicemembers and their families are now protected against high cost RALs. The John Warner Defense Authorization Act of 2007, also known as the Military Lending Act (MLA), caps rates for loans to the military at 36% APR including fees and insurance premiums. n94.1 The Department of Defense issued regulations that include RALs as one of three loan products covered by the new federal protections. The regulations, effective October 1, 2007, cap interest rates for loans secured by expected tax refunds at 36% annual interest, which includes all fees associated with extending credit ("military APR"). Thus the "Refund Account" fee charged by RAL lenders for the dummy account used to repay the loan must be included in the military APR.

[7] Payday Loans/Check Advancement Loans

[a] The Lenders and the Loans Described

A fast growing segment of the "fringe credit" market is "payday loans," small, short-term unsecured loans with usually high fees, primarily targeted to consumers who do not have access to tradition sources for small loans.

Payday loans go by a variety of names, including "deferred presentment," "cash advances," "deferred deposits," or "check loans." They all work like this: the consumer provides the lender a live or a post-dated check written on his or her bank account for the amount borrowed plus a fee. The fee is stated as either a percentage of the check or loan amount or in a dollar amount. This fee translates into annual percentage rates typically not less than 390% and averaging close to 500%, though advocates and credit code enforcement agencies have noted rates of 1300% to 7300%. n95 The check is then held for one to four weeks (usually until the customer's payday), at which time the consumer

redeems the check by paying the face amount, allows the check to be cashed, or pays another fee to extend the loan.

The largest segment of the industry consists of storefronts that provide only one product: payday loans. The leading examples as of 2001 include Advance America, CNG (Cash'n Go) Financial, and Check Into Cash. Other payday lenders offer other products as well, such as pawn loans and check cashing services. The largest of these "full-service" lenders include Ace Cash Express (a thousand locations in 29 states), Dollar Financial (244 stores in 12 states), and First Cash Financial Services (160 outlets in 11 states).

[b] Types of Abuses

The abuses occur in the making and collection of payday loans in a variety of ways. Cash-strapped consumers rarely have the ability to repay the entire loan when their payday arrives because that leaves little or nothing on which to live until the next paycheck. Lenders then encourage consumers to rollover or refinance one payday loan with another. The result is that the consumer pays another round of charges and fees and obtains no additional cash in return. Some consumers end up renewing their loans ten to twelve times before they can pay off the loan. n96

Further, payday lenders often threaten to use the criminal system to collect these debts or routinely file criminal charges when a check is returned for insufficient funds. The fact that the lender holds a borrowers check makes the collection process easier and more reliable than when consumers only sign a promissory note to repay.

Many payday lenders fail to give Truth In Lending disclosures which makes it impossible to understand the true cost of these loans. Even when TILA disclosures are given, they are frequently inaccurate.

Finally, payday lenders in usury cap states disguise these transactions, claiming that they are not making loans. In Texas, for example, the two main subterfuges presently used are "sale-leaseback" transactions and "cash-back ad sales." n97 In the sale-leaseback scam, the lender "buys" an item of personal property from the consumer, for example, a television, and "leases" it back for a "rental payment" which is due in two weeks. In cash-back ad sales, the consumer must "buy" an advertisement of one line for every $100 borrowed and pay an "ad fee" of $33 per $100 (translating to an APR of 858%). In both scenarios, the lender requires a signed check just in case the consumer fails to make the payment in two weeks hence.

[c] State Regulation of Payday Lending

Whether payday loans and the accompanying abuses violate a panoply of state and federal laws often depends, in the first instance, on the state of the law in the state where the loan transaction took place. n98 The states fall into three categories.

Category one: Twelve states, the District of Columbia, and the Virgin Islands require payday lenders to comply with state law, commonly a small loan or criminal usury law, which contain usury caps ranging from 24% to 36%, including fees. n99 These laws typically contain extensive provisions specifying the maximum loan amount, the maximum interest rate and permitted charges, the penalties for the charging of excessive interest and other violations, on other requirements. Since the allowable interest rates and fees are substantially below that which the payday industry charges, the lenders in these states are usually operating illegally by ignoring the small loan law. It is in these states where the industry has the greatest incentive to disguise the transaction.

Category two: The small loan laws of one state and of Puerto Rico permit payday lenders to operate and charge any interest rate or fee which the parties to the loan agree to pay. The lenders in these states usually must comply with other provisions of the state's small loan act, however. n100

Category three: Thirty-seven states have enacted industry-backed laws or regulations specifically authorizing payday

lending, usually in derogation of a protective usury statute. n101 Generally, these laws require either licensing or registration. Some mandate that the lenders put up a bond and/or maintain a certain level of net assets or worth. They typically specify a maximum term and maximum amount of the loan and fix the interest rate or fees to be charged.

Where payday loans are authorized in category-three states, many obligate the lender to provide a written agreement to the consumer. About half of these states prohibit rollovers, *i.e.*, the refinancing or repaying of one such loan with another, at which time the consumer incurs another round of charges. (Many payday lenders avoid this prohibition by refinancing the loan rather than renewing it.) Others set a maximum number of such loans that a consumer may have outstanding at any one time. Additionally, most states create some type of criminal or administrative penalties. However, only seven states provide for some type of limited private right of action allowing the consumer to obtain relief against the lender. Only a small number prohibit the lender from threatening to file or filing criminal charges against a consumer as a mechanism to collect on the debt. Finally, in seven of these states, only check cashers are allowed to make payday loans. On the other hand, several states expressly prohibit check cashers from accepting post-dated checks, making loans, or failing to immediately deposit the check for payment. n102

[d] Legal Claims

The first line of defense raised by payday lenders when sued in states where such loans are illegal is to claim that the transaction is really not a loan, but is rather the deferred presentment of a check. In category-one states, the courts have uniformly pierced this smokescreen to hold that the transaction is, in substance, a loan. n103 Several consequences flow from this fundamental finding. The state usury law is violated because the usury cap is exceeded (often by more than 100 times), and also, in small loan states, licensing and other requirements are ignored. Payday companies routinely fail to give Truth In Lending disclosures because of the pretense that the arrangement is not a loan. n104

In addition, several courts have addressed the viability of a RICO claim and ruled favorably. n105 In the payday loan context, the claim arises where the state usury law is violated and the amount of interest charged or collected exceeds twice the cap. n106 Violating RICO is particularly significant for recovery purposes because the act allows the consumer to hold the individuals liable as well as the company as an entity.

If the lender threatens or uses the criminal bad check law to collect the debt, such behavior may violate the state unfair or deceptive trade practices act. Giving a post-dated check is not passing a "bad" check, because the lender knows the consumer does not have sufficient funds in the checking account at the time of the loan to cover the amount of the cash advanced. n107 Such conduct could also violate state fair debt collection practices acts that apply to creditors as collectors (and the federal act where the collector is a third party or attorney). n108

State federal credit repair laws may provide additional remedies in the payday lending context. Typically, these laws require registration, bonding, disclosures, and a right to cancel. Almost all offer a private cause of action, often with minimum damages, punitive damages, and attorney fees. Significantly, most of these state statutes cover organizations that assist or offer to assist consumers in obtaining extensions of credit. n109 Local storefronts who partner with banks to assist the customer in obtaining credit, for example, should be covered. The federal Credit Repair Organizations Act may have a more limited use in the payday lending context, unless the creditor expressly or impliedly claims that the payday loan will improve the customer's credit record. n110

Viable defenses to payday lending exist even in states whose laws expressly permit these transactions. Truth In Lending disclosures are often inaccurate, or may be presented in such a way so as to violate the requirement that the disclosures be clear and conspicuous and separately segregated n111 The check itself may be security for the loan and must be properly disclosed as such. n112

In addition, the doctrine of unconscionability can be used to challenge the amount of fees and interest that is charged in states with no caps. Finally, noncompliance with payday loan laws can arguably void the loan if only criminal penalties

are imposed. Violation of the act may also trigger UDAP liability.

Payday lenders, like many finance companies, are placing arbitration clauses in their contracts. In those states where payday loans are illegal because they violate the usury cap, the courts may refuse to enforce arbitration on the theory that the underlying transaction, the loan, is unenforceable or unconscionable. n113

Payday loans made over the Internet present special problems. The lenders may behave as though they are not subject to the laws of the state where the consumer resides. The loan agreements likely include choice of law provisions that identifies another state or country's law as governing the transaction. Despite these clauses, state agencies often take the position that the consumer's home state law applies. n113.1 This means that the licensing and usury or payday laws apply, which the Internet lenders would have invariably violated.

[e] Federal and State Laws Protecting Military Personnel and Dependents from Payday Loans

On September 30, 2006, Congress enacted legislation that caps the interest rate on loans to military servicemembers and their dependents at 36%. The provision (the "Talent/Nelson Amendment") was added by Senators Jim Talent (R-Mo.) and Bill Nelson (D-Fla.) as an amendment to the Sen. John Warner National Defense Authorization Act, n113.2 which President Bush signed in October 2006.

The statute gives the Department of Defense (DOD) authority to promulgate regulations and to define key terms. DOD did so on August 31, 2007. n113.3 Both the Act and the regulations went into effect on October 1, 2007.

The regulations define payday lending covered under the Act to include only closed-end credit, with a term of 91 days or less, and an amount financed of $2,000 or less. The borrower, contemporaneously with receipt of funds, must provide a check or other payment instrument or debit authorization that is deferred for more than one day. n113.4

The Act contains a provision that preserves the ability of states to pass additional measures to protect the military from abusive credit practices so long as they are not inconsistent with the federal law. n113.5 Several states have passed special protections for members of the military, including: Arkansas, Arizona, Georgia, and Virginia. However, one state attorney general issued a letter in which he opined that the federal act preempts applicable state law when the two conflict, in this case over whether a payday loan can be made to military personnel even at the 36% cap. n113.6 The attorney general answered in the negative because the federal law prohibits the lender from using a check or other method of access to a bank account as security for the loan. Therefore, no payday loan at any price can be extended to military personnel.

[8] Income Buyers

Another form of high-cost lending occurs when companies buy the rights to certain future income sources in exchange for immediate cash payment. These income sources may include a stream-of-government benefits, n114 actual or potential settlements of legal actions, n115 and lottery winnings. n116 The annualized interest rates on these loans have been reported to be as high as 280%. n117

Most times, lenders will not characterize these transactions as loans, but will call them an assignment, sale of a *chose* in action, or similar name. n118 Such characterizations may be harder to challenge if the income source is contingent upon an event, such as potential settlement of a lawsuit. n119 For streams of income that are not contingent, these transactions may present not only usury claims, but claims under state UDAP statutes. n120 Finally, note that the terms of the income source may prohibit assignment. n121

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawFederal ActsGeneral OverviewBanking LawNational BanksInterest & UsuryGeneral OverviewBanking LawNational BanksInterest & UsuryInterestBanking LawNational BanksInterest & UsuryUsury LitigationContracts LawDebtor & Creditor Relations

FOOTNOTES:
(n1)Footnote 1. *See, e.g.,* Black's Law Dictionary (5th ed. 1979).

(n2)Footnote 2. *See § 6.05[3] infra.*

(n3)Footnote 3. *See* Eskridge, *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction, 70 Va. L. Rev. 1083, 1092 (1984).*

(n4)Footnote 4. *See, e.g., Matter of Ferris, 764 F.2d 1475 (11th Cir. 1985)* (document preparation fee not interest in Georgia); *Fikes v. First Fed. Sav. & Loan of Anchorage, 533 P.2d 251 (Alaska 1975)* ; *Harris v. Guar. Fin. Corp., 244 Ark. 218, 424 S.W.2d 355 (1968)* ; *Klett v. Security Acceptance Corp., 38 Cal. 2d 770, 242 P.2d 873 (1952)* ; *Collins v. Union Fed. Sav. & Loan Ass'n, 662 P.2d 610 (Nev. 1983) . See also Anderson v. Chainani (In re Kemper), 263 B.R. 773 (E.D. Tex. 2001)* (summary judgment inappropriate on issue of whether a "consulting fee" is interest as parties dispute whether any services were actually performed); Eskridge, *One Hundred Years of Ineptitude: The Need For Mortgage Rules Consonant With the Economic and Psychological Dynamics of the Home Sale and Loan Transaction, 70 Va. L. Rev. 1083, 1096 (1984). But cf. Pechinski v. Astoria Fed. Sav. & Loan Ass'n, 238 F. Supp. 2d 640* (S.D.N.Y.) , *aff'd, 345 F.3d 78 (2d Cir. 2003)* ("assignment fee" constituting 0.875% of outstanding mortgage balance was not finance charge under TILA, despite fact that bank conceded fee bore little relationship to cost of assignment; court declined to exercise supplemental jurisdiction over state law claims after dismissing TILA claim).

(n5)Footnote 5. *See also Johnston v. Citizens Bank & Trust Co., 659 F.2d 865 (8th Cir. 1981)* (applying Arkansas law); *In re General Am. Communications Corp., 63 B.R. 534 (Bankr. S.D.N.Y. 1986)* (when creditor obtained loans from bank and reloaned funds to borrower, the interest paid by the creditor to the bank was overhead expense which could not be passed on to borrower except as interest). Some state statutes do permit lenders additional fees to cover their overhead expenses. *See, e.g., Henley v. Cameron Auto Pawn (In re Henley), 228 B.R. 425 (Bankr. E.D. Ark. 1998)* (Tennessee auto title pawn law permits lender to charge 2% interest plus "customary fee to defray the ordinary costs of operating a title-pledge office"; in this case, lender permitted to charge "customary fee" of $432 per month on loan of $2,400; court noted that generally Tennessee law indicated that lender charges should not include overhead, but the auto title pawn statute was legislatively created exception).

(n6)Footnote 6. *Motzer Dodge Jeep Eagle, Inc. v. Ohio Atty. Gen., 95 Ohio App. 3d 183, 642 N.E.2d 20 (1994)* (fee violated Ohio UDAP act where delivery and handling fee, supposedly optional, was actually mandatory, where dealer failed to itemize the activities performed for the fee and where manufacturer actually reimbursed for some of the fees). *See also Dressel v. Ameribank, 635 N.W.2d 328 (Mich. Ct. App. 2001)* , *appeal pending* (entity which charged a fee for preparing or filling in the blanks on legal documents was engaged in the unauthorized practice of law, reversing the trial court's dismissal of a UDAP claim predicated upon the charging of an illegal fee). Note that the charging of a fee that is otherwise illegal may have Truth In Lending implications depending upon whether that fee is treated as a finance charge. *See* National Consumer Law Center, Truth in Lending § 3.9.6.2.3 (6th ed. 2007) (document preparation fees charged in a real estate secured loan must be bona fide and reasonable to be disclosed as part of the amount financed; if fee is illegal, it cannot be either bona fide or reasonable).

(n7)Footnote 7. If the fee is imposed on credit customers and not loan customers, it should be included in the finance charge. *See* National Consumer Law Center, Truth in Lending § 3.6.5 (6th ed. 2007). *See also* National Consumer Law Center, Truth in Lending § 3.9.6.2.3 (6th ed. 2007) (document preparation fees charged in a real estate secured loan must be bona fide and reasonable to be disclosed as part of the amount financed; if fee is illegal, it cannot be either bona fide or reasonable).

(n8)Footnote 8. *786 N.E.2d 279 (Ind. Ct. App. 2003)* .

(n9)Footnote 9. *See generally* Eskridge, *One Hundred Years of Ineptitude: The Need For Mortgage Rules Consonant With the Economic and Psychological Dynamics of the Home Sale and Loan Transaction, 70 Va. L. Rev. 1083, 1093 (1984). Miner v. Beneficial Mortgage Co. of Kan. (In re Miner), 369 B.R. 655, 659 n.4 (D. Kan. 2007)* (agreeing that one point equals 1% of the loan amount but characterizing "points" to mean "discount points").

(n10)Footnote 10. *See Fikes v. First Fed. Sav. & Loan of Anchorage, 533 P.2d 251 (Alaska 1975)* (among other considerations listed, the variation of a "loan fee" with the amount or risk of a loan suggests interest).

(n11)Footnote 11. *See, e.g., United-Bilt Homes, Inc. v. Teague, 245 Ark. 132, 432 S.W.2d 1 (1968)* ; *VanderWeyst v. First State Bank of Benson, 425 N.W.2d 803 (Minn. 1988)* (origination fee is interest if not related to expenses; affidavit of bank officer simply making that assertion not adequate to establish that; case remanded for factual determination), *cert. denied, 488 U.S. 943, 109 S. Ct. 269, 102 L. Ed. 2d 359 (1988)* .

(n12)Footnote 12. *See, e.g., Smith v. Anderson, 801 F.2d 661 (4th Cir. 1986)* (applying Virginia law); *Perry v. Stewart Title Co., 756 F.2d 1197 (5th Cir. 1985)* (front end charges were interest, but "spreading" of interest avoids usury violation); *Johnston v. Citizens Bank & Trust, 659 F.2d 865 (8th Cir. 1981)* (applying Arkansas law). *See also Kidd v. Delta Funding Corp., 2000 N.Y. Misc. LEXIS 29* (N.Y. Sup. Ct. Feb. 22, 2000) (processing fee which was not identified as a permitted "application" fee violates N.Y. Banking regulation for motion to dismiss purposes). *But see Olympic Coast Inv., Inc. v. Wright (In re Wright), 256 B.R. 626 (Bankr. D. Mont. 2000)* (in commercial case, court held origination fee is not interest, or at least not usurious, using the spreading doctrine).

(n13)Footnote 13. *See, e.g.,* Kan. Code § 16a-2-401(9)(3 points authorized in real estate loans; 2 points on other closed-end loans); *Md. Code Ann., Com. Law § 12-401*. Consumers' attorneys should check statutes which permit the exclusion of a percentage fee from interest to see how this fee may be calculated. Equitably, fees should be calculated as a percentage of the sum received by the borrower. Yet, lenders often collect a percentage of every sum that they finance, including previously assessed fees and the points themselves. Depending on the precise statutory language, this practice of assessing fees on fees may well be usurious. *See In re Bogan, 281 F. Supp. 242 (W.D. Tenn. 1968)* ; *Md. Code Ann., Com. Law § 12-107*.

(n14)Footnote 14. *See Va. Code Ann. § 6.1-330.72* (Michie 1988 Replacement Volume) (broker's fee by lender payable as part of "loan fee" or interest); *Ind. Code § 24-4.5-3-202(1)(h)(i)* (2% origination fee authorized unless document preparation fee imposed).

(n15)Footnote 15. *United Cos. Lending Corp. v. Autrey, 723 So. 2d 617 (Ala. 1998)* , *reh'g denied*, (Oct. 16, 1999) (points equal finance charge and excess over 5% cap violates Alabama's Mini-Code; issue arose in context of resolving which of two possible remedy provisions apply); *see Smith v. Anderson, 801 F.2d 661 (4th Cir. 1986)* (applying Virginia law); *Bandas v. Citizens State Bank, 412 N.W.2d 818 n.1 (Minn. Ct. App. 1987)* (controlling statute designates permitted charges which are not interest; loan origination fee is not listed, therefore, is interest), *rev'd and remanded on other grounds sub nom. VanderWeyst v. First State Bank, 425 N.W.2d 803 (Minn. 1988)* (different statute controlled transaction), *cert. denied, 488 U.S. 943, 109 S. Ct. 369, 102 L. Ed. 2d 359 (1988)* .

(n16)Footnote 16. *E.g., St. Petersburg Bank & Trust Co. v. Hamm, 414 So. 2d 1071 (Fla. 1982)* ; *People v. Cent. Fed. Sav. & Loan Ass'n, 46 N.Y.2d 41, 412 N.Y.S.2d 815, 385 N.E.2d 555 (1978) . But cf. Brazosport Bank v. Oak Park Townhouses, 837 S.W.2d 652 (Tex. Ct. App. 1992)* (evidence inconclusive that up-front fee was a bona fide commitment fee or authorized interest, so court upheld trial finding that it was an unauthorized fee for making loan; appellate court held appropriate penalty under relevant statute was disallowance of fee rather than a usury violation), *rev'd on other grounds, 851 S.W.2d 189 (Tex. 1993) . See generally* Annot., *93 A.L.R.3d 1156 (1979)* .

(n17)Footnote 17. *See Altherr v. Wilshire Mortgage Corp., 104 Ariz. 59, 448 P.2d 859 (1968)* (*reasonable* commitment fee); *First Am. Bank & Trust v. Windjammer Time Sharing Resort, Inc., 483 So. 2d 732 (Fla. Dist. Ct. App.*

1986) (reasonableness depends on market conditions and industry practice; 20% commitment fee was clearly unreasonable when industry norm was between 1.5% and 5%).

(n18)Footnote 18. *See Henslee v. Madison Guar. Sav. & Loan, 297 Ark. 183, 760 S.W.2d 842 (1988)* ; *First Nat'l Mortgage Co. v. Arkmo Lumber & Supply Co., 277 Ark. 298, 641 S.W.2d 31 (1982)* .

(n19)Footnote 19. *See, e.g., Pacific E. Corp. v. Gulf Life Holding Co., 902 S.W.2d 946 (Tenn. Ct. App. 1995)* (where insurance company was a lender, question of fact whether life insurance policy required as collateral on life of a principal in a commercial loan was pretext for usury).

(n20)Footnote 20. *See, e.g., Darden v. Schussler, 154 Ala. 372, 45 So. 130 (1907)* ; *Curtiss Nat'l Bank of Miami Springs v. Solomon, 243 So. 2d 475 (Fla. Dist. Ct. App. 1971)* ; *Standard Sav. Ass'n v. Greater New Canaan Missionary Baptist Church, 786 S.W.2d 774 (Tex. Ct. App. 1990)* (payment of third party debt interest only when required as condition of making loan; it is a question of fact, though borrower's affidavit alone insufficient to warrant finding of usury on motion for summary judgment; stricter standard of proof required); *Dodson v. Citizens State Bank of Dalhart, 701 S.W.2d 89 (Tex. Ct. App. 1986)* (assumption of third party debt is interest only when it is a condition for the extension of credit). *But cf. Victoria Bank & Trust Co. v. Brady, 811 S.W.2d 931 (Tex. 1991)* (amount of third party debt owed to a *different* lender that borrower was required to assume is not interest; it was third party expense to protect priority as to creditor's security, which is not necessarily interest (note dissent)). *See generally* Annot., *31 A.L.R.3d 763 (1970)* .

(n21)Footnote 21. *See* Annot., *16 A.L.R.3d 475 (1967)* (sharing earnings from property as usurious). *See also Bagri v. Desai, 349 S.E.2d 309 (N.C. Ct. App. 1986)* (loan for purchase of motel; profits from motel shared with lender). *E.g.,* Jones v. Wells Fargo Bank, *5 Cal. Rptr. 3d 835 (Ct. App. 2003)* (example of a "classic shared appreciation loan arrangement" in real estate investment context; no usury because California law exempted from usury cap national banks acting as a fiduciary for a trust).

(n22)Footnote 22. *Compare Beavers v. Taylor, 434 S.W.2d 230* (Tex. Civ. App. 1968 writ ref'd n.r.e.) ("no interest" contract that gave lender a percentage of business' gross receipts was not usurious because payments were contingent on existence and quantity of any gross receipts), *with Najarro v. SASI Int'l, Ltd., 904 F.2d 1002 (5th Cir. 1990)* , *cert. denied, 498 U.S. 1048, 111 S. Ct. 755, 112 L. Ed. 2d 775 (1991)* (a contract is usurious if there is any contingency by which the lender can receive usurious interest). In *First USA Mgmt., Inc. v. Esmond, 911 S.W.2d 100 (Tex. App. 1995)* , *rev'd on other grounds*, *960 S.W.2d 625 (Tex. 1997)* , the court reconciled the apparent conflict by noting that in *Beavers*, the sum which would be payable under the contract in the event of the contingency was uncertain, and would not necessarily have been usurious. By contrast, in *Najarro*, the amount of contingent interest written into the contract was usurious: if the contingency occurred, the amount payable would definitely be usurious.

(n23)Footnote 23. Even if late fees are considered to be interest, courts may apply the spreading doctrine to hold that the late fees do not make the loan usurious. *Torres v. Overby, 2000 Tex. App. LEXIS 2493* (Tex. App. Apr. 17, 2000) . For a discussion of the spreading doctrine, which allows a court to ignore the fluctuations in the effective rate of return during the loan term and look at whether the actual charges exceed the permitted charges, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 4.6.5 (3rd ed. and Supp.).

(n24)Footnote 24. See *§ 6.07[2] infra*, on statutory construction.

(n25)Footnote 25. *See, e.g., Camilla Cotton Oil Co. v. Spencer Kellogg & Sons, Inc., 257 F.2d 162 (5th Cir. 1958)* ; *Bunn v. Weyerhauser Co., 268 Ark. 445, 598 S.W.2d 54 (1980)* (stating rule); *Hayes v. First Nat'l Bank, 256 Ark. 328, 507 S.W.2d 701 (1974)* (distinguishing late fees from extension fees); *Harris v. Guar. Fin. Corp., 244 Ark. 218, 424 S.W.2d 355 (1968)* ; *O'Connor v. Televideo Sys., Inc., 218 Cal. App. 3d 709, 267 Cal. Rptr. 237 (6th Dist. 1990)* ; *Barbour v. Handlos Real Estate & Bldg. Corp., 152 Mich. App. 174, 393 N.W.2d 581 (1986)* ; *Alston v. Crown Auto, Inc., 224 F.3d 332 (4th Cir. 2000)* ; *Domizio v. Progressive County Mut. Ins. Co., 54 S.W.2d 867 (Tex. App. 2001)*

(payment of insurance premiums in installments does not equal credit; therefore, late fees are not subject to usury claim; no evidence presented regarding the liquidated damages claim). *But see Dikeou v. Dikeou, 928 P.2d 1286 (Colo. 1997)* (in commercial loan context, late fee held to be interest which, when added to contract interest rate, did not exceed the usury cap); *Seaton v. City of Lexington, 97 S.W.3d 72 (Mo. Ct. App. 2002)* (late payment fee designed to ensure prompt payment of municipal sewer bill is not the equivalent of interest charged for the use of money, despite fact that statute authorizing late payments referred to the bearing of "interest"). Even if late fees are considered to be interest, courts may apply the spreading doctrine to hold that the late fees do not make the loan usurious. *Torres v. Overby, 2000 Tex. App. LEXIS 2493* (Tex. App. Apr. 17, 2000) . *See, e.g., Domizio v. Progressive County Mut. Ins. Co., 54 S.W.3d 867 (Tex. App. 2001)* , *reh'g denied,* (Apr. 4, 2002) (payment of insurance premiums in installments does not equal credit; therefore, late fees are not subject to usury claim; no evidence presented regarding the liquidated damages claim). *See also Nolen v. Nucentrix Broadband Networks, 293 F.3d 926 (5th Cir. 2002)* , *cert. denied, 537 U.S. 1047 (2002)* (cable TV provider's late fee of up to 30% per month was not interest and thus not usurious); *Alston v. Crown Auto, Inc., 224 F.3d 332 (4th Cir. 2000)* ; *Mallard v. Forest Heights Water Works, 580 S.E.2d 602 (Ga. Ct. App. 2003)* (late payment penalty of 10% of monthly water bill did not constitute interest; Georgia law required a "loan or forbearance of money" as element of usury); *Garcia v. Tex. Cable Partners, Ltd. P'ship, 114 S.W.3d 561 (Tex. App. 2003)* (cable TV late fee not interest because no use, forbearance, or detention of money involved); *Domizio v. Progressive County Mut. Ins. Co., 54 S.W.3d 867 (Tex. App. 2001)* .

(n26)Footnote 26. This point was recognized in *Begelfer v. Najarian, 409 N.E.2d 167 (Mass. 1980)* . *See also Scarr v. Boyer, 818 P.2d 381, 383 (Mont. 1991)* . "Usury statutes protect borrowers who lack real bargaining power against overreaching by creditors." Default does not alter this public policy and, in fact, increases the need; "a debtor who cannot retire a debt compounded by legal interest certainly lacks the resources to pay usurious interest." Although a late fee provides an incentive for prompt payment when the borrower actually has the ability to make a payment, the notion of incentive loses its value when the borrower has no money.

(n27)Footnote 27. *Cf.* Opinion of the Kansas Att'y General No. 88-30, Consumer Cred. Guide (CCH) P 95,908 (Mar. 3, 1988) (reasonable late charge assessed by cable television company is not interest, so long as actual efforts to collect are made and delinquent users are not offered alternative options for payment). Most studies show that late charges are, in fact, not regularly billed. *See, e.g.,* Report of Presiding Officer, Trade Regulation Rule on Credit Practices 192 n.16 (FTC 1978).

(n28)Footnote 28. *See, e.g., Fisher v. Westinghouse Credit Corp., 760 S.W.2d 802 (Tex. Ct. App. 1988)* (late fee computed as interest on past due payments, rather than one-time charge; late fee is a separate agreement tested separately for usury from underlying contract); *Rea v. Breakers Ass'n, 674 So. 2d 496 (Miss. 1996)* . *See also Bowman Plumbing, Heating & Elec. v. Logan, 59 Va. Cir. 446 (Va. Cir. Ct. 2002)* (Virginia late payment statute caps fees at 5%).

(n29)Footnote 29. *See Reliable Credit Corp. v. Smith, 406 So. 2d 231 (La. Ct. App. 1981)* , *amended, 418 So. 2d 1311 (La. 1982)* (improperly imposed extension fee). *See also* Bumpus v. Vandeford, Clearinghouse No. 54,570 (N.D. Miss. 2002) (late fee imposed prior to expiration of 15-day statutory period is finance charge); *Steves Sash & Door Co. v. Ceco Corp., 751 S.W.2d 473 (Tex. 1988)* (charging interest during a grace period when none is due is interest).

(n30)Footnote 30. *E.g., Reliable Credit Corp. v. Smith, 418 So. 2d 1311 (La. 1982)* ; *Wright Ins. Agency v. Scott, 371 So. 2d 1207 (La. Ct. App. 1979)* ; *Begelfer v. Najarian, 409 N.E.2d 167 (Mass. 1980)* ; *Hardwick v. Austin Gallery of Oriental Rugs, Inc., 779 S.W.2d 438, 443 (Tex. Ct. App. 1989)* ; *Veytia v. Seiter, 740 S.W.2d 64 (Tex. Ct. App. 1987)* ; *Dixon v. Brooks, 604 S.W.2d 330 (Tex. Ct. App. 1980)* (writ ref'd n.r.e.).

(n31)Footnote 31. Delaware and South Dakota were the pioneers in this regard. However, other states have followed suit. Nebraska, for example recently deemed credit card charges and fees to be interest for these purposes. Consumer Cred. Guide (CCH) P Neb. 6201. New Hampshire added late fees to its definition of interest Consumer Cred. Guide (CCH) P NH 6251.

(n32)Footnote 32. *See Smiley v. Citibank (South Dakota), 517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996). Contra Sherman v. Citibank (S.D.), N.A., 668 A.2d 1036 (N.J. 1995)* , and remanded, *517 U.S. 1241, 116 S. Ct. 2493, 135 L. Ed. 2d 186 (1996)* (in light of *Smiley*); *Mazaika v. Bank One, Columbus, N.A., 653 A.2d 640 (Pa. Super. Ct. 1994)* , *rev'd on other grounds, 680 A.2d 845 (Pa. 1996)* (applying the holding in *Smiley*).

(n33)Footnote 33. *See, e.g., Late Charges are Interest, [National Credit Union Administration] Says, Saying State-Based Objections Preempted,* 62 BNA Banking News 745 (Apr. 25, 1994) (Letter from Richard Schulman, 4/11/94). The OCC has recently issued a formal interpretive ruling defining late fees and overlimit fees, among others, to be interest within the meaning of § 85 of the National Bank Act. *12 C.F.R. § 7.4001, 61 Fed. Reg. 4,869* (Feb. 9, 1996).

(n34)Footnote 34. The import of these cases is that a borrower in state A with a $10 late charge limit, may nonetheless be charged a $25 late fee by a card issuer in Delaware.

(n35)Footnote 35. *See, e.g., In re Richards, 272 F. Supp. 480 (D. Me. 1967)* (credit insurance); *Cooprider v. Security Bank, 319 Ark. 75, 890 S.W.2d 240 (1994)* (title insurance); *Grantham v. First Union Home Equity Bank, 685 So. 2d 748 (Ala. Civ. App. 1996)* (interpreting *Ala. Code §§ 5-19-1* and *5-19-4(b)*); *Concord Realty Co. v. Cont'l Funding Corp., 776 P.2d 1114 (Colo. 1989)* (*en banc*) (appraisal fee, inspection fee, credit reports, federal express charges, legal fees at closing); *Swanson v. Gulf W. Int'l Corp., 429 So. 2d 817 (Fla. Dist. Ct. App. 1983)* (broker's fee).

(n36)Footnote 36. *See Family Fed. Sav. & Loan v. Davis (In re Davis), 172 B.R. 437 (Bankr. D.D.C. 1994)* ; *In re Bryant, 39 B.R. 313 (Bankr. D. Nev. 1984)* ; *Walker v. Pliss, 34 B.R. 432 (Bankr. D. Or. 1983)* ; *In re Verdini Enters., 13 B.R. 739 (Bankr. S.D. Fla. 1981)* ; *Swanson v. Gulf W. Int'l Corp., 429 So. 2d 817 (Fla. Dist. Ct. App. 1983)* ; *Ashland Nat'l Bank v. Conley, 231 Ky. 844, 22 S.W.2d 270 (1929)* ; Annot., *52 A.L.R.2d 703 (1957)* .

(n37)Footnote 37. *See Diane Inc. v. Kapnison, 667 P.2d 450 (N.M. 1983)* (interpreting *N.M. Stat. Ann. § 56-8-7* (1978)). However, such statutes frequently contain broad loopholes. The Nebraska statute governing loan brokers, for example, excludes attorneys, real estate brokers, real estate salespeople, and most lenders. *Neb. Rev. Stat. § 45-190* (1983).

(n38)Footnote 38. *See, e.g., Matter of Dukes, 24 B.R. 404 (Bankr. E.D. Mich. 1982)* ; *North Am. Invs. v. Cape San Blas Joint Venture, 378 So. 2d 287 (Fla. 1978)* ; *Feemster v. Schurkman, 291 So. 2d 622 (Fla. Dist. Ct. App. 1974)* ; *Howes v. Curtis, 104 Idaho 563, 661 P.2d 729 (1983)* ; *Duckworth v. Bernstein, 55 Md. App. 710, 466 A.2d 517 (1983)* . *See generally* Annot., *52 A.L.R.2d 703 (1957)* . *See also Tavares v. Sprunk (In re Tavares), 298 B.R. 195 (Bankr. D. Mass. 2003)* (broker fees explicitly included in calculation of interest rate for purposes of determining whether loan violates Massachusetts criminal usury statute). *But see Lovick v. Ritemoney Ltd., 378 F.3d 433 (5th Cir. 2004)* (recognizing that $1,500 of $2,000 paid to a broker could be interest under Texas law but finding that a "special" agency relationship only existed between the broker and the lender, which is not enough to transform the broker fee into interest, particularly when the complaint failed to allege that the lender received some benefit from the additional fee and the additional fee paid to the third party "was a subterfuge to evade the usury statute"; holding that the state credit services organization act applies as a more recent law but contains no cap on the amount the entity can charge for arranging a loan; dissent argues that the case should not be dismissed before discovery could be conducted to show if any part of the $1,500 fee made its way into the lender's pocket).

(n39)Footnote 39. *See In re Mickler, 50 B.R. 818 (Bankr. M.D. Fla. 1985)* (sham referral fee); *Howes v. Curtis, 104 Idaho 563, 661 P.2d 729 (1983)* ; *United-Bilt Homes, Inc. v. Knapp, 239 Ark. 940, 396 S.W.2d 40 (1965)* (credit life insurance and appraisal fees not actually expended); *Stubbs v. Security Consumer Disc. Co., 85 N.J. 353, 426 A.2d 1014 (1981)* ; *National Am. Life Ins. Co. v. Bayou Country Club, 16 Utah 2d 417, 403 P.2d 26 (1965)* . *See also Kenty v. Bank One, Columbus, N.A., 1992 U.S. Dist. LEXIS 16645* (S.D. Ohio Apr. 29, 1992) (insurance kickbacks), *aff'd in part, rev'd in part, 92 F.3d 384 (6th Cir. 1996)* .

(n40)Footnote 40. See *Hubschman v. Broda, 103 N.J. Super. 494, 247 A.2d 698 (1968)* ; *Pease v. Taylor, 496 P.2d 757 (Nev. 1972)* .

(n41)Footnote 41. *Middleton v. Southern Atl. Fin. Servs., Inc., 512 S.E.2d 525 (S.C. Ct. App. 1999)* (evidence to contradict the written brokerage agreement disclaiming agency not presented in this case; parol evidence rule may prevent the introduction of oral representations of broker absent claims of fraud).

(n42)Footnote 42. *12 U.S.C. § 2607*; Reg. X, *24 C.F.R. § 3500.14*.

(n43)Footnote 43. *See, e.g., Owens v. Conelly, 77 Ariz. 349, 272 P.2d 345 (1954)* ; *Greeley Nat'l Bank v. Sloan, 677 P.2d 409 (Colo. Ct. App. 1983)* ; *Bizzoco v. Chintz, 193 Conn. 304, 476 A.2d 572 (1984)* ; *Lairsen v. Slutzky, 80 S.W.3d 121 (Tex. App. 2002)* (upholding award of attorney fees for breach of contract under Texas Civil Practice Code; both contract and statute permitted imposition of attorney fees). *Cf. Quinn v. McCoy, 2002 Cal. App. Unpub. LEXIS 5360* (Cal. Super. Ct. June 14, 2002) (while deed of trust authorized lender to impose attorney fees to enforce loan contract, lender not entitled to attorney fees for successful defense against borrowers' lawsuit for wrongful foreclosure, since such claims sounded in tort). *See also Rockstad v. Erikson, 113 P.3d 1215 (Alaska 2005)* (court affirmed a judgment for attorney fees awarded to the mortgagee's attorney based on the contract provisions in the note and mortgage for time collecting on the loan due to default and for time spent defending against the mortgagor's claims; court refused to allow mortgagee to collect attorney fees for time spent responding to the homeowner's bankruptcy on the grounds that only the bankruptcy court has jurisdiction to award fees if the contract permits). *Cf. Shwartz v. American Express Travel Related Serv. Co., 2003 U.S. Dist. LEXIS 5821* (E.D. La. Apr. 8, 2003) (two credit card attorney fee provisions at issue in this case; court reversed an award of a "reasonable" fee for both accounts where one agreement limited the attorney fee to 15% of the balance and the other agreement allowed a fee for time spent collecting the balance due; court construed this latter provision against the maker and held that the card issuer could only recover for time spent collecting the debt but not for defending consumer's lawsuit; total fee awarded was substantially reduced).

(n44)Footnote 44. In a few cases, creditors which have assessed usurious charges have retroactively attempted to justify them as valid charges for attorneys' fees. This gambit has not held up in court. *See Ganus v. Jopes, 470 So. 2d 237 (La. Ct. App. 1985)* ; *Coppedge v. Colonial Sav. & Loan Ass'n, 721 S.W.2d 933 (Tex. Ct. App. 1986)* .

(n45)Footnote 45. *See Browne v. Nowlin, 117 Ariz. 73, 570 P.2d 1246 (1977)* ; *see also Ganus v. Jopes, 470 So. 2d 237 (La. Ct. App. 1985)* (dictum). *Cf. Cuevas v. Montoya, 48 Wash. App. 871, 740 P.2d 858 (1987)* (lender/attorney's own fees to set up a loan were interest). *See also Tavares v. Sprunk (In re Tavares), 298 B.R. 195 (Bankr. D. Mass. 2003)* (attorney fees included in calculation of interest rate for purposes of determining whether loan violates Massachusetts criminal usury statute).

(n46)Footnote 46. *E.g., In re Salzman, 83 B.R. 233 (Bankr. S.D.N.Y. 1988) . See Md. Code Ann., Com. Law § 12-623*. On the general question of charging fees for services performed by creditor employees, see *Winston v. Personal Fin. Co. of Pine Bluff, 220 Ark. 580, 249 S.W.2d 315 (1952)* (fees were interest).

(n47)Footnote 47. This is the rule in Texas. *See Imperial Corp. of Am. v. Frenchman's Creek Corp., 453 F.2d 1338 (5th Cir. 1972)* (applying Texas law); *Texas Commerce Bank v. Goldring, 665 S.W.2d 103 (Tex. 1984)* ; *Nevels v. Harris, 129 Tex. 190, 102 S.W.2d 1046 (1937)* .

(n48)Footnote 48. *See, e.g., Turner v. First Union Nat'l Bank, 162 N.J. 75, 740 A.2d 1081 (1999)* (imposition of document preparation fee by lender's attorney limited by statute to certain circumstances, though a careful read of the decision reveals that the court's interpretation of the statute eliminates all of the protections in the law).

(n49)Footnote 49. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 4.6.1.2 (4th ed. 2009). For further discussion of other types of hidden interest, such as requiring a payment on the date of consummation rather than thirty days later, or requiring that the borrower pay a deposit that is held by the

lender until the debt is paid off, see Cost of Credit § 7.4.2. *See also Williams v. Chartwell Fin. Servs., Ltd., 204 F.3d 748 (7th Cir. 2000)* (requiring deposit to get loan, and including deposit in amount financed of loan may violate Truth in Lending Act).

(n50)Footnote 50. *See Compton v. Altavista Motors, Inc., 121 F. Supp. 2d 932 (W.D. Va. 2000)* (summary judgment denied on whether GAP insurance was voluntary; if required, the premium was an unlawful finance charge under state law).

(n51)Footnote 51. *Mitchell v. Trustees of U.S. Real Estate Inv. Trust, 375 N.W.2d 424 (Mich. Ct. App. 1985)* .

(n52)Footnote 52. For a description of different types of wraparound transactions, *see* Arditto, *The Wraparound Deed of Trust*: *An Answer to the Allegation of Usury, 10 Pac. L.J. 923 (1979).*

(n53)Footnote 53. *See, e.g., Summers v. Consolidated Capital Special Trust, 783 S.W.2d 580 (Tex. 1989)* (payoff bid at foreclosure sale of wraparound mortgage should include the wrapped debt even if borrower was exempted from liability on the debt by the mortgage); *Greenland Vistas v. Plantation Place, 746 S.W.2d 923 (Tex. Ct. App. 1988)* (upon acceleration of wraparound note, permissible to include demand for underlying lien balance and accrued interest along with balance of wrap loan). For example, a 1985 Michigan case recognized that wraparound mortgages executed for refinancing purposes are not subject to federal usury preemption under the Depository Institutions Deregulation and Monetary Control Act of 1980 because they are not secured by first liens as required by the Act. *Mitchell v. Trustees of U.S. Real Estate Inv. Trust, 375 N.W.2d 424 (Mich. Ct. App. 1985) . See generally* Annot., *36 A.L.R.4th 144 (1985)* (validity and effect of wraparound mortgages).

(n54)Footnote 54. For a discussion of wraparound notes under California law, *see* Arditto, *The Wraparound Deed of Trust*: *An Answer to the Allegation of Usury, 10 Pac. L.J. 923 (1979).*

(n55)Footnote 55. *See, e.g.,* Fla. Stat. § 665.077 (1985) (Savings & Loans only); La. Stat. Ann. § 9:3504B (West 1983); *Minn. Stat. § 47.20* (1984). The Florida statute applies to savings and loan associations and not to finance companies. *In re Hamlett, 63 B.R. 492 (Bankr. M.D. Fla. 1986)* .

(n56)Footnote 56. *See* Eskridge, *One Hundred Years of Ineptitude: The Need For Mortgage Rules Consonant With the Economic and Psychological Dynamics of the Home Sale and Loan Transaction, 70 Va. L. Rev. 1083, 1136 n.167 (1984).*

(n57)Footnote 57. Reg. Z, *12 C.F.R. § 226.4(b)(9).*

(n58)Footnote 58. Reg. Z, *12 C.F.R. § 226.4(c)(5), as interpreted in* Official Staff Commentary § 226.4(c)(5). Prior to the "simplification" of Regulation Z, seller points were treated as finance charge only if they were passed on to the buyer in the sale price. *See* Official F.R.B. Interpretation 226.406 (10/23/70).

(n59)Footnote 59. For a discussion of agreed rate statutes and their potential effect on seller's points transactions, see *§ 6.07[1][g] infra.*

(n60)Footnote 60. *See Metcalf v. Bartrand, 491 P.2d 747 (Alaska 1971)* ; *Kawauchi v. Tabata, 413 P.2d 221 (Haw. 1966)* (equitable mortgage); *Thomas v. Klemm, 185 Md. 136, 43 A.2d 193 (1945)* (equitable mortgage; usury not an issue); *Fales v. Glass, 402 N.E.2d 1100 (Md. Ct. App. 1980)* (equitable mortgage, usury not at issue); *Wilcox v. Moore, 354 Mich. 499, 93 N.W.2d 288 (1958)* (found to be usurious loan with mortgage taken); *Boyd v. Layher, 170 Mich. App. 93, 427 N.W.2d 593 (1988)* ; *McConnell v. Sutherland, 135 Or. App. 477, 898 P.2d 254 (1995)* , *rev. denied*, *322 Or. 489, 909 P.2d 161 (1996)* (deed with option to repurchase was an equitable mortgage; issue remained whether loan was subject to statutory usury exemption). *See Perry v. Queen, 2006 U.S. Dist. LEXIS 17120* (M.D. Tenn. Feb. 27, 2006) (transfer of home created an equitable mortgage where the consumer was unsophisticated and not represented by counsel, where the payment made by the "purchaser" was only 10% of the fair market value of the home, and where the

mortgage remained in the consumer's name); *Wilson v. Bel Fury Investments Group, L.L.C., 2006 U.S. Dist. LEXIS 35740* (D. Neb. Feb. 6, 2006) ; *Brown v. Grant Holding, L.L.C., 394 F. Supp. 2d 1090 (D. Minn. 2005)* (court evaluated six factors to determine the existence of an equitable mortgage); *Rowland v. Haven Properties, L.L.C., 2005 U.S. Dist. LEXIS 13353* (N.D. Ill. June 24, 2005) (court refused to dismiss the equitable mortgage claim where a house worth $245,000 was deeded away for only $91,500 and where the homeowner alleged fraud and no intent to sell); *Hruby v. Larsen, 2005 U.S. Dist. LEXIS 42285* (D. Minn. June 30, 2005) (court granted preliminary injunction to maintain status quo; court reviewed elements to prove an equitable mortgage and found that the consumers have a likelihood of success on the merits; court ordered a bond of $1,000 plus monthly payments of $500). *Cf. MERS v. Wilson, 2005 WL 1284047* (N.J. Super. Ct. Ch. Div. May 27, 2005) (court reviewed common law rules regarding proving an equitable mortgage; no allegation of usury).

(n61)Footnote 61. *Cf. Burnett v. Ala Moana Pawn Shop, 3 F.3d 1261 (9th Cir. 1993)* (pawn was really loan subject to Truth in Lending). *But see People v. Lee, 447 Mich. 552, 526 N.W.2d 882 (1994)* (sale with repurchase option not a loan because no obligation to repay--this was a 4/3 decision in a criminal usury prosecution); *Halco Fin. Servs., Inc. v. Foster, 770 S.W.2d 554 (Tenn. Ct. App. 1989)* ; *see also Mertens v. Division of Consumer Servs., 596 So. 2d 89 (Fla. Dist. Ct. App. 1992)* (state challenging auto sale/leaseback/repurchase arrangement as usurious loans with interest rates of 200% to 1000%; decision addresses creditor's *Fifth Amendment* right to decline to produce documents to state agency).

(n62)Footnote 62. *E.g. Ga. Code Ann. § 10-1-393(b)(20)(c)*. This Georgia statute specifically regulates "foreclosure recovery sales," in which a lender purchases a dwelling from a borrower in default, and the borrower remains in possession of the dwelling after the purchase. The statute requires a written contract with certain disclosures and right to cancel 10 days after the purchase. *Cf. Greene v. Team Props., 544 S.E.2d 726 (Ga. Ct. App. 2001)* (discussing statute but holding that borrower's claim past statute of limitations.). *See also Eicher v. Mid America Fin. Inv. Corp., 702 N.W.2d 792 (Neb. 2005)* (foreclosure rescue scam). In addition, six states have enacted laws governing purported sale/leasebacks of homes: Cal. Civ. Code §§ 1695.0-1695.17; *Ga. Code Ann. § 10-1-393(b)(20)(A)*; Ill. S.B. 2349, effective Jan. 1, 2007 (not yet codified); *Md. Real Prop. Code Ann. §§ 7-105(A-1), 7-301-321*; Minn. Stat. Ann. §§ 325N.01-325N.18; *Mo. Ann. Stat. §§ 407.935-407.943*.

(n63)Footnote 63. *754 F. Supp. 860 (S.D. Ala. 1991) . See also Lynn v. Fin. Solutions Corp. (In re Lynn) 173 B.R. 894 (Bankr. M.D. Tenn. 1994)* ; *Quick Cash of Clearwater, Inc. v. State Dep't of Agric., 605 So. 2d 898 (Fla. Dist. Ct. App. 1992)* . For sample pleadings in auto pawn cases, see National Consumer Law Center, Consumer Law Pleadings No. 3, §§ 4.2, 4.3 (2003 Cumulative CD-Rom and Index Guide).

(n64)Footnote 64. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 7.5.2.3 (3rd ed. 2005 and Supp.) for discussion of this and other cases on auto pawn transactions. *See also SAL Leasing, Inc. v. State ex rel. Napolitano, 198 Ariz. 434, 10 P.3d 1221 (Ct. App. 2000)* (court applied six factors to sale/leaseback auto scheme to determine that the transaction was really a loan and subject to state's small loan law).

(n65)Footnote 65. *See, e.g., Fla. Stat. Ann § 537.001*(in 2000, Florida slashed the permissible interest rate from 20% per month to 30% per year on the first $2,000, 24% per year on the amount between $2,000 and $3,000, and 18% on amounts above $3,000, forcing the industry to abandon the state); *Ky. Rev. Stat. Ann. §§ 368.200*-.285, 368.991. Tennessee licensed 214 companies with 894 locations in 2004. Tennessee Dep't of Fin. Inst., Report to the Tennessee General Assembly (Feb. 1, 2006), *available at* www.tennessee.gov/tdfi/admin/GeneralAssemblyReportTitlePledge.pdf. Tennessee also reported that Alabama had 997 locations, followed by Missouri with 250, Utah with 180, South Carolina with 175, Idaho with 119, New Hampshire with 63 (payday and auto title), and Oregon with 58 offices. In 2005, the New Mexico Attorney General enacted auto title lending regulations under authority conferred by the New Mexico Unfair Practices Act. These regulations were to be effective on February 15, 2006 but have been stayed pending the outcome of an industry lawsuit that challenges the regulations. The regulations likely will severely restrict auto title lending; they declare that it is unconscionable to charge more than 54% per annum, require repayment in installments, require underwriting, among other protections. The regulations are available at

www.ago.state.nm.us/divs/cons/small_loan_ruels_regs/small_loan_regs.pdf. *See also Nev. Rev. Stat. §§ 646.010 to 646.060*; *Ohio Rev. Code § 4505.102*; *S.C. Code Ann. §§ 34-39-110 to 34-39-260*; *See also* Idaho Department of Finance Enforcement Policy #2000-1, Fraudulent and Unconscionable Conduct in Title Loans (defines what conduct relating to ability to repay, disclosures, and sale of the vehicles may be unconscionable), *available at* http://finance.idaho.gov/form/ConsumerLender/policy2000-1.pdf; Tennessee Attorney Gen. Op. No. 05-11 (July 12, 2005) (finding that auto title lenders must comply with Article 9 of the U.C.C. unless it conflicts with provisions of the Title Pledge Statute), *available at* www.attorneygeneral.state.tn.us/op/2005/op/op111.pdf.

(n66)Footnote 66. *La. Rev. Stat. Ann. §§ 37:1801.D*; Me. Rev. Stat. § 30-A:3960; Ohio Rev. Stat. §§ 4505.102, 4727.01(A) and 4727.08(E); *S.C. Code Ann. § 40-39-10(3)*. However, South Carolina permits auto title lending not structured as a pawn transaction. *See S.C. Code Ann. § 37-3-413*.

(n67)Footnote 67. *See Malish v. City of San Diego, 101 Cal. Rptr. 2d 18 (Cal. Ct. App. 2000)* (upholding city's right to require pawnbroker to obtain local permit, but striking down parts of ordinance that were inconsistent with state pawnbroker licensing law); *Missouri Title Loans v. City of St. Louis Board of Adjustment, 62 S.W.3d 408 (Mo. Ct. App. 2001)* (zoning action); *Circle D Pawn #2, Inc. v. Norman, 956 P.2d 931 (Okla. Ct. App. 1998)* (local law did not conflict with the state act). *See also* Meredith Fischer and Paige Akin, Board Rules Against Lender: Chesterfield Calls Store Site Wrong, Richmond Times-Dispatch, Jan. 3, 2003, at A12; Dan Kulin, City Considers Restrictions For Payday, Car Loan Firms, Las Vegas Sun, Nov. 5, 2002, at 3.

(n68)Footnote 68. OCC Advisory Letter, No. AL 2000-11 (Nov. 27, 2000), *available at* www.occ.treas.gov/advlst00.htm.

(n69)Footnote 69. For a discussion of leases as secured sales under the UCC, see *§ 10.02[1][c][iv] infra*. *See* National Consumer Law Center, Repossessions §§ 2.1.5, 14.1.1-14.1.3 (6th ed. 2005 and Supp.). *See also* Annot., *4 A.L.R.4th 85 (1981)* ("sale" within scope of UCC Article 2).

(n70)Footnote 70. *See* Ch. 1 *supra* (re: TILA); Ch. 10, "Repossessions," *infra*.

(n71)Footnote 71. *See 15 U.S.C. § 1602(g)*; *compare Clark v. Rent-It Corp., 685 F.2d 245 (8th Cir. 1982)* , *cert. denied, 459 U.S. 1225, 103 S. Ct. 1232, 75 L. Ed. 2d 466 (1983)* ; Green v. Continental Rentals, Clearinghouse No. 50,403 (N.J. Super. Ct. Law Div., Passaic County, Mar. 25, 1994) (RTO agreement a credit sale subject to TIL), *with Smith v. ABC Rental Sys., 491 F. Supp. 127 (E.D. La. 1978)* , *aff'd, 618 F.2d 397 (5th Cir. 1982)* . *See generally* Annot., *59 A.L.R. Fed. 929 (1982)* (leases as TILA credit sales). The above cases were generally decided prior to a 1981 amendment to Reg. Z § 226.2(a)(16), which now defines a credit sale to include certain leases "unless terminable without penalty or at any time by the customer." Many RTO contracts are drafted to fall into that loophole, but at least one court has held that if the transactions are used as a means of purchase, rather than true short-term rentals, they may still be credit sales subject to TIL despite that language. *See In re Hanley, 105 B.R. 458 (Bankr. C.D. Ill. 1989)* , *on motion to alter or amend, 111 B.R. 709 (Bankr. C.D. Ill. 1990)* . Courts differ on whether the fact that a customer forfeits any built-up equity is properly considered as a penalty within the meaning of the Regulation. *Compare In re Hanley, 105 B.R. 458 (Bankr. C.D. Ill. 1989)* , *on motion to alter or amend, 111 B.R. 709 (Bankr. C.D. Ill. 1990)* ; Starks v. Rent-A-Center, Clearinghouse No. 45,215 (Minn. Dist. Ct. 1990), *with* Green v. Continental Rentals, Clearinghouse No. 50,403 (N.J. Super. Ct. Law Div., Passaic County, Mar. 25, 1994) (customer had paid $3336 on $2785 worth of goods at time of repossession; court held penalty includes a forfeiture).

(n72)Footnote 72. *See Sight & Sound of Ohio, Inc. v. Wright, 36 B.R. 885 (S.D. Ohio 1983)* ; *Murphy v. McNamara, 36 Conn. Supp. 183 (1979)* (RTO agreement was unconscionable sale); Broad v. Curtis Mathes Sales Co., Clearinghouse No. 36,376 (CV-82-1254 Me. Sup. Ct., Feb. 6, 1984). *See generally § 10.02 infra*. *See also* National Consumer Law Center, Repossessions § 14.33 (6th ed. 2005).

(n73)Footnote 73. *See In re Puckett, 60 B.R. 223 (Bankr. M.D. Tenn. 1986)* . *See also Michaels v. Ford Motor*

Credit Co., 156 B.R. 584 (Bankr. E.D. Wis. 1993) (court found that the intent of the parties determined that the agreement was a disguised security agreement even though it was called a "Rental Agreement"). *But see In re DWE Screw Prods., Inc., 157 B.R. 326 (Bankr. N.D. Ohio 1993)* . *See generally* National Consumer Law Center, Consumer Bankruptcy Law and Practice, § 11.8 (8th ed. 2006).

(n74)Footnote 74. *See Burney v. Thorn Americas, Inc., 944 F. Supp. 762 (E.D. Wis. 1996)* (measure of damages is the difference between the finance charge and a 5% interest rate; finance charge includes everything except the retail price); *In re Rose, 94 B.R. 103 (Bankr. S.D. Ohio 1988)* ; *Murphy v. McNamara, 36 Conn. Supp. 183 (1979)* ; *Miller v. Colortyme, Inc., 518 N.W.2d 544 (Minn. 1994)* ; Starks v. Rent-A-Center, Clearinghouse No. 45,215 (Minn. Dist. Ct. 1990); Green v. Continental Rentals, Clearinghouse No. 50,403 (N.J. Super. Ct. Law Div., Passaic County, Mar. 25, 1994); *Commonwealth of Pennsylvania v. Riverview Leasing, Inc., Clearinghouse No. 50,401, No. 325 M.D. 1993* (Pa. Commw. Ct. Aug. 5, 1994); Chandler v. Riverview Leasing, Inc., Clearinghouse No. 40,628 (Pa. C.P. Northampton County May 15, 1986); State v. Rentavision Corp. of Am., Clearinghouse No. 35,731 (Tenn. Chanc. Ct. 1983); *Palacios v. ABC TV & Stereo Retail, 123 Wis. 2d 79, 365 N.W.2d 882 (Ct. App. 1985)* ; *LeBakken Rent-To-Own v. Warnell, 223 Wis. 2d 582, 589 N.W.2d 425 (Ct. App. 1998)* ; *Rent-A-Center v. Hall, 181 Wis. 2d 243, 510 N.W.2d 789 (Ct. App. 1993)* . *But see Givens v. Rent-A-Center, Inc., 720 F. Supp. 160 (S.D. Ala. 1988)* , *aff'd mem., 885 F.2d 879 (11th Cir. 1989)* (rental agreement not credit sale under Alabama Consumer Finance Act); *Hawkes Television Inc. v. Maine Bureau of Consumer Credit Protection, 462 A.2d 1167 (Me. 1983)* ; *State v. Action TV Rentals, Inc., 467 A.2d 1000 (Md. 1983)* ; *see also Remco Enters., Inc. v. Houston, 677 P.2d 567 (Kan. App. 1984)* (RTO contract not unconscionable). Note that if an RTO transaction can be shown to be a usurious credit sale at twice the permitted rate or higher, a federal (or state) RICO claim may be appropriate. *See § 6.08[7][b] infra*.

(n75)Footnote 75. For instance, the Minnesota statute being interpreted in Starks v. Rent-A-Center, Clearinghouse No. 45,215 (Minn. Dist. Ct. 1990), included terminable leases within the definition of credit sale in certain circumstances. *See Minn. Stat. § 325G.15* (1989), *superseded by Minn. Stat. §§ 325F.82 to 325F.95*, which, in turn, was interpreted in *Miller v. Colortyme, Inc., 518 N.W.2d 544 (Minn. 1994)* , and *Fogie v. Rent-A-Center, Inc., 867 F. Supp. 1398 (D. Minn. 1993)* (RTO contracts are credit sales for all purposes and, thus, are subject to general contract usury ceiling), *aff'd sub nom. Fogie v. Thorn Ams., Inc., 95 F.3d 645 (8th Cir. 1996)* , *cert. denied, 520 U.S. 1166, 117 S. Ct. 1427, 137 L. Ed. 2d 536 (1997)* .

(n76)Footnote 76. Further analysis and discussion of these arguments can be found in National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 7.5.3 (3rd ed. and Supp.). The Supreme Court of New Jersey recently affirmed that rent-to-own contracts as structured were closer to sales and violated that state's Retail Installment Sales Act. *Perez v. Rent-A-Center, Inc., 892 A.2d 1255 (N.J. 2006)* .

(n77)Footnote 77. For a fuller discussion of RALs and other fringe loans, *see* Lynn Drysdale and Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Socio-Economic Role of Usury Law in Today's Society, 51 S.C. L. Rev. 589 (2000). See also* Chi Chi Wu, Jean Ann Fox & Elizabeth Renuart, *Tax Preparers Peddle High Cost Tax Refund Loans: Millions Skimmed from the Working Poor and the U.S. Treasury*, National Consumer Law Center and Consumer Federation of America (Jan. 31, 2002), *available at* www.consumerlaw.org.

(n78)Footnote 78. This rule comes from the longstanding usury distinction between sales and loans and is a good example of the illogic of the distinction.

(n79)Footnote 79. The use of a sham intermediary will not prevent the application of usury laws. *See, e.g., Graham & Locke Inv., Inc. v. Madison, 295 S.W.2d 234 (Tex. Civ. App. Dallas 1956)* , *writ ref'd n.r.e.*; *Baske v. Russell, 67 Wash. 2d 268, 407 P.2d 434 (1965)* . The argument can be made in the tax refund context that the IRS is merely a sham intermediary for the borrower/assignor's payment to the lender/assignee since the refund is technically the borrower's money. At least one court has held that the assignment of a tax refund falls within this exception to usury law, and that the assignment is not a loan because the taxpayer is never obligated to repay anything to the assignee. *See Cullen v.*

Bragg, 180 Ga. App. 866, 350 S.E.2d 798 (1986) .

(n80)Footnote 80. *See* State *ex rel. Salazar v. The Cash Now Store, Inc., 31 P.3d 161 (Colo. 2001)* (tax assignments were loans, court held, because Cash Now advanced money in exchange for right to collect consumer's anticipated tax refund, which was valuable to lender, creating a debt). *See also* Opinion of the Attorney General of Kentucky, May 3, 1982, Clearinghouse No. 41,261.

(n81)Footnote 81. *See, e.g., Tiffany v. Boatman's Instit., 85 U.S. (18 Wall.) 375, 21 L. Ed. 868, 870 (1874)* . *Cf. Baxter v. Stevens, 54 Wash. App. 456, 773 P.2d 890 (1989)* , *review denied, 113 Wash. 2d 1029, 784 P.2d 530 (1989)* ("sale" of promissory note with recourse guarantee was a loan).

(n82)Footnote 82. *But see Cullen v. Bragg, 180 Ga. App. 866, 350 S.E.2d 798 (1986)* (neither state usury law nor the TILA applied to refund assignment). For a discussion of Truth in Lending rules on tax refund anticipation loans, see National Consumer Law Center, Truth in Lending § 4.4.10.2 (6th ed. 2007).

(n83)Footnote 83. *See Consent Order, 94 F.T.C. 425* (Sept. 12, 1979) , *modified 51 Fed. Reg. 43,587* (Dec. 3, 1986) (Beneficial Finance precluded from using the terms "instant tax refund" or "immediate tax refund" except in immediate conjunction with the word "loan"). For a compilation of enforcement actions filed by state attorney generals based upon this mischaracterization, see *JTH Tax, Inc. v. H&R Block E. Tax Servs., 128 F. Supp. 2d 926, 938 (E.D. Va. 2001)* , *aff'd in part, vacated in part, and remanded in part*, *28 Fed. Appx. 207, 2002 U.S. App. LEXIS 477 (4th Cir. 2002)* .

(n84)Footnote 84. *See* Chi Chi Wu, Jean Ann Fox & Elizabeth Renuart, *Tax Preparers Peddle High Cost Tax Refund Loans: Millions Skimmed from the Working Poor and the U.S. Treasury*, at 11-15, National Consumer Law Center and Consumer Federation of America (Jan. 31, 2002), *available at* www.consumerlaw.org.

(n85)Footnote 85. *See* National Consumer Law Center, Truth in Lending § 4.4.10.2 (6th ed. 2007).

(n86)Footnote 86. *See Cades v. H & R Block, 43 F.3d 869 (4th Cir. 1994)* , *cert. denied, 515 U.S. 1103, 115 S. Ct. 2247, 132 L. Ed. 2d 255 (1995)* (H & R Block office itself did not constitute a "branch" office); *see also Christiansen v. Beneficial Nat'l Bank, 972 F. Supp. 681 (S.D. Ga. 1997)* (same relying upon *Cades* decision). *See also* OCC amendment to Interpretive Ruling (7.1012 addressing "messenger services"), *64 Fed. Reg. 60,092* (Nov. 4, 1999) .

(n87)Footnote 87. *Conn. Gen. Stat. § 42-480(d)* and *(e)*. The Connecticut RAL cap was struck down as preempted by the National Bank Act. *Pacific Capital Bank, N.A. v. Conn., 2006 U.S. Dist. LEXIS 55627* (D. Conn. Aug. 10, 2006) . The case is currently on appeal to the Second Circuit Court of Appeals.

(n88)Footnote 88. *815 Ill. Comp. Stat. 177/1 to 177/99*.

(n89)Footnote 88.1. *Cal. Bus. & Prof. Code §§ 22251*, *22253.1* (West).

(n90)Footnote 88.2. *Minn. Stat. § 270.30*; Nev. Rev. Stat. §§ 52.2 to 52.18; *N.C. Gen. Stat. §§ 53-245 to 53-254*; *Or. Rev. Stat. 673.605*; *Va. Code Ann. 6.1-474*; *Wash. Rev. Code §§ 19.265.010 to 19.265.900*; *Wis. Stat. §§ 421.301*, *422.310*.

(n91)Footnote 88.3. San Antonio City Code §§ 16-901 to 16-907; N.Y. City Admin. Code § 20-739; ACORN Press Release, *Seattle Passes Anti-RAL Legislation*, Sept. 24, 2004.

(n92)Footnote 89. *See, e.g., Petersen v. H & R Block Tax Servs., 22 F. Supp. 2d 795 (N.D. Ill. 1998)* ; *Affatato v. Beneficial Corp., 1998 U.S. Dist. LEXIS 12447* (E.D.N.Y. Aug. 7, 1998) ; *Green v. H & R Block, Inc., 355 Md. 488, 735 A.2d 1039 (1999)* ; *Basile v. H & R Block, Inc., 777 A.2d 95, 2001 Pa. Super. 136 (2001)* , *appeal denied*, *806 A.2d 857 (Pa. 2000) subsequent proceedings at 2004 Pa. Dist. & Cnty. Dec. LEXIS 253* (Pa. Super. Ct. Mar. 1, 2006) (trial

court's order to de-certifying the class reversed due to the defendant's failure to appeal the certification order in 1997) (reversing finding on fiduciary relationship); *H & R Block v. Haese, 976 S.W.2d 237 (Tex. App. 1998)* .

(n93)Footnote 90. *Compare Peterson v. H & R Block Tax Servs., 971 F. Supp. 1204 (N.D. Ill. 1997)* (motion to dismiss on breach of duty of good faith and fair dealing denied; granted as to breach of fiduciary duty, *174 F.R.D. 78 (N.D. Ill. 1997)* (class certification granted on RICO and UDAP claim); *Green v. H & R Block, Inc., 355 Md. 488, 735 A.2d 1039 (1999)* (tax preparer found to be agent of consumer thus creating fiduciary duty to advise the consumer that it receives payments and other benefits from the lender for facilitating the making of the loan), *with Beckett v. H & R Block, 306 Ill. App. 3d 381, 239 Ill. Dec. 736, 714 N.E.2d 1033 (1st Dist. 1999)* , *reh'g denied*, (Aug. 3, 1999) (tax preparer not an agent; no duty to disclose secret profit to consumer); *Basile v. H & R Block, Inc., 563 Pa. 359, 761 A.2d 1115 (2000)* , *appeal denied*, *806 A.2d 857 (Pa. 2002)* (reversed lower court decision denying summary judgment on breach of fiduciary duty).

(n94)Footnote 91. *2000 U.S. Dist. LEXIS 11535* (N.D. Ill. July 21, 2000) (objections to the settlement included allegations that it would only pay pennies on the dollar and that it was a product of collusion between Block, Beneficial, and some "friendly" plaintiffs' attorneys; these claims were rejected by the court).

(n95)Footnote 92. *Reynolds v. Beneficial Nat'l Bank, 288 F.3d 277 (7th Cir. 2002)* .

(n96)Footnote 93. *Reynolds v. Beneficial Nat'l Bank, 260 F. Supp. 2d 680 (N.D. Ill. 2003)* .

(n97)Footnote 94. *Carnegie v. Household Int'l, Inc., 220 F.R.D. 542 (N.D. Ill. 2004)* (in addition, court dismissed the breach of contract claim as to H & R Block, and withdrew class certification for several state claims on the basis that a fifty state legal analysis would be required to resolve them, presenting an intractable class manageability problem; court also reaffirmed a ruling by prior judge enforcing mandatory arbitration clauses against those RAL customers whose contracts included them), *aff'd*, *376 F.3d 656 (7th Cir. 2004)* . In 2005, the district court refused to proceed to a fairness hearing regarding another weak settlement proposal and refused to enjoin lawsuits proceeding in other courts. *Carnegie v. Household Int'l, Inc., 371 F. Supp. 2d 954 (N.D. Ill. 2005)* ; *see also Turner v. Beneficial Nat'l Bank, 405 F. Supp. 2d 929 (N.D. Ill. 2005)* (court approved only a fraction of the fee sought by a named plaintiff in the large class case who decided to pursue her own individual case; court had previously determined that the attorney had not adequately represented the class).

(n98)Footnote 94.1. Public Law 109-364 (Passed by Congress:109th Congress (2nd Session)).

(n99)Footnote 95. *See* State of Colorado, Department of Law 1998 Post-Dated Check Cashers Supervised Lenders' Annual Report; Indiana Department of Financial Institutions, Summary of Payday Lender Examinations Conducted from 7/99 thru 10/99. *See also* Jean Ann Fox, *The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry*, Consumer Federation of America (Nov. 1998). *See also Thomas v. Money Mart Fin. Servs., Inc. (In re Thomas), 2005 U.S. App. LEXIS 29334 (8th Cir. 2005)* (court describes payday loans with APRs of almost 704%; holding is case is unrelated to size of APRs--presentment of checks for payment after the due date and after bankruptcy was filed but before actual discharge does not violate the automatic stay).

(n100)Footnote 96. *See, e.g., Smith v. Short Term Loans, LLC, 2001 U.S. Dist. LEXIS 1554* (N.D. Ill. Feb. 9, 2001) (one named plaintiff received 15 payday loans in a 9 month period, while the other plaintiff obtained 11 loans in an 8 month span); *GoldX Fin. Servs., Inc. v. Bank of Am., 2001 Cal. App. Unpub. LEXIS 2749* (Cal. Ct. App. Oct. 11, 2001) (payday lender involved in this suit against its bank claimed that the average number of transactions per customers at two of its locations was about 21). *See also* Indiana Department of Financial Institutions, Summary of Payday Lender Examinations Conducted from 7/99 thru 10/99.

(n101)Footnote 97. *See Henry v. Cash Today, Inc., 199 F.R.D. 566 (S.D. Tex. 2000)* (class certification granted in cash back ad sale case on TILA, RICO, usury, UDAP, and civil conspiracy claims); *Cashback Catalog Sales, Inc. v. Price, 102 F. Supp. 2d 1375 (S.D. Ga. 2000)* (catalog sale sham).

(n102)Footnote 98. A notable and increasingly problematic exception applies to national and state banks and similar entities, discussed in *§ 6.02 supra*.

(n103)Footnote 99. These states are: Arkansas; Connecticut; Georgia; Maine; Maryland; Massachusetts; New Jersey; New York; North Carolina (payday loan law expired on Aug. 31, 2001); Pennsylvania; Vermont; Virgin Islands; West Virginia.

The Attorneys General in Florida, Indiana, Maryland, and New York have issued opinions letters finding that payday loans do, indeed, violate the laws of those states. The New York Banking Department has issued a letter warning against payday lending in excess of that state's usury cap.

(n104)Footnote 100. This state is Wisconsin.

(n105)Footnote 101. These states are: Alabama, Arizona, Alaska, California, Colorado, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, and Wyoming. In 2000, the Texas Finance Commission adopted regulations to permit small loan lenders to hold a check; other provisions of the small loan act apply, though the allowable rates are higher than for other small loans. Regulations in Illinois and Oregon have both survived initial challenges by the payday loan industry. *See* 51 *Dev. Corp. v. Vega, 781 N.E.2d 528 (Ill. App. Ct. 2002)* (legislation contained a permissible delegation of authority to the state agency; subsequent regulations were not void or issued in violation of state administrative procedures act); *Northwest Title Loans v. Div. of Fin., 42 P.3d 313 (Or. Ct. App. 2002)* . Delaware, which does not have a usury cap, passed a payday loan law in 2002 that provides very limited protections for payday loan borrowers. South Dakota, another state without a usury cap, passed a similarly limited payday loan law in 2002.

(n106)Footnote 102. These states are: Delaware, Maine, New Jersey, New York, Pennsylvania, Virginia, and West Virginia.

(n107)Footnote 103. *See Cashback Catalog Sales, Inc. v. Price, 102 F. Supp. 2d 1375 (S.D. Ga. 2000)* ; *Turner v. E-Z Check Cashing, Inc., 35 F. Supp. 2d 1042 (M.D. Tenn. 1999)* ; *Hamilton v. York, 987 F. Supp. 953 (E.D. Ky. 1997)* ; *White v. Check Holders, Inc., 996 S.W.2d 496 (Ky. 1999)* .

(n108)Footnote 104. *See Arrington v. Colleen, Inc., 2000 U.S. Dist. LEXIS 20651* (D. Md. Aug. 7, 2000) (order and memorandum denying lender's motion for summary judgment); *Turner v. E-Z Check Cashing, Inc., 35 F. Supp. 2d 1042 (M.D. Tenn. 1999)* ; *Hamilton v. York, 987 F. Supp. 953 (E.D. Ky. 1997)* . The Federal Reserve Board, which promulgates regulations and interpretations under the Truth in Lending Act, amended the definition of credit in the Official Staff Commentary to include payday loans. *65 Fed. Reg. 17,129* (Mar. 31, 2000) .

(n109)Footnote 105. *Cashback Catalog Sales, Inc., 102 F. Supp. 2d 1375 (S.D. Ga. 2000)* ; *Arrington v. Colleen, Inc., 2000 U.S. Dist. LEXIS 20651* (D. Md. Aug. 7, 2000) (order and memorandum denying lender's motion for summary judgment); *Hamilton v. York, 987 F. Supp. 953 (E.D. Ky. 1997) . See also Henry v. Cash Today, Inc., 199 F.R.D. 566 (S.D. Tex. 2000)* (class certification granted in cash back ad sale case). *But see Bellizan v. Easy Money of La., Inc., 2001 U.S. Dist. LEXIS 18570* (E.D. La. Nov. 9, 2001) (RICO claims dismissed without prejudice).

(n110)Footnote 106. For a discussion of the elements of a RICO claim in the credit transaction context, see *§ 6.08[7] infra*.

(n111)Footnote 107. *Jones v. Kunin, 2000 U.S. Dist. LEXIS 6380* (S.D. Ill. May 1, 2000) (no intent by consumer to defraud when the parties agreed at the time a check is written that there are not sufficient funds to cover it); *Hartke v. Illinois Payday Loans, Inc., 1999 U.S. Dist. LEXIS 14937* (C.D. Ill. Sept. 13, 1999) (in the course of denying the defendants' motion to dismiss, court observes that the Illinois bad check statute does not apply to agreements to hold

post-dated checks because the payee knows the check is no good when written).

(n112)Footnote 108. *See, e.g., Boyce v. Attorney's Dispatch Serv., 1999 U.S. Dist. LEXIS 12970* (S.D. Ohio Apr. 27, 1999) (court found "egregious conduct" on the part of a collector of a payday loan which violated the Fair Debt Collection Practices Act; the collector identified himself as a police officer and threatened criminal prosecution); *King v. Cashland, Inc., 2000 Ohio App. LEXIS 3943* (Ohio Ct. App. Sept. 1, 2000) (court reversed grant of summary judgment on an invasion of privacy claim based upon payday lender's attempts to collect the debt). *See Smith v. Short Term Loans, LLC, 2001 U.S. Dist. LEXIS 1554* (N.D. Ill. Feb. 14, 2001) (the lender's employee, an attorney, may be liable under the federal Fair Debt Collection Practices Act for the content of collection letters sent to the consumer while wearing his attorney hat). *See also* National Consumer Law Center, Fair Debt Collection § 4.2.3 (4th ed. 2000 and Supp.).

(n113)Footnote 109. For a detailed discussion of state credit repair laws, see National Consumer Law Center, Unfair Acts and Practices § 6.15 (7th ed. 2008 and supp.).

(n114)Footnote 110. The federal act is discussed in National Consumer Law Center, Unfair Acts and Practices § 6.15 (7th ed. 2008 and supp.).

(n115)Footnote 111. Checking the TILA math to determine if the APR, finance charge, amount financed, total of payments, and payment schedule can prove fruitful. *See Gilkey v. Central Clearing Co., 202 F.R.D. 515 (E.D. Mich. 2001)* (class certified on TILA claims that the finance charge and annual percentage rate did not include the check cashing fee and that additional information detracted from the finance charge disclosure); *Smith v. Check-N-Go, Inc., 200 F.3d 511 (7th Cir. 1999)* (reinstated a TILA claim based upon the creditor's practice of stapling a receipt over part of the TILA disclosure).

(n116)Footnote 112. For other Truth in Lending claims raised in the payday loan context, see National Consumer Law Center, Truth in Lending §§ 4.9.4 (6th ed. 2007 and supp.).

(n117)Footnote 113. This and other defenses to arbitration clauses are discussed in *§ 6.06[6][f] infra. See also Gilkey v. Central Clearing Co., 202 F.R.D. 515 (E.D. Mich. 2001)* (class certified on TILA claims that the finance charge and annual percentage rate did not include the check cashing fee and that additional information detracted from the finance charge disclosure); *Brown v. Payday Check Advance, Inc., 202 F.3d 987* (7th Cir.) , *cert. denied, 531 U.S. 820, 121 S. Ct. 61, 148 L. Ed. 2d 27 (2000)* (including itemization of the amount financed in the federal box violates the segregation requirement but statutory damages not available for this violation). For a critique of the holding relating to statutory damages, see National Consumer Law Center, Truth in Lending § 8.6.5 (2000 Supp.).

(n118)Footnote 113.1. *See, e.g., N.C. Gen. Stat. § 53-190(a)*; *In re* United Consumer Fin. Servs., Inc., Case No. 06-CM-725 (Kan. State Bank Commissioner Aug. 22, 2006) (consent and settlement agreement), *available at* www.consumerlaw.org/unreported; Press Release, Massachusetts Office of Consumer Affairs and Business Regulation (Apr. 19, 2007) (consumer alert indicating that no payday lenders are licensed in the state and therefore, none should be doing business with Massachusetts residents by whatever means), *available at* www.mass.gov/?pageID=pressreleases&agId=Eoca&prModName=ocapressrelease&prFile=07_04_19_paydayalert.xml. *Cf. Rascon v. Checkcare Enters., 2006 U.S. Dist. LEXIS 56433* (N.D. Cal. Aug. 1, 2006) (California court may have personal jurisdiction over a Kentucky payday lender though its activities with its collection agency located in California; lender's motion to dismiss denied). At least one Internet payday lender filed a preemptive strike seeking a declaration that it need not comply with state law. *Quik Payday, Inc. v. Stork, 2006 U.S. Dist. LEXIS 69436* (D. Kan. Sept. 26, 2006) (court found this Internet payday lender has standing to file a § 1983 claim against the bank commissioner alleging a violation of due process for attempting to apply Kansas law against it; lender need not exhaust administrative remedies).

(n119)Footnote 113.2. Pub. L. No. 109-364, § 670, *120 Stat. 2266 (2006)*. Section 670 is codified as *10 U.S.C. § 987*. They have been posted on the National Consumer Law Center's website (wwww.consumerlaw.org) under "Action

Agenda" and "Military Personnel."

(n120)Footnote 113.3. *72 Fed. Reg. 50,585* (Aug. 31, 2007) .

(n121)Footnote 113.4. *32 C.F.R. § 232.3(b)(1)(i).*

(n122)Footnote 113.5. *10 U.S.C. § 987(d).*

(n123)Footnote 113.6. Arkansas Att'y Gen. Op. No. 2007-264 (Dec. 19, 2007), *available at* http://ag.arkansas.gov/opinions/docs/2007-264.pdf.

(n124)Footnote 114. *See, e.g.*, Favors v. Stewart, Clearinghouse No. 54,590 (Ga. Sup. Ct. July 9, 2002) (complaint).

(n125)Footnote 115. *See, e.g., Sparks v. Stone Street Capital, 2002 U.S. Dist. LEXIS 13744* (N.D. Tex. July 15, 2002) (class action on behalf of consumers who transferred their interests in structured settlement payments in exchange for money; motion to compel arbitration granted); *Rancman v. Interim Settlement Funding Corp., 2001 Ohio 1669* (App. Ct.) (payment collateralized by possible settlement in personal injury litigation), *appeal pending*.

(n126)Footnote 116. *See, e.g., Singer Asset Fin. v. Duboff Family Invs. (In re Duboff), 290 B.R. 652 (Bankr. C.D. Ill. 2003)* (assignment of Illinois lottery prize payments violated Illinois lottery law and thus was void).

(n127)Footnote 117. *See, e.g., Rancman v. Interim Settlement Funding Corp., 2001 Ohio 1669* (App. Ct.) , *aff'd on other grounds, 789 N.E.2d 217 (Ohio 2003)* .

(n128)Footnote 118. *See, e.g., Sparks v. Stone Street Capital, 2002 U.S. Dist. LEXIS 13744* (N.D. Tex. July 15, 2002) (motion to compel arbitration granted); *Rancman v. Interim Settlement Funding Corp., 2001 Ohio 1669* (App. Ct.) (lender characterized payment collateralized by possible settlement a "contingent cash advance" and not a loan; court disagreed), *appeal pending*.

(n129)Footnote 119. *But see Rancman v. Interim Settlement Funding Corp., 2001 Ohio 1669* (App. Ct.) (payment collateralized by possible settlement in automobile personal injury litigation was loan when there was no real probability that non-payment would occur), *appeal pending*.

(n130)Footnote 120. *See, e.g., In re Wiggins, 273 B.R. 839 (Bankr. D. Idaho 2001)* (income buyer violated Idaho UDAP statute in convincing young accident victim suffering from brain injuries to sell his rights to a structured annuity).

(n131)Footnote 121. With respect to lottery payments, some states may prohibit their assignment by statute or regulation. *See, e.g., Singer Asset Fin. v. Duboff Family Invs. (In re Duboff), 290 B.R. 652 (Bankr. C.D. Ill. 2003)* . With respect to a tort claim that has already been settled, many of those settlements result in annuities being paid to the plaintiff that often contain an anti-assignment clause. *See, e.g., Liberty Life Assurance Co. v. Stone Street Capital, 93 F. Supp. 2d 630 (D. Md. 2000)* (anti-assignment clause of structured settlement was enforceable by insurer that paid annuity); *Grieve v. General Am. Life Ins., 58 F. Supp. 2d 319 (D. Vt. 1999)* (same). There may be an issue of whether these anti-assignment clauses are prohibited by Article 9 of the Uniform Commercial Code. *See* National Consumer Law Center, Cost of Credit § 7.5.8 (4th ed. 2009); and National Consumer Law Center, Repossessions, § 2.2.8 (6th ed. 2005 and supp.).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 6 The Cost of Credit

1-6 Consumer Credit Law Manual § 6.06

§ 6.06 Credit Insurance

[1] Introduction

One of the most remunerative methods for imposing extra costs on a credit transaction is the sale of credit insurance. This chapter will seek to identify some of the potential overcharge claims which may arise in regard to credit insurance, and to identify other theories which also may be used to challenge various common credit insurance practices.

[2] Types of Credit Insurance

[a] Credit Life

Credit life pays off an outstanding obligation in the event of the borrower's death. There are two types of credit life.

[i] Decreasing or Declining Term Credit Life Insurance

This is the most commonly sold type of credit life. "Decreasing term" means that the amount of coverage decreases as the balance on the loan declines because of the installment payments.

[ii] Level Term Credit Life Insurance

In this type of policy, the amount of coverage or benefits payable does not decrease despite the fact that the installment payments reduce the account balance. The benefits payable remain level over the entire term of the policy.

Because the coverage does not decline with the loan balance, level life overinsures the loan even more than gross coverage decreasing insurance; it provides excessive coverage for which the borrower pays. It is more expensive than declining term; premium rates may be over 50% higher. For these reasons, it is illegal to write level term credit life on amortized loans in most states. If it is sold impermissibly, an overcharge claim may be raised. n1

[b] Credit Disability/Accident and Health

The purpose of credit disability insurance is to insure that payments on a loan or credit sale will still be made should

sickness or accident cause a significant unanticipated interruption in income. Credit disability is indemnity coverage, which makes the monthly payments while the insured borrower is unable to work due to a disability covered under the policy--a "covered loss."

Two critical terms determine what type of credit disability insurance is offered: "waiting period" and "elimination period." The waiting period is the number of continuous days a person is required to be "disabled" by sickness or accident before the disability comes within the coverage provisions of the policy. The elimination period is the initial number of days in the period of disability for which there are no benefits payable by the policy. Another restriction in some policies is a shifting definition of "total disability," whereby for the first year benefits are available when the insured cannot perform duties of the insured's current occupation, and thereafter benefits only continue if the insured cannot perform duties of any occupation. n1.1

Other restrictions may apply and insurance policies and information provided the consumer should be carefully reviewed. For example, one bank offered a "credit protection plan" (a package of credit insurances) sold in conjunction with credit card accounts. Restrictions related to the hospitalization, sickness, or disability coverage included: the consumer could only collect for the number of months that the consumer paid in; claims could be denied for pre-existing conditions unless the consumer had paid six months of premiums, if the consumer's account was not current or over-limit, if the consumer paid more than the minimum payment to any credit card account other than the bank's, and if the consumer accessed credit from any credit card other than the bank's. n2

[c] Involuntary Unemployment Insurance

This protection is aimed primarily at loss of income caused by lay-offs, though some policies will also make monthly payments on a credit account if, in certain circumstances, the borrower goes out on strike or is fired. Unemployment insurance may be sold separately, or in combination with credit disability coverage.

The benefits of this type of insurance are usually limited, for example, providing protection only for short-term unemployment, paying a limited number of payments, or paying only the minimum monthly payment. n3

In addition, recent products sold in conjunction with credit card accounts may limit coverage to the number of months that the consumer paid in or if the consumer is self-employed and may deny claims if the consumer's account was not current or over-limit, if the consumer paid more than the minimum payment to any credit card account other than the bank's, and if the consumer accessed credit from any credit card other than the bank's. n4 Others may fail to pay the minimum monthly payment due on the credit card. n5

[d] Credit Property

Credit property insurance insures the borrower's property, rather than health or life. The coverage is designed to protect the creditor against loss to the collateral taken as security on the insured loan. However, it is not unknown for credit property insurance to be written on property unrelated to the loan, or for coverage to be written in amounts greater than the loan despite the fact that this practice may be illegal in many states. n6 Credit property insurance is less thoroughly regulated than credit life and A&H, and generally is not rate regulated at all.

[e] Vendor's Single Interest Insurance

Vendor's Single Interest Insurance ("VSI") protects only the creditor's interest in the property. Generally it pays the lesser of the actual loss on the property or the outstanding balance on the loan.

VSI appears on many automobile retail installment contracts as an additional charge of $15 to $50. Sometimes the car dealer, i.e., the vendor, has no relationship with the insurance company. Instead, the assignee purchasing the loan from

the dealer has a group policy with an insurance company for the purchase of a policy. The charge for that policy is passed through the dealer to the consumer.

Arguably, the charge is not for "vendor's" insurance because the vendor, i.e., the dealer, did not actually sell any insurance to the consumer. The "VSI" charge, in this instance, may simply be a charge by a third party to accept assignment of the contract. In addition, the consumer may have had no real "choice" about the charge because the business practice between the dealer and the assignee is that every retail installment contract must contain the charge in order to be assigned.

[f] Dual Interest

Dual interest protects the value of the insured property including the borrower's equity, and is not limited by the outstanding balance on the loan.

[g] Motor Vehicle Credit Insurance

As with other types of credit property, credit property insurance on cars can be either VSI or dual interest. It is very difficult for a consumer to accurately compare the cost of credit property insurance on a motor vehicle with ordinary auto insurance. However, the much-less-comprehensive coverage of credit property insurance usually does not result in much cheaper premiums. n7

Auto loans have also been a prime source of problems with force-placed insurance, or collateral protection insurance ("CPI"). n8 Creditors have a legitimate interest in requiring that their collateral is insured against collision, theft and fire. Most auto loan contracts provide that the creditor has the right to purchase property insurance and add the cost to the debt if borrowers let their coverage lapse or otherwise fail to provide it. While this might sound perfectly convenient and unobjectionable for the borrower, the force-placed insurance is generally VSI, leaving the borrower's equity unprotected. More to the point, it is very expensive. The same forces driving other credit insurance abuses drive this, too: the coverage is purchased from affiliated companies; large commissions; and rebates are given to the creditors.

Some of the additional expense of force-placed insurance derives from purchasing default protection for the lender, in addition to insuring the collateral. The premium price for this add-on coverage has been held to constitute interest. n9 A wide range of other abuses have made force-placed insurance the subject of litigation resulting in $300 million settlements. n10

[3] Debt Cancellation and Debt Suspension Agreements

Credit insurance may soon be replaced by debt cancellation or debt suspension agreements in the consumer loan context. One reason for this anticipated shift is that many states do not regulate these products, having decided that they are "banking products" and thus do not constitute "insurance." n11 In the public arena, single-premium credit insurance has fallen out of favor in the mortgage-lending context.

For the consumer, a debt cancellation or suspension agreement functions much like traditional credit insurance. For a fee (akin to a premium), the lender agrees to cancel payment on the consumer's loan in the event of death, serious illness or injury, unemployment, or loss of collateral securing the loan or suspend payments for some of these same events as well as when divorce, family leave from work, military relocation, and even incarceration of a spouse occur. While credit insurance usually involves a third-party insurer, debt cancellation or suspension agreements are between the consumer and the lender.

Although similar in structure, debt cancellation and suspension agreements generally offer far fewer benefits than credit insurance due to differences in covered or triggering events and the types of benefits provided. For example, unlike

credit insurance, death benefits under most debt protection products generally apply only in case of accidental death. As a result, only about ten percent of the eligible claims under a credit life insurance policy would result in a payment of benefits under a debt cancellation agreement. Moreover, a debt suspension agreement provides even more limited benefits than those provided by a debt cancellation agreement; instead of canceling payment of interest and principal, it simply waives the monthly finance charge for the covered months. Most credit card credit insurance programs have been replaced by these limited debt suspension agreement programs. n12

Guaranteed Auto Protection ("GAP") agreements are among the most common forms of debt cancellation agreements currently on the market. Under a GAP plan, when a consumer finances the purchase of a car, the creditor agrees to hold the consumer harmless for the difference between the balance on the debt and the amount paid under an automobile physical damage insurance policy in the event that the vehicle is totaled or stolen. n13 Truth in Lending treats debt cancellation contracts, including GAP, the same as credit insurance for purposes of disclosure requirements and finance charge treatment. n14

New regulations issued by the OCC n15 have opened the floodgates for the sale of debt cancellation and suspension agreements (collectively, "DCAs") as banking products rather than insurance. While most of the OCC regulations concerning DCAs became effective on June 16, 2003, implementation of certain key provisions has been indefinitely delayed due to industry concerns. The OCC announced that it is delaying the date for mandatory compliance with regulations requiring creditors to offer a periodic payment option in cases of broker sales ("unaffiliated, non-exclusive agents of a national bank that offer that bank's DCC or DSA in connection with closed-end consumer credit"). n16 Related disclosure requirements have also been suspended. They apply only to national banks. Under Gramm-Leach-Bliley, n17 the regulations preempt state regulation of national banks with regard to DCAs. n18

The OCC's newly adopted regulations codify its long-held view that DCAs are not insurance n19 and provide only minimal substantive consumer protections. The OCC primarily relies on disclosure of the terms of the agreement to protect consumers. n20 Because of Gramm-Leach-Bliley preemption, state provisions that limit fees, require refunds of lump-sum premiums in the event of prepayment, and otherwise treat DCAs as insurance no longer apply to national banks.

[4] Types of Regulation

[a] Sources of Regulation

Most states specifically designate in their insurance codes chapters devoted to credit insurance. The majority of these are based on the Model Credit Life, Accident and Health Insurance Act, developed by the National Association of Insurance Commissioners ("NAIC") in 1960. n21 In 2001, the NAIC finally adopted a credit personal property insurance model act. n22 If enacted by the states, this act will curb some of the abuses in this market, most especially excessive cost of this type of insurance. Another source of insurance legislation dealing with credit insurance, in addition to the state's special chapter on credit insurance, is the state's general group insurance laws. n23

For purposes of examining a debt for insurance-related overcharges, the most important state insurance law provisions regulating credit insurance are those dealing with rate structure and any restrictions on coverage, such as insured amount or term of the insurance. Premium rates are set by statute or regulation, or approved in accordance with formulae set by insurance regulations.

In addition, special usury laws, such as small loan acts, consumer loan acts, industrial loan acts, second mortgage laws or general credit statutes, including retail installment sales acts, may contain important limitations on the sale of credit insurance.

Most importantly for usury purposes, special usury statutes usually establish limitations on the premium cost, often by

providing that insurance must be written in compliance with the credit insurance code, n24 or by otherwise referring to the insurance department rate limitations. n25 These statutes often specify, implicitly or explicitly, the conditions which must be met in order for the insurance premiums to be excluded from the finance charge, such as that the insurance must be voluntary, n26 or that the charges must be imposed in compliance with specified statutory provisions. n27 Special usury statutes also may impose disclosure requirements in addition to those of the Truth in Lending Act. n28

UDAP laws should also be considered as a source for establishing the consumer's rights and remedies in these cases. However, care must be taken to assure that the state UDAP statute does not exclude credit or insurance transactions from coverage. n29

In addition to general UDAP statutes, every state has adopted some version of an "unfair insurance trade practices act" ("UNIP"), n30 again based on an NAIC Model UNIP Act. Though UDAP and UNIP statutes will generally be of little value in dealing with usury issues raised by credit insurance, it is important to be aware of them, as they may squarely address some of the marketing abuses often involved in credit insurance sales.

There are also federal causes of action that should be considered in credit insurance cases. Truth in Lending is one such statute. However, it is a disclosure statute which does not substantively regulate the cost or terms of credit insurance. The most important TIL provisions relating to credit insurance set forth the conditions under which the lender may exclude the premium cost from the calculation of the finance charge for TIL disclosure purposes. n31 Where a creditor retains a portion of the credit insurance premium, TIL requires the creditor to disclose that it is receiving such a payment. n32

Additionally, for loans entered into on or after October 1, 2002, single premium credit insurance and debt cancellation coverage are included in the "points and fees" calculation when determining whether the Homeownership and Equity Protection Act (HOEPA) applies. n33 As a result, high-cost loans with substantial single premium credit insurance or debt cancellation coverage are more likely to be covered by HOEPA and therefore subject to additional restrictions, prohibitions and disclosure requirements.

The insurance-related activities of banks and bank holding companies are subject to the requirements of the Bank Holding Company Act and Regulation Y. n34 The Act prohibits tying credit to the purchase of credit insurance from the bank, holding company, or an affiliate. n35 It also limits the right of regulated banks and bank holding companies to underwrite insurance to those circumstances where the underwriter's performance could "reasonably be expected to produce benefits to the public." n36

In 2000, the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision issued joint regulations under this provision of the Act. n37 The effective date was October 1, 2001. n38 The regulations cover prohibited practices, disclosures, restrictions on where insurance activities may take place, and insurance sales personnel licensing requirements and qualifications.

The regulations prohibit any covered person from leading a consumer to believe that an extension of credit is conditional upon either: (1) the purchase of an insurance product or an annuity from the bank or any of its affiliates or (2) an agreement by the consumer not to obtain, or a prohibition on the consumer from obtaining, any insurance product or annuity from an unaffiliated entity. In addition, disclosures regarding insurance products are required. n39

Following publication of the regulations, these agencies issued responses to questions from the American Bankers Insurance Association and the American Bankers Association. These topics covered include: under what circumstance private mortgage insurance and renewals of insurance are covered by the regulations and timing of disclosures when solicitation of the customer to purchase insurance does not occur until after the loan application has been approved. This document is available at www.occ.treas.gov/abaqa8-13.doc.

Finally, insurance premium financing statutes commonly apply to automobile insurance premiums where the insured cannot afford to pay the entire amount in a single installment. However, these statutes may also apply, in some instances, to a lender's sale of extraneous insurance such as are often sold in insurance-packing schemes. Some of these statutes do not apply to traditional lenders, however. n40

In 2000, the Office of Comptroller of the Currency published for comment three requests that the OCC determine that certain state insurance laws are preempted by Gramm-Leach Bliley. n41 The OCC has acted upon only two of these requests, the ones addressing West Virginia and Massachusetts law. The agency opined that some provisions of West Virginia insurance law are preempted and some are not. n42 On the other hand, the OCC found that all of the sections of Massachusetts law at issue are preempted. n43

[b] Substance of Credit Insurance Regulations

[i] Rates

Most states have a prescribed mechanism for establishing authorized rates for credit life and disability insurance. Few states have any rate regulation for credit property or involuntary unemployment insurance. Consequently, this discussion relates primarily to credit life and disability rates.

With respect to credit life, a few states have established maximum rates by statute or regulation. These are generally cast as x cents per $100 of the initial indebtedness per year, e.g., 60cent(s)/$100/yr. n44 The more common approach for both credit life and disability, however, is not an inflexible statutory maximum ceiling, but the more fluid concept of prima facie rates. The generally used method of determining what premium rate would be "reasonable in relation to the benefits" is to adopt a "benchmark loss-ratio," and then to attempt to establish rates expected to produce that benchmark loss-ratio.

One problem with prima facie rates is that they result from a guess as to what will achieve the benchmark loss-ratio, though past experience is supposed to guide the process. The guessing historically has been on the high side.

As the term indicates, the prima facie rate is a presumptive standard of reasonable benefits. An insurer may request that the insurance department grant an "upward deviation," which then allows it to charge a higher premium. Theoretically, the insurer must present actuarial evidence to the department to establish that the prima facie rate is insufficient. Only a few states have mandatory downward deviations if the rates charged do not meet the benchmark loss-ratio. n45

However, in some circumstances, it may be possible to challenge prima facie rates. A state commissioner who has authorized prima facie rates which result in loss-ratios lower than the state's target benchmark loss-ratio may be vulnerable to a mandamus challenge from consumers. This rarely has been done, though consumers were ultimately successful in Ohio and Illinois when this approach was tried. n46

[ii] Non-Rate Regulation

In addition to rates, there are a number of other aspects of the credit insurance transaction which may be governed by insurance, credit, or UNIP statutes. For credit life and disability, the term of coverage may be limited; n47 the NAIC Model Code excludes long-term credit transactions from its coverage. Initial coverage usually is limited to the initial indebtedness, n48 interpreted to mean the total of payments. n49 Many states require that credit life be written on a declining term basis, to reflect the fact that the balance declines as payments are made. n50

The Model Act prohibits charging for a policy the term of which extends more than 15 days beyond the scheduled maturity date of the transaction. n51 If a credit transaction is refinanced, the old insurance must be canceled and required rebates made before writing new insurance, thus prohibiting the practice of "pyramiding" insurance. n52

In 2001, the NAIC adopted a credit personal property insurance model act. n53 States have not yet adopted this model act. The Act's key non-rate provisions include a prohibition against using gross debt in calculating the premium. n54 Insurance premium rebates must be made by the pro rata method. n55 For closed-end loans, the credit insurance cannot exceed the amount of the underlying debt, unless otherwise required by state law, nor can the insurer sell insurance with a term that exceeds the scheduled term of the underlying credit transaction. n56

The credit insurance cannot be sold unless the loan amount exceeds a minimum amount to be set by each adoptive state. n57 The insurance cannot be bundled with other types of insurance and it must be optional and not a condition of obtaining credit approval. n58 Consumers must receive a pre-purchase clear and conspicuous disclosure describing certain rights. n59 The insurer must provide consumers with certificates of insurance that shall contain certain information. n60

In addition, no claim may be denied because the consumer was ineligible for coverage later than ninety days after the initiation of coverage unless the consumer misrepresented a material fact. If a claim is denied because the consumer misrepresented a material fact or was ineligible for coverage within ninety days of the initiation of coverage, the insurer must refund all of the premium paid *and* the creditor must refund any finance charge paid on the premium. n61

Finally, statutes governing consumer credit and unfair trade practices statutes may further regulate credit insurance coverage, marketing, and disclosure practices. Such statutes may require that credit property insurance be written only on collateral, n62 and that coverage be limited to either the loan amount or the value of the property. n63 Further, there may be a limitation on writing property insurance in connection with loans below a specified amount. n64

[5] Common Abuses and Possible Remedies

[a] Voluntariness

One of the first steps in examining a transaction involving credit insurance is to determine whether the insurance purchase was voluntary. The existence of a signed "voluntary" insurance authorization as required by the TILA does not end the inquiry. Relevant statutes and rules in many states specifically address the voluntariness issue. The UCCC, for example, specifically prohibits compulsory credit life or disability insurance. It incorporates the TIL requirement that the borrower be informed that such purchase is not a factor in obtaining the credit, as well as TIL's cost disclosure and signature requirements. n65

Most states permit creditors to require property insurance on collateral as long as the borrower has a choice of providers. n66 However, it rarely happens that creditors openly admit that they require insurance, and the mere fact that a borrower did not read the insurance authorization form indicating the purchase is voluntary before signing it is unlikely to warrant a finding that the insurance was compulsory. n67 Because credibility likely will be an issue in such cases, it is important to have buttressing evidence. Parol evidence may be admissible to show usury, n68 at least where there are allegations of fraud, illiteracy, or duress. n69 Clients must be questioned to ascertain whether they knew they purchased credit insurance, whether they were orally informed that the insurance was required, or whether the creditor implied that the insurance was necessary. The allegations in a recent case are instructive. n70

A good source for suggestions as to the type of corroborative evidence which may be probative is found in *In re USLIFE* and other Federal Trade Commission enforcement cases. n71

There may also be non-usury claims of coercion under various federal and state states. State UDAP statutes are one important source. n72 However, either insurance or credit transactions may be specifically excluded from some state UDAP acts. Beyond the conventional notions of coercion and voluntariness, there is also an argument that credit insurance is not voluntary when the insurance is valueless. This argument might apply when the consumer cannot

recover any benefits because of ineligibility.

Another possible set of claims to consider are based on antitrust law. A sophisticated analysis is beyond the scope of this volume and, therefore, only a general overview is presented below.

The possibility of an antitrust claim arises when there is explicit or implied n73 coercion in the sale of credit insurance. Tie-in arrangements, in which the sale of one product is tied to the sale of a second product, are generally condemned under the antitrust laws. n74

One of the historic obstacles to using antitrust as a vehicle to challenge credit insurance sales practices has been the McCarran-Ferguson Act, n75 which many mistakenly assume to provide a blanket exclusion from antitrust laws where insurance is at issue. Generally speaking, the Act leaves the "business of insurance" to state regulation and mandates that state law overrides conflicting federal law unless the federal law specifically relates to the business of insurance. n76 McCarran-Ferguson, however, does not provide an insurmountable obstacle to antitrust challenges to insurance practices. The Fifth Circuit has held that Federal Trade Commission ("FTC") investigations of coercive credit insurance sales practices by creditors are not barred by McCarran-Ferguson, because such conduct is not "the business of insurance." n77 In addition, some states have their own versions of anti-trust laws, which may be applicable to insurance tie-ins. McCarran-Ferguson would not be a threshold issue if state antitrust law formed the basis of the claim. n78

In sum, an antitrust challenge to a credit insurance practice should be viable based upon one of the following arguments: (1) the specific practice is not the business of insurance because it arises from a credit relationship, not an insurer-insured relationship; (2) even if the practice falls within the business of insurance, the state's laws do not specifically regulate the practice; or (3) even if the practice is part of the business of insurance, and is specifically regulated by the state, the antitrust claim would not invalidate, impair or supercede the state's regulating law.

[b] Excessive Cost of Credit Insurance

There are at least three ways in which a creditor can overcharge for credit insurance discussed below. The first one is to charge a premium rate higher than that permitted by law or regulation. Generally, this practice is usury.

In most circumstances, the statutory foundation for such a claim is found in the usury law applicable to the credit transaction in question rather than in the credit insurance code. The NAIC Model Act provides that insurers shall not issue a policy "for which the premium rate exceeds that determined by the schedules of such insurer as then on file with the Commissioner," n79 and that the amount then charged to a debtor "shall not exceed the premiums charged by the insurer." n80 However, in most states, the credit insurance code regulates the insurers, not the creditors, and there is usually no direct private remedy granted to insured debtors under the credit insurance codes. n81

In addition, small loan, industrial loan, or consumer loan acts may specifically authorize the imposition of credit insurance premiums only under specified conditions. n82

A second method in which a creditor can overcharge for credit insurance is if the insurance coverage exceeds that permitted by law. As discussed above, writing level life on an installment loan provides excessive coverage because it always insures the full amount of the original loan, and does not reflect the fact that the loan balance declines. Since it does provide this excessive coverage, it is much more expensive than declining term life. n83 Consequently, most states prohibit the writing of level term credit life insurance.

With respect to other types of excess coverage, courts have long recognized that usury may exist when lenders charge borrowers for coverage in an amount "greater than the amount of the loan with a purpose of increasing the proportion of charges to the amount of money lent." n84 Most regulations similarly restrict credit life and disability coverage to the

amount and term of the indebtedness. This limitation is found in both the credit insurance codes n85 and often in the special credit regulatory laws. n86

Credit property insurance has been the source of particular abuse regarding excess coverage because it is rarely regulated. In 2001, the NAIC finally adopted a credit personal property insurance model act. n87 If enacted by the states, this act will curb some of the abuses in this market, most especially the excessive cost of this type of insurance. n88 Currently, most credit insurance codes do not address this type of insurance at all.

A number of states' *credit* statutes, however, place some limitations on the sale of credit property insurance, n89 specifying, for example, that property insurance can only be written on collateral. The UCCC provides that property insurance can be written on property "related to the credit transaction." n90 Thus, property insurance written on non-collateral property should be an excessive charge where a statute limits the specified authorized charges to an inclusive list. n91 The possibility of insurance premiums paying for extra unauthorized types of coverage has arisen in the context of "force-placed" insurance. In automobile-secured loans, for example, borrowers are typically required to furnish proof of insurance (in favor of the creditor) and to maintain it throughout the loan. If the borrower does not, the creditor usually is authorized by the contract to purchase insurance and add the charge to the borrower's balance. A number of cases have been filed in which borrowers allege that the creditor has force-placed insurance with extraneous endorsements. Such extra types of coverage may not be authorized by either statute or contract, are unnecessary to protect the collateral, and the premiums attributable to them would be considered interest. n92

Finally, excess coverage may also be argued in situations where the coverage buys illusory benefits. This may occur, for example, in connection with open-end accounts, where the account balance reflects non-durable purchases, such as lunches at the department store restaurant, tune-ups at the auto-center, or cosmetics. Phantom coverage may also occur where the property insured is worth less than the total of payments.

[c] Insurance Packing

Insurance packing refers to increasing a consumer's debt by padding or "packing" the amount financed through the sale of expensive, unnecessary and often unwanted products, primarily insurance. It should also be noted that insurance packing often goes hand-in-hand with flipping abuses (frequent refinancing) as insurance is one of the elements of the refinancing price escalator. n93 The tradition of pushing credit insurance coverage continues to be alive and well to this day. n93.1

There are many forms of insurance packing, some of which are discussed below.

Insurance packing may occur when unnecessary collateral is taken as security in order to write profitable property insurance. The FTC, FRB, and OTS Credit Practices Rules n94 restrict the right of creditors to take a non-purchase money security interest in household goods. One exception to the Rule is for purchase-money security interests, which are permitted. A second exception arises in the definition of household goods provided in the FTC and related rules. Some items which either tend to have greater value, or are less necessary for daily living, are excluded from the Rule's scope. n95

Another practice was alleged in cases against ITT Financial. A number of suits alleged that ITT Financial or its subsidiaries, usually unbeknownst to its customers, "packed" or loaded various types of expensive optional insurance onto consumer loans along with traditional credit insurance. n96

A third abuse is the sale of credit insurance to borrowers who are ineligible for the insurance coverage under the terms of the policies that they buy. Such sales may be viewed as a pretext for usury because the insurance provides no benefit to borrowers. The sole benefit is to the creditor and insurer and, thus, should be argued to be a pretext for usury, or even fraud. n97

Other appropriate claims involving the sale of insurance with no benefit to the insured includes the straight contract defense of failure of consideration, UDAP, and unconscionability. In its laundry list of factors which are relevant to determining unconscionability, the UCCC lists a sale of services where the seller knows the consumer could not receive substantial benefits from the services sold. n98 Such a sale also should be a breach of fiduciary duty n99 or a breach of the common law duty of disclosure. n100

There are some theories of recovery for these consumers if the feared casualty actually occurs but they were ineligible for the insurance. Since credit insurance is sold only through creditors, never directly by the insurer, the insurer's liability in these circumstances may depend upon whether the creditor/seller is viewed as the insurer's agent, or the borrower's agent, about which there is a divergence of judicial opinion. If the creditor acts as the insurer's agent, its knowledge of disqualifying factors, or misrepresentations, may be attributed to its principal, the insurer. The creditor's potential liability should always be assessed, too, particularly as it can be independent of the insurer's liability. n101

Contract, tort and some statutory claims may be appropriate. In some circumstances, UDAP statutes n102 or even RICO may be used. n103 Some states also have incontestability clauses, limiting the rights of the insurer to contest the validity of the policy in some specified circumstances. n104 It should also be noted that insurance packing often goes hand-in-hand with flipping abuses (frequent refinancing), as insurance is one of the elements of the refinancing price escalator, described further in *§ 6.04 supra* .

[d] Post-Claim Underwriting, Ineligibility

Another abusive practice is the sale of credit insurance to borrowers who are ineligible for the insurance coverage under the terms of the policies that they buy. Unlike ordinary insurance sales, creditors rarely ask borrowers for information relating to their eligibility for benefits under credit insurance policies, such as medical histories. n105 Instead, only after a claim is filed are eligibility factors such as health, age, and employment checked to see if grounds exist for denying coverage. Many policies simply provide that the policy will be canceled and the premium refunded if ineligibility is determined. The result of this arrangement is that creditors and insurance companies keep the premiums paid by ineligible borrowers who never file an insurance claim, while refusing to pay on the same policies if claims are ever filed. n106

Such sales may be viewed as a pretext for usury, because the insurance provides no benefit to borrowers. The sole benefit is to the creditor and insurer. Other appropriate claims involving the sale of insurance with no benefit to the insured includes the straight contract defense of failure of consideration, UDAP and unconscionability, or even fraud. n107

A somewhat related situation arises where the borrower is sold only partial coverage, but where the benefits of such a policy are misrepresented as being full coverage. This practice should give rise to a UDAP claim or a common law fraud claim.

[6] Rebates

The issue of refunding unearned insurance premium charges must be explored in any insured credit transaction. The premium usually pays for coverage for a term concurrent with the scheduled term of the loan. n108 The refund issue may arise when the credit transaction is prepaid, either by prepayment, refinancing, or otherwise, or when the insurance policy is terminated. Termination of the policy may occur on occasions which may or may not coincide with paying off the credit transaction by one of these means.

The NAIC Model Act requires that each credit life or A&H insurance policy provide for a prompt refund or credit "to the person entitled thereto" in the event of termination of *insurance* prior to the scheduled maturity date of indebtedness.

n109 The Model Act also requires that the insurance be terminated when the account is prepaid by renewal or otherwise. n110 The two provisions together thus mandate a refund any time the debt is prepaid by refinancing or otherwise. This Credit Insurance Code provision is often reiterated in the applicable credit statutes. n111

State Insurance Departments generally will prescribe the method by which a rebate must be calculated, usually authorizing the generous Rule of 78 formula. n112 There may be a minimum amount below which rebates need not be made. n113

An important issue which may arise is whether a credit insurance rebate is required when a debt is in default, accelerated, or reduced to judgment. Some state statutes require that all unearned charges, including insurance, be rebated on prepayment, and further require that acceleration be treated as prepayment. n114 The lender, however, may not credit the account with a refund upon acceleration, arguing the policy will remain in force until the originally scheduled maturity and that the insurance premium is, therefore, an "earned" charge not subject to the rebate requirement. n115

[7] Remedies

[a] Usury

As has been noted throughout this chapter, excess insurance charges may be imposed in a number of ways. Careful attention must be paid to presenting evidence regarding the circumstances: the full extent of the creditor's profit; evidence regarding the borrower's level of sophistication or education; the borrower's impression of implicit or explicit coercion; n116 or the borrower's special relationship of confidence with the lender. Lacking such specific evidence of overreaching, the court may view the premiums as a legitimate charge passed on to a third party, and may also view commissions as compensation for services in connection with the insurance just as any other agent commission is treated. n117

Where the credit insurance is hidden interest, any specific statutory remedy for excessive charge, or the more general array of traditional usury remedies, should be available. n118 (If the statute provides only for administrative enforcement, it may be necessary to argue there is an implied private right of action.) n119

[b] Breach of Fiduciary Duty and Duty to Disclose

Creditors may have a fiduciary duty to borrowers, which they may breach if they impose disadvantageous credit insurance charges. Ordinarily, debtors do not have a fiduciary relationship with creditors, n120 but one may be extrapolated with respect to credit insurance from a number of sources. n121 It is a question of fact whether the creditor owes a fiduciary duty to any given borrower. n122

Even if the facts do not establish a duty which rises to the level of a fiduciary duty, there may nonetheless be a common law "duty to disclose." Fraud or related claims may also be appropriate in some circumstances. n123

[c] UDAP

In addition, UDAP statutes are often well suited to challenge credit insurance abuses. However, it is necessary to review the UDAP statute and case law in a particular jurisdiction carefully because some UDAP statutes exclude credit or insurance transactions from their coverage. n124

Some states also have passed statutes that go beyond general UDAP laws by addressing specific abusive practices in high-cost mortgage lending. Some of these include prohibitions and restrictions regarding credit insurance. For example, the New York high-cost home loan law prohibits the financing of single premium insurance on high-cost home loans. n125 This prohibition applies to credit insurance, any other life or health insurance premiums, and any debt

cancellation or suspension agreements. n126 Insurance premiums or other fees calculated and paid on a monthly basis are not considered "financed." n127

[d] Unconscionability

Unconscionability claims may also be raised to challenge credit insurance abuses. A number of states have incorporated unconscionability into their credit statutes. n128 Even absent a statutory reference, unconscionability is a common law concept which should be available in most states. n129

[e] Fraud; Misrepresentation and Concealment

Fraud or related claims may be appropriate in some circumstances. For example, as was discussed previously, knowingly selling credit insurance to a borrower unlikely to be eligible for benefits has been found to be fraudulent under Alabama law. n130

[f] Arbitration Clauses

Over the last few years, mandatory arbitration clauses have become quite common additions to consumer credit contracts. Creditors use these clauses as a shield to prevent consumers from litigating their claims in a judicial forum. Frequently, these provisions require the consumer, but not the creditor, to submit all claims and defenses to arbitration. The creditor reserves the right to file a judicial action to collect on the debt or repossess the security. Consumers always lose their right to a jury trial in arbitration clauses, and creditor exposure to punitive damages awards is dramatically reduced.

Where such provisions exist in contracts, creditors frequently file motions to dismiss or to stay court proceedings pending arbitration before filing responsive pleadings. Consumer advocates must be prepared to fight attempts to arbitrate early in the case.

There are many reasons why arbitration clauses found in consumer credit transactions are suspect. n131 These contracts are always contracts of adhesion, n132 and should be subject to a higher level of judicial scrutiny. n133 Some theories to consider in combating arbitration clauses include lack of mutuality, n134 unconscionability, n135 fraud, and other contract defenses. n136

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawDebtor & Creditor RelationsInsurance LawDisability InsuranceGeneral OverviewInsurance LawGeneral Liability InsuranceConflicts of InterestInsurance LawLife InsuranceGeneral OverviewInsurance LawLife InsuranceCredit Life

FOOTNOTES:
(n1)Footnote 1. *See § 6.06[4][b] infra*.

(n2)Footnote 1.1. *See Meyer v. CUNA Mut. Group, 2007 U.S. Dist. LEXIS 72833* (W.D. Pa. Sept. 28, 2007) (interpreting such a provision).

(n3)Footnote 2. *See* In the Matter of Providian Nat'l Bank, Consent Order #2000-53 (June 28, 2000), *available at* www.occ.treas.gov/ftp/eas/ea2000-53.pdf.

(n4)Footnote 3. *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 8.3.1.4 (3rd ed. and Supp.).

(n5)Footnote 4. *See* In the Matter of Providian Nat'l Bank, Consent Order #2000-53 (June 28, 2000) *available at* www.occ.treas.gov/ftp/eas/ea2000-53.pdf.

(n6)Footnote 5. *See, e.g., Hammett v. American Bankers Ins. Co. of Fla., 203 F.R.D. 690* (S.D. Fla. Nov. 19, 2001) (nationwide class action denied on RICO claim due to reliance issues and on state breach of contract claim due to the possibility of variances in the laws of 50 states).

(n7)Footnote 6. *See § 6.06[4][b] infra.*

(n8)Footnote 7. The less comprehensive coverage for typical property insurance risks may be supplemented by coverage for credit loss risks; *e.g.,* repossession expenses, premium deficiency, etc. *See, e.g., Kenty v. Bank One, Columbus, N.A., 1992 U.S. Dist. LEXIS 16645* (S.D. Ohio Apr. 29, 1992) , *aff'd in part, rev'd in part, 92 F.3d 384 (6th Cir. 1996)* ; *Kenty v. Transamerica Premium Ins. Co., 650 N.E.2d 863 (Ohio 1995)* .

(n9)Footnote 8. This type of insurance has recently crept into the mortgage lending context as well. *See, e.g.,* Kirkland v. Midland Mortgage Co., CV198-083 (S.D. Ga. Jan. 4, 2000) (defendant's motion for reconsideration of denial of summary judgment and grant of class certification denied; motion for certification of interlocutory appeal granted), Clearinghouse No. 52,504 and 52,504A.

(n10)Footnote 9. *See, e.g., Kenty v. Bank One, Columbus, N.A., 1992 U.S. Dist. LEXIS 16645* (S.D. Ohio Apr. 29, 1992) (interest under the National Bank Act), *aff'd in part, rev'd in part on other grounds, 92 F.3d 384 (6th Cir. 1996)* (without disturbing the ruling that the excess premium cost would constitute interest, court held that there was no usury because the national bank defendant was entitled to most favored lender status, and thus was entitled to assert the unlimited interest privilege granted Ohio thrifts under Ohio law). *See also American Bankers Ins. Co. v. Alexander, 818 So. 2d 1073* (Miss.) , *cert. denied, 534 U.S. 944, 122 S. Ct. 324, 151 L. Ed. 2d 242 (2001)* (motion to dismiss misrepresentation claim denied; filed-rate doctrine does not prevent a consumer from bringing breach of good faith and fair dealing, breach of fiduciary duty, UDAP, and common law fraud claims based upon allegations that American Bankers consciously ignored its filed rates and that the manner in which the policies were force-placed was calculated to benefit the insurance company through a kickback scheme); *Pitts v. American Sec. Ins. Co., 144 N.C. App. 1, 550 S.E.2d 179 (2001)* (class certification denial reversed on appeal), *aff'd, 356 N.C. 292, 569 S.E.2d 647 (2002)* .

(n11)Footnote 10. *See* Mark A. Chavez, *If You Can't Beat Them, Change the Rules: The Industry Response to Force-Placed Insurance Litigation,* The Consumer Advocate, Vol. 3, Issue 5 (Nov./Dec. 1997). These cases and force-placed insurance are discussed in more detail in National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.3.10 (4th ed. 1997 and Supp.); National Consumer Law Center, Consumer Law Pleadings with Disk, Number One, Ch. 2 (1994).

(n12)Footnote 11. *See, e.g., 1994 Md. AG LEXIS 50* (Oct. 17, 1994) (debt cancellation agreements do not constitute contracts of insurance).

(n13)Footnote 12. *See* Center for Economic Justice, The Impact of Debt Cancellation Contracts on State Insurance Regulation (July 2003), *available at* www.cej-online.org/cej.

(n14)Footnote 13. For a discussion of GAP plans and hidden finance charges, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, §§ 7.4.2, 8.3.2.3 (4th ed. 2009). GAP in connection with negative equity in the car-financing context is discussed in National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, §§ 11.6.3 (4th ed. 2009)

(n15)Footnote 14. *See* Regulation Z and Official Staff Commentary §§ 226.4(b)(10) and 226.4(d)(3); *see also* National Consumer Law Center, Truth in Lending § 3.9.4.7 (6th ed. 2007 and supp.).

(n16)Footnote 15. *See 67 Fed. Reg. 58,962* (Sept. 19, 2002) .

(n17)Footnote 16. *68 Fed. Reg. 35,283* (June 13, 2003) .

(n18)Footnote 17. For a discussion of Gramm-Leach-Bliley, see *§ 6.02 supra*.

(n19)Footnote 18. *See, e.g.*, Opinion Letter Regarding Banks Sales of Debt Suspension Agreements and Debt Cancellation Contracts, Clearinghouse No. 54,591 (New York State Insurance Department Apr. 4, 2003). A few states are explicitly retaining the power to regulate DCAs as insurance for some classes of financial institutions. *See, e.g., Utah Code Ann. § 7-1-324*; Opinion Letter Regarding Regulation of National Banks Offering Debt Cancellation Contracts and Debt Suspension Agreements, Clearinghouse No. 54,593 (Nevada Division of Insurance Apr. 2, 2003).

(n20)Footnote 19. *See 67 Fed. Reg. 58,963* (Sept. 19, 2002) .

(n21)Footnote 20. *See 67 Fed. Reg. 58,963* (Sept. 19, 2002) .

(n22)Footnote 21. Model Bill to Provide for the Regulation of Credit Life Ins. and Credit Accident and Health Ins., National Association of Ins. Commissioners, Model Regulatory Service, 360-1, 370-1, and 375-1 (NIARS Corporation, 1984 [hereinafter NAIC Model Act]; *Alaska Stat. §§ 21.57.010 to 21.57.170*; Ariz. Rev. Stat. Ann. §§ 20-1601 to 20-1616; Ark. Stat. Ann. §§ 23-87-1018 to 23-87-119; *Cal. Ins. Code §§ 779.1 to 779.25*; *Colo. Rev. Stat. §§ 10-10-101 to 10-10-116*; *Conn. Gen. Stat. §§ 38-249 to 38-262*; *Del. Code Ann. tit. 18, §§ 3701 to 3713*; *Ga. Code §§ 33-31-1 to 33-31-12*; *Haw. Rev. Stat. §§ 431:10B-101 to 431:10B-114*; Idaho Rev. Stat. §§ 41-2301 to 41-2316; Ill. Rev. Stat. ch. 73, §§ 767.50 to 767.64; *Ind. Code §§ 27-8-4-1 to 27-8-4-14*; *Ky. Rev. Stat. §§ 304.19-010 to 304.19-140*; *Me. Rev. Stat. Ann. tit. 24-A, §§ 2851 to 2864*; Md. Ann. Code art. 48A, §§ 436-C to 436-O; *Mich. Comp. Laws §§ 550.601 to 550.624*; *Minn. Stat. §§ 62B.01 to 62B.14*; *Mo. Rev. Stat. §§ 385.010 to 385.080*; *Mont. Code Ann. § 33-21-101 to 33-21-207*; *Neb. Rev. Stat. §§ 44-1701 to 44-1713*; *Nev. Rev. Stat. §§ 690A.010 to 690A.140*; N.H. Rev. Stat. Ann §§ 408A:1 to 408A:15; *N.J. Stat. Ann. §§ 17B:20-1 to 17B:29-13*; *N.M. Stat. Ann. §§ 59A-25-1 to 59A-25-15*; N.C. Gen. Stat. §§ 58-341 to 58-357; *N.D. Cent. Code §§ 26-1-37-01 to 26-1-37-16*; Ohio Rev. Stat. Ann. §§ 3918.01 to 3918.99; *Or. Rev. Stat. §§ 743.561 to 743.588*; Pa. Stat. Ann. tit. 40, §§ 63-101 to 63-114; *Tex. Ins. Code art. 3.53*; *Utah Code Ann. §§ 31A-22-801 to 31A-22-809*; *Vt. Stat. Ann. tit. 8, §§ 4101 to 4115*; *Va. Code §§ 38.2-3717 to 38.2-3729*; *Wash. Rev. Code §§ 48.34.010 to 48.34.120*; *Wyo. Stat. §§ 26-21-101 to 26-21-114*. The NAIC is currently reviewing credit insurance issues.

(n23)Footnote 22. *See* NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564. The NAIC's 1960 model credit insurance code does not cover credit property insurance.

(n24)Footnote 23. *E.g.*, Iowa Code §§ 509, 515; *Vt. Stat. Ann. tit. 8, §§ 3805, 3806*.

(n25)Footnote 24. *E.g.*, Fla. Stat. Ann. (West) § 516.35; *N.H. Rev. Stat. Ann. § 399-A:11* (lender licensing); *Vt. Stat. Ann. tit. 8, § 2224(b)*.

(n26)Footnote 25. *E.g., Del. Code Ann. tit. 6, § 4307* (RISA); *Ga. Code Ann. § 7-3-14(3)* (Ind. Loan); *Vt. Stat. Ann. tit. 9, § 2355(g)*.

(n27)Footnote 26. *E.g., Ala. Code § 5-19-20*; *Iowa Code § 537.2501(2)*; La. Rev. Stat. tit. 9, § 3542(A).

(n28)Footnote 27. *E.g., Ala. Code § 5-19-1(1)*; *Ga. Code Ann. § 7-3-14(3). See also McCullar v. Universal Underwriters Life Ins. Co., 687 So. 2d 156 (Ala. 1996)* (regulatory language requiring that when repayment is in substantially equal installments, the credit insurance can "never exceed approximate unpaid balance of the loan" prohibits gross coverage notwithstanding contrary agency interpretations; question of fact whether creditor's telling consumers that gross amount of insurance was needed to pay off debt in event of death constituted fraud). *See also Singleton v. Protective Life Ins. Co., 857 So. 2d 803 (Ala. 2003)* (applying *McCullar* and finding that borrowers failed to establish sale of excess insurance where net coverage was sold and finding that state rate requirements were followed).

(n29)Footnote 28. *E.g.,* Conn. Gen. Stat. Ann. § 36-234; *N.D. Cent. Code § 51-13-02*; *Vt. Stat. Ann. tit. 9, § 2355(f)(4)*.

(n30)Footnote 29. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 2.3.1 (7th ed. 2008 and supp.).

(n31)Footnote 30. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 10.5 (7th ed. 2008 and supp.).

(n32)Footnote 31. Calculating the finance charge for TIL purposes is different than calculating interest for purposes of the state usury law. *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 8.5.2.2 (3rd ed. and Supp.). *See* Ch. 1 *supra*. For further details of TIL requirements relating to credit insurance disclosures, see National Consumer Law Center, Truth in Lending § 3.9.4 (6th ed. 2007).

(n33)Footnote 32. *15 U.S.C. § 1638*; Reg. Z, *12 C.F.R. § 226.18*; Official Staff Commentary § 226.18(c)(1)(iii)-2; *see also Guinn v. Hoskins Chevrolet, 836 N.E.2d 681 (Ill. App. Ct. 2005)* (TILA commentary requires disclosure of fact that creditor is retaining premium upcharge--additional amount retained by creditor--but does not require disclosure of the amount).

(n34)Footnote 33. Reg. Z § 28.1(b)(1)(iv).

(n35)Footnote 34. *12 U.S.C. § 1843(c)(8)*; *12 C.F.R. § 225.25(b)(8)* and *(9)*. *See* Hinkle, *Insurance Activities of National Banks and Bank Holding Companies, 105 Banking L.J. 137 (1988)*.

(n36)Footnote 35. *12 U.S.C. § 1972*.

(n37)Footnote 36. *12 U.S.C. § 1843(c)(8)*.

(n38)Footnote 37. *65 Fed. Reg. 75,822* (Dec. 4, 2000) .

(n39)Footnote 38. *66 Fed. Reg. 15,345* (Mar. 19, 2001) .

(n40)Footnote 39. *12 C.F.R. § 208.83* (FRB regulations).

(n41)Footnote 40. *E.g., Ala. Code §§ 27-40-1*; *Alaska Stat. §§ 06.40.010*; Ariz. Rev. Stat. Ann. §§ 20-2001; *Idaho Code §§ 28-43-301(20), 28-43-205*; *Ky. Rev. Stat. § 304.30-010*; *Minn. Stat. Ann. §§ 59A.01*

(n42)Footnote 41. *65 Fed. Reg. 35,420* (June 2, 2000) (West Virginia); *65 Fed. Reg. 57,427* (Sept. 22, 2000) (Rhode Island); *65 Fed. Reg. 43,827* (July 14, 2000) (Massachusetts).

(n43)Footnote 42. *66 Fed. Reg. 51,502* (Oct. 9, 2001) . *Preempted* were provisions: (1) requiring financial institutions to use separate employees for insurance solicitations; (2) restricting the timing of bank employees' referral or solicitation of insurance business from customers who have loan applications pending with the bank; (3) restricting the sharing of information with bank affiliates acquired by a financial institution in the course of a loan transaction to solicit or offer insurance; (4) requiring that financial institutions segregate the place of solicitation or sale of insurance so that it is readily distinguishable from deposit-taking and lending areas. *Not* preempted were provisions: (1) prohibiting a requirement or implication that the purchase of an insurance product is required as a condition of a loan; (2) prohibiting a financial institution from offering an insurance product in combination with other products unless all of the products are available separately; (3) requiring that, where insurance is required as a condition of credit, the insurance and credit transactions be completed independently and through separate documents.

(n44)Footnote 43. *67 Fed. Reg. 13,405* (Mar. 22, 2002) .

(n45)Footnote 44. *E.g., Ky. Rev. Stat. § 304.19-080*; Mass. Gen. Laws Ann. ch. 255, § 126 (West); *Mo. Ann. Stat. § 385.070* (Vernon); *Tenn. Code Ann. § 56-7-908(a)*.

(n46)Footnote 45. *E.g.,* Ohio Admin. Code § 3901-1-14(C)(8).

(n47)Footnote 46. Madrigal v. O'Connor, No. 81 L 27570, Clearinghouse No. 41,268 (Cook County Cir. Ct. Mar. 4, 1987); *State Ex. Rel. Consumers League v. Ratchford, 457 N.E.2d 878 (Ohio Ct. App. 1982)* . In 1988, the Illinois Department of Insurance completed the review process begun as a result of the mandamus in *Madrigal*, *supra*. Many policies were disapproved and rates were lowered by 23%. The plaintiffs' attorneys estimated a savings of $22 million a year to consumers.

Though the Ohio case was dismissed on standing grounds, the court did conclude that the insurance department was under a duty to seek a rate reduction. The department subsequently did so.

(n48)Footnote 47. The NAIC Model Act applies only to credit life and disability policies of less than 10 years duration. Longer term insurance is subject to general insurance laws. State versions may vary. Under the revised NAIC Model Act, net coverage would be mandated. NAIC Consumer Credit Insurance Model Act § 4(A)(1994).

(n49)Footnote 48. NAIC Model Act § 4. Under the revised NAIC Model Act, net coverage would be mandated. NAIC Consumer Credit Insurance Model Act § 4(a)(1994).

(n50)Footnote 49. *Winkle v. Grand Nat'l Bank, 601 S.W.2d 559, 571 (Ark. 1980) . But cf. McCullar v. Universal Underwriters Life Ins. Co., 1995 Ala. LEXIS 405* (Ala. Sept. 29, 1995) . *But see Gall v. Am. Heritage Life Ins. Co., 3 F. Supp. 2d 1344 (S.D. Ala. 1998)* (court states it is not bound by plurality in *McCullar* and, agreeing with the dissent, finds that insurance can be calculated on the total of payments); *Liberty Bank & Trust Co., N.A. v. Splane, 959 P.2d 600 (Okla. Civ. App. 1998)* (court construes provision in UCCC restricting the amount of the permissible credit insurance to that which does not "exceed the debt" and another provision in Oklahoma insurance law restricting the amount of such insurance to "the approximate unpaid balance of the loan" to allow insurance premiums to be calculated on the total of payments; court specifically rejects the plurality in *McCullar*).

(n51)Footnote 50. NAIC Model Act § 4A(1). Compare NAIC Consumer Credit Insurance Model Act § 4(A)(1)(1994), which would mandate net debt coverage.

(n52)Footnote 51. NAIC Model Act § 5.

(n53)Footnote 52. NAIC Model Act § 5. *See also* In the Matter of Assocs. Fin. Life Ins. Co., Case No. 99C-014A (Ga. Office of Insurance and Safety Fire Commissioner, Jan. 31, 2000), Clearinghouse No. 52,508 (when lender sold multiple policies, it incorrectly calculated unearned premium for each insurance product separately and failed to rebate when each rebate was lower than the $10 floor per *Ga. Comp. R. & Regs. r. 120-2-27-18*, e.g., if each rebate was less than $10 but, combined, exceeded $10, both must be refunded).

(n54)Footnote 53. NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564. The Act does not cover insurance on motor vehicles designed for highway use and mobile homes, insurance written in connection with a credit transaction that is secured by a real estate mortgage or deed of trust, force-placed insurance, non-filing insurance, or insurance for which no identifiable charge is made or collected from the consumer. NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564, at § 2.

(n55)Footnote 54. NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564, at § 4(G).

(n56)Footnote 55. NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564, at § 10.

(n57)Footnote 56. NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564, at §§ 4(B),

(C).

(n58)Footnote 57. NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564, at § 4(A).

(n59)Footnote 58. NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564, at §§ 4(F), 5(a)(2).

(n60)Footnote 59. NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564, at §§ 5(A), (B).

(n61)Footnote 60. NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564, at §§ 5(D), (E).

(n62)Footnote 61. NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564, at § 11(D).

(n63)Footnote 62. *E.g.*, Ariz. Rev. Stat. Ann. § 6-626 (consumer loans); *Iowa Code Ann. §§ 536.27*, *536A.23(3)*, *537.2501(2)*; *Miss. Code Ann. § 75-67-121* (small loans); UCCC § 4-301(1).

(n64)Footnote 63. *E.g., 12 C.F.R. § 225.25(b)(8)(B)(ii)(A)*; Ariz. Rev. Stat. Ann. § 6-626(D); 25 S.C. Code Ann. Regs. 69-11.1C(1)(d).

(n65)Footnote 64. *E.g., Ala. Code § 5-19-20(d)* (no property insurance unless loan amount exclusive of charges is $300 or over and value of property is $300 or more); *Colo. Rev. Stat. § 5-4-301* (same provisions, but with amounts of $300 and $630, respectively).

(n66)Footnote 65. UCCC §§ 2-202(2), 3-202(2) (1968); UCCC § 2-501(2) (1974). *See also Cope v. American Int'l Group, 2006 U.S. Dist. LEXIS 8040* (M.D. Ala. Feb. 9, 2006) (alleging that finance company representative told borrower that obtaining credit insurance would improve her credit score and thus would increase her chances of obtaining the desired loan); FTC v. Stewart Fin. Co., Civ. No. 103CV-2648 (N.D. Ga. Nov. 9, 2005) (stipulated final judgment and order) ($10.5 million settlement, liquidation of assets, and court receivership of lender where Commission alleged that a subprime lender and nine related companies sold credit insurance and other add-on products, such as car club memberships, to consumers by telling them that it was required--even where the consumer was not eligible for the insurance or did not own a car--and by representing that the products were free; the lender allegedly targeted Social Security recipients for its scheme and also allegedly failed to rebate unearned premiums, collected illegal fees by deceptively promoting a "direct deposit program," and violated the Credit Practices Rule by taking security for small personal loans), *available at* www.ftc.gov/os/2005/11/051109stewartstipa103cv2648.pdf.

(n67)Footnote 66. *E.g., Ala. Code § 5-19-20(a) & (b)*; UCCC §§ 2-202(2)(a), 3-202(2)(a) (1968); UCCC § 2-501(2)(a) (1974); UCCC § 4-109 (1968 and 1974). In London v. Wal-Mart Stores, Inc. *, 340 F.3d 1246 (11th Cir. 2003)* , the court, which retained supplemental jurisdiction after TILA claims were settled, held that a credit card applicant who obtained related credit insurance had suffered "injury in fact," even though he knew the insurance was not required and the enrollment form stated it was optional. The creditor, however, did not comply with a state law requirement to disclose to an applicant that purchasing the insurance is not a prerequisite to obtaining the loan. The court ruled that the applicant suffered injury per se by paying consideration for an illegal contract.

(n68)Footnote 67. *Universal C.I.T. Credit Corp. v. Lackey, 228 Ark. 101, 305 S.W.2d 858 (1957) . See also Anthony v. Community Loans & Inv. Corp., 559 F.2d 1363 (5th Cir. 1977) .*

(n69)Footnote 68. *Aclin Ford v. Cordell, 625 S.W.2d 459 (Ark. 1982) . See also Fisher v. Beneficial Fin. Co. of Hoxsie, 383 F. Supp. 895 (D.R.I. 1974)* (borrower could introduce evidence that defendant actually required insurance by its conduct). *But see Dixon v. S & S Loan Serv. of Waycross, 754 F. Supp. 1567 (S.D. Ga. 1990) .*

(n70)Footnote 69. *Anthony v. Community Loans & Inv. Corp., 559 F.2d 1363, 1369 (5th Cir. 1977)* .

(n71)Footnote 70. *Lemelledo v. Beneficial Mgmt. Corp. of Am., 289 N.J. Super. 489, 674 A.2d 582 (App. Div. 1996)* , *aff'd on other grounds*, *150 N.J. 255, 696 A.2d 546 (1997)* . *See also FTC v. Citigroup, Inc., 239 F. Supp. 2d 1302 (N.D. Ga. 2001)* (complaint available at www.ftc.gov/os/2001/03/citigroupcmp.pdf) (in a recently settled enforcement action, in which Citigroup agreed to pay $240 million, the FTC alleged that the Associates trained its employees to add the cost of a "total payment protection" package of credit insurance products to the monthly payment which they quoted to borrowers without explaining that this payment included the premium charges; employees instructed to discuss only the "benefits" of the insurance and not the costs or limitations on coverage); *Compton v. Altavista Motors, Inc., 121 F. Supp. 2d 932 (W.D. Va. 2000)* (credit insurance "protection plan" form not given to car buyer until after the credit contract was signed; summary judgment to creditor on usury claim due to alleged lack of choice in purchasing the protection plan denied); *Fabricant v. Sears Roebuck & Co., 202 F.R.D. 310 (S.D. Fla. 2001)* (certifying class in case of retailer selling credit card plan with package of credit life, disability, property, and unemployment insurance without properly advising consumer that the package was optional), *subsequent history*, Order on Motions for Summary Judgment, Clearinghouse No. 54,563 (S.D. Fla. Mar. 5, 2002) (granting summary judgment on two of plaintiffs' counts and voiding the contracts as unenforceable on public policy grounds); *Baron v. Best Buy Co., 75 F. Supp. 2d 1368 (S.D. Fla. 1999)* (similar allegations as in *Fabricant*; motion to compel arbitration clause denied as defendant failed to show that the arbitration forum is a neutral, inexpensive forum to litigate the issues raised); *Easterling v. Gulf Guar. Ins. Co., 60 F. Supp. 2d 586 (S.D. Miss. 1999)* (case remanded to state court; claims included a challenge to the condition of purchasing credit insurance in order to get the loan); *Roberson v. Money Tree, 954 F. Supp. 1519 (M.D. Ala. 1997)* (borrowers allege that the lender misrepresented that they would not qualify for credit unless they purchased credit insurance and financed the cost through the loan; merits not reached as court upheld an arbitration clause and stayed case pending arbitration). *But see Williams v. Norwest Fin. Ala., Inc., 723 So. 2d 97 (Ala. Civ. App. 1998)* (a claim that the lender fraudulently misrepresented that the purchase of credit insurance was required to obtain the loan failed because credit insurance was not sold by the vendor in all of the several loan transactions with the borrower, no employee told the borrower that the insurance was required, (though the "voluntary" disclosure was given as one of the several documents which she was instructed to sign without explanation), and the borrower was relatively sophisticated); *Swyters v. Motorola Employees Credit Union, 535 S.E.2d 508 (Ga. App. 2000)* (consumer is bound to read contract in absence of illiteracy; summary judgment granted to creditor on whether insurance was required).

(n72)Footnote 71. *In re USLIFE Credit Corp. & USLIFE Corp., 91 FTC 984* , Consumer Cred. Guide CCH P 97,938 (1978), *modified on other grounds, 92 FTC 353 (1978)* , *rev'd on other grounds*, *599 F.2d 1387 (5th Cir. 1979)* .

(n73)Footnote 72. *See, e.g.,* Matter of Tower Loan of Miss., Consumer Cred. Guide Rpt. No. 579, FTC Docket No. 9241 (filed July 5, 1990), in which the FTC alleges that the creditor violated the FTC Unfair and Deceptive Practices Act by obtaining false statements from consumers stating that the purchase of credit insurance was voluntary, when the creditor was, in fact, requiring the purchase and failing to include the premiums in the finance charge in violation of TIL. *But see Credithrift of Am., Inc. v. Whitley, 190 Ga. App. 833, 835, 380 S.E.2d 489, 492 (1989)* . Court held that creditors' statement that "although they were not required by law to purchase certain insurance ... as a practical matter they would probably not be approved for the loan unless the insurance was purchased" did not constitute fraudulent misrepresentation or a violation of the state fair business practices act. Note: the court's reasoning is viable only if creditors are free under state law to deny credit if consumers refuse to buy insurance. But in many, if not most, states, consumer credit regulation laws do not permit creditors to require credit life or disability insurance as a condition of receiving the loan, in which case decision is inapposite.

(n74)Footnote 73. Though the legal issues are generally the same, the factual issues establishing the claim are more difficult in cases of implicit coercion.

(n75)Footnote 74. As a practical matter, § 1 of the Sherman Act, *15 U.S.C. §§ 1 et seq.* , would be the applicable statute, as the Clayton Act, though forbidding tying arrangements, does not apply to intangibles such as credit or

insurance. Polden, *The Antitrust Implications of Credit Insurance Tying Arrangements, 32 Drake L. Rev. 862, 882 n.78* (1982-83). (Much of this discussion is derived from this article.) For an example of this phenomenon, see *Fabricant v. Sears Roebuck & Co., 202 F.R.D. 310 (S.D. Fla. 2001)* (certifying class in case of retailer selling credit card plan with package of credit life, disability, property, and unemployment insurance without properly advising consumer that the package was optional), *subsequent history*, Order on Motions for Summary Judgment, Clearinghouse No. 54,563 (S.D. Fla. Mar. 5, 2002) (granting summary judgment on two of plaintiffs' counts and voiding the contracts as unenforceable on public policy grounds), *subsequent proceedings*, *202 F.R.D. 306 (S.D. Fla. 2001)* (class certified on TILA and state law claims), *class cert. granted, 202 F.R.D. 310 (S.D. Fla. 2001)* (Sears card "credit plan" is sold as a package which automatically includes credit life, disability, property, and unemployment insurance; antitrust claim not raised); *Baron v. Best Buy Co., Inc., 75 F. Supp. 2d 1368 (S.D. Fla. 1999)* , *rev'd*, *260 F.3d 625 (11th Cir. 2001)* (court reversed denial of motions to compel arbitration) (same, but Best Buy calls the package the "Payment Maker Protection Plan").

(n76)Footnote 75. *15 U.S.C. §§ 1012*, *1013*. The McCarran-Ferguson exclusion provision reads in its entirety as follows:

> (b) Federal regulation. No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *15 USCS §§ 1 et seq. 15 USCS §§ 41 et seq.*

5 U.S.C. § 1012(b) (emphasis added).

(n77)Footnote 76. *15 U.S.C. § 1012(b)*; *Barnett Bank, N.A. v. Nelson, 517 U.S. 25, 116 S. Ct. 1103, 134 L. Ed. 2d 237 (1996)* ; *United States Dep't of Treasury v. Fabe, 508 U.S. 491, 113 S. Ct. 2202, 124 L. Ed. 2d 449 (1993)* . Courts have described the test for exclusion in two different ways. The Fifth Circuit has a four part test as follows: A state law preempts a federal statute under the Act if: (1) the federal statute does not "specifically relate[] to the business of insurance;" (2) if the acts challenged are part of the "business of insurance;" (3) if the state has enacted a law "for the purpose of regulating insurance;" and (4) if application of the federal statute would "invalidate, impair, or supersede" the state law. *Edwards v. Your Credit, 148 F.3d 427, 433 (5th Cir. 1998)* (quoting *15 U.S.C. § 1012*). *See also Highmark, Inc. v. UPMC Health Plan, Inc., 276 F.3d 160 (3d Cir. 2001)* (following analysis similar to that of *Edwards*). The Seventh Circuit uses a broader test expressed in three parts as follows: a state law preempts a federal statute under the Act if: (1) the federal statute at issue does not "specifically relate to the business of insurance;" (2) the state statute was "enacted ... for the purpose of regulating the business of insurance;" and (3) application of the federal statute would "invalidate, impair or supersede" the state law. *Autry v. Northwest Premium Servs., 144 F.3d 1037, 1043 (7th Cir. 1998) . See also Standard Sec. Life Ins. Co. v. West, 267 F.3d 821 (8th Cir. 2001)* (three step analysis); *Moore v. Liberty Nat'l Life Ins. Co., 267 F.3d 1209 (11th Cir. 2001)* , *cert. denied, 535 U.S. 1018, 122 S. Ct. 1608, 152 L. Ed. 2d 622 (2002)* (same); *Mayard-Paul v. Mega Life & Health Ins. Co., 2001 U.S. Dist. LEXIS 22256,* at *6 (S.D. Fla. Dec. 21, 2001) (same). The three-part test doesn't address the activity being challenged, but rather allows state law to preempt federal law even if the specific activity at issue does not relate to the business of insurance, so long as a state law governs it.

(n78)Footnote 77. *FTC v. Dixie Fin. Co., 695 F.2d 926 (5th Cir. 1983)* , *cert. denied*, *461 U.S. 928, 103 S. Ct. 2088, 77 L. Ed. 2d 299 (1983)* . To determine whether particular conduct falls within "the business of insurance," courts have used a three part test derived from three Supreme Court decisions: *Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119, 102 S. Ct. 3002, 73 L. Ed. 2d 647 (1982)* ; *Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205, 99 S. Ct. 1067, 59 L. Ed. 2d 261 (1979)* , *cert. denied, 469 U.S. 1160, 105 S. Ct. 912, 83 L. Ed. 2d 925 (1985)* and *S.E.C. v. National Sec., Inc., 393 U.S. 453, 89 S. Ct. 564, 21 L. Ed. 2d 668 (1969)* . This test asks: whether the practice has the effect of transferring or spreading a policyholder's risk; whether the practice is an integral part of the policy relationship between the insurer and the insured; and whether the practice is limited to entities within the insurance industry. *See, e.g., O'Connor v. UNUM Life Ins. Co., 146 F.3d 959, 962 (D.C. Cir. 1998)* ; *Autry v. Northwest Premium Servs., 144*

F.3d 1037, 1044 (7th Cir. 1998) ; *see also Homestead Mobile Homes, Inc. v. Foremost Corp. of Am., 603 F. Supp. 767 (N.D. Tex. 1985)* (where mobile home financing arrangements tied to insurance, conduct not exempt from antitrust as business of insurance. Further, because insurer acted in concert with a non-exempt entity, exemption would have been forfeited in any case); *FTC v. Manufacturer's Hanover Consumer Serv., 567 F. Supp. 992 (E.D. Pa. 1983)* . *See also Standard Sec. Life Ins. Co. v. West, 267 F.3d 821, 823 (8th Cir. 2001)* (McCarran-Ferguson barred application of Federal Arbitration Act because state statute prohibiting arbitration clauses in insurance contracts involved the business of insurance); *Smith v. PacifiCare Behavioral Health of Cal., Inc., 93 Cal. App. 4th 139, 113 Cal. Rptr. 2d 140, 155 (2d Dist. 2001)* , *cert. denied, 537 U.S. 818, 123 S. Ct. 92, 154 L. Ed. 2d 23 (2002)* (state law requiring specific disclosures in health care service plans' binding arbitration clauses were enacted for the purpose of regulating the business of insurance). *See generally* Polden, *The Antitrust Implications of Credit Insurance Tying Arrangements, 32 Drake Law Rev. 862, 903-05* (1982-1983); Kintner, Bauer & Allen, *Application of the Antitrust Laws to the Activities of Insurance Companies, 63 N.C.L. Rev. 431, 461-65 (1985).*

(n79)Footnote 78. Note that McCarran-Ferguson may also be raised to defend against consumer's federal claims regarding credit-related insurance practices other than antitrust, such as truth in lending and RICO. It is generally held not to bar such claims at least as to the creditor's conduct. *E.g., Kenty v. Bank One, Columbus, N.A., 92 F.3d 384 (6th Cir. 1996)* , *aff'd in relevant part, 92 F.3d 384 (6th Cir. 1996)* , *reh'g, en banc, denied, 1996 U.S. App. LEXIS 24797* (6th Cir. Sept. 19, 1996) . The Supreme Court broadly defined "impair" in holding that RICO does not conflict with nor frustrate Nevada's Unfair Insurance Practices Act in a case against a health care insurer that failed to pass on discounts it received from service providers on to its consumers. *Humana Inc. v. Forsyth, 525 U.S. 299, 119 S. Ct. 710, 142 L. Ed. 2d 753 (1999)* .

For a more extensive analysis of possible antitrust claims, see National Consumer Law Center, Cost of Credit § 8.5.2.5.3.

(n80)Footnote 79. NAIC Model Act § 8(A).

(n81)Footnote 80. NAIC Model Act § 8(D).

(n82)Footnote 81. *Cope v. Aetna Fin. Co. of Maine, 412 F.2d 635, 640 (1st Cir. 1969)* ; *Jennings v. Globe Life & Accident Ins. Co., 922 P.2d 622 (Okla. 1996)* (court also rejected the creative argument that the Oklahoma version of the UCCC provided a private right of action to enforce violations of regulations promulgated by the Insurance Commissioner; the UCCC is specifically limited to "creditor," not "insurer," violations).

(n83)Footnote 82. *E.g.,* Ariz. Rev. Stat. Ann. § 6.626(F); Conn. Gen. Stat. Ann. § 36-234; *Vt. Stat. Ann. tit. 8, § 2224(b).*

(n84)Footnote 83. In the event a claim is made, there would be a surplus which should be paid to the borrower's estate.

(n85)Footnote 84. *Western Guar. Loan Co. v. Dean, 309 S.W.2d 857, 862 (Tex. Civ. App. 1957)* ; *Industrial Fin. Serv. Co. v. Riley, 295 S.W.2d 498, 506 (Tex. Civ. App. 1956)* . *See, e.g., Brown v. Protective Life Ins. Co., 135 Fed. Appx. 647 (5th Cir. 2005)* (alleging that amount of coverage on credit life insurance sold in connection with financed vehicle purchase exceeded the financed amount and included coverage for unearned interest in violation of the state motor vehicle sales finance act; claim against insurer rejected because the auto finance company is not a licensing agent of the insurer for lending purposes under the state law).

(n86)Footnote 85. *E.g.,* NAIC Model Code §§ 4(A) (life), 4(B) (A&H), 5 (term).

(n87)Footnote 86. *E.g., Ala. Code § 5-18-17* (small loan); § 5-19-20 (Credit Code). *See also McCullar v. Universal Underwriters Life Ins. Co., 687 So. 2d 156 (Ala. 1996)* (interpreting Alabama law to mandate net coverage, not gross coverage, as agencies had interpreted the law). *But see Gall v. American Heritage Life Ins. Co., 3 F. Supp. 2d 1344*

(S.D. Ala. 1998) (court states it is not bound by plurality in *McCullar* and, agreeing with the dissent, finds that insurance can be calculated on the total of payments); *Liberty Bank & Trust Co. v. Splane, 959 P.2d 600 (Okla. Civ. App. 1998)* (court construes provision in UCCC restricting the amount of the permissible credit insurance to that which does not "exceed the debt" and another provision in Oklahoma insurance law restricting the amount of such insurance to "the approximate unpaid balance of the loan" to allow insurance premiums to be calculated on the total of payments; court specifically rejects the plurality in *McCullar*). *See also Dixon v. Ford Motor Credit Co., 2000 U.S. Dist. LEXIS 7934* (E.D. La. May 31, 2000) (allegations that Louisiana law mandates net coverage, that terms of insurance were not properly disclosed, and that excessive commissions were paid to sell insurance product warrants denial of motion for summary judgment on RICO claim), *aff'd without opinion, 252 F.3d 1156 (5th Cir. 2001) , cert. denied, 534 U.S. 952, 122 S. Ct. 349, 151 L. Ed. 2d 263 (2001) .*

(n88)Footnote 87. *See* NAIC Credit Personal Property Insurance Model Act, Clearinghouse No. 53,564.

(n89)Footnote 88. Its key provisions are described in *§ 6.06[4][b] supra* .

(n90)Footnote 89. *See e.g.,* Ga. Ind. Loan Act Regs. § 120-1-11.04(3) and 120-1-14-17(3); *Robinson v. Central Loan & Fin. Corp., 609 F.2d 170, 175 (5th Cir. 1980)* ; *Ala. Code § 5-19-20(d)*; UCCC § 4-301.

(n91)Footnote 90. UCCC § 4-301(1)(a). *See Department of Fin. Inst. v. Beneficial Fin. Co. of Madison, 426 N.E.2d 711, 713 (Ind. Ct. App. 1981) .*

(n92)Footnote 91. *See § 6.06[4] supra*; *see also § 6.06[5][c] infra.*

(n93)Footnote 92. *See, e.g., Kenty v. Bank One, Columbus, N.A., 1992 U.S. Dist. LEXIS 16645* (S.D. Ohio Apr. 29, 1992) (interest under the National Bank Act), *aff'd in part, rev'd in part on other grounds, Kenty v. Bank One, Columbus, N.A., 92 F.3d 384 (6th Cir. 1996)* ; Boyd v. Society Bank & Trust, Clearinghouse No. 47,939A (Ohio Ct. Com. Pleas), *order on motion to dismiss* (Oct. 29, 1991) (state usury law); *contra Doe v. Norwest Bank Minn., N.A., 107 F.3d 1297 (8th Cir. 1997) , reh'g, en banc, denied, 1997 U.S. App. LEXIS 11337* (8th Cir. May 12, 1997) .

(n94)Footnote 93. Some of the recent litigation challenges the overreaching from the combined impact of insurance packing and frequent flipping. *See, e.g., Emery v. American Gen. Fin., Inc., 71 F.3d 1343 (7th Cir. 1995) .*

(n95)Footnote 93.1. *See, e.g., Miner v. Beneficial Mortgage Co. of Kan. (In re Miner), 369 B.R. 655 (Bankr. D. Kan. 2007)* (describing a series of loan refinancings containing credit insurance and culminating in a one-time, financed fee of almost $10,000 for credit life and credit disability insurance on a loan of almost $75,000; ultimately, the credit insurance application was denied and the premiums were refunded).

(n96)Footnote 94. 16 C.F.R. § 444 (FTC); 12 C.F.R. § 535 (OTS); *12 C.F.R. § 227 (FRB). See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 5.3.12 (6th ed. 2004 and Supp.).

(n97)Footnote 95. *E.g.,* VCRs, a second television, artwork, jewelry other than wedding rings. *16 C.F.R. § 444.1(i).*

(n98)Footnote 96. For an example of some complaints, see James v. ITT Fin. Servs., Report of Prof. Robert Hartley, submitted in support of Plaintiff's Motion to Certify Class, Oct. 10, 1989, Clearinghouse No. 44, 801X.

(n99)Footnote 97. *See § 6.06[7] infra*; *see also § 6.05[2][c] supra.*

(n100)Footnote 98. UCCC § 5-108(4)(b).

(n101)Footnote 99. *See § 6.06[7] infra.*

(n102)Footnote 100. *See Suburban State Bank v. Squires, 145 Wis. 2d 445, 427 N.W.2d 393 (Ct. App. 1988)*

(where borrower had heart attack and collected on disability insurance and loan was refinanced, court upheld finding that creditor was negligent in not advising borrower that new disability policy would bar recovery if borrower had another heart attack).

(n103)Footnote 101. For example, the Alabama Supreme Court recently upheld a jury verdict for $2 million punitive damages (after remitter) for fraud against both the creditor and insurer in a recent case involving sale of credit life insurance to a borrower in ill health. *Union Sec. Life Ins. Co. v. Crocker, 667 So. 2d 688 (Ala. 1995)* , *cert. denied*, *523 U.S. 1074, 118 S. Ct. 1515, 140 L. Ed. 2d 668 (1998)* . Because the amount of punitive damages awarded in this case got caught up in the debate in the United States Supreme Court about the propriety of punitive damages awards in relation to the amount of compensatory damages awarded, the Court vacated the decision in this case, *517 U.S. 1230, 116 S. Ct. 1872, 135 L. Ed. 2d 169 (1996)* , *upon remand from Supreme Court, 709 So. 2d 1118 (Ala. 1997)* (court reduced punitive damages award to $1 million), for further consideration by the Alabama Supreme Court in light of *BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 116 S. Ct. 1589, 134 L. Ed. 2d 809 (1996)* . *Cf. Miller v. Dobbs Mobile Bay, Inc., 661 So. 2d 203 (Ala. 1995)* .

(n104)Footnote 102. *See generally § 6.06[7] infra*; National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 10.5.11.2 (7th ed. 2008 and supp.).

(n105)Footnote 103. For example, the Third Circuit reversed summary judgment in favor of the insurer and remanded a case where borrowers had alleged that the insurer failed to pay excess disability benefits as provided for in their policies. *Schroeder v. Acceleration Life, 972 F.2d 41 (3d Cir. 1992)* .

(n106)Footnote 104. *E.g., Ala. Code § 27-18-4* (group life).

(n107)Footnote 105. *See, e.g., Justus v. Mountain Life Ins. Co., 1999 Tenn. App. LEXIS 702* (Tenn. App. Oct. 15, 1999) (bank employee took no application but represented that a credit life insurance policy was in full force and effect). *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 8.5.5 (4th ed. 2009).

(n108)Footnote 106. *See Taylor v. American Bankers Ins. Group, Inc., 267 A.D.2d 178, 700 N.Y.S.2d 458 (N.Y. App. Div. 1999)* (class certification granted in case where consumers allege practice of rejecting insurance claims on grounds that customers had not been paying for the appropriate type of insurance after disclosing the nature of the insurance in small, inconspicuous type). *See Union Sec. Life Ins. Co. v. Crocker, 709 So. 2d 1118 (Ala. 1997)* (punitive damages award for fraud in sale of credit life insurance coverage to plaintiff and her husband when he was known to have disqualifying health problems; award was reduced after U.S. Supreme Court concluded that a higher amount would violate due process, *see 517 U.S. 1230 (1996))* ; *Lucas v. Cont'l Cas. Co., 170 S.E.2d 856 (Ga. Ct. App. 1969)* (jury question existed regarding waiver of exclusion for prior illness where insured questioned auto dealer about whether prior heart condition would limit credit insurance availability). *But see Southards v. Cent. Plains Ins. Co., 441 P.2d 808 (Kan. 1968)* (plaintiff denied coverage under credit disability policy where he did not know at the time of purchase that he had a certain degenerative disease, although a medical expert could have detected it if the plaintiff would have been examined); *S. Branch Valley Nat'l Bank v. Williams, 155 S.E.2d 845 (W. Va. 1967)* (credit insurer was not liable under policy where cashier for bank processed insurance application for insured who was ineligible based on age). Another issue that may arise is where a consumer becomes eligible for an insurance claim but the loan is in default. One court found that the claim should be paid because, despite the default, the insurer had not provided notice of cancellation to the borrower according to the contract. *Smith v. Liberty Life Ins. Co., 2005 WL 2445430* (W.D. La. Sept. 30, 2005) (where borrower with credit insurance covering accidental death died in auto accident almost two months after receiving a formal notice of default, court found that insurance company was required to pay claim because it had not provided notice of policy cancellation to the borrower).

(n109)Footnote 107. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 8.5.5.2 (3rd ed. and Supp.).

(n110)Footnote 108. Occasionally, the insurance may be for a shorter term if, for example, the borrower will reach the age of ineligibility prior to the loan maturation date, or if the scheduled loan term is longer than the insurance term allowed under the state credit insurance code. Because of the expense of insurance coverage for long-term loans (and state law restrictions on long-term insurance), an alternative called "truncated life" has been developed recently, which may cover the first 5 years on a 10 year loan, or 1 to 3 years on shorter loans. Fagg, Credit Life and Disability Insurance 19 (1986). Similarly, disability insurance may provide "critical period coverage," which would cover disability occurring any time during the loan term, but would limit monthly payments to a shorter period. For example, two year critical period coverage may be written on a 10-year loan. Truncated disability may also be written, with the coverage period coinciding with the term covered under a truncated life policy. *Id*. at 27-28 .

(n111)Footnote 109. NAIC Model Act § 8B.

(n112)Footnote 110. NAIC Model Act § 5.

(n113)Footnote 111. *E.g., Iowa Code § 537.2510*. It may also be incorporated by a general reference in the credit statute to the applicability of the credit insurance code.

(n114)Footnote 112. Even in states where interest rebates must be calculated by the actuarial method, the Rule of 78 may be authorized for credit insurance rebates. Other authorized methods are the pro rata method, an average of the 78 and pro rata methods, or the Rule of Anticipation. *See* Fagg, Credit Life and Disability Insurance 182-84 (1986).

(n115)Footnote 113. NAIC Model Act § 8B.

(n116)Footnote 114. *E.g., Iowa Code § 537.2510(1)* and *(6)*.

(n117)Footnote 115. *Williams v. Charter Credit Co., 179 Ga. App. 721, 347 S.E.2d 635 (1986)* . The Supreme Court of Mississippi has ruled that an undue delay of a premium refund supports an award for punitive damages. *Mic Life Ins. Co. v. Hicks, 825 So. 2d 616 (Miss. 2002)* (finding that a punitive damages award is appropriate for a two-year delay, but holding that a $1 million award for failure to refund $637.99 is unconstitutionally excessive and that trial and evidentiary errors in this particular case preclude a punitive damage award against the insurer).

(n118)Footnote 116. A number of cases declined to find usury where there was no indication the insurance was more expensive than if purchased elsewhere, or no circumstances of compulsion, duress, or fraud. Compare the Arkansas Supreme Court's analysis in *Poole v. Bates, 520 S.W.2d 273 (Ark. 1975)* , *with* its analyses in *Robinson v. Rebsamen Ford, Inc., 530 S.W.2d 660 (Ark. 1975)* , *and Aclin Ford v. Cordell, 625 S.W.2d 459 (Ark. 1982)* . *See also Coner v. Morris S. Berman Unlimited, 65 Md. App. 514, 501 A.2d 458 (1985)* ($25,000 coverage on a small loan not improper where there was no evidence that the excess coverage added cost to the premium).

(n119)Footnote 117. *See, e.g., Anthony v. Community Loans & Inv. Corp., 559 F.2d 1363 (5th Cir. 1977)* ; *Poole v. Bates, 520 S.W.2d 273 (Ark. 1975)* .

(n120)Footnote 118. *See § 6.08[7] infra*.

(n121)Footnote 119. *E.g., Bailey v. Defenbaugh & Co. of Cleveland, Inc., 513 F. Supp. 232, 240-41 (N.D. Miss. 1981)* ; *Transamerica Fin. Corp. v. Superior Court, 158 Ariz. 115, 761 P.2d 1019 (1988)* , *rev'g Transamerica Fin. Corp. v. Superior Court, 155 Ariz. 327, 746 P.2d 497 (Ct. App. 1987)* ; *Tew v. Dixieland Fin., Inc., 527 So. 2d 665 (Miss. 1988)* . *But see Dixon v. S & S Loan Serv. of Waycross, 754 F. Supp. 1567 (S.D. Ga. 1990)* (federal court holds no implied private right of action under Ga. Comp. R. & Regs. § 120, implementing the Georgia Industrial Loan Act). *See also § 6.08[7] infra*.

(n122)Footnote 120. *See Hutson v. Wenatchee Fed. Sav. & Loan Ass'n, 22 Wash. App. 91, 588 P.2d 1192, 1198 (1979)* .

(n123)Footnote 121. *See In re Dickson, 432 F. Supp. 752 (W.D.N.C. 1977)* (creditors which are part of bank holding company have fiduciary obligation when selling credit life insurance to borrowers; duty violated by selling insurance at inflated premiums, receiving, and failing to disclose commission); *Stone v. Davis, 66 Ohio St. 2d 74, 20 Ohio Op. 3d 64, 419 N.E.2d 1094 (1981)* , *cert. denied*, *454 U.S. 1081, 102 S. Ct. 634, 70 L. Ed. 2d 614 (1981)* (court found fiduciary relationship in "trust and confidence" which borrower placed in creditor); *Tomaszewski v. McKeon Ford, Inc., 240 N.J. Super. 404, 573 A.2d 501 (1990)* (fiduciary duty found where creditor gave advice to borrower). *See also Harris v. Ill. Vehicle Premium Fin. Co., 2000 U.S. Dist. LEXIS 13763* (N.D. Ill. Sept. 7, 2000) ; *Hobson v. Lincoln Ins. Agency, Inc., 2000 U.S. Dist. LEXIS 13314* (N.D. Ill. Sept. 7, 2000) (breach of fiduciary duty and UDAP claims survived motions to dismiss where insurance premium finance company and insurance company were connected and failed to disclose this fact to the consumer).

(n124)Footnote 122. *Browder v. Hanley-Dawson Cadillac, 62 Ill. App. 3d 623, 379 N.E.2d 1206, 1210-11 (1978)* .

(n125)Footnote 123. *See, e.g., Union Sec. Life Ins. Co. v. Crocker, 667 So. 2d 688 (Ala. 1995)* , on other grounds, *517 U.S. 1230, 116 S. Ct. 1872, 135 L. Ed. 2d 169 (1996)* , *upon remand from Supreme Court, 709 So. 2d 1118 (Ala. 1997)* .

(n126)Footnote 124. *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices, §§ 2.2.1, 2.3.1 (7th ed. 2008).

(n127)Footnote 125. N.Y. Banking Law § 6-1. For a discussion of similar laws, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 2.3.3.7 (3rd ed. and Supp.).

(n128)Footnote 126. N.Y. Banking Law § 6-1.

(n129)Footnote 127. N.Y. Banking Law § 6-1.

(n130)Footnote 128. *E.g.*, UCCC §§ 4-106, 5-108.

(n131)Footnote 129. *E.g., Besta v. Beneficial Loan Co., 855 F.2d 532, 535 (8th Cir. 1988)* (a bargain is unconscionable "if it is such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other"); *Williams v. Walker-Thomas Furn. Co., 350 F.2d 445 (D.C. Cir. 1965)* ; *Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960)* .

(n132)Footnote 130. *See Union Sec. Life Ins. Co. v. Crocker, 667 So. 2d 688 (Ala. 1995)* , on other grounds, *517 U.S. 1230, 116 S. Ct. 1872, 135 L. Ed. 2d 169 (1996)* , *upon remand from Supreme Court, 709 So. 2d 1118 (Ala. 1997)* . Note that general claims of fraud regarding the terms of the insurance often will face the argument that a plaintiff has a duty to read the contract and cannot rely on oral representations regarding a written contract. *See, e.g., Ross v. Citifinancial, 344 F.3d 458 (5th Cir. 2003)* . The Alabama Supreme Court held that in evaluating the factual question of whether the premium calculation method was fraudulently suppressed, a claim will fail where the method for calculating the premiums is contained in the loan documents signed by the borrowers. *See Singleton v. Protective Life Ins. Co., 857 So. 2d 803 (Ala. 2003)* . Moreover, where plaintiffs brought a purported class action alleging a common course of conduct in the sale of gross, rather than net, coverage of credit insurance, the Alabama Supreme Court found that a class cannot be certified for claims of negligent supervision/hiring that led to fraudulent suppression because the allegations of oral misrepresentations do not allow for common questions of law and fact to predominate. *Voyager v. Whitson, 867 So. 2d 1065 (Ala. 2003)* .

(n133)Footnote 131. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, §§ 12.6.8 (7th ed. 2008). *See also* Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 Ohio St. J. on Disp. Resol. 267 (1995); Michael D. Donovan, David A. Searles, *Preserving Judicial Recourse for Consumers: How to Combat Overreaching Arbitration Clauses*, 10 Loy. Consumer L. Rep. 269 (1998).

(n134)Footnote 132. *Lackey v. Green Tree Fin. Corp., 330 S.C. 388, 498 S.E.2d 898 (Ct. App. 1998)* (despite finding the mobile home purchase contract one of adhesion, court found lack of mutuality regarding remedies available to the parties alone insufficient to preclude arbitration); *Med Ctr. Cars, Inc. v. Smith, 727 So. 2d 9 (Ala. 1998)* (consumer must show facts to support finding that contract was presented on a "take it or leave it" basis).

(n135)Footnote 133. *Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 111 S. Ct. 1522, 113 L. Ed. 2d 622 (1991)* , *superseded by statute as stated in Yang v. M/V Minas Leo, 1996 U.S. App. LEXIS 2235* (9th Cir. Cal. Jan. 26, 1996) .

(n136)Footnote 134. *Med Ctr. Cars, Inc. v. Smith, 727 So. 2d 9 (Ala. 1998)* (arbitration clause only appeared in the buyer's order and contained a provision stating that the clause was the "complete and exclusive" agreement; accordingly, arbitration could not be invoked by the dealer when the buyer's order was between the consumer and the manufacturer; also, arbitration clause not binding on consumer when the contract was not signed by the dealer and the contract stated it was not valid unless accepted by the seller); *Jones v. Money Tree, 686 So. 2d 1166 (Ala. 1996)* (court refused to compel arbitration sought by insurer against borrower who sued the lender and insurer since the insurance contract did not include an arbitration clause; the only arbitration clause existed in the loan document). *But see Roberson v. Money Tree of Ala., Inc., 954 F. Supp. 1519 (M.D. Ala. 1997)* (court held that credit insurance company could enforce arbitration clause in loan document even though the insurance company was not a party to the loan because borrowers alleged that the lender and the insurance company cooperated in a fraudulent scheme to sell them unnecessary insurance through various suppressions and misrepresentations; thus, borrower's claims against each defendant were founded upon and intertwined with the underlying contact obligations).

(n137)Footnote 135. *Harris v. Green Tree Fin. Corp., 1997 U.S. Dist. LEXIS 20792* (E.D. Pa. Dec. 16, 1997) (in home improvement financing scheme, one-sided arbitration clause which, essentially, bound only the consumer to mandatory arbitration held unconscionable), *rev'd, remanded, 183 F.3d 173, 1999 U.S. App. LEXIS 14799 (3d Cir. 1999)* ; *Patterson v. ITT Consumer Fin. Corp., 14 Cal. App. 4th 1659, 18 Cal. Rptr. 2d 563 (1993)* , *cert. denied, 510 U.S. 1176, 114 S. Ct. 1217, 127 L. Ed. 2d 563 (1994)* ; *Williams v. Aetna Fin. Co., 83 Ohio St. 3d 464, 700 N.E.2d 859 (1998)* , *cert. denied, 526 U.S. 1051, 119 S. Ct. 1357, 143 L. Ed. 2d 518 (1999)* ; *Arnold v. United Cos. Lending Corp., 204 W. Va. 229, 511 S.E.2d 854 (1998)* .

(n138)Footnote 136. *See Badie v. Bank of Am., 67 Cal. App. 4th 779, 79 Cal. Rptr. 2d 273 (1st Dist. 1998)* , *rev. denied, 1999 Cal. LEXIS 1198* (Cal. Feb. 24, 1999) (credit card issuer cannot impose binding arbitration on its cardholders via a bill-stuffer that eliminates the fundamental right to a jury trial even where original agreement stated that "all terms subject to change"); *see also* National Consumer Law Center, Consumer Arbitration Agreements (5th ed. 2007); National Consumer Law Center, Unfair and Deceptive Acts and Practices, §§ 12.6.8 (7th ed. 2008).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 6 The Cost of Credit

1-6 Consumer Credit Law Manual § 6.07

§ 6.07 The Statute: Determining the Applicable Statute and Principles of Statutory Construction

[1] Which Usury Statute Applies?

The first step in analyzing whether a consumer has a claim for violation of a statute regulating credit charges is to determine which statute is applicable. As was discussed earlier, most states have several different usury statutes, so an understanding of the state's regulatory scheme is critical to assure that the transaction is being assessed by the correct standards.

The following characteristics and issues are important in determining the scope of a special usury statute.

[a] Is the Loan for Consumer or Business Purposes?

It is often necessary to examine the purpose of the credit as usury laws frequently distinguish business loans from consumer credit, allowing higher interest rates or completely eliminating usury ceilings for business transactions. For example, the Uniform Consumer Credit Code applies only to credit extended "primarily for a personal, family, household, or agricultural purpose," n1 so the statute does not reach business transactions. More frequently, business loans are treated as a specific exception to a general usury law which would cover business transactions but for the exclusion.

It is also important to examine the statute carefully to determine whether the business purpose exemption displaces all of the otherwise applicable usury statute, or merely certain specific portions of it. Even if the general usury statute contains an exception for business loans, there may still be an applicable criminal usury ceiling, typically in the state criminal code. n2 In California, a loan to a borrower who has assets over $2 million is exempt from the state constitution's usury ceiling if the borrower has a preexisting relationship with the lender or the lender and the borrower are financially sophisticated. n3

Given the number of cases involving corporate or business usury exemptions, surprisingly few opinions discuss in any detail the difference between a business purpose and a personal or individual purpose. n4 The issue is generally viewed as a question of fact which will vary from case to case. n5

[b] Distinctions Based on the Type of Credit

In addition to the common distinction between consumer purpose and business purpose, a number of other distinctions among types of credit may be relevant to determining which usury statute is applicable. The most common distinctions are between open-end (revolving) and closed-end credit, and between loans and installment credit sales. n6

[c] Distinctions Based on the Type of Creditor

Some statutes use a standard relating to either the frequency with which one engages in lending (e.g., applying to one who "regularly extends credit,") n7 or whether one is in the business of making loans. Of course, lending is an integral part of their business for most depository lenders, such as banks and credit unions, so this requirement will typically only present an issue with some non-depository lenders, usually individuals. n8 On the other hand, a court may consider a lender to be "in the business" if he makes only a single loan, at least if done as a business proposition as opposed to a personal accommodation for the borrower. n9

When the creditor is a state bank, credit union, or other depository lender, the special usury statute setting forth the legal standards against which an individual contract is to be measured may be the one applicable to the type of credit involved, such as installment sales or revolving credit, rather than the statute regulating that type of creditor.

National banks, federal savings and loan associations, and federal credit unions, although federally regulated, are also subject to state law, including usury statutes, unless the state law directly conflicts with the federal regulations, in which case the state law is preempted. n10

Under limited circumstances, some state lenders may be treated as federal lenders and may follow federal regulations to the exclusion of state law. Specifically, most housing creditors may invoke Office of Thrift Supervision n11 regulations when they are issuing variable rate or balloon mortgages. n12 Furthermore, state parity laws sometimes grant state depository lenders the right to issue loans on the same terms as federal depository lenders. n13

Non-depository creditors are subject to a state's general usury law unless the creditor has situated itself to take advantage of a specific usury statute which may allow the charging of higher interest rates or otherwise provide the creditor with special advantages.

State laws also sanction specific non-depository institutions established for the purpose of making consumer credit available. The primary examples of this type of lender are finance companies operating under small loan acts, industrial loan acts, or consumer finance acts. The advantage of the often more lucrative rate ceilings available under these laws may be enjoyed only if the company has obtained a license and subjected itself to regulation and supervision. n14 The state licensing statutes which regulate such non-depository creditors are therefore critical in evaluating an individual transaction with such a creditor. n15 Transactions with lenders who are not licensed, but should be, may be void even in the absence of a special statutory provision to that effect. n16 In addition, a court may be willing to require an unlicensed entity to refund any money the consumer has already paid, on an unjust enrichment theory. n17 The fact that a lender has a license does not mean that any loan it makes can take advantage of the higher usury ceiling in the licensing statute. If a licensee makes a loan that does not conform to the requirements of the licensing law, the loan will be subject to the general usury ceiling. n18

In the early 1990s, a special breed of small loan company developed a technique to evade state regulation. These lenders targeted personnel at state military bases, but they would lend only to personnel who were not legal residents of the state where the base was located. Since many state credit laws apply their protections only to residents of the state, these lenders argued that those laws did not apply to their loans.

The loan products that these specialty lenders offer typically have a term of less than a year. An APR in the 30% to 40% range is probably most common, but some are close to 100%, and there may be significant credit insurance charges that

are not included in the APR calculation.

In 2006, Congress enacted a new law, the Military Lending Act, that attempted to address this loophole in state lending laws. n18.1 The new law prohibits different treatment under state law of service members and dependents.

The law gave the Department of Defense (DOD) the authority to issue implementing regulations, but the draft regulations could undercut the different treatment provision and its statutory protection for service members. The draft regulations issued in April 2007 n18.2 define the "consumer credit" covered by the Act to include only credit that falls into narrow definitions of payday loans, auto title loans, and refund anticipation loans. The military small loan companies generally fall outside of these categories because they are not secured in the fashion necessary to meet the regulatory definitions, and also have (or soon will have) a term longer than 91 days.

The new law took effect on October 1, 2007. The Secretary of Defense expected to issue final regulations prior to that date. n18.3

If the regulations change so that the military small loans are covered, or if the different treatment provision is interpreted to apply to all loans, the new law would nullify the state regulators' opinion letters that exempted creditors from complying with state laws in their dealings with non-resident military personnel.

[d] Distinctions Based on Loan Size; Loan-Splitting and Loan-Packing to Evade Regulation

Creditors' attempts to claim that loans are too large to be covered by special usury statutes have raised two major questions in litigation: first, what loan fees may be counted as principal for purposes of reaching the threshold loan size needed for the exemption; and, second, when can several smaller loans be claimed as one large loan which qualifies for an exemption.

The practice of adding fees to the face amount of a loan note in order to reach the minimum loan size needed for a usury exemption is sometimes known as "packing" or "padding" the principal. n19 To some extent, packing the loan principal is legal because most states recognize reasonable third party fees, such as credit insurance premiums, and sometimes limited fees for lender services as valid non-interest expenses, which a lender may properly finance as part of the loan principal. n20 However, if a lender includes fees which qualify as interest payments in the face amount of the note, then that note no longer represents the size of the loan for purposes of determining whether the threshold loan size for the usury exemption has been reached. n21 In addition to padding a loan with extra charges, a lender may also do so by requiring or encouraging the borrower to consolidate other debts, or by the added incremental costs that come with soliciting a borrower for frequent refinancings. To the extent such practices work to the disadvantage of borrowers, there may be grounds for challenging these types of loan padding practices under non-usury theories, such as unconscionability or state UDAP statutes. n22

A second question created by statutes that raise or eliminate usury ceilings for loans which exceed a certain size is whether several small loans, which do not individually reach the statutory threshold, may be treated as one loan to which the higher ceiling applies. This question depends on the specific language of the relevant usury statute, but most such statutes seem to apply a transactional approach. In other words, if a borrower and lender signed a contract under which the lender agreed to advance, in several installments, an aggregate sum in excess of the statutory threshold, this series of advances will generally be treated as a single loan, based on a single transaction. n23

Lenders may also engage in loan splitting in order to avoid giving the borrower meaningful information about the cost and terms of the loan. Most borrowers will, for example, be unable to calculate a composite interest rate for two loans issued on the same day. This issue has arisen in the Truth in Lending context, n24 but can also arise in the context of state credit statutes that require credit terms to be disclosed in a single document. In the Truth in Lending context, the test courts have applied is whether "the debtor wants, requests, and expects to get a single loan consummated in a single

transaction, but the lender instead documents and makes disclosures for the loan as if it were two separate transactions." n25

Loan-splitting is also attractive to lenders who are operating under a statute that allows per-loan fees. For example, a payday loan law may allow a minimum finance charge of a certain dollar amount regardless of the size of the loan. Splitting a loan into two smaller loans allows the lender to double these fees without extending any additional credit. n26

[e] Distinctions Based on Security Taken

The existence of any security in a credit transaction and the identity of that security is, in most states, a subject that is intertwined with the identification of the particular credit statute that regulates the transaction. In many situations, the existence of a particular security will dictate which special usury statute will apply.

[f] Criminal Usury Statutes

With particularly high rate credit, it may warrant checking whether the state has a criminal usury ceiling which may be applicable. Some states, when deregulating their civil usury statutes, nonetheless retained their criminal usury ceilings, n27 which may be invoked to challenge high cost credit.

[g] Usury in "Deregulated" States

In the late 1970s and early 1980s, numerous state legislatures decided to remove interest ceilings on some or all types of credit transactions. However, even in deregulated states, there usually remain benchmarks, which, if a creditor violates, provide a consumer with possible claims or defenses. This section will discuss one such possible benchmark which may be breached--the credit agreement itself.

During deregulation, many states altered only that portion of the usury statute which set a numerical interest rate ceiling, often modifying to permit any "agreed rate." n28 The most obvious way that a creditor could violate an "agreed rate" usury statute would be to assess charges to which the borrower had not agreed.

A more subtle approach is for lenders to actually charge an above-market interest rate, while stating a lower rate. One way to accomplish this is to inflate the loan principal through the inclusion of various "fees," such as points, service charges, commitment or other fees, or sham closing costs.

The understatement of interest rates in a deregulated state is basically a disclosure problem, n29 and, at least in consumer transactions, it is theoretically addressed by TILA because points and some other fees are generally "finance charges" which must be included in the computation of the TILA's annual percentage rate (APR) disclosure. n30 However, the TILA does not apply to all credit transactions, and, even when it does apply, its disclosures can still be minimized by an unscrupulous lender.

Another answer to an understated interest rate accomplished through the use of one-time fees may lie in the apparently emasculated usury statute. The usury statute sets the usury ceiling at a *rate* agreed upon by the parties and, under both normal usage and statutory definition, a rate is a percentage figure, not a total charge. n31 The rate stated on the face of the loan note will be lower than the effective interest rate if the lender has charged hidden interest fees, such as points or other charges. Since the rate stated on the face of the note is arguably the only *rate* to which the parties have agreed, then this rate is the usury ceiling for the transaction. By charging a higher effective rate, the lender has exceeded the usury ceiling, and the frequently serious sanctions that the legislature left on the books when it "deregulated" the usury statute can be invoked. n32

[h] Choice of Laws in Interstate Transactions

When conflicts of law arise in consumer credit cases, consumer attorneys must emphasize to courts the public policy reasons for applying a particular state's usury statute. There are special public policy arguments that support application of a particular state's consumer usury law even when that argument may not apply to application of a commercial usury law. n33

In some situations, contacts with state residents through the Internet can meet the "minimum contacts" jurisdictional test. Courts have generally found that where a defendant uses a website to transact business by entering into contracts and exchanging files, the minimum contacts test is satisfied. n34 Passive websites that do no more than post advertisements that are accessible to people in the forum state are usually found to be insufficient to give the forum state jurisdiction. n35

[i] Electronic Credit Transactions

Another developing issue in consumer credit is paperless lending. While electronic credit transactions offer new convenience for borrowers, they also create new opportunities for fraud. Either federal or state law, or both, may apply to these transactions. n36

Congress gave an impetus to electronic transactions by passing the Electronic Signatures in Global and National Commerce Act ("E-Sign"), n37 effective October 1, 2000. General jurisdiction may be established either by showing that state residents in fact interacted with the website or that the website actively sought to encourage residents to access it. n38 It provides that neither a signature nor a contract can be denied legal effect, validity, or enforceability solely because it is in electronic form. n39 It also provides that "if a statute, regulation, or other rule of law requires that information relating to a transaction or transactions in or affecting interstate or foreign commerce be provided or made available to a consumer in writing," the information can be provided electronically, as long as certain conditions are met. n40

The new statute applies not only to transactions that the consumer initiates electronically, but also to traditional paper transactions. It authorizes creditors to provide information electronically in transactions that are otherwise conducted entirely on paper, as long as the new statute's requirements are satisfied. For consumer transactions, the key requirement is that the consumer must consent in a very specific way to receive electronic disclosures. n41

Many state credit laws require that the credit contract be in writing. Because of E-Sign, a contract cannot be invalidated solely because it is electronic rather than written, or solely because it was electronically signed. n42 These same credit laws also typically require that the consumer be given a copy of the written contract. E-Sign will override the requirement that delivery of the information be in written rather than electronic format, but only if the consumer follows E-Sign's specific electronic consent procedures and the transaction meets the other requirements of E-Sign. Even if the consumer consents, however, E-Sign does not authorize electronic provision of certain important notices such as foreclosure or utility termination notices. E-Sign also establishes important consumer protections regarding document integrity, so that consumers will be able to retain electronic documents and produce them accurately for later reference. n43

The federal statute allows states to supersede some of its provisions, including its key consumer protection provisions, by passing the Uniform Electronic Transactions Act ("UETA") n44 or other state laws that are technologically neutral and consistent with the federal statute. n45 By 2002, over three-quarters of the states had adopted some form of UETA. n46

Like E-Sign, UETA provides that contracts, other records, and signatures cannot be denied legal effect because they are in electronic form. n47 It also echoes E-Sign in providing that electronic documents and electronic signatures satisfy state laws that require writings. n48 But UETA is different in many ways from the federal statute. First, it does not

require E-Sign's specific consent procedures. It merely requires that the parties agree to conduct transactions by electronic means. n49 Second, UETA does not make exceptions for important documents like foreclosure notices. Third, UETA allows oral records for all purposes, n50 and its document integrity requirements are significantly weaker than E-Sign's. States that displace E-Sign by enacting UETA have the option of preserving these consumer protections, however. n51

Except for laws that require physical signatures or written documents, both E-Sign and UETA leave state consumer protection and credit statutes unchanged. E-Sign provides that it does not "limit, alter, or otherwise affect any requirement imposed by a statute, regulation, or rule of law relating to the rights and obligations of persons under such statute, regulation, or rule of law other than a requirement that contracts or other records be written, signed, or in nonelectronic form." n52 UETA does not have such a specific savings clause, but states "[a] transaction subject to this Act is also subject to other applicable substantive law." n53 Neither E-Sign n54 nor UETA n55 requires the use or acceptance of electronic contracts or signatures.

Neither the federal statute nor UETA applies to a contract or other record (electronic document) "to the extent that it is governed by" Article 9 of the Uniform Commercial Code, n56 but the 1999 revision to Article 9, which all states have adopted, has its own provisions allowing electronic documents in secured transactions. n57

When confronting an electronic credit transaction, the key questions for the consumer's attorney are:

- Did the consumer actually agree to the terms of the electronic contract?

- Does the electronic document that the creditor produces accurately reflect the terms of the transaction? If the consumer contests the creditor's version of the terms of the transaction, can the creditor prove that it met E-Sign's or UETA's document integrity requirements?

- If state or federal law requires the contract, credit disclosures or later documents to be provided in writing to the consumer, do the electronic documents satisfy this requirement? If not, then the consumer has the right to whatever remedies the state or federal law provides.

- Can the creditor prove delivery of any documents that it claims were delivered electronically? n58

A number of other issues may arise in electronic credit transactions, including which law applies, whether the contract was in a format that allowed retention and accurate reproduction for later reference by the consumer, and did the consumer actually have the equipment to keep it? n59

[2] Statutory Construction

[a] Applying General Rules of Interpretation

Usury is a statutory offense rather than an infraction of common law, and principles of statutory construction come into play in the many cases where the controlling usury statutes are vague or ambiguous. n60

The fact that specific usury ceilings did not exist at common law can be misleading: To some it suggests that the interest restrictions contained in modern usury statutes are novel restrictions on previously unregulated lending and, thus, these restrictions should be narrowly construed because they would be in derogation of common law. In fact, at early common law, it was forbidden to charge *any* interest at all, and common law recognized an action to recover usury (i.e., interest) paid.

Thus, usury statutes are actually in derogation of common law only to the extent that they *allow* the charging of interest,

not to the extent that they restrict interest charges. Therefore, when applying the rule that statutes in derogation of common law should be strictly construed, one must conclude that it is the right to *charge* interest in modern usury statutes which should be strictly construed. Conversely, restrictions on that right should be broadly interpreted. n61

The conflict between the broad construction of remedial statutes and the narrow construction of penal statutes also may cloud statutory construction issues. Specifically, usury statutes are remedial to the extent that they seek to protect necessitous debtors from the exploitation of avaricious lenders n62 and to compensate debtors for the damages they have incurred through the payment of usurious interest. The remedial purposes indicate that ambiguous provisions should be broadly construed to protect the consumer in usury statutes. n63 Moreover, consumer credit regulatory statutes may specify that they are to be construed broadly to effectuate their ends, and such specific statutory directive must supersede any contrary common law. n64

On the other hand, many usury statutes go beyond compensating the victims of usury and impose penalties and forfeitures upon creditors who are guilty of usury. n65 These remedies are penal, and their presence suggests that usury statutes should be strictly construed. n66

The result of these conflicts often is a legal deadlock which effectively leaves the court free to construe usury statutes as it wishes, and usury decisions which involve any degree of statutory construction frequently seem based as much on the equities of the case or the predisposition of the court as on any compelling logical reason for choosing one rule of construction over another. n67

[b] Retroactive Amendment of Usury Statutes

After the dramatic changes in usury law during the 1970s and 1980s, many creditors whose conduct violated existing usury statutes claimed that subsequent amendments to those statutes retroactively validated the theretofore illicit practices. Many courts accepted this argument n68 even though the retroactive application of laws in general runs contrary to principles of American jurisprudence. n69

As affirmed by the U.S. Supreme Court in *Ewell v. Daggs*, n70 it is fairly clear that the retroactive repeal of a usury statute or the retroactive increase of a usury ceiling does not unconstitutionally infringe on a borrower's rights. However, modifications of usury laws are not universally given retroactive effect.

If a usury statute expressly states in a savings clause that its application should be prospective only, or that it should not affect pending litigation, then that statute clearly should not be given retroactive effect, although the precise scope of such savings clauses is often disputed. n71 However, the presence of a savings clause is not a prerequisite to finding that a legislature intended to amend a usury statute prospectively. n72

When the legislative intent regarding the effective date of a usury statute is not clear, a few courts have given the relevant statute only prospective effect, n73 despite the statement in *Ewell* that retrospective effect should be presumed under these circumstances. n74 Advocates should check their state constitutions and state laws to determine whether, as a matter of state law, there are any limitations to the state legislature's ability to apply a statutory change retroactively.

The analysis previously presented in this section has presumed that statutory modifications have raised or eliminated usury limitations, thus legalizing previously usurious transactions. It is, of course, possible for an amended usury statute to prohibit transactions which had previously been legal. n75 Under such circumstances, it is clear that usury statutes do not have retroactive effect because retroactive application would impair the existing contractual obligation. n76

Legal Topics:

For related research and practice materials, see the following legal topics:

Banking LawNational BanksInterest & UsuryGeneral OverviewBanking LawNational BanksInterest & UsuryUsury LitigationContracts LawDebtor & Creditor Relations

FOOTNOTES:

(n1)Footnote 1. UCCC §§ 2.104, 2.106, 3.104 (1968 Model Code); UCCC §§ 1.301(12), 1.301(14), 1.301(15) (1974 Model Code). *See also Borowski v. Falleder, 296 A.D.2d 301, 744 N.Y.S.2d 177 (2002)* (loan to individual in personal capacity is not business loan even if borrower owned a business and put the loan to corporate use); *Edwards v. Alabama Farm Bureau Mut. Casualty Ins. Co., 453 So. 2d 746 (Ala. Ct. App. 1983)* (definition of consumer credit transaction under Alabama "Mini-Code"). *See generally Hall v. Owen County State Bank, 175 Ind. App. 150, 370 N.E.2d 918 (1978)* ; *Bill Brown Mfg. Inc. v. Crane, 589 P.2d 708 (Okla. Ct. App. 1978)* . *See, e.g., Smith v. Eisen, 97 Ark. App. 130, 245 S.W.3d 160, 2006 Ark. App. LEXIS 858* (Ark. Ct. App. Dec. 13, 2006) (sale-repurchase agreement for home was loan); *Pinchuck v. Canzoneri, 920 So. 2d 713 (Fla. Dist. Ct. App. 2006)* ; *Decision Point, Inc. v. Reece & Nichols Realtors, Inc., 144 P.3d 706 (Kan. 2006)* (loans were for consumer purposes where they were used for medical expenses, household expenses, and gambling).

(n2)Footnote 2. *Hufnagel v. George, 135 F. Supp. 2d 406 (S.D.N.Y. 2001)* (New York's 25% criminal usury ceiling applied to large business loan that was otherwise exempt from civil usury statute); *Tower Funding, Ltd. v. David Berry Realty, Inc., 755 N.Y.S.2d 413 (App. Div. 2003)* (defense of criminal usury may be asserted even by a corporation).

(n3)Footnote 3. *Cal. Corp. Code § 25118. See Raceway Props., L.L.C. v. LSOF Carlsbad Land L.P., 157 Fed. Appx. 959 (9th Cir. 2005)* (unpublished, citation limited) (finding borrower to be financially sophisticated).

(n4)Footnote 4. In addition to the usury cases cited *infra* in this section, cases decided under the Truth in Lending Act, *15 U.S.C. §§ 1601 et seq.* , may provide persuasive authority for the definition of "consumer" credit. (Note, however, that the current TILA excludes credit extended for agricultural purposes from its definition, unlike many state usury laws.) *See, e.g., Tower v. Moss, 635 F.2d 1161 (5th Cir. 1980)* (home improvement transaction primarily for consumer purpose although home had been leased for nominal rent); *Gallegos v. Stokes, 593 F.2d 372 (10th Cir. 1979)* (purchase of truck primarily for personal use where borrower also intended to use truck for business but did not have an on-going business nor the prospect of establishing one). *See § 1.03[1][a] supra.*

(n5)Footnote 5. *See, e.g., Jansen v. Nu-West, Inc., 2000 Wash. App. LEXIS 1993* (Wash. App. Aug. 17, 2000) (if borrower's oral representations are different from the written representations, jury must decide the facts).

(n6)Footnote 6. In some circumstances, there may be a higher ceiling for credit sales than for certain loans, which creates an incentive to disguise the transaction as a credit sale. *See De La Rosa v. Western Funding, Inc., 24 P.3d 637 (Colo. Ct. App. 2001)* .

(n7)Footnote 7. *E.g., Ala. Code § 5-19-1(3)*, interpreted in *In re Crotzer, 147 B.R. 252 (Bankr. N.D. Ala. 1992)* (creditor who extended real estate secured credit 26 times during the year prior to transaction and 24 times during the year of transaction, as shown by county records, fell within that definition); *Iowa Code § 537.1301 (14)(a)(1)* ("regularly engaged in the business of making loans").

(n8)Footnote 8. The legal or contractual usury statute, however, may apply.

(n9)Footnote 9. *See, e.g., Gottesfeld v. Kaminski, 216 N.J. Super. 679, 524 A.2d 872, 875 (App. Div. 1987)* (that is apparently the test used). *But see Rivera v. Schlick, 887 A.2d 492 (D.C. 2005)* (lender was not in business of lending money so not covered by loan shark law even though he made three loans, where they were all part of a single real estate rehabilitation endeavor by a former business partner).

(n10)Footnote 10. *See generally § 6.02 supra.*

(n11)Footnote 11. Prior to August 9, 1989, the regulations were those of the Federal Home Loan Bank Board. That

agency was abolished and its functions transferred to the newly created OTS.

(n12)Footnote 12. *See § 6.02[7] supra*. Some balloon mortgages may also be subject to the Home Ownership and Equity Protection Act. *See* Ch. 2 *supra*.

(n13)Footnote 13. *See § 6.02[10] supra*.

(n14)Footnote 14. *See, e.g., Ala. Code § 5-19-22*; *Farmer v. Hypo Holdings, Inc., 675 So. 2d 387 (Ala. 1996)* (a mere assignee of a loan which makes no direct loans in Alabama or any other state is exempt from licensing requirements because it did not meet the definition of a creditor; the original creditor need not be licensed because the transaction was a "consumer credit sale" and not a "consumer loan"). *See also RCDI Constr. v. Spaceplan/Architecture, Planning & Interiors, P.A., 148 F. Supp. 2d 607 (W.D.N.C. 2001)* (contract with unlicensed construction firm is unenforceable), *aff'd on other grounds, 29 Fed. Appx. 120, 2002 U.S. App. LEXIS 640 (4th Cir. 2002)* . (It is evident that advocates must review the pigeonholes in the relevant state statute to determine if licensing is required given the nature of the transaction.) *Ohio Rev. Code Ann. § 1321.02*; *Vt. Stat. Ann. tit 8, § 2201*; UCCC § 3.502 (1968); UCCC § 2.301 (1974). Further, unlicensed lenders cannot take advantage of higher-rate special usury statutes by use of a contractual clause providing that the parties agree that the transaction will be subject to such a statute. *Floyd v. Baton Rouge Sash & Door Co., 502 So. 2d 1073 (La. 1987) . See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 9.2.4.5 (3rd ed. and Supp.).

(n15)Footnote 15. Some states have schemes which will require reference to both the licensing statute governing the creditor and the special usury statute governing the type of credit. In Iowa, for example, when making a consumer loan, a finance company must comply with both the Iowa Regulated Loan Act, Ch. 536, and the Iowa Consumer Credit Code, Ch. 537. *See Iowa Code § 536.13(7). See also Schmidt v. Beneficial Fin. Co., 400 A.2d 1124 (Md. Ct. App. 1979)* .

The special licensing statutes also supplant general usury statutes where there is a conflict. *Benoit v. United Cos. Mortg., 504 So. 2d 196 (Miss. 1987)* .

(n16)Footnote 16. *Beneficial Hawaii, Inc. v. Kida, 30 P.3d 895 (Haw. 2001)* (loan arranged by unlicensed broker is void and unenforceable pursuant to Hawaii statute; holder may have equitable lien but only in amount of consideration it paid for the obligation); *Rancman v. Interim Settlement Funding Corp., 2001 Ohio App. LEXIS 4818* (Oct. 31, 2001) (loan made by unlicensed lender void under Small Loan Act); Fabricant v. Sears Roebuck, Clearinghouse No. 54563B (S.D. Fla. Mar. 5, 2002) (citing Restatement; failure to obtain license to sell credit insurance makes contract void). *See also Mincks Agri Ctr., Inc. v. Bell Farms, Inc., 611 N.W.2d 270 (Iowa 2000)* .

(n17)Footnote 17. *Kowalski v. Cedars of Portsmouth Condo. Ass'n, 769 A.2d 344 (N.H. 2001)* (unlicensed real estate broker).

(n18)Footnote 18. *Agapitov v. Lerner, 133 Cal. Rptr. 2d 837 (Ct. App. 2003)* .

(n19)Footnote 18.1. *10 U.S.C. § 987(d)(2)*. The law was an amendment to the John Warner National Defense Authorization Act for Fiscal Year 2007, but it is commonly referred to as the Talent/Nelson Military Lending Act.

(n20)Footnote 18.2. *72 Fed. Reg. 18,157* (Apr. 11, 2007) .

(n21)Footnote 18.3. Department of Defense, Notice with Request for Comments, *71 Fed. Reg. 70,512* (Dec. 5, 2006) .

(n22)Footnote 19. In a state with a small loan law but no general interest ceiling, the incentives for a less than scrupulous lender to pack loan principal can be powerful. First, by inflating the principal amount, the lender does not actually lend as much money as it would normally have to lend to escape the small loan limits, so its risk is reduced and

it can lend more elsewhere. Second, except under careful examination, the loan appears to be free from the small loan law, so the lender can apparently charge whatever interest rate it wants. Third, if the inflated principal exceeds $25,000 and is not secured by the borrower's home, the loan appears to be free from Truth in Lending disclosures, except, again, under careful examination. Finally, inflating loan principal enables the lender to understate the rate it is actually charging.

(n23)Footnote 20. *See § 6.05[3] supra*.

(n24)Footnote 21. *See Aetna Fin. Co. v. Darwin, 38 Wash. App. 921, 691 P.2d 581 (1984)* (textbook case of packing principal); *Sparkman & McLean Income Fund v. Wald, 10 Wash. App. 765, 520 P.2d 173 (1974)* .

(n25)Footnote 22. *See § 6.09 infra*.

(n26)Footnote 23. *See Citizens & Southern S. DeKalb Bank v. Watkins, 236 Ga. 759, 225 S.E.2d 266 (1976)* (stating rule). *See also Mohr, Inc. v. Bank of Cal., 443 F. Supp. 370 (D. Or. 1978)* , *aff'd, 622 F.2d 594 (9th Cir. 1980)* (line of credit); *Negaard v. Miller Constr. Co., 396 N.W.2d 833 (Minn. Ct. App. 1986)* (debts aggregated in construction contract). *See also Rockstad v. Erickson, 113 P.3d 1215 (Alaska 2005)* (loan was single loan where it was represented by a single promissory note, regardless of whether lender paid proceeds by two checks or treated transaction as two loans).

(n27)Footnote 24. *See* National Consumer Law Center, Truth in Lending, § 4.9.2.2 (6th ed. 2007 and supp.).

(n28)Footnote 25. *See Rendler v. Corus Bank, 154 F. Supp. 2d 1365 (N.D. Ill. 2001)* , *aff'd, 272 F.3d 992 (7th Cir. 2001)* ; *MorEquity v. Naeem, 118 F. Supp. 2d 885, 894-95 (N.D. Ill. 2000)* .

(n29)Footnote 26. *See Bellizan v. Easy Money of La., 2002 U.S. Dist. LEXIS 13419* (E.D. La. July 19, 2002) (denying summary judgment to payday lender whose loan-splitting allegedly violated payday loan statute).

(n30)Footnote 27. *See, e.g.,* Georgia, 5% per month (*Ga. Code Ann. § 7-4-18*); New York, 25% (Penal Law § 190.40; Gen. Oblig. Law § 5-521(3)); New Jersey, 30% (*N.J. Stat. Ann. § 2C:21-19(a)*). *See, e.g.,* Florida, 25% (*Fla. Stat. § 687.071(2)* (statute also prescribes a civil penalty for violating criminal usury statute)). *See also People v. Farrell, 218 A.D.2d 749, 630 N.Y.S.2d 791 (1995)* (criminal usury conviction upheld; terms at issue 3% weekly), *appeal denied, 87 N.Y.2d 846, 638 N.Y.S.2d 604, 661 N.E.2d 1386 (1995)* . Massachusetts has a criminal usury statute, but it allows lenders to exceed the cap if they register with the Massachusetts Attorney General before making the loan. *See Cannarozzi v. Fiumara, 371 F.3d 1 (1st Cir. 2004)* (notifying attorney general at time of refinancing was sufficient even to invoke exemption for new loan even though original loan also exceeded cap); *Clean Harbors, Inc. v. John Hancock Life Ins. Co., 833 N.E.2d 611 (Mass. App. Ct. 2005)* (filing with attorney general a few hours after making the loan is a violation, but may be *de minimis*).

(n31)Footnote 28. Another formula would limit the contract rate to ten percent unless the parties agree to a higher rate. Under many such statutes the agreement must be in writing. Oral agreements for a higher rate (in this example, for more than 10% interest) would then be usurious or, at least, unenforceable. *See In re Bradford Realty, Inc., 55 B.R. 218 (Bankr. D.N.H. 1985)* (oral agreement unenforceable); *Northwestern Equip., Inc. v. Badinger, 403 N.W.2d 8 (N.D. 1987)* (written agreement met by merely mailing unsigned invoices to borrower; statute specifically provided that, as between merchants, that constituted a written agreement unless the borrower objected to it in writing).

(n32)Footnote 29. *See Chroniak v. Golden Inv. Corp., 983 F.2d 1140 (1st Cir. 1993)* (specifying only dollar amount of interest where statute required disclosure of rate of interest and set cap at agreed upon rate of interest violates that statute and also is a UDAP violation; court notes that full disclosure of interest rates takes on added significance with the elimination of usury ceilings). *Id. at 1147 . Cf. Fidelity Fin. Servs. v. Hicks, 574 N.E.2d 15 (Ill. App. Ct. 1991)* (in ruling that statute deregulating interest rates did not implicitly repeal a statutory limitation on points, court notes possibility of misuse of points to gouge consumers, undercut legitimate competition, and discriminate against

disfavored borrowers).

(n33)Footnote 30. Some other types of hidden interest, such as brokers' fees, closing attorneys' fees, or inflated closing costs, however, are often excluded from the calculation of the TIL APR as well, as they are not categorically considered a finance charge, as are points. (In some factual circumstances, though, they are.) For a discussion of how finance charges may be hidden in TILA disclosures, see generally Ch. 1, § 1.05[2][f] (TILA) *supra*.

(n34)Footnote 31. *Chroniak v. Golden Inv. Corp., 983 F.2d 1140 (1st Cir. 1993)* .

(n35)Footnote 32. Other possible challenges are discussed in *§ 6.09 infra*.

(n36)Footnote 33. *See* State *ex rel. Meierhenry v. Spiegel, Inc., 277 N.W.2d 298 (S.D. 1979)* , *appeal dismissed, 444 U.S. 804, 100 S. Ct. 25, 62 L. Ed. 2d 17 (1979)* (stronger public policy concerns in consumer transactions). For additional analysis of this issue, see National Consumer Law Center, Cost of Credit § 9.2.9.

(n37)Footnote 34. *See, e.g., Zippo Mfg. Co. v. Zippo Dot Com, Inc., 952 F. Supp. 1119 (W.D. Pa. 1997)* (sale of services to forum state residents by credit card through website gave forum state jurisdiction over trademark infringement case); *Obabueki v. IBM, 2001 U.S. Dist. LEXIS 11810* (S.D.N.Y. Aug. 14, 2001) (jurisdiction established by website that allowed users to download applications and request pre-employment screening searches via the Internet).

(n38)Footnote 35. *See, e.g., Search Force, Inc. v. Data Force Int'l, Inc., 112 F. Supp. 2d 771 (S.D. Ind. 2000)* (job postings on sites like Monster.com and Dice.com are analogous to passive ads); *Uncle Sam's Safari Outfitters, Inc. v. Uncle Sam's Army Navy Outfitters-Manhattan, Inc., 96 F. Supp. 2d 919 (E.D. Mo. 2000)* ; *GTE New Media Servs. Inc. v. Bellsouth Corp., 199 F.3d 1343 (D.C. Cir. 2000)* (maintaining a website that is accessible to residents of the jurisdiction is insufficient); *Bird v. Parsons, 2002 U.S. App. LEXIS 9543* (6th Cir. May 21, 2002) (doing business over Internet with residents of forum statute sufficient for specific jurisdiction although not for general jurisdiction); *Arnold v. Goldstar Fin. Sys., Inc., 2002 U.S. Dist. LEXIS 15564* (N.D. Ill. Aug. 22, 2002) (acceptance of payment on webpage is "roughly analogous to [defendant] setting up a twenty-four hour storefront [in the forum state]").

(n39)Footnote 36. Electronic transactions of all sorts are examined in detail in Ch. 9 of National Consumer Law Center, Consumer Banking and Payments Law (2d ed. 2002).

(n40)Footnote 37. Pub. L. No. 106-229, *114 Stat. 464* (June 30, 2000), *codified at 15 U.S.C. §§ 7001 et seq*.

(n41)Footnote 38. *Biometics v. New Womyn, 112 F. Supp. 2d 869 (E.D. Mo. 2000)* (jurisdiction established where website contained a "sales rep. locator" feature with a box labeled "Missouri" for the user to check off).

(n42)Footnote 39. *15 U.S.C. § 7001(a)*.

(n43)Footnote 40. *15 U.S.C. § 7001(c)*.

(n44)Footnote 41. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 9.2.10.4 (4th ed. 2009).

(n45)Footnote 42. *15 U.S.C. § 7001(a)*.

(n46)Footnote 43. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 9.2.10.6 (4th ed. 2009); National Consumer Law Center, Consumer Banking and Payments Law Ch. 11 (3rd ed. 2005 and Supp.).

(n47)Footnote 44. UETA can be found in the pocket part to Part 1 of 7A Uniform Laws Annotated. The text of UETA is also posted on the website of the National Conference of Commissioners on Uniform State Laws,

www.nccusl.org, along with a list of the states that have adopted it.

(n48)Footnote 45. *15 U.S.C. § 7002(a).*

(n49)Footnote 46. The complex question of whether a state's adoption of UETA has superseded portions of E-Sign is discussed in detail in National Consumer Law Center, Consumer Banking and Payments Law § 9.2 (4th ed. 2009).

(n50)Footnote 47. UETA § 7.

(n51)Footnote 48. UETA § 7.

(n52)Footnote 49. UETA § 5(b).

(n53)Footnote 50. UETA § 2 cmt. 6, 7.

(n54)Footnote 51. *See* National Consumer Law Center, Cost of Credit § 9.2.10.2.5 (discussion of states that have adopted UETA after E-Sign's passage); National Consumer Law Center, Consumer Banking and Payments Law § 9.2 (4th ed. 2009).

(n55)Footnote 52. *15 U.S.C. § 7001(b)(1). See* Comments of Sen. Leahy, 106th Cong., 2d Sess., 146 Cong. Rec. S. 5221 (June 15, 2000) ("the bill does not limit any legal requirement or prohibition other than those involving the writing, signature, or paper form of a contract").

(n56)Footnote 53. UETA § 3(d).

(n57)Footnote 54. *15 U.S.C. § 7001(b)(2)*; *see Prudential Ins. Co. v. Prusky, 413 F. Supp. 2d 489 (E.D. Pa. 2005)* .

(n58)Footnote 55. UETA § 5(a).

(n59)Footnote 56. *15 U.S.C. § 7003(a)(3)*; UETA § 3(b).

(n60)Footnote 57. *See* National Consumer Law Center, Repossessions §§ 3.2.3, 10.4.8 (6th ed. 2005 and supp.).

(n61)Footnote 58. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 9.2.10.5 (4th ed. 2009).

(n62)Footnote 59. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 9.2.10.6 (4th ed. 2009). *See 15 U.S.C. § 7001(e)* (electronic documents may be denied legal effect if they are not in a form that is capable of being retained and accurately reproduced by all parties); UETA § 8(a) (electronic documents must be capable of being retained by recipient). Even though UETA does not have a specific requirement regarding accurate reproduction of electronic documents, without such procedures a seller would have difficulty laying a foundation for introduction of the document into evidence.

(n63)Footnote 60. Note that statutory construction is only an issue when some ambiguity exists for a court to construe. If statutory language is clear, it must be applied as written. *See Rhodes v. Hartford, 201 Conn. 89, 513 A.2d 124 (1986) . See also In re Jordan, 91 B.R. 673 (Bankr. E.D. Pa. 1988)* (statute governing late charge ambiguous as to whether allowed 11/2% calculated on full delinquent balance or 11/2% calculated on only delinquent installment; court looked to general principles of statutory and contract law to interpret).

(n64)Footnote 61. *See generally Dennis v. Bradbury, 236 F. Supp. 683 (D. Colo. 1964)* , *aff'd*, *368 F.2d 905 (10th Cir. 1966)* ; Whitworth & Yancy v. Adams, 5 Rand. 333, *26 Va. 333 (1827)* . Note, *Interest Rates and the Law: A History of Usury*, *1981 Ariz. St. L.J. 61;* Horach, *A Survey of the General Usury Laws*, 8 Law and Contemp. Probs. 7 (1941).

(n65)Footnote 62. *See, e.g., Watkins v. Miss. Bar, 589 So. 2d 660 (Miss. 1991)* (central purpose of usury law is to protect borrowers from overreaching creditors); *Scarr v. Boyer, 818 P.2d 381, 383 (Mont. 1991)* ("Usury statutes protect borrowers who lack real bargaining power against overreaching by creditors"); *Schneider v. Phelps, 41 N.Y.2d 238, 359 N.E.2d 1361, 1365 (1977)* ; *Nelson v. Associates Fin. Servs. Co., 253 Mich. App. 580, 659 N.W.2d 635 (Mich. Ct. App. 2002)* (purpose of restrictions on prepayment penalties is to protect loan customers from being locked in to high interest rates). *See generally* Steven W. Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive and Commercial Interest Rates Under the Unconscionability Standard, 31 Houston L. Rev. 721 (1994).*

(n66)Footnote 63. For cases adopting liberal construction of usury statutes because of their remedial purposes, see, e.g., *GMAC v. Mid-West Chevrolet Co., 66 F.2d 1 (10th Cir. 1933)* ; *In re Feldman, 259 F. Supp. 218 (D. Conn. 1966)* ; *State v. Weiner, 42 Del. 62, 28 A.2d 16 (1942)* ; *Fin. Co. v. Catterton, 161 Md. 650, 158 A. 16 (1932)* (small loan law); *Williams v. Standard Fed. Sav. & Loan Ass'n, 76 Md. App. 452, 545 A.2d 708 (1988)* (Maryland usury statute interpreted as remedial and not penal for purpose of applying statute of limitations). *Perez v. Rent-A-Center, 892 A.2d 1255, 1268 (N.J. 2006)* (RISA must be liberally construed). *See also Pakay v. Davis, 367 Ark. 421, 241 S.W.3d 257, 2006 Ark. LEXIS 512* (Ark. Oct. 12, 2006) (applying general rule that provisions of state constitution should be liberally construed; giving continued effect to constitutional usury cap by substituting different FRB rate for one that FRB discontinued).

(n67)Footnote 64. *E.g., Iowa Code § 537.1102. See generally* 17 Am. Jur. 2d *Consumer Protection* § 270 (state credit construed to effectuate purpose and courts strict in requiring compliance).

(n68)Footnote 65. *See, e.g., Seidel v. 18 East 17th St. Owners, Inc., 79 N.Y.2d 735, 598 N.E.2d 7, 9 (1992)* (New York's severe penalty of voiding the loan reflects legislative view that severe "consequences are necessary to deter the evils of usury").

(n69)Footnote 66. For cases adopting strict construction of usury laws because of their penal nature, see, e.g., *Thrift v. Hubbard, 44 F.3d 348 (5th Cir. 1995)* , *reh'g denied, 1995 U.S. App. LEXIS 6443* (5th Cir. Mar. 16, 1995) ; *Allied Chem. Corp. v. Jack MacKay, 695 F.2d 854 (5th Cir. 1983)* ; *Morosani v. First Nat'l Bank of Atlanta, 539 F. Supp. 1171 (N.D. Ga. 1982)* ; *Indian Springs State Bank v. Kelley's Auto Supply, Inc., 9 Kan. App. 2d 211, 675 P.2d 379 (1984)* ; *Ranson v. C.A. Snyder, 222 Miss. 248, 75 So. 2d 738 (1954)* ; *Crisman v. Corbin, 169 Or. 332, 128 P.2d 959 (1942)* ; *Maners v. Lexington County Sav. & Loan Ass'n, 275 S.C. 31, 267 S.E.2d 422 (1980)* ; *Standard Sav. Ass'n v. Greater New Canaan Missionary Baptist Church, 786 S.W.2d 774 (Tex. Ct. App. 1990)* .

(n70)Footnote 67. *See, e.g., Amaro v. Capital One Bank, 1998 U.S. Dist. LEXIS 8373* (N.D. Ill. May 19, 1998) (in construing Virginia law in the exportation context, an Illinois court opted for the position argued by the bank, i.e., the provision in Virginia law relating to revolving accounts which permitted banks to charge any "charges and fees" as agreed to by the parties applied; in contrast, another provision specifically involving late fees (the issue in the lawsuit) which arguably applied to all credit transactions and limited the fee to 5% of the late installment, though providing greater consumer protection, was rejected).

(n71)Footnote 68. *But see Merritt v. Knox, 380 S.E.2d 160, 162 (N.C. Ct. App. 1989)* ("majority rule" is that "changes in the legal rate will not be applied retroactively"); *Arguelles v. Kaplan, 736 S.W.2d 782 (Tex. Ct. App. 1987)* (settled rule that question of usury is determined at inception of contract; subsequent change in permissible rate will not validate it). *But see Dua v. Comcast Cable, 805 A.2d 1061 (Md. 2002)* (retroactive authorization of late fees on cable TV bills abrogated a vested right so it violates state constitution).

(n72)Footnote 69. *Ex post facto* laws are expressly prohibited by the U.S. Constitution. *U.S. Const. art. 1, § 10, cl. 1.* However, it is recognized that the *ex post facto* prohibition applies only to criminal statutes, *See generally* Annot., *53 L. Ed. 2d 1146 (1978)* (Supreme Court's views on scope of *ex post facto* clause), and that Congress or the states may adopt civil statutes with retrospective effect so long as other constitutional limitations are respected. Most notably for

the purposes of usury amendments, retrospective statutes may not impair the obligation of existing contracts, *U.S. Const. art. 1, § 10, cl. 1*, and may not deny due process. *U.S. Const. amends. 5, 14*.

(n73)Footnote 70. *108 U.S. 143, 2 S. Ct. 408, 27 L. Ed. 682 (1883)* .

(n74)Footnote 71. *See Mickler v. Maranatha Realty Assoc., 20 B.R. 346 (Bankr. M.D. Fla. 1982)* ; *Credit Alliance Corp. v. Timmco Equip. Co., 507 So. 2d 657 (Fla. Dist. Ct. App. 1987)* (statute amending usury penalty expressly operative prospectively); *Hamon v. St. Petersburg Bank & Trust Co., 379 So. 2d 1300 (Fla. Dist. Ct. App. 1980)* , *rev'd on other grounds, 414 So. 2d 1071 (Fla. 1982)* ; *Farmland Enters. v. Schuemann, 212 Neb. 342, 322 N.W.2d 665 (1982)* ; *Hazen v. Cook, 55 Or. App. 66, 637 P.2d 195 (1981)* .

(n75)Footnote 72. *See Southern Guar. Corp. v. Doyle, 353 S.E.2d 510 (Ga. 1987)* (amendment given prospective effect despite absence of savings clause); *Norstar Bank v. Pickard & Anderson, 547 N.Y.S.2d 734 (1989)* (no savings clause in amendment, but general provision in statute prohibits interest rate exceeding that authorized at time loan was made and thus limits amendment to prospective effect unless amendment expressly states otherwise); *Hardwick v. Austin Gallery of Oriental Rugs, Inc., 779 S.W.2d 438 (Tex. Ct. App. 1989)* (intended prospectivity found present by implication in statutory exception providing that increased interest rate would apply to renewals and extensions; only if increase were prospective would this exception be necessary; court also refused to apply new rate even though "charge" in issue occurred after date of amendment).

(n76)Footnote 73. *See Mapes v. Palo Alto Town & Country Village, Inc., 584 F. Supp. 508 (D. Nev. 1984)* (applying Nevada law); *Walker v. Pliss, 34 B.R. 432 (Bankr. D. Or. 1983)* (applying Oregon law); *Broussard v. Crochet Broussard & Co., 477 So. 2d 166 (La. Ct. App. 1985)* ; *U.S. Life Title Ins. Co. v. Brents, 676 S.W.2d 839 (Mo. Ct. App. 1984)* ; *Hazen v. Cook, 55 Or. App. 66, 637 P.2d 195 (1981)* (statutory increase in interest ceiling was not retroactive, but forfeiture of loan principal to the state was penal and was repealed retroactively).

(n77)Footnote 74. *Ewell v. Daggs, 108 U.S. 143, 2 S. Ct. 408, 27 L. Ed. 682 (1883)* .

(n78)Footnote 75. Also, previously unregulated transactions can be brought under regulation, but statutes accomplishing this normally do not have retroactive reach. *See, e.g., Givens v. Rent-A-Center, Inc., 720 F. Supp. 160 (S.D. Ala. 1988)* , *aff'd mem., 885 F.2d 879 (11th Cir. 1989)* (Alabama Rental Purchase Agreements Act).

(n79)Footnote 76. *See Hoyne v. Prudential Sav. & Loan Ass'n, 711 S.W.2d 899 (Mo. Ct. App. 1986)* ; *Garrett v. Citizens Sav. Ass'n, 636 S.W.2d 104 (Mo. Ct. App. 1982)* ; *Weinstein v. Investors S&L Ass'n, 154 N.J. Super. 164, 381 A.2d 53 (1977)* .

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 6 The Cost of Credit

1-6 Consumer Credit Law Manual § 6.08

§ 6.08 The Trial: The Right to a Jury Trial; Elements of a Prima Facie Case; Creditor Defenses and Borrowers' Remedies

[1] Right to Jury Trial

The right to a trial by jury in a state court is not addressed by the *Seventh Amendment to the United States Constitution* and is, therefore, a matter of state law, at least in civil cases. n1

The right to a jury in usury cases is seldom litigated because in the average usury case the presence of the right is obvious. Usury is usually raised as a debtor defense or counterclaim in the creditor's action on a debt. n2 Such a creditor action is a suit seeking the recovery of money damages for breach of contract, which is the epitome of an action recognized at common law. n3 The debtor can thus request a jury by right as the defendant in the creditor's suit.

Obtaining a jury is similarly seldom a problem in affirmative usury actions. The one circumstance in which a debtor may have trouble obtaining a jury to hear a usury claim exists when the creditor is attempting to foreclose on property given as security for the debt and the debtor is raising usury as a defense to the foreclosure. n4 Even when there is a right to a jury trial, some issues may be questions of law. For example, a Washington court has held that it is for the jury to decide what the borrower told the lender about the purpose of a loan, but whether these facts make it a business loan is a question of law for the court. n5

[2] Elements of a Prima Facie Case

[a] Loan or Forbearance

The first element of almost all usury violations is the existence of a "loan" or "forbearance" of money. Although the definition of these terms may vary from statute to statute, a loan may generally be thought of as a temporary transfer of money or its equivalent from a creditor to a debtor or to a third party on the debtor's behalf. n6 A forbearance, on the other hand, is an agreement between an existing debtor and creditor under which the debtor gives consideration (i.e., pays interest) in return for the creditor's agreement to refrain from demanding immediate payment of a pre-existing debt which has come due. n7

Most usury statutes treat loans and forbearances interchangeably. n8 The fact that most usury statutes cover

forbearances means that many transactions which are not normally considered extensions of credit may become subject to usury limitations.

Absent specific statutory guidance, the chief uncertainty about the definition of a loan is whether this term includes credit extended in connection with the installment sale of goods or services. This is called the time price differential. Some courts have held that it does not. n9 Other courts have deemed credit sales to be within the general coverage of the usury laws but subject to an exception.

In jurisdictions where the time price doctrine remains in force, a buyer's attorney should closely examine any credit sale transaction to be certain that the exception actually applies. However, this exception no longer applies to consumer credit transactions in most jurisdictions. In Arkansas, where the usury ceiling is found in the state constitution, the courts have the role of determining whether a transaction is a loan; the legislature does not have the authority to define a type of transaction as a non-loan. n10 A payment plan for delinquent taxes and water and sewer charges is a forbearance. n11

[b] Obligation to Repay Principal

The second element of a traditional usury case is the debtor's absolute obligation to repay the principal amount of the money transferred to him or her.

In the average consumer credit case, proving the existence of an absolute obligation to repay principal is not a problem as the obligation is stated on the face of the note or credit contract and can be established by the introduction of these documents into evidence. In the occasional cases where creditors attempt to evade laws regulating credit and credit charges by constructing a transaction in a way in which this element appears to be missing, courts typically will look behind the facade to determine the true nature of the agreement.

Some makers of refund anticipation loans like to characterize the transaction as the sale of a chose in action rather than a loan. These businesses claim that they are relying for payment upon the right to receive the refund, and the borrower/seller is only liable if the IRS refuses to pay the refund in the requested amount. The Colorado Supreme Court has rejected this argument, holding that the taxpayer's obligation to repay the lender if the tax refund did not come through as anticipated was sufficient to make the transaction a loan under the UCCC. n12 While the court stressed the differences between the UCCC and other states' definitions of "loan," its reasoning should be persuasive in other states, as the court debunked the claim that the transaction was merely the sale of a chose in action. n13

Terming the obligation to repay a refund anticipation loan contingent is unjustified in any event. There is no uncertainty in the amount of the payment. Neither repayment itself nor the amount of the repayment is contingent upon a future event. Similarly, other courts have followed the maxim that substance prevails over form and have seen through alleged contingencies to recognize the underlying absolute obligation of the borrower to repay. n14 Some courts have held that purchase of a stake in litigation does not involve usury where there is no repayment obligation if the suit is unsuccessful. n15 A loan will not be considered contingent unless the lender, by the terms of the loan, is subjected to some greater hazard than that the borrower will fail to repay the loan or that the security will depreciate in value. n16

[c] Interest Overcharge

The heart of every usury case is an overcharge of interest. Logically, this element of proof can be divided into three parts:

a) The creditor exacted or attempted to exact payments from the debtor.

b) The payments were "interest" under the relevant usury statute.

c) The total of payments exceeded the statutory limit. n17

The precise wording of usury statutes varies, n18 but generally creditors may not "contract for," "collect," "exact," "receive," or "charge" payments in excess of those specifically permitted by statute.

Usurious payments may not always be revealed by the contract itself. For example, the lender might require the borrower to pay fees not mentioned by the contract. n19

Once the payments charged or received by a creditor have been identified, the next question is which of those payments constitute "interest" or an excess charge under the relevant statute. Most obviously, the creditor may simply calculate the interest erroneously. n20

But beyond the obvious charge for the use of money, the definition of "interest" sometimes is a complicated issue which varies from statute to statute. Nevertheless, most statutes classify all payments made by a borrower as either principal, interest, or non-interest fees in the following manner.

First, non-interest fees are charges, such as insurance premiums or late fees, which are most often expressly excluded from interest by statute. n21 However, such charges are often subject to separate regulation by consumer credit regulatory statutes, n22 and may be among the types of charges for which statutory liability may attach if limits are exceeded. n23 Next, "principal" generally includes loan proceeds given to the borrower or paid on the borrower's behalf and often may include any non-interest fees which the lender pays on the borrower's behalf. n24 Finally, "interest" is any payment not attributable to the repayment of principal or to non-interest fees. n25

Once the amount of interest charged or collected in connection with a contract has been determined, the last step to proving an interest overcharge is to show that the interest assessed by the creditor is excessive. Since most usury ceilings are expressed as rates, the easiest way to demonstrate an overcharge is normally to calculate the highest permissible interest charge under the controlling statutory rate formula, given the principal amount properly determined n26 and the length of time the loan or credit has been outstanding n27 or was scheduled to be outstanding. n28

Keep in mind that it is necessary to make the interest overcharge determination by establishing the maximum that the particular creditor in question can charge for that particular kind of transaction, n29 and that no preemption questions are involved. n30

[d] Intent

Some statutes, particularly those regulating charges in consumer credit transactions, may have no intent requirement. n31 Apart from those statutes, typically the final element of a usury claim is the usurious intent of the lender.

In almost all states, n32 if usury appears on the face of a credit contract, the requisite usurious intent is merely the intent of the lender to charge the interest rate which, in fact, was contracted for. This intent may be presumed from the contract. n33

A lender's only defense to usury on the face of the contract is to rebut the presumption of usurious intent by demonstrating that a bona fide error occurred in the preparation of the contract and that the lender, therefore, did not intend to charge the stated rate. The defense of mistake or bona fide error is a narrow one which must be proven by the lender. n34

In situations where a contract is not usurious on its face, the courts apply a broad spectrum of approaches to determine the existence of usurious intent. Three overall approaches seem to exist.

First, in at least one state, the courts draw no distinction between facially usurious contracts and other forms of usury, and look only at the lender's objective intent to make the loan. n35 A second, and most common approach to cases where usury is not facially apparent is to deny the borrower the presumption of intent otherwise granted, and to regard the existence of intent as a question of fact. n36

The third approach to usury which is not apparent on the face of the contract, taken by only a small minority of courts, is to require proof that the lender subjectively intended to evade the usury laws by structuring the contract as it did. n37

[3] Burden of Proof

Courts generally presume the validity of contracts, and a party which claims that a contract is usurious therefore carries the burden of proving the usury, whether the claim is being asserted as an independent cause of action or as an affirmative defense. n38 The major exception to this rule is that once a facially usurious interest rate has been demonstrated by the debtor, the burden may shift to the creditor to rebut the allegation of usury. n39

The precise standard of proof by which usury must be demonstrated varies significantly from jurisdiction to jurisdiction. n40

[4] Contract Construction

Construction of a credit contract only becomes an issue if the contract is ambiguous on some relevant point. A contract which unambiguously calls for usurious payments cannot be cured by a forgiving "interpretation." n41 Indeed even if the contract was usurious due to mutual mistake, a creditor may not be able to salvage it by seeking reformation. n42

There are essentially two ways for debtors to combat the tendency of courts to construe contracts in favor of creditors, both of which depend on a recognition of the fact that creditors write consumer credit contracts. First, because of this fact, a consumer's attorney should not rely on the contract alone to prove a usury case if there is any conceivable ambiguity in the contract terms. Instead, remembering that a court should consider all the facts and circumstances around a transaction when considering usury, a debtor's attorney should attempt to build a record showing the intent of the parties at the time the transaction was consummated and, if a form contract is at issue, the manner in which the creditor has applied the disputed contract provision in other transactions.

The second method of dealing with unfavorable rules of contract construction is to attack them head-on, at least insofar as they apply to consumer credit contracts. It is widely recognized that contracts should be construed against their drafter, n43 and consumer credit contracts are not only written by creditors, they are almost uniformly contracts of adhesion which are offered to the consumer on a take-it-or-leave-it basis. n44 Recognizing the one-sidedness of this situation, some courts have held that a presumption of legality does not apply to consumer credit contracts. n45 Other courts, observing that ambiguous contract language can mislead consumers about their rights and dissuade them from asserting their rights, have suggested that consumer credit contracts should be construed as the average consumer would interpret them. n46

[5] Creditor Defenses

[a] Defenses of Assignees and Holders in Due Course

The holder in due course doctrine permits those who purchase "negotiable instruments" n47 to protect themselves from claims of any other parties, and to free themselves from many, but not all, defenses to payment on the instrument. n48

Holder doctrine, however, is not absolute, and not all assignees can successfully assert it in response to a consumer's claims and defenses. Most importantly for consumer advocates, the holder rule has been severely restricted for many

common consumer transactions, as the uneven bargaining power and unequal sophistication in these transactions meant the operation of the rule unfairly inflicted great hardships. n49 Thus, many state consumer credit statutes limit its impact, as does the FTC Preservation of Claims and Defenses Rule in the context of consumer retail sales. State legislatures and case law may also protect consumers.

The meaning of "holder" takes on a new dimension as electronic transactions increase. The UETA n50 envisions electronic promissory notes, termed "transferrable records," the rights to which could be transferred just as paper notes are assigned. In addition, Congress included provisions for electronic promissory notes in the Electronic Signatures in Global and National Commerce Act "E-Sign"), n51 although only for promissory notes secured by real property. Revised Article 9 of the Uniform Commercial Code, which all states have adopted, also allows electronic "chattel paper," a term that includes the typical motor vehicle installment sales contract or lease. n52 The development of transferrable electronic promissory notes faces a number of technological hurdles, however. n53 There must be a way to identify the original, so that electronic copies cannot be passed as originals. Second, the technology must allow the holder of the electronic document to record an assignment of the document, but must prevent non-holders from doing so. Third, there must be a way to transfer control over the electronic document to an assignee. The drafters' comments to UETA indicate that this technology had not been developed at the time UETA was drafted. n54 Nonetheless, Congress included UETA's provisions for electronic promissory notes in the Electronic Signatures in Global and National Commerce Act, n55 although only for promissory notes secured by real property. The advent of electronic promissory notes may introduce new uncertainty for debtors and courts about who actually is the holder of a note, n56 but otherwise the holder in due course analysis will be unaffected. n57

Most importantly, in 1975 the FTC issued a Trade Regulation Rule, pursuant to the Federal Trade Commission Act, which declared that it was an "unfair or deceptive act or practice" under the Act for a seller to enter a consumer credit contract which failed to contain the following language:

> "NOTICE
>
> "Any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained pursuant hereto or with the proceeds hereof. Recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder." n58

The Rule requires sellers to include this language in all instruments created in consumer credit sales financed directly by a seller of goods or services. The Rule also requires sellers to arrange for the language to be included in instruments embodying a debt that arises from a "purchase money loan" with a third party creditor. The Rule defines "purchase money loan" as any loan used to purchase goods or services if the seller either refers the consumer to the lender or is affiliated with the lender by "common control, contract, or business arrangement." n59

The effect of the FTC Rule is quite dramatic. The Rule eliminates contract clauses which waived a consumer's right to assert defenses against an assignee, and which had previously been permitted by the UCC. n60

The insertion of the FTC notice provision in an "instrument," such as a credit contract or a note, has a second effect which is both more subtle and more far-reaching; it removes the instrument from the definition of a "negotiable instrument" under the UCC because negotiable instruments must contain an unconditional promise to pay, and the FTC notice imposes conditions on payment. n61 Consequently, no holder of an instrument containing the FTC notice can become a holder in due course, regardless of the manner in which it takes the instrument, because only a holder of a negotiable instrument can be a holder in due course. n62

Assignees and holders in due course may nonetheless continue to give consumers problems in some credit transactions. First, some contracts, particularly purchase money loans which purport to be independent third-party loans, do not include the FTC notice. Holders of such instruments may potentially gain holder in due course status even while the

seller is liable for unfair or deceptive practices under the FTC Act or state UDAP statutes. n63 The revised version of UCC Article 9, now in effect in all states, addresses this problem by reading the FTC Holder Notice into any consumer contract that should have included it. n64 This provision does not apply to negotiable instruments such as promissory notes, but the National Conference of Commissioners on Uniform State Laws has approved revisions to Article 3 that imply the Holder Notice into any promissory note whenever that notice should have been inserted into the note. n65 This provision, if adopted by the states, will apply to direct loans where the seller refers the consumer to the lender and the consumer then signs a note with the lender. Even without these UCC amendments, a number of courts have found grounds to read the Holder Notice into contracts and notes that should have included it. n66 Second, the FTC rule only applies to sales-related consumer contracts, and not to traditional straight loans. n67 The UCC rules of assignment and negotiability therefore remain relevant in a significant number of consumer credit transactions. n68

If a note or other writing evincing the obligation does not qualify as a negotiable instrument, or if its holder for some reason does not qualify as a holder in due course, the holder takes the obligation subject to all claims and defenses to which the original payee was subject. n69 Consequently, if the transaction is not subject to one of the consumer exceptions, advocates facing a claim of holder in due course must examine the transaction carefully to determine whether all UCC prerequisites are met.

One of the preconditions is that the assignee be a "holder" of a "negotiable instrument." That is, it must have in its possession an "instrument ... drawn, issued or indorsed to him or to his order or to bearer or in blank." n70

The requirements for negotiability of the instrument are set out in *UCC section 3-104(1)*: (a) it must be "signed by the maker or drawer; (b) contain an *unconditional* promise or order to pay a *sum certain* in money and no other promise ... (c) be payable on demand or at a definite time; and (d) be payable to order or to bearer." Checks and promissory notes are typical examples of a negotiable instrument. Negotiability must be determinable from the face of the documents. n71

Assuming these prerequisites are met, the assignee still must establish that it qualifies for holder in due course status, i.e., a person who acquires a negotiable instrument for value, in good faith, and without notice that it is overdue, that it has been dishonored, that any defense exists to payment on the instrument, or that any other party has a claim to it. n72 Often negotiable instruments are transferred more than once. For example, the original payee may negotiate the instrument to an entity that qualifies as a holder in due course, and then the holder may transfer that instrument to a second entity. Under the UCC, the second entity acquires the rights of a holder in due course even if it would not qualify as a holder in due course on its own. n73 For example, if the second entity knew of a defense to the instrument before it acquired it, it would still acquire the rights of a holder in due course. n74 There is an important exception, however, if the second entity engaged in fraud or illegality affecting the instrument. n75 "A person who is party to fraud or illegality affecting the instrument is not permitted to wash the instrument clean by passing it into the hands of a holder in due course and then repurchasing it." n76 Achieving holder-in-due-course status protects the holder against many, but not all, of the obligor's defenses. Defenses which can be asserted against a holder in due course include infancy, the lack of the maker's capacity to execute the instrument, duress, the illegality of the transaction, misrepresentation of the essential character or terms of the contract, "fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms," and bankruptcy. Usury can be a defense to a holder in due course in some cases.

If the payee transfers the instrument to a holder who does not qualify as a holder in due course, that does not shield the next transferee unless that transferee independently qualifies as a holder in due course. In other words, that transferee becomes a holder in due course only if it takes the instrument in good faith, for value, and without notice, and the form of the instrument and the manner of its transfer meet the requirements of Article 3. There are also certain defenses which can be raised, even against holders in due course, including usury in some cases and fraud in the factum. n77

Common law theories of participation, ratification, and acceptance of benefits with knowledge of the fraud can also

make a lender liable for the acts of the originator. n78 To the extent that these theories require proof of intent and knowledge, it is sufficient to show willful blindness, i.e. that the defendant had limited information but failed to inquire further because of fear of what the inquiry would show. n79

Discovery may reveal irregularities in the loan file that should have put the holder on notice of the potential defenses. n79.1 In addition, the history of dealings between the loan originator and the current holder may be sufficient to establish notice. For example, the holder may have forced the loan originator to repurchase previous loans or may have received complaints from other consumers.

Conversely, there is another situation in which the UCC limits the liability even of third party holders who may not qualify for holder in due course status. The assignee of a credit sale contract or lease which does not qualify as a "negotiable instrument" may nevertheless acquire the same rights as a holder in due course if the contract contains a provision waiving the right of the buyer or lessee to assert defenses against assignees, and if the assignee takes the contract for value, in good faith, and without notice of any claims or defenses. n80 However, this waiver provision applies only to defenses which could not be asserted against a holder in due course, and it is expressly subject to any special rules regarding waivers that may apply to consumer transactions under other provisions of state law.

If a debtor does sign a note which qualifies as a negotiable instrument under the UCC, or a credit contract which contains a waiver of assignee liability and state law allows such waivers, there are two ways in which claims relating to credit overcharges may nevertheless be asserted against an assignee under UCC law. First, if an assignee takes an instrument in bad faith or with notice of defenses to the instrument, then that assignee cannot either qualify as a holder in due course under *UCC section 3-302* or otherwise obtain the rights of a holder in due course under section 9-206, and is subject to any claim or defense.

Another way usury or fraud can be asserted against an assignee is under *UCC section 3-305*, which defines the rights of a holder in due course and which specifies that even a holder in due course is subject to the defense of the "illegality of the transaction, as renders the obligation of the [debtor] a nullity ... ." n81

Although there is some questionable authority to the contrary, n82 and although a few states have special rules, n83 it seems clear that a usury violation or a fraud which renders an obligation void under state law is an "illegality" which renders the obligation a "nullity" under the UCC and may thus be asserted as a defense against a holder in due course of the obligation. n84

[b] Standing to Assert Usury

Noting that usury statutes are designed to protect needy borrowers rather than to penalize lenders, courts have widely viewed usury as a claim that is personal to the borrower. n85 It is fairly clear that any maker or obligor on a note has standing to assert usury. Thus, a co-signer can plead usury. n86 Furthermore, a person whose interest in the litigation derives from the borrower may be able to assert usury on the borrower's behalf, but the extent to which such derivative rights exist can vary significantly with the plaintiff and the state. n87

Most cases where creditors dispute a plaintiff's standing to assert usury involve guarantors or sureties to a debt, and while a few opinions to the contrary exist, n88 the large majority of courts hold that guarantors and sureties do not have standing to assert usury. n89 However, some statutes absolutely bar the lender from recovering any interest if the loan is usurious. Even if a guarantor does not have standing to assert an affirmative claim for usury remedies, this language may allow the guarantor to prevent the lender from recovering the usurious interest. n89.1

A last party whose standing to assert usury may be questioned is the assignee of a credit buyer--i.e., the person who purchases used goods and who, in so doing, assumes the original buyer's rights and obligations under the original credit contract. Several courts have held that usury claims may not be assigned. n90 Other courts, however, have developed

somewhat more even-handed rules. n91

[c] Estoppel and Waiver

Estoppel is a loosely defined equitable doctrine under which a party may be barred from asserting legal or factual claims in court for any one of numerous reasons, including fraud, misrepresentation, previous judicial rulings (i.e. "collateral estoppel"), or waiver. In what is probably the most common application of the doctrine in usury cases, a party may be estopped from denying the truth of facts that it previously asserted if the party seeking the estoppel reasonably relied, to its detriment, on the earlier assertion. n92 However, a review of the relevant decisions demonstrates that the doctrine is inapplicable to most consumer usury cases. n93

A borrower who has already made payments on a usurious loan may have to contend with an ancient, sporadically-recognized defense, the voluntary payment doctrine. The doctrine developed in tax cases, and was created to prevent those who had paid illegally imposed taxes from recouping their payments from the tax collector. n94 The basis for the doctrine lies in the fiscal concerns of a government that may need to be certain of the amount of funds available for disbursement. The doctrine protects it from having to refund collected taxes that it may have already spent in a previous year. n95 To justify the doctrine, courts have employed the fiction that every person is supposed to know and understand the law and the limits it places on taxing authorities, and therefore a person who voluntarily makes a demanded but unauthorized payment may not later use ignorance of the law to justify a refund. n96

Though lenders have asserted the voluntary payment defense in usury cases, the majority of jurisdictions addressing the issue have refused to apply it in those circumstances. n97 Even where the voluntary payment doctrine is accepted in other contexts, courts have recognized that strong policy reasons argue against applying it in usury cases. First of all, allowing the defendant to retain the usurious interest would thoroughly undermine the purpose of usury laws, which seek to protect borrowers from overreaching lenders. n98 By allowing borrowers to recover the illegal interest they have paid, the state encourages the enforcement of the usury laws and the development of the policies under girding them. Second, the voluntary payment rule fails to recognize the imbalance of power between most lenders and their borrowers. In rejecting the doctrine, one Georgia court noted that the usurer is an "oppressor" and the debtor a "victim," thus payment of the usury was by definition involuntary. n99 In a few states, statutes have abrogated the common law doctrine. n100 In addition, the doctrine does not apply where there is a statutory right to recover. n101 Some courts may also distinguish between criminal usury, with its stiffer penalties, and civil usury. n102

Nonetheless, a number of jurisdictions have applied the voluntary payment doctrine to bar a consumer from recovering usurious interest paid to a lender. n103 Even where accepted, however, the defense has nuances that may help an overcharged borrower defeat its use by a lender. For example, while a payment made under a mistake of law is considered voluntary, one made under a mistake of fact is considered involuntary. n104 Under this reasoning, a borrower may recover an overpayment of interest made due to a mistaken calculation, but may not recover a payment of usury. n105 Other courts have distinguished cases where the loan has been only partially paid from those where the loan has been completely paid, allowing a borrower to recover usurious interest in the former, but not the latter. n106 However, payments considered involuntary, such as a payment made only after judgment was rendered against a borrower, may be recovered. n107 As with the tax version, compulsion precludes application of the doctrine. n108

[d] Res Judicata

Closely related to the defense of equitable estoppel is the doctrine of res judicata, which prohibits the relitigation of issues previously decided by the courts.

Direct attack upon a judgment often occurs in the case of default judgments where the borrower never appeared and, therefore, asserted no defenses at all. Borrowers who have acquiesced n109 in the entry of default judgments on their debt, only to realize later that they might have asserted a usury defense, occasionally attempt to have the default

judgments set aside. The success of such efforts varies significantly from state to state depending on the grounds recognized as sufficient for setting aside judgments. n110 In addition, a direct attack upon creditor conduct in charging interest or fees in excess of that allowed by contract or state law can be successful. Consumers may seek injunctive relief to stop such behavior, as well as money damages, without disturbing the judgments themselves. n111

The second situation in which res judicata affects usury claims arises from the ability of a borrower in most states to assert usury either as a defense to the lender's action or as an independent cause of action for statutory penalties.

As a general rule, a defendant who could raise a claim as a counterclaim, but who fails to do so, is precluded from raising that claim subsequently in two situations: (1) The counterclaim is required to be imposed by a compulsory counterclaim statute or rule of court; or (2) the relationship between the counterclaim and the plaintiff's claim is such that the successful prosecution of the second action would nullify the initial judgment or would impair rights established in the initial action. n112 Compulsory counterclaim statutes, to the extent that they exist, vary significantly from state to state and are not thoroughly treated here.

In the absence of a controlling compulsory counterclaim statute, most decisions hold that a judgment for a creditor in a foreclosure action or an action on a note necessarily affirms the validity of a debt and would be undermined if subsequent usury claims were permitted. Consequently, usury is generally viewed as a "common law compulsory counterclaim" which is barred by res judicata if not asserted when a creditor's action on a debt is litigated. n113

However, note that a judgment operates as res judicata only on issues actually or necessarily decided by the court, n114 and when a debtor and creditor have executed a series of notes, several courts have held that a judgment on one note need not preclude the assertion of usury against the remaining notes, n115 even if they are only extensions of the note on which judgment had been given. n116

[e] Statutes of Limitations

Usury, like other causes of action, is subject to statutes of limitations. The length of time allotted varies from state to state, but typically ranges from one to three years after the usury action accrues. n117

[f] *De Minimis* Violations

The *de minimis* defense to usury is the argument that penalties should not be assessed for trivial usury violations. This defense is rejected in some states on the ground that its recognition by the courts in the face of mandatory statutory penalties would constitute judicial legislation beyond the courts' authority. n118 Nevertheless, the *de minimis* defense is recognized in other states. n119

[g] Industry Custom and Usage

A less commonly raised usury defense is the argument that long-standing and widely accepted financial industry practices should not be deemed usurious or otherwise illegal. However, courts have universally held that industry practice is no defense to usury. n120

[h] Usury Saving Clauses

Many credit contracts contain boilerplate "saving clauses" which, in one form or another, recite that the parties to the contract intend to comply with applicable usury laws, and that the contract should not be interpreted as providing for usurious interest rates. Saving clauses frequently specify that any charge above the usury ceiling should be deemed a mistake, and that the overcharge should either be refunded to the borrower or be credited against the outstanding principal balance.

Because of the potential which saving clauses hold for undermining usury laws, courts have given them only limited effect. n121 Creditors cannot rebut usurious intent or otherwise avoid usury statutes simply by rebating excessive charges that the debtor has already paid. n122 The one situation in which saving clauses may carry some weight is in ambiguous contracts which can plausibly be interpreted as either usurious or non-usurious.

[i] Correction of Error as a Defense

Allowing a creditor a period of time after notice to avoid liability by correcting the error is a common feature of usury statutes. n123

Texas provides a lender a statutory defense if it corrects the violation, including paying interest on the overcharge at the contract rate, within sixty days after discovering it and gives written notice of the violation to the obligor before the obligor gives written notice of the violation or files an action alleging the violation. n124 Sending a demand letter asking only for the non-usurious portion of the obligation, without explicitly releasing the usurious portion, is probably insufficient. n125 In addition, the creditor's notice to the obligor must acknowledge the specific usury violation. n126 Another Texas provision allows a lender another 60 days to correct the error after receiving notice of the violation. n127 Responding to the obligor's notice by arguing that there was no usury violation is insufficient. n128 The Minnesota MVRISA was amended in 1996 to allow dealers a 120-day period to cure violations of the requirement to provide the buyer with a signed copy of the contract. Sending the buyer a letter stating that the buyer can request a copy is insufficient. n129 One bankruptcy court declined to dismiss a usury claim on the grounds that the borrower failed to send a statutorily required pre-suit notice where the parties had already been through pre-trial mediation that served the same purpose. n129.1

[j] The Enforceability of Arbitration Agreements

[i] General

An increasingly common occurrence is for a loan agreement to include a binding arbitration agreement, which the lender hopes will protect it from class actions, claims for punitive damages, intrusive discovery requests, and juries. This section considers several issues of special relevance to a consumer challenging a requirement that a usury or related claim go to arbitration. n130

The general rule is that the Federal Arbitration Act ("FAA") n131 supports the enforceability of an agreement to arbitrate disputes. State law limiting the enforceability of such agreements is preempted, n132 with certain exceptions. n133 But the FAA does not favor arbitration of disputes where there is no agreement to arbitrate. The consumer need not arbitrate a matter if the arbitration agreement does not apply to the lender or to the promissory note, if the arbitration clause is found in a void agreement, if the arbitration clause is unconscionable, if the arbitration clause was never agreed to, or if the lender has waived that clause.

[ii] Usurious, Illegal and Unlicensed Loan Agreements

If the contract containing the arbitration clause is found to be void, the arbitration clause is void as well. n134 A contract can be void either because a state usury or other statute specifies that violation of the statute makes the contract void, or because state law generally holds that illegal contracts are void.

If a contract is illegal or criminal in nature, courts will not enforce an agreement to arbitrate disputes under that contract. n135

A usurious contract thus can be void on two different bases. One is that the state usury statute specifically so states. If a usurious contract is void, the agreement and the arbitration clause therein cannot be enforced. n136 The other is that it is illegal and/or criminal and is thus void. Courts have decided that the issue of whether a contract is usurious, and the

arbitration agreement thus void, is to be determined by the court, not the arbitrator. n137

The Sixth Circuit appears to distinguish between void ab initio and contracts later declared void. While a consumer cannot be bound by a contract that never really existed, that is void ab initio, a consumer can be bound by a contract that he intended to enter, but later discovered that certain terms of the contact may violate state usury law, thus voiding the contract. n138 More is required to void an arbitration clause than an allegation of statutory violation. There must be a failure to assent to the documents or a failure of signatory power. n139

While the Sixth Circuit view may not be accepted by most courts, most courts will distinguish between void and voidable. If a contract is void by operation of law, the arbitration agreement is void. But if the law allows the consumer to seek to rescind a contract on certain grounds, then the contract is voidable, but not void, and the arbitrator must make that determination. n140 Nevertheless, a number of recent decisions have even sent an arbitrator cases where the consumer argued that the usury violation made the contract void ab initio. n141

In addition, states often require merchants or lenders to become licensed, and find that operation of that business without a license makes any resulting contracts void. n142 If a contract is void for this reason, the arbitration clause is also void. n143 The determination as to whether a lender or other merchant's contracts are void for want of a license is to be determined by the court, not an arbitrator. n144

[iii] Cancellation: Spot Delivery and Rescission

A common situation in consumer sales where an agreement is void involves a "yo-yo" or "spot delivery" sale, where a car is sold conditioned on the dealer being able to obtain financing for the purchase. If the deal falls through and the dealer cancels the retail installment sales agreement, then no part of the agreement remains effective, including the binding arbitration agreement contained therein. The consumer can bring a claim against the dealer who has backed out of the deal, and the consumer is not bound by the arbitration clause. n145

If a consumer contract can be cancelled under a three-day cooling-off period provision, then cancellation of the contract cancels the arbitration provision. Cancellation does not involve legal action or a dispute under the contract. The consumer has the absolute right to send a notice, and the contract is thus automatically cancelled. If state law finds a contract in violation of the cooling-off period provision is void, then violation of the provision also voids the arbitration agreement. n146

Similarly, Truth in Lending provides a right to rescind certain credit agreements. n147 The consumer sends a notice to the creditor, and the transaction is thus cancelled. If the transaction is cancelled, then the arbitration agreement is void. Any litigation as to the consumer's right to rescind or the creditor's failure to follow steps after rescission is not governed by the arbitration agreement because the transaction including the agreement has already been cancelled. A number of courts rule otherwise, that the arbitrator and not the court must consider whether a transaction has been rescinded under Truth in Lending. n148 But these courts confuse common law claims for rescission, where the court is asked to rescind a transaction, with statutory entitlements under Truth in Lending and state cooling-off statutes where the transaction is never fully consummated by operation of the consumer's letter, and the action before the court involves a contract that was never effective. For example, several of the courts that rule otherwise n149 rely on a court of appeals decision that involves a common law rescission claim. n150

[A] Does Agreement Apply to Lender, Co-Signer, and to Promissory Note?

"Arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." n151 If the parties did not agree to arbitrate certain claims, then the consumer cannot be forced to arbitrate those claims, even if it would be more efficient to do so.

Consumers are not bound by arbitration agreements they did not sign, even if their spouse or other related party signed the agreement. n152 Nothing in the FAA authorizes a court to compel arbitration of parties not covered by the agreement. n153 "It goes without saying that a contract cannot bind a nonparty." n154

Nevertheless, courts may find an arbitration provision enforceable when the plaintiffs are third party beneficiaries of consumers who did in fact sign the arbitration agreement. n155 To find a third party beneficiary status, at a minimum, the consumer's claim must seek the benefit of the agreement that contains the arbitration clause. n156 Thus, where a consumer that has not signed the agreement brings a tort claim that does not rely on the agreement, no third party beneficiary status is created, and the consumer is not bound by the arbitration agreement. n157

Likewise, consumers should be able to avoid arbitrating a dispute with a lender, broker, insurer or other entity where that entity is not a party to the arbitration clause or is not listed in the arbitration clause as a party to the agreement. n158 Arbitration is a matter of contract and a consumer is entitled to know, by looking at the terms of the arbitration agreement, what potential parties are covered by the agreement.

Nevertheless, there are situations where a court will find that consumers are bound to arbitrate claims against certain individuals or entities who were not explicitly listed in the original arbitration agreement. Courts sometimes find that a party not mentioned in the arbitration agreement can still enforce the agreement based on equitable estoppel. n159 Equitable estoppel may be found to apply only where the consumer sues a party not enumerated in the arbitration clause, and the consumer is relying on the terms of the agreement containing the arbitration clause in asserting claims against that party. n160 Even then, finding equitable estoppel is in the court's discretion. n161

In general, assignees n162 and individual employees of the corporate signatory n163 may be able to enforce an arbitration agreement. On the other hand, a credit insurer, n164 forced-placed insurer n165 or service contract company n166 will have difficulty piggy-backing on the dealer's arbitration clause.

Issues of coverage may arise where an arbitration clause is contained in only one, or some, but not all, of a series of documents. For example, motor vehicle sales finance statutes and retail installment sales acts often require that the installment sale be evidenced by a writing that contains all the agreements of the parties with reference to the subject matter of the sale. n167 If a car dealer places the arbitration agreement in the sales order or other preliminary document, but not in the installment sales agreement, then the arbitration agreement is not part of the final transaction, and is not binding on the consumer. n168

This is even the case where the arbitration clause in the sales order explicitly states it applies to the installment sales agreement. State installment sales acts typically either explicitly or implicitly require that the parties execute a single, comprehensive installment agreement, without side agreements or riders. n169

[B] Unconscionability

Unconscionability is one of the most important challenges to an arbitration agreement. There are literally over a hundred cases each year discussing whether an arbitration clause is unconscionable, and these cases are collected in NCLC's *Consumer Arbitration Agreements* § 4.3 (4th ed. 2004 and Supp.). This subsection lays out the broad parameters of an unconscionability challenge, without specific case citations.

While there are exceptions, in general, state courts are more open to an unconscionability challenge than federal courts. Unconscionability is a matter of state law, and courts should look at that state's general standards as to unconscionability. They should then look at the facts of the particular case before them to see if those facts lead to an unconscionability finding. This is more important than whether a court in another state found an arbitration agreement unconscionable or not based on the different facts of that case.

Nevertheless, it appears quite often that courts will look for evidence of both procedural and substantive unconscionability. It is thus important to introduce evidence of both types of unconscionability. For example, procedural unconscionability could be shown by the fact that other similar lenders require arbitration (showing lack of choice), the lender's unwillingness to negotiate this clause, the small print and confusing language of the arbitration clause, and other factors that show this requirement was not negotiated among equals, in good faith.

A number of factors might lead to a finding of substantive unconscionability:

- That the consumer's action must be arbitrated, while actions the lender might initiate need not be arbitrated;
- The arbitration clause limiting the consumer's causes of action or remedies, such as limits on multiple, consequential, or punitive damages or attorney fees;
- The arbitration clause prohibiting class arbitration;
- The arbitration clause shortening the statute of limitations;
- The arbitration clause prohibiting public dissemination of information about the dispute;
- The arbitration process requiring unaffordable payments from the consumer to pay the arbitrator or for other fees; and
- Bias in the arbitration service provider.

Although any one of these might be enough for a court to find substantive unconscionability, the consumer should allege all aspects of the clause that make it unconscionable. The court can either throw out the whole arbitration requirement or reform it to delete the offending provisions. The more provisions that are found unconscionable, the more likely the court will throw out the whole arbitration agreement.

[C] Special Rules for Insurance Transactions

While the FAA preempts state law that limits the enforceability of arbitration agreements, there is an important exception for insurance transactions. The federal McCarran-Ferguson Act prohibits federal regulation of insurance practices to the extent that they would invalidate, impair or supersede state law enacted for the purpose of regulating the business of insurance, unless the federal law explicitly relates to the business of insurance. n170 The FAA does not explicitly relate to the business of insurance. n171 Consequently, if a state statute regulating insurance limits the enforceability of an arbitration provision, the FAA conflicts with the state statute, and therefore state law, not the FAA, determines whether the arbitration provision is enforceable. n172

In order for this exception to apply, first the state law must be enacted for the purpose of regulating insurance. A number of state statutes limit the enforceability of arbitration, but do not mention insurance specifically. Instead, these are laws of general application that apply to insurance and most other forms of commerce. For example, Alabama law states that agreements to submit controversies to arbitration cannot be enforced, but does not mention insurance. n173 The Alabama courts find that the statute is not one regulating the business of insurance, so as to supersede the FAA under McCarran-Ferguson. n174 On the other hand, a statute need not be enacted solely for the purpose of regulating insurance. For example, a number of states have enacted the Uniform Arbitration Act, but have explicitly stated that the provision concerning the enforceability of arbitration agreements does not apply to insurance or certain lines of insurance. n175 Such an exemption is a state enactment for the purpose of regulating insurance. n176

It is not enough, however, that a state enact statutes regulating the business of insurance. These statutes must also restrict the enforceability of arbitration agreements. If they do not, there is no conflict with the FAA, and the FAA continues to apply. n177 State insurance law does not preempt the field, but only supersedes federal law that is inconsistent with it. n178 A number of states clearly restrict the enforceability of arbitration agreements concerning certain lines of insurance. For example, a number of states have amended their enactment of the Uniform Arbitration Act to specify that arbitration agreements are enforceable except as to insurance claims. n179

[iv] Bill Stuffers and Unilateral Change in Terms

In quite a few cases, the fine print that contains an arbitration clause is not sent to consumers until well after a contract is consummated. This must be distinguished from the situation where the product is delivered to the consumer, contingent on the consumer accepting the terms sent with the product, one of which is the arbitration agreement.

An arbitration clause is not enforceable where it is unilaterally presented to the consumer after the agreement has been reached. An arbitration clause is a material term that cannot be unilaterally added by one party after two parties have agreed upon terms for a binding contract. n180

In the last few years, a great many credit card issuers have attempted to create a binding arbitration agreement by inserting a notice to that effect in a monthly billing statement, stating either that this is a change of terms, as authorized in the master agreement, or that the fact that the consumer continues to use the credit card is evidence the consumer agrees to the change in terms. Some of these arbitration clauses, by their very terms, only apply to consumers who *do* use the credit card after that date.

The more common question is whether a consumer who does not really pay attention to all the material and fine print stuffed in with the billing statement, and who continues to use the card is bound by an arbitration clause created through a bill stuffer. Some courts have enforced arbitration clauses that were sent out to consumers as bill stuffers, n181 but the current trend appears to be otherwise. n182

To evade the recent holdings that bill-stuffers may not be effective to add an arbitration clause, some credit card issuers have re-written their change of terms provisions to purportedly authorize the lender to add any new term to the contract as well as change any existing terms. There is a serious question, however, as to whether a bank can enforce a contract against a consumer that essentially says "we can change our agreement or add terms to it in the future without any limitation whatsoever and you agree at the outset of those changes without knowing what they will be." n183 The credit card industry has also pushed for protective state legislation to legalize bill stuffers arbitration agreements. n184

There are other issues to explore when a creditor attempts to add an arbitration clause by bill stuffer. For example, did the company follow its own procedure in changing the terms? If a credit card agreement specifies a procedure for the card issuer to change terms, it must follow that procedure for the change to be effective. In at least one case, the court found that insufficient evidence was submitted to show that the contract had been properly amended. n185

The company must reasonably inform the consumer of the change in terms. If a jurisdiction embraces a standard along the lines of the voluntary, knowing and intelligent requirement, consumers who did not notice or know about an arbitration clause may be able to argue powerfully that they did not agree to arbitrate their claims. At least one court refused to enforce the change where the company could not establish that the notice was actually mailed. n186

Even if the bill stuffer was actually received, very few consumers may ever detect the notice of the arbitration clause (particularly if is buried among a number of advertisements, or if they are written in impenetrable legalese). The preeminent example of this is *Ting v. AT&T*, where the effect of AT&T's arbitration agreement was enjoined, where the consumers conducted extensive discovery, hired experts, and presented a compelling case that AT&T's bill stuffer was intended by AT&T *not* to be read and was not in fact read or understood by the overwhelming percentage of customers.

n187

[v] Lender's Collection Action as Waiver

A lender's right to compel arbitration may be waived, where the lender has taken actions that are inconsistent with the right to arbitrate and where these actions have caused prejudice to the consumer. n188 A creditor who sues a consumer on a contract may waive its right to compel arbitration of the consumer's claims. n189

[vi] Non-Mutual Remedies as Unconscionable

Lenders often insert non-mutual arbitration clauses: the consumer must arbitrate claims, but the lender can resort to judicial or non-judicial remedies. For example, the arbitration provision may require the consumer's disputes to go to binding arbitration, but reserve the right for the creditor to engage in self-help repossession or foreclosure without first submitting the dispute to binding arbitration. Other provisions allow the creditor to file a judicial collection action even though consumers must arbitrate their disputes.

A number of cases find unconscionable arbitration agreements that contain such one-sided clauses, coupled with the typical procedural aspects of a consumer negotiation. n190 A number of courts, on the other hand, particularly in Alabama, have found this not to be enough to make an arbitration clause unconscionable. n191

In response to case law finding lack of mutuality to be unconscionable, creditors may draft their arbitration provisions to give the appearance of binding both sides to arbitrate. The practical effect of the clause though is not to bind the creditor.

For example an arbitration clause may state that any multi-party claims, such as class actions, are to be sent to arbitration. No creditor collection actions are ever brought as a class, but consumer claims often are. Courts are willing to look beneath the surface of an arbitration agreement to determine if in fact the merchant as a practical matter will arbitrate its disputes, or whether the arbitration provision allows the merchant to avoid the impact of the requirement. n192

[vii] Other Challenges to Agreement's Enforceability n193

Other challenges to the enforceability of a consumer arbitration agreement include:

- That the transaction is not in interstate commerce and state law restricts arbitration agreements;
- That the agreement specifies it will be governed by a state's laws, and that state's laws restrict arbitration agreements;
- That the agreement to arbitrate was not knowingly, willingly, and intelligently given, or the agreement to arbitrate is ambiguous or equivocal;
- That the agreement is not signed;
- That the arbitration clause is procedurally unconscionable or that substantive terms are unconscionable, such as limitations on remedies, bias by the arbitrator or arbitration mechanism, excessive fees and costs, inconvenient arbitration venue, loser pay rules;
- Fraud in the factum in the creation of the whole contract or fraud in the inducement as to the arbitration clause;

- Under defenses under state contract law or state statutory law applying to any contract; or

- Where the arbitration agreement conflicts with a federal statute or prevents the effective vindication of federal statutory rights.

[viii] Class Arbitration

Consumers invariably are better off bringing individual claims in court instead of before an arbitrator--particularly since the dealer has selected the arbitration service provider. But the same may not be true of a classwide arbitration. Corporations appear to fear class arbitration more than class actions, and consumers may have more success getting a case certified before an arbitrator than a judge.

The U.S. Supreme Court has held that, where the availability of class arbitration is ambiguous, it is for the arbitrator to decide whether the arbitration can go forward on a classwide basis. n193.1 Unless a clause unambiguously prohibits class arbitration, the consumer can bring the arbitration on a classwide basis, and it is up to the arbitrator whether to allow it to proceed on that basis. Arbitrators are increasingly allowing cases to move forward on that basis, and defendants find themselves in the uncomfortable position of forcing consumers into a procedure that the defendants want to avoid at any cost.

As a result, corporations are amending their arbitration agreements to ban class arbitration. The fact that the current version of an arbitration agreement prohibits class arbitration does not mean that an earlier version did; thus class arbitration may still be possible on behalf of those who signed the earlier version of the agreement.

Moreover, where the arbitration agreement explicitly bans classwide arbitration, the consumer can seek to throw out the whole arbitration clause as unconscionable. A large number of courts in recent years have struck down such bans as unconscionable, but an almost equal number have upheld them. n193.2 It will be important in any unconscionability challenge to demonstrate how individual arbitration is not practical. A number of courts have found this to be the case, in the context of credit cards or wireless charges where the amount at stake for each class member is small. n193.3 It is imperative to show that this is still the case in credit contexts where individual recoveries are larger. Where a court finds the ban on class arbitration to be unconscionable, it can either strike the ban (thus allowing the consumer to seek classwide arbitration) or throw out the whole arbitration clause (allowing the consumer to seek a class action in court).

[ix] Individual Arbitration Seeking Punitive Damages

While not as potent an approach as class arbitration, an individual arbitration seeking punitive damages poses real risks for the defendant. Unlike a court action, there is very limited judicial review of a large punitive damages award. n193.4 A private arbitration does not involve state action, so that a defendant will have difficulty pursuing a due process challenge to a large punitive damages award. n193.5 While consumer attorneys find most arbitrators to have a pro-corporation bias, and are unlikely to award punitive damages, the defendant is rolling the dice, because any large award will likely stand--while the defendant has several avenues of judicial relief to respond to a large punitive damages award made by a jury.

Unless the arbitration clause or arbitration service provider rules prohibit recovery of punitive damages, the consumer should be able to seek them in arbitration. The U.S. Supreme Court has ruled that the arbitration agreement controls whether punitive damages are available, and that silence or ambiguity will be interpreted in favor of allowing such damages. n193.6 Consequently, check the language of the arbitration clause and also examine the rules of any arbitration mechanism referred to in the arbitration clause. Currently, the three major arbitration mechanisms (the American Arbitration Association (AAA), the National Arbitration Forum (NAF), and Judicial Arbitration and Mediation Services (JAMS)) all appear to allow punitive damage awards, n193.7 so it is particularly important to

examine the arbitration agreement itself to see if any limitations on damages are specified there. Even where state law prohibits an arbitrator from awarding punitive damages, n193.8 the Federal Arbitration Act may preempt these limits, particularly as the Supreme Court has indicated that the arbitration agreement controls the issue. n193.9

If the arbitration agreement either explicitly or implicitly prohibits recovery of punitive damages, the defendant runs the risk that the agreement will be unenforceable and the consumer can sue in court. A number of cases find unconscionable an arbitration agreement that more generally limits the consumer's damage remedy or that specifically limits the consumer's right to punitive damages. n193.10 The chances of the arbitration clause being thrown out are increased where a federal statute authorizes recovery of punitive damages, because then the limitation on punitive damages may not only make the arbitration requirement unconscionable, but also make it conflict with federal statutory rights. n193.11 For example, the Credit Repair Organizations Act, the Fair Credit Reporting Act, and the Equal Credit Opportunity Act all authorize recovery of punitive damages.

[6] Special Defenses of Federal Receivers: *D'Oench* and Related Doctrines.

[a] *D'Oench* and *12 U.S.C. Section 1823*.

Below is a summary of the special defenses available to the federal agencies responsible for insuring banks and thrifts. n194

In 1942, in *D'Oench, Duhme & Co. v. FDIC*, n195 the United States Supreme Court crafted a federal common law doctrine of equitable estoppel to prevent borrowers from asserting "secret side agreements" with bank officers as a defense against obligations being administered by the FDIC. n196 The doctrine, based on public policy grounds, sought to provide the FDIC with some immunity against claims arising out of the failed banks' past misconduct in order to allow the FDIC to more easily assess the strength of the bank's assets.

Eight years after the *D'Oench* decision, the Federal Deposit Insurance Act of 1950 ("FDIA") included a section, *12 U.S.C. section 1823(e)*, which added a new dimension to the limited immunity afforded by the equitable estoppel doctrine created in *D'Oench*. n197 Only an "agreement" which meets the four conditions of section 1823(e) is enforceable against the FDIC when it relates to an asset acquired by the FDIC in its corporate (as opposed to receiver) capacity. n198

The courts have taken an extremely broad view of what constitutes an agreement under *D'Oench* and section 1823(e). In the last few years, however, the courts have begun to pull back a little and examine the D'Oench cases with more of an eye toward the equities. n199 It is also important to note that although the *D'Oench* doctrine and the requirements of section 1823(e) are closely intertwined, they are not identical.

[b] Federal Holder in Due Course Doctrine

As the cost of the 1980s bank crisis mounted and litigation ballooned, the protective policies of *D'Oench* and section 1823 were pushed even further, with the creation of "super holder in due course" or "federal holder in due course" n200 status for FDIC and Resolution Trust Corporation ("RTC"). More recently, there is moderating precedent to the cases reading the federal holder status broadly. n201 It may be that the *O'Melveny* decision has settled the question of federal holder in due course once and for all. If not, there remain other arguments which can be made by consumer advocates faced with this issue.

Beyond policy arguments, the present body of *D'Oench*-related law offers sound arguments as to why the FTC holder notice should make consumer claims and defenses enforceable against the FDIC. First, because the Rule works by requiring that it be included in the note, effectively making it a written contractual provision, it should be considered a "bilateral agreement," imposing duties on the bank. *D'Oench* does not protect the FDIC or RTC from breach of contract

claims arising from written agreements. n202 Second, the effect of inserting the holder notice is to render an instrument non-negotiable, n203 and the Fifth Circuit at least has held that the federal holder in due course doctrine does not apply to non-negotiable instruments. n204 At least one court has apparently permitted recovery in a home improvement case against the RTC based on the FTC notice, and further ruled that the borrower was entitled to a recovery of payments made even though the RTC and its co-defendant did not receive the payments. n205

As the bank crisis of the 1980s comes under control and begins to fade into the past, some courts are expressing more concern about past misapplications of the *D'Oench* doctrine. Consequently, some common consumer claims have survived, or seem likely to survive, *D'Oench* and related defenses. n206

Finally, as a general rule, *D'Oench* and related doctrines will not protect the FDIC or RTC from claims or defenses arising out of its own conduct. n207 There is also a broader developing question in the growing area of FDIC accountability: whether the Federal Tort Claims Act n208 ("FTCA") affords a remedy for "negligent operation of the receivership" by the FDIC or RTC. n209 Note that pursuant to FIRREA, all parties asserting claims against failed institutions must participate in a mandatory administrative claims review process. n210 The requirements for this process are stringent and the failure to properly submit claims can result in a claim being barred altogether, so it is imperative that any consumer attorney confronting the possibility of a claim against a failed bank look closely at the statutory requirements. n211

[7] Remedies for Illegal Overcharges; Traditional Usury Remedies

[a] State Remedies

[i] Remedies at Law

The remedies available to victims of illegal overcharges are primarily determined by individual state statutes. However, there are also other sources to consider.

Some licensing statutes, such as small loan laws or consumer loan laws metamorphosing from small loan laws, may not include specific provisions for individual remedies, nor may other statutes limiting the right to impose certain charges. However, the consumer may argue that such statutes create an implied private right of action. n212

Generally speaking, illegal contracts are unenforceable as a matter of common law, but whether a particular usurious contract fits into this category depends on the nature of the violation and public policy considerations. n213 Civil voidness penalties have been read into statutes for contracts violating their criminal provisions. n214 Usury cases have extended this principle even to the situation in which the criminal violation in question had no express civil penalty, but other types of criminal violations did. n215 Or a court, finding a contract to be illegal due to a violation of a criminal usury statute, may order that interest and other charges be forfeited. n216

A number of practical issues often arise in determining how to handle payments made by a borrower after bringing a successful usury-based claim. First, very often a statute will declare a usurious loan void as to all or part of the interest, while leaving the principal obligation intact. n217 Under such statutes, the widely- accepted rule is that all payments already made on the contract, unless the parties have specifically agreed otherwise, n218 will be applied to the principal debt until that debt has been paid off. n219

A second critical question which often arises when a loan is declared usurious is: What happens to the money already paid to the creditor? The answer will depend partly on whether the statute voids the entire obligation or merely the interest. If only interest is forfeited, it is fairly clear, as mentioned previously, that all payments made under the contract will be credited to the principal debt until that debt is satisfied, unless the parties have specifically attributed some of those payments to interest. Less clear is what happens if the loan is completely void so that no principal debt technically

ever existed, if payments exceed the amount of the principal originally extended to the borrower, or if the payments were expressly deemed to be interest payments by the parties.

Some statutes, which declare usurious loans to be completely void, spell out the debtor's right to recover payments made, in which case the problem is solved. n220 A federal court in Michigan allowed buyers to recover finance charges from a dealer under this type of statutory provision even though the dealer had sold and assigned the credit contracts to finance companies. n221 The court reasoned that the finance company's payment to the dealer was based at least in part on the present value of the interest payments the buyers were expected to make, so the dealer had received a benefit from those finance charges.

However, it can be difficult without such statutory or judicial authority to argue that payments to principal or interest may be recovered simply because the obligation is declared "void" by statute. The problem is multifaceted. First, strictly speaking, if a contract is "void," a court will generally refuse to recognize its existence and will leave the parties where it finds them. n222 This suggests that while a lender could not sue the debtor on the purported debt, neither could the debtor recover payments back without specific statutory authorization, although courts have sometimes rejected this reasoning because of the intent of usury statutes to protect borrowers. n223 Second, courts frequently reason that even though a statute declares a usurious debt to be "void," the debt is actually voidable at the option of the debtor. n224 This position has led some courts to hold that a borrower can waive the usury by "voluntary" payment, n225 and having so waived his rights, may not recover the payments. n226 Third, some usury statutes are structured so that usury remedies are exclusively defensive. For example, a statute might declare a usurious loan "void," but then proceed to provide merely that the creditor may not collect on the debt. n227

One implication could be that no debtor recovery is available except by recoupment in a creditor's action. However, it is possible to argue that such statutes create an implied private right of action to enforce the borrower's rights under the usury statute, and, in the absence of clear statutory language making it solely defensive, the consumer's advocate should explore that option. A New Hampshire trial court has also concluded that a borrower can sue affirmatively to recover finance charges and other charges that the usury statute bars the creditor from collecting. n228 The court reasoned that it would be illogical to require a buyer to stop making payments, and wait to be sued, in order to take advantage of this right.

A significant exception to the rule against the debtor's recovery of payments made, apart from statutes which specifically provide a recovery remedy, is that many states recognize a common law action for the recovery of the usurious portion of interest payments made on a contract. n229

Consumer attorneys should be careful to plead a common law action, if available in their jurisdiction, separately in their complaint or counterclaim so that it will not be deemed waived.

Beyond providing restitution to a borrower who has proved usury, usually in the form of a credit for or recovery of usurious interest paid, usury statutes often impose penalties on the creditor involved. The penalties frequently take the form of an award to the borrower of double or triple either the interest or the usurious portion of the interest paid on the contract. n230

[ii] Equitable Remedies

Although most usury and other overcharge remedies exist under statutes or common law, there are circumstances when a debtor's appropriate remedy for usury is in equity. The most common occasion is when the creditor is attempting to foreclose upon security, often the borrower's home, given in conjunction with the usurious loan. Borrowers who want to enjoin foreclosures must typically invoke the court's equitable powers to do so.

Seeking equitable remedies for usury can present serious problems for borrowers. The main obstacle is the rule that a

party seeking equity must do equity which, in the case of a borrower facing foreclosure of a usurious mortgage, means tendering the principal balance owed on the debt, n231 sometimes with legal interest, n232 and sometimes with amounts expended by the lender to maintain the security. n233

Tender may be avoided if a statute declares the underlying debt to be void or if the payments already made on the contract exceed the principal originally lent, because in either case the principal balance owed is zero. n234 Yet, if principal is still owed, the debtor will have the difficult task of producing a large sum of money quickly.

A second problem with equitable usury remedies is that the debtor may be unable to obtain in a foreclosure proceeding all the offsets or penalties which might be available in a creditor's action on the debt.

A final equitable issue that may arise in usury cases is the question of reformation. Creditors have sometimes sought to avoid usury penalties by requesting that usurious contracts be reformed to non-usurious rates. Such reformation has occasionally been granted on grounds of mutual mistake of the parties or on grounds of fraud by the borrower. n235 Another basis for a reformation-like remedy is any usury savings clause by which the lender agrees to refund any excess interest. While typically consumers seek to avoid the effect of these clauses so they can recover usury penalties, such a clause can form the basis of a contract claim if no other remedy is available. n235.1 However, outside of these narrow circumstances, courts have viewed statutory usury remedies as mandatory and have refused to resort to equity. n236

[b] Federal Remedies

[i] National Bank Act; DIDA; Excess Charges on High Cost Mortgages

The National Bank Act establishes the remedy for a usurious loan issued by a national bank: the lender forfeits the entire contract interest, and the borrower may recover a penalty of twice the interest paid within two years of the action. n237 Similar, but not identical remedies, apply to state banks, state and federal savings and loan institutions, and state and federal credit unions which are claiming federal preemption of state usury laws under the alternative ceiling provisions of the DIDA. n238 If the alternative ceiling exceeds the interest rate allowed by the state, and the state ceiling is thereby preempted, but the lender charges a rate even higher than allowed by the DIDA alternative ceiling, then the lender forfeits the entire contract interest and the borrower may recover twice the amount of the interest paid within two years of the commencement of the action. If the state interest ceiling exceeds the DIDA alternative ceiling, or, if for some other reason, such as a state opt-out, the alternative ceiling preemption does not apply, the wording of DIDA suggests that state usury remedies control.

A separate set of federal remedies is available in the case of charges contracted for or imposed on certain high cost mortgages in violation of the Home Ownership and Equity Protection Act of 1994. n239

[ii] RICO

The Racketeer Influenced and Corrupt Organizations Act (RICO) n240 provides powerful civil remedies, n241 including attorney's fees and treble damages, to victims of a broadly defined range of "racketeering activity" or to those who have been subjected to the collection of an "unlawful debt," which is defined as any usurious debt bearing interest of at least twice the "enforceable rate." n242

In order to state a claim under RICO, a plaintiff must allege either the conduct of an "enterprise" through a "pattern" of "racketeering activity" n243 or the conduct of an enterprise through the collection of an "unlawful debt." n244 In *H.J. Inc. v. Northwestern Bell Telephone Co.*, n245 the Supreme Court held that the concept of "pattern" has two separate properties that must be established: relationship and continuity. n246 The relationship property is met if the acts have "the same or similar purposes, results, participants, victims, or methods of commission, or are otherwise interrelated." n247 As for continuity, although the Court declined to express a specific test, it roughed out the requirement by

providing that a plaintiff could meet the requirement by showing either closed-ended or open-ended continuity. n248 Closed-ended continuity could be shown "by proving a series of related predicates extending over a substantial period of time." n249 Alternatively, a plaintiff could show "open-ended" continuity by proving a threat of continued racketeering activity. n250

Several RICO cases involving allegedly fraudulent creditor overcharges have been litigated. n251

Many states have state RICO statutes, which should also be considered. n252 Some of them may also offer treble damages for collection of an unlawful debt. n253

[iii] Class Actions

Usury cases are well-suited to class action treatment. n254 Lenders who overcharge typically do so systematically, so there are common issues of law and fact. Often each borrower is entitled to a relatively small recovery, such as double the amount of the overcharge. A primary purpose of class actions is to provide a way to recover damage awards that are too small to make individual suits economically feasible. n255

Usury class actions produce other benefits as well. As the California Supreme Court has noted, such actions often produce "several salutary by-products, including a therapeutic effect upon those sellers who indulge in fraudulent practices, aid to legitimate business enterprises by curtailing illegitimate competition, and avoidance to the judicial process of the burden of multiple litigation involving identical claims." n256

Individual issues are likely to be minimal in a usury class action. Some usury statutes apply only to non-business loans, but, since in most cases the purpose of the loan is determined by the written representations the borrower made to the lender, this can easily be determined from the lender's records. If there are individual factual questions about the purpose of the loan, they can be resolved through the claims process or by bifurcating the proceedings. n257 Damages can usually be determined from the lender's own records. n258 For nationwide class actions, however, the court will either have to find a basis for applying the law of a single state, or conclude that variations among the states' laws are not so significant as to make the class action unmanageable. n259

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawNational BanksInterest & UsuryGeneral OverviewBanking LawNational BanksInterest & UsuryUsury LitigationContracts LawDebtor & Creditor RelationsContracts LawDefensesGeneral OverviewContracts LawDefensesUsury

FOOTNOTES:
(n1)Footnote 1. *See Woods v. Holy Cross Hosp., 591 F.2d 1164, 1171 (5th Cir. 1979)* ; *Wartman v. Branch 7, Civil Div., County Court, 510 F.2d 130 (7th Cir. 1975)* .

(n2)Footnote 2. Some state usury laws may only be raised defensively. *See, e.g., Kan. Stat. Ann. § 16-207(a)*; *George v. Capital S. Mortgage Invs., Inc., 265 Kan. 431, 961 P.2d 32 (1998)* . Kansas recognizes an affirmative claim for usury, however, under its common law. *Id.*

(n3)Footnote 3. *See generally Dairy Queen v. Wood, 369 U.S. 469, 82 S. Ct. 894, 8 L. Ed. 2d 44 (1962)* (action to collect debt for breach of contract); *Raedeke v. Gibraltor Sav. & Loan Ass'n, 10 Cal. 3d 665, 111 Cal. Rptr. 693, 517 P.2d 1157 (1974)* ; *Whitfield v. Cornelius, 554 S.W.2d 870 (Ky. Ct. App. 1977)* , *writ vacated, 563 S.W.2d 9 (Ky. 1978)* .

(n4)Footnote 4. *See Rowell v. Kaplan, 103 R.I. 60, 235 A.2d 91 (1967)* ; *see generally* Annot., *17 A.L.R.3d 1321 (1968)* (right in equity suit to jury trial of legal counterclaim).

(n5)Footnote 5. *Jansen v. Nu-West, Inc., 2000 Wash. App. LEXIS 1993* (Wash. App. Aug. 17, 2000) . *Cf. Bryer v. Green-Venable, 2001 Cal. App. LEXIS 3238* (Dec. 12, 2001) (unpublished, citation limited) (question whether a transaction is usurious is mixed question of law and fact).

(n6)Footnote 6. *See generally Kenty v. Bank One, Columbus, N.A., 92 F.3d 384 (6th Cir. 1996)* (financing force-placed insurance premium was a loan), *reh'g, en banc, denied, 1996 U.S. App. LEXIS 24797* (6th Cir. Sept. 19, 1996) ; *Turner v. E-Z Check Cashing, Inc., 35 F. Supp. 2d 1042 (M.D. Tenn. 1999)* (deferred presentment of check constitutes a loan); *Hamilton v. York, 987 F. Supp. 953 (E.D. Ky. 1997)* (same); *Cazenovia Coll. v. Renshaw (In re Renshaw), 229 B.R. 552 (B.A.P. 2d Cir. 1999)* , *aff'd, 222 F.3d 82 (2d Cir. 2000)* (unpaid balance of tuition, room, and board a credit sale and not a loan even though the college charged a 19.2% per year "service charge"; therefore dischargeable by debtor in Chapter 7 bankruptcy proceeding); *Eikenberry v. Adirondack Spring Water Co., 65 N.Y.2d 125, 490 N.Y.S.2d 484, 480 N.E.2d 70 (1985)* (distinguishing loan and forbearance); *Miro v. Allied Fin. Co., 650 S.W.2d 938 (Tex. Ct. App. 1983)* (no loan when loan instrument cancelled shortly after signing and never funded). Statutes which regulate charges for the "use" of money are generally addressing loans. *See Tygrett v. Univ. Gardens Home Ass'n, 687 S.W.2d 481 (Tex. Ct. App. 1985) . Aple Auto Cash Express, Inc. v. State ex rel. Oklahoma Dep't of Consumer Credit, 78 P.3d 1231 (Okla. 2003)* (sale-leaseback). *Decision Point, Inc. v. Reece & Nichols Realtors, Inc., 144 P.3d 706 (Kan. 2006)* (applying U.C.C.C. definition of loan as "creation of debt by the lender's payment of or agreement to pay money to the debtor"; advancing money to real estate agents in return for their agreement to repay it either through assignment of specific anticipated commissions or repurchase of the account creates loans); *Opella v. Opella, 896 A.2d 714 (R.I. 2006)* (finding intra-family transfer to be loan rather than gift; fact that father kept meticulous records of payments to son is persuasive).

Finding no loan or credit: *Rivera v. AT&T Corp., 141 F. Supp. 2d 719 (S.D. Tex. 2001)* (late payment of cable TV bill not a loan even though equipment was "loaned" to subscribers); *Hoxie Implement Co. v. Baker, 2001 Tex. App. LEXIS 6472* (Tex. App. Amarillo Sept. 21, 2001) , *pet. for review denied,* (Mar. 21, 2002) (demand for money allegedly due as a result of nonpayment of debt was not usury where jury found that no debt was actually owed); *Benchmark Land Dev., Inc. v. Wooley, 2001 Tex. App. LEXIS 8390* (Tex. App. Austin Dec. 20, 2001) , *pet. for review denied,* (Mar. 14, 2002) (agreement to repay unauthorized transfers of funds would not be loan). *See also Carey v. Lincoln Loan Co., 165 Or. App. 657, 998 P.2d 724 (2000)* (installment land contract is not a loan as defined by statute that limits restrictions on prepayment); *Betts v. Advance Am., 213 F.R.D. 466 (M.D. Fla. 2003)* (payday loan); *In re Hoberg, 300 B.R. 752 (Bankr. C.D. Cal. 2003)* (husband's obligation to pay money to satisfy spousal support and division of property claims not loan or forbearance); *Carter v. Four Seasons Funding Corp., 97 S.W.3d 387 (Ark. 2003)* (sale of accounts receivable by sophisticated business entity not a loan even though buyer had recourse against seller if accounts proved uncollectable); *Mackey v. Bristol W. Ins. Servs., 130 Cal. Rptr. 2d 536 (Ct. App. 2003)* (financing of auto insurance policy not a credit transaction when insured was under no obligation to pay for full term, but could cancel after paying for any number of months).

(n7)Footnote 7. *See generally Henson v. Columbus Bank & Trust Co., 770 F.2d 1566 (11th Cir. 1985)* (refraining from calling a demand note is not a forbearance); *Smith Mach. Co. v. Jenkins, 654 F.2d 693 (10th Cir. 1981)* (detention, not forbearance); *Sunburst Bank v. Keith, 648 So. 2d 1147 (Miss. 1995)* (oral agreements to extend loan term accompanied by payment of foreclosure fee were forbearance agreements); *Eikenberry v. Adirondack Spring Water Co., 65 N.Y.2d 125, 490 N.Y.S.2d 484, 480 N.E.2d 70 (1985)* (agreement was a forbearance); *Lowell & Austin, Inc. v. Traux, 507 A.2d 949 (Vt. 1985)* (no forbearance); *Carper v. Kanawha Banking & Trust Co., 207 S.E.2d 897 (W. Va. 1974)* (no reversible error in usury verdict where debtor's attorney claimed usurious "loan" in opening argument, but later proved usurious "forbearance").

(n8)Footnote 8. *Edwards v. Alabama Farm Bureau Mut. Casualty Ins. Co., 509 So. 2d 232 (Ala. Civ. App. 1986)* , *cert. quashed, 509 So. 2d 241 (1987)* (no distinction between treatment of loan and forbearance in Alabama Mini-Code).

(n9)Footnote 9. *See, e.g., Computer Sales Corp. v. Rousonelos Farms, Inc., 190 Ill. App. 3d 338, 546 N.E.2d 761*

(1989) ; *Citipostal, Inc. v. Unistar Leasing, 283 A.D.2d 916, 724 N.Y.S.2d 555* (4th Dep't 2001) (neither a credit sale nor a lease constitutes a loan or forbearance). *Cf. Bell v. Muller, 118 P.3d 405 (Wash. Ct. App. 2005)* (amended usury statute excludes retail installment sales from its coverage), *amended on other grounds, Bell v. Muller, 2005 Wash. App. LEXIS 3111* (Wash. Ct. App. Dec. 8, 2005) . *But cf. Perez v. Rent-A-Center, Inc., 892 A.2d 1255 (N.J. 2006)* (holding that interest and time-price differential are indistinguishable).

(n10)Footnote 10. *Luebbers v. Money Store, Inc., 40 S.W.3d 745 (Ark. 2001)* .

(n11)Footnote 11. *Pollice v. National Tax Funding, 225 F.3d 379, 396-97 (3d Cir. 2000)* . *Compare Sheehy v. Franchise Tax Bd., 100 Cal. Rptr. 2d 760 (App. 2000)* (no agreement to forbear collection of unpaid taxes, so usury laws did not apply); *Alaskan Fireplace, Inc. v. Everett, 266 Wis. 2d 694, 667 N.W.2d 378 (2003) (Wis. Ct. App. 2003)* (not a credit transaction when seller did not grant buyers the right to defer payment, but imposed 1.5% monthly late charge as means of dissuading late payment), *review denied 266 Wis. 2d 64, 671 N.W.2d 851 (Wis. 2003)* .

(n12)Footnote 12. State *ex rel. Salazar v. The Cash Now Store, Inc., 31 P.3d 161 (Colo. 2001)* .

(n13)Footnote 13. State *ex rel. Salazar v. The Cash Now Store, Inc., 31 P.3d 161, 167 (Colo. 2001)* (noting that the lender demonstrates that it does not view the refund as a chose in action because the borrower owes it a sum of money whether the refund of "chose" is valuable to the lender or not).

(n14)Footnote 14. *See, e.g., Britz v. Kinsvater, 351 P.2d 986 (Ariz. 1960)* ; *Seargeant v. Smith, 163 P.2d 680 (Ariz. 1945)* . *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 10.5.3 (3rd ed. and Supp.).

(n15)Footnote 15. *Dopp v. Yari, 927 F. Supp. 814 (D.N.J. 1996)* . *See also Kraft v. Mason, 668 So. 2d 679 (Fla. Dist. Ct. App. 1996)* (no usury where borrower had duty to repay principal, but the usurious interest was contingent on litigation success). *See also Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87 (Tex. App. 2006)* (loan that was only to be paid back at the successful completion of litigation created no absolute obligation to repay and was not therefore usurious); *Goffney v. O'Quinn, 2004 Tex. App. LEXIS 9593* (Tex. App. Oct. 28, 2004) (unpublished, citation limited) (contingency contracts between attorneys and clients for repayment of litigation expenses upon successful completion of case do not create an absolute obligation to repay and so are not usurious).

(n16)Footnote 16. *Britz v. Kinsvater, 351 P.2d 986 (Ariz. 1960)* .

(n17)Footnote 17. Some statutes, however, may impose liability for imposing any charge in excess of that authorized, irrespective of whether the overall yield to the creditor would breach an applicable ceiling.

(n18)Footnote 18. For example, the Uniform Small Loan Law, 7th Draft § 13(c) (June 1, 1942), provides that amounts beyond those allowed may not be "directly or indirectly charged, contracted for, or received." The UCCC § 5.201(3) (1974 Act) provides consumer remedies when a creditor has "contracted for or received" excess charges or has refused to give the consumer a valid refund within a reasonable time after demand.

(n19)Footnote 19. *In re McCorhill Pub., Inc., 86 B.R. 783, 793-94 (Bankr. S.D.N.Y. 1988)* .

(n20)Footnote 20. *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, Ch. 4 (3rd ed. and Supp.)

(n21)Footnote 21. Third party fees may also be treated as non-interest expenses by judicial interpretation of general usury laws. *See § 6.05[3] supra*.

(n22)Footnote 22. Non-interest charges may be the subject of separate regulation, even if the interest rate itself is deregulated. *E.g., Mayo v. Key Fin. Servs., Inc., 1994 Mass. Super. LEXIS 549* (June 22, 1994) (interpreting *Mass. Gen.*

Laws Ch.183, § 63), *aff'd, as modified, on other issues*, *678 N.E.2d 1311 (Mass. 1997)* ; *Torres v. Overby, 2000 Tex. App. LEXIS 2493* (Apr. 17, 2000) (unpublished, citation limited) (late fees are contingent additional charges treated as interest under the usury laws, although not under the common law definition). Similarly, real estate closing fees may be limited to actual or reasonable and necessary fees. *Va. Code Ann. § 6.1-330.70-72*. *See also Alston v. Crown Auto, Inc., 224 F.3d 332 (4th Cir. 2000)* (excessive late fees do not make loan usurious, but penalties in late fee statute apply); *S & A Indus., Inc. v. Bank Atlanta, 543 S.E.2d 743 (Ga. Ct. App. 2000)* (concurring opinion for half of equally divided court) (late charge is considered a fee under criminal usury statutes but did not exceed limits). *See, e.g., Rieser v. Todd (In re Chari), 2005 Bankr. LEXIS 2895* (Bankr. S.D. Ohio Sept. 2, 2005) (fees were interest even though termed loan commitment fees where they were consideration for the loan; extension fees also interest to extent they exceeded reasonable late fees).

(n23)Footnote 23. *E.g., Garrison v. First Fed. Sav. & Loan Ass'n of S.C., 402 S.E.2d 24 (Va. 1991)* (risk management fee not listed among permissible charges and, therefore, was an illegal charge; only "actual" appraisal cost authorized, excess constituted interest). *Cf.* May v. Key Fin. Servs., Inc., Clearinghouse No. 49,969 (Mass. Super Ct. June 22, 1994) (implied private right of action for violation of statute limiting points; assertable by a suitable common law remedy; borrowers choose to assert common law restitution).

(n24)Footnote 24. "Principal" or "amount financed" is often statutorily defined. Observe that the principal amount of a loan in this functional sense may not be the face amount of the note signed by the borrower because lenders often include charges such as "points"--which really are compensation to the creditor--in the face amount of the note. Applicable law often sanctions this.

(n25)Footnote 25. *E.g., Yazzie v. Ray Vicker's Special Cars, Inc., 12 F. Supp. 2d 1230 (D.N.M. 1998)* (pawn service fee exceeded legal limit); *Fryer v. Easy Money Title Pawn, Inc., 183 B.R. 322 , reconsid. denied, 183 B.R. 654 (Bankr. S.D. Ga. 1995)* (pawnbroker's 23% per month "service charge" was not to reimburse it for any specific expenses, and was, therefore, interest); *Dunnam v. Burns, 901 S.W.2d 628 (Tex. Ct. App. 1995)* (additional sum to be repaid with principal was interest, even though not denominated as such). *But see Nicholas v. Deposit Guar. Nat'l Bank, 182 F.R.D. 226 (S.D. Miss. 1998)* (NSF fee held not to be interest under Mississippi law because it was not charged in connection with a credit transaction).

(n26)Footnote 26. *See § 6.05 supra*.

(n27)Footnote 27. But see *§ 6.03 supra*, where early termination is at issue.

(n28)Footnote 28. For common interest calculation formulae, such as simple interest, add-on interest, or discount interest, parties can frequently stipulate to the accuracy of a published rate chart which will show the permissible finance charge for any given principal amount (or amount financed) and rate. A common source is The Cost of Personal Borrowing in the United States, published by the Financial Publishing Company, Boston, MA. Requests for admission might also be used. *See Ogier v. Johnson (In re Healing Touch, Inc.), 2005 Bankr. LEXIS 1399* (Bankr. N.D. Ga. May 6, 2005) (court calculated interest rate by "taking the total amount of interest charged under the loan and dividing by the number of months in the loan" and then comparing that to the permissible rate); *Wellman v. Bank One, 2005 Mich. App. LEXIS 2238* (Mich. Ct. App. Sept. 20, 2005) (court calculates simple interest rate, lender had to know rate was usurious) (unpublished, citation limited). *Cf. In re Williams, 330 B.R. 534 (Bankr. M.D. La. 2005)* (court relied on lender's testimony that rate calculated correctly in absence of evidence from borrowers); *Rivera v. Schlick, 887 A.2d 492 (D.C. 2005)* (borrower failed to prove interest rate or provide information from which the court could calculate the interest rate; conclusory allegations of interest rate insufficient); *Perez v. Rent-A-Center, Inc., 892 A.2d 1255 (N.J. 2006)* (citing borrowers' expert witness on the interest rate of the rent-to-own contracts).

(n29)Footnote 29. *See generally § 6.07[1] supra*.

(n30)Footnote 30. *See § 6.02 supra*.

(n31)Footnote 31. *See, e.g., In re Swartz, 37 B.R. 776 (Bankr. D.R.I. 1984)* (small loans); *Beneficial Fin. Co. v. Administrator of Loan Laws, 260 Md. 430, 272 A.2d 649 (1971)* (no intent requirement under Small Loan Act); *Duckworth v. Bernstein, 466 A.2d 517 (Md. Ct. Spec. App. 1983)* (no intent requirement under second mortgage law unless treble damages sought); *Thelen v. Ducharme, 151 Mich. App. 441, 390 N.W.2d 264 (1986)* ; *Commercial Credit Equip. Corp. v. West, 677 S.W.2d 669* (Tex. Ct. App. 1984 writ ref'd n.r.e.) .

(n32)Footnote 32. An exception is Florida which generally requires a showing of "corrupt intent." *See, e.g., North Am. Mortgage Invs. v. Cape San Blas Joint Venture, 378 So. 2d 287 (Fla. 1979)* (corrupt intent demonstrated); *Dixon v. Sharp, 276 So. 2d 817 (Fla. 1973)* (discussion of corrupt intent); *Gergora v. Goldstein Professional Ass'n Defined Benefits Plan Pension & Trust, 500 So. 2d 695 (Fla. Dist. Ct. App. 1987)* (no corrupt intent). "Corrupt intent" is also required in North Carolina but, as interpreted by the courts of that state, only the intent to charge a rate in excess of the statutory limit need be shown. *See Swindell v. Overton, 342 S.E.2d 391 (N.C. Ct. App. 1986)* .

New Mexico has also now adopted the "corrupt intent" rule. *See, e.g., Maulsby v. Magnuson, 107 N.M. 223, 755 P.2d 67 (1988)* (the court overturned *Hays v. Hudson, 85 N.M. 512, 514 P.2d 31 (1973))* .

(n33)Footnote 33. *See Fogie v. Thorn Americas, Inc., 95 F.3d 645 (8th Cir. 1996)* , *cert. denied, 520 U.S. 1166, 117 S. Ct. 1427, 137 L. Ed. 2d 536 (1997)* (applying Minnesota law); *Henson v. Columbus Bank & Trust Co., 770 F.2d 1566 (11th Cir. 1985)* ; *Duderwicz v. Sweetwater Sav. Ass'n, 595 F.2d 1008 (5th Cir. 1979)* (applying Georgia law); *In re McCorhill Pub., Inc., 86 B.R. 783 (Bankr. S.D.N.Y. 1988)* (New York law). *See also Brodie v. Schmutz (In re Venture Mortgage Fund), 282 F.3d 185 (2d Cir. 2001)* (loan is usurious if lender intends to take and receive interest in excess of that allowed by law even though lender has no specific intent to violate usury laws; loans made by victims to Ponzi scheme operator because of promised high returns are void); *SAL Leasing, Inc. v. State ex rel. Napolitano, 10 P.3d 1221 (Ariz. Ct. App. 2000)* (unlawful intent is shown by mere fact of intentionally doing what is forbidden by statute); *Robinson v. Poferl, 2000 Minn. App. LEXIS 58* (Minn. Ct. App. Jan. 25, 2000) .

(n34)Footnote 34. *See, e.g., Cochran v. American Sav. & Loan Ass'n of Houston, 586 S.W.2d 849 (Tex. 1979)* ; *Commerce Crowdus & Canton, Ltd. v. DKS Constr., Inc., 776 S.W.2d 615, 618-19 (Tex. Ct. App. 1989)* (" 'bona fide error' defense is only available when the evidence shows that the charge of usury results from the ignorance of a material fact or from other unintentional mishaps in office practice or routine which may be fairly characterized as 'clerical' errors").

(n35)Footnote 35. *See Alamo Lumber Co. v. Gold, 661 S.W.2d 926 (Tex. 1983)* .

(n36)Footnote 36. *See, e.g., Greglon Indus., Inc. v. Bowman, 572 A.2d 369 (Conn. Ct. App. 1990)* ; *Dang v. F & S Land Dev. Co., 618 P.2d 276 (Haw. 1980)* ; *A&M Dev. v. Sherwood & Roberts, Inc., 457 P.2d 439 (Idaho 1969)* ; *Freitas v. Geddes Sav. & Loan Ass'n, 63 N.Y.2d 254, 471 N.E.2d 436, 481 N.Y.S.2d 665 (1984)* (plurality opinion); *Norstar Bank v. Pickard & Anderson, 547 N.Y.S.2d 734 (App. Div. 1989)* ; *W. Auto Supply v. Vick, 277 S.E.2d 360 (N.C. 1981)* , *reaff'd on reh'g, 283 S.E.2d 101 (1981)* .

(n37)Footnote 37. *See, e.g., Handi Inv. Co. v. Mobil Oil Corp., 550 F.2d 543 (9th Cir. 1977)* (applying California law); *McDermott v. Strauss, 678 S.W.2d 334 (Ark. 1984)* .

(n38)Footnote 38. *See, e.g., OMP v. Security Pac. Bus. Fin. Inc., 716 F. Supp. 239 (N.D. Miss. 1989)* ("no 'presumption of usury' under Mississippi law: one claiming usury must furnish clear, positive, and certain proof of usury"); *In re Borum, 60 B.R. 516 (Bankr. E.D. Ark. 1986)* (burden of proof on debtor when contract not usurious on its face). *See generally* Annot., *51 A.L.R.2d 1087 (1957)* . *See also Transmedia Rest. Co. v. 33 East 61st St. Rest. Corp., 710 N.Y.S.2d 756 (Sup. Ct. 2000)* ("strong presumption against the finding of usury").

(n39)Footnote 39. *See Grotjohn Precise Connexiones Int'l, S.A. v. JEM Fin., Inc., 12 S.W.3d 859 (Tex. App. 2000)* (if loan is usurious on its face, lender has burden of proving bona fide error).

(n40)Footnote 40. *See Bellagio Ins., Ltd. v. Digital Broad. Corp., 2005 U.S. Dist. LEXIS 4629* (W.D. Va. Mar. 23, 2005) (under either New York or Virginia law, burden of proof by "clear and convincing" or "clear and cogent" evidence on debtor); *Hickman v. Courtney, 361 Ark. 5 (2005)* (debtor has burden of proof by "clear and convincing" evidence); *Comstock v. Steinbergh, 18 Mass. L. Rep. 573 (Mass. Super. Ct. 2004)* (debtor has burden); *Hochman v. LaRea, 789 N.Y.S.2d 300 (N.Y. App. Div. 2005)* (debtor has "heavy burden" of showing usury by "clear and convincing" evidence). *See also Pierce v. Emigrant Mortg. Co., 2005 U.S. Dist. LEXIS 22397* (D. Conn. Sept. 29, 2005) (burden of proving that mortgage was bona fide and therefore qualified for mortgage exception for usury statute on defendant lender).

(n41)Footnote 41. *See, e.g., Giventer v. Arnow, 37 N.Y.2d 305, 372 N.Y.S.2d 63 (1975)* ; *Matter of Estate of Dane, 55 A.D.2d 224, 390* N.Y.S.2d (1976) . *See also C.I.O.S. Foundation v. Berkston Ins., 2000 U.S. Dist. LEXIS 2337* (N.D. Miss. Jan. 28, 2000) (where usurious contract was unambiguous, parol evidence was not admissible).

(n42)Footnote 42. *See Olson v. Porter, 539 N.W.2d 523 (Mich. Ct. App. 1995) . Cf. Robinson v. Poferl, 2000 Minn. App. LEXIS 58* (Jan. 25, 2000) (unpublished, citation limited) (taking reasonable precautions to avoid usury, such as consulting qualified third party, can negate intent; not shown where lender did not retain own attorney and refused to reform loan after borrower discovered the usury).

(n43)Footnote 43. *Zwayer v. Ford Motor Credit Co., 279 Ill. App. 3d 906, 216 Ill. Dec. 585, 665 N.E.2d 843 (1996)* (court held the contract was ambiguous and should be construed against the maker where it contained a clause allowing the use of the Rule of 78s to rebate upon prepayment, but was silent if acceleration occurred), *appeal denied, 168 Ill. 2d 629, 219 Ill. Dec. 578, 671 N.E.2d 745 (1996) .*

(n44)Footnote 44. For a discussion of the interpretation of adhesive contracts, see *Drennan v. Security Pac. Nat'l Bank, 28 Cal. 3d 764, 170 Cal. Rptr. 904, 621 P.2d 1318 , cert. denied, 454 U.S. 833, 102 S. Ct. 132, 70 L. Ed. 2d 112 (1981) .*

(n45)Footnote 45. *Cf. Gonzalez v. Gainan's Chevrolet City, Inc., 690 S.W.2d 885 (Tex. 1985)* (no presumption of legality for contracts under Consumer Credit Code *except* in cases alleging usury).

(n46)Footnote 46. *See Matter of Sprouse, 577 F.2d 989 (5th Cir. 1978) .*

(n47)Footnote 47. Checks and promissory notes are classic examples of instruments which generally fall within the UCC definition of a "negotiable instrument." *UCC § 3-104.*

(n48)Footnote 48. *UCC § 3-305.* Defenses which can be asserted against a holder in due course include the lack of the maker's capacity to execute the instrument, *e.g., Shepard v. First Am. Mortgage Co., 347 S.E.2d 118 (S.C. Ct. App. 1986)* , the illegality of the instrument, misrepresentation of the essential character or terms of the contract, *American Plan Corp. v. Woods, 16 Ohio App. 1, 45 Ohio Op. 2d 2, 240 N.E.2d 886 (1968)* , and bankruptcy. As is discussed in this section, usury can be a defense too as to holder in due course. For a discussion of fraud as a defense to a holder in due course, see generally Annot., *78 A.L.R.3d 1020 (1977)* ; *§ 6.09[6] infra* .

(n49)Footnote 49. *See, e.g., Leasing Serv. Corp. v. River City Constr., 743 F.2d 871 (11th Cir. 1984) .*

(n50)Footnote 50. UETA § 16. UETA is published at 7A U.L.A. Pt. 1 (Supp.). The text of UETA can also be found on the website of the National Conference of Commissioners on Uniform State Laws, www.nccusl.org. By the end of 2000, UETA had been adopted in 24 states.

(n51)Footnote 51. *15 U.S.C. § 7021. See* National Consumer Law Center, Consumer Banking and Payments Law Ch. 9 (2d ed. 2002 and Supp.).

(n52)Footnote 52. *U.C.C. § 9-102(a)(11)*, (31). *See* ANSI X9.103-2004, *Motor Vehicle Retail Sale and*

Lease--Electronic Contracting, *available at* webstore.ansi.org.

(n53)Footnote 53. UETA § 16.

(n54)Footnote 54. UETA § 3 cmt. 6, § 16 cmt. 1.

(n55)Footnote 55. *15 U.S.C. § 7021*, effective Oct. 27, 2000 (90 days after the enactment date of June 30, 2000). *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 9.2.10 (4th ed. 2009) and National Consumer Law Center, Truth in Lending § 4.2.9 (6th ed. 2007 and supp.) for further discussion of this statute.

(n56)Footnote 56. *See 15 U.S.C. § 7021(f)* and UETA § 16(f), which require the person in control of a transferrable record to provide the obligor "reasonable proof" of control.

(n57)Footnote 57. *See 15 U.S.C. § 7021(d)*, *(e)*, and UETA § 16(d), (e), both of which refer to the UCC for rules governing the rights of holders and obligors.

(n58)Footnote 58. *See 16 C.F.R. § 433.2 (1986)*.

(n59)Footnote 59. *See 16 C.F.R. § 433.1(d) (1986)*.

(n60)Footnote 60. *Cf. Heastie v. Community Bank, 727 F. Supp. 1133 (N.D. Ill. 1989)* . For an interpretation of the final sentence of the FTC notice which limits a debtor's recovery under the FTC Rule, see *Home Sav. Ass'n v. Guerra, 720 S.W.2d 636 (Tex. Ct. App. 1986)* .

(n61)Footnote 61. *See UCC § 3-104(1)(b)*.

(n62)Footnote 62. *UCC §§ 3-102(1)(e)*, *3-302*. *See Mahaffey v. Investor's Nat'l Sec. Co., 747 P.2d 890 (Nev. 1987)* (home improvement contract with FTC holder rule notice precluded assignee from asserting holder in due course; liable for defenses arising out of contractor's conduct, including fraudulent inducement and failure of consideration). *See also Carper v. Kanawha Banking & Trust Co., 207 S.E.2d 897 (W. Va. 1974)* (conditional sales contract was not negotiable instrument).

(n63)Footnote 63. *See Capital Bank & Trust Co. v. Lacey, 393 So. 2d 668 (La. 1980)* . For a discussion of consumer remedies for creditor violations of FTC Rules, see National Consumer Law Center, Unfair and Deceptive Acts and Practices § 6.6 (5th ed. 2001 and Supp.). That section contains a detailed discussion of assignee liability, including the argument that consumer credit contracts impliedly incorporate all applicable laws, including the FTC notice, even where it is not explicitly included. *Id*.

(n64)Footnote 64. *UCC §§ 9-403*, *9-404*.

(n65)Footnote 65. Rev. *UCC § 3-305(e)*.

(n66)Footnote 66. *See, e.g., Associates Home Equity Servs., Inc. v. Troup, 343 N.J. Super. 254, 778 A.2d 529 (App. Div. 2001) . But see Crisomia v. Parkway Mortgage, Inc., 2001 Bankr. LEXIS 1469* (Bankr. E.D. Pa. Aug. 21, 2001) . *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 6.6.5.4.2 (5th ed. 2001 and Supp.).

(n67)Footnote 67. *Cf. Barnes v. Michigan Nat'l Bank Corp., 159 Mich. App. 433, 407 N.W.2d 23 (Mich. Ct. App. 1987)* (state MVSFA did not apply to direct loan entered into between bank and borrower to finance vehicle purchase where no recourse by bank against dealer or other relationship between bank and dealer).

This loophole has been somewhat limited in the context of certain high cost home equity loans. *See* Ch. 2 *supra*.

(n68)Footnote 68. *See* Ch. 2 *supra*.

(n69)Footnote 69. *UCC § 3-306*.

(n70)Footnote 70. *UCC § 1-201(20)*. *UCC § 3-302* describes a holder in due course as one who takes an "instrument" under certain conditions. An "instrument" is defined as a "negotiable instrument." *UCC § 3-102(1)(e)*. (Advocates should note that, in addition to the FTC Holder Rule, this provision also may protect consumers from holder in due course defenses in many retail installment sales, as many Retail Installment Sales Acts prohibit the use of negotiable instruments in creating the credit agreement.) Again, as noted above, no holder of an instrument containing the FTC notice can become a holder in due course, regardless of the manner in which it takes the instrument, because only a holder of a negotiable instrument can be a holder in due course. *UCC §§ 3-102(1)(e)*, *3-302*.

(n71)Footnote 71. *Taylor v. Roeder, 360 S.E.2d 191, 4 U.C.C. Rep. Serv. 2d 652, 655 (Va. 1987)* .

(n72)Footnote 72. *UCC § 3-302*.

(n73)Footnote 73. *UCC § 3-203*.

(n74)Footnote 74. Official Comments 2, 4 to *UCC § 3-203*.

(n75)Footnote 75. *UCC § 3-203(b)*.

(n76)Footnote 76. Official Comment 2 to *UCC § 3-203*; *see Triffin v. Somerset Valley Bank, 777 A.2d 993 (N.J. Super. Ct. App. Div. 2001)* (buyer of forged check from holder in due course entitled to assert rights of holder).

(n77)Footnote 77. *See also § 6.09[6] infra*; National Consumer Law Center, Unfair and Deceptive Acts and Practices, §§ 11.7.2.5 (7th ed. 2008).

(n78)Footnote 78. *Maberry v. Said, 927 F. Supp. 1456, 1461-63 (D. Kan. 1996)* .

(n79)Footnote 79. *United States v. Cunningham, 83 F.3d 218 (8th Cir. 1996)* (affirming criminal fraud conviction); *United States v. Camuti, 78 F.3d 738 (1st Cir. 1996)* (affirming mail fraud conviction); *Louis Vuitton S.A. v. Lee, 875 F.2d 584, 590 (7th Cir. 1989)* (trademark infringement by selling counterfeit goods); *Bosco v. Serhant, 836 F.2d 271, 276 (7th Cir. 1987)* (brokerage's liability in securities fraud case), *cert. denied*, *486 U.S. 1056, 108 S. Ct. 2824, 100 L. Ed. 2d 925 (1988)* .

(n80)Footnote 79.1. *See U.C.C. §§ 3-302(a)(1)* (holder is not holder in due course if instrument is so irregular or incomplete as to call into question its authenticity), 1-202(a)(3) (definition of "notice").

(n81)Footnote 80. *UCC § 9-206*.

(n82)Footnote 81. *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 11.7.2 (7th ed. 2008 and supp.).

(n83)Footnote 82. *See Beatty v. Franklin Inv. Co., 319 F.2d 712 (D.C. Cir. 1963)* (NIL decision); *Katz v. Simcha Co., 251 Md. 227, 246 A.2d 555 (1968)* (dictum, citing *Beatty, supra*); *see also Hatton v. Money Lenders & Assocs., Ltd., 127 Ill. App. 3d 577, 469 N.E.2d 360 (Ill. App. Ct. 1984)* (summary judgment awarded to note holder once good faith and absence of notice of usury defense established; no discussion of possibility that usury is defense against a holder in due course).

(n84)Footnote 83. *See Michigan Nat'l Bank v. Mattingly, 212 S.E.2d 754 (W. Va. 1975)* ; *Carper v. Kanawha Banking & Trust Co., 207 S.E.2d 897 (W. Va. 1974)* (West Virginia usury statute amended to preclude recovery from holder in due course).

(n85)Footnote 84. *See, e.g., Bank of N.C. v. Rock Island Bank, 630 F.2d 1243 (7th Cir. 1980)* ; *Andrews v. Martin, 436 S.W.2d 285 (Ark. 1969)* ; *Fuller v. Universal Acceptance Corp., 264 A.2d 506 (D.C. 1970)* ; *Lucas v. Beco Homes, Inc., 494 S.W.2d 417 (Mo. Ct. App. 1973)* ; *Westervelt v. Gateway Fin. Serv., 190 N.J. Super. 615, 464 A.2d 1203 (Super. Ct. Ch. Div. 1983)* ; *Robinson v. Rudy, 666 S.W.2d 507* (Tex. Ct. App. 1984 writ. ref'd n.r.e.) ; *Michigan Nat'l Bank v. Mattingly, 212 S.E.2d 754 (W. Va. 1975)* (transaction prior to statutory amendment). *See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 6.6.5.5 (4th ed. 1997 and Supp.).

(n86)Footnote 85. *See, e.g., Midwest Fed. Sav. v. West Bend Mut. Ins., 407 N.W.2d 690 (Minn. Ct. App. 1987)* (insurance company could not assert usury claim both because claim was personal to the borrower-insureds and because the usury defense is unavailable to corporations); *La Barre v. Gold, 520 So. 2d 1327 (Miss. 1988) . See also* All *Seasons Window & Door Mfg. v. Red Dot Corp., 181 S.W.3d 490 (Tex. App. 2005)* (company for whose use funds were advanced cannot claim usury since only its president was a party to the contract). *Cf. Wombold v. Assocs. Fin. Servs. Co. of Mont., Inc., 104 P.3d 1080 (Mont. 2004)* (finding implied private right of action under Montana's Consumer Loan Act, since enacted to benefit borrowers).

(n87)Footnote 86. *See Bizzoco v. Chintz, 193 Conn. 304, 476 A.2d 572 (1984)* ; *Fidelcor Mortgage Co. v. Tyroff, 250 Ga. 900, 302 S.E.2d 96 (1983)* (individual co-maker had standing to assert usury but lost claim because of business purpose usury exception); *Ciminelli v. Ford Motor Credit Co., 624 S.W.2d 903 (Tex. 1981)* ; *Miller v. First State Bank of Bedford, 551 S.W.2d 89 (Tex. Civ. App. 1977) ,, 563 S.W.2d 572 (Tex. 1978)* ; *Williams v. Security Sav. & Loan Ass'n, 120 Wis. 2d 480, 355 N.W.2d 370 (Ct. App. 1984)* .

(n88)Footnote 87. *See, e.g., Seidel v. 18 East 17th St. Owners, 598 N.E.2d 7 (N.Y. 1992)* (original borrower's corporate transferee was essentially same people, and transfer occurred as a result of building's conversion to a co-op, not a sale to an independent third party; transferee, therefore, could assert usury). *See, e.g., Family Fed. Sav. & Loan v. Davis (In re Davis), 172 B.R. 437 (Bankr. D.D.C. 1994)* ("purchaser of equity of redemption in real estate who is in privity of estate or contract with the mortgagor and grantor can plead usury" (D.C. law)). *See, e.g., Eisenstein v. DiPrimio, 2000 Ga. App. LEXIS 1140* (Ga. Ct. App. Sept. 15, 2000) (law firm had standing to claim usury as defense when its client's creditor sought to impose constructive trust over money in client trust account). *See also Sheehan v. Richardson, 315 B.R. 226 (D.R.I. 2004)* (trustee has standing to pursue assigned claim); *In re Colad Group, Inc., 324 B.R. 208 (Bankr. W.D.N.Y. 2005)* (debtor's waiver of defense of usury does not bind the bankruptcy estate).

(n89)Footnote 88. *See Martin v. Ajax Constr. Co., 124 Cal. App. 2d 425, 269 P.2d 132 (1954)* .

(n90)Footnote 89. *See, e.g., Superior Funding Corp. v. Big Apple Capital Corp., 738 F. Supp. 1468 (S.D.N.Y. 1990)* (guarantor of corporate debt cannot assert usury as defense); *Bizzoco v. Chintz, 193 Conn. 304, 476 A.2d 572 (1984)* ; *Snyder v. Woxo, Inc., 185 Neb. 545, 177 N.W.2d 281 (1970) . See generally* Annot., *63 A.L.R.2d 924 (1959)* .

But see Johnson v. Ronamy Consumer Credit Corp., 515 A.2d 682 (Del. 1986) (second mortgage statute covered guarantors); *First Nat'l Consumer Disc. Co. v. Fuller, 419 A.2d 940 (Del. 1980)* (same); *Skeen v. Slavik, 555 S.W.2d 516 (Tex. Civ. App. 1977)* (corporation's guarantor, who later executes personal note to lender assuming the debt of the corporation, may assert usury).

(n91)Footnote 89.1. *Washburn v. Makedonsky, 718 N.W.2d 842 (Mich. Ct. App. 2006)* .

(n92)Footnote 90. *See General Elec. Credit Corp. v. Best Refrigerated Express, Inc., 222 Neb. 499, 385 N.W.2d 81 (1986)* ; *Rader v. Burnett, 175 Neb. 663, 122 N.W.2d 747 (1963)* ; *Eposti v. Rivers Bros. Inc., 207 Cal. 570, 279 P. 423 (1929)* .

(n93)Footnote 91. A New York decision, for example, allowed an assignee to claim usury after tendering the principal and legal interest to the creditor. *Moore v. Plaza Commercial Corp., 9 A.D.2d 223, 192 N.Y.S.2d 770 (N.Y. App. Div. 1959)* , *aff'd, 202 N.Y.S.2d 321, 168 N.E.2d 390 (N.Y. 1960)* ; *see also Benser v. Independence Bank, 735*

S.W.2d 566 (Tex. Ct. App. 1987) .

(n94)Footnote 92. The precise statement of the rule varies from court to court. *Compare Murphy v. Hagan, 275 S.C. 334, 271 S.E.2d 311 (S.C. 1980)* , *with First State Bank of Bedford v. Miller, 551 S.W.2d 89 (Tex. App. 1977)* , on other grounds and aff'd as modified, *563 S.W.2d 572 (Tex. 1978)* . *See also Olson v. Froslee, 2000 Minn. App. LEXIS 795* (Aug. 1, 2000) (unpublished, citation limited) (recognizing estoppel defense if borrower knows of usury, but finding it not shown here).

(n95)Footnote 93. *See, e.g., Seidel v. 18 East 17th St. Owners, 598 N.E.2d 7 (N.Y. 1992)* ; *Lenart v. Ragsdale, 148 Mich. App. 571, 385 N.W.2d 282 (Mich. Ct. App. 1986)* ; *Lucas v. Beco Homes, Inc., 494 S.W.2d 417 (Mo. Ct. App. 1973)* . *See also Russo v. Carey, 706 N.Y.S.2d 760 (App. Div. 2000)* (lender could raise defense of estoppel where he and borrower were friends, borrower prepared note and set interest rate, and some evidence suggested that borrower deliberately inserted usurious interest rate to avoid repayment); *Hornblower & Weeks, Inc. v. Blue Marlin Breweries, Inc., 2000 U.S. Dist. LEXIS 13748* (S.D.N.Y. Sept. 21, 2000) (borrower not estopped from raising criminal usury as defense even if it knew loan was usurious and its agent prepared documents); *In re Venture Mortg. Fund, L.P., 245 B.R. 460 (Bankr. S.D.N.Y. 2000)* , *aff'd, 282 F.3d 185 (2d. Cir. 2002)* (lender must show special relationship with borrower, a representation by borrower that the transaction is legal, intent to induce reliance, actual reliance, and injury; not shown here); *Hufnagel v. George, 135 F. Supp. 2d 406 (S.D.N.Y. 2001)* (no estoppel without special relationship, which is limited to attorney-client, fiduciary, trustee, or long-standing relationship or its equivalent; borrower's suggestion of interest rate is not a defense). *But see Keezing v. Rodriguez, 765 N.Y.S.2d 196 (Sup. Ct. 2003)* (reducing interest to legal rate but refusing to void loan when debtor initiated and structured the transaction and prepared the documents). *Van Carr Enters., Inc. v. Hamco, Inc., 365 Ark. 625, 232 S.W.3d 427, 2006 Ark. LEXIS 198* (Ark. Mar. 16, 2006) (no estoppel even though borrower's principal transcribed the parties' agreement, where there was testimony that he did not discuss state usury rate and did not know if contract was usurious).

(n96)Footnote 94. *See, e.g., City of Little Rock v. Cash, 644 S.W.2d 229 (Ark. 1982)* (applying doctrine), *cert. denied, 462 U.S. 1111 (1983)* ; *Sullivan v. Board of Comm'rs of Oak Lawn Park Dist., 743 N.E.2d 1057 (Ill. Ct. App. 2001)* (applying doctrine); *Louisville & N. Ry. Co. v. Hopkins County, 9 S.W. 497 (Ky. Ct. App. 1888)* (applying doctrine); *Quaker Oats Co. v. Stanton, 96 S.W.3d 133 (Mo. Ct. App. 2003)* (applying doctrine); *Shenango Furnace Co. v. Fairfield Township, 78 A. 937 (Pa. 1911)* (applying doctrine); *City of Laredo v. South Tex. Nat'l Bank, 775 S.W.2d 729 (Tex. App. 1989)* (doctrine did not apply to taxes paid into court registry pursuant to an agreement between the taxing authority and the taxed); *G. Heileman Brewing Co. v. City of LaCrosse, 312 N.W.2d 875 (Wis. Ct. App. 1981)* (applying doctrine). *See generally BMG Direct Mktg. v. Peake, 178 S.W.3d 763, 768-771 (Tex. 2005)* (discussing history of the voluntary payment doctrine; asserting that it has only been applied "infrequently" to illegal taxes); *King v. First Capital Fin. Servs. Corp., 828 N.E.2d 1155, 1170-74 (Ill. 2005)* (discussing history of voluntary payment doctrine in Illinois).

(n97)Footnote 95. *Quaker Oats Co. v. Stanton, 96 S.W.3d 133, 143 (Mo. Ct. App. 2003)* (taxing authority needs to have certainty so that collector can disburse collected taxes); *Putnam v. Time Warner Cable of Southeastern Wis., Ltd., 649 N.W.2d 626, 637 (Wis. 2002)* (government needs to have stability and certainty over funds that have been transferred without dispute).

(n98)Footnote 96. *See, e.g., City of Little Rock v. Cash, 644 S.W.2d 229, 232 (Ark. 1982)* , *cert. denied, 462 U.S. 1111 (1983)* ; *Yates v. Royal Ins. Co., 65 N.E. 726, 727 (Ill. 1902)* .

(n99)Footnote 97. *See, e.g., La Barr v. Tombstone Territorial Mint, 580 P.2d 744* (Ariz. Ct. App.) (rejecting *in pari delicto* argument), *opinion adopted by 582 P.2d 639 (Ariz. 1978)* ; *Stock v. Meek, 221 P.2d 15 (Cal. 1950)* ; *Baruch Inv. Co. v. Huntoon, 65 Cal. Rptr. 131 (Ct. App. 1967)* ; *Richlin v. Schleimer, 7 P.2d 711 (Cal. Ct. App. 1932)* ; *Babcock v. Olhasso, 293 P. 141 (Cal. Ct. App. 1930)* ; *Morgan v. Shepherd, 154 S.E. 780 (Ga. 1930)* ; *Young v. Barker, 342 P.2d 150, 159 (Kan. 1959)* (arguing that it would be futile to declare usury to be criminal while allowing the lender to keep the "fruits of [its] crime").

(n100)Footnote 98. *See, e.g., Baruch Inv. Co. v. Huntoon, 65 Cal. Rptr. 131 (Ct. App. 1967)* (noting that usury laws are designed to protect society); *Stock v. Meek, 221 P.2d 15, 20 (Cal. 1950)* (rejecting *in pari delicto* reasoning on grounds that applying voluntary payment doctrine would vitiate the usury law).

(n101)Footnote 99. *Morgan v. Shepherd, 154 S.E. 780, 783 (Ga. 1930)* ; *see also Chakford v. Sturm, 65 So. 2d 864, 865 (Fla. 1953)* (describing statute as regarding lender as oppressor and borrower as oppressed).

(n102)Footnote 100. *See, e.g., Chakford v. Sturm, 65 So. 2d 864 (Fla. 1953)* (under *Fla. Stat. Ann. § 687.03*, immaterial that usurious interest was paid voluntarily); *Ostiguy v. A.F. Franke Constr., Inc., 347 P.2d 1049 (Wash. 1959)* (citing *Wash. Rev. Code § 19.52.030*).

(n103)Footnote 101. *BMG Direct Mktg. v. Peake, 178 S.W.3d 763, 776 n.9 (Tex. 2005) . Cf. Gonzalez v. Codilis & Assocs., P.C., 2004 U.S. Dist. LEXIS 5463* (N.D. Ill. Mar. 31, 2004) (FDCPA preempts voluntary payment doctrine).

(n104)Footnote 102. *Wellman v. Bank One, 2005 Mich. App. LEXIS 2238* (Mich. Ct. App. Sept. 20, 2005) (unpublished, citation limited).

(n105)Footnote 103. *See, e.g., Matter of Goehring, 23 B.R. 323 (Bankr. D. Mich. 1982)* ; *Lincoln Nat'l Bank v. Kaufman, 406 F. Supp. 448 (D. Mich. 1976)* ; *Bell v. Barnes, 190 So. 273 (Ala. 1939)* ; *Bizzoco v. Chinitz, 476 A.2d 572 (Conn. 1984)* (based on *Conn. Gen. Stat. § 37-2*); *Christian v. Filbert, 249 Ill. App. 230 (1928)* ; *Bebee v. Grettenberger, 266 N.W.2d 829 (Mich. Ct. App. 1978)* ; *Wright v. First Nat'l Bank of Monroe, 297 N.W. 505 (Mich. 1941)* ; *Farmers' Bank & Trust Co. v. Redwine, 167 S.E. 687 (N.C. 1933)* . These cases should be distinguished from decisions that bar plaintiffs from asserting a cause of action to recover illegal interest on the grounds that it may only be used defensively. *See, e.g., Alabama Cash Credit Corp. v. Bartlett, 144 So. 808 (Ala. 1932)* (statute only prohibits requirement to pay usury and does not allow plaintiff to sue to recover usurious interest already paid). *BMG Direct Mktg., Inc. v. Peake, 178 S.W.3d 763 (Tex. 2005)* (voluntary payment doctrine applies where debtor pays late charge with knowledge of its amount and the circumstances in which it is imposed, even though debtor does not know whether amount so exceeds creditor's damages that it is illegal as a penalty).

(n106)Footnote 104. *See e.g. Luebke v. Moser, 598 N.E.2d 760 (Ohio Ct. App. 1991)* (allowing defense where plaintiff paid usurious interest due to a mistake of law).

(n107)Footnote 105. *Bell v. Barnes, 190 So. 273, 275 (Ala. 1939)* .

(n108)Footnote 106. *See e.g. Lincoln Nat'l Bank v. Kaufman, 406 F. Supp. 448 (D. Mich. 1976)* (allowing plaintiff to recover prepaid interest where loan had not yet been fully repaid); *Matter of Goehring, 23 B.R. 323, 325-26 (Bankr. D. Mich. 1982)* (allowing debtor to recoup interest paid on unfulfilled note, but barring claim based on fully paid note, on grounds payment was "voluntary"); *Waldorf v. Zinberg, 307 N.W.2d 749 (Mich. Ct. App. 1981)* (defendant must apply collected usurious interest against principal due on matured loan); *Bebee v. Grettenberger, 266 N.W.2d 829 (Mich. Ct. App. 1978)* ; *Sienkiewicz v. Leonard Mortgage Co., 229 N.W.2d 352 (Mich. Ct. App. 1975)* .

(n109)Footnote 107. *Thelen v. Ducharme, 390 N.W.2d 264 (Mich. Ct. App. 1986)* .

(n110)Footnote 108. *See, e.g., Richter v. Burdock, 100 N.E. 1063 (Ill. 1913)* (finding that compulsion existed when note was assigned to an innocent.

(n111)Footnote 109. This discussion assumes that proper service was made upon the borrower. Obviously, in the absence of service, default judgments may be challenged on jurisdictional or due process grounds, but this topic is beyond the scope of this chapter.

(n112)Footnote 110. For general statements of these grounds outside of the context of usury, see, e.g., *Citizens Nat'l Bank of Univ. City v. Gehl, 567 S.W.2d 423 (Mo. Ct. App. 1978)* (moving party must show reasonable diligence);

Household Fin. Co. v. Avery, 476 S.W.2d 165 (Mo. Ct. App. 1972) (lender could not reopen judgment).

(n113)Footnote 111. *See Fielder v. Credit Acceptance Corp., 10 F. Supp. 2d 1101 (W.D. Mo. 1998)* (court rejected argument that it lacked jurisdiction to rectify such creditor conduct, and held that res judicata did not bar the consumers' affirmative attack because the issue of excessive post-maturity interest charges and official fees was not raised in the prior state court proceedings), *partial summ. judgment granted, in part, partial summ. judgment denied, in part, 19 F. Supp. 2d 966 (W.D. Mo. 1998)* , *vacated, remanded, mot. denied, 188 F.3d 1031 (8th Cir. 1999)* .

(n114)Footnote 112. Restatement, Judgments 2d § 22 (1982). *See also Circle v. Jim Walter Homes, 654 F.2d 688 (10th Cir. 1981)* .

(n115)Footnote 113. *See, e.g., Circle v. Jim Walter Homes, 654 F.2d 688 (10th Cir. 1981)* (citing cases); *Andrews v. Reidy, 60 P.2d 832 (Cal. 1936)* ; *Madden v. Harlandale Bank, 574 S.W.2d 590* (Tex. Ct. App. 1978 writ ref'd n.r.e.) . *See generally* Annot., 98 A.L.R. 1027 (1935) . Some authority to the contrary does exist, but much of it seems questionable in light of its age, later case law, or special circumstances. *See Flint v. Kimbrough, 45 N.M. 342, 115 P.2d 84 (N.M. 1941)* (court in the underlying foreclosure action had not obtained personal jurisdiction over the borrower); *Murphy v. Fidelity Inv. Co., 161 Okla. 48, 17 P.2d 472 (1932)* ; *Weaver v. White, 164 S.W.2d 48 (Tex. Civ. App. 1942)* (questionable authority after *Madden v. Harlandale Bank, 574 S.W.2d 590* (Tex. Ct. App. 1978 writ ref'd n.r.e.)) ; *McDonald v. Smith, 53 Vt. 33 (1880) . But see Fielder v. Credit Acceptance Corp., 10 F. Supp. 2d 1101 , partial summ. judgment granted, in part, partial summ. judgment denied, in part, 19 F. Supp. 2d 966 (W.D. Mo. 1998)* , *vacated, remanded, mot. denied, 188 F.3d 1031 (8th Cir. 1999)* (res judicata did not bar consumers' affirmative attack because issue of excessive post-maturity interest charges and official fees was not raised in the prior state court proceedings).

(n116)Footnote 114. *See Henson v. Columbus Bank & Trust Co., 770 F.2d 1566 (11th Cir. 1985)* (state court usury decision based solely on statute of limitations does not subsequently bar federal court's consideration of merits of the same usury claim).

(n117)Footnote 115. *See Alston v. Goodwin, 343 P.2d 993 (Cal. Ct. App. 1959)* ; *Yager v. Rubymar Corp., 216 N.Y.S.2d 577 (Sup. Ct. Spec. Term 1961)* (interpreting New Jersey law). *See also Heine v. Albin Gustafson Co., 118 Misc. 2d 593, 461 N.Y.S.2d 934 (Sup. Ct. 1983) . Cf. Sunbelt Sav., FSB. v. Barr, 824 S.W.2d 600 (Tex. Ct. App. 1991)* (a note and a guaranty are separate transactions; prior suit against individual in his capacity as guarantor was not res judicata as to suit against him as a partner on the partnership's note).

(n118)Footnote 116. *See Yager v. Rubymar Corp., 216 N.Y.S.2d 577 (Sup. Ct. Spec. Term 1961)* (interpreting New Jersey law).

(n119)Footnote 117. *See, e.g., Scott v. Forest Lake Chrysler-Plymouth Dodge, 637 N.W.2d 587 (Minn. Ct. App. 2002)* (two year statute for penalty applies to MVRISA claim); *Trapp v. Hancuh, 1997 Minn. App. LEXIS 779* (Minn. Ct. App. July 15, 1997) (unpublished, citation limited) (two year statute for actions upon a statute for a penalty applies). *But see Beltz v. Dings, 27 Kan. App. 2d 507, 6 P.3d 424 (2000)* (cause of action for usury accrues with each payment made on a continuing contract). *But see Miller v. Pac. Shore Funding, 92 Fed. Appx. 933, 2004 U.S. App. LEXIS 1270* (4th Cir. Jan. 28, 2004) (table) (statute of limitations for challenge to closing costs runs from day of closing because they are legally enforceable then, even if they are financed).

(n120)Footnote 118. *See, e.g., Matter of Ferris, 42 B.R. 374 (S.D. Ga 1984) , rev'd on other grounds, 764 F.2d 1475 (11th Cir. 1985)* ($16.56 overcharge was not *de minimis*); *Georgia Inv. Corp. v. Norman, 231 Ga. 821, 204 S.E.2d 740 (1974)* ($1.00 notary fee not *de minimis*); *In re Swartz, 37 B.R. 776 (Bankr. D.R.I. 1984)* ; *Dickey v. Bank of Clarksdale, 183 Miss. 748, 184 So. 314 (1938)* (overcharges between $0.50 and $1).

(n121)Footnote 119. The *de minimis* defense has regularly been recognized in Texas in cases of small overcharges. *Compare Ceco Corp. v. Steve's Sash & Door Co., 714 S.W.2d 322 (Tex. Ct. App. 1986)* ($245.69 was not *de minimis* on total contract price of $71,702.95), *with Yates Ford v. Ramierez, 692 S.W.2d 51 (Tex. 1985)* ; *Cf. In re Cadillac*

Wildwood Dev. Corp., 138 B.R. 854 (Bankr. W.D. Mich. 1992) ($3 overcharge on closing costs was "mistake of fact" needing correction, but was not a usurious overcharge). *See also Buendia v. Advanta Mortgage Corp.-USA, 2003 Tex. App. LEXIS 7136* (Tex. App. Aug. 21, 2003) (unpublished) ($2.36 overcharge is *de minimus*). *Cf. Clean Harbors, Inc. v. John Hancock Life Ins. Co., 833 N.E.2d 611* (Mass. App. Ct.) (failure to notify attorney general of rate until the afternoon when loans funded in the morning, although a violation of the statute, will not support a finding of usury).

(n122)Footnote 120. *See, e.g., Cohen v. District of Columbia Nat'l Bank, 382 F. Supp. 270 (D.D.C. 1974)* (custom of ignoring declining balance in interest calculation); *Perlman v. First Nat'l Bank of Chicago, 15 Ill. App. 3d 784, 305 N.E.2d 236 (Ill. App. Ct. 1973)* , *appeal dismissed, 331 N.E.2d 65 (Ill. 1975)* (360-day year); *Beneficial Fin. Co. v. Administrator of Loan Laws, 260 Md. 430, 272 A.2d 649 (1971)* (alleged custom of correcting errors discovered in lender's books without imposing penalty); *Dickey v. Bank of Clarksdale, 183 Miss. 748, 184 So. 314 (1938)* (custom of imposing service charge on small loans); *Cowgill v. Jones, 99 Mo. App. 390, 73 S.W. 995 (Mo. Ct. App. 1903)* (sales commissions); *Kollman v. Hunnicutt, 385 S.W.2d 600 (Tex. Civ. App. Fort Worth 1964)* (car dealer floor plan financing); *Harmon v. Lehmann, 85 Ala. 379, 5 So. 197 (1888)* (sales commission). *See also Barclay Kitchen, Inc. v. California Bank, 25 Cal. Rptr. 383 (2d Dist. 1962)* (bank deposits).

(n123)Footnote 121. *See, e.g., Jersey Palm-Gross, Inc. v. Paper, 658 So. 2d 531 (Fla. 1995)* . Court rejected use of savings clause as absolute bar to usury claim; rather, it is one factor to be considered in overall determination of creditor's intent. Other factors listed as illustrative: how narrow the margin; whether it is a complex transaction in which a mathematical error was made; whether the usury was contingent; and lender's knowledge of the urgency of borrower's need. The finding of usury was upheld. *See also Mims v. Fid. Funding, Inc., 307 B.R. 849 (N.D. Tex. 2002)* (savings clause did not save contract that was usurious on its face; hypothetical possibility that conditions for charging usurious fees would not occur did not make savings clause effective). *See, e.g., Rieser v. Todd (In re Chari), 2005 Bankr. LEXIS 2895* (Bankr. S.D. Ohio Sept. 2, 2005) (giving no effect of savings clause where transaction was usurious on its face). *Cf. Lieberman v. Emigrant Mortg. Co., 436 F. Supp. 2d 357 (D. Conn. 2006)* (existence of savings clause gives borrower a contract remedy for refund of unconscionable interest).

(n124)Footnote 122. *See Duderwicz v. Sweetwater Sav. Ass'n, 595 F.2d 1008 (5th Cir. 1979)* (cancellation of usurious escrow account); *Kissell Co. v. Gressley, 591 F.2d 47 (9th Cir. 1979)* (acceleration due to lender's misconduct; savings clause given no effect); *Armstrong v. Steppes Apts. Ltd., 57 S.W.3d 37 (Tex. App. 2001)* , *cert. denied, 536 U.S. 951, 122 S. Ct. 2645, 153 L. Ed. 2d 823 (2002)* .

(n125)Footnote 123. *See, e.g., Vickers v. Interstate Dodge, 882 So. 2d 1236, 1244 (La. App. 2004)* (creditor cannot complain of penalty for technical violation when it failed to correct the error after receiving notice); *Scott v. Forest Lake Chrysler-Plymouth Dodge, 637 N.W.2d 587 (Minn. App. 2002)* .

(n126)Footnote 124. *Tex. Fin. Code Ann. § 305.103(a). See In re CPDC, Inc., 337 F.3d 436 (5th Cir. 2003)* (sixty days run from lender's subjective discovery that lender has violated usury prohibition); *Strasburger Enterprises, Inc. v. TDGT Ltd. P'ship, 110 S.W.3d 566 (Tex. App. 2003)* (no defense when complaint that did not seek usurious interest was delivered to debtor only after creditor received usury notice). *See Sotelo v. Interstate Fin. Corp., 224 S.W.3d 517 (Tex. App. 2007)* (lender has 60 days after notice to correct the usury; notice sent while suit was abated is treated same as pre-suit notice).

(n127)Footnote 125. *Anderson v. Chainani (In re Kemper), 263 B.R. 773 (Bankr. E.D. Tex. 2001)* .

(n128)Footnote 126. *Anderson v. Chainani (In re Kemper), 263 B.R. 773 (Bankr. E.D. Tex. 2001) . See also Pagel v. Whatley, 82 S.W.3d 571 (Tex. App. 2002)* (attachment to complaint acknowledging possibility of usury violation was sufficient where debtor first raised usury issue after receiving complaint).

(n129)Footnote 127. *Tex. Fin. Code Ann. § 305.006(c). See also Ohio Rev. Code Ann. § 1317.08* (similar provision allowing refund within 10 days after receiving notice).

(n130)Footnote 128. *Anderson v. Chainani (In re Kemper), 263 B.R. 773 (Bankr. E.D. Tex. 2001)* .

(n131)Footnote 129. *Scott v. Forest Lake Chrysler-Plymouth Dodge, 637 N.W.2d 587 (Minn. Ct. App. 2002)* .

(n132)Footnote 129.1. *Rieser v. Todd (In re Chari), 2005 Bankr. LEXIS 2895* (Bankr. S.D. Ohio Sept. 2, 2005) .

(n133)Footnote 130. National Consumer Law Center, Consumer Arbitration Agreements (5th ed. 2007), examines the enforceability of such agreements in detail.

(n134)Footnote 131. *9 U.S.C. § 1.*

(n135)Footnote 132. *Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 116 S. Ct. 1652, 134 L. Ed. 2d 902 (1996)* ; *Perry v. Thomas, 482 U.S. 483, 107 S. Ct. 2520, 96 L. Ed. 2d 426 (1987)* .

(n136)Footnote 133. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 10.3 (3rd ed. and Supp.).

(n137)Footnote 134. *Alabama Catalog Sales v. Gloria Harris M.Q., Inc., 794 So. 2d 312 (Ala. 2000)* .

(n138)Footnote 135. *Party Yards, Inc. v. Templeton, 751 So. 2d 121 (Fla. Dist. Ct. App. 2000)* ; *FastFunding The Co., Inc. v. Betts, 758 So. 2d 1143 (Fla. Dist. Ct. App. 2000)* (payday lending case).

(n139)Footnote 136. *Alabama Catalog Sales v. Gloria Harris M.Q., Inc., 794 So. 2d 312 (Ala. 2000)* (payday lending); *FastFunding The Co., Inc. v. Betts, 758 So. 2d 1143 (Fla. Dist. Ct. App. 2000)* (payday lending case).

(n140)Footnote 137. Williams v. Showmethemoney, Inc., Clearinghouse No. 52,500 (Ark. Cir. Ct. Aug. 26, 1999) (payday lending case), *aff'd on other grounds, 27 S.W.3d 361 (Ark. 2000)* ; *Party Yards, Inc. v. Templeton, 751 So. 2d 121 (Fla. Dist. Ct. App. 2000)* .

(n141)Footnote 138. *Burden v. Check Into Cash of Ky., LLC, 267 F.3d 483 (6th Cir. 2001)* , *cert. denied, 535 U.S. 970, 122 S. Ct. 1436, 152 L. Ed. 2d 380 (2002)* .

(n142)Footnote 139. *Burden v. Check Into Cash of Ky., LLC, 267 F.3d 483 (6th Cir. 2001)* , *cert. denied, 535 U.S. 970, 122 S. Ct. 1436, 152 L. Ed. 2d 380 (2002)* .

(n143)Footnote 140. *See Sphere Drake Ins. v. All Am. Ins. Co., 256 F.3d 587 (7th Cir. 2001)* (holding that, if a contract is void and wholly unenforceable, an arbitration clause within that contract will not be enforced; if a contract is merely voidable, such as a contract induced by fraud, the arbitration clause will be enforced), *rev'd, 307 F.3d 617 (7th Cir. 2002)* , *cert. denied, 538 U.S. 961, 123 S. Ct. 1754, 155 L. Ed. 2d 512 (2003)* ; *Haga v. Martin Homes, Inc., 1999 Ohio App. LEXIS 1740* (Ohio Ct. App. Apr. 19, 1999) . *Cf. In re FirstMerit Bank, 52 S.W.3d 749 (Tex. 2001)* (that the consumer has revoked acceptance of a purchase does not void the arbitration agreement; revocation of acceptance does not automatically void a sales agreement).

(n144)Footnote 141. *Bess v. Check Express, 2002 U.S. App. LEXIS 12118* (11th Cir. June 19, 2002) ; *Burden v. Check Into Cash of Ky., LLC, 267 F.3d 483 (6th Cir. 2001)* ; *Conner v. Instant Cash Advance, 2003 U.S. Dist. LEXIS 2583* (S.D. Ind. Feb. 20, 2003) ; *Buckeye Check Cashing, Inc. v. Cardegna, 824 So. 2d 228 (Fla. Dist. Ct. App. 2002)* .

(n145)Footnote 142. *See Southern Metal Treating Co. v. Goodner, 271 Ala. 510 (1960)* ; *see also* National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges 9.2.4.5.2 (2d ed. and Supp.).

(n146)Footnote 143. *See Camaro Trading Co. v. Nissei Sangyo America, LTD., 577 So. 2d 1274 (Ala. 1991)* ; *Island House Developers v. AMAC Constr. Co., 686 So. 2d 1377 (Fla. Dist. Ct. App. 1997) . See also Ackel v. Ackel, 696 So. 2d 140 (La. Ct. App. 1997)* (whether contract is void as against public policy is not arbitrable), *writ denied, 703*

So. 2d 1310 (La. 1997) .

(n147)Footnote 144. Harris v. Montgomery Catalog Sales, Clearinghouse No. 52,505 (Ala. Cir. Ct. May 21, 1999) (payday lending).

(n148)Footnote 145. *Ex parte Payne, 741 So. 2d 398 (Ala. 1999)* .

(n149)Footnote 146. Cheatham v. Air Sys. Eng'g Co., Clearinghouse No. 51,969 (Cal. Super. Ct. Apr. 30, 1997).

(n150)Footnote 147. *See* National Consumer Law Center, Truth in Lending Ch. 6 (4th ed. 1999 and Supp.).

(n151)Footnote 148. *See Fluehmann v. Associates Fin. Servs., 2002 U.S. Dist. LEXIS 5755* (D. Mass. Mar. 29, 2002) ; *Large v. Conseco Fin. Servicing Corp., 167 F. Supp. 2d 203 (D.R.I. 2001)* , *aff'd, 292 F.3d 49 (1st Cir. 2002)* ; *Livingston v. Associates Fin., Inc., 2001 U.S. Dist. LEXIS 8678* (N.D. Ill. June 22, 2001) ; *Phillips v. Associates Home Equity Servs., 179 F. Supp. 2d 840 (N.D. Ill. 2001)* ; *Dorsey v. H.C.P. Sales, Inc., 46 F. Supp. 2d 804 (N.D. Ill. 1999)* .

(n152)Footnote 149. *See Fluehmann v. Associates Fin. Servs., 2002 U.S. Dist. LEXIS 5755* (D. Mass. Mar. 29, 2002) ; *Livingston v. Associates Fin., Inc., 2001 U.S. Dist. LEXIS 8678* (N.D. Ill. June 22, 2001) ; *Dorsey v. H.C.P. Sales, Inc., 46 F. Supp. 2d 804 (N.D. Ill. 1999)* .

(n153)Footnote 150. *Sweet Dreams Unlimited, Inc. v. Dial-a-Mattress Int'l, Ltd., 1 F.3d 639 (7th Cir. 1993)* .

(n154)Footnote 151. *AT&T Technologies, Inc. v. Communications Workers of Am., 475 U.S. 643, 648, 106 S. Ct. 1415, 1418, 89 L. Ed. 2d 648 (1986)* .

(n155)Footnote 152. *See Fleetwood Enters. v. Gaskamp, 2002 U.S. App. LEXIS 933* (5th Cir. Jan. 24, 2002) , *reh'g, en banc, denied, supplemented, remanded, 303 F.3d 570 (5th Cir. 2002)* ; *Oakwood Mobile Homes, Inc. v. Godsey, 824 So. 2d 713 (Ala. 2001)* ; *Equifirst Corp. v. Ware, 808 So. 2d 1 (Ala. 2001)* ; *Med Ctr. Cars, Inc. v. Smith, 727 So. 2d 9 (Ala. 1998)* ; *Ex parte Dickinson, 711 So. 2d 984 (Ala. 1998)* , *reh'g overruled, 1998 Ala. LEXIS 96* (Ala. Mar. 20, 1998) , *ops. combined at 711 So. 2d 984 (Ala. 1998)* ; *Pacheco v. Allen, 55 P.3d 141 (Colo. Ct. App. 2001)* , *cert. granted, 2002 Colo. LEXIS 839* (Colo. Sept. 23, 2002) ; *see also Kaplan v. First Options, 19 F.3d 1503 (3d Cir. 1994)* , *aff'd, 514 U.S. 938, 115 S. Ct. 1920, 131 L. Ed. 2d 985 (1995)* ; *Liberty Communications, Inc. v. MCI Telecommunications Corp., 733 So. 2d 571 (Fla. Dist. Ct. App. 1999)* (individual signed in corporate capacity and thus clause not binding on individual).

(n156)Footnote 153. *EEOC v. Waffle House, Inc., 534 U.S. 279, 122 S. Ct. 754, 151 L. Ed. 2d 755 (2002)* .

(n157)Footnote 154. *EEOC v. Waffle House, Inc., 534 U.S. 279, 122 S. Ct. 754, 151 L. Ed. 2d 755 (2002)* .

(n158)Footnote 155. *Ballard Servs. v. Conner, 807 So. 2d 519 (Ala. 2001)* ; *Colonial Sales-Lease-Rental, Inc. v. Target Auction & Land Co., 735 So. 2d 1161 (Ala. 1999)* ; *Westendorf v. Gateway 2000, Inc., 2000 Del. Ch. LEXIS 54* (Del. Ch. Mar. 16, 2000) , *aff'd, 763 A.2d 92 (Del. 2000)* ; *Terminix Int'l Co., LP v. Ponzio, 693 So. 2d 104 (Fla. Dist. Ct. App. 1997)* ; *In re FirstMerit Bank, N.A., 52 S.W.3d 749 (Tex. 2001)* ; *Nationwide of Bryan v. Dyer, 969 S.W.2d 518 (Tex. App. 1998) . But see Kaplan v. First Options, 19 F.3d 1503 (3d Cir. 1994)* , *aff'd, 514 U.S. 938, 115 S. Ct. 1920, 131 L. Ed. 2d 985 (1995)* .

(n159)Footnote 156. *See, e.g., Fluehmann v. Associates Fin. Servs., 2002 U.S. Dist. LEXIS 5755* (D. Mass. Mar. 29, 2002) ; *Ballard Servs. v. Conner, 807 So. 2d 519 (Ala. 2001)* ; *In re FirstMerit Bank, N.A., 52 S.W.3d 749 (Tex. 2001)* .

(n160)Footnote 157. *Oakwood Mobile Homes, Inc. v. Godsey, 824 So. 2d 13 (Ala. 2001)* ; *Equifirst Corp. v. Ware, 808 So. 2d 1 (Ala. 2001)* .

(n161)Footnote 158. *Jim Burke Auto., Inc. v. McGrue, 826 So. 2d 122 (Ala. 2002)* ; *Monsanto Co. v. Benton Farm, 813 So. 2d 867 (Ala. 2001)* ; *Parkway Dodge, Inc. v. Yarbrough, 779 So. 2d 1205 (Ala. 2000)* .

(n162)Footnote 159. *See Choctaw Generation L.P. v. American Home Assurance Co., 271 F.3d 403 (2d Cir. 2001)* ; *MS Dealer Serv. Corp. v. Franklin, 177 F.3d 942 (11th Cir. 1999)* , *remanded with instructions to grant motion to compel arbitration, 1999 U.S. Dist. LEXIS 10662* (N.D. Ala. July 9, 1999) ; *Goodwin v. Ford Motor Credit Co., 970 F. Supp. 1007 (M.D. Ala. 1997)* (FMCC can enforce arbitration agreement found in dealership's installment sales agreements when FMCC is the intended and actual assignee); *Boyd v. Homes of Legend, 981 F. Supp. 1423 (M.D. Ala. 1997)* , *remanded on jurisdictional grounds, 188 F.3d 1294 (11th Cir. 1999)* ; *Roberson v. Money Tree, 954 F. Supp. 1519 (M.D. Ala. 1997)* (forced-placed insurer can benefit from arbitration provision); *Staples v. Money Tree, 936 F. Supp. 856 (M.D. Ala. 1996)* ; *Usina Costa Pinto S.A. Acucar E Alcool v. Louis Dreyfus Sugar Co., 933 F. Supp. 1170 (S.D.N.Y. 1996)* ; *Ex parte Napier, 723 So. 2d 49 (Ala. 1998)* ; *Ex parte Isbell, 708 So. 2d 571 (Ala. 1997)* ; *Nissan Motor Acceptance Corp. v. Ross, 703 So. 2d 324 (Ala. 1997)* (assignee steps into shoes of assignor); *Ex parte Gray, 686 So. 2d 250 (Ala. 1996)* (salesman can enforce arbitration agreement entered into by dealership employing the salesperson); *Ex parte Gates, 675 So. 2d 371 (Ala. 1996) . But see Boyd v. Homes of Legend, Inc., 981 F. Supp. 1423 (M.D. Ala. 1997)* (finding estoppel theory inapplicable to the facts of the case), *remanded on jurisdictional grounds, 188 F.3d 1294 (11th Cir. 1999)* ; *Knepp v. Credit Acceptance Corp. (In re Knepp), 229 B.R. 821 (Bankr. N.D. Ala. 1999)* .

(n163)Footnote 160. *Price Plaintiffs v. Humana Ins. Co. (In re Humana Inc. Managed Care Litig.), 285 F.3d 971 (11th Cir. 2002)* , *rev'd, remanded sub nom. PacifiCare Health Sys. v. Book, 538 U.S. 401, 123 S. Ct. 1531, 155 L. Ed. 2d 578 (2003)* ; *Choctaw Generation L.P. v. American Home Assurance Co., 271 F.3d 403 (2d Cir. 2001)* ; *MS Dealer Serv. Corp. v. Franklin, 177 F.3d 942 (11th Cir. 1999)* , *remanded with instructions to grant motion to compel arbitration, 1999 U.S. Dist. LEXIS 10662* (N.D. Ala. July 9, 1999) ; *Sunkist Soft Drinks v. Sunkist Growers, 10 F.3d 753 (11th Cir. 1993)* , *cert. denied, 513 U.S. 869, 115 S. Ct. 190, 130 L. Ed. 2d 123 (1994)* .

(n164)Footnote 161. *Hill v. GE Power Sys., 282 F.3d 343 (5th Cir. 2002)* .

(n165)Footnote 162. *Goodwin v. Ford Motor Credit Co., 970 F. Supp. 1007 (M.D. Ala. 1997)* ; *Universal Underwriters Life Ins. Co. v. Dutton, 736 So. 2d 564 (Ala. 1999)* ; *Nissan Motor Acceptance Corp. v. Ross, 703 So. 2d 324 (Ala. 1997) . Cf. Green Tree Fin. Corp. v. Channell, 825 So. 2d 90 (Ala. 2002)* (where assignee could not take advantage of arbitration clause in one document between consumer and dealer, it could still take advantage of arbitration clause found in the installment sales agreement).

(n166)Footnote 163. *Monsanto Co. v. Benton Farm, 813 So. 2d 867 (Ala. 2001)* ; *Ex parte Gray, 686 So. 2d 250 (Ala. 1996)* (salesman can enforce arbitration agreement entered into by dealership employing the salesperson).

(n167)Footnote 164. *Knepp v. Credit Acceptance Corp. (In re Knepp), 229 B.R. 821 (Bankr. N.D. Ala. 1999)* ; *Universal Underwriters Life Ins. Co. v. Dutton, 736 So. 2d 564 (Ala. 1999)* ; *First Family Fin. Servs. v. Rogers, 736 So. 2d 553 (Ala. 1999) . But see Staples v. Money Tree, 936 F. Supp. 856 (M.D. Ala. 1996)* ; *Ex parte Napier, 723 So. 2d 49 (Ala. 1998)* (seller of physical damage insurance on mobile home).

(n168)Footnote 165. *Ex parte Jones, 686 So. 2d 1166 (Ala. 1996) . But see Roberson v. Money Tree, 954 F. Supp. 1519 (M.D. Ala. 1997)* .

(n169)Footnote 166. *But see MS Dealer Serv. Corp. v. Franklin, 177 F.3d 942 (11th Cir. 1999)* (claims against service contract company are based on the contract containing arbitration clause and are based on interdependent misconduct between dealer signing contract and service contract company), *remanded with instructions to grant motion to compel arbitration, 1999 U.S. Dist. LEXIS 10662* (N.D. Ala. July 9, 1999) .

(n170)Footnote 167. *See, e.g., Mich. Comp. Laws § 566.302*; *Mich. Comp. Laws § 492.112(a)*.

(n171)Footnote 168. *Rugumbwa v. Betten Motor Sales, 136 F. Supp. 2d 729 (W.D. Mich. 2001)* .

(n172)Footnote 169. *See, e.g., Cal. Civ. Code § 2985.8* (leasing); *Kroupa v. Sunrise Ford, 77 Cal. App. 4th 835, 92 Cal. Rptr. 2d 42 (2d Dist. 1999)* , *review denied, request denied, 2000 Cal. LEXIS 1894 (Cal. 2000)* ; *Wash. Rev. Code § 63.14.040*; Commonwealth v. Metro Chrysler-Plymouth Jeep-Eagle, Inc., Clearinghouse No. 52,028 (Pa. Commw. Ct. 1997); *Kenworthy v. Bolin, 17 Wash. App. 650, 564 P.2d 835 (1977)* . *See also Ohio Rev. Code § 1317.02*. *But see Sharlow v. Wally McCarthy Pontiac-GMC Trucks-Hyundai, Inc., 2000 U.S. App. LEXIS 15627* (8th Cir. July 6, 2000) (unpublished, citation limited) (following *Scott*); *Scott v. Forest Lake Chrysler-Plymouth-Dodge, 611 N.W.2d 346 (Minn. 2000)* (contingency clause need not be included in retail installment contract despite single document rule), *appeal after remand, remanded, 637 N.W.2d 587 (Minn. Ct. App. 2002)* .

(n173)Footnote 170. *15 U.S.C. § 1012(b)*; *see also United States Dep't of Treasury v. Fabe, 508 U.S. 491, 113 S. Ct. 2202, 124 L. Ed. 2d 449 (1993)* .

(n174)Footnote 171. *See Standard Sec. Life Ins. Co. of N.Y. v. West, 267 F.3d 821, 823 (8th Cir. 2001)* (noting agreement of parties that FAA does not specifically relate to business of insurance); *American Bankers Ins. Co. v. Crawford, 757 So. 2d 1125 (Ala. 1999)* .

(n175)Footnote 172. *Standard Sec. Life Ins. Co. of N.Y. v. West, 267 F.3d 821 (8th Cir. 2001)* ; *Quackenbush v. Allstate Ins. Co., 121 F.3d 1372 (9th Cir. 1997)* (insurance statute prohibiting insurance liquidator from being compelled to arbitrate disputes prevails over FAA); *Stephens v. American Int'l Ins. Co., 66 F.3d 41 (2d Cir. 1995)* ; *Mutual Reinsurance Bureau v. Great Plains Mut. Ins. Co., 969 F.2d 931* (10th Cir.) , *cert. denied, 506 U.S. 1001, 113 S. Ct. 604, 121 L. Ed. 2d 540 (1992)* ; *Smith v. PacifiCare Behavioral Health of Cal., Inc., 93 Cal. App. 4th 139, 158, 161-62, 113 Cal. Rptr. 2d 140, 154, 156-57 (2d Dist. 2001)* , *cert. denied, 537 U.S. 818, 123 S. Ct. 92, 154 L. Ed. 2d 23 (2002)* ; *Balaban-Zilke v. Cigna Healthcare of Cal., Inc., 2003 Cal. App. Unpub. LEXIS 5198* (Cal. Ct. App. May 28, 2003) *cert. denied 540 U.S. 1110, 124 S. Ct. 1077, 157 L. Ed. 2d 897 (2004)* ; *Ciccarelli v. Blue Cross of Cal., 2003 Cal. App. Unpub. LEXIS 660* (Cal. Ct. App. Jan. 22, 2003) ; *Imbler v. PacifiCare of Cal., Inc., 103 Cal. App. 4th 567, 126 Cal. Rptr. 2d 715 (2002)* ; *Pagarigan v. Super. Ct., 102 Cal. App. 4th 1121, 126 Cal. Rptr. 2d 124 (2001)* .

(n176)Footnote 173. *Ala. Code § 8-1-41*. For the most recent Supreme Court discussion about whether a statute "regulates the 'business of insurance,' " see *UNUM Life Ins. Co. of Am. v. Ward, 526 U.S. 358, 119 S. Ct. 1380, 143 L. Ed. 2d 462 (1999)* .

(n177)Footnote 174. *American Bankers Ins. Co. v. Crawford, 757 So. 2d 1125 (Ala. 1999)* ; *see also Clayton v. Woodmen of the World Life Ins. Soc'y, 981 F. Supp. 1447 (M.D. Ala. 1997)* ; *Celtic Life Ins. Co. v. McLendon, 814 So. 2d 222 (Ala. 2001)* . *See also Triton Lines, Inc. v. S.S. Mut. Underwriting Ass'n, 707 F. Supp. 277, 279 (S.D. Tex. 1989)* (dealing with interrelationship of Texas insurance code and state UDAP statute); *Hart v. Orion Ins. Co., 453 F.2d 1358 (10th Cir. 1971)* ; *Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co., 408 F.2d 606 (2d Cir. 1969)* . *But see Knepp v. Credit Acceptance Corp. (In re Knepp), 229 B.R. 821 (Bankr. N.D. Ala. 1999)* .

(n178)Footnote 175. *Ark. Code Ann. § 16-108-201*; *Ga. Code Ann. § 9-9-1* (arbitration statute significantly different than the Uniform Arbitration Act); *Kan. Stat. Ann. § 5-401*; Mo. Stat. § 435.350; *Mont. Code Ann. § 27-5-111*; *Neb. Rev. Stat. § 25-2601*; Okla. Stat. Rev. tit 15, § 802.

(n179)Footnote 176. *Standard Sec. Life Ins. Co. v. West, 267 F.3d 821 (8th Cir. 2001)* ; *Mutual Reinsurance Bureau v. Great Plains Mut. Ins. Co., 969 F.2d 931* (10th Cir.) , *cert. denied, 506 U.S. 1001, 113 S. Ct. 604, 121 L. Ed. 2d 540 (1992)* ; *Friday v. Trinity Universal, 262 Kan. 347, 939 P.2d 869 (1997)* .

(n180)Footnote 177. *See Miller v. National Fid. Life Ins. Co., 588 F.2d 185 (5th Cir. 1979)* (no law in Georgia insurance code is impaired by the Federal Arbitration Act).

(n181)Footnote 178. *Humana Inc. v. Forsyth, 525 U.S. 299, 119 S. Ct. 710, 142 L. Ed. 2d 753 (1999)* .

(n182)Footnote 179. *Ark. Code Ann. § 16-108-201*; *Ga. Code Ann. § 9-9-1* (arbitration statute significantly different than the Uniform Arbitration Act); *Kan. Stat. Ann. § 5-401*; Mo. Stat. § 435.350; *Mont. Code Ann. § 27-5-111*; *Neb. Rev. Stat. § 25-2601*; Okla. Stat. Rev. tit 15, § 802.

(n183)Footnote 180. *Diskin v. J.P. Stevens & Co., 836 F.2d 47 (1st Cir. 1987)* ; *Coastal Indus., Inc. v. Automatic Steam Prods. Corp., 654 F.2d 375 (5th Cir. 1981)* ; *Supak & Sons Mfg. Co. v. Pervel Indus., Inc., 593 F.2d 135 (4th Cir. 1979)* ; *N&D Fashions, Inc. v. DHJ Indus., Inc., 548 F.2d 722 (8th Cir. 1976)* .

(n184)Footnote 181. *See, e.g., Hill v. Gateway 2000, Inc., 105 F.3d 1147 (7th Cir. 1997)* , *cert. denied, 522 U.S. 808, 118 S. Ct. 47, 139 L. Ed. 2d 13 (1997)* (arbitration agreement binding where consumer orders a product over the telephone, product can be returned within thirty days if not opened, and product arrives with an arbitration agreement included in the papers inside the box); *Marsh v. First USA Bank, N.A., 103 F. Supp. 2d 909 (N.D. Tex. 2000)* .

(n185)Footnote 182. *Badie v. Bank of Am., 67 Cal. App. 4th 779, 79 Cal. Rptr. 2d 273 (1998)* (finding that a "bill-stuffer"-imposed change in terms that takes away the right to a jury trial is fundamentally different from change in interest rate, late charges, or other card terms); *Union Planters Bank, N.A. v. Watson, 2000 Ala. LEXIS 546* (Ala. Dec. 15, 2000) , *reh'g granted, op. withdrawn, substituted op., 794 So. 2d 1094 (Ala. 2001)* (cited *Badie* approvingly; held (based on the agreement's language) that arbitration clause would apply only if the cardholders affirmatively manifested their consent by signing a card). The consumer's complaint and two trial briefs from *Badie* are included in hard copy and on a WordPerfect disk in National Consumer Law Center's Consumer Law Pleadings With Disk, Number One, Ch. 1 (1994). *See also* Hurley State Bank v. French, No. 97-C-1645-W (N.D. Ala. Sept. 10, 1997) (stuffer arbitration agreement is unenforceable); Navarro-Rice v. First USA Bank, Civ. No. 97009-06901 (Or. Cir. Ct. 1998) (arbitration agreement requiring cardholders to choose between arbitration and closing their accounts enjoined when mailed out to card holders after class action instituted); *Myers v. MBNA Am. & N. Am. Capitol Corp., 2001 U.S. Dist. LEXIS 11900* (D. Mont. Mar. 28, 2001) ; *Long v. Fidelity Water Sys., 2000 U.S. Dist. LEXIS 7827* (N.D. Cal. May 24, 2000)) .

(n186)Footnote 183. *See also Avedon Eng'g, Inc. v. Seatex, 126 F.3d 1279 (10th Cir. 1997)* (state law determines whether an unsigned statement requiring binding arbitration should be incorporated into the signed contract between the two parties); Hurley State Bank v. French, No. 97-C-1645-W (N.D. Ala. Sept. 10, 1997) (stuffer arbitration agreement is unenforceable); Navarro-Rice v. First USA Bank, Civ. No. 97009-06901 (Or. Cir. Ct. 1998) (arbitration agreement enjoined where mailed out to card holders after class action instituted requiring choice between arbitration and closing their accounts).

(n187)Footnote 184. *See* 1999 Del. Laws Ch. 15 (Apr. 9, 1999). *See also* 1999 Utah Laws Ch. 180 (defining a change and term and authorizing use of bill stuffers to change terms).

(n188)Footnote 185. *Blue Cross & Blue Shield v. Woodruff, 803 So. 2d 519 (Ala. 2001)* .

(n189)Footnote 186. *Kennedy v. Conseco Fin Corp., 2000 U.S. Dist. LEXIS 17704* (N.D. Ill. Nov. 29, 2000) .

(n190)Footnote 187. *182 F. Supp. 2d 902 (N.D. Cal. 2002)* , *aff'd in part, rev'd in part, 319 F.3d 1126 (9th Cir. 2003)* .

(n191)Footnote 188. *See, e.g., United Computer Sys., Inc. v. AT & T Corp., 298 F.3d 756 (9th Cir. 2002)* ; *Chappel v. Laboratory Corp. of Am., 232 F.3d 719, 724 (9th Cir. 2000)* ; *Barker v. Golf U.S.A., Inc., 154 F.3d 788, 793 (8th Cir. 1998)* ; *PPG Indus., Inc. v. Webster Auto Parts, Inc., 128 F.3d 103, 107 (2d Cir. 1997)* . The Seventh Circuit, however, has rejected the prejudice requirement for finding waiver, focusing entirely on the actions and intentions of the party against whom waiver is sought. *Grumhaus v. Comerica Sec., Inc., 223 F.3d 648, 652 (7th Cir. 2000)* ("the central question is whether the party against whom the waiver is to be found intended its selection and not whether either party would be prejudiced by the forum change.").

(n192)Footnote 189. *Worldsource Coil Coating, Inc. v. McGraw Constr. Co., Inc., 946 F.2d 473, 477 (6th Cir.*

1991) (applying Illinois law, and finding waiver of right to arbitrate based on moving party's filing of a state court action seeking preliminary and permanent injunctions and compensatory and punitive damages); *Palm Harbor Homes, Inc. v. Crawford, 689 So. 2d 3 (Ala. 1997)* (manufacturer waives right to arbitrate breach of warranty claims by substantially invoking litigation process); *Checksmart v. Morgan, 2003 Ohio 163 (Ct. App. 2003)* . *But see Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading, Inc., 252 F.3d 218, 229* (2d Cir.) , *cert. denied, 534 U.S. 1020, 122 S. Ct. 546, 151 L. Ed. 2d 423 (2001)* (finding no waiver when party filed suit eight days before commencing arbitration and no litigation activity took place beyond parties' initial assertion of claims); *Williams v. HealthAlliance Hosps., Inc., 158 F. Supp. 2d 156, 161 (D. Mass. 2001)* (finding no waiver when plaintiff sought arbitration before filing litigation complaint and complaint included arbitration request if agreement were found to be applicable).

(n193)Footnote 190. *Nicholson v. Labor Ready, Inc., 1997 U.S. Dist. LEXIS 23494 (N.D. Cal. 1997)* ; *Armendariz v. Foundation Health Psychare Servs., Inc., 24 Cal. 4th 83, 99 Cal. Rptr. 2d 745, 6 P.3d 669 (2000)* ; *Pinedo v. Premium Tobacco Stores, Inc., 85 Cal. App. 4th 774, 102 Cal. Rptr. 2d 435 (2d Dist. 2000)* (arbitration clause held to be unconscionable, in part because it only addressed claims that would normally be raised by employees and not employers); *Arnold v. United Cos. Lending Corp., 511 S.E.2d 854 (W. Va. 1998)* .

(n194)Footnote 191. *Bess v. Check Express, 294 F.3d 1298, 1301 (11th Cir. 2002)* (fact that lender may litigate while borrower must arbitrate does not by itself render clause unconscionable); *Harris v. Green Tree Fin. Corp, 183 F.3d 173 (3d Cir. 1999)* (inequality of bargaining power not reason enough to invalidate arbitration agreement); *Torrance v. Aames Funding Corp., 242 F. Supp. 2d 862 (D. Or. 2002)* (reserving foreclosure claims for court justified on the basis of business realities; clause struck down on other unconscionability grounds); *Pridgen v. Green Tree Fin. Servs. Corp., 88 F. Supp. 2d 655 (S.D. Miss. 2000)* ; *Goodwin v. Ford Motor Credit Co., 970 F. Supp. 1007 (M.D. Ala. 1997)* ; *Ex parte Perry, 744 So. 2d 859 (Ala. 1999)* ; *Green Tree Fin. Corp. v. Wampler, 749 So. 2d 409 (Ala. 1999)* ; *Green Tree Fin. Corp. v. Vintson, 753 So. 2d 497 (Ala. 1999)* ; *Pick v. Discover Fin. Servs., Inc., 2001 U.S. Dist. LEXIS 15777*, at *15-16 (D. Del. Sept. 28, 2001) ("mutuality is not a requirement of a valid arbitration clause, provided that the underlying contract is supported by consideration"); *Hale v. First USA Bank, N.A., 2001 U.S. Dist. LEXIS 8045* (S.D.N.Y June 12, 2001) ; *Conseco Fin. Servicing Corp. v. Wilder, 47 S.W.3d 335 (Ky. Ct. App. 2001)* ("there is no inherent reason to require that the parties have equal arbitration rights").

(n195)Footnote 192. *See Pitchford v. Oakwood Mobile Homes, Inc., 124 F. Supp. 2d 958 (W.D. Va. 2000)* . *But see Zawikowski v. Beneficial Nat'l Bank, 1999 U.S. Dist. LEXIS 514* (N.D. Ill. Jan. 7, 1999) (finding no problems as to non-mutuality because the consumer still has the right to invoke arbitration).

(n196)Footnote 193. *See* National Consumer Law Center, Consumer Arbitration Agreements (5th ed. 2007 and supp.).

(n197)Footnote 193.1. *Green Tree v. Bazzle, 539 U.S. 444 (2003)* .

(n198)Footnote 193.2. *See* National Consumer Law Center, Consumer Arbitration Agreements § 4.3.2 (5th ed. 2007 and supp.).

(n199)Footnote 193.3. *Id.*

(n200)Footnote 193.4. *Id.* § 9.6 (Supp.).

(n201)Footnote 193.5. *Id.*

(n202)Footnote 193.6. *Mastrobuono v. Shearson Lehman Hutton, 514 U.S. 52, 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995)* .

(n203)Footnote 193.7. The AAA rules are found at www.adr.org, the NAF rules at www.arbitration-forum.com, and the JAMS rules at http://JAMSadr.com. The AAA's Consumer Due Process Protocol, Principle 14 states that

punitive damages are available in an arbitration proceeding. On the other hand, NAF Rule 37B states that the award can not exceed the amount requested in the claim, thus apparently requiring a consumer seeking $11,000 in actual damages and $250,000 in punitive damages to list such amounts in the claim and to pay NAF a filing fee based on a $261,000 claim: quite expensive indeed.

(n204)Footnote 193.8. *See* National Consumer Law Center, Consumer Arbitration Agreements § 4.3.2.4 (5th ed. 2007 and supp.).

(n205)Footnote 193.9. *Id.*

(n206)Footnote 193.10. *Id.*

(n207)Footnote 193.11. National Consumer Law Center, Consumer Arbitration Agreements § 4.3 (5th ed. 2007 and supp.).

(n208)Footnote 194. These special defenses may be asserted by the RTC and the FSLIC as well as the FDIC. The Resolution Trust Corporation (RTC) is appointed receiver by the Office of Thrift Supervision created by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, *103 Stat. 183*. Among other things, FIRREA serves to clarify and amend certain sections of the Federal Deposit Insurance Act, which includes *12 U.S.C. § 1823(e)*. Section 1821(d)(a) of FIRREA provides that "[a]ny agreement which does not meet the requirements set forth in [section 1823(e)] shall not form the basis of, or substantially comprise, a claim against the receiver or the corporation." As a result of FIRREA, duties of the former Federal Savings and Loan Insurance Corporation (FSLIC) have been transferred either to the FDIC or Resolution Trust Corporation (RTC). Assignees of these agencies are also protected.

For a more extensive discussion, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses. § 10.7 (4th ed. 2009)

(n209)Footnote 195. *315 U.S. 447, 62 S. Ct. 676, 86 L. Ed. 956 (1942)* .

(n210)Footnote 196. *D'Oench* applies only to claims raised by borrowers, not depositors. *Fletcher Village Condo. Ass'n v. FDIC, 864 F. Supp. 259 (D. Mass. 1994)* . *D'Oench* also does not apply to agreements between the receiver and a party other than a borrower. *See, e.g., Maryland Nat'l Bank v. RTC, 895 F. Supp. 762 (D. Md. 1995)* .

(n211)Footnote 197. Federal Deposit Insurance Act of 1950, § 2(13)(e), *codified at 12 U.S.C. § 1823(e)*. Section 1823(e) is often referred to as a "codification" of the holding in *D'Oench*. It is not a codification, but requires a separate legal analysis. To the extent § 1823(e) is a codification, it merely codifies the positive duty of the FDIC to honor agreements between debtors and banks. There is no debate of § 1823(e) in its legislative history. 96 Cong. Rec. 10, 731-32 (1950).

(n212)Footnote 198. The fact that a lawsuit was initiated against the bank before its failure and that pleadings would have been part of the bank's records is insufficient to circumvent *D'Oench*. It is not enough that bank records give notice of a potential defense to the obligation. *Randolph v. RTC, 995 F.2d 611 (5th Cir. 1993)* (if pleadings qualified as bank records under *D'Oench,* regulators would have to speculate as to the outcome of pending lawsuits).

(n213)Footnote 199. *See, e.g., John v. RTC, 39 F.3d 773 (7th Cir. 1994)* (*D'Oench* not "limitless, per se guarantee of victory"); *E.I. DuPont de Nemours & Co. v. FDIC, 32 F.3d 592 (D.C. Cir. 1994)* , *reh'g denied, 45 F.3d 458 (D.C. Cir. 1995)* (only if disclosure could have made a difference does *D'Oench* "logically bar recovery for failure to disclose"). This trend has been helped along immeasurably by the Supreme Court's decision in *O'Melveny & Myers v. FDIC, 512 U.S. 79, 114 S. Ct. 2048, 129 L. Ed. 2d 67 (1994)* , which held that FIRREA is a comprehensive statute which does not provide for extension though federal common law. *See also Cinco Enters., Inc. v. Benso, 1999 Okla. LEXIS 93* (Okla. Sept. 28, 1999) (unpublished) (the court cited evidence that showed that it was the guarantor's and

bank's intention that the guaranty would cover only one note, and other evidence indicating that the guaranty was never relied on for antecedent debts); *FDIC v. Deglau, 207 F.3d 153 (3d Cir. 2000)* (suggesting that a conflict of interest defense, arising from the representation of an attorney to the original transaction who allegedly induced them to sign the guaranty, would not be barred by § 1823(e) because it is not the sort of issue that would be the subject of bank records). *But see Beal Bank, SSB v. Lucks, 791 A.2d 752 (Del. Ch. 2000)* (deferring issue to trial). *See EMC Mortg. Corp. v. Davis, 167 S.W.3d 406, 417 (Tex. App. 2005)* (where note ambiguous on its face, section 1823(e) did not bar consideration of additional documents to construe the note's balloon payment provision because those documents did not tend to diminish the mortgagee's interest in the note, but rather helped define that interest).

(n214)Footnote 200. Holder in due course is defined in *UCC § 3-302(a)(2)* as

> "the holder of an instrument [where] ...
>
> "(2) the holder took the instrument for value, (ii) in good faith, (iii) *without notice that the instrument is overdue or has been dishonored ...* (iv) *without notice that any party has a defense or claim in recoupment ...*"

(emphasis added).

(n215)Footnote 201. In *O'Melveny & Meyers v. FDIC, 512 U.S. 79, 114 S. Ct. 2048, 129 L. Ed. 2d 67 (1994)* , Justice Scalia roundly rejected the idea of a federal common law supplementing FIRREA and refused to displace state law merely because the FDIC was involved. The lower courts that have taken note of the *O'Melveny* decision have concluded that FIRREA implicitly excludes defenses based on federal common law which are not specifically mentioned in the statute. *See, e.g., Ledo Fin. Corp. v. Summers, 122 F.3d 825 (9th Cir. 1997)* (*D'Oench* doctrine not applicable in light of *O'Melveny*, but court declines to decide whether *D'Oench* overruled); *Murphy v. FDIC, 61 F.3d 34 (D.C. Cir. 1995)* ; *DiVall Insured Income Fund Ltd. P'ship v. Boatmen's First Nat'l Bank, 69 F.3d 1398 (8th Cir. 1995)* ; *Nashville Lodging Co. v. RTC, 59 F.2d 236 (D.C. Cir. 1995) . But see Young v. FDIC, 103 F.3d 1180* (4th Cir.) , *cert. denied, 522 U.S. 928, 118 S. Ct. 329, 139 L. Ed. 2d 255 (1997)* (*D'Oench* remains separate and independent ground for decision); *Rankin v. Toberoff, 1998 U.S. Dist. LEXIS 9714* (S.D.N.Y. June 30, 1998) (concluding that *D'Oench* survives *O'Melveny* in Second Circuit). *See also FDIC v. Deglau, 207 F.3d 153 (3d Cir. 2000)* (holding that *O'Melveny* overruled *D'Oench*); *DiMuzio v. RTC, 68 F.3d 777, 780 n.2 (3d Cir. 1995)* (suggesting that *D'Oench* may no longer exist as a separate bar to defenses).

(n216)Footnote 202. *See also Allied Elevator v. East Tex. State Bank, 965 F.2d 34 (5th Cir. 1992)* (*D'Oench* inapplicable to breach of contract claim for bank's failure to procure credit life insurance requested in writing on the note).

(n217)Footnote 203. *See § 6.08[5] supra.*

(n218)Footnote 204. *See, e.g., FSLIC v. Mackie, 962 F.2d 1144, 1151 (5th Cir. 1992)* ; *see also FDIC v. Aetna Casualty & Sur. Co., 947 F.2d 196 (6th Cir. 1991)* (*D'Oench* is inapplicable to insurance contracts which are conditional agreements and not negotiable instruments).

(n219)Footnote 205. *RTC v. Cook, 840 S.W.2d 42 (Tex. Ct. App. 1992)* .

(n220)Footnote 206. For a sampling of claims and defenses making inroads, see National Consumer Law Center, Cost of Credit § 10.7.5.

(n221)Footnote 207. *FDIC v. Blue Rock Shopping Ctr., 766 F.2d 744 (3d Cir. 1985)* (*D'Oench* and § 1823(e) do not protect the FDIC from the consequences of its own conduct). *Maryland Nat'l Bank v. RTC, 895 F. Supp. 762 (D. Md. 1995)* (RTC cannot use *D'Oench* to contest enforceability of settlement agreement between the plaintiff and itself);

Kuehl v. Numerica Fin. Corp., 1994 U.S. Dist. LEXIS 17259 (D.N.H. Nov. 23, 1994) (unpublished) (claim for misapplication of proceeds after FDIC stepped in is not barred); *Cadle Co. v. Wallach Concrete, Inc., 897 P.2d 1104 (N.M. 1995)* (claim based on FDIC's breach of duty of good faith and commercial reasonableness not barred).

(n222)Footnote 208. *28 U.S.C. §§ 2680*

(n223)Footnote 209. The U.S. Supreme Court in *United States v. Gaubert, 885 F.2d 1284 (5th Cir. 1989)* , and remanded, *499 U.S. 315, 111 S. Ct. 1267, 113 L. Ed. 2d 335 (1991)* , found that a discretionary function exception shields FHLBB decisions upon takeover. (It should be noted, however, that as Justice Scalia observed in *Gaubert*, the lack of a factual record in this case made it quite difficult to find that the particular activities involved were properly shielded by DFE immunity. Since the Court could do little more than speculate about the nature of the FHLBB's alleged negligent decision-making, a properly developed factual record could produce a different result.) *See also FDIC v. Healey, 991 F. Supp. 53 (D. Conn. 1998)* (finding that DFE immunity would bar any claims based upon an act or omission in the execution of FIRREA); *First Nat'l Ins. Co. of Am. v. FDIC, 977 F. Supp. 1060 (S.D. Cal. 1997)* .

(n224)Footnote 210. *12 U.S.C. § 1821(d)*. See *RTC v. Kolea, 866 F. Supp. 197 (E.D. Pa. 1994)* , for a good discussion of the case law in this area.

(n225)Footnote 211. Several courts have found that affirmative defenses are not subject to the claims process. *Bolduc v. Beal Bank, 167 F.3d 667 (1st Cir. 1999)* (borrower's challenge to foreclosure action not a FIRREA "claim" subject to exhaustion); *RTC v. Love, 36 F.3d 972 (10th Cir. 1994)* (defense to action for deficiency after foreclosure not "claim" or "action" as used in § 1821(d)(13)(D)); *National Union Fire Ins. Co. v. City Sav., F.S.B., 28 F.3d 376 (3d Cir. 1994)* (distinguishes between affirmative defense and counterclaim which would be barred).

(n226)Footnote 212. *Bailey v. Defenbaugh & Co., 513 F. Supp. 232 (N.D. Miss. 1981)* ; *Transamerica Fin. Corp. v. Superior Court, 158 Ariz. 115, 761 P.2d 1019 (1988)* , *rev'g 155 Ariz. 327, 746 P.2d 497 (Ct. App. 1987)* (consumer loan act voiding usurious loans implied a right of action to seek that remedy). *But see Taylor v. Citizens Fed. Sav. & Loan, 846 F.2d 1320 (11th Cir. 1988)* (no private right of action to enforce FHLBB regulations promulgated pursuant to Home Owner's Loan Act of 1933, *12 U.S.C. § 1461*); *Doubet v. USA Fin. Servs., Inc., 714 F. Supp. 980 (C.D. Ill. 1987)* ; *Miller v. Pacific Shore Funding, 224 F. Supp. 2d 977 (D. Md. 2002)* (no private cause of action to enforce provision of licensing statute that limits lender's operations to certain locations); *Staley v. Americorp Credit Corp., 164 F. Supp. 2d 578 (D. Md. 2001)* (no private cause of action to enforce requirement that lender may operate only out of specific location); *Luckett v. Alpha Constr. & Dev., Inc., 2001 U.S. Dist. LEXIS 17623* (N.D. Ill. Oct. 22, 2001) (no private right of action under Ill. Residential Loan Act where there was no evidence of legislative intent to create private remedy and court found criminal penalty sufficient for enforcement). *See also Wombold v. Assocs. Fin. Servs. Co. of Mont., Inc., 104 P.3d 1080 (Mont. 2004)* (finding implied private right of action under Montana's Consumer Loan Act, since enacted to benefit borrowers); *Patchell v. Option One Mortgage Corp. (In re Patchell), 334 B.R. 492 (Bankr. D. Mass. 2005)* (loan may be avoided or rescinded, even though no civil penalties available).

(n227)Footnote 213. *See Lloyd Capital Corp. v. Pat Henchar, Inc., 544 N.Y.S.2d 178 (App. Div. 1989)* (violation of SBA regulations insufficient to render contract unenforceable), *aff'd, 603 N.E.2d 246 (N.Y. 1992) . See generally § 6.08[7][a][ii] infra*.

(n228)Footnote 214. 2B Singer, Sutherland Statutory Construction § 55.07 (5th ed. 1992).

(n229)Footnote 215. *Walker v. Peoples Fin. & Thrift Co., 46 Ariz. 224, 49 P.2d 1005 (Ariz. 1935)* ; *G. Nicotera Loan Corp. v. Gallagher, 115 Conn. 102, 160 A. 426 (1932)* ; *Hartsfield Co. v. Robertson, 48 Ga. App. 735, 173 S.E. 201 (Ga. Ct. App. 1934)* ; *Burque v. Brodeur, 85 N.H. 310, 158 A. 127 (1932)* .

(n230)Footnote 216. *Moore v. Comfed Sav. Bank, 908 F.2d 834 (11th Cir. 1990)* ; *Norris v. Sigler Daisy Corp., 392 S.E.2d 242 (Ga. 1990) . See also Schuran, Inc. v. Walnut Hill Assocs., 606 A.2d 885 (N.J. Super. Ct. 1991)* (criminal usury statute silent as to penalty; court held it made only excessive interest illegal, not contract, thus, court

severed illegal interest provision and permitted recovery of loan principal).

(n231)Footnote 217. *E.g., In re Vehm Eng'g Corp., 521 F.2d 186 (9th Cir. 1975)* ; *Speare v. Consolidated Assets Corp., 367 F.2d 208 (2d Cir. 1966)* ; *Patterson v. Green, 474 So. 2d 725 (Ala. Ct. App. 1985)* ; *Thomas Lakes Owners Assoc. v. Riley, 612 N.W.2d 529 (Neb. App. 2000)* (obligation to pay interest is void, and creditor cannot replace usurious interest with interest at legal rate); *Daenzer v. Wayland Ford, Inc., 193 F. Supp. 2d 1030 (W.D. Mich. 2002)* (finance charges void where seller does not give copy of contract to buyer at time buyer signs, but civil penalties under separate Motor Vehicle Sales Finance Act apply only if seller has sought prohibited charges); *Route 50 Auto Sales, Inc. v. Muncy, 771 N.E.2d 635 (Ill. App. Ct. 2002)* (credit seller whose contract did not include items required by MVRISA cannot recover interest, late charges, or repossession fees, but debt for principal is not void); *Thomas Lakes Owners Assoc. v. Riley, 612 N.W.2d 529 (Neb. Ct. App. 2000)* (obligation to pay interest is void, and creditor cannot replace usurious interest with interest at legal rate). *See also First Bus. Credit Co. v. Graboyes (In re Grayboyes), 2006 U.S. Dist. LEXIS 6671* (E.D. Pa. Feb. 22, 2006) (where interest capped by statute, interest reduced to statutory rate cap); *Walters v. PDI Mgmt. Servs., 2004 U.S. Dist. LEXIS 19570* (S.D. Ind. June 14, 2004) (same); *Van Carr Enters. v. Hamco, Inc., 2006 Ark. LEXIS 198* (Ark. Mar. 16, 2006) (loan void only as to unpaid interest); *Meklir v. J.C. Penney Co., 2005 Mich. App. LEXIS 1608* (Mich. Ct. App. July 5, 2005) (unpublished, citation limited) (loan void as to interest, late fees, and attorney fees); *Badalamento v. Blonde, 57 U.C.C. Rep. Serv. 2d (Callaghan) 186 (Mich. Ct. App. 2005)* (unpublished, citation limited) (interest void on loan).

(n232)Footnote 218. *Compare Cherry v. Berg, 508 S.W.2d 869 (Tex. Civ. App. 1974)* (usurious bonus designated by parties as interest), *with In re Vehm Eng'g Corp., 521 F.2d 186 (9th Cir. 1975)* (payments under usurious agreement, although denominated as interest, will be deemed payment on principal); *Baruch Inv. Co. v. Huntoon, 257 Cal. App. 2d 485, 65 Cal. Rptr. 131 (1967)* (no actual application to interest shown).

(n233)Footnote 219. *See, e.g., In re Vehm Eng'g Corp., 521 F.2d 186 (9th Cir. 1975)* (California law); *Speare v. Consolidated Assets Corp., 367 F.2d 208 (2d Cir. 1966)* (New Jersey law); *Westman v. Dye, 214 Cal. 28, 4 P.2d 134 (1931)* ; *Tauber v. Johnson, 8 Ill. App. 3d 789, 291 N.E.2d 180 (Ill. App. Ct. 1972)* (decision under MVRISA); *In re Castillian Apartments, Inc., 281 N.C. 709, 190 S.E.2d 161 (1972)* ; *Packer v. Wardwell, 88 Or. App. 236, 744 P.2d 1312 (Ct. App. 1987)* ; *In re Bogan, 281 F. Supp. 242 (W.D. Tenn. 1968)* (Tennessee law).

(n234)Footnote 220. *See, e.g.,* UCCC § 5.202(2) (1968 Model Code); *Edwards v. Alabama Farm Bureau Mut. Casualty Ins. Co., 509 So. 2d 232 (Ala. Civ. App. 1986) , cert. quashed, 509 So. 2d 241 (1987)* (loan by unlicensed lender voided under Alabama Mini-Code; borrower also entitled to refund of payments made). Some versions of the uniform small loan act have denied the creditor the right to "retain" payments, so a refund is obviously required. *See Young v. Barker, 185 Kan. 246, 342 P.2d 150 (1959)* (Kansas has since adopted a version of the UCCC). *See also Ganus v. Jopes, 470 So. 2d. 237 (La. Ct. App. 1985)* (statutory "forfeiture" required return of all interest payments); *Chandlee v. Tharp, 161 Miss. 623, 137 So. 540 (1931)* (usury ceiling is 8%; payment to principal recoverable if contract rate exceeds 20%); *Ferrari v. Howard, 2002 Ohio App. LEXIS 3632* (July 11, 2002) (unpublished) (interpreting former version of retail installment sales act; when violation was willful, consumer has no further obligation on the contract, need not return the collateral, and is entitled to refund of all payments). *See also Robertson v. Strickland (In re Robertson), 333 B.R. 894 (Bankr. M. D. Fla. 2005)* (under Florida law, entire principal obligation is voided); North Carolina *ex rel. Cooper v. NCCS Loans, Inc., 624 S.E.2d 371 (N.C. Ct. App. 2005)* (North Carolina law requires voiding usurious loan and return of all payments); *Malespin v. AB, 10 Misc. 3d 1057A (N.Y. Civ. Ct. 2005)* (under New York law, entire loan is void and borrower can "walk away" from the loan with no obligation and recover amounts paid).

(n235)Footnote 221. *Daenzer v. Wayland Ford, Inc., 210 F.R.D. 202 (W.D. Mich. 2002)* .

(n236)Footnote 222. *See Szerdahelyi v. Harris, 67 N.Y.2d 42, 499 N.Y.S.2d 650, 490 N.E.2d 517 (1986)* (voiding is neither penalty nor forfeiture).

(n237)Footnote 223. *See In re Harrington, 6 B.R. 655 (Bankr. D.R.I. 1980)* ; *Kuykendall v. Malernee, 516 P.2d*

558 (Okla. Ct. App. 1973) .

(n238)Footnote 224. *Ewell v. Daggs, 108 U.S. 143, 2 S. Ct. 408, 27 L. Ed. 682 (1883)* (interpreting Texas statute); *Wakefield v. Goldstein, 644 F.2d 707 (8th Cir. 1981)* (Arkansas law); *Chandlee v. Tharp, 161 Miss. 623, 137 So. 540 (1931)* .

(n239)Footnote 225. The precise distinction between the voluntary and involuntary payment of usury is far from obvious. It is apparently a question of fact. *See Conrad v. Home & Auto Loan Co., Inc., 53 A.D.2d 48, 385 N.Y.S.2d 979 (1976)* (remand for factual determination). *See also Thelen v. Ducharme, 151 Mich. App. 441, 390 N.W.2d 264 (Mich. Ct. App. 1986)* (payment by borrowers after judgment rendered against them is not voluntary payment which would waive usury); *Sienkiewicz v. Leonard Mortgage Co., 59 Mich. App. 154, 229 N.W.2d 352 (Mich. Ct. App. 1975)* (issue of voluntariness not properly raised).

(n240)Footnote 226. *See, e.g., Wakefield v. Goldstein, 644 F.2d 707 (8th Cir. 1981)* ; *Bizzoco v. Chintz, 193 Conn. 304, 476 A.2d 572 (1984)* ; *Waldorf v. Zinberg, 106 Mich. App. 159, 307 N.W.2d 749 (Mich Ct. App. 1981)* ; *Sienkiewicz v. Leonard Mortgage Co., 59 Mich. App. 154, 229 N.W.2d 352 (Mich Ct. App. 1975)* . Other courts have held that usury voluntarily paid is nevertheless recoverable. *See Kline v. Robinson, 428 P.2d 190 (Nev. 1967)* ; *Siefkes v. Clark Title Co., 215 N.W.2d 648 (S.D. 1974)* . It is frequently unclear whether the opinions addressing the recovery of usurious interest paid are based on statutory interpretation or on the common law as it stands in the relevant jurisdiction.

(n241)Footnote 227. *See Olsen v. Porter, 213 Mich. App. 25, 539 N.W.2d 523 (Mich Ct. App. 1995)* (Michigan law requiring prior interest paid be applied to principal applies only in defense to creditor's action to enforce usurious contract; creditor's action to reform the contract was not enforcement action, so remedy unavailable to borrowers). *Michigan Mobile Homeowners Ass'n v. Bank of Commonwealth, 56 Mich. App. 206, 223 N.W.2d 725 (Mich Ct. App. 1974)* (discussing former Michigan law). *Cf. Bank of Guam v. Demapan, 839 F.2d 1344 (9th Cir. 1988)* (where statute merely limits the amount of interest a lender can recover when suing on the contract and does not otherwise provide for voiding the contract or punishing the lender, court will not enforce the contract for the excess; but borrower cannot recover interest paid).

(n242)Footnote 228. *Couture v. G.W.M., Inc., 2002 WL 31962752* (N.H. Super. Ct. Dec. 3, 2002).

(n243)Footnote 229. *See Dennis v. Bradbury, 236 F. Supp. 683 (D. Colo. 1964)* , *aff'd, 368 F.2d 905 (10th Cir. 1966)* ; *Westman v. Dye, 214 Cal. 28, 4 P.2d 134 (1931)* ; *Commercial Credit Equip. Corp. v. West, 677 S.W.2d 669* (Tex. Ct. App. 1984 n.r.e.) (recovery extends to legal interest as well as usurious interest paid); *Flannery v. Bishop, 81 Wash. 2d 696, 504 P.2d 778 (1972)* . *But see Marker v. Pacific Mezzanine Fund, 309 F.3d 744 (10th Cir. 2002)* (provision for forfeiture of interest does not create right to recover interest already paid); *Anderson v. Chainani (In re Kemper), 263 B.R. 773, 781 n.15 (Bankr. E.D. Tex. 2001)* (noting Texas legislature's 1999 abolition of common law remedies for usury).

(n244)Footnote 230. *See, e.g., Skinner v. Cen-Pen Corp., 414 S.E.2d 824 (Va. 1992)* (Va. Code § 6.1-330.46 interpreted to allow recovery of twice all interest paid within limitations period); *Trapp v. Hancuh, 530 N.W.2d 879 (Minn. Ct. App. 1995)* (interpreting *Minn. Stat. § 334.011 subd.2* [small business/agricultural loans], providing for forfeiture of all interest plus recovery of twice interest actually paid); *Williams v. Seeley (In re Williams), 227 B.R. 83 (Bankr. E.D. Va. 1998)* (Virginia's secondary mortgage loan law provides for the recovery of the total amount of interest paid in excess of that permitted, plus twice the total amount of interest paid during the two years immediately preceding the filing of the action plus court costs and attorney fees); *Skinner v. Cen-Pen Corp., 243 Va. 279, 414 S.E.2d 824 (1992)* (Va. Code § 6.1-330.46 interpreted to allow recovery of twice all interest paid within limitations period).

(n245)Footnote 231. *Speare v. Consolidated Assets Corp., 367 F.2d 208 (2d Cir. 1966)* (applying New Jersey law); *Metcalf v. Bartrand, 491 P.2d 747 (Alaska 1971)* ; *Winnett v. Roberts, 179 Cal. App. 3d 909, 225 Cal. Rptr. 82 (1986)* (proper tender made; foreclosure sale set aside); *Feemster v. Schurkman, 291 So. 2d 622 (Fla. Dist. Ct. App.*

1974) . But see Williams v. Macchio, 69 Misc. 2d 94, 329 N.Y.S.2d 405 (Sup. Ct. 1972) (no tender necessary when usurious contract signed under duress).

(n246)Footnote 232. *See Kawauchi v. Tabata, 413 P.2d 221 (Haw. 1966)* (emphasizing the equities in this particular case); *Bohlinger v. American Credit Co., 594 S.W.2d 710 (Tenn. Ct. App. 1979) .*

(n247)Footnote 233. *Compare Barco Auto Leasing Corp. v. House, 202 Conn. 106, 520 A.2d 162 (1987)* (creditor which violated Retail Installment Sales Financing Act was not entitled to offset for fair rental value of automobile when buyer rescinds contract), *and Kuykendall v. Malernee, 516 P.2d 558 (Okla. Ct. App. 1973)* (payment for excise taxes and expenses on automobile not recoverable), *with Metcalf v. Bartrand, 491 P.2d 747 (Alaska 1971)* (tender must include amount paid for real estate tax); *Feemster v. Schurkman, 291 So. 2d 622 (Fla. Dist. Ct. App. 1974)* (lender can recover expenses related to prior lease and first mortgage).

(n248)Footnote 234. *See I.D.S. Homes Corp. v. Lucas, 228 Ga. 521, 186 S.E.2d 745 (1972)* (borrower must tender amount admittedly due; complete failure of consideration could obviate tender in proper case); *Bjornstad v. Perry, 92 Idaho 402, 443 P.2d 999 (1968)* (recovery by borrowers exceeds remaining principal due); *Pisano v. Rand, 30 A.D.2d 173, 291 N.Y.S.2d 82 (1968)* (mortgage was void).

(n249)Footnote 235. *See Turney v. Roberts, 255 Ark. 503, 501 S.W.2d 601 (1973)* ; *Beach Assocs., Inc. v. Fauser, 9 Mass. App. 386, 401 N.E.2d 858 (1980) . Cf. Clean Harbors, Inc. v. John Hancock Life Ins. Co., 833 N.E.2d 611 (Mass. App. Ct. 2005)* (Massachusetts law permits judge to fashion equitable remedies for usury). *See generally* Annot., *74 A.L.R.3d 1239 (1976)* (reformation of usurious contracts). Reformation due to fraud or misrepresentation of the borrower is similar to a creditor's defense of estoppel. *See § 6.08[5][c] supra.*

(n250)Footnote 235.1. *See Lieberman v. Emigrant Mortg. Co., 436 F. Supp. 2d 357, 365 (D. Conn. 2006) .*

(n251)Footnote 236. *See Bjornstad v. Perry, 92 Idaho 402, 443 P.2d 999 (1968)* (court cannot reform contract after action to enforce contract is brought and usury defense is raised); *Szerdahelyi v. Harris, 67 N.Y.2d 42, 499 N.Y.S.2d 650, 490 N.E.2d 517 (1986)* (loan is void despite tender of excess interest to borrower); *Matter of Dane's Estate, 390 N.Y.S.2d 249 (1976)* (cannot invoke equity when statute mandates penalty); *cf. Missouri-Kansas-Texas R.R. Co. v. Fiberglass Insulators, 707 S.W.2d 943 (Tex. Ct. App. 1986)* (in face of statute setting interest rate when contract states no specific rate, court cannot invoke equitable powers to grant lender a higher prejudgment rate on its recovery, and a demand for higher rate would be usurious; extensive discussion of Texas cases on point).

(n252)Footnote 237. *12 U.S.C. § 86.* For cases interpreting the Nat'l Bank Act remedies, see, e.g., *McCollum v. Hamilton Nat'l Bank, 303 U.S. 245, 58 S. Ct. 568, 82 L. Ed. 819 (1938)* ; *American Timber & Trading v. First Nat'l Bank of Ore., 690 F.2d 781 (9th Cir. 1982)* (subclass recovers double interest paid on usurious loans, but prejudgment interest denied); First Nat'l Bank in *Mena v. Nowlin, 509 F.2d 872 (8th Cir. 1975)* (state remedies preempted); *Bokum v. First Nat'l Bank, 740 P.2d 693 (N.M. 1987)* (National Bank Act claim disallowed where not filed within two years). For a discussion of usury preemption under the National Bank Act, see *§ 6.02[2] supra.*

(n253)Footnote 238. The remedy provisions are found at *12 U.S.C §§ 1463g*(b) (thrifts); 1785(g) (credit unions); 1813d (state banks). For a discussion of DIDA preemption, see *§ 6.02[4] supra.*

(n254)Footnote 239. Subtit. B of Title I, Riegle Community Development and Regulatory Improvement Act of 1994, (H.R. 3474) Pub. L. No. 103-325, *108 Stat. 2160* (Sept. 23, 1994). *See generally § 6.09 infra.*

(n255)Footnote 240. *18 U.S.C. §§ 1961 et seq.* The RICO Act is reprinted in Vol. 1B *infra.* For a detailed analysis of RICO, see *§ 4.07 supra.* Some states have adopted their own RICO statutes which may be even more favorable to consumers. *See In re Giorgio, 62 B.R. 853 (Bankr. D.R.I. 1986)* ("unlawful debt" is any debt which is unenforceable in whole or in part due to usury); *In re Marill Alarm Sys., Inc., 68 B.R. 399 (Bankr. S.D. Fla. 1986)* (usury in sham consulting fees triggers state RICO statute).

(n256)Footnote 241. *See 18 U.S.C. § 1964*.

(n257)Footnote 242. *18 U.S.C. § 1961(6). See U.S. v. Megale, 363 F. Supp. 2d 359, 364 (D. Conn. 2005)* (indictment that charged defendant with making a loan of $2,500 at a rate of $100 per week in interest sufficiently charged collection of an unlawful debt where allowable interest under state law would have been approximately $5.77 per week).

(n258)Footnote 243. *See Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 105 S. Ct. 3275, 3285, 87 L. Ed. 2d 346, 358-59 (1985)* . *See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 9.2.3.4 (5th ed. 2001 and Supp.) (detailed discussion of pattern).

(n259)Footnote 244. *See, e.g., Durante Bros. & Sons, Inc. v. Flushing Nat'l Bank, 755 F.2d 239* (2d Cir.) , *cert. denied, 473 U.S. 906, 105 S. Ct. 3530, 87 L. Ed. 2d 654 (1985)* , *on remand 652 F. Supp. 101 (E.D.N.Y. 1986)* (overruled as to "racketeering injury" requirement by implication of *Sedima, supra* note 233), *on remand, 652 F. Supp. 101 (E.D.N.Y. 1986)* .

(n260)Footnote 245. *Id.*

(n261)Footnote 246. *Id. at 239* .

(n262)Footnote 247. *Id. at 240* (quoting *18 U.S.C. § 3575(e)*).

(n263)Footnote 248. *Id. at 241* .

(n264)Footnote 249. *Id. at 242* . Predicate acts committed over just a few weeks or months would not satisfy closed-ended continuity, in such a case the plaintiff would have to show "open-ended" continuity to meet the continuity property of the pattern element.

(n265)Footnote 250. *Id. at 242* .

(n266)Footnote 251. *See American Nat'l Bank & Trust Co. of Chicago v. Haroco, Inc., 473 U.S. 606, 105 S. Ct. 3291, 87 L. Ed. 2d 437 (1985)* , *aff'g 747 F.2d 384 (7th Cir. 1984)* (fraudulent overcharging stated RICO claim); *Leff v. Olympic Fed. Sav. & Loan Ass'n, Case No. 86-3026, 1987 U.S. Dist. LEXIS 5589* (N.D. Ill. June 19, 1987) (RICO claim stated by mortgagor for alleged overcharge for tax and insurance escrow). *See also Dixon v. Ford Motor Credit Co., 2000 U.S. Dist. LEXIS 7934* (E.D. La. May 31, 2000) (unpublished), *aff'd without op., 252 F.3d 1356 (5th Cir. 2001)* , *cert. denied, 534 U.S. 952, 122 S. Ct. 349, 151 L. Ed. 2d 263 (2001)* (allegations that auto dealer failed to disclose commissions on credit life insurance sales could present predicate act of mail fraud sufficient to avoid dismissal of RICO claim). *See generally* National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges § 10.8.3.2 (2d ed. and Supp.). *But see Bellizan v. Easy Money of La., Inc., 2002 U.S. Dist. LEXIS 13419* (E.D. La. July 19, 2002) (because "overlapping" loans made by payday lender did not violate state laws prohibiting "rollover" or "renewal" loans, plaintiff failed to establish that defendant collected an unlawful debt); *Porter v. ACE Cash Express, Inc., 2000 U.S. Dist. LEXIS 15996* (E.D. La. Oct. 26, 2000) (because term of loans made to plaintiff exceeded those defined by state payday loan act by 5 days, they fell outside its interest limitations; since loans were not usurious under state law they did not meet RICO's definition of an unlawful debt, action dismissed), *aff'd, 277 F.3d 1372 (5th Cir. 2001)* (table). *See also Raceway Props., L.L.C. v. LSOF Carlsbad Land L.P., 157 Fed. Appx. 959, 964* (9th Cir. Oct. 31, 2005) (refusing to dismiss RICO claim based on alleged bait-and-switch lending scheme); *Beard v. Worldwide Mortg. Corp., 354 F. Supp. 2d 789, 800-08 (W.D. Tenn. 2005)* (denying motion to dismiss § 1962(c) claim against a title company and an attorney based on an alleged predatory lending scheme).

(n267)Footnote 252. *E.g., George A. Fuller Co. v. Carpet Servs., Inc., 823 S.W.2d 603, 604 (Tex. 1992)* ; *Sumrall v. Navistar Fin. Corp., 818 S.W.2d 548, 559 (Tex. Ct. App. 1991)* .

(n268)Footnote 253. *See, e.g., In re Marill Alarm Sys., Inc., 68 B.R. 399 (Bankr. S.D. Fla. 1986)* , *aff'd, 81 B.R. 119 (S.D. Fla. 1987)* (when sham "consulting fees" to third party were considered interest, actual interest rates paid were 74%-95%; resultant violation of criminal usury statute or criminal fraud statute constituted violation of Florida RICO statute).

(n269)Footnote 254. *Violette v. P.A. Days, Inc., 214 F.R.D. 207 (S.D. Ohio 2003)* (certifying class on claim that interest charge exceeded RISA limits); Car Now Acceptance Co. v. Block, No. 427973 (Ohio C.P. Nov. 25, 2002) (unpublished), *aff'd, 2003 Ohio 3964, 2003 Ohio App. LEXIS 3533* (Ct. App. July 14, 2003) ; *Tomlin v. Dylan Mortg. Inc., 2002 NCBC LEXIS 4* (N.C. Super. Ct. Feb. 1, 2002) (certifying class on usury claim).

(n270)Footnote 255. *See, e.g., Linder v. Thrifty Oil Co., 2 P.3d 27, 38 (Cal. 2000)* (class action challenging surcharge imposed on customers who paid with credit card).

(n271)Footnote 256. *Id.* (*quoting Vasquez v. Superior Court, 484 P.2d 964 (Cal. 1971))* .

(n272)Footnote 257. *See Fed. R. Civ. P. 23(c)(4)(A)*; 2 Newberg on Class Actions, §§ 9.53, 9.64 (3d ed. 1992).

(n273)Footnote 258. *See* National Consumer Law Center, Consumer Class Actions, § 9.5.2.6 (6th ed. 2006 and supp.).

(n274)Footnote 259. *See Washington Mut. Bank v. Superior Court, 15 P.3d 1071 (Cal. 2001) . See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 13.5.5 (7th ed. 2008 and supp.).

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PART I Consumer Credit
CHAPTER 6 The Cost of Credit

1-6 Consumer Credit Law Manual § 6.09

§ 6.09 Challenging Overreaching Credit: Common Law Claims and Other Relevant Statutes

[1] Statutes Relating to Real Estate Secured Credit

[a] RESPA

HUD published proposed changes to Regulation X on July 29, 2002. n1 These regulations would have disclosed yield spread premiums and important loan terms on good faith estimates and settlement statements beyond what is currently required. The forms would have also been streamlined in other ways. Further, HUD outlined a whole new shopping tool called a "Guaranteed Mortgage Package Agreement," designed to give shoppers in competitive markets the ability to obtain guaranteed quotes before significant fees attach. This agreement and a revamped settlement statement would have substituted the good faith estimate and the "normal" HUD-1, if lenders chose to offer this product. If so, HUD proposed that those lenders would be exempt from the anti-kickback provision of RESPA. These revisions were quite controversial. Industry objections and an FTC report evaluating the clarity of these suggested disclosures n2 likely were factors in the withdrawal of this proposal in March, 2004. n3 The regulations may be retooled and proposed again in the future.

The express purpose of the Real Estate Settlement Procedures Act (RESPA) n4 is to protect consumers from unnecessarily high settlement charges and certain abusive practices that have developed in the residential real estate industry.

While RESPA initially applied only to loans secured by a first lien on residential real property of one to four units, n5 in 1992 it was amended to include all such loans secured by subordinate liens as well. n6 In addition, RESPA's scope is limited to "federally related mortgage loans," which are defined as those made by federally-insured depository lenders (other than for temporary financing, such as a construction loan), HUD-related loans, loans intended to be sold on the secondary market to FNMA, GNMA or the Federal Home Loan Mortgage Corporation, or to creditors who make or invest more than $1 million a year in residentially secured loans. n7 Thus, most home equity loans, as well as refinancings and the like, are now subject to RESPA requirements. Mobile home purchase loans and construction loans are usually covered by RESPA. However, any loan secured by vacant land is excluded unless a structure or manufactured home will be constructed or placed on the real property using the loan proceeds within two years from the date of settlement. n8 Further, "[i]f a loan for a structure or manufactured home to be placed on vacant or unimproved property will be secured by a lien on that property, the transaction is covered. ..." n9

An exception to RESPA coverage that may prove troublesome is that which applies to secondary market transactions. n10 A bona fide secondary market transaction is one where a mortgage lender makes loans for its own portfolio and finances these loans from its own or borrowed funds. The lender will usually hold the loan for varying periods of time with the option of selling its loans on the open market. In contrast, a table-funded transaction, which is subject to RESPA, is one where the nominal "lender" is actually originating the loan for another entity whose money is used to fund the loan. The loan will be transferred within a relatively short period of time to the ultimate lender. HUD admonishes, though, that the substance, not the form, of the transaction should be reviewed. n11

Disputes about RESPA coverage under this exception usually cannot be resolved at the summary judgment stage. However, the Eighth Circuit recently did just that, dismissing the borrower's case. n12 The majority looked primarily at the source of the nominal lender's funding in making the loan, characterizing the monies as the lender's own. The dissent, however, pointed to prior agreements with Norwest under which such loans would be quickly transferred to a trust for Norwest, which would then wire funds to the nominal lender's bank which provided the alleged "line of credit." Given these facts, the dissent characterized the transaction as "a pure circumvention" of RESPA. n13

RESPA requirements begin to play a role early in the home mortgage process. No later than three business days after application, the consumer must be given a "good faith estimate" of settlement costs. n14 In November 2008, HUD released amendments to Regulation X, most of which are effective January 1, 2010, that significantly alter RESPA disclosure requirements. n14.1 The new rules, among other things, standardize the good faith estimates, limit increases on most fees, unless circumstances change, and revamp settlement statements. Under the new rules, the loan originator--defined to mean a broker or a lender n14.2--must issue a GFE to the borrower in the form prescribed by HUD within three days of application. This is the first time HUD has mandated that a specific form be used for the GFE. n14.3 Actual costs (not ranges) must be quoted. No fees may be charged, other than a credit report fee, before the application is provided. n14.4 The GFE is generally binding on lenders for ten business days. Of course, where the time between application and closing is less than three days, the RESPA statement may be just one more of the many papers presented at consummation to the borrower, who does not have the time to review and absorb the information. Even where disclosure is made in a timely fashion, it may not have meaning for some consumers. However, information in these disclosures still may prove useful long after closing of a covered transaction. For instance, it could aid practitioners in determining whether protection under the Home Ownership and Equity Protection Act of 1994 is triggered. n15 Also, equity-skimming generally would be easier to detect. n16 Typically, the settlement agent would be required to use a HUD-1 (or HUD-1A for refinancings and junior liens) settlement statement for this purpose. This form itemizes every charge associated with the transaction, such as points and all the usual closing costs, including real estate agents' and brokers' fees. n17 A review of the HUD-1 provided at settlement will reveal whether the estimate of the costs was at all close to the actual charges. If not, the consumer may have been baited with better terms then switched into a disadvantageous loan, thus raising fraud and UDAP claims. In addition to this settlement statement, a booklet explaining these costs must be given. n18 Also required, where a so-called "controlled business arrangement" is involved, is a statement disclosing the lender's relationship to any such required provider of settlement services; n19 and if an application is received by a mortgage broker who is not an exclusive agent of the lender, the broker also must provide a good faith estimate within three business days.

HUD has not issued any formal policy statements regarding the cost disclosures with the exception of the instructions accompanying Regulation X. n20 In 2000, one of HUD's assistant general counsels, responded to a list of questions and answers from the Massachusetts Bankers Association relating to disclosures on the HUD-1 form. This letter did not receive public attention until the Office of the Comptroller of the Currency circulated it to the chief executive officers of all of the national banks in the country. n21

One of HUD's most interesting revelations relates to whether the actual dollar amount of the commission earned by the settlement agent or closing attorney for issuing a title insurance policy must be disclosed on the HUD-1. HUD unequivocally states that the commission must be listed. n22 The agency goes further and opines that line 1107

(attorney fees) or, alternatively, line 1113 (blank) on the HUD-1 must show the amount of the commission and the services provided for that fee. (Note that if the services listed are compensated for elsewhere on the HUD-1, the commission may be an illegal kickback under RESPA.) n23

No remedies are specifically prescribed for a violation of this section, but failure to comply might be argued as a violation of a state unfair and deceptive acts and practices statute. n24

RESPA, in addition, contains provisions mandating servicers to tell consumers about the possibility that the mortgage loans which they sign may be transferred and when a transfer is imminent. n25 Importantly, the note holder or servicer cannot assess a late fee or treat a payment as late during the 60-day period after the servicing has been transferred if the consumer pays the old servicer before the due date. n26 This particular section of RESPA also places a substantive duty upon servicers to pay the taxes, insurance, and other escrowed monies to the appropriate recipients. There is a private right of action to enforce these provisions. n27 This section also contains a mechanism for consumers to obtain answers about their accounts and to obtain corrections to their accounts where appropriate. An individual consumer may recover actual damages, costs, and reasonable attorney's fees under this section. n28

RESPA also limits the amount of money a lender can require the borrower to deposit into an escrow account to pay "taxes, insurance premiums, or other charges with respect to the property." n29

Another important provision, which gets at the heart of the problem of undisclosed arrangements involving hidden fees for referral of borrowers, is the prohibition against kickbacks and unearned fees. n30 The private remedy for a violation of this provision is treble damages and attorney's fees.

[i] Prohibition Against Kickbacks and Unearned Fees

RESPA recognizes that disclosure alone is inadequate security against a sophisticated industry whose consumers tend to be inexperienced in complicated financial transactions, and can easily be overwhelmed by the mere volume of legalistic documents plunked down before them at closing. An even more important provision, which gets at the heart of the problem of undisclosed arrangements involving hidden fees for referral of borrowers, is the prohibition against kickbacks and unearned fees. n31 The private remedy for a violation of this provision is treble damages and attorneys fees.

Under RESPA, no person shall give and no person shall accept any fee, kickback, or other thing of value n32 pursuant to any oral or written agreement or understanding for the referral of a settlement service in the scope of loans described above. n33 Regulation X explicitly provides that the referral of settlement services is not compensable, thus making it a violation for a company to pay any other company or the employees of any other company for the referral of settlement services. n34 Furthermore, the regulation provides that there shall be no splitting of any charges made or received for the rendering of a settlement service in connection with a covered loan other than for services actually performed. n35 Examples of specific situations which do and not violate these rules can be found in Appendix B to Regulation X. One court held that a referral arrangement between a large-volume institutional seller of real property and a provider of escrow and title services did not violate RESPA based upon an "economies of scale" analysis. n36 These entities negotiated lower-than-normal rates that the title company would charge the seller for basic escrow services and for owner's title insurance. The court determined that there was little or no conclusive proof that the fees depended upon a certain volume of business, though it was clear that some volume of business was anticipated. More importantly for the court, however, was the lack of evidence that the discounts were "abnormally low," distinguishing an example described by HUD in Appendix B to Regulation X where HUD determined that RESPA was violated. The Ninth Circuit affirmed. n37

Many different types of referral arrangements, including lender-paid brokers fees, may violate the prohibitions of section 2607(a). For example, in *Kahrer v. Ameriquest Mortgage Co.,* n38 the court held that the class plaintiff

sufficiently pleaded a claim under section 2607(a) where a third-party creditor referred plaintiffs to lender for the purpose of refinancing her home. In exchange for the referral, lender promised the third-party creditor that it would condition the refinancing on the payment of the creditor from the proceeds of the loan. Plaintiff, however, did not allege that she was overcharged for the settlement services. After a lengthy discussion of the history and purpose of RESPA, the court determined that the plaintiff did not need to allege an overcharge to state a claim under section 2607(a).

A potential exemption from RESPA liability exists for referral fees or the splitting of charges: if the payment is for goods or services actually rendered, the fee is legal. n39 There is limited guidance in the statute and in Regulation X as to what this means, but it is clear that mere referrals are not compensable. n40 Regulation X does require that the payment bear a reasonable relationship to the market value of the goods furnished or services provided. n41 However, this leaves an opening for settlement service providers and others to create imaginary services merely to justify receipt of fees. n42 By the same token, prohibited payments may also be obtained for noncompensable services by billing consumers a blanket fee for eclectic tasks grouped under an ambiguous title such as "document preparation." n43 Other exceptions to the kickback and referral prohibitions include: payments to attorneys for services actually rendered or by a title company to its duly appointed agent for services actually performed in the issuance of a title insurance policy; n44 payments made pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers. n45

In addition, payments or fees split between "affiliated" businesses may be exempt from the section 2607 prohibitions if certain disclosures are made at specific times to the borrower, the entity making the referral has not required the use of the services from the affiliated business (there are some exceptions), and the only thing of value received from the arrangement, other than specified types of payments, is a return on the ownership or franchise interest. n46 HUD recently issued a policy statement regarding the standard to apply in determining whether lender-paid broker fees are legal. n47

[A] Lender-Paid Broker Fees

HUD estimates that mortgage brokers handle about half of all home mortgage loans, or about 3 million mortgages per year totaling $333 billion. n48

Lender kickbacks to brokers for bringing them business are often paid in one of two ways: by a "yield spread premium" or "volume-based compensation." A yield spread premium is a fee from a mortgage lender to a mortgage broker, paid when the broker arranges a consumer mortgage loan where the interest rate on the loan is inflated to an amount higher than the "par" rate to cover the cost of the fee. The par interest rate is the base rate at which the lender will make a loan to a borrower on a given day. Some lenders also compensate brokers based upon the volume of loans which brokers steer their way.

These payments to brokers can drive up the cost of mortgage loans and create reverse competition where brokers have incentives to steer borrowers to lenders that pay brokers the most rather than to lenders who give borrowers the most favorable terms. This problem is exacerbated for low-income borrowers (over 39% of all families below the federal poverty level own their homes) n49 because they have or perceive themselves to have fewer credit choices, and brokers often engage in steering with legal impunity.

Since the early 1990s, when lender payments to brokers began to surface, there have been numerous challenges to these payments as illegal kickbacks under RESPA. n50 The likelihood that the "premium" or "compensation" is a prohibited kickback is stronger the more the borrower pays directly to the broker. n51

[B] HUD Policy Statement on Lender-Paid Broker Fees

HUD recently published a much-anticipated policy statement dealing with the legality of lender-paid broker fees. n52

At the outset, HUD makes clear that it does not consider yield spread premiums to be *per se* legal or illegal.

The policy enunciates a two-part test for legality of fees. In determining whether a lender payment to a broker is permissible under RESPA, the first question is whether goods or services were actually performed or facilities were actually provided *for* the compensation paid. n53 The policy statement provides a list of compensable services normally performed in the origination of the loan. n54 Though the list is not dispositive, HUD will be generally satisfied that sufficient work was performed to justify compensation if a broker took information from the borrower, filled out an application, and then performed at least five additional items on the list. n55

Next, the analysis turns to whether the payments are reasonably related to the value of the goods, facilities, or services actually provided. In answering this question, HUD believes that the total compensation to the broker should be scrutinized. "Total compensation" includes direct fees paid by the borrower and indirect fees by the lender or other parties, including volume-based compensation. Further, the total of payments

> must be commensurate with the amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets. n56

If the fee bears no reasonable relationship to the market value of the goods, facilities, or services, the excess may be evidence of a referral or unearned fee. n57*64 Fed. Reg. 10,086* HUD defines "goods" to include appraisals, credit reports, and other documents. For the first time, however, the agency makes clear that the mortgage loan itself cannot be regarded as a "good." "Facilities" may encompass a reasonable portion of the broker's retail or store-front operation. n58

Separate from the issue of the legality of the fees, HUD urges, though does not require, clearer disclosures of lender-paid fees. The agency opines that, at a minimum, all fees to the mortgage broker (from whatever source) should be clearly labeled and properly estimated on the good faith estimate form. n59 Codes like "YSP POC" are inadequate. Instead, HUD suggests that lenders describe a yield spread payment in the following way: "Mortgage broker fee from lender to XYZ Corp. (P.O.C.)." Otherwise, one goal of RESPA, to make mortgage transactions understandable to the consumer, is undermined.

Although the HUD statement provides that percentage-based fees be included in the "total compensation," this prong of the analysis only arises if the compensation at issue was paid *for* the goods, facilities, or services provided.

The brokerage industry sees the HUD statement as affirming its position, i.e., that one simply adds up the value of the services, goods, and facilities provided on one side of the page and compares it to the total amount of compensation paid directly or indirectly to the broker from whatever source, on the other. n60 Using this method, lenders and brokers can try to avoid the more careful scrutiny that the statute requires.

Even under the industry interpretation, though, lender paid fees should be suspect for several reasons. First, advocates should review the services performed by the broker which must be itemized and clearly labeled on the Good Faith Estimate and HUD-1 Settlement Statement. n61 It is less likely that a broker can claim that fees are paid for services, goods, or facilities that are not properly disclosed to its customer.

Second, on the "value of the services provided" side of the equation, "value" should be measured in specific dollar amounts for each good, service, or facility provided. The reasonable value cannot include percentages of the loan amount because the value of a particular service would then be tied to the value of the loan, not the local market. n62

Third, advocates should compare several loans involving the same broker and lender. If the same services are provided in each transaction but the total compensation for each loan is a different dollar amount, the compensation received by the broker cannot be related to the reasonable value of the goods, services, or facilities actually provided. Instead, the

differences must be related to the value of the referral itself.

Fourth, if the lender-paid portion of the total compensation is always calculated as a percentage of the loan amount, regardless of the amount of the borrower-paid fees, it is likely that the total compensation is not reasonably related to the goods, services, or facilities actually provided. n63 Rather, the lender-paid portion must be related to the referral itself.

Fifth, fees and payments should be analyzed to see if the lender payment duplicates direct compensation paid by the borrower for the services actually rendered. n64 If so, then section 2607 has been violated.

Finally, volume-based compensation, by definition, is paid to a broker because of the number of loans that it refers to the lender. "Total compensation" must include any volume-based payment. One of two things should occur when the lender makes such a payment. If the volume-based payment results in a reduction of borrower-paid fees, the total may be reasonably related to the value of what the broker provided. However, if there is no corresponding reduction in the borrower-paid fees, the total compensation, by definition, will never be reasonably related to the value of the good, services, or facilities (because the volume-based payment will unreasonably inflate the total fees paid).

Though HUD hoped the Policy statement would clarify the law, it has instead fueled a judicial debate over its meaning. Several courts have used it to deny consumer motions for class certification and a few have granted summary judgment against the consumers on the merits. n65 One court has denied the lender's motion for summary judgment. n66

Following these court decisions, HUD's General Counsel released a letter dated December 17, 1999 responding about the Policy Statement. n67 HUD clearly and unequivocally repeated that, in the first instance, the broker services must have been performed *for* (*i.e.*, in exchange for) the yield spread premium.

In 2001, the Eleventh Circuit released a second decision in the *Culpepper* case, becoming the first appellate court to apply the 1999 HUD policy statement in determining whether a class should be certified in a case challenging the legality of the yield-spread premium payments. n68 The panel agreed that, in the first instance, the goods, services, or facilities must be performed or furnished *for* (*i.e.*, in exchange for) the lender-paid fee. In this case, the agreement between the lender and broker did not make payment of the premium contingent upon the performance of any services, and the payment was calculated in the same way on each loan (a percentage of the rate "upcharge"). Because services were not performed *for* the fee, there was no need to evaluate the value of the services in comparison to the amount of the fee, and the court affirmed the class certification.

This decision did not end the matter. The industry reacted strongly to *Culpepper II* and pushed HUD to step in and "clarify" its policy statement. n69 HUD accepted the invitation and issued its second policy statement on the subject on October 18, 2001. n70 The agency explicitly repudiated the decision in *Culpepper II*. n71 HUD articulated the standard thusly: the total compensation paid to the broker *from any source* (not just the lender-paid fee) must be for goods, services, or facilities. n72 Arguably, if the broker provided *any* goods, services, or facilities for *any* payment made or to be made to it, the first prong of the test is met. Of course, the broker will have done something in brokering each loan, so meeting the first prong may become *pro forma*. As far as class actions were concerned, HUD unequivocally opined that it is necessary to look at each transaction individually.

Several court decisions quickly endorsed the new HUD standard. n73 In one such case, *Glover v. Standard Federal Bank*, n74 the Eighth Circuit ruled that the 2001 HUD statement was controlling authority, entitled to deference, and reversed a grant of class certification. n75

Is the Eighth Circuit correct in its deference analysis? This court focused primarily on the substance of the policy, paying little or no attention to the procedural prerequisites necessary to trigger deference. A careful analysis of Supreme Court deference standards casts doubts on the both procedural and substantive viability of HUD's actions. n76 The 2001

statement was not ordered by Congress, nor did HUD follow the usual publication and comment procedure. Moreover, the statute is not ambiguous: section 2607(c) states that the payment to any person of bona fide salary or compensation or other payment *for* goods, services, or facilities actually provided is not prohibited. It seems that Congress intended that the payment at issue be in exchange for the services, a position adopted by the court in *Culpepper II*.

[C] Broker Kickback Practice Issues

Figuring out whether a yield spread premium has been paid to a broker can be tricky. While the premium must be disclosed on the second page of the HUD-1 settlement statement, the description can be quite cryptic. For example, some settlement statements will list "(P.O.C. ysp--$1,500)."

Under the new rules, n77 effective January 2010, yield spread premiums and other payments from lenders to brokers will be disclosed on HUD-1 Line 802 and GFE Line 2 as a "credit" to borrowers. Unfortunately, this disclosure does not appear clearer than the current practice of listing fees as "Y.S.P. P.O.C." In addition, by calling the yield spread premium a "credit," HUD assumes that the lender's payment to the broker necessarily provides borrowers with lower settlement or origination costs.

If nothing remotely like this appears on the settlement statement, the broker can be asked if it received such a payment prior to filing a case. The settlement officer can be approached to provide copies of the checks distributed at the settlement that may yield this information.

Advocates should expect lenders to immediately file motions to dismiss and for summary judgment. Consequently, the consumer's attorney should serve discovery demands as soon as possible. n78 Some courts have seemed unwilling to dismiss cases where there has been no opportunity for discovery given the speed at which the request for dismissal was filed and where factual development could prove crucial. n79

It is important to sue both the broker and the lender. While the lender may successfully eliminate itself from the case through a motion to dismiss or for summary judgment, the broker may not, since the borrower may have independent claims against the broker under other legal theories. In addition to alleging violations of RESPA, advocates should include breach of fiduciary duty, fraud, misrepresentation, RICO, TILA, and state UDAP and usury claims where appropriate.

In the past few years, more often than not, class certification has been denied in yield spread premium cases, though the tide has recently turned a bit. Courts have generally denied class status on the ground that the factual determination as to whether the fee bore any reasonable relationship to the value of the goods or services provided was suitable for trial only on an individual basis. n80 These courts, by and large, ignored the fact that, by definition, the amount of the fee at issue bore no relationship to the work performed, the fact that often the defendants could not even prove the threshold requirement, i.e., that the premium was paid *for* any good, facilities, or services, and the fact that the rates and premiums offered by the lenders were uniformly set on a daily basis.

The courts of late, however, have been more thoughtful in their approach to class certification. Classes have recently been approved on the ground that section 2607(c) requires the court to first assess whether the fee represented payment for goods, facilities, or services performed. n81 Only in the event that the fee was paid for goods, facilities, or services can the court reach the issue of its reasonableness. n82 In one case, the court held that consumers could prove on a class-wide basis that a broker did not furnish the legitimate goods or services required to earn the yield spread premium: the lender/broker loan correspondent agreement unequivocally stated that the broker would be compensated by the customer, not the lender, and while the level of service to the customer did not change, the yield spread premium increased as the interest rate increased. In addition, the lender calculated the fee based on the net asset value of the loan and the value of the servicing rights, not on the value of services performed. n83 In another case, the broker provided no goods to the lender as it never owned the loan in the first instance. Further, the size of the premium varied exclusively

according to the difference between the par interest rate and the rate at which the mortgage closed, without reference to the kind or degree of services performed. n84

Individual affirmative cases n85 or defenses to foreclosure continue to be viable avenues to attack this industry practice. The statute provides for damages of three times the amount of the illegal charge, attorney's fees, and costs. n86 The statutory damages may be sufficient to offset any alleged delinquency in a foreclosure proceeding.

[D] Steering by Seller to Title Insurance Company

As discussed previously, the payment of referral fees and the splitting of fees for the provision of settlement services are generally prohibited under RESPA. Congress went further in the context of steering that occurs between sellers of real property, particularly large development corporations, and title insurance companies. It specifically prohibited a seller of property to be purchased with the assistance of a covered mortgage loan from directly or indirectly requiring that the buyer purchase title insurance from a particular title company, regardless of whether any referral fees are paid. n87

"Requiring the use" of a particular title company to purchase the insurance is defined by Regulation X. n88 The general definition includes the

> situation in which a person must use a particular provider of a settlement service in order to have access to some distinct service or property, and the person will pay for the settlement service of the particular provider or will pay a charge attributable, in whole or in part, to the settlement service.

Excluded from this definition is the offering of a package, discounts, or rebates to consumers for the purchase of multiple settlement services so long as the package or discounts are optional to the purchaser. Sham discounts, e.g., a discount that is made up by higher costs elsewhere in the settlement process, will not meet this exemption. n89

Any seller who violates this prohibition is liable to the buyer in an amount equal to three times all charges made for such title insurance. n90 The measure of damages is three times the entire fee, not three times the amount by which the fee for the insurance issued by the required title company exceeds that available to the buyer from another source. Claims under section 2608 must be brought within one year from the date of the occurrence of the violation. n91 Though section 2608 does not specifically provide for the payment of attorney's fees and costs to the prevailing party, Regulation X makes a violation of section 2608 a *per se* violation of section 2607 (the anti-kickback section of RESPA). n92 Since section 2607 contains a fee-shifting provision, consumers can argue that fees are recoverable under section 2607. n93

Though there are no reported decisions regarding the merits of a section 2608 claim, one court recently granted class certification in a case where the seller development company inserted a clause in the agreement of sale authorizing the seller to place title insurance with a particular title insurance company whose name was or would be inserted into a blank in the clause. n94 The court had little trouble finding that the commonality requirement was met despite the defendants' claim that different oral representations were made to purchasers, and that some purchasers might have had the "blank" filled in with the name of a title company and others might not.

[E] Other Kickback Issues

[1] Loan Padding

Virtually every mortgage transaction involves an array of "settlement services" which have the potential to generate costs for the borrower. Those services include, but are not limited to, title services, preparation of closing documents, rendering of credit reports or appraisals, property surveys and inspections, in addition to real estate agent, loan broker and attorney services, loan origination, and processing. n95 Brokers, agents, and lenders play an especially powerful role because of their presence from beginning to end of the process. They have ample opportunity for financial abuse of

unwary and vulnerable customers who rely on their experience, judgment, and advice when making important decisions.

As mortgage brokers, and, in some areas, closing attorneys, have become major players in many of the seedier second mortgage scams, the prohibition against kickbacks and unearned fees may be of considerable benefit to consumers. Many of these scams involve "loan padding," where the loan includes excessive and sometimes exorbitant fees for a full array of closing services, many of which are unnecessary. Regulation X gives HUD the authority to investigate high cost loans to see if they are padded by kickbacks or referral fees. While "high prices standing alone are not proof of a RESPA violation," if there is no "reasonable relationship to the market value of the goods or services provided," the excess may be "unearned" and therefore a RESPA violation. n96 While articulated for HUD enforcement purposes, this test should serve equally well in private litigation.

[2] Fee Splitting

Fee splitting involves payment of charges to one party for referral of business to another, where the first party performs no other services justifying the fee; the fee is then split with the party to whom the business was referred. This practice is prohibited by RESPA section 2607 where at least two parties share in the benefit of a service charge, which is considered an unearned fee. n97

Where a charge is duplicative or unnecessary, but is not a kickback or split with another party, advocates can successfully mount an attack under the Truth in Lending Act if the fee is not included in the finance charge and is not authorized under Regulation Z n98 or through state UDAP statutes. n99 Motions to compel arbitration have reared their heads in the RESPA context. n100 One court ordered arbitration between not only the lender and borrower but also with the non-signatory broker where the borrower alleged that the misconduct by the lender and broker was "substantially interdependent and concerted." n101

[F] Potential Loopholes

There are at least three ways to be exempted from coverage by RESPA, and probably others as well. One possible loophole is that RESPA does not cover loans that are intended to be sold to creditors who make or invest less than $1 million per year in residentially secured loans. n102 As a result, unscrupulous brokers need only market and sell their loans to small-scale creditors who do not exceed the threshold and who may be just as unsuspecting and vulnerable as some consumers.

The second, regarding referral fees and the splitting of charges, is described in *§ 6.09[1][a][i][E][2] supra* .

The final exemption creating potential for abuse is for qualified computer loan origination ("CLO") services. n103 A CLO system is a computer system that (1) provides prospective borrowers with information about rates and terms of federally related mortgage loans; (2) collects, assembles, and transmits information about the borrower, the property, and other relevant information on a potential mortgage loan for evaluation by lenders; and (3) responds to the borrower with information such as loan terms, rates, and payment schedules for various loan products that would be available to the borrower. n104 Regulation X lists numerous criteria for qualified CLO services, and requires that certain disclosures be made. However, this is a fairly new development in the mortgage lending industry, and the effectiveness of the regulation in protecting consumers from further overreaching practices remains to be proven.

RESPA includes an express provision relating to the preemption of inconsistent state laws. n105 If the state law provides greater protections than RESPA, then the law is not preempted. n106 In one recent case, the denial of the lender's motion to dismiss a RESPA complaint raising issues of inflated settlement costs and fee-padding as violations of the state UDAP act and state common law torts, prompted the lender to request a writ of mandamus from an appellate court to vacate the trial court's decision. n107

[G] Electronic Provision of Information Required by RESPA

E-Sign, n108 effective October 1, 2000, allows lenders to replace written documents with electronic documents in certain circumstances. If a statute, regulation, or other rule of law requires that information relating to a transaction be provided to the consumer in writing, then the information may be provided electronically if:

- Certain disclosures are made to the consumer; n109

- The consumer consents electronically, or confirms his or her consent electronically, in a manner that reasonably indicates that he or she can access information electronically in the format used by the provider of the information; n110 and

- The electronic document is in a form that is capable of being retained and accurately reproduced for later reference by all parties or persons who are entitled to retain it. n111

These requirements apply whenever a lender wants to use an electronic document to replace a document that RESPA requires to be in writing. n112

Requirements in RESPA that information be provided in writing are overridden only if the lender complies with E-Sign's requirements. If the lender did not comply, then the consumer should be entitled to whatever penalty RESPA would provide if the information had not been provided. n113

[H] Implications for Practice

As the discussion indicates, of these highlighted provisions, n114 only one has specific statutory remedies. But the failure to comply with any provision may well fall within the scope of a state UDAP statute which applies to the credit transaction at issue. n115 For example, failure to give the required settlement statement which could have alerted a consumer to exorbitant closing costs or brokers fees in time to seek credit elsewhere could be considered either a *per se* UDAP violation, a violation of applicable law n116 or, more generally, a deceptive practice such as omission of critical information. n117

As with Truth in Lending, RESPA provides consumers with important information. The itemized settlement statement required by RESPA, in fact, helps close one of TIL's loopholes. Since TIL does not mandate that consumers be given an itemization of the amount financed, n118 some overreaching second mortgage lenders were formerly able to conceal exorbitant costs and other forms of loan padding by providing consumers only with a statement setting forth a lump sum. Consumers may now consult the required list of fees charged at settlement to determine if padding and duplication occur.

Moreover, RESPA's limitation on unearned charges and kickbacks, which carries the possibility of a maximum $10,000 fine as well as the treble damages private remedy, gives advocates a handle on at least some of the loan padding techniques used by unscrupulous lenders. The Act's authorization for an award of attorneys fees to the "prevailing party," n119 however, may be significant deterrent to private enforcement.

The statute of limitations for RESPA's private remedies is one year. n120 At least two courts have held that the statute of limitations is not jurisdictional, which subjects it to a tolling argument. n121 If a violation of the statute is being challenged as a UDAP violation, however, the UDAP statute of limitations should be the applicable one.

[b] Other Statutes

Other statutes to consider include HOEPA and fair lending and civil rights statutes. n122 UDAP statutes are another

important remedy as has been discussed throughout this chapter.

The Equal Credit Opportunity Act prohibits discrimination in *any* aspect of credit on the basis of age, race, or national origin, among other grounds. n123 The federal Fair Housing Act and its state counterparts prohibit discrimination on the basis of race in housing related financing, including home equity loans and home improvement financing. n124 Both of these acts also allow homeowners with predatory loans to pursue relief against actors higher up in the food chain than the original lender.

The Civil Rights Act provides that the same right to contract, purchase, and hold property available to white citizens must also be extended to all citizens. n125 These statutes may be invoked in the lending context when, *e.g.*, a homeowner is targeted for less favorable terms on the basis of race. n126

In addition, RICO may be implicated in cases involving overreaching. Mail and wire fraud are perhaps the most commonly invoked predicate acts in stating a RICO claim, n127 and some questionable practices may fall within that rubric. The increasing problem of consumers paying higher interest rates due to divided loyalties of loan arrangers has also been challenged under RICO's mail fraud provisions, with differing results. n128 Credit-related insurance, too, has received some RICO attention. n129 Where the consumer can allege a civil conspiracy between the mortgage broker and lender and fraud in the selling of mortgage loans on terms different from those represented, a RICO claim may be stated, at least under the Ohio RICO statute. n130

[c] State High-Cost Mortgage Statutes

In May 2006, Ohio passed a broad state predatory lending law. n131 It adopts a 5% points and fees trigger for most loans (and expanded the law to cover open-end loans and reverse mortgages, but not purchase money loans), limits or prohibits prepayment penalties in many instances, and mandates counseling for loans with a debt-to-income ratio over 50%. It also applies the state's UDAP law to mortgage brokers, loan officers, and non-depository lending institutions, creates a bright-line list of unconscionable acts or practices (such as failing to consider a borrower's ability to repay), prohibits appraiser coercion, requires certain enhanced disclosures about loan terms and enhanced licensing requirements, clamps down on title agents and title company referrals, and enumerates broad broker and lender duties, but it shields assignees from most liability.

Minnesota amended its Minnesota Residential Mortgage Originator and Servicer Licensing Act, effective August 1, 2007. n132 Without imposing any financial thresholds, the amendments to the Mortgage Act prohibit residential mortgage originators and servicers from making, providing, or arranging for a residential mortgage loan without: verifying the borrower's reasonable ability to repay; charging prepayment penalties on subprime loans; refinancing a loan without a tangible net benefit; failing to properly disclose the amounts of taxes and insurance; or making, providing, or arranging for a negatively amortizing residential mortgage loan, other than a reverse mortgage loan. The amendments also impose an agency relationship between a mortgage broker and borrower, and impose a duty on mortgage brokers to act in the best interests of the borrower and in good faith.

In July 2006, Rhode Island also passed a strong law. n133 The law, which applies to both open- and closed-end loans, has a 5% points and fees trigger for most loans (and includes most yield spread premium charges and prepayment penalties in that trigger), and for covered loans requires a net tangible benefit for many refinancings, bans mandatory arbitration, limits payment shock in adjustable rate loans, requires originators to reasonably ensure that the borrower can afford to repay the loan for loans with a debt-to-income ratio at or above 50%, caps points and fees, and bans prepayment penalties. Holders are shielded from assignee liability if they take certain steps to exclude purchase of high-cost loans.

Tennessee passed a law in May 2006 that adopts the HOEPA thresholds and imposes numerous obligations for covered loans including a requirement that originators reasonably ensure that the borrower can afford to repay the loan for loans

with a debt-to-income ratio at or above 50%, a limit or ban on certain prepayment penalties, a requirement to provide two free payoff statements every 12 months, limits on late fees and limits on the financing of points and fees. n134

[2] Unconscionability

Unconscionability case law has developed through several different vehicles: Common law, n135 *UCC section 2-302*, non-UCC statutory unconscionability provisions, n136 and some UDAP statutes where unfairness or deception standards meld into unconscionability standards. n137 However, since there is considerable overlap, n138 case law as to what type of conduct or contract terms may be unconscionable should be helpful irrespective of which of the above vehicles was used. Advocates should not be deterred from relying on case law decided under an unconscionability statute in another state simply because their state has not codified the doctrine.

There are two forms of unconscionability: Procedural and substantive. n139 Procedural unconscionability involves the bargaining process when the contract was made. n140 Substantive unconscionability focuses on the content of the contract. n141

The most typical type of procedural unconscionability involves oppression or surprise in the bargaining process. n142 Oppression occurs when there is a disparity in bargaining power between the parties. n143 Oppressive contracts involve no negotiation over the terms of the agreement. n144 For example, a form contract in which one party has no choice in the matter and cannot obtain better terms elsewhere might be oppressive. n145 Surprise occurs when creditors hide contract terms from the consumer in fine print or unusually complex clauses. n146

Procedural unconscionability alone usually is not sufficient to invalidate a term of a contract. n147 The consumer advocate must normally also show substantive unconscionability.

A court will find substantive unconscionability if the contract unfairly and unjustifiably "reallocates the risks of the bargain in an objectively unreasonable or unexpected manner." n148 Thorough investigation and command of the facts of the case are critical to an unconscionability claim under statute or common law. n149

The remedy for unconscionability is usually limited to a defense against the enforcement of the unconscionable contract or terms and may not support an affirmative claim for restitutionary damages. n150 State codifications of unconscionability may offer other relief though. n151

[3] Duty of Good Faith and Fair Dealing

The duty of good faith and fair dealing between parties to a contract is based both in common law n152 and the UCC. n153

One kind of contract enforcement issue arguably subject to the duty is when the credit terms in a contract include a balloon payment, which the creditor knew the borrower would be unlikely to meet. n154 At the loan's maturity, the borrower must then refinance or face foreclosure. While ordinarily a creditor's decision as to whether to extend credit is not subject to the duty, the creditor may be subject to some mandatory obligation to refinance such a loan, in which case the refinancing decision would be subject to the duty of good faith and fair dealing. n155 In a few circumstances, the mandate may be by virtue of statute. n156

Another area where the doctrine may be useful relates to the creditor's decision to accelerate and foreclose on collateral, which has also been held to be subject to the duty of good faith and fair dealing. n157

NOTE:

Some of the recent amendments to state statutes of frauds designed to limit lender liability may affect

> claims based on oral promises not to accelerate. The borrower, of course, is equally subject to the duty of good faith. n158 Similarly, the duty may have been breached where the lender consistently overstated the payoff amount and improperly capitalized certain costs that should have been assessed as separate fees, all of which prevented the consumer from paying off the mortgage and led to foreclosure. n159

Unilaterally refusing to accept mortgage payments from the homeowner's tenant, raising the monthly payments to cover an escrow shortfall without notice to the homeowner, and continuing a course of action that forced the homeowner into foreclosure constitutes a breach of this duty. n160

Charging fees at the time of payoff or default that are not authorized by statute or the loan documents may be conduct that violates this duty, though consumers have more often alleged breach of contract and UDAP claims in this context. n161

Creditor behavior which thwarts the consumer's ability to file for and obtain payments to the creditor under a credit disability policy may also state a cause of action under this theory. n162 Similarly, insurance companies have a duty to deal fairly and act in good faith with those whom they insure. This duty is breached where, in the credit insurance context or otherwise, it deliberately and willfully engages in a pattern of canceling insurance policies as soon as claims are filed without determining whether it has good cause to do so. n163

A lender's practice of force-placing mortgage hazard insurance that is several times more expensive than the homeowner's policy and receiving kickbacks from the insurance company may also state a claim for breach of the covenant of good faith and fair dealing. n164 One court found a breach of the implied covenant of good faith and fair dealing as a result of the servicer's inability, or unwillingness, to account for and properly credit payments made by the borrower and the bankruptcy trustee. n165

[4] Fiduciary or Quasi-Fiduciary Duty

The existence of a fiduciary or quasi-fiduciary duty at the least gives rise to a duty of fair and honest disclosure of all facts which might be presumed to influence the consumer in regard to his or her actions, n166 including those favorable to the creditor or a third party and adverse to the borrower's interest. n167

When there is a duty to disclose, failure to do so should give rise to a tort action for nondisclosure, n168 or the silence may qualify as misrepresentation. n169 A principal has the right to repudiate a contract made by one individual acting as the agent of both parties in violation of his fiduciary duty. n170 The principal also may have a claim for damages, including return of commission. n171

[5] Intentional Interference With a Contractual Relationship

Under this tort, lenders who reward brokers for bringing borrowers to them may be required to share the blame for the brokers' breach of duty. n172

The elements of this tort are: the existence of a contractual relationship; the defendant's knowledge of the contract; the intent to interfere; and the plaintiff suffers damages. n173 Buyers who asserted this tort in relation to force-placed insurance with alleged excess coverage and inflated premiums survived a motion to dismiss. n174

[6] Fraud and Misrepresentation

One of the more striking developments in recent years is the effort to reach behind shoddy contractors, brokers, and predatory second mortgage companies to the financiers who enable them to operate by providing them their financial lifeline. The vicarious liability of the lender for a seller's wrongs under the FTC holder rule is discussed elsewhere, as is

the expanded liability under the Home Ownership and Equity Protection Act. *See* Chapter 2 *supra*. However, recovery against the financiers under both provisions is limited. Hence, to impose liability for damages sufficient to act as a deterrent, such as punitive damages for fraud, a borrower would need to establish that the initial party acted as the financier's agent, that the lender participated directly in the fraud, n175 that the lender aided and abetted the tortfeasor, n176 or that there were some other special circumstances which required a lender to disclose to the borrower information it knew about the seller and failed to reveal. n177 Some of the cases find liability against the lender based on either agency or conspiracy. n178 Finally, a theory of lender liability not often used in the credit context is aiding and abetting. This theory is separate and distinct from a civil conspiracy theory. n179 While civil conspiracy involves a tortious act in concert with another or pursuant to a common design, aiding and abetting involves knowledge that another's conduct constitutes a breach of duty and providing substantial assistance or encouragement to the other. n180 In other words, conspiracy involves an agreement, explicit or by conduct, to participate in a wrongful activity. Aiding and abetting, on the other hand, focuses on whether the lender gave "substantial assistance" to someone who engaged in wrongful conduct. Whether or not the lender agreed to join the wrongful conduct is irrelevant to liability under this theory. n181 A lender may also be liable for the fraud of its employees. n182

Advocates should be wary of a thorny problem that can arise when arguing agency theory or joint collusion to defraud on the part of two apparently separate entities. Arbitration clauses, which work to deprive consumers of important rights including the right to trial by jury, may exist in loan documents, broker agreements, home improvement contracts or credit insurance agreements. Even a non-signatory to a document containing an arbitration clause may successfully invoke arbitration where the borrower's claims against the defendants involve agency or are intimately founded upon and intertwined with the underlying contact obligations. n183

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionReal Estate Settlement ProceduresGeneral OverviewBanking LawFederal ActsGeneral OverviewBanking LawNational BanksInterest & UsuryGeneral OverviewBanking LawNational BanksInterest & UsuryUsury LitigationContracts LawDebtor & Creditor Relations

FOOTNOTES:
(n1)Footnote 1. *67 Fed. Reg. 49,134* (July 29, 2002) .

(n2)Footnote 2. James M. Lacko & Janis K. Pappalardo, The Effect of Mortgage Broker Compensation Disclosures on Consumer and Competition: A Controlled Experiment, Federal Trade Commission (Feb. 2004), *available at* www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf.

(n3)Footnote 3. Letter from Acting Secretary Alphonso Jackson (Mar. 22, 2004), *available at* www.hud.gov/news/letter.pdf.

(n4)Footnote 4. *12 U.S.C. §§ 2601*

(n5)Footnote 5. *12 U.S.C. § 2602(1)(A).*

(n6)Footnote 6. Pub. L. No. 102-550, § 908 (Oct. 28, 1992). *See also 59 Fed. Reg. 6,506, 6,511* (Feb. 10, 1994) .

(n7)Footnote 7. *12 U.S.C. § 2602(1)(B).* In the latter category, "creditors" are defined by reference to the Truth in Lending definition. *See 15 U.S.C. § 1602(f)*; *see also § 1.03[1][b] supra.*

(n8)Footnote 8. Reg. X, *24 C.F.R. § 3500.5(a)(4).*

(n9)Footnote 9. Reg. X, *24 C.F.R. § 3500.5(a)(4).*

(n10)Footnote 10. Reg. X § 500.5(a)(7).

(n11)Footnote 11. Reg. X § 500.5(a)(7).

(n12)Footnote 12. *Chandler v. Norwest Bank Minn., N.A., 137 F.3d 1053* (8th Cir.) , *cert. denied, 525 U.S. 922, 119 S. Ct. 278, 142 L. Ed. 2d 229 (1998)* .

(n13)Footnote 13. *Chandler v. Norwest Bank Minn., N.A., 137 F.3d at 1058* .

(n14)Footnote 14. *12 U.S.C. § 2603*; Reg. X § 3500.7. If a mortgage broker, rather than a lender, gets the application, the broker must provide the good faith estimate. However, no estimate is required for home equity lines of credit, since Regulation Z already provides for extensive disclosures in such transactions. *See 15 U.S.C. § 1637a*; *see* Ch. 1 *supra*.

(n15)Footnote 14.1. *73 Fed. Reg. 68,204* (Nov. 17, 2008) . For further discussion of the new requirements, *see* National Consumer Law Center, Cost of Credit, § 12.2.1.3.3 (4th ed. 2009).

(n16)Footnote 14.2. *73 Fed. Reg. 68,239* (Nov. 17, 2008) , *codified* at *24 C.F.R. § 3500.2*.

(n17)Footnote 14.3. The original disclosure regime required the lender to provide a standardized information booklet and the HUD-1, the latter to be given to the borrower not later than seven days after loan commitment. *40 Fed. Reg. 22,448* (May 22, 1975) . There was no GFE at that time. The rule effective until January, 2010 states that the Appendix contains a "suggested format" for the GFE. *24 C.F.R. § 3500.7(a)*. GFEs have varied significantly in appearance among lenders.

(n18)Footnote 14.4. Some states prohibit the charging of any fee at application. HUD's permission of a credit report fee should be read as "where not otherwise prohibited by law," given HUD's assertion that the rule "does not preempt State law." *73 Fed. Reg. 68,238*.

(n19)Footnote 15. Reg. X, 24 C.F.R. pt. 3500, app. A. (See also HUD's website for frequently asked questions and answers about RESPA at http://www.hud.gov/offices/hsg/sfh/res/resconsu.cfm.

(n20)Footnote 16. *See* National Consumer Law Center, Truth in Lending Ch. 9 (6th ed. 2007 and supp.).

(n21)Footnote 17. *12 U.S.C. § 2602(3)*; Reg. X § 3500.2(a)(16). *See, e.g., Briggs v. Countrywide Funding Corp., 931 F. Supp. 1545 (M.D. Ala. 1996)* (yield-spread premium to broker at issue; court denied lender's motion to dismiss, holding RESPA requires disclosure of yield-spread premium, and it preempts Alabama state law to the extent it does not require its disclosure; a variety of state law claims pled, including fraudulent concealment, improper interference with brokerage contract and inducement to breach fiduciary duties, RICO), *vacated on other grounds*, *949 F. Supp. 812 (M.D. Ala. 1996)* ; *Weatherman v. Gary-Wheaton Bank of Fox Valley, N.A., 239 Ill. Dec. 12, 713 N.E.2d 543 (1999)* (recording fees may be aggregated on one line of good faith estimate, in contrast to the HUD-1 used at settlement; dissent argues that a gross estimate of all recording fees is not adequate where the recording fees relate to different transactions, i.e., the recordation of the new mortgage versus the release of the old). *But cf. Bloom v. Martin, 77 F.3d 318 (9th Cir. 1996)* (RESPA's disclosure requirements do not apply to demand and reconveyance fees).

(n22)Footnote 18. *12 U.S.C. § 2604*; Reg. X § 3500.6 (not required for refinancings).

(n23)Footnote 19. Reg. X § 3500.15.

(n24)Footnote 20. *See* Reg. X, 24 C.F.R. § 3500.

(n25)Footnote 21. At the time of its circulation by the OCC on May 31, 2000, the letter was available on the Internet. Now, however, it is only referenced on the website of the OCC. *See*

www.occ.treas.gov/ftp/advisory/2000-5.doc. It is reprinted in full in National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges, App. C.3.5.

(n26)Footnote 22. HUD points to the Instructions contained in Appendix A to Regulation X. Appendix A states that the HUD-1 must "itemize all charges imposed upon the borrower and the seller by the lender and all sales commissions, whether to be paid at settlement or outside of settlement, and any other charges which either the Borrower or the Seller will pay for at settlement."

(n27)Footnote 23. *12 U.S.C. § 2607(c)* (this section exempts payments by a title company to its agent from the kickback prohibitions but only if the payment was for services actually performed in the making of the loan; so, if the other charges paid to the closing agent include all the services the agent actually preformed, the commission could violate RESPA). For a discussion of payments that are legal and illegal under RESPA, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses. § 12.2.1 (3d ed. and supp.).

(n28)Footnote 24. *See, e.g., Brophy v. Chase Manhattan Mortgage Co., 947 F. Supp. 879 (E.D. Pa. 1996)* (although Truth in Lending claim was dismissed, borrower could pursue state law claims in state court on issue of whether disparities between good faith estimate and HUD-1 settlement statement violated Pennsylvania's UDAP statute); *Weatherman v. Gary-Wheaton Bank, N.A., 286 Ill. App. 3d 48, 221 Ill. Dec. 685, 676 N.E.2d 206 (Ill. App. Ct. 1996)* , *vacated and remanded on procedural grounds, 173 Ill. 2d 548, 226 Ill. Dec. 140, 684 N.E.2d 1343 (1997)* (RESPA requires an itemization of recording fees; gross estimate of recording fees in circumstances of this case is not adequate; good discussion of fact that since RESPA created a duty to disclose, failure to itemize in the good faith estimate may violate the state UDAP statute); National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 3.2.7 (6th ed. 2004 and supp.).

(n29)Footnote 25. *12 U.S.C. § 2605*. HUD has also promulgated regulations under § 2605 and created form notices. Regulation X, 24 C.F.R. § 3500 and Appendices. Certain governmental agencies, *e.g.,* the RTC and FDIC, or governmentally sponsored entities, *e.g.,* Fannie Mae, Ginnie Mae, and others, are exempt from coverage in certain circumstances. § 2605(i)(2). Section 2605(a) was considerably shortened in 1996 by the Omnibus Consolidated Appropriations Act, 1997. Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).

(n30)Footnote 26. *12 U.S.C. § 2605(d)*; *24 C.F.R. § 3500.21(d)(5)*.

(n31)Footnote 27. *12 U.S.C. § 2605(f)*.

(n32)Footnote 28. *12 U.S.C. § 2605(f)(1)*; Reg. X § 3500.21(f)(1). This section of RESPA is discussed in more detail in National Consumer Law Center, Foreclosures, § 5.2 (2005).

(n33)Footnote 29. *12 U.S.C. § 2609*. *See also 58 Fed. Reg. 5,520* (Jan. 21, 1993) . In addition, under the Home Ownership and Equity Protection Act of 1994, prepaid payments, which a lender sometimes withholds from loan proceeds and keeps in an escrow account for future payments on the loan, are limited to two.

(n34)Footnote 30. *12 U.S.C. § 2607*; Reg. X, *24 C.F.R. § 3500.14*. HUD has issued a proposed rule that clarifies when under RESPA a lender must disclose fees paid to brokers. *62 Fed. Reg. 53,912* (Oct. 16, 1997) .

(n35)Footnote 31. *12 U.S.C. § 2607*; Reg. X, *24 C.F.R. § 3500.14*.

(n36)Footnote 32. "Thing of value" is broadly defined. *See Aiea Lani Corp. v. Hawaii Escrow & Title, Inc., 64 Haw. 638, 647 P.2d 257 (1982)* (discount to developer on construction loan title insurance for referring individual subdivision closings to defendant constituted a "thing of value" within meaning of RESPA).

(n37)Footnote 33. Reg. X, § 3500.14(b). In an odd context, a court held that it is an illegal kickback for a lender to charge a closing agent a higher fee for the use of its offices at settlement for loans it closed for that lender than for loans

it closes for other lenders. *Lawyers Title Ins. Corp. v. Dearborn Title Corp., 939 F. Supp. 611 (N.D. Ill. 1996)* , *aff'd in part, 118 F.3d 1157 (7th Cir. 1997)* , *upon remand*, *22 F. Supp. 2d 820 (N.D. Ill. 1998)* . This case may be limited to its facts since there was no showing that the consumer paid a higher settlement cost as a result. The issue arose when the title insurance company sued the closing agent for fraudulently mishandling money held in escrow. The kickback issue arose as a defense (interesting defense) to the title insurance company's attempts to attach monies that the closing agent had paid to the lender.

(n38)Footnote 34. Reg. X, § 3500.14(b).

(n39)Footnote 35. Reg. X, § 3500.14(c). Herein lies a potential loophole that leaves room for a party to assert the performance of some bogus service to justify payment or receipt of a fee.

(n40)Footnote 36. *Lane v. Residential Funding Corp., 2000 U.S. Dist. LEXIS 10717* (N.D. Cal. June 6, 2000) .

(n41)Footnote 37. *Lane v. Residential Funding Corp., 323 F.3d 739 (9th Cir. 2003)* .

(n42)Footnote 38. *Kahrer v. Ameriquest Mortgage Co., 418 F. Supp. 2d 748 (W.D. Pa. 2006)* .

(n43)Footnote 39. *12 U.S.C. § 2607(c)*; Reg. X, § 3500.14(c) and (g).

(n44)Footnote 40. Reg. X, § 3500.14(b). "Referral" is defined at § 3500.14(f).

(n45)Footnote 41. *24 C.F.R. § 3500.14(g)(2)*.

(n46)Footnote 42. *See United States v. Grissom, 814 F.2d 577 (10th Cir. 1987)* (president of savings and loan being prosecuted for embezzlement tried unsuccessfully to invoke a defense under RESPA that his appropriation of part of an origination fee paid by a borrower was really compensation for his actual service to the borrower in arranging the loan); *see also United States v. Gannon, 684 F.2d 433* , *cert. denied, 454 U.S. 940, 102 S. Ct. 475, 70 L. Ed. 2d 248 (1981)* (counterman for county recorder received a salary for processing land registration and transfer documents, a service for which a statutory fee was imposed; no other services were provided in official or unofficial capacity justifying amounts accepted which exceeded statutory fee).

(n47)Footnote 43. *Cf.* Texas St. Bar Prof. Ethics Comm., Opinion 490 (10/20/93), 61 BNA Banking Report 903 (12/6/93) (state ethics committee held that bank's plan to charge loan applicants a separate fee for its salaried in-house counsel's preparation of loan documents violated professional ethics rules against lawyer's fee-splitting where bank retained the fee; however, a blanket document preparation fee covering all bank personnel and overhead would not).

(n48)Footnote 44. *See* Title Insurance Practices in Florida, RESPA Statement of Policy 1996-4, *61 Fed. Reg. 49,398* (Sept. 19, 1996) (HUD issued this policy statement indicating that the payments in this context must be for core title services).

(n49)Footnote 45. *24 U.S.C. § 2607*(c)(1)(3).

(n50)Footnote 46. *24 U.S.C. § 2607*(c)(4); Reg. X, *24 C.F.R. § 3500.14(b)*.

(n51)Footnote 47. *64 Fed. Reg. 10,079* (Mar. 1, 1999) .

(n52)Footnote 48. See News Release of September 17, 1997, *available at* www.hud.gov/fha/res/respa_hm.hmtl, accompanying HUD's announcement of changes to Regulation X regarding broker fees proposed in *62 Fed. Reg. 53,912* (Oct. 16, 1997) . This regulation was never finalized. Instead, HUD released a policy statement on Mar. 1, 1999.

(n53)Footnote 49. American Housing Survey for Selected Metropolitan Areas, 1991-1994.

(n54)Footnote 50. *Culpepper v. Inland Mortgage Corp., 132 F.3d 692 , reh'g, en banc, denied, 144 F.3d 717 (11th Cir. Ala. 1998)* ; *Lawyers Title Ins. Corp. v. Dearborn Title Corp., 118 F.3d 1157,1162 (7th Cir. 1997)* ; *DeLeon v. Beneficial Constr. Co, 998 F. Supp. 859 (N.D. Ill. 1998)* ; *Barbosa v. Target Mortgage Co., 968 F. Supp. 1548 (S.D. Fla. 1997)* ; *Dubose v. First Sec. Sav. Bank, 974 F. Supp. 1426 (N.D. Ala. 1997) , superseded by statute as stated in Golan v. Ohio Sav. Bank, 1999 U.S. Dist. LEXIS 16452* (N.D. Ill. Oct. 14, 1999) ; *Hastings v. Fidelity Mortgage Decisions Corp., 984 F. Supp. 600 (N.D. Ill. 1997)* ; *Mentecki v. Saxon Mortgage Inc., 1997 U.S. Dist. LEXIS 1374* (E.D. Va. Jan. 31, 1997) ; *Briggs v. Countrywide Funding Corp., 931 F. Supp. 1545 (M.D. Ala. 1996) , vacated on other grounds, 949 F. Supp. 812 (M.D. Ala. 1996)* .

(n55)Footnote 51. *See, e.g., Mulligan v. Choice Mortgage Corp. USA, 1998 U.S. Dist. LEXIS 13248* (D.N.H. Aug. 11, 1998) (broker collected $4,570 from the homeowners and another $3,720 from the lender); *Mentecki v. Saxon Mortgage Inc., 1997 U.S. Dist. LEXIS 1374* (E.D. Va. Jan. 31, 1997) (borrowers paid broker for several specified services in addition to almost $13,000 for origination fee, while lender kicked in over $2,000).

(n56)Footnote 52. *64 Fed. Reg. 10,079* (Mar. 1, 1999) . The Policy Statement is effective immediately.

(n57)Footnote 53. *64 Fed. Reg. 10,084*.

(n58)Footnote 54. *64 Fed. Reg. 10,085*. HUD includes in this list the provision of disclosures as a compensable service. However, RESPA expressly prohibits a lender from charging a fee "for or on account of the preparation and submission" of TILA and RESPA good faith estimates. *12 U.S.C. § 2610*. Since the lender/broker cannot charge a fee, preparing and providing these disclosures cannot be a service that is "compensable" for purposes of justifying a yield spread premium.

(n59)Footnote 55. If the services provided were only "counseling-type" activities, the agency will look to see that meaningful counseling--not steering--occurred. The report includes criteria HUD would use to make that determination. *64 Fed. Reg. 10,085*. Significantly, HUD opines that the loan itself is not a good thereby disposing of the industry's argument that the loan itself justifies the yield spread premium. *Id*.

(n60)Footnote 56. *64 Fed. Reg. 10,086*.

(n61)Footnote 57. *64 Fed. Reg. 10,086*.

(n62)Footnote 58. *64 Fed. Reg. 10,085*.

(n63)Footnote 59. *64 Fed. Reg. 10,086-87*.

(n64)Footnote 60. *See* E. Robert Levy, *HUD Policy Statement Helps Resolve Lender Paid Mortgage Broker Fee Issues*, New England Mortgage Report, Mar. 1999, at 8.

(n65)Footnote 61. *64 Fed. Reg. 10,086-87*.

(n66)Footnote 62. *64 Fed. Reg. 10,085*.

(n67)Footnote 63. *64 Fed. Reg. 10,084*. ("[H]igher interest rates alone cannot justify higher total fees to mortgage brokers.")

(n68)Footnote 64. *64 Fed. Reg. 10,086*.4

(n69)Footnote 65. *Golon v. Ohio Sav. Bank, 1999 U.S. Dist. LEXIS 16452* (N.D. Ill. Oct. 15, 1999) (class certification denied); *Brancheau v. Residential Mortg. & Mercantile Bank of St. Louis, 187 F.R.D. 591 (D. Minn. 1999)* (decertification of the class, defendant's motion for summary judgment granted); *McCrillis v. WMC Mortg. Corp., 133 F. Supp. 2d 470 (S.D. Miss. 2000)* (summary judgment for lender granted); *In re Old Kent Mortg. Co. Yield Spread*

Premium Litig., 191 F.R.D. 155 (D. Minn. 2000) (motion to strike class certification granted).

(n70)Footnote 66. *Marbury v. Colonial Mortg. Co., 2001 U.S. Dist. LEXIS 1632* (M.D. Ala. Jan. 12, 2001) (defendant's contention that yield spread premium was paid for release of servicing rights does not support its claim that the premium represents goods, services, or facilities; servicing rights do not equal "goods" because they do not arise until after loan is closed; class certification stayed pending appeals in other cases before 11th Circuit). *See also Culpepper v. Inland Mortgage Corp., 189 F.R.D. 668 (N.D. Ala. 1999)* , *aff'd sub nom. Culpepper v. Irwin Mortg. Corp., 253 F.3d 1324 (11th Cir. 2001)* , *cert. denied, 534 U.S. 1118, 122 S. Ct. 930, 151 L. Ed. 2d 893 (2002)* ; *Dujanovic v. MortgageAmerica, Inc., 185 F.R.D. 660 (N.D. Ala. 1999)* (granting class certification).

(n71)Footnote 67. The full text of the letter is contained in National Consumer Law Center, Cost of Credit, App. C.3.4.1.

(n72)Footnote 68. *Culpepper v. Irwin Mortgage Corp., 253 F.3d 1324 (11th Cir. 2001)* , *cert. denied, 534 U.S. 1118, 122 S. Ct. 930, 151 L. Ed. 2d 893 (2002)* . The first *Culpepper* decision, *Culpepper I, is at Culpepper v. Inland Mortgage Corp., 189 F.R.D. 668 (N.D. Ala. 1999)* .

(n73)Footnote 69. See letter from the Consumer Mortgage Coalition to HUD Secretary Martinez of Sept. 25, 2001, *available at* www.houselaw.net/alerts/092801a.pdf.

(n74)Footnote 70. *66 Fed. Reg. 53,052* (Oct. 10, 2001) . Consumer representatives responded with grave concerns to the new policy. *See, e.g.*, Margot Saunders, *No Shades of Gray--HUD's New Statement of Policy Hurts Homeowners and Will Cost Millions*, *available at* www.consumerlaw.org, click on predatory lending.

(n75)Footnote 71. *66 Fed. Reg. 53,054-55*.

(n76)Footnote 72. *66 Fed. Reg. 53,055*.

(n77)Footnote 73. *Glover v. Standard Fed. Bank, 283 F.3d 953* (8th Cir.) , *cert. denied, 537 U.S. 943, 537 U.S. 943, 154 L. Ed. 2d 251 (2002)* ; *Geraci v. Homestreet Bank, 203 F. Supp. 2d 1211 (W.D. Wash. 2002)* (lender's motion for judgment on the pleadings granted where the homeowner failed to allege that the yield spread premium did not bear a reasonable relationship to the value of the goods or services provided; the decision was issued after *Glover* was decided but did not rely upon *Glover*); *LaCasse v. Washington Mut., Inc., 198 F. Supp. 2d 1255 (W.D. Wash. 2002)* (class certification denied); *Empalmado v. First Franklin Fin. Corp., 2002 U.S. Dist. LEXIS 1929* (N.D. Ill. Feb. 5, 2002) (reconsideration of class certification denial denied); *Michalowski v. Flagstar Bank, FSB, 2002 U.S. Dist. LEXIS 1245* (N.D. Ill. Jan. 24, 2002) (lender motion to dismiss case denied because the legality of a yield spread premium is highly dependent on the facts of each case; court cites to the 2002 policy statement); *Vargas v. Universal Mortg. Corp., 2001 U.S. Dist. LEXIS 19635* (N.D. Ill. Nov. 29, 2001) (class certification denied under the 2001 policy statement); *Bjustrom v. Trust One Mortg., 178 F. Supp. 2d 1183 (W.D. Wash. 2001)* (summary judgment for lender granted), *aff'd in part, remanded in part, 322 F.3d 1201 (9th Cir. 2003)* .

(n78)Footnote 74. *283 F.3d 953* (8th Cir.) , *cert. denied, 537 U.S. 943* ; *123 S. Ct. 344, 154 L. Ed. 2d 251 (2002)* .

(n79)Footnote 75. In *Culpepper II*, on the other hand, the Eleventh Circuit found ambiguity in the 1999 policy statement and interpreted it in a way it believed was consistent with § 2607.

(n80)Footnote 76. *See Christensen v. Harris County, 529 U.S. 576, 587, 120 S. Ct. 1655, 1662-63, 146 L. Ed. 2d 621, 631-32 (2000)* .

(n81)Footnote 77. *See* National Consumer Law Center, Cost of Credit, § 12.2.1.3, (4th ed. 2009) (discussion of the old and new disclosure requirements under RESPA and Regulation X).

(n82)Footnote 78. Much of the relevant information consists of: the rate sheet used for the loan in question; the identity of other lenders, if any, that the broker approached to place the loan in question; the rate sheets of those other lenders for the time period in question; the discussions and written agreements, if any, between the broker and the homeowners (and between the lender and the homeowners) about payment for services rendered by the broker and whether the homeowner wished to pay the higher interest rate; if the broker is the table-funded lender, the purchase agreement between it and the funding lender; any written or oral agreements/discussions between the broker and the lender; what specific services the broker performed for the borrower and the amount of time it took to perform each; the underwriting criteria of the lender and that of any other lender with whom the broker tried to place the loan; whether the loan would have been made by the lender at par rate; number of loans made by the lender at par, below par, and above par; and the amount of fees paid to the broker by the borrower in each such loan (whether designated as "broker fees" or not on the HUD-1 settlement statement); the method by which the yield spread premium was calculated.

(n83)Footnote 79. *See, e.g., Hastings v. Fidelity Mortgage Decisions Corp., 984 F. Supp. 600 (N.D. Ill. 1997)* .

(n84)Footnote 80. *See, e.g., Taylor v. Flagstar Bank, FSB, 181 F.R.D. 509 (M.D. Ala. 1998)* ; *Hinton v. First Am. Mortgage, 1998 U.S. Dist. LEXIS 2712* (N.D. Ill. Mar. 3, 1998) ; *Conomos v. Chase Manhattan Mortgage Corp., 1998 U.S. Dist. LEXIS 3135* (S.D.N.Y. Mar. 17, 1998) ; *Marinaccio v. Barnett Banks, Inc., 176 F.R.D. 104 (S.D.N.Y. 1997)* ; *Moniz v. Crossland Mortgage Corp., 175 F.R.D. 1 (D. Mass. 1997)* . All of these cases were *superseded by statute as stated in Golon v. Ohio Sav. Bank, 1999 U.S. Dist. LEXIS 16452* (N.D. Ill. Oct. 14, 1999) .

(n85)Footnote 81. *Brancheau v. Residential Mortgage, 182 F.R.D. 579 (D. Minn. 1998)* , *recons. granted, vacated, in part, summ. judgment granted, claim dismissed, 187 F.R.D. 591 (D. Minn. 1999)* ; *Mulligan v. Choice Mortgage Corp. USA, 1998 U.S. Dist. LEXIS 13248* (D.N.H. Aug. 11, 1998) ; *see also Culpepper, 132 F.3d at 697* (wherein court remanded case instructing the lower court to review class certification in light of the opinion on the merits).

(n86)Footnote 82. The earlier court decisions got these steps reversed. By doing so, the courts immediately got hung up on the issue of the reasonableness of the fee, an intensely factual standard. *But see Taylor v. Flagstar Bank, FSB, 181 F.R.D. 509 (M.D. Ala. 1998)* (court properly recognized that the payment must be compensation for some good, facility, or service provided by the broker; it then suggested, however, that the lender could defend on the ground that the premiums were additional payment for services it rendered for which the borrower also paid a fee, thus forcing the court to make individualized determinations for each class member), *superseded by statute as stated in Golon v. Ohio Sav. Bank, 1999 U.S. Dist. LEXIS 16452* (N.D. Ill. Oct. 14, 1999) .

(n87)Footnote 83. *Brancheau v. Residential Mortgage, 182 F.R.D. 579 (D. Minn. 1998)* , *recons. granted, vacated, in part, summ. judgment granted, claim dismissed, 187 F.R.D. 591 (D. Minn. 1999)* .

(n88)Footnote 84. *Mulligan v. Choice Mortgage Corp. USA, 1998 U.S. Dist. LEXIS 13248* (D.N.H. Aug. 11, 1998) .

(n89)Footnote 85. Be aware that the statute of limitations is one year from the date the violation occurred. *12 U.S.C. § 2614*. RESPA violations, however, may be raised at any time by way of recoupment.

(n90)Footnote 86. *12 U.S.C. § 2607(d)(2)*.

(n91)Footnote 87. *12 U.S.C. § 2608(a)*.

(n92)Footnote 88. *24 C.F.R. § 3500.2(b)*.

(n93)Footnote 89. *24 C.F.R. § 3500.2(b)*; *24 C.F.R. § 3500.16*.

(n94)Footnote 90. *12 U.S.C. § 2608(b)*.

(n95)Footnote 91. *12 U.S.C. § 2614*.

(n96)Footnote 92. *24 C.F.R. § 3500.19(c)*.

(n97)Footnote 93. *See 12 U.S.C. § 2607(d)(5)*; *see also Weisberg v. Toll Bros., Inc., 617 F. Supp. 539 (E.D. Pa. 1985)* (court awarded attorneys fees upon settlement of a § 2608 class action but did not discuss any authority for the award since, by agreement, the motion for fees was unopposed).

(n98)Footnote 94. *Rendler v. Gambone Bros. Dev. Co., 182 F.R.D. 152 (E.D. Pa. 1998)* .

(n99)Footnote 95. Loan origination and processing is a "settlement service" as a result of both the 1992 Reg. X changes, *57 Fed. Reg. 49,601,* and the 1992 statutory amendment. Pub. L. No. 102-550, § 908(a).

(n100)Footnote 96. Reg. X, § 3500.14(g)(3). *But see Durr v. Intercounty Title Co., 826 F. Supp. 259 (N.D. Ill. 1993)* , *aff'd, 14 F.3d 1183 (7th Cir. 1994)* , *cert. denied, 513 U.S. 811, 115 S. Ct. 63, 130 L. Ed. 2d 20 (1994)* (court viewed class action for alleged RESPA violations in overcharging for recording of deeds and mortgages as the plaintiff attorney's attempt to "turn this petty dispute into a big-ticket lawsuit"); *Duggan v. Independent Mortgage Corp., 670 F. Supp. 652 (E.D. Va. 1987)* (broker's failure to lock in agreed upon interest rate even after receiving and accepting fee for that purpose was not an offense within the meaning of RESPA's unearned fee provision).

(n101)Footnote 97. *See Mercado v. Calumet Fed. Sav. & Loan Ass'n, 763 F.2d 269 (7th Cir. 1985)* ; *Willis v. Quality Mortgage USA, Inc., 5 F. Supp. 2d 1306 (M.D. Ala. 1998)* .

(n102)Footnote 98. National Consumer Law Center, Truth in Lending, Chapter 3 (6th ed. 2007 and supp.).

(n103)Footnote 99. National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 3.2.7 (7th ed. 2008 and supp.).

(n104)Footnote 100. National Consumer Law Center, Consumer Arbitration Agreements (5th ed. 2007).

(n105)Footnote 101. *Blount v. National Lending Corp., 108 F. Supp. 2d 666 (S.D. Miss. 2000)* .

(n106)Footnote 102. *12 U.S.C. § 2602(1)(B)*.

(n107)Footnote 103. Reg. X, § 3500.14(g)(3). See *57 Fed. Reg. 49,600, 49,603* (Nov. 2, 1992), for the background on this so-called CLO rule.

(n108)Footnote 104. Reg. X, § 3500.2; *59 Fed. Reg. 37,360, 37,374* (July 21, 1994) .

(n109)Footnote 105. *12 U.S.C. § 2616*.

(n110)Footnote 106. *See 24 C.F.R. § 3500.13*.

(n111)Footnote 107. *Washington Mut. Bank v. Superior Court, 75 Cal. App. 4th 773, 89 Cal. Rptr. 2d 560 (2d Dist. 1999)* (HOLA preempts certain claims based on state law).

(n112)Footnote 108. Pub. L. No. 106-229, *114 Stat. 464* (June 30, 2000), codified at *15 U.S.C. §§ 7001 et seq*.

(n113)Footnote 109. *15 U.S.C. § 7001(c)(1)(B), (C)(1)*. See National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, §§ 9.2.10, 12.1.10 (4th ed. 2009), for a more detailed discussion of these requirements.

(n114)Footnote 110. *15 U.S.C. § 7001(c)(1)(C)(ii)*. See National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 12.1.10 (4th ed. 2009), for further discussion of this requirement.

(n115)Footnote 111. *15 U.S.C. § 7001(e)*.

(n116)Footnote 112. *15 U.S.C. § 7002* allows states to supersede E-Sign's effect on state law by passing the Uniform Electronic Transactions Act or a similar statute that is consistent with E-Sign. A state's enactment of superseding legislation would not, however, affect the application of E-Sign to federal statutes such as RESPA. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 12.2.1.9 (3rd ed. 2005) for further discussion of this issue.

(n117)Footnote 113. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 12.2.1 (4th ed. 2009).

(n118)Footnote 114. The Act contains other provisions which are less relevant to the most common second mortgage scams, but may occasionally be important. For example, there are requirements that lenders disclose whether the servicing of the loan may be transferred, a provision that includes damages for violations. *12 U.S.C. § 2605*.

(n119)Footnote 115. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, §§ 2.2.1, 2.3.3 (7th ed. 2008 and supp.); *Washington Mut. Bank v. Superior Court, 75 Cal. App. 4th 773, 89 Cal. Rptr. 2d 560 (2d Dist. 1999)* , *further proceedings*, *24 Cal. 4th 906, 103 Cal. Rptr. 2d 320, 15 P.3d 1071 (2001)* (nationwide class certification reversed and remanded due to the trial court's failure to adjudicate the effect of a choice of law provision in the mortgage), *further proceedings*, *95 Cal. App. 4th 606, 115 Cal. Rptr. 2d 765 (2d Dist. 2002)* (HOLA preempts certain claims based on state law).

(n120)Footnote 116. National Consumer Law Center, Unfair and Deceptive Acts and Practices, §§ 3.2.7 (7th ed. 2008 and supp.).

(n121)Footnote 117. National Consumer Law Center, Unfair and Deceptive Acts and Practices, §§ 4.2.14 (7th ed. 2008 and supp.).

(n122)Footnote 118. Reg. Z, *12 C.F.R. § 226.18(c)(2)*; National Consumer Law Center, Truth in Lending, § 4.7.3 (6th ed. 2007).

(n123)Footnote 119. Reg. X, § 3500.19(b)(4); *12 U.S.C. § 2607(d)(5)*.

(n124)Footnote 120. Reg. X, § 3500.19(d). For attorneys generally, it is a 3-year statute of limitations. *Id*.

(n125)Footnote 121. *Lawyers Title Ins. Corp. v. Dearborn Title Corp., 118 F.3d 1157 (7th Cir. 1997)* , *upon remand*, *22 F. Supp. 2d 820 (N.D. Ill. 1998)* (applying the equitable tolling doctrine, court found that Lawyers Title failed to act with due diligence to discover its cause of action; statute of limitations, therefore, not tolled); *Kerby v. Mortgage Funding Corp., 992 F. Supp. 787 (D. Md. 1998)* . *See also Salois v. Dime Sav. Bank, FSB, 128 F.3d 20 (1st Cir. 1997)* (court assumes equitable tolling doctrine applies but finds that law documents contained all of the information necessary to determine bases of claims; inquiry notice satisfied); *Pedraza v. United Guar. Corp., 114 F. Supp. 2d 1347 (S.D. Ga. 2000)* (equitable tolling doctrine recognized but tolling can only occur for three years; plaintiff did not adequately plead facts to support equitable tolling claim; complaint dismissed without prejudice).

(n126)Footnote 122. For a discussion of HOEPA, see Ch. 2 *supra*. For a discussion of fair lending and civil rights statutes, see Ch. 5, "Credit Discrimination," *supra*.

(n127)Footnote 123. *15 U.S.C. § 1691*, Regulation B, *12 C.F.R. § 202.2(l)*, Official Staff Commentary, *12 C.F.R. § 202.2(l)*.

(n128)Footnote 124. U.S.C. § 3605, *24 C.F.R. § 100.115*. State fair lending laws are compiled in National Consumer Law Center, Credit Discrimination, Appx. F (4th ed. and supp.). *See also* National Consumer Law Center,

The Cost of Credit: Regulations, Preemption and Industry Abuses, § 12.3 (4th ed. 2009).

(n129)Footnote 125. *42 U.S.C. §§ 1981 et seq.*

(n130)Footnote 126. *See, e.g.*, Steele v. Bronstein, Clearinghouse No. 53,510, Civil Action No. 98-1940 (RMU) (D.D.C. June 30, 2000) (memorandum opinion) (in this case, however, the homeowner could only show that she was targeted on the basis of the neighborhood where she lived which had a high concentration of African-Americans and because she was a female head-of-household; case remanded to D.C. superior court on UDAP and local human rights act claims); *Matthews v. New Century Mortg. Corp., 185 F. Supp. 2d 874 (S.D. Ohio 2002)* (reverse redlining claim under § 3605 of the FHA and the Ohio state law equivalent survive motion to dismiss; ECOA claims withstand motion to dismiss as well because consumer need only allege that she was discriminated against in the terms of her credit for a prohibited reason). *See also* National Consumer Law Center, Credit Discrimination, Chapters 7 and 8 (4th ed. and supp.).

(n131)Footnote 127. *18 U.S.C. § 1961(1)(B). See also Beard v. Worldwide Mortg. Corp., 354 F. Supp. 2d 789, 800-08 (W.D. Tenn. 2005)* (denying motion to dismiss § 1962(c) claim against a title company and an attorney based on an alleged predatory lending scheme).

(n132)Footnote 128. *See, e.g., Perino v. Mercury Fin. Co., 912 F. Supp. 313 (N.D. Ill. 1995) . Compare* Johnson v. Mercury Fin., Clearinghouse No. 50, 407, Case No. CV 93-952 (Ala. Cir. Ct. jury verdict Aug. 1994). *See also Balderos v. City Chevrolet, Buick, Geo, Inc., 1998 U.S. Dist. LEXIS 4398* (N.D. Ill. March 31, 1998) , *aff'd in part, rev'd in part on other grounds, 214 F.3d 849 (7th Cir. 2000)* (auto dealer's Truth in Lending Act violations accomplished through wire and mail communications did not, on their own, raise wire and mail fraud allegations sufficient to avoid dismissal of RICO claim).

(n133)Footnote 129. *See, e.g., Kenty v. Bank One, Columbus, N.A., 67 F.3d 1257 (6th Cir. 1995) . See also Hobson v. Lincoln Ins. Agency, Inc., 2000 U.S. Dist. LEXIS 13314* (N.D. Ill. Sept. 7, 2000) (RICO claims were dismissed but with leave to amend in these cases where insurance premium finance company and the insurance company were connected and failed to disclose this fact to the consumer), *further proceedings, 2001 U.S. Dist. LEXIS 476* (N.D. Ill. Jan. 18, 2001) (RICO claim dismissed again after opportunity to amend); *Dixon v. Ford Motor Credit Co., 2000 U.S. Dist. LEXIS 7934* (E.D. La. May 31, 2000) , *further proceedings, 137 F. Supp. 2d 702 (E.D. La. 2000)* , *aff'd without op., 252 F.3d 1156* (5th Cir.) , *cert. denied, 534 U.S. 952, 122 S. Ct. 349, 151 L. Ed. 2d 263 (2001)* (RICO claims ultimately dismissed because consumers did not rely upon the misrepresentations; allegations that auto dealer failed to disclose commissions on credit life insurance sales could present predicate act of mail fraud sufficient to avoid dismissal of RICO claim).

(n134)Footnote 130. *Matthews v. New Century Mortgage Corp., 185 F. Supp. 2d 874 (S.D. Ohio 2002) .*

(n135)Footnote 131. *Ohio Rev. Code §§ 1345.01 to 1345.03* (2006).

(n136)Footnote 132. *Minn. Stat. §§ 58.02, 58.13, 58.137, 58.15, 58.16* (2007).

(n137)Footnote 133. *R.I. Gen. Laws § 34-25.2-1* (2006).

(n138)Footnote 134. *Tenn. Code Ann. § 45-20-101* (2006).

(n139)Footnote 135. For brief discussions of common law origins of unconscionability, see National Consumer Law Center, Consumer Warranty Law, § 11.2 (3d ed. and supp.), and Spanogle, *Analyzing Unconscionability Problems,* 117 U. Pa. Rev. 931, 936-41 (1968-69).

(n140)Footnote 136. *See, e.g., Cal. Civ. Code § 1670.5*; *Iowa Code § 537.5108*; *Tenn. Code Ann. § 47-14-117(c).* California has enacted several statutes that must be reviewed in determining whether a contract provision is

unconscionable, depending on the context. For example, *Cal. Civ. Code § 1668* provides that it is against public policy for a contract to exempt anyone from responsibility for her own fraud or willful injury to the person or property of another or violation of law, whether wilful or negligent. Further, the unconscionability of an arbitration clause may be measured against Cal. Civ. Code § 1281.2 (California's arbitration statute). *See also Stirlen v. Supercuts, Inc., 51 Cal. App. 4th 1519, 60 Cal. Rptr. 2d 138 (1997)* .

(n141)Footnote 137. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 4.4 (7th ed. 2008 and supp.).

(n142)Footnote 138. *See, e.g.,* UCCC § 5.108 cmts. P 1, 3; *Perdue v. Crocker Nat'l Bank, 702 P.2d 503, 511 n.10* , *appeal dismissed, 475 U.S. 1001, 106 S. Ct. 1170, 89 L. Ed. 2d 290 (1986)* . For a more complete discussion of unconscionability, see National Consumer Law Center, Consumer Warranty Law § 11.2 (3d ed. 2006 and supp.).

(n143)Footnote 139. *See generally A&M Produce v. FMC Corp., 135 Cal. App. 3d 473 (1982)* ; National Consumer Law Center, Consumer Warranty Law § 11.2 (2d ed. 2001 and Supp.); Steven W. Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive and Commercial Interest Rates Under the Unconscionability Standard, 31 Houston L. Rev. 721 (1994);* Leff, *Unconscionability and the Code--The Emperor's New Clause, 115 U. Pa. L. Rev. 485 (1967);* Note, *Reviving the Law of Substantive Unconscionability, Applying the Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts, 33 UCLA L. Rev. 940, 944 (1986).*

(n144)Footnote 140. Note, *Reviving the Law of Substantive Unconscionability, Applying the Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts, 33 UCLA L. Rev. 940, 944 (1986);* Leff, *Unconscionability and the Code--The Emperor's New Clause, 115 U. Pa. L. Rev. 485, 539 (1967)* ("bargaining naughtiness").

(n145)Footnote 141. Note, *Reviving the Law of Substantive Unconscionability, Applying the Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts, 33 UCLA L. Rev. 940, 946 (1986);* Leff, *Unconscionability and the Code--The Emperor's New Clause, 115 U. Pa. L. Rev. 485, 509 (1967).*

(n146)Footnote 142. Note, *Reviving the Law of Substantive Unconscionability, Applying the Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts, 33 UCLA L. Rev. 940, 944 (1986).* For an explanation of "oppression" and "surprise," see *A&M Produce v. FMC Corp., 135 Cal. App. 3d 473, 486 (1982)* (" 'Oppression' arises from an inequality of bargaining power which results in no real negotiation and absence of meaningful choice ... . 'Surprise' involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms."). *Sosa v. Paulos, 924 P.2d 357 (Utah 1996)* .

(n147)Footnote 143. Speidel, *Unconscionability, Assent and Consumer Protection, 31 U. Pitt. L. Rev. 359 (1970).* *See also Williams v. E.F. Hutton Mortgage Corp., 555 So. 2d 158 (Ala. 1989)* (gross inequality of bargaining power). *Cf. Marshall v. Mercury Fin. Co., 550 So. 2d 1026 (Ala. Civ. App. 1989)* (unconscionability is an extraordinary remedy reserved for parties who are uneducated and unsophisticated; plaintiff who had college education and understood transaction did not establish claim of unconscionability).

(n148)Footnote 144. *A&M Produce v. FMC Corp., 135 Cal. App. 3d 473, 486 (1982) . Cf. OMP v. Security Pac. Bus. Fin., Inc., 716 F. Supp. 239 (N.D. Miss. 1989)* (transaction involved arms-length negotiations between commercial parties and was "not a case involving a contract of adhesion forced upon an unwilling and powerless consumer"). California has liberalized this standard somewhat. Even if the party raising unconscionability is well-educated and highly paid, procedural responsibility will be found where there was no realistic opportunity to modify the terms of the contract, which was a generic contract and presented after employment began. *Stirlen v. Supercuts, Inc., 51 Cal. App. 4th 1519, 60 Cal. Rptr. 2d 138 (1997)* ; *see also Graham v. Scissor-Tail, Inc., 28 Cal. 3d 807, 171 Cal. Rptr. 604, 623*

P.2d 165 (Cal. 1981) .

(n149)Footnote 145. *See* Kripke, *Gesture and Reality in Consumer Credit Reform, 44 N.Y.U. L. Rev. 1, 7 (1969)* ("The ghetto shopper is not a comparison shopper and does not have access to the lowest prices.").

(n150)Footnote 146. *A&M Produce v. FMC Corp., 135 Cal. App. 3d 473, 486 (1982)* . *See also Williams v. E.F. Hutton Mortgage Corp., 555 So. 2d 158 (Ala. 1989)* . *See also Knapp v. American Gen. Fin. Inc., 111 F. Supp. 2d 758 (S.D. W. Va. 2000)* (though the contract terms may have been clear, the lender misrepresented the contents of the documents to consumers who could not read).

(n151)Footnote 147. *A&M Produce v. FMC Corp., 135 Cal. App. 3d 473 (1982)* . *See also In re Allen, 174 B.R. 293 (Bankr. D. Or. 1994)* (RTO transaction not unconscionable; noting Oregon courts typically generally use a balancing approach, using both procedural and substantive unconscionability); National Consumer Law Center, Consumer Warranty Law, § 11.2.4.3 (3d ed. and supp.). *But see Maxwell v. Fidelity Fin. Servs., Inc., 184 Ariz. 82, 907 P.2d 51 (1995)* (Arizona court adopts the rule that a claim of unconscionability can be established with a showing of substantive unconscionability alone, especially in cases involving either price-cost disparity or limitation of remedies. "If only procedural irregularities are present, it may be more appropriate to analyze the claims under the doctrines of fraud, misrepresentation, duress, and mistake, although such irregularities can make a case of procedural unconscionability." *Id.* at 59 .). *See also Taylor v. Bob O'Connor Ford, Inc., 2000 U.S. Dist. LEXIS 11486* (N.D. Ill. June 29, 2000) (allegations of lack of education and sophistication alone is not enough to state an unconscionability claim in auto packing case).

(n152)Footnote 148. *Williams v. First Gov't Mortg. & Invs. Corp., 974 F. Supp. 17 (D.D.C. 1997)* ; *A&M Produce v. FMC Corp., 135 Cal. App. 3d 473, 487 (1982)* ; *Sosa v. Paulos, 924 P.2d 357 (Utah 1996)* (clause in arbitration paragraph in a medical malpractice contract was found to be substantively unconscionable where it required the patient to pay all costs incurred by the physician to defend the arbitration, and all costs of the arbitration itself if the arbitrator awarded the patient less than one half of the amount she sought). *But cf. Shadoan v. World Savings & Loan Ass'n, 268 Cal. Rptr. 207 (Ct. App. 1990)* (using unconscionability standard to evaluate a UDAP claim, court held that contract combining a unilateral call provision and a prepayment penalty did not impermissibly reallocate risk; court notes that "significantly" the prepayment penalty would not attach if the lender exercised its call option).

(n153)Footnote 149. The fact intensive nature of the unconscionability inquiry should preclude summary judgment unless there are no factual disputes. *See Herrod v. First Republic Mortgage Corp., Inc., 625 S.E.2d 373 (W. Va. 2005)* . *See also Cazares v. Pacific Shore Funding, 2006 U.S. Dist. LEXIS 1081* (C.D. Cal. Jan. 3, 2006) ("determination of whether contract is unconscionable requires consideration of facts beyond scope of a motion to dismiss").

(n154)Footnote 150. *Cowin Equip. Co. v. General Motors Corp., 734 F.2d 1581 (11th Cir. 1984)* ; *Williams v. E.F. Hutton Mortgage Corp., 555 So. 2d 158 (Ala. 1989)* ; *Best v. United States Nat'l Bank of Oregon, 78 Or. App. 1, 714 P.2d 1049, 1 U.C.C. Rep. Serv. 2d 6 (1986)* , on other grounds, *303 Or. 557, 739 P.2d 554, 4 U.C.C. Rep. Serv. 2d 8 (1987)* . *See generally* Steven W. Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive and Commercial Interest Rates Under the Unconscionability Standard, 31 Houston L. Rev. 721 (1994).*

(n155)Footnote 151. *See, e.g., D.C. Code § 28-3904(r)*; *Iowa Code § 537.5108* (court may refuse to enforce unconscionable agreement, in whole or in part; consumer may be awarded actual damages and attorneys' fees).

(n156)Footnote 152. Restatement (Second) of Contracts § 205 (1979). *See also In re Peterson, 93 B.R. 323 (Bankr. D. Vt. 1988)* . *But see Johnstone v. Bank of Am., N.A., 173 F. Supp. 2d 809 (N.D. Ill. 2001)* (does not recognize an independent cause of action for the breach of the duty of good faith and fair dealing, relying on *Voyles*); *Voyles v. Sandia Mortg. Co., 196 Ill. 2d 288, 256 Ill. Dec. 289, 751 N.E.2d 1126 (2001)* , *reh'g denied,* (June 29, 2001) (Illinois does not recognize an independent cause of action for the breach of the duty of good faith and fair dealing); *Citibank*

(S.D.), N.A. v. Gifesman, 63 Conn. App. 188, 773 A.2d 993 (2001) (the implied duty cannot be applied to achieve a result contrary to the clear expressed contract terms, unless those terms are contrary to public policy). *Compare Perdue v. Crocker Nat'l Bank, 38 Cal. 3d 913, 216 Cal. Rptr. 345, 702 P.2d 503 (1985) , appeal dismissed, 475 U.S. 1001, 106 S. Ct. 1170, 89 L. Ed. 2d 290 (1986)* (both unconscionability and duty of good faith implicated in the bank's imposing NSF charges), *with Best v. United States Nat'l Bank, 303 Or. 557, 739 P.2d 554 (1987)* (unconscionability doctrine not applicable to bank's NSF charges, because the specific fee was not part of agreement; duty of good faith and fair dealing was applicable).

NOTE: In sorting through the conflicting cases on duty of good faith in lender liability cases, it is important to note the distinction between those sounding in tort and those sounding in contract. Tort liability for breach of the covenant of good faith probably requires a showing of some special relationship beyond that of lender and customer, such as special circumstances giving rise to a fiduciary or quasi-fiduciary relationship or other indicia of a heightened duty. *See § 6.09[4] infra*; *cf. Wallis v. Superior Court, 160 Cal. App. 3d 1109, 207 Cal. Rep. 123 (1984)* . The contractual obligation, in contrast, is firmly established and applies to every contract, see, e.g., *Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 261 Cal. Rptr. 735, 741 (1989)* .

(n157)Footnote 153. *UCC § 1-203*.

(n158)Footnote 154. Note that this conduct may violate unconscionability standards, as well.

(n159)Footnote 155. *See, e.g., Flagship Nat'l Bank v. Gray Distrib. Sys., Inc., 485 So. 2d 1336, 1 U.C.C. Rep. Serv. 2d 601, 606 (Fla. Dist. Ct. App. 1986)* .

(n160)Footnote 156. *See, e.g.,* UCCC §§ 2-405, 3-402 (1968); § 3-308 (1974); *Ala. Code § 5-19-7*; *Ky. Rev. Stat. § 367.390*; and some RISA statutes, e.g., *6 Del. Code Ann. § 4326*. (Note that, even if such statutes apply to home equity lending, in some circumstances they may be preempted by federal law. *See generally § 6.02 supra*.)

(n161)Footnote 157. *See, e.g., Duffield v. First Interstate Bank, 13 F.3d 1403 (10th Cir. 1993) , cert. denied, 512 U.S. 1205, 114 S. Ct. 2674, 129 L. Ed. 2d 810 (1994) . See also Littlejohn v. Parrish, 839 N.E.2d 49 (Ohio Ct. App. 2005)* (reversing summary judgment in favor of mortgagee who refused to permit prepayment of loan and finding good faith and fair dealing requires not only honesty but also reasonableness in the enforcement of the contract) *with Cable & Assoc. Ins. Agency v. Commercial Nat'l Bank, 875 A.2d 361 (Pa. Super. Ct. 2005)* (lender not required to surrender rights granted by statute or conferred by contract; no breach where lender refused to release security interest to allow borrower to secure additional credit); *Farm Credit Servs. of America v. Dougan, 704 N.W.2d 24 (S.D. 2005)* (use of remedies expressly provided for in contract--foreclosure--does not give rise to breach of duty).

(n162)Footnote 158. *Teachers Ins. & Annuity Ass'n of Am. v. Butler, 626 F. Supp. 1229 (S.D.N.Y. 1986)* ; *Liebergesell v. Evans, 93 Wash. 2d 881, 613 P.2d 1170 (1980)* .

(n163)Footnote 159. *Chedick v. Nash, 151 F.2d 1077 (D.C. Cir. 1998)* (court recognized the tort of promissory fraud, i.e., misrepresentation of present intent to perform an act in the future; the act here was the duty to act in good faith).

(n164)Footnote 160. *Voyles v. Sandia Mortg. Corp., 724 N.E.2d 1276 (Ill. App. 2000)* (recognized this tort in Illinois in "egregious" cases).

(n165)Footnote 161. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 12.8 (4th ed. 2009).

(n166)Footnote 162. *See, e.g., Chandler v. General Motors Acceptance Corp., 68 Ohio App. 2d 30, 19 Ohio Op. 3d 90, 426 N.E.2d 521 (Ohio Ct. App. 1980)* .

(n167)Footnote 163. For a good example listing the types of proof obtained by a deceased consumer's spouse, see *Vining v. Enterprise Fin. Group, Inc., 148 F.3d 1206 (10th Cir. 1998)* .

(n168)Footnote 164. *Washington Mut. Bank v. Superior Court, 70 Cal. App. 4th 299, 82 Cal. Rptr. 2d 564 (4th Dist. 1999)* (nationwide class action certified; no ruling on merits of claim).

(n169)Footnote 165. *In re Nosek, 2006 Bankr. LEXIS 1279* (Bankr. D. Mass. June 30, 2006) . The court awarded the plaintiff $250,000 in emotional distress damages for the breach of the implied covenant of good faith and fair dealing. On appeal, the district court held (incorrectly) that the plaintiff's common law claims were preempted by the Bankruptcy Code. *Ameriquest v. Nosek, 354 B.R. 331 (D. Mass. 2006)* . On remand, the bankruptcy court held the defendant liable for the same conduct under *§ 105 of the Bankruptcy Code* and awarded $250,000 in emotional distress damages and $500,000 in punitive damages. *In re Nosek, 363 B.R. 643, 2007 Bankr. LEXIS 769* (Bankr. D. Mass. Mar. 6, 2007) .

(n170)Footnote 166. *Stewart v. Phoenix Nat'l Bank, 49 Ariz. 34, 64 P.2d 101, 106 (1937)* ; *see also Capital Bank v. MVB, Inc., 644 So. 2d 515 (Dist. Ct. App. 1994)* , *rev. denied, mot. denied, mandamus denied, 659 So. 2d 1086 (Fla. 1995)* ; *Sallee v. Fort Knox Nat'l Bank, N.A. (In re Sallee), 286 F.3d 878* (6th Cir.) , *cert. denied, 537 U.S. 949, 123 S. Ct. 415, 154 L. Ed. 2d 294 (2002)* (ordinarily no fiduciary duty on bank to act in the borrower's interest; fraud claim actionable, however, where the bank kept one appraisal secret while revealing another as duty to disclose arises from a partial disclosure of information where a party to the contract has superior knowledge; case involved business loans); *Citibank (S.D.), N.A. v. Gifesman, 63 Conn. App. 188, 773 A.2d 993 (2001)* ; *Geiger v. Crestar Bank, 778 A.2d 1085 (D.C. 2001)* (relationship between bank and depositor is governed by the written agreement; ordinarily no fiduciary duty owed by the bank); *Lattier-Holmes v. Peoples State Bank, 796 So. 2d 176 (La. App. 2001)* , *cert. denied, 537 U.S. 897, 123 S. Ct. 197, 154 L. Ed. 2d 167 (2002)* (same). *See also Sutton v. Viking Oldsmobile Nissan, Inc., 2001 Minn. App. LEXIS 866* (Minn. Ct. App. July 31, 2001) , *review denied, 2001 Minn. LEXIS 724* (Minn. Oct. 24, 2001) (no fiduciary duty between consumer and car dealer). *Irvin v. American Gen. Fin., Inc., 2005 Ohio 3523 (Ohio Ct. App. 2005)* (whether special circumstances exist giving rise to fiduciary relationship between lender and borrower question of fact precluding dismissal). *Cf. Fridenmaker v. Valley Nat. Bank, 534 P.2d 1064 (Ariz. Ct. App. 1975)* (mortgagor's consultation with competent counsel militates against finding that confidential relationship existed); *Mans v. Peoples Bank of Imboden, 10 S.W.3d 885 (Ark. 2000)* (husband's 23-year relationship with bank and widow's lack of sophistication insufficient to create fiduciary duty such that bank had duty to inform widow of lapse in credit life insurance policy). *Frye v. American Gen. Fin., Inc., 307 F. Supp. 2d 836 (S.D. Miss. 2004)* (acknowledging special circumstances may give rise to fiduciary duty between lender and borrower; such circumstances not sufficiently alleged). *But see Jenkins v. Hyundai Motor Fin. Co., 389 F. Supp. 2d 961 (S.D. Ohio 2005)* ("touting" and "selling" credit disability insurance not sufficient to create fiduciary duty).

(n171)Footnote 167. *Barrett v. Bank of Am., 229 Cal. Rptr. 16 (Ct. App. 1986)* .

(n172)Footnote 168. Restatement (Second) of Torts § 551.

(n173)Footnote 169. *First Nat'l Bank v. Brown, 181 N.W.2d 178, 182 (Iowa 1970)* (if the misrepresentation amounts to fraud in the inducement "whether innocent or not," that may give the defrauded party the right to avoid the contract in an action in equity). *But see Basile v. H & R Block, Inc., 761 A.2d 1115 (Pa. 2000)* (tax preparer not an agent of customer in tax refund loan transaction, but see the dissents), *further proceedings, 777 A.2d 95 (Pa. Super. Ct. 2001)* (tax preparer can create a confidential relationship with its customers, where, as in this case, the tax preparer and customer are in different positions of knowledge and where the tax preparer cultivated customer trust through an extended and extensive media ad campaign, the focal point of which was the tax preparer's expertise in tax matters and the trustworthy character of its services; trial court reversed and remanded).

(n174)Footnote 170. *Frey v. Fraser Yachts, 29 F.3d 1153, 1159 (7th Cir. 1994)* .

(n175)Footnote 171. *Frey v. Fraser Yachts, 29 F.3d 1153, 1159 (7th Cir. 1994)* .

(n176)Footnote 172. A lender may also be liable to return money or property it received in consequence of another's breach of fiduciary duty, particularly if there was bad faith on the lender's part. *See, e.g., Briggs v. Countrywide Funding Corp., 931 F. Supp. 1545 (M.D. Ala. 1996)* (denying lender's motion to dismiss variety of claims challenging yield-spread premiums, including improper interference with brokerage contract and that offer of the yield-spread premium induced the broker to breach its fiduciary duty), *vacated on other grounds, 949 F. Supp. 812 (M.D. Ala. 1996)* . *Cf. Trenton Trust Co. v. W. Sur. Co., 599 S.W.2d 481 (Va. 1980)* .

(n177)Footnote 173. *See, e.g., Optivision, Inc. v. Syracuse Shopping Ctr. Assoc., 472 F. Supp. 665, 684 (N.D.N.Y. 1979)* . *See also Thrift v. Hubbard, 44 F.3d 348 (5th Cir. 1995)* (stating elements under Texas law), *reh'g denied, 1995 U.S. App. LEXIS 6443* (5th Cir. Mar. 16, 1995) ; *Kenty v. Transamerica Premium Ins. Co., 650 N.E.2d 863 (Ohio 1995)* , *reh'g, en banc, denied, 1996 U.S. App. LEXIS 24797* (6th Cir. Sept. 19, 1996) .

(n178)Footnote 174. *Kenty v. Transamerica Premium Ins. Co., 650 N.E. 2d 863 (Ohio 1995)* .

(n179)Footnote 175. *See, e.g., Hays v. Bankers Trust Co. of Cal., 46 F. Supp. 2d 490 (S.D. W. Va. 1999)* (denial of lender's motion for summary judgment based solely upon inconsistent disclosures); *George v. Capital S. Mortgage Invs., Inc., 265 Kan. 431, 961 P.2d 32 (1998)* (lender and broker held liable for fraud and usury under joint venture theory); *Williams v. Aetna Fin. Co., 83 Ohio St. 3d 464, 700 N.E.2d 859 (1998)* , *cert. denied, 526 U.S. 1051, 119 S. Ct. 1357, 143 L. Ed. 2d 518 (1999)* (civil conspiracy); *Union Mortgage Co. v. Barlow, 595 So. 2d 1335 (Ala. 1992)* , *cert. denied, 506 U.S. 906, 113 S. Ct. 301, 121 L. Ed. 2d 224 (1992)* .

(n180)Footnote 176. *See Halberstam v. Welch, 705 F.2d 472 (D.C. Cir. 1983)* (case involved civil liability of a live-in companion for murder committed during a burglary; good discussion of the differences and similarities between liability as a conspirator and as an aider and abettor).

(n181)Footnote 177. *Richfield Bank & Trust Co. v. Sjogren, 309 Minn. 362, 244 N.W.2d 648 (1976)* (commercial case where lender knew the seller was insolvent and failed to warn its customer); *Hays v. Bankers Trust Co., 46 F. Supp. 2d 490 (S.D. W. Va. 1999)* (lender's motion for summary judgment denied based solely upon inconsistent disclosures on face of commitment letter and the actual terms of the loan provided at closing); *George v. Capital S. Mortg. Invs., 265 Kan. 431, 961 P.2d 32 (1998)* (lender, broker, and middle-man held liable for fraud and usury under joint venture theory); *Williams v. Aetna Fin. Co., 83 Ohio St. 3d 464, 700 N.E.2d 859 (1998)* , *cert. denied, 526 U.S. 1051, 119 S. Ct. 1357, 143 L. Ed. 2d 518 (1999)* (court held lender liable for acts of home improvement contractor under civil conspiracy claim where lender allowed home improvement contractor to have access to loan money that was necessary to further his fraudulent actions, lender selected "authorized" contractor, and readily made loans to his customers despite knowledge of complaints about, and problems with, the contractor); *Union Mortg. Co. v. Barlow, 595 So. 2d 1335* (Ala.) , *cert. denied, 506 U.S. 906, 113 S. Ct. 301, 121 L. Ed. 2d 224 (1992)* ; *see also United Cos. Fin. Corp. v. Brown, 584 So. 2d 470 (Ala. 1991)* (financer steered borrowers to contractor who failed to perform work and released escrow funds knowing work was not done; compensatory and punitive damages awarded); Lockhart v. Lovett, Clearinghouse No. 50,406 (Cir. Ct., Miss., complaint filed Feb. 17, 1993) (a jury verdict in excess of $1.5 million was rendered in Aug. 1994, against the finance company financing a contractor's home improvement sales contracts). *But see Miller Planning Corp. v. Wells, 253 A.D.2d 859, 678 N.Y.S.2d 340* (2d Dep't 1998) (no evidence that lender had a relationship with the contractor or that lender participated in or had knowledge of the home improvement contractor's scheme).

(n182)Footnote 178. For a discussion and listing of these cases, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 12.10.1 (4th ed. 2009).

(n183)Footnote 179. *See Halberstam v. Welch, 705 F.2d 472 (D.C. Cir. 1983)* (discusses the similarities and differences between these theories).

(n184)Footnote 180. Restatement (Second) of Torts § 876 (1979).

(n185)Footnote 181. *Halberstam v. Welch, 705 F.2d 472 (D.C. Cir. 1983)* .

(n186)Footnote 182. *Schunk v. United Fin. Mortg. Corp., 2001 U.S. Dist. LEXIS 5685* (D. Kan. Apr. 11, 2001) (lender's motion to dismiss denied where lender's employee allegedly forged the customer's initials on a document at the direction of the lender's vice-president; lender can be liable for tortious conduct of it employees); *Holley v. Gurnee Volkswagen & Oldsmobile, Inc., 2001 U.S. Dist. LEXIS 7274* (N.D. Ill. Jan. 4, 2001) (car salesperson acted as agent of car dealer; car dealer is liable for acts of fraud of salesperson, at least at motion to dismiss stage); *Inter Mountain Mortg., Inc. v. Sulimen, 78 Cal. App. 4th 1434, 93 Cal. Rptr. 2d 790 (4th Dist. 2000)* (the theory of respondeat superior and liability of the employer of the tortfeasor is flushed out in this case which deals with the lender suing the mortgage broker for the fraud of its employee).

(n187)Footnote 183. *See, e.g., Roberson v. Money Tree of Ala., Inc., 954 F. Supp. 1545 (M.D. Ala. 1997)* ; *Staples v. Money Tree, Inc., 936 F. Supp. 856 (M.D. Ala. 1996). Contra Jones v. Money Tree, 686 So. 2d 1166 (Ala. 1996)* (court strictly applied contract law by holding that since the insurer was a non-signatory to the loan documents containing the arbitration clause, it had no right to invoke arbitration).

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PART I Consumer Credit
CHAPTER 7 Rent-to-Own Transactions

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§ 7.12 RTO Company and Consumer Liability After Repossession

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§ 7.15 Disclosure of RTO Transaction's Effective Annual Percentage Rate

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§ 7.17 UCC Article 2A Unconscionability as Alternative to UDAP.

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PART I Consumer Credit
CHAPTER 7 Rent-to-Own Transactions

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§ 7.01 Rent-to-Own Appliance Contracts Described

"Rent-to-Own" ("RTO") businesses are essentially appliance and furniture retailers which arrange lease agreements rather than typical installment sales contracts for those customers who cannot purchase goods with cash or who are unsophisticated about money management. These lease agreements contain several special features. First, the lease agreements contain purchase options which typically enable the lessees to obtain title to the goods in question by making a nominal payment at the end of a stated period, such as 18 months. Second, the leases are short term, so that "rental payments" are due weekly or monthly. Third, the leases are "at will." In other words, the leases theoretically need not be renewed at the end of each weekly or monthly term. n1

The RTO industry aims its marketing efforts at low-income consumers by advertising in minority media, buses, and in public housing projects, and by suggesting it has many features attractive to low-income consumers: quick delivery, weekly payments, no or small down payments, quick repair service, no credit checks, and no harm to one's credit rating if the transaction is canceled. Most RTO customers enter into these transactions with the expectation of buying an appliance and are seldom interested in the rental aspect of the contract. n2 This attitude is encouraged by RTO dealers who emphasize the purchase option in their marketing even while they are minimizing its importance in the written contract. Of course, if and when a transaction is challenged in court, a RTO dealer will point to the rental provisions of the contract and claim that statutes which control traditional retail installment sales are irrelevant to RTO agreements.

The chief problem with RTO contracts is not only that these supposed leases are used to mask installment sales, but also that these sales are made at astronomic and undisclosed effective interest rates. Under most RTO contracts, the customer will pay between $1000 and $2400 for a TV, stereo, or other major appliance worth as little as $200 retail, if used, and seldom more than $600 retail, if new. This means that a low-income RTO customer may pay 1 1/2 to 12 times what a cash customer would pay in a traditional retail store for the same appliance. Seldom is there any disclosure of the age of a used appliance being sold.

The finance charge and interest rate or annual percentage rate ("APR") of an RTO contract depends on the retail cash value of the appliance (especially whether new or used) and the timing, amount, and number of payments.

For example, in the Boston area, a 19-inch brand name, new color TV with standard features sells for less than $300. A 25-inch table model, color television sells for less than $500 and a 25-inch console television sells for less than $600.

Therefore, if an RTO customer leases a new 19-inch color TV (worth $300) for $16.00 per week for 52 weeks, the APR would be about 254%. However, if the customer leased a *used* 19-inch color TV (worth about $200 or less) for the same payment terms, the APR could be 408% or more.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionGeneral OverviewCommercial Law (UCC)General OverviewContracts LawSecured TransactionsInstallment ContractsGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. For a recent comprehensive discussion of Rent-to-Own [hereinafter RTO] issues, see Susan Lorde Martin & Nancy White Huckins, *Consumer Advocates vs. the Rent-to-Own Industry: Reaching a Reasonable Accommodation*, *34 Am. Bus. L.J. 385 (1997)*. For detailed description of a rent-to-own contract, see *Sight & Sound of Ohio, Inc. v. Wright, 36 B.R. 885 (Bankr. S.D. Ohio 1983) . See also A Study of Appliance Rental Practices: Appliance Rentals and Purchases by Low-Income Consumers*, *20 Clearinghouse Rev. 1515 (Apr. 1987)*.

(n2)Footnote 2. The industry often says that less than one-quarter of its customers purchase the "rented" goods, but its method of deriving that statistic is suspect. Discovery obtained in one class action against a major RTO company showed that 66% of one year's inventory was sold, and between 73% and 77% of the company's revenues came from sales, not rentals. *See* Ramp, *Renting-To-Own in the United States*, *24 Clearinghouse Rev. 797 (Dec. 1990)*. Data obtained from RTO dealer's databases from different chains in several states confirm that 75% or more of the dealer's gross revenue is derived from customers who purchase goods. For example, RTO Enterprises Inc., Canada's largest rent-to-own company, reports that approximately 85% of RTO's revenues are generated through the rent-to-own program and approximately 87% of all rent-to-own customers purchase the merchandise at the end of the rental term. *See* www.stockdepot.com/buylowsellhigh/rto.html for RTO Enterprises Inc. *But see* Michael H. Anderson & Raymond Jackson, *A Reconsideration of Rent-to-Own*, 35 J. Cons. Affairs 295 (2001) (authors argue that the total cost, potential lost equity, and the APR is not a good measure of the true value to the consumer of a RTO transaction; instead, the benefits to the consumer should be measured by the value of: delivery; set up; maintenance; repair; immediate product availability without a formal credit check and without a security deposit or down payment; payments by cash or check on a weekly or monthly basis; ability to secure insurance against damage or theft; termination of the agreement at any time without further financial liability or damage to credit history).

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CHAPTER 7 Rent-to-Own Transactions

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§ 7.02 Legal Status of RTO Contracts

Rent-to-own (RTO) transactions have generally won widespread, but not universal, exemption from UCC Article 9. This exemption is surprising because the very name rent-to-*own* and consumer expectations are that these are sales transactions, with the RTO company reserving the right to seize the goods if the consumer defaults.

Article 9 does not govern RTO transactions primarily because special RTO statutes have been enacted in many states that specifically exempt RTO transactions from Article 9. In addition, the 1987 amendments to the definition of security interest in *UCC § 1-201(37)* [revised *U.C.C. §§ 1-201(b)(35), 1-203*], now adopted by all fifty states and the District of Columbia, make it more difficult to argue that a RTO transaction involves a security interest. Instead of Article 9, Article 2A applies to RTO contracts, except in a few states that have enacted a specific exemption. n1 Similarly, RTO transactions may be held to constitute security agreements rather than true leases under the Bankruptcy Code, thereby giving bankrupt consumers greater rights than normal lessees. n2 Leases under which the lessee agrees to pay a sum equal to or exceeding the value of goods, and under which the lessee acquires an option to purchase for nominal consideration, may be credit sales requiring Truth in Lending ("TIL") disclosures. n3 Last, but not least, RTO agreements may be subject to usury limitations under state installment sales acts ("RISAs"). n4 The Supreme Court of New Jersey recently affirmed that rent-to-own contracts as structured were closer to sales and violated that state's Retail Installment Sales Act. n5

For the past twenty years, legal service attorneys, state attorneys general, and other consumer advocates have made these arguments with mixed success. n6 During this same period, the RTO industry has aggressively (and successfully in most cases) lobbied state legislatures and the Congress for a statutory exemption from consumer protection statutes, from annual percentage rate disclosure requirements, and from usury rate limitations. In nearly every state, there are now RTO statutes which were carefully drafted by the industry to insulate dealers from claims of consumer abuse. n7

The specific exemption of RTO transactions from other state and federal laws is the essential feature of these RTO statutes. All of the RTO laws provide that transactions that comply with their provisions are not "credit sales." Many statutes explicitly exempt RTOs from the state's home solicitation sales laws and from UCC Article 9 security interest definitions.

Although there are variations, nearly all RTO statutes require certain disclosures in the contract, including: the number

and timing of the payments necessary to acquire ownership of the property; a statement declaring that the consumer will not own the property until the consumer has made the total payment necessary to acquire ownership; the cash price of the property (most commonly defined as whatever price the lessor sets); and a statement as to whether the property is new or used. n8 Although many state statutes provide that these disclosures must be made clearly and conspicuously, none require that the information be given on a separate document or separately segregated. The mandated disclosures, therefore, often appear scattered throughout the contract. State statutes generally do not mandate in-store price tag disclosures.

All RTO statutes contain "consumer remedy" provisions, but these must be read carefully. For example, Florida provides for statutory damages with attorney's fees and costs. Dealers, however, are only liable if they were notified of the violation in writing and failed to correct it within thirty days. n9 In Maryland, dealers escape liability if they can show that the error was unintentional, resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adopted to avoid that type of error, and that the error was corrected within thirty days of discovering or receiving notice of the error. n10 Some states provide for a mandatory minimum recovery of, say, $100, which is not permitted if the case is filed as a class action. n11 Other states statutes do not include a minimum statutory award. n12

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)General OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. *See* National Consumer Law Center, Repossessions, § 14.3.3.4 (6th ed. 2005 and Supp.).

(n2)Footnote 2. *See In re Minton, 271 B.R. 335 (Bankr. W.D. Ark. 2001)* (RTO agreements were true leases and not conditional sales because they fit the definition of "rental-purchase agreements" under Arkansas law.); *In re Puckett, 60 B.R. 223 (Bankr. M.D. Tenn. 1986) . See also Michaels v. Ford Motor Credit Co. (In re Michaels), 156 B.R. 584 (Bankr. E.D. Wis. 1993)* (court found that the intent of the parties determined that the agreement was a disguised security agreement even though it was called a "Rental Agreement"); National Consumer Law Center, Consumer Bankruptcy Law and Practice § 11.8 (9th ed. 2009) (rent-to-own transactions in bankruptcy).

(n3)Footnote 3. *See 15 U.S.C. § 1602(g). Compare Clark v. Rent-It Corp., 685 F.2d 245 (8th Cir. 1982) , cert. denied, 459 U.S. 1225, 103 S. Ct. 1232 (1983) , with Ortiz v. Rental Mgmt., Inc., 65 F.3d 335 (3d Cir. 1995) . See generally* Annot., *59 A.L.R. Fed. 929 (1982)* (leases as Truth in Lending Act [hereinafter TILA] credit sales).

(n4)Footnote 4. *Anoushian v. Rent-Rite, 2002 Phila. Ct. Com. Pl. LEXIS 98* (Pa. Commw. Ct. May 10, 2002) (Pennsylvania Retail Installment Sales Act, not RTO statute, governed lease agreement with option to purchase). *Anoushian* was legislatively overruled in 2003, see *KFJ Enters., LLC v. Rembert (In re Rembert), 293 B.R. 664 (Bankr. M.D. Pa. 2003)* , and abrogated by *Griffin v. Rent-A-Center, 843 A.2d 393 (Pa. Super. Ct. 2004)* (2003 amendments were a clarification, which the court applied retroactively.) *See LeBakken Rent-to-Own v. Warnell, 589 N.W.2d 425 (Wis. Ct. App. 1998)* ; *Rent-A-Center, Inc. v. Hall, 510 N.W.2d 789 (Wis. Ct. App. 1993) . Cf. Fogie v. Rent-A-Center, Inc., 1995 WL 649575 (D. Minn. 1995)* (RTO contracts are credit sales for all purposes, and are subject to general contract usury ceiling), *aff'd sub nom. Fogie v. Thorn Ams., Inc., 95 F.3d 645 (8th Cir. 1996) . See also Burney v. Thorn Ams., Inc., 944 F. Supp. 762 (D. Minn. 1996)* (measure of damages is the difference between the finance charge and a 5% interest rate; finance charge includes everything except the retail price).

(n5)Footnote 5. *Perez v. Rent-A-Center, Inc., 892 A.2d 1255 (N.J. 2006)* .

(n6)Footnote 6. The most recent successful cases are primarily from three states: Wisconsin, New Jersey, and

Minnesota. *See Fogie v. Thorn Ams., Inc., 95 F.3d 645 (8th Cir. 1996) , cert. denied, 520 U.S. 1166, 117 S. Ct. 1427, 137 L. Ed. 2d 536 (1997)* ; *Miller v. Colortyme, Inc., 518 N.W.2d 544 (Minn. 1994) , pet. denied, 1994 Minn. LEXIS 623* (Minn. Aug. 1, 1994) ; Robinson v. Thorn Ams., Inc., Case No. L-003697-94, Clearinghouse No. 52,047 (N.J. Super. Ct. Dec. 19, 1997); *Rent-A-Center, Inc. v. Hall, 181 Wis. 2d 243, 510 N.W.2d 789 (Ct. App. 1993) .*

(n7)Footnote 7. *See* Susan Lorde Martin & Nancy White Huckins, *Consumer Advocates vs. the Rent-to-Own Industry: Reaching a Reasonable Accommodation, 34 Am. Bus. L.J. 385, 396-400 (1997). See also* National Consumer Law Center, Cost of Credit § 7.5.3.5 (3rd ed. 2005 and Supp.).

(n8)Footnote 8. The disclosure of an effective interest rate is never required, although consumers have tried to convince a court that it should be disclosed under New York law, despite its silence. *Colon v. Rent-A-Center, Inc., 716 N.Y.S.2d 7 (App. Div. 2000) .*

(n9)Footnote 9. *Fla. Stat. § 559.9239.*

(n10)Footnote 10. Md. Code Ann., Com. Law II § 12-1110(c).

(n11)Footnote 11. *See, e.g., Ky. Rev. Stat. Ann. § 367.983(1)(b).*

(n12)Footnote 12. *See, e.g., Iowa Code § 537.3621.*

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§ 7.03 RTO Repossessions Generally

If RTO transactions are found to be secured transactions covered by UCC Article 9, then RTO repossessions would be governed by UCC principles. RTO companies typically do not comply with these standards, and thus would be subject to *UCC section 9-507(1)* [Revised *UCC section 9-625*] actual or statutory damage awards. n1 Because the Article 9 violations would be systematic, the RTO company would be exposed to significant class action liability.

Nevertheless, most states have enacted RTO statutes that specify that Article 9 does not apply to RTO transactions. n2 Other states have also enacted specific RTO statutes, but these statutes do not explicitly exempt RTO transactions from Article 9. The mere passage of RTO legislation, where that legislation does not explicitly override Article 9's applicability, should not be interpreted as a legislative intent to exclude RTO transactions from Article 9's coverage. n3 In the states where there is no explicit exclusion, the issue will be whether Article 9 by its own terms applies to RTO transactions. Article 9 applies to security interests, no matter their form, and *UCC section 1-201(37)* [Revised *UCC section 1-203*] defines when a transaction involves a security interest.

The Servicemembers Civil Relief Act (known as the Soldiers' and Sailors' Civil Relief Act before its amendment in 2003) prohibits RTO companies from using self-help to retake the leased items if the buyer paid a deposit or installment prior to entering active duty. n4 The rental company has the right to seek a court order to retake the goods, but the Act has various protections for servicemembers in litigation. n5

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Secured Transactions (Article 9)General OverviewContracts LawSecured TransactionsDefaultForeclosure & RepossessionGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. There is no precedent to show how to calculate *U.C.C. § 9-507(1)* [Revised *UCC § 9-625*] statutory damages of the finance charge plus 10% of the cash price in RTO cases. Consumers will want to argue that the cash

price is the fair market value of the item when purchased, and that the difference between that amount and the total of payments over the scheduled lease term is the finance charge. RTO companies may argue that some of that differential is not a finance charge, e.g., arguing that RTO products come with a full replacement warranty, in-home delivery, etc. But even then, any amount taken out of the finance charge must be added into the cash price for purposes of calculating statutory damages.

(n2)Footnote 2. *See In re Trusty, 189 B.R. 977 (Bankr. N.D. Ala. 1995)* (RTO agreements are neither leases nor secured transactions, but executory contracts under Alabama law); *In re Osborne, 170 B.R. 367 (Bankr. M.D. Tenn. 1994)* ; *In re Morris, 150 B.R. 446, 20 U.C.C. Rep. Serv. 2d 663 (Bankr. E.D. Mo. 1992)* ; *In re Taylor, 130 B.R. 849 (Bankr. E.D. Ark. 1991) . See also In re Knowles, 253 B.R. 412 (Bankr. E.D. Ky. 2000)* ; *In re Stellman, 237 B.R. 759 (Bankr. D. Idaho 1999)* (RTO contracts do not create security interests).

(n3)Footnote 3. *See In re Smith, 2000 Bankr. LEXIS 1772* (Bankr. E.D. Va. Oct. 31, 2000) (*U.C.C. § 1-201(37)* makes RTO transaction a sale despite RTO statute); *In re Burton, 128 B.R. 807 , aff'd, 128 B.R. 870 (Bankr. N.D. Ala. 1989)* .

(n4)Footnote 4. *50 U.S.C. app. § 532(a).*

(n5)Footnote 5. *See* National Consumer Law Center, Repossessions, § 6.3.5.1 (6th ed. and Supp.).

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PART I Consumer Credit
CHAPTER 7 Rent-to-Own Transactions

1-7 Consumer Credit Law Manual § 7.04

§ 7.04 Arguments That RTO Transactions Are Intended for Security Under UCC § 1-201(37).

In fifteen jurisdictions, the state RTO statute does not exclude RTO transactions from Article 9, and the 1987 version of *UCC section 1-201(37)* [Revised *UCC section 1-203*] determines whether the transaction is intended for security. n1 The new definition of security interest departs from the original by stating that where a transaction is terminable by the lessee, the right to purchase the goods for nominal consideration does not, in and of itself, make a transaction one intended for security. Thus, many courts will find RTO transactions not to be intended for security under this new definition. n2

An analysis of sections 1-201(37) [Revised *UCC section 1-203*] and 2A-103(j) provides several arguments as to why many RTO transactions are intended for security.

The key to this analysis is the concept found in Article 2A that a terminable lease may start out as a "true lease," but later become one intended for security. The fourth paragraph of the comment to *UCC section 2A-103(j)* states: "However, with each renewal of the lease the facts and circumstances at the time of each renewal must be examined to determine if that conclusion remains accurate, as it is possible that a transaction that first creates a lease, later creates a security interest." As a consequence, the factors found in section 1-201(37) [Revised *UCC section 1-203*] must be applied not just when a lease is created, but at every point in the lease.

UCC section 1-201(37) [Revised *UCC section 1-203*] sets out several standards for when a lease is automatically intended for security, if the lease is not subject to termination during the lease's term. While RTO contracts are terminable at the end of each payment period (i.e., after each week or month), the lessee cannot terminate the lease *during* a week or month, but only at the end of the week or month. Thus, these standards are to be applied to the RTO transaction as if the transaction's term is only one week or one month.

Under *UCC section 1-201(37)* [Revised *UCC section 1-203*], a security interest is created if the lessee is "bound" to renew the lease. The fourth paragraph of the comment to *UCC section 2A-103(j)* makes it clear that "economic duress or coercion" as well as a legal obligation could make a lessee "bound." Thus, where a consumer is well into an RTO transaction and has built up substantial "equity," what may have started as a lease not intended for security could become a security interest because the economic realties would dictate that the weekly or monthly lease be renewed each week or month. n3

Moreover, even if none of the standards that automatically make a lease one intended for security apply, the issue under section 1-201(37) [Revised *UCC section 1-203*] is still determined by the facts of each case. Courts can find a RTO contract intended for security because of the weight of all the facts--the RTO advertising, the consumer's expectations, the pricing structure, the nominal purchase option, the consumer's obligation to pay sales tax, the risk of damage being placed on the consumer, and the fact that the total of payments would far exceed the property's value and any reasonable interest payment. n4 The parties' intent is still a primary factor. n5

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)General OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. Alaska, District of Columbia, Georgia, Illinois, Massachusetts, Michigan, Minnesota, Montana, New Jersey, North Carolina, Ohio, Texas, West Virginia, and Wisconsin.

In South Carolina, the original version of *U.C.C. § 1-201(37)* is in effect and South Carolina bankruptcy courts have found that Article 9 applies to RTO transactions. *S.C. Rentals, Inc. v. Arthur, 187 B.R. 502 (Bankr. D.S.C. 1995)* .

(n2)Footnote 2. *See In re Jarrells, 205 B.R. 974, 31 U.C.C. Rep. Serv. 2d 657 (Bankr. M.D. Ga. 1997)* ; *In re Johnson, 203 B.R. 498 (Bankr. S.D. Ga. 1996)* ; *In re Bowman, 194 B.R. 227 (Bankr. D. Ariz. 1995)* ; *In re Allen, 174 B.R. 293, 26 U.C.C. Rep. Serv. 2d 1156 (Bankr. D. Or. 1994)* .

(n3)Footnote 3. *See In re Bailey, 103 B.R. 886 (Bankr. S.D. Ohio 1988)* (RTO transaction might have been found to be lease had debtor presented evidence that number of renewals made continued renewal and purchase only economically feasible option). *See also In re Allen, 174 B.R. 293 (Bankr. D. Or. 1994)* (court examines facts and circumstances at time of renewal, but finds a lease because consumer made only 1 weekly payment of $70 before filing for bankruptcy).

(n4)Footnote 4. *See Green v. Continental Rentals, 678 A.2d 759, 30 U.C.C. Rep. Serv. 2d 1039 (N.J. Super. Ct. Law Div. 1994)* ; *Rent-A-Center, Inc. v. Hall, 181 Wis. 2d 243, 510 N.W.2d 789 (Ct. App. 1993)* . *Cf. In re Zaleha, 159 B.R. 581 (Bankr. D. Idaho 1993)* (interpreting new version in context of car lease, but discussing forfeiture of built-up equity).

(n5)Footnote 5. *Mr. C's Rent To Own v. Jarrells (In re Jarrells), 205 B.R. 994 (Bankr. M.D. Ga. 1997)* .

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PART I Consumer Credit
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1-7 Consumer Credit Law Manual § 7.05

§ 7.05 Does State Credit Legislation Apply to RTO Transactions?

As with UCC Article 9, if state retail installment sales acts or other state credit legislation were to apply to RTO transactions, then most RTO companies would be in violation of such statutes. Then RTO repossession practices would lead to actual and, in many cases, significant statutory damage awards. Moreover, RTO companies would also be subject to substantial class action liability because their violation of the state consumer credit legislation would be on a systematic basis.

Whether state credit legislation applies to RTO transactions is generally a unique determination for each individual state. The first step is to consider a state's RTO legislation that, in many cases, provides an explicit exemption for RTO transactions from a state's consumer credit legislation. n1

Nevertheless, such provisions should be examined carefully to make sure that they specifically override the relevant piece of state legislation. Passage of the RTO legislation in and of itself does not preempt such legislation. n2

Another place to search for an exemption for RTO transactions from the scope of consumer credit legislation is in the consumer credit legislation itself. Some state credit laws explicitly exempt RTO transactions or regulate RTO transactions separately, setting out different (and generally minimal) requirements for RTO transactions, in effect creating a RTO statute within the state credit legislation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. *See KFJ Enters., LLC v. Rembert (In re Rembert), 293 B.R. 664 (Bankr. M.D. Pa. 2003)* (Pennsylvania's RTO law exempts RTO transactions from state retail installment sales act).

(n2)Footnote 2. *Miller v. Colortyme, Inc., 518 N.W.2d 544 (Minn. 1994) . See In re Shelby, 127 B.R. 682, 15*

U.C.C. Rep. Serv. 2d 584 (Bankr. N.D. Ala. 1991) . *See also* National Consumer Law Center, Cost of Credit, § 7.5.3.2 (2d ed. 2000 and Supp.). The most recent successful cases are primarily from three states, Wisconsin, New Jersey, and Minnesota. *See Fogie v. Thorn Ams., 95 F.3d 645 (8th Cir. 1996)* ; *Perez v. Rent-A-Center, 892 A.2d 1255 (N.J. 2006)* ; Robinson v. Thorn Ams., Inc., Case No. L-003697-94, Clearinghouse No. 52,047 (N.J. Super. Ct. Dec. 19, 1997); *Rent-A-Center, Inc. v. Hall, 181 Wis. 2d 243, 510 N.W.2d 789 (Wis. Ct. App. 1993)* . In addition, a Vermont court upheld a state attorney general rule requiring RTO companies to disclose the effective annual percentage rate of their RTO transaction. *See* Thorn Ams., Inc. v. Vermont Attorney General, Clearinghouse No. 51,957 (Vt. Super. Ct. Mar. 7, 1997).

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PART I Consumer Credit
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1-7 Consumer Credit Law Manual § 7.06

§ 7.06 Applicability of State Credit Legislation to RTO Where RTO Not Explicitly Exempted

In many states, neither a RTO statute nor the state credit legislation will explicitly exempt RTO transactions from the credit statute. In those states, there is a good case for the proposition that the credit legislation does apply to RTO transactions. n1 Since the exact wording of the credit statute's scope is very important in these cases, advocates must parse the applicable language carefully. n2

In examining the scope of state credit statutes, it is important to distinguish between RTO transactions and short term, true rental transactions which many state credit statutes were drafted to exclude. That is, a distinction must be drawn between rent-to-own and rent-to-rent.

A particular problem in arguing that RTO agreements should be controlled by state credit laws is that, on their face, RTO leases do not create a debt which the consumer is legally obligated to repay. In theory, RTO purchasers can return their goods at any time and will owe the RTO dealer nothing. n3 This apparent fact has prevented courts in several cases from invoking installment sales acts, although the cases are split. n4

When faced with a state credit statute which does not clearly include or exclude RTO contracts, consumer advocates should emphasize that the nature of a transaction is controlled by the intent of the parties. n5 RTO advertising, the inability of RTO customers to pay cash, and the nature of the goods leased demonstrate that the parties to RTO contracts intend the sale, rather than the lease, of merchandise. n6

In addition, RTO transactions are not really terminable, since RTO customers are clearly compelled to continue making weekly "rental" payments by the economic characteristics of the transaction even if not by the contract language. n7 The New Jersey Supreme Court held that the consumer's right to cancel the lease at any time was irrelevant because the statute defined a retail installment sale to include any transaction in which the bailee or lessee had the option of becoming the owner of the goods. n8 A consumer quickly builds equity in the "leased" property under an RTO contract and must continue to pay in order to protect that equity. Furthermore, consumers will go to great lengths to avoid losing goods, such as refrigerators or beds, which are necessities of day-to-day life.

Moreover, a fundamental aspect of usury law, including this state credit legislation, is that a court must examine the substance of a transaction, rather than its form, in order to decide whether usury is present. n9 RTO contracts involve

effective interest rates vastly exceeding most statutory limits. To uphold such contracts is to place their form above the clear intent of installment sales acts, and almost every state has a few usury opinions stating such formalism should be rejected.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. *See Burney v. Thorn Americas, Inc., 944 F. Supp. 762 (E.D. Wis. 1996)* ; *Starks v. Rent-A-Center, 1990 U.S. Dist. LEXIS 20099* (D. Minn. May 15, 1990) ; *In re Rigg, 198 B.R. 681 (Bankr. N.D. Tex. 1996)* ; *In re Rose, 94 B.R. 103 (Bankr. S.D. Ohio 1988)* ; *Murphy v. McNamara, 36 Conn. Supp. 183, 416 A.2d 170, 27 U.C.C. Rep. Serv. 911 (1979)* ; *Miller v. Colortyme, Inc., 518 N.W.2d 544 (Minn. 1994)* , *on remand*, Clearinghouse No. 47,957 (Minn. Dist. Ct. 1995) (summary judgment for consumers); *Perez v. Rent-A-Center, 892 A.2d 1255 (N.J. 2006)* ; Robinson v. Thorn Americas, Inc., Clearinghouse No. 52,047, No. L-3697-94 (N.J. Super. Ct. Law Div. Oct. 26, 1995); *Green v. Cont'l Rentals, 292 N.J. Super. 241, 678 A.2d 759, 30 U.C.C. Rep. Serv. 2d 1039 (Super. Ct. Law Div. 1994)* ; *Commonwealth v. Riverview Leasing, Inc., 648 A.2d 580 (Pa. Commw. Ct. 1995)* (decision predates state's adoption of RTO law); Chandler v. Riverview Leasing, Inc., Clearinghouse No. 40,628 (Pa. C.P. May 15, 1986) (decision predates state's adoption of RTO law); State v. Rentavision Corp. of Am., Clearinghouse No. 35,731 (Tenn. Ch. Ct. 1983); *LeBakken Rent-to-Own v. Warnell, 223 Wis. 2d 582, 589 N.W.2d 425 (Ct. App. 1998)* (RTO transaction is "consumer credit sale" subject to Wisconsin Consumer Act even if it includes early purchase option; creditor was liable for costs and attorney fees for filing replevin action without complying with Act); *Rent-A-Center, Inc. v. Hall, 181 Wis. 2d 243, 510 N.W.2d 789 (Ct. App. 1993)* (RTO transactions are "consumer credit sales" subject to Wisconsin Consumer Act); *Palacios v. ABC TV & Stereo Retail, 123 Wis. 2d 79, 365 N.W.2d 882 (Ct. App. 1985) . But see Givens v. Rent-A-Center, Inc., 720 F. Supp. 160 (S.D. Ala. 1988)* (mem.) (rental agreement not credit sale under Alabama Consumer Finance Act), *aff'd*, *885 F.2d 879 (11th Cir. 1989)* (table); *Hawkes Television Inc. v. Maine Bureau of Consumer Credit Protection, 462 A.2d 1167 (Me. 1983)* ; *State v. Action TV Rentals, Inc., 467 A.2d 1000 (Md. 1983)* .

(n2)Footnote 2. *Fogie v. Rent-A-Center, 1995 WL 649575 (D. Minn. 1995), aff'd sub nom. Fogie v. Thorn Ams., Inc., 95 F.3d 645 (8th Cir. 1996)* .

(n3)Footnote 3. *See, e.g., Crumley v. Berry, 298 Ark. 112, 766 S.W.2d 7, 9 U.C.C. Rep. Serv. 2d 448 (1989)* (over strong dissent, court finds a true lease if lessee has right to terminate, though recognizes that there may be some exceptions).

(n4)Footnote 4. *See Burney v. Thorn Ams., Inc., 944 F. Supp. 762 (D. Minn. 1996)* ; *Miller v. Colortyme, Inc., 518 N.W.2d 544 (Minn. 1994) . See also Fogie v. Rent-A-Center, Inc., 1995 WL 649575 (D. Minn. 1995), aff'd sub nom. Fogie v. Thorn Ams., Inc., 95 F.3d 645 (8th Cir. 1996)* ; *Palacios v. ABC TV & Stereo Rental, 123 Wis. 2d 79, 365 N.W.2d 882 (Wis. Ct. App. 1985)* .

(n5)Footnote 5. *E.g., Hervey v. R.I. Locomotive Works, 93 U.S. 664, 23 L. Ed. 1003 (1876)* .

(n6)Footnote 6. *See In re Puckett, 60 B.R. 223 (Bankr. M.D. Tenn. 1986)* ; *Sight & Sound of Ohio, Inc. v. Wright, 36 B.R. 885 (Bankr. S.D. Ohio 1983)* .

(n7)Footnote 7. *See In re Puckett, 60 B.R. 223, 239-40 (Bankr. M.D. Tenn. 1986)* ; *Green v. Continental Rentals, 678 A.2d 759, 30 U.C.C. Rep. Serv. 2d 1039 (N.J. Super. Ct. 1994)* ; *Rent-A-Center v. Hall, 181 Wisc. 2d 243, 510 N.W.2d 789 (Ct. App. 1993)* .

(n8)Footnote 8. *Perez v. Rent-A-Center, 892 A.2d 1255, 1267 (N.J. 2006)* .

(n9)Footnote 9. *See McGalliard v. Liberty Leasing Co. of Alaska, 534 P.2d 528 (Alaska 1975)* ; *see generally* Annot., *94 A.L.R. 3d 640 (1979)* (application of usury laws to "leases"); *see* Ch. 6 *supra*.

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1-7 Consumer Credit Law Manual § 7.07

§ 7.07 Application of Federal Consumer Leasing Act and Truth in Lending to RTO

The Federal Consumer Leasing Act ("CLA") does not apply to RTO transactions, and it may be that TIL does not apply either. n1

The CLA applies only to leases greater than four months in duration. n2 Because a RTO transaction is terminable without penalty before four months have expired, most courts have held that such a lease is not covered by the Act. n3

Even if a court were to find that an RTO transaction is not really terminable without penalty before four months have expired, the CLA would not apply. The CLA does not apply to transactions covered by TIL, n4 and, if a court were to find a RTO transaction not terminable without a penalty, then TIL would apply to the RTO transaction. TIL applies to non-terminable leases where lease payments exceed the value of the property and the consumer can become the owner for nominal consideration. n5 That is, courts would only find the CLA to apply to RTO transactions under the same theory where they would also find TIL to apply, and, in situations where they both apply, the CLA states that only TIL applies.

While only TIL could apply to RTO transactions, it is uncertain whether even TIL applies. n6 TIL Regulation Z states that a covered credit sale includes certain leases unless terminable without penalty at any time by the consumer. n7 Courts have differed as to whether the forfeiture of the consumer's built up equity in a RTO transaction is a penalty within the meaning of Regulation Z. n8 Another theory to find TIL coverage is to find that the RTO transaction is in fact used as a means of purchase, and not to lease the product. n9

If TIL does apply to RTO transactions, then the RTO company must make certain disclosures. Failure to do so will lead to actual and statutory damages and attorney fees, with the possibility of class action liability. n10

[1] Application of Article 2A

UCC Article 2A regulates leases in forty-nine states and the District of Columbia. n11 A few states have RTO statutes which state that RTO transactions are not governed by Article 2A, n12 but in most states RTO transactions are subject to Article 2A. While Article 2A is generally less protective of consumers than Article 9, it does:

- Prohibit unconscionable contracts and clauses and, if the lease is a consumer lease, allow the court to grant "any appropriate relief" and attorney fees; n13
- Create implied warranties in lease trans actions; n14
- Prohibit unreasonable liquidated damages clauses; n15 and
- Prohibit breach of the peace in self-help repossession. n16

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionConsumer LeasingGeneral OverviewBanking LawConsumer ProtectionTruth in LendingGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. The Consumer Leasing Act and the Truth in Lending Act are reprinted in Vol. 1A *infra*. *See Smith v. ABC Rental Sys., Inc. 618 F.2d 397 (5th Cir. 1980)* ; *Givens v. Rent-A-Center, Inc., 720 F. Supp. 160 (S.D. Ala. 1988)* , *aff'd without op., 885 F.2d 879 (11th Cir. 1989)* .

(n2)Footnote 2. *15 U.S.C. § 1667(1).*

(n3)Footnote 3. *In re Hanley, 105 B.R. 458 (Bankr. C.D. Ill. 1989)* .

(n4)Footnote 4. *15 U.S.C. § 1667(1).*

(n5)Footnote 5. *15 U.S.C. § 1602(g).*

(n6)Footnote 6. *Compare Clark v. Rent-It Corp., 685 F.2d 245 (8th Cir. 1982)* , *with Ortiz v. Rental Mgmt., Inc., 65 F.3d 335 (3rd Cir. 1995)* .

(n7)Footnote 7. Reg. Z § 226.2(a)(16). *See, e.g., In re Martin, 64 B.R. 1 (Bankr. S.D. Ga. 1984)* .

(n8)Footnote 8. *Compare In re Hanley, 105 B.R. 458 (Bankr. C.D. Ill 1989)* , *on motion to alter or amend, 111 B.R. 709 (Bankr. C.D. Ill. 1990)* (rejecting that argument), *with Green v. Continental Rentals, 678 A.2d 759, 30 U.C.C. Rep. Serv. 2d 1039 (N.J. Super. Ct. 1994)* (court found that "the 'penalty' required by Regulation Z, then, may properly be considered to include any forfeiture incurred when a rent-to-own customer loses equity accured [sic] by reason of rental payments made prior to repossession").

Regulation Z is reprinted in Vol. 1A *infra*.

(n9)Footnote 9. *In re Hanley, 105 B.R. 458 (1989)* , *on motion to alter or amend, 111 B.R. 709 (1990)* , *rev'd, 135 B.R. 311 (Bankr. C.D. Ill. 1990)* . See National Consumer Law Center, Truth in Lending, § 2.5.4 (6th ed. 2007 and Supp.), for more detail on those theories.

(n10)Footnote 10. *See 15 U.S.C. § 1640(a)*; Susan Lorde Martin & Nancy White Huckins, *Consumer Advocates vs. the Rent-to-Own Industry: Reaching a Reasonable Accommodation, 34 Am. Bus. L.J. 385, 388-90 (1997).*

(n11)Footnote 11. *See* National Consumer Law Center. Consumer Warranty Law, Ch. 21 (3d ed. and Supp.).

(n12)Footnote 12. *See Haw. Rev. Stat. § 481M-3(a)(2)*; *Mont. Code Ann. § 30-19-104(1)(c)*; *N.M. Stat. § 57-26-3*

(RTO transactions are not covered by the "provisions of the U.C.C.").

(n13)Footnote 13. *U.C.C. § 2A-108*.

(n14)Footnote 14. *U.C.C. §§ 2A-210 to 2A-213*; *see* National Consumer Law Center, Consumer Warranty Law, § 21.3 (3d ed. 2006 and supp.).

(n15)Footnote 15. *U.C.C. § 2A-504*.

(n16)Footnote 16. *U.C.C. § 2A-525(3)*.

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PART I Consumer Credit
CHAPTER 7 Rent-to-Own Transactions

1-7 Consumer Credit Law Manual § 7.08

§ 7.08 Applicability of Other Federal Consumer Protection Laws

Since no credit is extended in RTO transactions, several other federal consumer statutes may not be applicable. This includes the Equal Credit Opportunity Act and the Fair Credit Reporting Act. The Fair Debt Collection Practices Act is not applicable either, so long as the rental agency is collecting on its own debts and has not referred them to a third party collector.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Debt CollectionGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

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PART I Consumer Credit
CHAPTER 7 Rent-to-Own Transactions

1-7 Consumer Credit Law Manual § 7.09

§ 7.09 Limitations on Seizure of RTO Goods

Almost all RTO goods, such as televisions, stereos, furniture, and appliances, remain inside the consumer's residence. This poses significant limitations on the repossession of RTO goods because the seizure invariably requires the RTO company to enter the consumer's home to seize the property, and this entry without the consumer's permission is generally illegal, even if Article 9 does not apply to the transaction.

UCC Article 2A regulates leases in 48 jurisdictions, and Article 2A prohibits seizures that breach the peace. n1 Case law for interpreting breach of the peace under Article 9 should apply in its entirety to the same concept under Article 2A. Thus, *any* entry into the consumer's residence without permission breaches the peace, even if the door to the residence has been left wide open. Similarly, any seizure over the consumer's objection breaches the peace.

This obviously poses problems for RTO companies who must obtain the consumer's permission to seize the goods. One RTO tactic is the "switch-out." A RTO representative will tell the customer that the appliance is being picked up for necessary repairs or maintenance or is being upgraded, when, in fact, it is being repossessed. Courts differ as to whether such repossession by trickery breaches the peace, but the conduct should be a deceptive trade practice in any event. n2 Article 2A also provides the court with the authority to grant appropriate relief and attorney fees where unconscionable conduct has occurred in the collection of a claim arising from a lease. n3

The same analysis applies to an RTO representative misrepresenting himself as a law enforcement official. Courts may differ as to whether this breaches the peace, but it should be a deceptive trade practice, n4 and the practice should be unconscionable.

RTO firms may threaten consumers that if they do not consent to a repossession, the RTO company will prosecute them under the state lease larceny statute. This statute criminalizes the failure to return rented property. But RTO contracts may not fall within the scope of lease larceny statutes, n5 and failure to allow entry of repossessors into one's home may not violate such statutes in any event. Moreover, an RTO company may have no intent to prosecute its customers under the lease larceny statute. In all three of these situations, the threat is deceptive and should violate the state deceptive practices statute, and, perhaps, state or federal debt collection statutes as well.

Another RTO tactic is to obtain, in advance in the RTO contract, the consumer's consent to the entry into the consumer's

residence or to the breach of the peace. But RTO legislation in approximately 40 states explicitly prohibits contract terms agreeing to a breach of the peace n6 and about half the state RTO statutes even more explicitly prohibit contract terms authorizing the RTO company to enter the consumer's residence to reclaim the goods. n7 In addition, such provisions are likely to run afoul of Article 2A's unconscionability provision, so that a court may find the provision unenforceable and award the consumer attorney fees and other relief. n8 In any event, such provisions in an RTO contract are most likely unenforceable as against public policy.

Additional outrageous examples of RTO repossession tactics include: employees breaking and entering into a customer's home, and not only repossessing the RTO merchandise but stealing the customer's other possessions; n9 and filing criminal charges when the customer does not return RTO merchandise. n10

Unauthorized entry and other breaches of the peace may lead to an action for punitive damages. n11 There could be several legal bases for finding the breach to be a tort, leading to the punitive damages award--the RTO company's breach of a statutory duty is a tort, the breach of the peace is a tort, n12 or the seizure is a conversion because seizure is only authorized if there is no breach of the peace.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)General OverviewContracts LawSecured TransactionsDefaultForeclosure & RepossessionGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. *U.C.C. § 2A-525(3).*

(n2)Footnote 2. *See State v. Action TV Rentals, Inc., 467 A.2d 1000 (Md. 1983)* (posing as law enforcement official found to be a deceptive trade practice).

(n3)Footnote 3. *U.C.C. § 2A-108(2).*

(n4)Footnote 4. *State v. Action TV Rentals, Inc., 467 A.2d 1000 (Md. 1983) .*

(n5)Footnote 5. *See State v. Ell, 813 S.W.2d 26 (Mo. Ct. App. 1991) .*

(n6)Footnote 6. *See, e.g., Fla. Stat. § 559.9234(2)*; *Kan. Stat. Ann. §§ 50-681 to 50-690*; *Ky. Rev. Stat. Ann. §§ 367.976 to 367.985*, *367.990.*

(n7)Footnote 7. *See, e.g., Idaho Code §§ 28-36-101 to 28-36-111*; *Ind. Code §§ 24-7-1-1 to 24-7-9-7*; *Neb. Rev. Stat. §§ 69-2101 to 69-2115*; *Wash. Rev. Code § 63.19.050.*

(n8)Footnote 8. *U.C.C. § 2A-108.*

(n9)Footnote 9. *Partridge v. Harvey, 805 So. 2d 668 (Miss. Ct. App. 2002) .*

(n10)Footnote 10. *Bragg v. Rent to Own, 570 S.E.2d 671 (Ga. Ct. App. 2002)* (customer sued RTO company for malicious prosecution and intentional infliction of emotional distress in obtaining an arrest warrant against him; tort claims were permitted to go to trial but trial court then directed verdict for RTO company on the basis that the company was not responsible for actions of employee); *State v. Cox, 2002 WL 1083897* (Ohio App. Dist. Ct. May 14, 2002). The filing of a criminal charge may give rise to tort claims against the RTO business.

(n11)Footnote 11. *Kimble v. Universal TV Rental, Inc., 65 Ohio Misc. 17, 19 Ohio Op. 3d 172, 417 N.E.2d 597 (1980)* ($4,000 punitive damages awarded for repossession by forced entry into consumer's home). *See also Mercer v. D.E.F., Inc., 48 B.R. 562 (Bankr. D. Minn. 1985)* ($8000 actual and punitive damages awarded for a frightening RTO repossession violating bankruptcy automatic stay).

(n12)Footnote 12. *Kimble v. Universal TV Rental, Inc., 65 Ohio Misc. 17, 19 Ohio Op. 3d 172, 417 N.E.2d 597 (1980)* .

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1-7 Consumer Credit Law Manual § 7.10

§ 7.10 Discriminatory Treatment Claims

There is some evidence that RTO dealers treat delinquent customers differently based on their race. n1 African-American customers may experience more rapid repossession and are less likely to have late fees waived than white customers. n2 The Equal Credit Opportunity Act arguably applies to RTO transactions. n3 If so, RTO dealers cannot treat customers differently post-default based on prohibited reasons. n4 Actual and punitive damages are available under the Act as well as attorney's fees and costs. n5

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionEqual Credit OpportunityGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. *See* Testimony of David Ramp regarding S.R. 1566, 1956, United States Senate Banking Committee, May 13, 1994, Clearinghouse No. 49,965.

(n2)Footnote 2. *See* Testimony of David Ramp regarding S.R. 1566, 1956, United States Senate Banking Committee, May 13, 1994, Clearinghouse No. 49,965.

(n3)Footnote 3. *See* National Consumer Law Center, Credit Discrimination, § 2.2.2.2.5 (5th ed. 2009).

(n4)Footnote 4. *See* National Consumer Law Center, Credit Discrimination, § 9.2.4 (5th ed. 2009).

(n5)Footnote 5. *See* National Consumer Law Center, Credit Discrimination, Ch. 11 (5th ed. 2009).

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1-7 Consumer Credit Law Manual § 7.11

§ 7.11 Right of Reinstatement

Article 2A provides for no right to cure or to reinstate, but RTO legislation in effect in most states provides a right to reinstate. Some might question why a consumer would ever want to reinstate an RTO contract because they so often offer consumers such bad deals. In addition, critics contend that the right to reinstate is just a gimmick to allow RTO companies to assess additional late charges and to assist in the seizure of the property (if the consumer consents to the entry, the consumer has extra time to reinstate the contract). But if a consumer only has a few remaining payments on the RTO contract, it is often better to reinstate the contract and retain the goods, rather than lose all the consumer's built up equity.

Under rights of reinstatement found in RTO statutes, typically the consumer must pay all past rental payments and late charges, a pick-up and redelivery fee, and sometimes even a reinstatement fee. Then the contract is reinstated where it was before the breach.

Statutes differ as to how long the consumer has to reinstate, but often the time period is very short unless the consumer has consented to the seizure of the property, in which case the consumer may have a month or two to reinstate. Where the consumer has paid more than 60% or a similar percentage of the payments, the reinstatement period may even be longer after a voluntary surrender.

The failure to honor a reinstatement leads to remedies under the RTO statute. n1 These often include actual and statutory damages and, in some states, attorney fees.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)General OverviewCommercial Law (UCC)Leases (Article 2A)General OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. *See Davis v. Rent-A-Center of Am., Inc., 150 Misc. 2d 403, 568 N.Y.S.2d 529 (City Ct. 1991)* (RTO

firm's failure to offer comparable substitute furniture upon the consumer's request to reinstate the RTO contract led to the consumer's recovery of damages under the N.Y. RTO statute). *See also Barnett v. Rent-A-Center, Inc., 2005 Conn. Super. LEXIS 1696* (Conn. Super. Ct. May 24, 2005) (finding, on disputed facts, that RTO company complied with reinstatement requirements of RTO law).

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1-7 Consumer Credit Law Manual § 7.12

§ 7.12 RTO Company and Consumer Liability After Repossession

Once the RTO appliance or other good is repossessed, the RTO firm retains the appliance (although no notice to that effect is sent to the consumer), and most likely rents the same appliance to a new customer, perhaps on the same rental terms. The question then arises as to what liability the consumer has to the RTO company and whether the RTO company which has kept the consumer's built up equity has to return anything to the consumer, assuming Article 9 does not apply.

The consumer will be liable for back-due RTO payments and for certain late charges and repossession expenses, to the extent that such charges are not limited in an RTO statute. An RTO company may not enforce a demand for charges that are not bona fide or reasonable.

Legitimate repossession and late charges and back payments are all that the consumer should owe. There can be no charges related to future payments because the RTO contract will state that the contract is terminable at will. If the RTO company seeks a penalty for the early termination, then the whole nature of the contract is altered (the transaction is no longer terminable at will), and Article 9, TIL, and state credit statutes may apply.

While the consumer's liability is limited in an RTO contract, the RTO company will not pay out any surplus, back rental payments, or other amount to the consumer after repossession, no matter how few months are left in the agreement. The RTO companies will claim that the lease is week-to-week or month-to-month, with no right to any refund upon cancellation.

The consumer's position, on the other hand, is that the consumer's rental payment goes toward rent and also toward building up the consumer's equity in the RTO property. The fact that the consumer can obtain the property for nominal consideration well before the end of the property's useful life means that rental payments must have included amounts allocated to pay for the property at the end of the lease term. This is confirmed by the astronomically high rental payments that RTO companies charge, several times what a cash customer would pay in a traditional retail store for the same appliance.

Assuming a consumer convinces the court that the consumer has built up equity, the consumer must still present the court with a legal theory requiring the RTO company to return this equity to the consumer. Article 2A and RTO statutes

do not require the return of built-up equity, and Article 9 (that requires creditors to return any surplus) will not apply to RTO transactions in most states.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)General OverviewContracts LawSecured TransactionsDefaultForeclosure & RepossessionGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

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CHAPTER 7 Rent-to-Own Transactions

1-7 Consumer Credit Law Manual § 7.13

§ 7.13 Importance of UDAP Approach

The consumer's best approach to many RTO practices may be a claim under a state unfair and deceptive practices ("UDAP") statute. The Federal Trade Commission ("FTC") has ruled that it is an unfair trade practice to use a contract provision whereby a defaulting consumer forfeits both ownership in the property and all installment payments. n1 This FTC authority should be direct precedent for a state UDAP claim against the RTO company.

In addition, the consumer should allege as a related UDAP claim any misrepresentations made by the RTO company in the original RTO transaction. n2

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionUnfair & Deceptive Credit PracticesContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. *See AMREP Corp., 102 F.T.C. 1362 (1983)* , *aff'd, 768 F.2d 1171 (10th Cir. 1985)* ; *Horizon Corp., 97 F.T.C. 464 (1981)* .

(n2)Footnote 2. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 5.6.4 (7th ed. 2008 and supp.). *See also Perez v. Rent-A-Center, Inc., 892 A.2d 1255 (N.J. 2006)* (UDAP act applied to RTO contracts even though the retail installment sales act covered the transaction).

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1-7 Consumer Credit Law Manual § 7.14

§ 7.14 Deceptive RTO Inducements, Sales and Warranty Practices

UDAP claims are an effective approach for dealing with the following RTO abuses:

- Advertising low-priced appliances, and then switching the consumer to a higher priced alternative.
- Engaging in high-pressure door-to-door sales.
- Misrepresenting easy credit terms, low payments, or that there will be no credit checks.
- Misrepresenting prices as bargains or the extent of savings compared to the RTO retailer's previous prices or competitors' prices.
- Failing to disclose a cash retail price if there is a possibility that the goods will ever be sold. n1
- Failing to disclose the true purchase price over the total lease term. n2
- Charging a total of payments that is several times the regular retail price of an item, or charging an implicit interest rate far in excess of the comparable limits on an installment sale. n3
- Describing the transaction as a lease when it, in fact, is a contract for sale. n4
- Lowballing, i.e, adding previously undisclosed delivery, documentary or other extra charges after the price has been agreed upon.
- Renting used appliances as new, misrepresenting an appliance's prior use, or not disclosing that appliances are used. n5
- Misrepresenting that most RTO participants end up owning the appliance where this is not the case, particularly where the RTO company strictly enforces the contract clauses to discourage ownership.

- Misrepresenting the steps necessary to exercise the purchase option.

- Referral sales, i.e., promising consumers a rebate if friends or neighbors referred by the consumer also lease merchandise from the lessor.

- Violating the state retail installment sales act, TIL, or other state or federal credit legislation. n6

- Delivering defective products, failing to repair as promised, or failing to live up to warranties.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewCommercial Law (UCC)General OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. State v. Colortyme, Inc., Clearinghouse No. 50,404 (Wis. Cir. Ct. May 25, 1994) (consent judgment).

(n2)Footnote 2. *See Murphy v. McNamara, 36 Conn. Supp. 183, 416 A.2d 170, 27 U.C.C. Rep. Serv. 911 (Conn. Super. Ct. 1979)* ; Mass. Regs. Code tit. 940, § 6.11(2).

(n3)Footnote 3. *Green v. Continental Rentals, 292 N.J. Super. 241 (Ct. 1996)* ; *Colon v. Rent-A-Center, Inc., 716 N.Y.S.2d 7 (App. Div. 2000)* (denying summary judgment to the RTO company and case sent to jury on the issue of whether the state's UDAP act was violated due to an overly inflated cash price).

(n4)Footnote 4. Barco Auto Leasing Corp. v. House, Clearinghouse No. 40,641 (Conn. Super. Ct. Oct. 26, 1983).

(n5)Footnote 5. See, e.g., Mass. Regs. Code tit. 940, § 6.11(3), which requires disclosure in advertising if goods leased with an option to purchase are in fact used. *But cf. State v. Action TV Rentals, Inc., 297 Md. 531, 467 A.2d 1000 (1983)* .

(n6)Footnote 6. Barco Auto Leasing Corp. v. House, Clearinghouse No. 40,641 (Conn. Super. Ct. Oct. 26, 1983).

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CHAPTER 7 Rent-to-Own Transactions

1-7 Consumer Credit Law Manual § 7.15

§ 7.15 Disclosure of RTO Transaction's Effective Annual Percentage Rate

A fundamental problem with RTO transactions is that the effective interest rate or annual percentage rate in the transaction is often 100%, 200%, or more, but this number is never disclosed to consumers.

A Vermont Attorney General Rule requiring RTO companies to disclose the cash price of the rented item and the effective annual percentage rate of their RTO transactions has recently been upheld. n1

RTO companies in Vermont unsuccessfully sought a preliminary injunction preventing the Rule from going into effect. n2 The RTO companies have *not* appealed this decision. The Vermont Attorney General's office has sent out letters to RTO sellers in Vermont informing them that the Rule is now in effect.

While Vermont is unique in requiring the state attorney general to enact a rule dealing with RTO disclosures, the majority of state UDAP statutes give the state attorney general authority to enact regulations defining unfair and deceptive practices. The failure to disclose important information in an RTO transaction can certainly be such an unfair or deceptive practice.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewCommercial Law (UCC)General OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. Vermont Consumer Fraud Rule (CF) 115, Clearinghouse No. 51,958 (effective Jan. 1, 1997).

(n2)Footnote 2. Thorn Ams., Inc. v. Vermont Attorney General, Clearinghouse No. 51,957 (Vt. Super. Ct. Mar. 7, 1997).

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1-7 Consumer Credit Law Manual § 7.16

§ 7.16 Applicability of Three-Day Cooling-Off Period to RTO Transactions

An often overlooked way to challenge an RTO transaction is to argue that the RTO retailer should have complied with either the FTC Rule concerning a "Cooling-Off Period for Door-to-Door Sales" n1 or with any analogous state statute. Such coverage should be investigated because some major RTO companies solicit customers door-to-door or by telephone and consummate business in the residence.

RTO and other rental transactions are clearly covered by the FTC Rule. A door-to-door transaction covered by the FTC Rule is:

> "A sale, *lease*, or *rental* of consumer goods or services with a purchase price of $25 or more, whether under single or *multiple contracts*, in which the seller or his representative personally solicits the sale, including those in response to or following an invitation by the buyer, and the buyer's agreement or offer to purchase is made at a place other than the place of business of the seller." (emphasis added) n2

The Rule's Statement of Basis and Purpose explains that the Rule was redrafted to make it clear that leases were covered so that door-to-door sellers could not escape the Rule provisions by leasing their goods instead of selling them. n3

The exemption for sales under $25 is to exclude "sales by milkmen, laundrymen, and other route salesmen ... ." n4 Moreover, the Rule's $25 minimum also applies to the total of multiple contracts "to insure that the rule would apply to transactions in which the seller writes up a number of invoices or contracts none of which show a price of $10 or more, but when taken together the total price exceeds that amount." n5

If the entire transaction is done on the telephone and there is no personal contact between the buyer and seller prior to the delivery of the goods, the rule does not apply.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionHome SolicitationBanking LawConsumer ProtectionGeneral OverviewCommercial Law (UCC)General OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease

Contracts

FOOTNOTES:

(n1)Footnote 1. 16 C.F.R. § 429.

(n2)Footnote 2. *16 C.F.R. § 429.0(a).*

(n3)Footnote 3. *See 37 Fed. Reg. 22,945* (Oct. 26, 1972) .

(n4)Footnote 4. *See 37 Fed. Reg. 22,945* (Oct. 26, 1972) .

(n5)Footnote 5. Statement of Basis and Purpose, *37 Fed. Reg. 22,945* (Oct. 26, 1982) .

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PART I Consumer Credit
CHAPTER 7 Rent-to-Own Transactions

1-7 Consumer Credit Law Manual § 7.17

§ 7.17 UCC Article 2A Unconscionability as Alternative to UDAP.

Another viable legal theory for many of the same RTO practices that a UDAP statute can reach is an unconscionability claim under UCC Article 2A on Leases. *UCC section 2A-108*, "Unconscionability," allows courts to refuse to enforce unconscionable provisions in the RTO agreement, and also to grant appropriate relief where an RTO transaction is induced by unconscionable conduct or where unconscionable conduct has occurred in the RTO collection activities. n1 The court must award prevailing consumers their attorneys' fees. Fees are available to a prevailing lessor only if the lessee knew the action was groundless.

A *UCC section 2A-108* claim will have the following advantages over a UDAP claim:

- *Post-Sale Transactions*. Some UDAP statutes do not apply to practices occurring after the transaction has been finalized, such as collection tactics. *UCC section 2A-108* specifically applies to those transactions.

- *Non-Deceptive Abuses*. Most UDAP statutes prohibit unfair or unconscionable practices, but some state statutes only prohibit deceptive practices or a specific laundry list of deceptive practices. In those states, *UCC section 2A-108*'s unconscionability standard is superior where the lessor's practice is abusive, but not deceptive.

- *Statute of Limitations*. Some UDAP statutes have a short limitations period. *UCC section 2A-506* specifies a four-year period for actions for default under a lease contract.

- *Equitable Relief*. Not all UDAP statutes authorize equitable relief (and a few may not even authorize a damage recovery). *UCC section 2A-108* authorizes a court to grant "appropriate relief."

- *Attorney Fees*. Some UDAP statutes do not authorize attorney fees, many do not mandate fees for consumers, while a few authorize fees for either party. *UCC section 2A-108* mandates fees for a consumer, but authorizes fees for the lessor only if the consumer knew the action was groundless.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)General OverviewCommercial Law (UCC)Sales (Article 2)Contract TermsUnconscionable AgreementsCommercial Law (UCC)Leases (Article 2A)General OverviewContracts LawDefensesUnconscionabilityGeneral OverviewContracts LawTypes of ContractsLease AgreementsPersonalty LeasesInstallment Lease Contracts

FOOTNOTES:
(n1)Footnote 1. Cari Rentals v. Hall, Clearinghouse No. 49,940 (Iowa Dist. Ct. 1993).

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PART I Consumer Credit
CHAPTER 8 Fair Debt Collection

1A-8 Consumer Credit Law Manual 8.syn

§ 8.syn Synopsis to Chapter 8: Fair Debt Collection

§ 8.01 Overview of the Fair Debt Collection Practices Act

[1] Scope, Purpose, and Effective Date

[2] Sources of Law and Research Aids

[a] The Language of the Act

[b] Federal Trade Commission Informal Staff Letters

[c] FTC Staff Commentary on FDCPA

[d] Federal Trade Commission Formal Advisory Opinion

§ 8.02 Persons and Transactions Covered by the Fair Debt Collection Practices Act

[1] Persons Who Must Comply as Debt Collectors

[a] Any Person Whose Principal Business Is Collecting Debts Is a "Debt Collector".

[b] Any Person Who Regularly Collects Debts Owed to Another Is a "Debt Collector".

[c] Creditors Using False Names Are "Debt Collectors"

[d] Repossession and Foreclosure Companies Are Treated as "Debt Collectors" Under Some Circumstances

[e] Flat Rate Collectors or Others Supplying Forms That Misrepresent Extent That They or Another Is Involved in Collecting a Debt Violate the Act

[i] Extent of Participation in the Collection Process

[ii] Lawyers Must Review File Before Signing Collection Letter

[f] Lawyers Regularly Collecting Consumer Debts Must Now Comply With All FDCPA Provisions

[i] 1986 Attorney Amendment

[ii] Scope of FDCPA Attorney Coverage

[iii] Issues Unique to Attorney Debt Collectors

[A] Venue Provision

[B] Communications With Third Parties

[C] Notice of Validation Rights

[D] Other Pitfalls to Avoid

[iv] Attorney Liable for Allowing Signature to Appear on Collection Letters Without Reviewing File

[v] Second Circuit Allows Lawyer to Dun and Disclose Before Reviewing Claim

[vi] FDCPA and Lawyers' Ethical Obligations Intertwine

[A] Lawyers' Collection Letters Must Avoid False Threat of Suit

[B] Interstate Collection Letters Must Avoid Misrepresenting Lawyer's Authority to Sue

[C] Representing Only Part of the Effects of Suit Is Deceptive

[D] Intermingling Activities of Collection Agency and Attorney May Be Unlawful

[g] FDCPA Applies to Debt Buyers

[2] New Coverage of Collection of Federal Income Taxes by Collection Agencies

[3] Persons Specifically Excluded From the Term "Debt Collector."

[a] Creditors' Employees Collecting in the Name of the Creditor Are Specifically Excluded

[b] A Commonly Owned or Affiliated Corporate Collector Collecting Only for Its Affiliates Is Specifically Excluded if It Is Not Principally a Debt Collector

[c] State and Federal Officials Performing Their Duties Are Specifically Excluded

[d] Process Servers Are Specifically Excluded

[e] Bona Fide Nonprofit Consumer Credit Counselors Are Specifically Excluded

[f] Persons Collecting Debts as Part of Bona Fide Fiduciary or Escrow Arrangements Are Specifically Excluded

[g] An Extender of Credit Collecting on Behalf of Another a Debt It Originally Extended Is Specifically Excluded

[h] Persons Collecting Debts Not in Default When Obtained Are Specifically Excluded

[i] The Enforcer of a Security Interest in an Account Used as Collateral for a Commercial Loan Is Specifically Excluded

[j] Check Collection Companies Disguised as District Attorneys

[4] Transactions Covered by the Act

[a] The Act Covers Only Debts Allegedly Owed by a Natural Person

[b] Consumer Debts, Not Commercial, Are Covered

[i] A Broad Range of Consumer Debts Are Covered

[ii] Coverage of Noncontractual Obligations Questioned

[5] FDCPA Protection of Persons Other Than Consumers

[6] Collection Activities Covered by the FDCPA

[a] "Communications" Covered by the FDCPA

[b] Litigation Activities Covered by the FDCPA

§ 8.03 Consumer Protections and Rights Under the Fair Debt Collection Practices Act

[1] General Principles of Construction of the Act

[2] FDCPA Limits a Collector's Communications With a Consumer

[a] Consumers' Privacy and Relationships Protected

[b] Contacts at Unusual or Inconvenient Times or Places Prohibited

[c] Collector May Not Contact a Consumer It Knows to Be Represented by an Attorney

[d] Contacts at Workplace Are Restricted

[e] Informing Most Other People of the Consumer's Indebtedness Is Prohibited

[i] Collector May Contact Certain Nondebtors

[ii] Contacts in Other Situations

[f] Obtaining Location Information About a Consumer From Other Persons Is Strictly Regulated

[g] Consumers May Waive, by Direct Prior Consent, Protections From Collection Contacts

[h] Right to Stop Collection Contacts

[3] Conduct Serving to Harass, Oppress, or Abuse Is Prohibited

[a] Harassing, Oppressive, and Abusive Conduct Generally Prohibited

[b] Collectors May Not Use or Threaten Violence or Criminal Conduct

[c] Collectors May Not Use Obscene, Profane, or Abusive Language

[d] Publishing a List of Allegedly Defaulting Debtors Is Prohibited

[i] Certain Credit Reporting Permitted

[e] Advertising a Debt for Sale to Coerce Payment Is Prohibited

[f] Repeated or Continuous Telephone Calls Intended to Annoy, Abuse, or Harass Are Prohibited

[g] Collector's Employee Must Provide Meaningful Disclosure of Identity When Telephoning

[i] Care Must Be Exercised When Leaving Messages

[4] False, Deceptive, or Misleading Representations and Collection Methods Are Prohibited by *15 U.S.C. § 1692e*

[a] Objective Standard of Deception Is Applied to Protect the "Least Sophisticated"

[b] Threat of Suit May Be Deceptive

[i] Misrepresenting Imminence of Suit, or Intent or Authority to Sue

[c] Other Threats and Statements May Be Deceptive

[i] Other Deceptive Threats

[ii] Other Deceptive Statements

[iii] Filing a Time-Barred Suit Is Deceptive

[d] Collectors May Not Falsely Imply an Affiliation With the Government

[e] Collectors May Not Falsely Represent the Character, Amount, or Legal Status of Any Debt

[f] Collectors May Not Falsely Represent the Services They Have Rendered or the Compensation to Which They Are Entitled

[g] Falsely Implying That a Person Is an Attorney or That a Communication Comes From an Attorney Is Prohibited

[h] Implying That Nonpayment Will Result in Arrest, Imprisonment, Garnishment, Attachment, Seizure, or Sale if Such Action Is Unlawful or Unintended Is Prohibited

[i] Threatening Unlawful or Unintended Action Is Prohibited

[i] False Threats

[j] Falsely Implying That Transfer of a Debt Will Preclude a Consumer's Claim or Defense or Will Subject the Consumer to a Practice Prohibited by the Act Is Prohibited

[k] Misrepresenting That the Consumer Committed a Crime or Engaged in Other Misconduct in Order to Disgrace the Consumer Is Prohibited

[l] Communicating or Threatening to Communicate False Credit Information Is Prohibited

[m] Using or Distributing Written Material Giving a False Impression of Its Source, Authorization, or Approval Is Prohibited

[n] False Representations or Deceptive Means to Collect or Attempt to Collect a Debt or to Obtain Information About a Consumer Is Prohibited

[o] Collector Must Disclose That a Communication Is to Collect a Debt and That Information Received Will Be Used for That Purpose

[i] Phone Calls, the Debt Collection Warning, and Other FDCPA Requirements

[p] Falsely Implying That Accounts Have Been Transferred to Innocent Purchasers for Value Is Prohibited

[q] Falsely Implying That Documents Are Legal Process Is Prohibited

[r] Using Any Business Name Other Than the True Name of the Collector's Business Is Prohibited

[s] Falsely Implying That Documents Are Not Legal Process Is Prohibited

[t] Falsely Implying That a Collector Operates or Is Employed by a Credit Reporting Agency Is Prohibited

[5] Use of Unfair or Unconscionable Collection Means Is Prohibited

[a] General Prohibition; Construing "Unfair" and "Unconscionable"

[b] Collecting Any Amount Not Permitted by Law Is Prohibited

[c] Restrictions on Soliciting, Accepting, and Depositing Postdated Checks

[d] Causing Expenses to a Person by Concealing the Collection Purpose of a Communication Is Prohibited

[e] Repossession or Threats of Repossession Are Prohibited When There Is No Right or Intent to Repossess or When the Property Is Exempt From Repossession

[f] Using a Postcard to Communicate With a Consumer Regarding a Debt Is Prohibited

[g] All Language and Symbols on Envelopes Used for Collection Are Prohibited Except for the Collector's Address and Name if the Name Does Not Indicate the Collector's Business

[6] Validation of a Debt

[a] Congress Considered Debt Validation Significant

[b] The FDCPA Regulates the Content, Placement, and Provision of the Validation Rights Notice

[i] Placement and Provision of Validation Rights Notice

[A] Placement of the Validation Rights Notice

[B] Providing Validation Rights Notices to Consumers

[1] Overview

[2] Providing the Notice Before Formal Pleadings

[3] Providing the Notice After Initiating Debt Collection with Formal Pleadings

[4] Exception for Certain Legal Notices

[ii] Content of Validation Notice

[iii] Collection Activities May Not Obscure the Validation Notice

[iv] Additions to Validation Notice to Avoid Deception or Confusion

[c] Verification of a Debt

[i] Consumers Should Request Verification in Writing

[ii] A Debt Collector Verifies a Debt by Providing Information That Is Responsive to the Consumer's Request

[iii] Debt Collector Must Cease Collecting From Time of Receipt of Verification Request Until Debt Verified

[d] Failure by a Consumer to Exercise Validation Rights May Not Be Taken as an Admission of Liability

[7] Consumer May Direct Application of Payments When a Collector Holds Multiple Accounts

[8] Restrictions Against Bringing Suits in Inconvenient Forums

[a] Suit Must Be Filed Where Consumer Resides or Signed Contract or Where Property Located

[b] Enforcing a Judgment in a Jurisdiction Where the Consumer Does Not Reside or Did Not Sign the Contract

§ 8.04 Availability of a Private Fair Debt Collection Practices Act Cause of Action

[1] Private Remedy Is Primary Enforcement Mechanism

[2] Cases and Parties Must Be Carefully Evaluated

[a] FDCPA Awards Increasing

[b] A Wide Range of Parties Plaintiff May Be Named Under the Act

[c] A Wide Range of Parties Defendant May Be Named Under the Act

[d] Parties to a Private FDCPA Action Are Entitled to a Trial by Jury

[3] Actual Damages Are Available to Any Person Injured by a Violation of the Act

[a] "Actual Damages" Are Defined Broadly by the Courts

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PART I Consumer Credit
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§ 8.01 Overview of the Fair Debt Collection Practices Act

[1] Scope, Purpose, and Effective Date

The Fair Debt Collection Practices Act of 1978 n1 ("the Act" or "FDCPA") promotes ethical business practices by debt collectors. n2 The FDCPA offers some of the strongest protections provided by any federal or state law regulating the activities of debt collectors. The Act was the result of compromises that resulted in its bipartisan support and support by both the major debt collection trade associations involved and consumer organizations.

Although the Act is limited in coverage, mainly to debt collection agencies and lawyers, its influence is significant. The Act should affect the development of case law dealing with torts that may be committed in the course of abusive collection efforts. The Act's detailed provisions and the developing case law construing those provisions are likely to be used for guidance by state courts in states with debt collection statutes that contain similar standards.

The FDCPA restricts debt collectors' collection efforts and choice of venue. The FDCPA applies to debt collector's activities in 49 states; Maine's substantially similar law applies to collection activities in Maine. n3 The term "debt collector" is defined by several tiers of definition within the FDCPA; it generally includes debt collection agencies, creditors using false names or collecting for other creditors, collection attorneys, purchasers of delinquent debts, repossession companies, and suppliers or designers of deceptive forms, n4 but generally excludes creditors collecting their own debts.

The FDCPA establishes general standards of proscribed conduct, defines and restricts abusive collection acts (in detail), and provides specific rights for consumers. General standards of proscribed conduct protect a consumer from invasion of privacy, harassment, abuse, false or deceptive representations, and unfair or unconscionable collection methods. n5 Specific debt collection acts prohibited include late night or repetitive phone calls and false threats of legal action.

The Act gives a consumer the right to require by letter that a collector stop all collection contacts. It requires a collector to deal with a consumer's attorney when the consumer has one. It gives a consumer the right to require a collector to verify the existence, legality, or amount of a disputed debt that it is attempting to collect. Debt collectors must provide two types of notices to consumers under the FDCPA. The courts require strict adherence to the Act's explicit terms to accomplish the remedial and preventative goals of Congress. n6

The Act became effective on March 20, 1978. The first substantive amendment to the FDCPA in 1986 repealed an exemption for most attorneys and broadened the Act's coverage to apply to attorneys who regularly collect consumer debts for creditors or collection agencies. The *second amendment*, passed in 1996, altered the debt collection notice.The *third amendment*, passed in 2006, altered some of the rules for giving debt verification notices and provided a potential exemption for district attorneys' closely supervised check collection agencies.

The FDCPA's constitutionality has been upheld. n7

[2] Sources of Law and Research Aids

[a] The Language of the Act

The language of the FDCPA, sometimes overlooked by courts and lawyers, is the clearest expression of congressional will, and should be the first point of reference in any action under the Act. n8

[b] Federal Trade Commission Informal Staff Letters

The Federal Trade Commission ("FTC") staff advises debt collectors, attorneys, and consumers of its policies and interpretations of the Act. Because the FTC is the primary enforcement agency under the Act, n9 its advice is entitled to some weight and deference. This advice is frequently presented in informal staff letters discussing the Act's requirements and their application to current industry practices. While the courts frequently cite the informal staff letters, they are not bound by them. n10

[c] FTC Staff Commentary on FDCPA

In 1988, the Federal Trade Commission hatched a final version of its Staff Commentary on the FDCPA. n11 The Commentary, which is not binding on the FTC, the public or the courts, n12 was intended to replace several hundred FTC letters. For the most part, the final Commentary embodies the original 1986 proposed Commentary n13 and staff positions developed in subsequent informal FTC staff letters since the 1986 proposal. n14

The major weakness of the Commentary is its superficiality. It often lacks any rationale for its positions, and where it does provide some rationale, it is much less analytical than other sources of FDCPA law--the statute, legislative history, case law and FTC informal staff letters. Because of this, it is likely to have less persuasive value to courts than other sources of FDCPA law, but lawyers litigating FDCPA cases must address the positions taken in the Commentary. The Commentary also fails to acknowledge where its positions conflict with court decisions or the plain language of the FDCPA. It has not been internally updated to reflect current FTC interpretations and policies.

[d] Federal Trade Commission Formal Advisory Opinion

In 2000, the FTC issued its first formal advisory opinion on the FDCPA, responding to the request of the American Collectors Association. The advisory opinion addressed two issues. First, the Commission advised that collectors may undertake collection activities during the thirty-day period during which a consumer may request the collector to validate debt as long as the collection activities do not overshadow or are not inconsistent with the notice of validation rights. Second, it advised that the FDCPA does not preempt any state laws that do not allow the FDCPA validation notice to be included in the summons when it is the first collection communication with the consumer because there is no conflict as the FDCPA allows the validation notice to be sent separately within five days of the initial collection communication with the consumer. n15

The FDCPA provides that an act done in good faith conformity with an advisory opinion of the FTC is insulated from FDCPA liability. n16 The FTC has a formal procedure for issuing formal advisory opinions. n17

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Debt CollectionGeneral OverviewBanking LawConsumer ProtectionFair Debt CollectionCommunicationsBanking LawConsumer ProtectionFair Debt CollectionLiabilityBanking LawConsumer ProtectionFair Debt CollectionUnfair PracticesReal Property LawLandlord & TenantTenant's Remedies & RightsFair Debt Collection Practices Act

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. §§ 1692-1692 o*, *reprinted in* Vol. 1B *infra*.

(n2)Footnote 2. For complete coverage of the Act, along with Official Federal Trade Commission [hereinafter FTC] staff commentary and informal FTC letters, case summaries, sample documents and pleadings, etc., see National Consumer Law Center, Fair Debt Collection (6th ed. 2008 and supp.).

(n3)Footnote 3. Maine was granted an exemption from the Fair Debt Collections Practices Act [hereinafter FDCPA] by the FTC pursuant to the FTC's authority under *15 U.S.C. § 1692 o*. *60 Fed. Reg. 66,972* (Dec. 27, 1995) (effective Mar. 26, 1996).

(n4)Footnote 4. *15 U.S.C. § 1692a(4), (6)*.

(n5)Footnote 5. *Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995)* ("The Fair Debt Collection Practices Act prohibits debt collectors' from making false or misleading representations and from engaging in various abusive and unfair practices"). *See also* Griffith, *Fair Debt Collection Practices Act: Some Problems In Interpretation*, *27 Willamette L. Rev. 237 (1991)*.

(n6)Footnote 6. *Frey v. Gangwish, 970 F.2d 1516 (6th Cir. 1992)* (the FDCPA is "an extraordinarily broad statute" and must be enforced "as Congress has written it"). *See also Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995) . See also Deere v. Javitch, Block & Rathbone, L.L.P., 413 F. Supp. 2d 886 (S.D. Ohio 2006)* ("The Sixth Circuit has described the statute as 'extraordinarily broad' and its terms must be literally enforced.").

(n7)Footnote 7. *United States v. Cent. Adjustment Bureau, Inc., 823 F.2d 880 (5th Cir. 1987) . See also Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995) .*

(n8)Footnote 8. *Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995)* (effect must be given to the plain meaning of the statute).

(n9)Footnote 9. *15 U.S.C. §§ 1692l(a), 1692m*.

(n10)Footnote 10. *See Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995)* (no deference to FTC staff commentary position that was "outside of the range of reasonable interpretation of the Act's express language").

(n11)Footnote 11. *53 Fed. Reg. 50097* (Dec. 13, 1988) .

(n12)Footnote 12. *53 Fed. Reg., 50101* (Dec. 13, 1988) *See Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995) , aff'd, Jenkins v. Heintz, 124 F.3d 824, 1997 U.S. App. LEXIS 22745 (7th Cir. Ill. 1997)* (FTC staff's Commentary is not binding on the Commission or the public and is not entitled to deference when it conflicts with the FDCPA's plain language); *Scott v. Jones, 964 F.2d 314 (4th Cir. 1992)* (court may not defer to an FTC informal staff letter to the defendant nor to the FTC staff's FDCPA commentary when that would defeat express congressional language in the FDCPA); *Carroll v. Wolpoff & Abramson, 961 F.2d 459 (4th Cir. 1992) , cert. denied, Wolpoff & Abramson v. Carroll, 506 U.S. 905 (1992)* (the court will not abide by the FTC's advisory opinion where it

contradicted the statute's unambiguous statement). *See also Shapiro & Meinhold v. Zartman, 823 P.2d 120 (Colo. 1992)* , *aff'g Zartman v. Shapiro & Meinhold, 811 P.2d 409 (Colo. Ct. App. 1990)* (contrary FTC staff letters and commentary ignored by court); Goldfarb, FTC Informal Staff Letter (Jan. 16, 1987) (FTC may not promulgate regulations. The proposed FTC Official Staff Commentary will not be binding on the FTC, the public or the courts. It reflects the staff's enforcement policy.).

(n13)Footnote 13. *51 Fed. Reg. 8019* (Mar. 7, 1986) . *See FTC Proposes Staff Commentary on FDCPA*, 4 NCLC REPORTS, *Debt Collection & Repo Ed.* 41 (Mar./Apr. 1986).

(n14)Footnote 14. *E.g.*, *FTC Staff Rapidly Expanding Its Litigation Loophole to the FDCPA*, 5 NCLC REPORTS, *Debt Collection & Repo Ed.* 9 (Nov./Dec. 1986); *Are Tort Claims Arising From A Car Accident Covered By The FDCPA?* 5 NCLC REPORTS, *Debt Collection & Repo Ed.* 26 (July/Aug. 1987).

(n15)Footnote 15. Mezines, FTC Advisory Opinion (Mar. 31, 2000), *available at* http://www.ftc.gov/os/2000/04/fdcpaadvisoryopinion.htm.

(n16)Footnote 16. *15 U.S.C. § 1692k(e).*

(n17)Footnote 17. *16 C.F.R. § 1.1 (2000).*

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§ 8.02 Persons and Transactions Covered by the Fair Debt Collection Practices Act

Coverage by the FDCPA is largely determined by the definition of "debt collector." n1 That definition is lengthy and incorporates three other terms, also defined in the Act--"consumer," "debt," and "creditor." n2 This makes coverage questions the most complex area of the FDCPA.

The Act *generally* applies to collection agencies, attorneys, creditors using a false name, creditors collecting for another person, certain activities of repossession companies, suppliers or designers of deceptive forms, purchasers of debt after default, debt poolers (for profit), and check "guarantee" services.

The Act may not require compliance of any person who does not "regularly" engage in debt collection. The Act applies only to "debts" which arise out of consumer not business transactions.

Generally excluded are creditors (collecting their own debts)--retail stores, banks, finance companies, etc.; assignees (before default)--car finance companies, banks, etc.; government employees, business debts, and nonprofit credit counseling services.

A purchaser of a debt in default is a debt collector under the FDCPA, not an exempt creditor. n3 When the FDCPA does not apply, the state laws discussed in *Section 8.09*, *infra*, are likely to provide a remedy, and are sometimes stronger than the FDCPA.

[1] Persons Who Must Comply as Debt Collectors

[a] Any Person Whose Principal Business Is Collecting Debts Is a "Debt Collector".

The term "debt collector" means any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts. n4

This phrase and the one following it provide the general language defining members of the class "debt collector," the term triggering most provisions of the Act. Since nearly all collectors use a telephone or the mails in their business, the limiting requirement of this part of the definition is that the collector's principal business purpose must be to collect consumer obligations.

Under the foregoing definition, most debt collection agencies and their employees are covered by the FDCPA, whether or not they own the debts they collect. Collection lawyers may be covered by this phrase as well as the following phrase in the Act. A collection agency's collection law firm is a debt collector, and the collection agency may be liable for the firm's FDCPA violations. n5 The definition may cover flat-rate debt collectors (companies hired by a creditor for a flat fee simply to mail debtors letters requesting payment directly to the creditor) and credit counselors who, for a profit, arrange for payment of consumers' debts. It may cover a check guarantee service.

[b] Any Person Who Regularly Collects Debts Owed to Another Is a "Debt Collector".

The term "debt collector" means any person who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another. n6

The persons covered by this language overlap to a great extent those covered by the preceding phrase defining "debt collector." Many collectors are brought in, however, who are not covered by the preceding phrase. These include collectors who partly engage in a business other than collecting debts (e.g., extending credit, practice of law or credit reporting). n7 Ownership of the debt is not necessarily determinative of coverage. n8

[c] Creditors Using False Names Are "Debt Collectors" n9

Creditors are generally exempt from FDCPA coverage. n10 This sentence of the FDCPA makes a creditor subject to the Act when it uses a name other than its own which suggests the involvement of a third-party collector, poses as a collection agency, or uses a third party's name in its collection efforts. The creditor may also become subject to the Act with its in-house lawyer who collects on letterhead suggesting that it is from a separate law office. n11 A creditor does not run afoul of this provision by referring a customer to its internal loan counseling department. n12

[d] Repossession and Foreclosure Companies Are Treated as "Debt Collectors" Under Some Circumstances

For the purpose of section 1692f(6) of this title, n13 such term ["debt collector'] also includes any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the enforcement of security interests. n14 This sentence contained in the definition of "debt collector" subjects repossession companies and others whose principal business is enforcing security interests to the FDCPA's proscription n15 of specific unfair or unconscionable means of enforcing security interests.

Because the *15 U.S.C. section 1692f(6)* proscriptions only apply if nonjudicial means are being used, security interest enforcers are constrained by this phrase only if they resort to self-help repossession, nonjudicial foreclosure, or other out-of-court enforcement tactics as opposed to replevin or similar judicial proceedings. n16

Some courts have split on the application of other provisions of the FDCPA to non-judicial n17 and judicial foreclosure. n18

In 2006 the Fourth and Fifth Circuits independently came to the conclusion that foreclosure lawyers may come under the general definition of debt collector subject to all of the FDCPA requirements. In *Wilson v. Draper & Goldberg, P.L.L.C.*, n19 the Fourth Circuit held that the FDCPA applies to lawyers conducting a deed of trust foreclosure, at least when the lawyers tell the debtor how much must be paid to reinstate the mortgage. The court rejected all three of the foreclosure lawyers' arguments: (1) because they were engaging in a foreclosure, no "debt" as defined by the Act was involved; (2) they were exempt as "fiduciaries;" and (3) as enforcers of a security interest, they were only required to comply with the requirements of *15 U.S.C. § 1692f(6)*. A dissenting opinion argued that the debt collectors should have fallen within the exemption for fiduciaries.

The court found two bases to reject the argument that there was no debt involved. First, the court rejected several decisions n20 that held that merely enforcing a security interest did not involve an obligation to pay money; to the contrary, following the Third Circuit's reasoning in *Piper v. Portnoff Law Assocs*. that the FDCPA may apply to *in rem* proceedings, the court held that the underlying mortgage was a qualifying transaction involving the loan of money. Second, the court pointed out that the collection attorneys in any event had sought payment of money in this case by writing the homeowner stating how much was to be paid to reinstate the mortgage.

The Fifth Circuit reached the same result in *Kaltenbach v. Richards,* a *pro se* case, without referring to the Fourth Circuit decision. n21 The Fifth Circuit looked at the breadth of FDCPA definition of debt collector and held that the complaint's allegation that the foreclosure attorney was a "debt collector" engaged in "collection activities" sufficed to state a claim against the foreclosure attorney for failing to provide the notice of debt validation rights. The foreclosure attorney argued that the last sentence of the definition of debt collector limited its compliance obligation to only the requirements of section 1692f(6). The Fifth Circuit rejected that construction and deferred to the Federal Trade Commission's interpretation that an enforcer of security interests could be subject to all the requirements of the FDCPA, not just section 1692f(6). n22 The Fifth Circuit pointed out that any other interpretation would make the FDCPA's convenient venue requirement for foreclosure in section 1692i superfluous, violating an important principal of statutory construction.

Finally, the Fifth Circuit noted that the focus of the key definition of "debt collector" is "regular" collection activities, not the specific foreclosure activities, of the foreclosing attorney. If the foreclosure attorney regularly seeks or obtains payments from the consumer, it would be subject to all the requirements of the FDCPA, even if it was not seeking payment at the time of the FDCPA violation in the particular case.

The overwhelming majority of foreclosures result in payment of the mortgage through refinancing or the homeowner's sale of the home before the foreclosure sale, or the reinstatement of the mortgage after payments, rather than foreclosure of the mortgage. n23 This strongly suggests that foreclosure attorneys are regularly collecting debts while they pursue foreclosure.

[e] Flat Rate Collectors or Others Supplying Forms That Misrepresent Extent That They or Another Is Involved in Collecting a Debt Violate the Act

This section n24 is the only proscription of the Act not limited to "debt collectors." Even individuals specifically excluded from the FDCPA definition of "debt collector," e.g., creditors, are liable for violations of this section.

[i] Extent of Participation in the Collection Process

There is no set minimum level of sufficient participation in the collection of a debt to take a flat-rate or any other collector outside the proscription of section 1692j.

[ii] Lawyers Must Review File Before Signing Collection Letter

By implication, a letter on a lawyer's letterhead would imply greater participation than a letter on a collection agency's letterhead because of the stronger remedies usually pursued by attorneys. If an attorney, for example, supplied form letters to a creditor or collection agency and did not otherwise participate in the collection efforts in the manner implied by the letters, he or she violates this section. n25

[f] Lawyers Regularly Collecting Consumer Debts Must Now Comply With All FDCPA Provisions

[i] 1986 Attorney Amendment

An attorney who regularly collects consumer debts is subject to all provisions of the FDCPA. n26 Even in-house

counsel collecting a debt for his or her employer may be covered if he or she sends collection letters that are designed to make the debtor believe that a private attorney has intervened. n27

[ii] Scope of FDCPA Attorney Coverage

The definition of "debt collector" includes any attorney "who regularly collects or attempts to collect, directly or indirectly, [consumer] debts owed or due or asserted to be owed or due another." n28 The key to the breadth of this definition is the concept of engaging in collection activities "regularly." An attorney meets the "regularly" test if the attorney engages in debt collection in more than isolated instances, if it is a minor but regular part of the attorney's practice, or if the attorney collects debts more than a few times in a year. An attorney who very seldom collects debts is not covered. n29

The Second Circuit found in *Goldstein* n30 that a lawyer issuing 145 notices demanding delinquent rent in a twelve-month period as part of an ongoing relationship with a landlord was "regularly" collecting debt as required to be covered by the FDCPA despite the collection work constituting less than .5% of his revenues. The court reviewed five factors: the number, frequency, and pattern of collection communications; staff and systems assigned to collections work; and an ongoing relationship with the creditor. n31 The court also noted that a law firm's marketing of collection services would also weigh in favor of finding regularity.

The *Goldstein* decision is significant as it joins the Fifth Circuit n32 in rejecting a line of decisions that focuses on the law firm's debt collection cases or revenues as a portion of its total cases or revenues, rather than looking at the whole picture including the number of collection cases handled. n33 Other courts find ninety collection cases in five months or four percent n34 of the caseload sufficient to meet the regularity test but not just twenty-three n35 or thirty-five n36 collection cases in one year or so.

The FDCPA's legislative history elaborates on what was meant by "regularly": "The requirement that debt collection be done regularly would exclude a person who collects a debt for another in an isolated instance, but would include those who collect for others in the regular course of business." n37

In contrast, the Sixth Circuit held that a collection lawyer must be substantially involved in debt collection work to be covered by the FDCPA. The Sixth Circuit inferred that the removal from the FDCPA of a broad exemption for attorneys in 1986 raised the threshold from "more than isolated instances of collection" and "in the regular course of business" to a requirement of "substantial" attorney debt collection for coverage to take effect. n38

[iii] Issues Unique to Attorney Debt Collectors

[A] Venue Provision

The venue provision requires that debt collectors bring suit only in the district where the consumer signed the contract upon which the suit is based or where the consumer resides. n39 Actions to enforce an interest in real property may be brought only where the property is located. n40 Any less protective state law venue provision is preempted. n41

[B] Communications With Third Parties

The Act's limitations on communication with third parties raise special issues in the context of discovery and post-judgment proceedings. However, the FDCPA contemplates the need to deal with third parties during litigation. n42

[C] Notice of Validation Rights

As a result of amendments to the FDCPA years apart, the initial notice of validation rights and of the debt collection purpose n43 need not be made until later if the first communication by a collection attorney to a consumer is a formal

pleading. In that situation the notice of the consumer's debt validation rights must be sent in the initial communication after any formal pleading. This is likely to be in the collection attorney's conversations with the consumer about the validity of the claim against the consumer or regarding payment of the claim or judgment. Because the later event triggering the debt validation notice may not be readily anticipated by the debt collector's system, it may be safer to provide the debt validation and the debt collection warning in a pre-suit demand letter encouraging the airing of disputes before suit. This helps assure that the collection suit is the collection device of last, rather than first, resort.

[D] Other Pitfalls to Avoid

Most of the practices forbidden by the FDCPA have long been prohibited by ethical standards applicable to attorneys. Violation of these ethical standards may now lead to the consumer's recovery of FDCPA actual and statutory damages and attorney fees.

Collection attorneys should avoid these other common trouble areas:

- Threatening to sue when there is no intention or ability to do so;
- Misrepresenting the source of the collection letter or the attorney's involvement (by allowing a collection agency to send out a demand letter over the name of an attorney); n44
- Imposing specious deadlines;
- Misleading representations as to the effect of litigation;
- Filing suit other than in the court permitted by *15 U.S.C. section 1692*.

[iv] Attorney Liable for Allowing Signature to Appear on Collection Letters Without Reviewing File

15 U.S.C. section 1692e(3) prohibits misrepresenting that "any communication is from an attorney." Where an attorney exercised no control or supervision over a debt collection letter, the appearance of his name and signature on a letter would violate *15 U.S.C. sections 1692e* and *1692e(10)*. n45

A Seventh Circuit decision revisits the issue of how much involvement is sufficient for a collection lawyer to sign his name to a collection letter without misrepresenting that he is involved as a lawyer in the collection of the debt. The decision builds on prior decisions of the court, and finds a lawyer's cursory information about individual GM credit cards insufficient to make a legal judgment that there was a legitimate claim to pursue. The court found that the collection attorney did not make a "considered, professional judgment" that individual consumers were delinquent and were candidates for legal action or that the dunning letter should be sent to them. Factors showing lack of attorney involvement were:

- The creditor made the decision about which consumers should receive the letters.
- The creditor did not provide sufficient information about the account for the collection lawyer to reach an independent, professional judgment about liability and collectibility.
- The use of the same form letter in every case and the great volume of accounts to which it was sent reinforced the finding that there was no use of professional judgment.
- The collection lawyer's role in dealing with responses to the letter was not more than ministerially referring most of them back to creditor. He had no authority to negotiate payments or settle the debt.

- The collection lawyer's flat fee of $2.45 per letter suggested that he was not being paid by the creditor for his legal judgment but rather for the marquee value of his name.

- The collection lawyer was not ever authorized to file suit for the creditor. n46

[v] Second Circuit Allows Lawyer to Dun and Disclose Before Reviewing Claim

In a decision that will give a big boost to the amount of junk mail consumers get, the Second Circuit, in *Greco v. Trauner, Cohen & Thomas*, n47 allowed a lawyer to send mass-mailed duns before making any evaluation of the legal merits of a claim as long as the lawyer clearly discloses to the consumer that the lawyer has not reviewed the claim. The court reasoned that even an unsophisticated consumer would not be misled where the collector's disclosure was clear and there was nothing in the letter to suggest the sender was actually acting in the capacity of a lawyer.

With no struggle, the court distinguished its prior decisions in *Clomon* n48 and *Miller* n49 finding deception when a lawyer sent a dun without being involved in evaluating the legality of the claim. The court was able to build on hedging language in the *Miller* decision:

> [T]he use of an attorney's signature implies--at least in the absence of language to the contrary--that the attorney signing the letter formed an opinion about how to manage the case of the debtor to whom the letter was sent. n50

The court distinguished *Clomon* and *Miller* based on the disclaimer, the lack of any language in the letter conflicting with the disclaimer, and the lack of any signature on the letter. The *Clomon* and *Miller* dunning letters contained strong requests for payment, facsimile signatures, and no disclaimers. In this case there was a clear disclosure, only a request the consumer call the law firm, the debt validation rights notice, and the law firm's name typed on the signature line.

[vi] FDCPA and Lawyers' Ethical Obligations Intertwine

Concepts of unfairness for FDCPA purposes can be established by the American Bar Association's Code of Professional Responsibility or the state bar association's equivalent and its predecessors. ABA Model Code of Professional Responsibility DR 7-104(A)(2) permits a lawyer to advise a self-represented person adverse to the lawyer's client to seek her own counsel and to make certain other related statements. These statements may include, where appropriate: identification of general legal issues that the self-represented person should address with a lawyer; undisputed statements of fact or law such as the position of the lawyer's client on a contested issue; and references to court-sponsored programs designed to assist a self-represented litigant. A lawyer may at any time explain or clarify the lawyer's role to the self-represented litigant and advise that person to obtain counsel. The lawyer must volunteer this information if she knows or should know that a self-represented person misunderstands the lawyer's role in the matter.

[A] Lawyers' Collection Letters Must Avoid False Threat of Suit

There can be little doubt that a letter from an attorney inherently conveys the impression that litigation is imminent. This impression is false if the attorney does not in fact have the authority and intention to promptly bring suit. In that case, this can be an ethical violation.

A collection letter may mislead even further by implying that a lawsuit has already been filed against the debtor. An American Bar Association ethical opinion condemned a collection letter that simulated legal process because, "unless carefully read, [it] will create the false impression that suit has been filed." n51

The Fair Debt Collection Practices Act prohibits false or misleading representations, but also prohibits false or misleading implications. n52

[B] Interstate Collection Letters Must Avoid Misrepresenting Lawyer's Authority to Sue

A lawyer who sends a collection letter into a state in which he or she is not admitted to practice, without disclosing that fact, may violate the FDCPA. n53 The failure to disclose the states in which the lawyer is admitted to practice is a deceptive omission.

[C] Representing Only Part of the Effects of Suit Is Deceptive

A demand letter can be deceptive if it fails to mention that post-judgment remedies include exemptions and due process protections: a judgment debtor is entitled to notice, and some of his or her property is safeguarded by exemption statutes. Without these qualifications, the mention of post-judgment remedies in an attorney's letter is misleading, can cause undue concern, and violates the FDCPA. n54

[D] Intermingling Activities of Collection Agency and Attorney May Be Unlawful

Collection agencies and lawyers that work together must take care that their roles are kept separate. Consumers should not be confused about whether a collection letter is from the attorney or the collection agency. Misrepresentation of the source of a document is specifically prohibited by the FDCPA. n55 The FDCPA also specifically prohibits the false representation or implication "that any communication is from an attorney." n56

The FTC takes the position that it is deceptive for a collection agency to send a letter under an attorney's letterhead without the attorney's supervision. n57 This has also been found to be an ethical violation.

[g] FDCPA Applies to Debt Buyers

The FDCPA covers debt buyers who engage in debt collection activities. n58 In *Federal Trade Comm'n v. Check Investors, Inc.,* n59 the Third Circuit held that it is immaterial that the defendants actually owned the debt they were trying to collect; that did not make them creditors under the Act. The focus must be on "whether a debt was in default when acquired to determine the status of 'creditor' vs. 'debt collector.' " n60 This reinforces the case law on the FDCPA's applicability to the growing number of debt buyers. One court held that the debt buyer's parent company was also a debt collector since the facts showed that the parent was "thoroughly enmeshed in the debt collection business" and "a significant participant in the debt collection process. n61 The seminal decision on the coverage of debt buyers is *Kimber v. Federal Fin. Corp.* n62 The coverage of a debt buyer that delegates all of the actual debt collection work depends on the nature and level of its involvement with the collection entity.

[2] New Coverage of Collection of Federal Income Taxes by Collection Agencies

In 2004 Congress extended new protections to taxpayers when it enacted a new law that allows the Internal Revenue Service to hire private debt collection agencies to collect federal tax debts from financially distressed families. n63 The new law provides that "[t]he provisions of the Fair Debt Collection Practices Act shall apply to any qualified tax collection contract." n64 The FDCPA does not apply, however, to the extent superseded by (1) the FDCPA-like prohibitions already in the tax code, (2) tax code restrictions on contact with third parties, and (3) "any other provision" of the tax code. n65 In other words, private tax collectors must comply with the FDCPA except where the tax code specifies conflicting duties.

As part of this new law, Congress specifically created a private cause of action against a debt collector who recklessly, intentionally, or negligently disregards any provision of the tax code or any regulation under it. n66 The taxpayer has the right to bring suit in federal court for "actual, direct economic damages," with a cap of $1,000,000 ($100,000 in the case of negligence), plus costs. n67 Unlike suits where the misdeeds are committed by IRS employees, the plaintiff need not exhaust administrative remedies. However, the new law insulates the IRS from any misconduct by the private collection, permitting suit to be brought against the private tax collector only, not against the United States. n68

It is also clear that private collectors are liable for common law torts committed in the course of collecting tax debts. The new law explicitly provides that the civil remedy it creates "shall not be an exclusive remedy." n69 It also appears that the taxpayer should be able to assert a claim under the FDCPA against the collector. While the new law says that the FDCPA shall apply to the contract, the legislative history shows that Congress meant by this language that provisions of the FDCPA "apply to the private debt collection company." n70 It is reasonable to interpret the new law as applying the FDCPA in full, including its private cause of action, to private tax collectors. The enactment of this language also suggests that Congress disagrees with the courts that have construed the term "debt" in the FDCPA narrowly as not to applying to tax debts. n71 The IRS expects to have private debt collectors collecting account in early 2007.

[3] Persons Specifically Excluded From the Term "Debt Collector."

Because "debt collector" is the principal triggering term for all but one n72 of the FDCPA's requirements, the ten exclusions from the term shield exempted individuals from most provisions of the Act.

[a] Creditors' Employees Collecting in the Name of the Creditor Are Specifically Excluded

This section n73 excludes from most FDCPA requirements a creditor's in-house collectors who use the creditor's true business name. n74 Creditors lose their exemption if they use a false name that indicates a separate debt collector is involved. n75 Even if they used the creditor's true business name, however, they may be covered if their collection contacts were designed to make the debtor believe that an independent collector had intervened. n76 By implication, creditor corporations collecting their own debts in their own name are also excluded because they can only act through their employees and officers. While a creditor may be responsible for its collection agencies' violations of state law, the weight of authority is that the FDCPA does not impose vicarious liability on FDCPA exempt creditors for their collection agencies' FDCPA violations. n77

[b] A Commonly Owned or Affiliated Corporate Collector Collecting Only for Its Affiliates Is Specifically Excluded if It Is Not Principally a Debt Collector

This exception n78 applies to debts transferred from one corporate affiliate or commonly owned organization to another, so long as the transferee is not principally a debt collector and collects transferred debts only for corporate affiliates. n79 One finance company branch, for example, may transfer a debt to a corporate affiliate in another city or state because the consumer owing the debt has moved, without falling outside this exclusion.

This section does not exclude from coverage unaffiliated companies transferring debts n80 or companies whose principal business is debt collection, regardless of their affiliation with the transferring entities. Nor does the exclusion apply where the transferee failed to disclose its relationship to the original creditor, leading the consumer to believe that a third party was now pursuing collection of the debt.

[c] State and Federal Officials Performing Their Duties Are Specifically Excluded

The exclusion n81 applies only to local government, state, n82 or federal employees and only if their attempts to collect particular debts are within their official duties. It does not apply to a private collection agency hired to collect debts for a state or federal agency. n83

A collection agency running a criminal bad check diversion program was denied its motion for summary judgment claiming exemption. n84

[d] Process Servers Are Specifically Excluded

This exclusion n85 applies, for example, to a sheriff serving a subpoena upon a witness to appear in an action for debt. It only applies while the process server is actually serving process in connection with a suit on a debt.

[e] Bona Fide Nonprofit Consumer Credit Counselors Are Specifically Excluded

Most cities have nonprofit counseling services or adjustment bureaus established and maintained by major credit extenders. These organizations commonly accept referrals of financially distressed consumers and help consumers arrange out-of-court plans to pay their creditors in an orderly fashion. To qualify for the exclusion, the counseling agency must be nonprofit, must engage in such service in good faith, and must receive and distribute payments, as well as provide financial counseling. n86

[f] Persons Collecting Debts as Part of Bona Fide Fiduciary or Escrow Arrangements Are Specifically Excluded

This section n87 excludes the above-named activities when practiced by bank trust departments, escrow companies, and other bona fide fiduciaries. Two decisions held a student loan guarantee agency was exempt under this provision because of the federal requirements for the agency's handling of reserve funds in a fiduciary manner. n88 In the Fourth Circuit, foreclosure attorneys argued that, because they were the substitute trustee of the deed of trust, n89 they were exempt as a fiduciary under *15 U.S.C. § 1692a(6)(F)(i)*. The court held that the defendant did not fall within the FDCPA fiduciary exemption since "actions to foreclose on a property pursuant to a deed of trust are not 'incidental' to its fiduciary obligation. Rather, they are central to it." n90

[g] An Extender of Credit Collecting on Behalf of Another a Debt It Originally Extended Is Specifically Excluded

This section n91 excludes from the general coverage of the Act a credit extender's collection (in its own name) of a debt that it originally extended and then sold or assigned to another creditor while remaining responsible for some or all aspects of collection.

[h] Persons Collecting Debts Not in Default When Obtained Are Specifically Excluded n92

The Senate report emphasized the application of this section to "mortgage service companies and others who service outstanding debts for others, so long as the debts were not in default when taken for servicing. ..." n93 This exempts servicers of mortgages, n94 student loans, n95 rental agreements, n96 utility bills, n97 medical debts, n98 and other consumer transactions n99 if they obtained the debt before default.

This exemption was not available to a check authorization/guarantee service which was owed the debt only as the result of the payee merchant assigning the debt already in default pursuant to a contract for check authorization/warranty services. n100

[i] The Enforcer of a Security Interest in an Account Used as Collateral for a Commercial Loan Is Specifically Excluded

Retailers and lenders sometimes use consumer accounts receivable as collateral for their own commercial financing. Upon default by the retailer or lender, the secured party may collect the payments due on the retailer's or lender's consumer accounts receivable. In such situations, the secured party may not be considered a debt collector by virtue of this section. n101

[j] Check Collection Companies Disguised as District Attorneys

In 2006 Congress amended the FDCPA, legalizing in some circumstances district attorneys' profitable contracts with

check collection agencies that operate invisibly in the name of the local district attorney. n102 So-called check diversion collection agencies, such as American Corrective Counseling Services, n103 are a new type of collection firm that collect dishonored checks for merchants in the name of the local district attorney by scaring consumers with the threat of criminal prosecution and jail time. This method of operation violates the FDCPA n104 unless the company is operating within the terms of the 2006 amendment. Typically these firms tell consumers that they can avoid prosecution if the consumers pay them very high fees to enroll in a financial responsibility class. The fees may exceed a small check by more than $150.

This shady business is likely to move into more neighborhoods, subjecting financially strapped families to threats of criminal prosecution and jail plus an additional very high collection fee if they cannot cover promptly a dishonored check.

The FDCPA exemption for check collections would not apply unless:

- The district attorney's office establishes the collection program and supervises and controls the check collection agency;
- The collection agency complies with the state penal laws and its contract with the district attorney;
- The collection agency does not exercise prosecutorial discretion;
- The district attorney determines that probable cause exists for a bad check prosecution;
- The check writer has failed to pay the check after demand for payment of the amount of the check;
- The district attorney makes a second determination of probable cause if the consumer disputes liability for the check based on identity theft, forgery or fraud;
- The collection agency does not impose fees greater than authorized by the district attorney.

Furthermore, the exemption would not apply to checks where:

- The check was postdated in connection with a payday or similar loan;
- There was a stop payment order issued in good faith and with reasonable cause;
- The check was dishonored because of an adjustment by the bank of the account on which it was drawn without notice to the issuer of the check;
- The check was for partial payment of a preexisting debt where partial payment had been accepted;
- The check writer was incompetent or not of legal age; or
- The check was to pay for an illegal transaction.

Where the check collection company falls outside the exemption, they will be subject to the FDCPA and are likely to be in violation because of the way they operate in the name of the district attorney and often charge fees in excess of those permitted by state law. Some consumers have pursued a civil rights claim in cases involving these companies. n105

[4] Transactions Covered by the Act

[a] The Act Covers Only Debts Allegedly Owed by a Natural Person

Artificial entities, such as corporations, cannot be consumers. n106 The Act does not limit its protections to residents or citizens of the United States.

[b] Consumer Debts, Not Commercial, Are Covered

This definition n107 limits the Act to coverage of the collection of consumer debts--those for personal, family, or household purposes; commercial debts are not within the definition. n108 The term "debt" includes consumer installment credit, such as small loans and retail installment sales, and other types of credit. The use of the loan proceeds is determinative of whether the loan is a "debt" within the coverage of the Act. n109 If the purpose for which the goods or services were acquired changes, the original purpose is determinative. n110 A court found that the FDCPA did not apply where an employee had received benefits under an employee benefit plan that may give rise to a reimbursement obligation but did not respond to the plan's inquiries about reimbursement, so that the insurer was forced to sue. n111

[i] A Broad Range of Consumer Debts Are Covered

The decisions generally construe the term broadly enough to include dishonored checks, n112 rent, n113 medical bills, n114 utility bills, n115 insurance bills and claims, n116 student loans, n117 campground memberships, n118 credit cards, n119 condominium fees, n120 and judgments. The weight of authority excludes the following transactions from the term "debt": taxes; child support; shoplifting civil claims; fines; car accidents; and torts. n121

The term "primarily for personal, family, or household use" was borrowed from the Truth in Lending Act ("TILA"). n122 It was intended to exclude transactions primarily for business purposes. n123

[ii] Coverage of Noncontractual Obligations Questioned

It seems reasonable to construe the term "debt" to include tax and other noncontractual obligations (such as tort claims) that are incurred by individuals and not in connection with conducting business. Some courts, however, have taken a different view, finding for example that tax assessments were not covered "debts," n124 that child support payments assigned to the state were not "debts," n125 and that a bank's efforts to recover an over-credited deposit amount is not a "debt." n126 Damages from a holding-over tenant were held not to involve a debt as there was no claim based on a lease or for rent. n126.1 A federal law passed in 2004 applies FDCPA protections to collection agencies collecting federal tax debts for the IRS. n127 On the other hand, the Seventh Circuit has interpreted the statute broadly, noting that there is no exception in the FDCPA even for consumers who may have fraudulently written a bad check, and it would not create one. n128

Given the possibilities for broad or narrow construction of the word "transaction," and, hence, the term "debt," the proper question is what best serves the congressional purpose for the FDCPA. It is clear that the primary function of the term "debt" was to exclude business transactions. The purposes of the FDCPA are remedial: to eliminate collection abuses, redress injuries inadequately protected by prior law, and encourage fair debt collection methods. n129

[5] FDCPA Protection of Persons Other Than Consumers

The FDCPA protects consumers--persons obligated or allegedly obligated to pay any debt--from violations of the Act. In addition, the private remedies provided by the Act are available to "any person." n130 Many of the protections afforded to "any person" are not limited by the terms "consumer" and "debt," n131 but apply to employers, creditors, relatives, friends, and neighbors affected by violations connected with consumer transactions. Including nonconsumers within the coverage of the FDCPA furthers its purpose of eliminating abusive debt collection practices. n132 So a son had standing to assert FDCPA claims against the credit union's collection attorney, where the credit union illegally

seized the son's money from a joint account with his father to pay his father's debt. n132.1

Actual damages are not required for standing under the FDCPA as the attempt to recover unlawful fees was made actionable by Congress without a requirement of actual damages to recover statutory damages. n133 The FDCPA applies whether or not the plaintiff owes the subject debt or any other debt or obligation. n134 The focus of the FDCPA is on the conduct of the debt collector, not on the conduct of the consumer. n135

[6] Collection Activities Covered by the FDCPA

The FDCPA was broadly written to cover all direct or indirect actions and attempts to collect consumer debt. n136 For example, the debt collector may be held liable for statements made to the consumer's attorney. n137 Sending false information about a delinquent payment to a credit reporting agency is debt collection conduct. n138 The FDCPA may apply to a debt collector's response to a consumer's inquiry. n139 Activities of a debt collector that are totally unrelated to collecting debts are not covered by the FDCPA. An FDCPA claim was upheld in a D.C. Circuit decision despite the lack of a direct communication between a lawyer and the son of the debtor. The FDCPA could be invoked by an "indirect" communication, such as illegally seizing the son's money, and because the FDCPA applies to "allegedly" obligated persons as well as actual debtors. n139.1

[a] "Communications" Covered by the FDCPA

The term "communication" means the conveying of information regarding a debt directly or indirectly to any person through any medium. n140

A broader interpretation of the term "communication" is required to give all provisions of the FDCPA effect. As long as the collector is directly or indirectly attempting to collect a debt, any interchange of information to accomplish the collection of that debt must be construed as a "communication." No other construction is consistent with the purposes of the other provisions of FDCPA. The FTC advises that a summons and complaint that refer to the debt is a communication covered by the Act. n141 However, there is a recent split of appellate decisions on this issue, neither of which cited the current FTC position. n142

[b] Litigation Activities Covered by the FDCPA

Litigation activities by debt collectors are covered by the FDCPA. n143 A split on this issue by the Seventh and Eleventh Circuits may create some uncertainty. The Seventh Circuit in *Thomas v. Law Firm of Simpson & Cybak* n144 held that the *15 U.S.C. § 1692g(a)* obligation to send the consumer a validation notice was triggered by the collection lawyer filing a summons and complaint against the consumer when the summons and complaint was the initial communication with the consumer. The split 6-4 decision disagrees with the Eleventh Circuit's contrary decision in *Vega v. McKay*. n145

The FDCPA provides consumers with an informal way to dispute a debt or find out who the original creditor was. The FDCPA debt validation provision requires the debt collector to give the consumer notice of this right in the "initial communication" or separately within five days of that communication. The collection firm argued that the broad definition of the term "communication" in the FDCPA should be narrowly construed to not include a summons and complaint. The Seventh Circuit followed the plain language of the FDCPA and kept an enormous loophole from developing in that Circuit. While there is some disagreement, a violation of the FDCPA may occur in a letter to the attorney representing a consumer. n146

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Debt CollectionGeneral OverviewBanking LawConsumer ProtectionFair Debt

CollectionCommunicationsBanking LawConsumer ProtectionFair Debt CollectionLiabilityBanking LawConsumer ProtectionFair Debt CollectionUnfair PracticesReal Property LawLandlord & TenantTenant's Remedies & RightsFair Debt Collection Practices Act

FOOTNOTES:

(n1)Footnote 1. *15 U.S.C. § 1692a(6). See Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995)* .

(n2)Footnote 2. *15 U.S.C. § 1692a(3), (4), (5).*

(n3)Footnote 3. *Schlosser v. Fairbanks Capital Corp., 323 F.3d 534, 536 (7th Cir. 2003)* .

(n4)Footnote 4. *15 U.S.C. § 1692a(6) (Supp. II 1979). See also Scally v. Hilco Receivables, L.L.C., 2005 U.S. Dist. LEXIS 13122* (N.D. Ill. June 23, 2005) (debt buyer would qualify as debt collector had it acted through retained counsel).

(n5)Footnote 5. *See Ditty v. CheckRite, Ltd., 973 F. Supp. 1320 (D. Utah 1997) . See also Kimber v. Federal Fin. Corp., 668 F. Supp. 1480 (M.D. Ala. 1987)* .

(n6)Footnote 6. *15 U.S.C. § 1692a(6). See, e.g., Oppong v. First Union Mortg. Corp., 407 F. Supp. 2d 658 (E.D. Pa. 2005)* (Wells Fargo was debt collector under "regularity" prong of FDCPA, where it obtained 356 defaulted mortgages in course of its business of acquiring over 550,000 mortgages in year; court reasoned that it was frequency with which mortgage servicer collected defaulted mortgages that was determinative).

(n7)Footnote 7. *Crossley v. Lieberman, 868 F.2d 566 (3d Cir. 1989)* (attorney routinely collecting consumer debts was a debt collector). *See Durkin v. Equifax Check Servs., Inc., 2002 U.S. Dist. LEXIS 20742* (N.D. Ill. Oct. 28, 2002) (defendant check authorization/guarantee service regularly engaged in the business of collecting debts where it collected over a million checks per year, although that number constituted less than 1% of the checks processed, because the initial focus of "regularity of debt collection depends on sheer volume," standard met here.); *Campion v. Credit Bureau Servs., Inc., 2000 U.S. Dist. LEXIS 20233* (E.D. Wash. Sept. 19, 2000) (corporate debt collector was liable for the misconduct of its attorney and its employees). *See also Russell v. Standard Fed. Bank, 2002 U.S. Dist. LEXIS 12334* (E.D. Mich. June 19, 2002) (FDCPA claim dismissed where plaintiff failed to provide the court with sufficient information as to whether defendant law firm collected debts regularly or how it violated the Act.). *See Berndt v. Fairfield Resorts, Inc., 337 F. Supp. 2d 1120 (W.D. Wis. 2004)* (timeshare resort management association was a debt collector because it regularly collected debts by sending 4700 payment notices a year, some on delinquent accounts, for amounts owed to a homeowner's association, even though the letters amounted to less than one percent of its management activities). *See Wesley v. Calvary Inv., L.L.C., 2006 U.S. Dist. LEXIS 27391* (E.D. Pa. May 9, 2006) (data furnisher/debt collector may be subject to both FCRA and FDCPA). *See also Roybal v. Equifax, 2006 U.S. Dist. LEXIS 22380* (E.D. Cal. Apr. 14, 2006) (credit reporting agency did not collect debts either directly or indirectly on behalf of themselves or others).

(n8)Footnote 8. *See Ransom v. Telecredit Serv. Corp., 1992 U.S. Dist. LEXIS 22738, at 13* (D. Md. Feb. 5, 1992) (exception to the creditor exclusion in § 1692a(4), which applies to "any person to the extent that he receives an assignment or transfer of a debt in default solely for the purpose of facilitating collection of such debt for another," applied to a computerized check authorization service that regularly attempted to collect on dishonored checks purchased from its subscribers because the debts were in default when purchased and debts originally belonged to another.). *See also Kimber v. Federal Fin. Corp., 668 F. Supp. 1480, 1485 (M.D. Ala. 1987)* ; *Winterstein v. Crosscheck, Inc., 149 F. Supp. 2d 466 (N.D. Ill. 2001)* (court rejected check guarantee service's arguments that it was not a debt collector).

(n9)Footnote 9. *15 U.S.C. § 1692a(6). But see Vincent v. Money Store, 402 F. Supp. 2d 501* (S.D.N.Y. Dec. 7, 2005) (court granted defendant summary judgment where consumer's evidence failed to establish that

creditor/defendant used alias through its sham employment of outside counsel to collect debts); *Mazzei v. Money Store, 349 F. Supp. 2d 651 (S.D.N.Y. 2004)* (same).

(n10)Footnote 10. *15 U.S.C. § 1692a(6)(A)* and *(G)*.

(n11)Footnote 11. *See Laws v. Cheslock, 1999 U.S. Dist. LEXIS 3416* (N.D. Ill. Mar. 8, 1999) ; *Young v. Citicorp Retail Servs., 1997 U.S. Dist. LEXIS 22669* (D. Conn. May 20, 1997) , *aff'd*, *Young v. Citicorp Retail Servs., 1998 U.S. App. LEXIS 20268* (2d Cir. Conn. June 29, 1998) ; *Zhang v. Haven-Scott Assocs., 1996 U.S. Dist. LEXIS 8738* (E.D. Pa. June 21, 1996) .

(n12)Footnote 12. *See Gorham-Dimaggio v. Countrywide Home Loans, Inc., 2005 U.S. Dist. LEXIS 34237* (N.D.N.Y. Aug. 30, 2005) .

(n13)Footnote 13. *15 U.S.C. § 1692a(6)*.

(n14)Footnote 14. *15 U.S.C. § 1692a(6)*

(n15)Footnote 15. *15 U.S.C. § 1692f(6)*.

(n16)Footnote 16. *See Rosado v. Taylor, 324 F. Supp. 2d 917 (N.D. Ind. 2004)* (FDCPA does not apply to a foreclosure action even if the foreclosure attorney seeks attorney fees, but it does apply to a §§ 1692e(11) and 1692g notice sent by the foreclosing attorney). *See also Thomson v. Professional Foreclosure Corp., 86 Fed. Appx. 352 (9th Cir. 2004)* (not for publication) (affirmed the district court's dismissal on the basis that the defendants were subject only to § 1692f(6) as enforcers of security interests). *See also McDaniel v. South & Assocs., P.C., 325 F. Supp. 2d 1210 (D. Kan. 2004)* (collection lawyer violated FDCPA by initiating judicial foreclosure action seeking a money judgment as well as foreclosure after receiving a timely validation request but before responding to it).

(n17)Footnote 17. *Compare Pettway v. Harmon Law Offices, P.C., 2005 U.S. Dist. LEXIS 21341* (D. Mass. Sept. 27, 2005) ("Harmon acted as a debt collector when it solicited borrowers to pay off the underlying mortgages;" fact that it was also pursuing foreclosure did not insulate it from FDCPA liability) *with Barbanti v. Quality Loan Serv. Corp., 2007 U.S. Dist. LEXIS 676* (E.D. Wash. Jan. 3, 2007) (enforcement of security interest through non-judicial forfeiture does not constitute collection of debt for purposes of FDCPA); *Chomilo v. Shapiro, Nordmeyer & Zielke, L.L.P., 2007 U.S. Dist. LEXIS 67826* (D. Minn. Sept. 12, 2007) (law firm that was retained to institute non-judicial foreclosure on the consumer's property was not a debt collector subject to the entirety of the FDCPA but was instead an enforcer of a security interest subject only to § 1692f(6)). *See also Kondratick v. Beneficial Consumer Discount Co., 2006 U.S. Dist. LEXIS 4754* (E.D. Pa. Feb. 8, 2006) (denying summary judgment including FDCPA claims where determination of whether Beneficial's failure to stop its foreclosure when it entered into ambiguous mortgage reinstatement agreement with state homeowner assistance program was breach of reinstatement agreement raised questions for trier of fact); *Fong v. Prof'l Foreclosure Corp., 2005 U.S. Dist. LEXIS 31643* (W.D. Wash. Nov. 22, 2005) (summary judgment granted to trustee who commenced foreclosure on property pursuant to deed of trust as trustee was not debt collector as defined by FDCPA as it was enforcing security interest and not collecting money); *Gonzalez v. Northwest Tr. Servs., Inc., 2005 WL 2297097* (D. Or. Sept. 20, 2005) (on unopposed motion for summary judgment against *pro se* plaintiff, court followed *Hulse* line of cases and held that defendant who pursued foreclosure alone, without seeking payment of money, was not "debt collector"); *Miller v. Northwest Trs. Servs., Inc., 2005 U.S. Dist. LEXIS 43770* (E.D. Wash. July 20, 2005) (mortgage companies and their trustees that engaged in foreclosure are not "debt collectors" under *15 U.S.C. § 1692a(6)* because they are not seeking payment of money); *Schuh v. Druckman & Sinel, L.L.P, 602 F. Supp. 2d 454 (S.D.N.Y. 2009)* (foreclosing attorney covered).

(n18)Footnote 18. *See Ray v. Int'l Bank, Inc., 2005 WL 2305017* (D. Colo. Sept. 21, 2005) (court denied attorney defendant's motion to dismiss, holding that his initiation of foreclosure proceedings and service of foreclosure documents constituted collection of debt, rejecting contrary *Hulse* line of cases, and explaining as follows: "Although foreclosure proceedings do not seek or result in a money judgment, they are an attempt to collect on a debt through

realization of the value of property which the debtor has pledged to secure the loan. Through foreclosure, the debt can be partially or fully satisfied.").

(n19)Footnote 19. *443 F.3d 373 (4th Cir. 2006)* .

(n20)Footnote 20. *Hulse v. Ocwen Fed. Bank, F.S.B., 195 F. Supp. 2d 1188 (2002)* ; *Heinemann v. Jim Walter Homes, Inc., 47 F. Supp. 2d 716, 722 (N.D. W. Va. 1998)* , *affd* , *173 F.3d 850 (4th Cir. 1999)* (unpublished) (noting that a foreclosure's purpose is a collateral sale to obtain money, following the Colorado Supreme Court's decision in *Shapiro & Meinhold v. Zartman, 823 P.2d 120, 124 (Colo. 1992))* .

(n21)Footnote 21. *464 F.3d 524 (5th Cir. 2006)* .

(n22)Footnote 22. FTC Staff Commentary on the Fair Debt Collection Practices Act, *53 Fed. Reg. 50,097* (Dec. 13, 1988) .

(n23)Footnote 23. *See, e.g., Pettway v. Harmon Law Offices, P.C., 2005 U.S. Dist. LEXIS 21341* (D. Mass. Sept. 27, 2005) .

(n24)Footnote 24. *15 U.S.C. § 1692j. See Rumpler v. Phillips & Cohen Assocs., Ltd., 219 F. Supp. 2d 251 (E.D.N.Y. 2002)* (complaint that alleged the debt was referred to a third party debt collector for collection and did not allege any other facts to support a § 1692j claim was insufficient to establish that the collector was a flat-rater under § 1692j. The use of the title "Esq." did not create the impression that the collector was an attorney where he was collecting under the title "Executive Vice President." The court described flat-rating as a letter sent by a creditor which appears to come from a third party collector.).

(n25)Footnote 25. *Taylor v. Perrin, Landry, deLaunay & Durand, 103 F.3d 1232 (5th Cir. 1997)* (creditor was a "debt collector" even though it was collecting its own debt because it used a lawyer's letterhead and facsimile signature on its dunning letters, falsely indicating that a third person was collecting the debt). *See also Newman v. CheckRite Cal., Inc., 912 F. Supp. 1354 (E.D. Cal. 1995)* (lawyers collecting debts for a check collection agency were covered by the Act and that coverage was not an unconstitutional interference with the state judiciary's supervision of lawyers); *Littles v. Lieberman, 90 B.R. 700 (Bankr. E.D. Pa. 1988)* (lawyer who gave his form letter to a creditor for mailing to specific debtors was liable under *15 U.S.C. § 1692j* when the creditor sent it to another debtor). *See, e.g., Nielsen v. Dickerson, 307 F.3d 623 (7th Cir. 2002)* (in case where the court found that the collection attorney did not make a "considered, professional judgment" that individual consumers were delinquent and were candidates for legal action or that the dunning letter should be sent to them, the collection letter was not genuinely from the attorney in the professional sense, and he violated § 1692j).

(n26)Footnote 26. *Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995)* ("In ordinary English, a lawyer who regularly tries to obtain payment of consumer debts through legal proceedings is a lawyer who regularly attempts 'to collect' those consumer debts."); *Addison v. Braud, 105 F.3d 223 (5th Cir. 1997)* . A limited attorney exemption in the FDCPA was eliminated by Congress in 1986.

(n27)Footnote 27. *Dorsey v. Morgan, 760 F. Supp. 509 (D. Md. 1991)* ; *Britton v. Weiss, 1989 U.S. Dist. LEXIS 14610* (N.D.N.Y. Dec. 7, 1989) (N.Y. Telephone's in-house attorney included employer's name in address, but failed to indicate that N.Y.T. was his employer and did not use familiar blue bell logo).

(n28)Footnote 28. *15 U.S.C. § 1692a(6). Romea v. Heiberger & Assocs., 988 F. Supp. 712, 714-15 (S.D.N.Y. 1997)* , *motion granted, 988 F. Supp. 715* (S.D.N.Y.) , *aff'd, 163 F.3d 111 (2d Cir. 1998)* (law firm regularly sending notices demanding payment of residential rent arrears was engaged in "communication" for the purpose of collecting a "debt" within the meaning of the FDCPA).

(n29)Footnote 29. *See Goldstein v. Hutton, Ingram, Yuzek, Gainen, Carroll & Bertolotti, 155 F. Supp. 2d 60*

(S.D.N.Y. 2001) (where law firm's income from collections was 0.5% of its total annual income, it was not a debt collector within the FDCPA); *Patrissi Landscaping, Inc. v. Jacunski, 2005 Conn. Super. 308 (Conn. Super. Ct. 2005)* (court overruled fact-finder's conclusion that collection attorney regularly collected debts since only evidence was single collection case). *See also Corbett v. Wolfgang, 2006 U.S. Dist. LEXIS 80917* (S.D. Ohio Nov. 6, 2006) (attorney did not regularly collect where evidence showed that he had filed 29 foreclosure cases during course of the year, that debt collection was less than 1% of his cases and his revenues, and that he performed that collection work for only four of his 200 clients).

(n30)Footnote 30. *Goldstein v. Hutton, Ingram, Yuzek, Gainen, Carroll & Bertolotti, 374 F.3d 56 (2d Cir. 2004)* .

(n31)Footnote 31. *Id. at 62-63* .

(n32)Footnote 32. *See Garrett v. Derbes, 110 F.3d 317 (5th Cir. 1997)* (attorney who collected against 639 different individuals in a nine-month period satisfied the requirement that he "regularly" collected debts for another although those 639 cases only represented.5% of his practice).

(n33)Footnote 33. *See Camara v. Fleury, 285 F. Supp. 2d 90 (D. Mass. 2003)* (where consumer failed to submit any evidence to the contrary, law firm's affidavit that only 4.57% of its practice consisted of consumer debt collection sufficiently supported holding that the attorney and his firm were not "debt collectors"); *Argentieri v. Fisher Landscapes, Inc., 15 F. Supp. 2d 55 (D. Mass. 1998)* , *later op., 27 F. Supp. 2d 84 (D. Mass. 1998)* (attorney who spent only 0.4% of his time in debt collection matters was not acting regularly and therefore is not a "debt collector" as defined).

(n34)Footnote 34. *See Cashman v. Ricigliano, 2004 U.S. Dist. LEXIS 17027* (D. Conn. Aug. 25, 2004) (defendants were debt collectors because they send 90 letters in five months pursuant to a written agreement with a collection agency, set up a special address and telephone line for the collection efforts; and sued some 53 consumers); *Cacace v. Lucas, 775 F. Supp. 502 (D. Conn. 1990)* (attorney who represented four collection agencies, filed over 150 collection suits in a two-year period, and sent one particular collection letter over 125 times in a 14-month period was a debt collector even though debt collection was merely incidental to his primary law practice).

(n35)Footnote 35. *Stojanovski v. Strobl & Manoogian, 783 F. Supp. 319 (E.D. Mich. 1992)* (law firm which collected debts only 4% of the time was a "debt collector" because such activity was regular and brought law firm within § 1692a(6)).

(n36)Footnote 36. *Mladenovich v. Cannonito, 1998 U.S. Dist. LEXIS 985* (N.D. Ill. Jan. 30, 1998) (attorney sent twenty-three collection letters on behalf of two clients, and that number was insufficient to establish that he "regularly" collected debts).

(n37)Footnote 37. *See* Senate Committee on Banking, Housing, and Urban Affairs, S. Rep. No. 95-382, on the Fair Debt Collection Practices Act, at 3 (1977).

(n38)Footnote 38. *See Eby v. Reb Realty, Inc., 495 F.2d 646 (9th Cir. 1974)* . Later, the FRB enacted numerical thresholds for coverage of creditors. National Consumer Law Center, Truth in Lending § 2.3.3 (5th ed. 2003 and Supp.).

(n39)Footnote 39. *15 U.S.C. § 1692i.*

(n40)Footnote 40. *Shapiro & Meinhold v. Zartman, 823 P.2d 120 (Colo. 1992)* (attorney collector, who brought foreclosure action in a county other than that where the real estate was situated, violated *15 U.S.C. § 1692i(a)(1)* even though state statute allowed such venue).

(n41)Footnote 41. *15 U.S.C. § 1692n.*

(n42)Footnote 42. *See § 8.03[2] infra*.

(n43)Footnote 43. *See* National Consumer Law Center, Fair Debt Collection, § 4.2.8.5.4(6th ed. 2008).

(n44)Footnote 44. *See In re Scheck, 171 A.D.2d 33, 574 N.Y.S.2d 372 (1991)* (allowing collection employees to act in a lawyer's name and violate the FDCPA were considered in a one year suspension of lawyer for violating N.Y. Code of Professional Responsibility).

(n45)Footnote 45. *Russey v. Rankin, 911 F. Supp. 1449 (D.N.M. 1995) . Accord Miller v. Wolpoff & Abramson, L.L.P., 321 F.3d 292 (2d Cir. 2003)* (court suggested that merely being told by the creditor that a debt was overdue, without the entire payment history and with only the last few creditor notes to the file, was insufficient for a lawyer to make a meaningful determination of whether it was due and its amount).

(n46)Footnote 46. *Nielsen v. Dickerson, 307 F.3d 623 (7th Cir. 2002) .*

(n47)Footnote 47. *Greco v. Trauner, Cohen & Thomas, L.L.P., 412 F.3d 360 (2d Cir. 2005) .*

(n48)Footnote 48. *Clomon v. Jackson, 988 F.2d 1314 (2d Cir. 1993) .*

(n49)Footnote 49. *Miller v. Wolpoff & Abramson, L.L.P., 321 F.3d 292 (2d Cir. 2003) .*

(n50)Footnote 50. *Id. at 300 .*

(n51)Footnote 51. ABA Formal Opinion 178 (Feb. 19, 1938), Opinions on Professional Ethics [Am. Bar Found.] 448 (1967).

(n52)Footnote 52. *15 U.S.C. § 1692e*.

(n53)Footnote 53. *15 U.S.C. § 1692e(5). See Newman v. CheckRite Cal., Inc., 912 F. Supp. 1354 (E.D. Cal. 1995)* (threats of suit were deceptive to least sophisticated consumers where they were made by counsel not yet licensed to practice law, by other counsel not licensed in the state where the threats were made, and there was no arrangement for in-state counsel when the threats were made). *But see Sturdevant v. Jolas, 942 F. Supp. 426 (D. Wis. 1996)* (opposite view based on possibility of obtaining local counsel).

(n54)Footnote 54. Bice v. Merchants Adjustment Serv., Clearinghouse No. 41,265 (S.D. Ala. 1985).

(n55)Footnote 55. *15 U.S.C. § 1692e(9). See also In re Zenner, 348 S.C. 499, 560 S.E.2d 406 (S.C. 2002)* (attorney sanctioned for loaning his name to lay collection agency that engaged in unauthorized practice of law and abusive debt collection).

(n56)Footnote 56. *15 U.S.C. § 1692e(3)*.

(n57)Footnote 57. *See Newman v. Checkrite Cal., Inc., 912 F. Supp. 1354 (E.D. Cal. 1995) .*

(n58)Footnote 58. *See Federal Trade Comm'n v. Check Investors, Inc., 502 F.3d 159 (3d Cir. 2007)* ; *Schlosser v. Fairbanks Capital Corp., 323 F.3d 534, 536 (7th Cir. 2003)* ; *Larsen v. JBC Legal Group, P.C., 533 F. Supp. 2d 290, 2008 U.S. Dist. LEXIS 10488* (E.D.N.Y. Feb. 12, 2008) ; *Kimber v. Federal Fin. Corp., 668 F. Supp. 1480, 1484 (M.D. Ala. 1987) .*

(n59)Footnote 59. *502 F.3d 159 (3d Cir. 2007) .*

(n60)Footnote 60. *Id. at 168-169 .*

(n61)Footnote 61. *Hernandez v. Midland Credit Mgmt., Inc., 2007 U.S. Dist. LEXIS 16054* (N.D. Ill. Mar 6, 2007)

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(n62)Footnote 62. *668 F. Supp. 1480, 1484 (M.D. Ala. 1987)* .

(n63)Footnote 63. Pub. Law No. 108-357, § 881 (Oct. 22, 2004).

(n64)Footnote 64. *26 U.S.C. § 6304(e)*.

(n65)Footnote 65. *Id.*, *cross-referencing 26 U.S.C. §§ 6304*, *7602(c)*.

(n66)Footnote 66. *26 U.S.C. §§ 7433A*, *7433(a)*.

(n67)Footnote 67. *26 U.S.C. § 7433*, *incorporated by reference in* § 7433A(a).

(n68)Footnote 68. *26 U.S.C. § 7433A(b)(1)*, *(4)*. *See also 26 U.S.C. § 6306(d)* (no federal liability for acts or omissions of private tax collectors).

(n69)Footnote 69. *26 U.S.C. § 7433A(b)(3)*. *Cf. 26 U.S.C. § 7433(a)* (cause of action created for collection abuses by IRS employee is exclusive remedy for recovering damages resulting from such action).

(n70)Footnote 70. Conference Report 108-755 (Oct. 7, 2004).

(n71)Footnote 71. *See* § 4.4.2.3, *infra*.

(n72)Footnote 72. *15 U.S.C. § 1692j*.

(n73)Footnote 73. *15 U.S.C. § 1692a(6)(A)*.

(n74)Footnote 74. *See Thomasson v. Bank One, La., N.A., 137 F. Supp. 2d 721 (E.D. La. 2001)* ; *Shevach v. American Fitness Franchise Corp., 2001 U.S. Dist. LEXIS 2899* (S.D.N.Y Mar. 14, 2001) .

(n75)Footnote 75. *Nielsen v. Dickerson, 307 F.3d 623 (7th Cir. 2002)* (creditor lost its FDCPA creditor exemption because it directed the mailing of the letters that created the false impression that the collection attorney was involved as an attorney, when he was not); *Smith v. Continental Cmty. Bank & Trust Co., 2002 U.S. Dist. LEXIS 11193* (N.D. Ill. June 24, 2002) (police and security officers' motion to dismiss was granted because consumer failed to allege that the officers were debt collectors but alleged them to be employees of the bank and therefore exempt).

(n76)Footnote 76. *Dorsey v. Morgan, 760 F. Supp. 509 (D. Md. 1991)* (asserting his status as an employee of the creditor will not shield an attorney from coverage by FDCPA where he sent dunning letters to consumers which appear to be from outside counsel). *See also Cordova v. Larson, 1997 U.S. Dist. LEXIS 23982 (D. Conn. 1997)* (where there were genuine issues of material fact as to whether an attorney, who was an employee of the creditor and sent a dunning letter, was principally engaged in the collection of debts or whether the attorney was exempt from the FDCPA because he was using stationery that would create the false impression he was from an independent law office).

(n77)Footnote 77. *See Doherty v. Citibank N.A., 375 F. Supp. 2d 158 (E.D.N.Y. 2005)* ; *Kolari v. New York-Presbyterian Hosp. 382 F. Supp. 2d 562 (S.D.N.Y. 2005) . See also Wadlington v. Credit Acceptance Corp., 76 F.3d 103, 108 (6th Cir. 1996)* (assignee before default creditor not vicariously liable for its collection attorney's alleged FDCPA violation).

(n78)Footnote 78. *15 U.S.C. § 1692a(6)(B) (Supp. II 1979)*.

(n79)Footnote 79. *See Daros v. Chase Manhattan Bank, 2001 U.S. App. LEXIS 21471* (2d Cir. Oct. 1, 2001) (not for publication) (neither bank nor affiliated credit card company was a debt collector for the purposes of the FDCPA);

Aubert v. American Gen. Fin., Inc., 137 F.3d 976 (7th Cir. 1998) (a corporate affiliate is excluded from FDCPA coverage if (1) the affiliate collects only for entities to which it is related, and (2) the principal business of the affiliate is not debt collection); *Backuswalcott v. Common Ground Cmty. HDFC, Inc., 104 F. Supp. 2d 363 (S.D.N.Y. 2000)* (defendant was the managing agent and nonprofit sole shareholder of a general partnership owning 1% of a homeless hotel; defendant was exempt under the affiliate exemption; factors included that debt collection was not defendant's most significant activity, nor its single largest or most important activity; the good will of the tenants was important to defendant, which provided many social services); *Friedman v. May Dep't Stores Co., 990 F. Supp. 571 (N.D. Ill. 1998)* ("common ownership" exemption applies only if subsidiary or affiliate acting as debt collector does so solely for the entity to which it is related or affiliated and its principal business is not debt collection); Kegley v. Miles Mgmt. Corp., Case No. 92 C 3438, *1992 U.S. Dist. LEXIS 18401* (N.D. Ill. Dec. 2, 1992) (entity, which primarily managed the operation and lease of real estate, but also collected debts arising from the leases, and which was owned by the owner of the real estate, was exempt from the definition of "debt collector" pursuant to *15 U.S.C. § 1692a(6)(B)*).

(n80)Footnote 80. *See, e.g., Challen v. Town & Country Charge, 545 F. Supp. 1014 (N.D. Ill. 1982)* (allegation that bank collects debts owed to VISA, U.S.A. was sufficient to withstand motion to dismiss the bank as not being a debt collector under FDCPA).

(n81)Footnote 81. *15 U.S.C. § 1692a(6)(C). See Hillman v. Secretary of the Treasury, 2000 U.S. Dist. LEXIS 4544* (W.D. Mich. Mar. 29, 2000) (*pro se* complaint was dismissed because the Internal Revenue Service [hereinafter IRS] was not subject to the FDCPA.); *Fleeger v. Bell, 95 F. Supp. 2d 1126 (D. Nev. 2000)* (district attorneys attempting to collect the markers pursuant to state bad check statutes were exempt from the FDCPA as officers of a state performing official duties), *aff'd, 2001 U.S. App. LEXIS 25491 (9th Cir. 2001)* .

(n82)Footnote 82. The term "state" is broadly defined to also include territories, possessions, etc. and political subdivisions of states. *15 U.S.C. § 1692a(8)*.

(n83)Footnote 83. *See Pollice v. National Tax Funding, L.P., 225 F.3d 379 (3d Cir. 2000)* (§ 1692a(6)(c) exemption for government employees did not extend to a collection agency hired by the government to collect water bills); *Gradisher v. Check Enforcement Unit, Inc., 133 F. Supp. 2d 988* (independent contractor was not entitled to an exemption as a government employee), *class certification granted, in part, 203 F.R.D. 271 (W.D. Mich. 2001) . See Albanese v. Portnoff Law Assocs., Ltd., 301 F. Supp. 2d 389 (E.D. Pa. 2004)* (law firm that contracted with municipalities to collect government debt was not within the government officer and employee exemption); *Israel v. Everson, 2005 U.S. Dist. LEXIS 28255* (S.D. Iowa Oct. 14, 2005) (IRS exempt); *Weiss v. Weinberger, 2005 U.S. Dist. LEXIS 11876* (N.D. Ind. June 9, 2005) (receiver appointed by federal court is officer of court and exempt). *See also §§ 8.02*[1.1] *supra*, regarding federal law passed in 2004 that applies FDCPA protections to collection agencies collecting federal tax debts for the IRS. *See 26 U.S.C. § 6304(e)*.

(n84)Footnote 84. *See Liles v. American Corrective Counseling Servs., 131 F. Supp. 2d 1114 (S.D. Iowa 2001)* (factual issues prevented a determination of whether a check collection agency was a debt collector. The collector was not a creditor's employee, an officer of the state, and admitted it was collecting debts, not just administering a bad check criminal diversion program.).

(n85)Footnote 85. *15 U.S.C. § 1692a(6)(D)*; *Flamm v. Sarner & Assocs., P.C., 2002 U.S. Dist. LEXIS 22255* (E.D. Pa. Nov. 6, 2002) (person who went beyond being merely a messenger in serving legal process and engaged in prohibited abusive or harassing activities to force an individual to repay a debt was no longer exempt under the legal process server exception and was a covered "debt collector" as defined by the FDCPA). *See also Flamm v. Sarner & Assocs., P.C., 2006 U.S. Dist. LEXIS 308* (E.D. Pa. Jan. 3, 2006) (where court had found process server was debt collector because he went beyond merely serving process, whether lawyers were vicariously liable for independent contractor's actions was jury question).

(n86)Footnote 86. *15 U.S.C. § 1692a(6)(E)*.

(n87)Footnote 87. *15 U.S.C. § 1692a(6)(F)(i).*

(n88)Footnote 88. *Pelfrey v. Educational Credit Mgmt. Corp., 71 F. Supp. 2d 1161 (Bankr. N.D. Ala. 1999)* , *aff'd, 208 F.3d 945 (11th Cir. 2000)* ; *Montgomery Educ. Credit Mgmt. Corp., 238 B.R. 806 (Bankr. D. Minn. 1999)* . *See Seals v. National Student Loan Program, 2004 WL 3314948* (N.D. W. Va. Aug. 16, 2004) (student loan guaranty agency was exempt under fiduciary obligation exception to FDCPA).

(n89)Footnote 89. *Wilson v. Draper & Goldberg, P.L.L.C., 443 F.3d 373 (4th Cir. 2006)* .

(n90)Footnote 90. *Id. at 377* .

(n91)Footnote 91. *15 U.S.C. § 1692a(6)(F)(ii).*

(n92)Footnote 92. *15 U.S.C. § 1692a(6)(F)(iii).*

(n93)Footnote 93. *Walker v. Michael W. Colton Trust, 33 F. Supp. 2d 585 (E.D. Mich. 1999)* (a pre-default assignee was not a debt collector as it was exempt under § 1692a(6)(F)(iii)); *Fischer v. Unipac Serv. Corp., 519 N.W.2d 793 (Iowa 1994)* . *See Orent v. Credit Bureau of Greater Lansing, Inc., 2001 U.S. Dist. LEXIS 17683* (W.D. Mich. Oct. 23, 2001) (where debt was not in default at the time of assignment, assignee was not a debt collector); *Osheyack v. Garcia, 2001 Fla. LEXIS 1573* (Fla. June 13, 2001) (local telephone company that billed and collected charges for long distance carrier was not debt collector since it acquired debt and commenced its collection activity prior to default).

(n94)Footnote 94. *See Brumberger v. Sallie Mae Servicing Corp., 2003 U.S. Dist. LEXIS 5235* (E.D. La. Mar. 28, 2003) , *aff'd, Brumberger v. Sallie Mae Servicing Corp., 84 Fed. Appx. 458, 2004 U.S. App. LEXIS 151 (2004)* .

(n95)Footnote 95. *See Skerry v. Massachusetts Higher Educ. Assistance Corp., 73 F. Supp. 2d 47 (D. Mass 1999)* (student loan guarantor was not "debt collector" where delinquent loan was never defaulted by the guarantor; finding FTC informal opinions and staff commentaries unpersuasive, court adopted the Federal Family Education Loan Program definition of "default" because the debt was a student loan); *Jones v. Intuition, Inc., 12 F. Supp. 2d 775 (W.D. Tenn. 1998)* ; *Coppola v. Connecticut Student Loan Foundation, 1989 U.S. Dist. LEXIS 3415 (D. Conn. Mar. 22 1989)* ; National Consumer Law Center, Student Loan Law (2d ed. 2002 and Supp.). *Brumberger v. Sallie Mae Servicing Corp., 84 Fed. Appx. 458 (5th Cir. 2004)* , (not for publication), *aff'd, 2004 U.S. App. LEXIS 151* (5th Cir. Jan. 7, 2004) (dismissed as did not allege that his debt was in default when Sallie Mae began servicing his loan).

(n96)Footnote 96. *See Franceschi v. Mautner-Glick Corp., 22 F. Supp. 2d 250 (S.D.N.Y. 1998)* . *See also* Sheehan, FTC Informal Staff Letter (Aug. 31, 1992) (management company for timeshare condominiums exempt).

(n97)Footnote 97. *See Whitaker v. Ameritech Corp., 129 F.3d 952 (7th Cir. 1997)* (phone bills); *In re Mayer, 199 B.R. 616 (E.D. La. 1996)* (phone); *Osheyack v. Garcia, 814 So. 2d 440 (Fla. 2001)* (phone).

(n98)Footnote 98. *See Hamilton v. Trover Solutions, Inc., 2003 U.S. Dist. LEXIS 8296* (E.D. La. May 12, 2003) , *aff'd, Hamilton v. Trover Solutions, Inc., 104 Fed. Appx. 942, 2004 U.S. App. LEXIS 13764 (2004)* (agency which received subrogation to recover medical expenses prior to default was not subject to the FDCPA). Silver, FTC Informal Staff Letter (July 13, 1987); Barker, FTC Informal Staff Letter (Oct. 22, 1987) (phone company); Gold, FTC Informal Staff Letter (May 7, 1986).

(n99)Footnote 99. *See Kvassay v. Hasty, 236 F. Supp. 2d 1240 (D. Kan. 2002)* (lawyers "obtained" checks which armored car service had lost; *Stark v. Hasty, 236 F. Supp. 2d 1214 (D. Kan. 2002)* (companion case to *Kvassay*; same result); *Orent v. Credit Bureau, Inc., 2001 U.S. Dist. LEXIS 17683* (W.D. Mich. Oct. 23, 2001) (debt acquired through merger); Shapiro, FTC Informal Staff Letter (Dec. 20, 1999); Shapiro, FTC Informal Staff Letter (Oct. 1, 1997) (company hired to do marketing, credit extension, and servicing also may be exempt under a *de facto* employee rationale Cardonick). *See Williams v. Edelman, 408 F. Supp. 2d 1261 (S.D. Fla. 2006)* (entity that serviced

condominium debt before it fell into default was not "debt collector" as defined by FDCPA).

(n100)Footnote 100. *Durkin v. Equifax Check Servs., Inc., 2002 U.S. Dist. LEXIS 20742* (N.D. Ill. Oct. 28, 2002) .

(n101)Footnote 101. *15 U.S.C. § 1692a(6)(F)(iv). See Friedman v. Textron Fin. Corp., 1997 U.S. Dist. LEXIS 11968* (N.D. Ill. Aug. 11, 1997) (secured party in a commercial transaction who arranged a consumer account that was used as collateral following default on loan from the commercial lender to the original creditor was excluded from definition of "debt collector" pursuant to *15 U.S.C. § 1692a(6)(F)(iv)*).

(n102)Footnote 102. Pub. L. No. 109-351 § 818, *120 Stat. 2004* (Oct. 13, 2006).

(n103)Footnote 103. *See* www.accs-inc.com.

(n104)Footnote 104. *E.g., Gradisher v. Check Enforcement Unit, Inc., 210 F. Supp. 2d 907 (W.D. Mich. 2002)* (although debt collector was independent contractor with county, its notices purporting to be from sheriff's department gave false impression that they were from sheriff in violation of *15 U.S.C. §§ 1692e(9)* and *1692e(14)*).

(n105)Footnote 105. *See Schwarm v. Craighead, 233 F.R.D. 655* (E.D. Cal. Mar. 7, 2006) .

(n106)Footnote 106. *15 U.S.C. § 1692a(3).*

(n107)Footnote 107. *15 U.S.C. § 1692a(5).*

(n108)Footnote 108. *See Beaton v. Reynolds, Ridings, Vogt & Morgan, P.L.L.C., 986 F. Supp. 1360 (W.D. Okla. 1998)* ; *M. Fabrikant & Sons v. Fuller, 1998 U.S. Dist. LEXIS 19843* (N.D. Tex. Dec. 14, 1998) ; *Garza v. Bancorp Group, Inc., 955 F. Supp. 68 (S.D. Tex. 1996)* ; *Allen v. BRT Util. Corp., 1996 U.S. Dist. LEXIS 22441* (D. Conn. Oct. 24, 1996) . *See also Slenk v. Transworld Sys., 236 F.3d 1072 (9th Cir. 2001)* (Summary judgment was inappropriate and reversed where there was conflicting evidence on whether a backhoe was purchased and used strictly for the building of the buyer's own home or whether it was bought for his construction business. A sole proprietor's purchase would not be for a consumer purpose covered by the FDCPA. If a loan was made for a business purpose, it would not become a consumer loan by virtue of the debt collector's dunning calls to the home of the collector.).

(n109)Footnote 109. *See Edwards v. Beatty, 2001 U.S. App. LEXIS 20788* (9th Cir. Sept. 20, 2001) (not for publication) (dismissal was affirmed where *pro se* plaintiff failed to offer evidence to support claim that commercial debt was converted into a consumer debt by defendant's collection activities, i.e., phoning him at home); *Broadnax v. Greene Credit Serv., 106 F.3d 400 (6th Cir. 1997)* (unpublished), *reported in full, 1997 U.S. App. LEXIS 776* (6th Cir. Jan. 15, 1997) ; *Bloom v. I.C. Sys., Inc., 972 F.2d 1067 (9th Cir. 1992)* (attention was focused on the actual purpose of the loan; neither the lender's motives--lender was personal friend of borrower--nor the stated purpose of the loan was dispositive); *Moore v. Principal Credit Corp., 1998 U.S. Dist. LEXIS 6917* (N.D. Miss. Mar. 30, 1998) . *Moss v. Cavalry Inv., L.L.C., 2004 U.S. Dist. LEXIS 24990* (N.D. Tex. Sept. 20, 2004) (underlying use of credit card for personal purposes created an issue of fact where card was used for both business and consumer purchases and application indicated it was for business purposes).

(n110)Footnote 110. *Miller v. McCalla, Raymer, Padrick, Cobb, Nichols, & Clark, L.L.C., 214 F.3d 872 , reh'g en banc denied, 2000 U.S. App. LEXIS 18232* (7th Cir. July 26, 2000) (debt for a house purchased as the buyer's residence and then rented when the buyer moved was a consumer debt originally; the subsequent use of the collateral would not alter the applicability of the FDCPA.).

(n111)Footnote 111. *Garner v. Augustine, Kern & Levens, Ltd., 1994 U.S. Dist. LEXIS 1573* (N.D. Ill. Feb. 16, 1994) .

(n112)Footnote 112. *Gary v. Goldman & Co., 2002 U.S. Dist. LEXIS 416* (E.D. Pa. Jan. 14, 2002) (a dishonored

check was a debt under the FDCPA); *Bass v. Stolper, Koritzinsky, Brewster & Neider, S.C., 111 F.3d 1322 (7th Cir. 1997)* ; *Gradisher v. Check Enforcement Unit, Inc., 133 F. Supp. 2d 988* , *class certification granted, in part, 203 F.R.D. 271 (W.D. Mich. 2001)* ; *Rosales v. National City Corp., 1997 U.S. Dist. LEXIS 23923* (D. Mass. Aug. 31, 1997) (check on which payment was stopped was a "debt."); *Narwick v. Wexler, 901 F. Supp. 1275 (N.D. Ill. 1995)* . *See Price v. Surety Acceptance Corp., 1999 U.S. Dist. LEXIS 22418* (D. Ariz. Aug. 13, 1999) (checks were debts). *Armstrong v. Rose Law Firm, P.A., 2002 U.S. Dist. LEXIS 4039* (D. Minn. Mar. 7, 2002) (FDCPA contains no fraud exception that would exclude the dishonored check); *Wiegand v. JNR Adjustment Co., 2002 U.S. Dist. LEXIS 7292* (D. Minn. Apr. 22, 2002) . *See also Winterstein v. Crosscheck, Inc., 149 F. Supp. 2d 466 (N.D. Ill. 2001)* (court rejected check guarantee service's arguments that it was not debt collector; it was not a creditor because check had been presented to creditor and forwarded to guarantee service after default; agreement assigning check before default exalted form over substance). *But see Krevsky v. Equifax Check Servs., Inc., 85 F. Supp. 2d 479 (M.D. Pa. 2000)* (dishonored check was not a debt under the FDCPA because payment by check was tantamount to paying with cash and did not involve the extension of credit).

(n113)Footnote 113. *E.g., Romea v. Heiberger & Assocs., 163 F.3d 111 (2d Cir. 1998)* ; *Emanuel v. American Credit Exch., 870 F.2d 805 (2d Cir. 1989)* ; *Wenrich v. Robert E. Cole, P.C., 2000 U.S. Dist. LEXIS 18687* (E.D. Pa. Dec. 22, 2000) (claim for rent for a residential apartment was a debt covered by the FDCPA). *But see Arrey v. Beaux Arts II, LLC, 101 F. Supp. 2d 225, 227 (S.D.N.Y. 2000)* (tenant *pro se* removed an eviction action to federal court because three-day eviction notice allegedly violated the FDCPA; the action was remanded: "[B]oth the removal and the contention that the alleged violation of the Act constitutes a defense to the nonpayment proceeding are utterly frivolous."); *Hodges v. Feinstein, Raiss, Kelin & Booker, L.L.C., 383 N.J. Super. 596, 893 A.2d 21* (N.J. Super. Ct. App. Div. Mar. 8, 2006) (eviction for nonpayment of rent); *Baer v. Harmon Law Offices, P.C., 2009 U.S. Dist. LEXIS 3014* (D. Mass. Jan. 14, 2009) (notice to quit and vacate premises that did not reference a preexisting financial obligation, and that sought to have the tenant vacate the premises and damages for holding over, rather than rent, was not an attempt to collect a debt, and was not covered by the FDCPA). *See also Hodges v. Feinstein, Raiss, Kelin & Booker, L.L.C., 383 N.J. Super. 596, 893 A.2d 21* (N.J. Super. Ct. App. Div. Mar. 8, 2006) (law firm that regularly engaged in summary eviction proceedings was subject to FDCPA; law firm sought eviction based on nonpayment of costs and attorney fees that did not constitute rent and could not be basis for eviction).

(n114)Footnote 114. *E.g., Adams v. Law Offices of Stuckert & Yates, 926 F. Supp. 521 (E.D. Pa. 1996)* .

(n115)Footnote 115. *E.g., Pollice v. National Tax Funding, L.P., 225 F.3d 379 (3d Cir. 2000)* (municipal water and sewer bills were debts covered by the FDCPA; the dicta in *Zimmerman* that a debt must involve credit was not controlling); *Clay v. Melchionne, 2000 WL 1838368 (D. Conn. 2000)* (water usage fee owed to a municipality was a "debt"); *Allen v. BRT Util. Corp., 1996 U.S. Dist. LEXIS 22441* (D. Conn. Oct. 24, 1996) . *E.g., Piper v. Portnoff Law Assocs., Ltd., 396 F.3d 227 (3d Cir. 2005)* (FDCPA applied to collection of municipal water bill by attorneys who also pursued municipal liens. The court noted that water service was voluntary and involved a *pro tanto* exchange of water for money, and rejected the argument that there was an *in rem* exemption in the FDCPA.); *Albanese v. Portnoff Law Assocs., Ltd., 301 F. Supp. 2d 389 (E.D. Pa. 2004)* (FDCPA applies to *in rem* collection proceedings to impose lien for municipal services on real property); *Keauhou Master Homeowners Ass'n, Inc. v. County of Hawaii, 104 Haw. 214, 87 P.3d 883 (2004)* (sewer debts covered).

(n116)Footnote 116. *Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995)* .

(n117)Footnote 117. *Brannan v. United Student Aid Funds, Inc., 94 F.3d 1260 (9th Cir. 1996)* , *cert. denied, 516 U.S. 1106, 117 S. Ct. 2484, 138 L. Ed. 2d 992 (1997)* ; *Juras v. Aman Collection Serv., Inc., 829 F.2d 739 (9th Cir. 1987)* .

(n118)Footnote 118. *Dorsey v. Morgan, 760 F. Supp. 509 (D. Md. 1991)* .

(n119)Footnote 119. Epstein v. Beck & McDonald, Clearinghouse No. 50,284 (N.D. Tex. 1994) (debt may not be

presumed not to be debt for personal purposes simply because of its large amount (over $300,000 on over 40 credit card accounts); motion to dismiss FDCPA claim dismissed).

(n120)Footnote 120. *Newman v. Boehm, Pearlstein & Bright, Ltd., 119 F.3d 477 (7th Cir. 1997)* , *reh'g denied, 1997 U.S. App. LEXIS 24820* (7th Cir. Sept. 12, 1997) . *See, e.g., Riter v. Moss & Bloomberg, Ltd., 932 F. Supp. 210 (N.D. Ill. 1996)* , *rev'd, remanded, 119 F.3d 477 (7th Cir. 1997)* . *See also Herbert v. Monterey Fin. Servs., Inc., 863 F. Supp. 76 (D. Conn. 1994)* (vacation time-share was a debt covered by the FDCPA). *See also Fuller v. Becker & Poliakoff, P.A., 192 F. Supp. 2d 1361 (M.D. Fla. 2002)* (delinquent maintenance assessments under a property owners' association contract were debts). *See Agan v. Katzman & Korr, P.A., 2004 U.S. Dist. LEXIS 4158* (S.D. Fla. Mar. 16, 2004) (condominium assessments covered). *See also Berndt v. Fairfield Resorts, Inc. 337 F. Supp. 2d 1120 (W.D. Wis. 2004)* (timeshare resort maintenance assessment covered.).

(n121)Footnote 121. *See* National Consumer Law Center, Fair Debt Collection, § 4.4.2.3 (5th ed. 2004 and Supp.).

(n122)Footnote 122. *15 U.S.C. § 1602(h).*

(n123)Footnote 123. *Bloom v. I.C. Sys., Inc., 972 F.2d 1067 (9th Cir. 1992)* (particular attention was focused on the actual purpose of the loan in determining whether it fit the definition of "debt"; neither the lender's motives--lender was borrower's personal friend--nor the manner of memorialization of the loan was dispositive); *See 15 U.S.C. § 1602(h). See also Broadnax v. Greene Credit Serv., 106 F.3d 400 (6th Cir. 1997)* (unpublished), *reported in full, 1997 U.S. App. LEXIS 776* (6th Cir. Jan. 15, 1997) ; *Allen v. BRT Util. Corp., 1996 U.S. Dist. LEXIS 22441* (D. Conn. Oct. 24, 1996) ; National Consumer Law Center, Truth in Lending (5th ed. and Supp.).

(n124)Footnote 124. *See Staub v. Harris, 626 F.2d 275 (3d Cir. 1980) . See also Israel v. Everson, 2005 U.S. Dist. LEXIS 28255* (S.D. Iowa Oct. 14, 2005) (IRS claim for back taxes was not "debt").

(n125)Footnote 125. *See Mabe v. G.C. Servs. Ltd. P'ship, 32 F.3d 86 (4th Cir. 1994) .*

(n126)Footnote 126. *Arnold v. Truemper, 833 F. Supp. 678 (N.D. Ill. 1993) . See also* FTC Official Staff Commentary § 803(5); Palmer, FTC Informal Staff Letter (Aug. 27, 1992) (law firms pursuit of civil damages arising from shoplifting violation was a tort action and thus not covered by FDCPA); Dunn, FTC Informal Staff Letter (Aug. 17, 1992) (tort claims and tort judgments were not "debts" covered by the FDCPA); Kaplan, FTC Informal Staff Letter (May 18, 1987).

(n127)Footnote 126.1. *See Baer v. Harmon Law Offices, P.C., 2009 U.S. Dist. LEXIS 3014* (D. Mass. Jan. 14, 2009) (notice to quit and vacate premises that did not reference a preexisting financial obligation, and that sought to have the tenant vacate the premises and damages for holding over, rather than rent, was not an attempt to collect a debt, and was not covered by the FDCPA).

(n128)Footnote 127. *See 26 U.S.C. § 6304(e).*

(n129)Footnote 128. *Keele v. Wexler, 149 F.3d 589 (7th Cir. 1998)* (while the FDCPA may apply to consensual transactions, there is no express FDCPA exception for transactions that are not consensual because the consumer entered into them with the intent to defraud the other party; the court would not create a fraud exception where Congress did not create one). *See also Wiegand v. JNR Adjustment Co., 2002 U.S. Dist. LEXIS 7292* (D. Minn. Apr. 22, 2002) (attempting to collect the amounts of stolen, forged checks from the checking account owner who reversed payment on them was attempting to collect a "debt" within the FDCPA, notwithstanding the underlying theft and the purported absence of a consensual transaction between the merchant and the putative debtor).

(n130)Footnote 129. *15 U.S.C. § 1692.*

(n131)Footnote 130. *15 U.S.C. § 1692k. See Wright v. Financial Serv. of Norwalk, Inc., 996 F.2d 820 (6th Cir.*

1993) , *aff'd en banc*, *22 F.3d 647 (6th Cir. 1994)* (executrix, deceased's daughter, stood in the shoes of the debtor, had authority to open and read letters addressed to the debtor, and had standing to bring actions under the FDCPA); *Wenrich v. Robert E. Cole, P.C., 2000 U.S. Dist. LEXIS 18687* (E.D. Pa. Dec. 22, 2000) (some protections of the FDCPA extended to "any person," including parents alleged to be obligated on the claim, if they were contacted by the collector to pay the debt); *Sibersky v. Borah, Goldstein, Altschuler & Schwartz, P.C., 2000 U.S. Dist. LEXIS 14043* (S.D.N.Y. Sept. 22, 2000) (husband who was not a consumer could pursue FDCPA claims under sections not restricted to consumers, such as a § 1692e(5) claim, but claim for violation of the notice requirements, which applied only to consumers, was dismissed); *Flowers v. Accelerated Bureau of Collections, Inc., 1997 U.S. Dist. LEXIS 3354* (N.D. Ill. Mar. 13, 1997) (consumer's spouse may bring FDCPA claim if debt collection efforts that would violate the Act were targeted at her; husband to which a collection call was targeted had standing to sue where the threats to sue and garnish his wages were received by his wife); *Dutton v. Wolhar, 809 F. Supp. 1130 (D. Del. 1992)* (protections not limited to "consumers"); *Dolan v. Schreiber & Assocs., P.C., 2002 U.S. Dist. LEXIS 6005* (magistrate recommendation), *adopted, 2002 U.S. Dist. LEXIS 5998* (D. Mass. Mar. 29, 2002) (alleged unlawful threat to attach the debtor's property stated a claim on behalf of a nondebtor co-owner of the property, since the threat had consequences for the nondebtor whose interest in the property could be harmed). *But see Kropelnicki v. Siegel, 290 F.3d 118 (2d Cir. 2002)* (consumer had no standing to claim that the contents of the letter violated the FDCPA because the letter was addressed to her daughter and was, therefore, not a communication with her).

(n132)Footnote 131. *See, e.g., 15 U.S.C. § 1692d.*

(n133)Footnote 132. *15 U.S.C. § 1692(e).*

(n134)Footnote 132.1. *Muir v. Navy Fed. Credit Union, 529 F.3d 1100 (D.C. Cir. 2008)* (court found the son had "prudential" standing by being within the zone of FDCPA protections).

(n135)Footnote 133. *See Robey v. Shapiro, Marianos & Cejda, L.L.C., 434 F.3d 1208 (10th Cir. 2006)* (Art. III constitutional standing satisfied).

(n136)Footnote 134. *See McCartney v. First City Bank, 970 F.2d 45, 46 (5th Cir. 1992)* ; *Baker v. G.C. Servs. Corp., 677 F.2d 775, 777 (9th Cir. 1982)* .

(n137)Footnote 135. *See Keele v. Wexler, 149 F.3d 589 (7th Cir. 1998)* .

(n138)Footnote 136. *15 U.S.C. § 1692a(6). See Hayes v. GC Servs., 1995 U.S. Dist. LEXIS 12045* (W.D. Va. June 19, 1995) (collection agency which made brief reminder phone calls to HUD mortgage holders who were one month late in payments was engaged in debt collection); *see also Knight v. Schulman, 102 F. Supp. 2d 867 (S.D. Ohio 1996)* (letter acknowledging payment was not a communication to collect a debt). *But see Santoro v. CTC Foreclosure Serv. Corp., 12 Fed. Appx. 476 (9th Cir. 2001)* (unpublished) (ignoring logic and plain meaning rule, court held FDCPA did not apply to letter sent by "foreclosure service" discussing creditor's workout policies and legal notice of foreclosure because they were not duns sent in connection with the collection of a debt); *Buckley v. Bass & Assocs., 249 F.3d 678 (7th Cir. 2001)* (letter seeking information about consumer's bankruptcy filing was not effort to collect a debt, so defendant need not comply with "initial communication" requirements of § 1692g).

(n139)Footnote 137. *See Van Westrienen v. Americontinental Collection Corp., 94 F. Supp. 2d 1087 (D. Or. 2000) . But see Young v. Manley, 2000 U.S. Dist. LEXIS 13035* (N.D. Ill. Sept. 6, 2000) (The defendant law firm sent a letter to plaintiff's bankruptcy attorney threatening a nondischargeability proceeding based on the amount of credit card charges incurred just before bankruptcy. The letter contained neither of the required FDCPA notices. The consumer's attorney was not a "consumer" within the FDCPA and did not need its protections; a collector was, indeed, required to communicate with the attorney who represented the debtor.).

Kropelnicki v. Siegel, 290 F.3d 118 (2d Cir. 2002) (stating in dicta, "[W]e assume the attorney, rather than the

FDCPA, will protect the consumer from a debt collector's fraudulent or harassing behavior. However, this is not an issue on which we need to rule today."); *Diesi v. Shapiro, 330 F. Supp. 2d 1002 (C.D. Ill. 2004)* (followed *dicta* in *Kropelnicki* and dismissed consumers' claim that mortgage servicer inflated mortgage balance in statement to her lawyer helping consumer prevent foreclosure); *Zaborac v. Phillips & Cohen Assoc., Ltd., 330 F. Supp. 2d 962, 966 (N.D. Ill. 2004)* ; *Tromba v. M.R.S. Assoc., Inc., 323 F. Supp. 2d 424, 428 (E.D.N.Y. 2004)* . *See also Phillips v. North Am. Capital Corp., 1999 U.S. Dist. LEXIS 7000* (N.D. Ill. Apr. 30, 1999) ("[f]urthermore, plaintiff has no standing to bring this claim. While the FDCPA prohibits certain communications with a 'consumer,' the statute does not prohibit such communications with a consumer's attorney. The underlying rationale of the statute--protecting unsophisticated consumers--does not support a ban on communications with consumers' attorneys, who presumably have a higher level of sophistication.").

(n140)Footnote 138. *See Blanks v. Ford Motor Credit, 2005 U.S. Dist. LEXIS 269* (N.D. Tex. Jan. 7, 2005) ; *Sullivan v. Equifax, Inc., 2002 U.S. Dist. LEXIS 7884* (E.D. Pa. Apr. 19, 2002) .

(n141)Footnote 139. *See, e.g., Pettway v. Harmon Law Offices, P.C., 2005 U.S. Dist. LEXIS 21341* (D. Mass. Sept. 27, 2005) ("Harmon's payoff and reinstatement letters state an amount owing which includes unearned fees and costs and asks the debtor to '[p]lease make your certified check ... payable to HARMON LAW OFFICES.' These letters clearly fall within FDCPA's definition of a debt collection communication, whether or not they are prompted by the borrower, and regardless of the fact that a misleading letter was preceded by one that was not."); *Spencer v. Hendersen-Webb, 81 F. Supp. 2d 582 (D. Md. 1999)* (debt collector's fax of bill to father of consumer's boyfriend in response to his request for information on debt was deemed to be an attempt to collect debt since debt collector believed father was consumer's attorney and that information would reach consumer indirectly; court determined that fax was debt collector's initial communication and thus failure to provide validation notice in connection with fax violated FDCPA; therefore, debt collector violated § 1692g(b) making offer and by failing to cease collection until debt was verified); *Weinberg v. Arcventures, Inc., 1996 U.S. Dist. LEXIS 9415* (N.D. Ill. July 3, 1996) (genuine issue of material fact existed as to whether collection agency's letter to debtor's daughter was an attempt to get daughter to pay debt she did not owe or was sent to daughter, an attorney, as legal representative of her mother; letter was sent in response to request by daughter, an attorney, for verification of her mother's debt). *But see Geiger v. Creditors Interchange, Inc., 59 Fed. Appx. 803 (6th Cir. 2003)* (not for publication) (second letter that was sent in response to consumer's accusation that collector had violated FDCPA did not convey information regarding debt itself, was not "communication" as defined by § 1692a(2), and therefore did not require § 1692e(11) disclosure); *Wexler v. Bank of Am. Auto Fin. Corp., 2000 U.S. Dist. LEXIS 12491* (N.D. Ill. Aug. 23, 2000) (letter, in response to Wexler's communication, that did not seek payment but was merely warning seeking to avert any collection consequences of nonpayment was not collection activity covered by FDCPA; plaintiff Wexler was defendant in prior FDCPA suits).

(n142)Footnote 139.1. *Muir v. Navy Fed. Credit Union, 529 F.3d 1100 (D.C. Cir. 2008)* .

(n143)Footnote 140. *15 U.S.C. § 1692a(2).*

(n144)Footnote 141. Mezines, FTC Formal Advisory Opinion (Mar. 31, 2000). *But see McKnight v. Benitez, 176 F. Supp. 2d 1301 (M.D. Fla. 2001)* (neither summons, complaint, or other papers served on consumer in conjunction with initiation of lawsuit is a "communication" under FDCPA; plaintiff's claim that papers failed to comply with § 1692g dismissed); *Frye v. Bowman, Heintz, Boscia & Vician, P.C., 193 F. Supp. 2d 1070 (S.D. Ind. 2002)* (court surveyed dispute of authority about whether a summons was a communication to collect a debt, but did not decide because a "communication" was not essential to the alleged violations).

(n145)Footnote 142. *Compare Vega v. McKay, 351 F.3d 1334 (11th Cir. 2003)* (summons not a communication) *with Thomas v. Law Firm of Simpson & Cybak, 354 F.3d 696 (7th Cir. 2004)* (not for publication), *vacated, 358 F.3d 446 (7th Cir. 2004)* (summons was a communication). *See also Gibson v. Grupo de Ariel, L.L.C., 2006 U.S. Dist. LEXIS 539* (N.D. Tex. Jan. 9, 2006) (FDCPA claim can be premised on flawed legal proceedings because FDCPA prohibits fraudulent, deceptive or misleading representations, including those made in judicial or governmental proceedings);

Anderson v. Frederick J. Hanna & Assocs., 361 F. Supp. 2d 1379 (N.D. Ga. 2005) (debt collector's argument that lawsuit to collect debt was not "collection activity" was patently frivolous).

(n146)Footnote 143. *Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995)* ("The Act does apply to lawyers engaged in litigation."); *see also Romea v. Heiberger & Assocs., 163 F.3d 111 (2d Cir. 1998)* (state mandated 3-day demand for payment of past-due rent and eviction notice sent by an attorney is covered); *Tomas v. Bass & Moglowski, 1999 U.S. Dist. LEXIS 21533* (W.D. Wis. June 29, 1999) (filing a complaint and other aspects of litigation were actions in connection with the collection of a debt); Mezines, FTC Formal Advisory Opinion (Mar. 21, 2000) ("In light of *Heintz*, the Commission concludes that, if an attorney debt collector serves on a consumer a court document 'conveying information regarding a debt,' that court document is a 'communication' for purposes of the FDCPA."). *But cf.* Dempsey, FTC Informal Staff Letter (Sept. 13, 1996) (while summary eviction proceedings may not be covered, under *Heintz*, dunning letters in connection with the litigation are covered).

(n147)Footnote 144. *392 F.3d 914 (7th Cir. 2004) . See also In re Gunter, 334 B.R. 900 (Bankr. S.D. Ohio 2005)* (summons and complaint are "communications" within FDCPA).

(n148)Footnote 145. *Vega v. McKay, 351 F.3d 1334 (11th Cir. 2003)* .

(n149)Footnote 146. *Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995)* ; *Paulemon v. Tobin, 30 F.3d 307 (2d Cir. 1994)* ; *Clark's Jewelers v. Humble, 823 P.2d 818 (Kan. Ct. App. 1991)* (debt collector violated § 1692g(b) where it failed to provide verification of the debt but continued to send dunning letters in care of consumers' attorney). *See also Frey v. Gangwish, 970 F.2d 1516, 1521 (6th Cir. 1992)* (dissenting opinion) (conveying information to an attorney is equivalent to conveying it to the attorney's client). *But cf. Kropelnicki v. Siegel, 290 F.3d 118, 128 (2d Cir. 2002)* (dicta: "Where an attorney is interposed as an intermediary between a debt collector and a consumer, we assume the attorney, rather than the FDCPA, will protect the consumer from a debt collector's fraudulent or harassing behavior."); *Dikeman v. National Educators, Inc., 81 F.3d 949 (10th Cir. 1996)* (the § 1692e(11) disclosures were not required to avoid deception in a communication to the consumer's attorney verifying the amount of debt in response to the consumer attorney's request for verification because the debt collection purpose of the letter would be apparent to the attorney. The jury had found the debt had not been verified when the verification given was inadequate because it overstated the collector's claim, but the jury excused the violation as a bona fide error because it was not an attempt to collect a debt but was designed to comply with the U.C.C.).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 8 Fair Debt Collection

1-8 Consumer Credit Law Manual § 8.03

§ 8.03 Consumer Protections and Rights Under the Fair Debt Collection Practices Actn1

[1] General Principles of Construction of the Act

To accomplish the consumer protection purpose of the FDCPA, the courts apply a least sophisticated consumer standard to analyze the protections of the Act. n2 The FDCPA is a "strict liability" statute. n3 As a result, a debt collector is responsible for a deviation from some of the FDCPA's requirements without regard to intent or knowledge or the willfulness of the violation.

The Supreme Court held that the congressional intent should be implemented by giving effect to the plain meaning in ordinary English of the Act. n4 The FDCPA is a remedial statute and should be liberally construed. n5

[2] FDCPA Limits a Collector's Communications With a Consumer

[a] Consumers' Privacy and Relationships Protected

The FDCPA restricts the times and places a debt collector may contact a consumer, limits third-party contacts, and prohibits contacting a consumer represented by an attorney. n6 These restrictions, along with others, n7 protect the consumer's right to privacy and the security of the consumer's relationships with third parties, including attorneys, co-workers, and employers. The Act also gives a consumer the right to require a collector to stop communicating with the consumer about a debt.

[b] Contacts at Unusual or Inconvenient Times or Places Prohibited n8

Generally no contact is allowed before 8 a.m. or after 9 p.m. This definitely covers telephone calls and personal visits. Places such as a neighbor's home, a hospital, or a funeral parlor are inconvenient or unusual places to contact a consumer about a debt and are thus prohibited. The collector has a burden of reasonable inquiry to determine the times or places that are unusual or inconvenient for a particular consumer. The consumer need not use legally precise language to indicate the inconvenience to the debt collector. n9

[c] Collector May Not Contact a Consumer It Knows to Be Represented by an Attorney

15 U.S.C. section 1692c(a)(2) prohibits consumer contacts by a collector who knows the consumer is represented by an attorney with respect to the debt. n10 According to the FTC staff, the creditor's knowledge that the consumer is represented by an attorney is not to be imputed to the collector. n11 The Eighth Circuit has weighed in agreeing that the plain language of the FDCPA does not allow the creditor's knowledge of the representation to be imputed to the collection agency. n12 But courts have disagreed. n13 One court held that the debt collector's confirmation that they will cease collection because of the consumer's legal representation is permissible because it is not a "communication" as defined by section 1692a(2), if there is not request for payment. n14

[d] Contacts at Workplace Are Restricted

Generally, collectors cannot contact a debtor at their place of employment if the debt collector knows or has reason to know that the consumer's employer prohibits the consumer from receiving such communication. n15

[e] Informing Most Other People of the Consumer's Indebtedness Is Prohibited

Generally, a collector may not communicate, in connection with the collection of any debt, with any person other than the consumer, his attorney, a consumer reporting agency if otherwise permitted by law, the creditor, the attorney of the creditor, or the attorney of the debt collector. n16 This means that contacting friends, neighbors, relatives, or an employer is usually prohibited. A debt buyer may not provide debtors' contact information to a creditor card issuer with the goal of having the credit card account pay off the debt. n17 A debt collector who leaves a message on a family's shared answering machine or voicemail risks communicating with an unobligated family member violating this provision.

[i] Collector May Contact Certain Nondebtors

The collector may contact only a select few nonconsumers in connection with the consumer's debt: the consumer's attorney; n18 a credit reporting agency; the creditor; the creditor's or collector's attorney; the consumer's spouse; n19 parent, if the consumer is a minor; n20 guardian, executor, or administrator; n21 and codebtors. n22 The only exceptions permit the collector to contact third parties in order to learn the consumer's residential address and phone number or his or her work address. n23 Even when obtaining this limited information, n24 however, the collector may not state that the consumer owes any money and cannot use the collection company's name unless it is requested. n25

A collector may also contact a third party if reasonably necessary to effect a postjudgment judicial remedy such as a garnishee in a garnishment action. n26

[ii] Contacts in Other Situations

Because other people may see an envelope addressed to the consumer, the collector may not use a name or other information on the envelope indicating that its contents pertain to debt collection. n27

When a collector contacts a consumer or permissible third party, *15 U.S.C. section 1692e(11)* requires that the person be told that the collector is collecting a debt and that any information provided will be used for that purpose (unless the collector is only trying to obtain location information). n28 A debt collector should not leave messages with third parties to have the debtor return their call n29 or prerecorded calls or messages on a telephone answering device that may be shared to avoid violating this provision. n30

A debt collector who leaves a message on a consumer's telephone answering device runs the risk of violating the FDCPA unless the answering device is used exclusively by the debtor or the consumer has consented directly to the debt collector to leaving messages on that answering machine. n31 The leading case on this issue is *Foti*, n32 which held that a debt collector must leave the section 1692e(11) disclosure in a voicemail that the caller is a debt collector, a statement that may not be made to third parties under section 1692c(b), thus prohibiting a debt collector from leaving

messages with most third parties. This also puts debt collectors at risk for leaving messages on voicemail systems that may be shared with third parties the debt collector may not contact like the debtor's children or roommate. In the absence of an individual voice mailbox for the consumer, a debt collector reaching an answering device must hang up and call back later or write the consumer to avoid the risk of an unlawful third party communication.

The FDCPA, *15 U.S.C. § 1692e(11)*, requires the debt collector to disclose in the initial communication that it is collecting a debt and any information provided by the consumer will be used to collect the debt. In subsequent communications it requires disclosure that it is a debt collector. Those disclosures must not be made to third parties. Nevertheless, some debt collectors leave voicemail messages for consumers without that disclosure and argue that they did not violate the disclosure requirement because their message was not a "communication" defined by the FDCPA because they did not mention the debt. However, two courts recently rejected that argument and required the section 1692e(11) disclosure in voicemails left for a consumer. n33 Both decisions rejected the debt collectors' argument noting the broad language Congress used in defining the word "communication" n34 and pointing out that the debt collectors' interpretation would render superfluous another provision of the FDCPA, *15 U.S.C. § 1692b*, also protecting consumers' privacy.

[f] Obtaining Location Information About a Consumer From Other Persons Is Strictly Regulated

15 U.S.C. sections 1692a(7) and *1692b* establish a narrow, limited exception to the general prohibition of third party contacts to obtain location information. Once the collector has *either* the consumer's home address and phone number or work address, its future activities do not fall within this exception.

This section closely regulates the content and form of permissible contacts in order to avoid having the third party learn that the consumer owes a debt. The debt collector's employees must use their own individual names n35 or, in some jurisdictions, a consistently used and recorded alias. The employee may reveal the collector's trade name only upon request and then must reveal the true legal name. n36 When contacting the third party, the collector may state only that "he is confirming or correcting location information concerning the consumer"; n37 the collector may not state that the consumer owes a debt. n38 The collector may not seek additional information like the consumer's employment status, salary or date of hire. n39

The collector may not use postcards to obtain location information. n40 It may not use any name, language, or symbol in any communication or on any envelope indicating that it is in the collection business or indicating the communication relates to debt collection. n41

Normally, the collector may contact a third party for location information only once.

[g] Consumers May Waive, by Direct Prior Consent, Protections From Collection Contacts

By direct prior consent, a consumer may waive the protections of *15 U.S.C. section 1692c(a)* and *(b)*, thereby allowing a collector to communicate with the consumer at inconvenient or unusual times or places, n42 when represented by an attorney, n43 or at his or her place of employment. n44 The consumer may also give prior consent to the collector to make third party contacts. n45 Since the consumer must give prior consent directly to the debt collector, a waiver included in the creditor's contract is not effective.

[h] Right to Stop Collection Contacts

15 U.S.C. section 1692c(c) requires a debt collector to halt its routine collection efforts upon receiving either a written request from a consumer to cease collection efforts or a written refusal to pay the debt. n46 After receiving the notice, the collector may contact the consumer only to advise that its collection efforts are being terminated and that it (or the creditor) intends to invoke specified remedies. The consumer need not exercise this right in any manner, so long as

notification is in writing. Notification is effective when the collector receives it. n47 If the consumer has requested verification of the debt pursuant to section 1692g as well as cessation of communications, one court has held that the debt collector may provide the requested verification. n48

[3] Conduct Serving to Harass, Oppress, or Abuse Is Prohibited

[a] Harassing, Oppressive, and Abusive Conduct Generally Prohibited

The Act prohibits any conduct the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt. n49 The term "harass" is not defined in the Act, but examples of actionable harassment are provided by the prohibitions in the subsections of *15 U.S.C. section 1692d*. This left room for courts to determine that various other behaviors by collectors violated the Act. n50

[b] Collectors May Not Use or Threaten Violence or Criminal Conduct

The use or threat of use of violence or other criminal means to harm the physical person, reputation, or property of any person violates the Act and creates a private cause of action and federal jurisdiction for actual or threatened violations of federal, state, and local criminal laws, many of which are seldom governmentally enforced. n51

[c] Collectors May Not Use Obscene, Profane, or Abusive Language

The Act prohibits the use of obscene or profane language or language the natural consequence of which is to abuse the hearer or reader. n52

[d] Publishing a List of Allegedly Defaulting Debtors Is Prohibited

The publication of a list of consumers who allegedly refuse to pay debts, except to a consumer reporting agency or to specified other persons violates the Act, n53 is prohibited as is the posting of "dead beat lists" or "shame lists" in the window of a collection agency or publishing such lists in local newspapers.

[i] Certain Credit Reporting Permitted

The Fair Credit Reporting Act ("FCRA") n54 lists specific circumstances under which a credit reporting agency may provide a third party with a consumer report, n55 generally where there is a legitimate business interest.

[e] Advertising a Debt for Sale to Coerce Payment Is Prohibited

A creditor is prohibited from advertising a consumer's debt as for sale in order to coerce payment from the consumer. n56

[f] Repeated or Continuous Telephone Calls Intended to Annoy, Abuse, or Harass Are Prohibited

Repeated or continuous phone calls to a consumer, which are intended to annoy, abuse, or harass the consumer, are prohibited. n57

[g] Collector's Employee Must Provide Meaningful Disclosure of Identity When Telephoning

This provision n58 prohibits anonymous phone calls by collectors by requiring collection employees to disclose their own name and the company for which they work. The use of aliases by collection employees is a controversial subject on which the FTC staff and the courts have offered contradictory opinions. n59 Use of a fake Caller ID name would not be considered the use of an alias and may violate this provision. n60

[i] Care Must Be Exercised When Leaving Messages

A debt collector must be careful not to disclose its identity as a debt collector to a third party to whom the debt collector is prohibited from communicating by *15 U.S.C. section 1692c(b)*. n61

[4] False, Deceptive, or Misleading Representations and Collection Methods Are Prohibited by *15 U.S.C. § 1692e*

[a] Objective Standard of Deception Is Applied to Protect the "Least Sophisticated"

Proof of actual deception is neither required nor relevant to the determination of a collector's liability. n62

[b] Threat of Suit May Be Deceptive

[i] Misrepresenting Imminence of Suit, or Intent or Authority to Sue

Collection letters and conversations frequently contain deceptive threats of suit violating the Act if suit is not really imminent, intended, or possible. n63

Westlaw has a database that can help expose some of a collector's litigation policies, and this information may be useful to prove FDCPA claims. n64

Statements that the collector "may," "can," or "could" pursue suit have given some courts some difficulty. The issue raised by those statements is whether the least sophisticated consumers would reasonably imply a threat of suit from such a statement and whether that threat is deceptive. n65 The use of a law firm's letterhead may not be a threat of legal action in itself but is a persuasive factor when combined with the other language used by the collector. n66 The consumer bears the burden of proving the lack of intent to sue and must be prepared with some evidence to rebut an assertion that the debt collector intended to sue. n67

[c] Other Threats and Statements May Be Deceptive

[i] Other Deceptive Threats

Threats of activities other than suit may be deceptive. The following threats have been found deceptive: referral to the creditor for legal action; referral to an attorney; referral to a credit reporting agency or other harm to the consumer's credit rating; drastic action or unspecified action; contacting third parties; adding unauthorized charges to the collector's claim falsely implying the charges were owed; mentioning postjudgment remedies before suit is filed; and misrepresenting that payment would improve the consumer's credit rating. n68

[ii] Other Deceptive Statements

Statements that are not threats may be deceptive and violate *15 U.S.C. section 1692e*.

[iii] Filing a Time-Barred Suit Is Deceptive

It is unfair under the FDCPA to file a time-barred collection suit against a consumer and deceptive to threaten to file such a suit. n69 Where the collector requests payment on a time-barred debt without threatening suit, the courts have found the request not to be deceptive because most statutes of limitation bar the remedy of suit but do not extinguish the debt. n70 The courts reached this result despite the collector's suppression of the fact that the debt was time barred and that a payment could restart the statute of limitations. On the other hand, where a state's statute of limitations extinguished the debt, it was deceptive to seek its payment. n71 Seeking admissions that would undermine the

consumer raising the statute of limitations as a defense would be abusive and unfair. n72

[d] Collectors May Not Falsely Imply an Affiliation With the Government

This provision n73 is intended, among other things, to prohibit a collector from impersonating a government official, such as a law enforcement officer. Collection companies may not use off-duty uniformed police officers to collect debts nor use an actual or simulated state seal. It also prohibits using collection names that imply governmental affiliation or the use of certain symbols, e.g., a police badge, judge, or scales of justice, in a dunning letter.

[e] Collectors May Not Falsely Represent the Character, Amount, or Legal Status of Any Debt

It is a violation of the Act to falsely represent that a debt exists, the amount of the debt, or the legal status, such as that a judgment has been obtained if one has not. n74 Making confusing statements about the amount to pay off the debt may be deceptive. n75

[f] Collectors May Not Falsely Represent the Services They Have Rendered or the Compensation to Which They Are Entitled

This provision n76 prohibits such practices as falsely representing that a consumer is subject to collection charges that are in fact illegal, including a complaint seeking attorney's fees to which an attorney was not entitled. n77

[g] Falsely Implying That a Person Is an Attorney or That a Communication Comes From an Attorney Is Prohibited

This provision n78 prohibits a collector from actually or implicitly impersonating an attorney. A collection agency that mails form letters carrying an attorney's letterhead and signature violates this provision. n79

The Second Circuit allowed a major exception to this line of cases when it determined that a law firm's disclaimer would overcome the deceptiveness of a lawyer mass mailing collection letters without reviewing the underlying claim. The court held a dunning letter on a collection law firm's letterhead was not deceptive where there was no attorney review of the claim and the letter stated: "At this time, no attorney with this firm has personally reviewed the particular circumstances of your account. However, if you fail to contact this office, our client may consider additional remedies to recover the balance due." n80 The court explained: "Put another way, our prior precedents demonstrate that an attorney can, in fact, send a debt collection letter without being meaningfully involved as an attorney within the collection process, so long as that letter includes disclaimers that should make clear even to the 'least sophisticated consumer' that the law firm or attorney sending the letter is not, at the time of the letter's transmission, acting as an attorney." n81

In *Rosenau v. Unifund Corp.*, n82 the Third Circuit found an FDCPA deception violation where a collection letter indicated it was from the debt buyer's "Legal Department," and the unit sending the letter was not supervised or staffed by any lawyers. None of Unifund's three in-house lawyers worked with the "Legal Department." Moreover, no lawyer or anyone else reviewed the consumer files before the collection letters were sent. Unifund mailed about 2000 of the letters each day, threatening the debt's referral to a collection lawyer.

[h] Implying That Nonpayment Will Result in Arrest, Imprisonment, Garnishment, Attachment, Seizure, or Sale if Such Action Is Unlawful or Unintended Is Prohibited

This provision is intended to protect the consumer from false threats or implications--for example, that the consumer will be arrested or that his or her property will be seized. n83

[i] Threatening Unlawful or Unintended Action Is Prohibited

This important provision prohibits the use of threats that the collector does not intend to carry out or that are illegal. n84

[i] False Threats

This provision prohibits both explicit and veiled threats of unintended legal action as well as other false threats. n85 The debt collector's statement about reporting an FCRA obsolete debt to a credit reporting agency may be deceptive. n86

[j] Falsely Implying That Transfer of a Debt Will Preclude a Consumer's Claim or Defense or Will Subject the Consumer to a Practice Prohibited by the Act Is Prohibited

This provision n87 was designed to prohibit a covered creditor or a collector from making direct or implied false threats to transfer a consumer's account to another, harsher collector.

[k] Misrepresenting That the Consumer Committed a Crime or Engaged in Other Misconduct in Order to Disgrace the Consumer Is Prohibited

This would cover false accusations of fraud or nonpayment of debts and should be seen through the eyes of the "least sophisticated debtor." n88

[l] Communicating or Threatening to Communicate False Credit Information Is Prohibited

This provision prohibits threats to tell another person without elaboration that a consumer refuses to pay a debt when either the consumer is unobligated or the debt is disputed. n89

[m] Using or Distributing Written Material Giving a False Impression of Its Source, Authorization, or Approval Is Prohibited

This provision n90 prohibits such common debt collection abuses as simulating legal process and using bogus legal documents. n91

[n] False Representations or Deceptive Means to Collect or Attempt to Collect a Debt or to Obtain Information About a Consumer Is Prohibited

This is a "catch-all" provision. n92 A false statement that the debt collector is licensed when it is not violates the FDCPA. n93

[o] Collector Must Disclose That a Communication Is to Collect a Debt and That Information Received Will Be Used for That Purpose

This section n94 requires a notice in the initial written communication with a consumer (if it is not a pleading) that the debt collector is collecting a debt and that any information obtained will be used for debt collection purposes. If the initial communication is oral, the notice must be included in the oral communication as well as the initial written communication. If the initial communications are formal pleadings, the notice is not required until a nonpleading communication occurs.

As a result of a 1996 amendment, a debt collection notice is no longer required in subsequent communications, but there must be a statement in subsequent communications which are not formal pleadings that the communication is from a debt collector. n95

[i] Phone Calls, the Debt Collection Warning, and Other FDCPA Requirements

A collector must not disclose the debt collection purpose of a phone call to most third parties when leaving messages for the consumer. The collector must, however, disclose the collection purpose to the consumer when the consumer returns the phone call if it is the initial communication. n96 In subsequent communications, the collector must state that the caller is a debt collector when speaking to the consumer, but not when leaving a message with a third party. n97

The 1996 amendment to this provision adopted the FTC staff position that the notice is not required in formal legal proceedings. n98

[p] Falsely Implying That Accounts Have Been Transferred to Innocent Purchasers for Value Is Prohibited

This provision n99 prohibits a debt collector from misrepresenting that it is an innocent purchaser not subject to the consumer's claims and defenses against the creditor; *15 U.S.C. section 1692e(6)(A)* more clearly prohibits such misrepresentations.

[q] Falsely Implying That Documents Are Legal Process Is Prohibited

A collection letter closely resembling the format, words, and type size and style of a court summons or complaint simulates legal process and is prohibited. n100

Use of simulated process by a collector renders actual legal process less recognizable and noteworthy to consumers, increasing the likelihood of default judgments. The use of deceptive means undermines the dignity of the courts, is unfair to consumers, and gives deceptive collectors an unjust advantage over competitors.

[r] Using Any Business Name Other Than the True Name of the Collector's Business Is Prohibited

This section n101 requires that the collection employee reveal his or her employer's true business name when the business name is requested by the person contacted.

When a collection employee telephones a person whom he or she is permitted to contact, *15 U.S.C. section 1692d(6)* requires a "meaningful disclosure of the caller's identity." To comply with *15 U.S.C. section 1692e(14)*, this disclosure must include identification of the collector's true business name.

The requirement that a true business name be used is fundamental to providing for accountability of firms regulated by the FDCPA. n102

State law is generally the source for determining the true name of a debt collection business, since state law, if any law, may provide for licensing debt collectors, n103 regulate the use of corporate, trade and fictitious names and provide a means of registration n104 of organizations' names. This provision also prohibits a collector using another's name, n105 such as law enforcement agency's n106 or an attorney.

[s] Falsely Implying That Documents Are Not Legal Process Is Prohibited

This provision n107 prohibits a collector from representing that a consumer need only send in payments, upon being sued, when in fact legal inaction will result in a default judgment. n108

[t] Falsely Implying That a Collector Operates or Is Employed by a Credit Reporting Agency Is Prohibited

A collection agency cannot misrepresent itself as a consumer reporting agency. n109 A court and the FTC staff have concluded that the use of a name including "creditor's bureau" was sufficiently different than using "credit bureau," which is synonymous with credit reporting agency, that it was not confusing or deceptive. n110

[5] Use of Unfair or Unconscionable Collection Means Is Prohibited

[a] General Prohibition; Construing "Unfair" and "Unconscionable"

A debt collector may not use unfair or unconscionable means to collect or attempt to collect any debt. n111 This general prohibition covers unfair or unconscionable collection acts falling outside the specific acts or practices prohibited in the various subsections to this section. The unsophisticated consumer analytical standard is appropriate for cases under this provision.

"Unconscionable" is a term of art borrowed from equity and the common law. It is codified in Uniform Commercial Code ("UCC") sections 2-302 and 2-719(3), in Uniform Consumer Credit Code ("UCCC") section 6.111(c), and in many state consumer protection statutes. n112 Section 1692f does not require the element of knowledge or intent. n113

[b] Collecting Any Amount Not Permitted by Law Is Prohibited

This provision prohibits "collecting more than is legally owing." n114 It covers both the collection of an entire debt not lawfully owed and the addition of illegal charges, such as noncontractual collection charges, service charges, attorney's fees, late fees, etc.

Creditor's and collector's charges are commonly regulated by usury and credit statutes. n115 Garnishment of the debtor's wages in violation of the bankruptcy automatic stay violates *15 U.S.C. § 1692f(1)*. n116 A claim may also be stated against a bank for falsely claiming to hold the consumer's mortgage. n117

[c] Restrictions on Soliciting, Accepting, and Depositing Postdated Checks

These subsections n118 restrict when a collector may solicit, accept, or deposit a postdated check. A postdated check may not be deposited by a collector before the date on the check. n119 A collector is prohibited from soliciting a postdated check in order to threaten or institute criminal prosecution. A collector's acceptance of a postdated check violates the Act unless it gives the consumer who wrote the check three to ten business days notice prior to depositing the check. n120

[d] Causing Expenses to a Person by Concealing the Collection Purpose of a Communication Is Prohibited

This provision n121 protects a consumer from incurring charges for collection communications when he or she has no reason to know the communications' purpose.

This provision prohibits a collector from placing a collect telephone call or telegram to a consumer without having notified the consumer to expect it and without having announced its collection purpose. A similar consideration would apply to calling a consumer's cell phone as the consumer is likely to be charged a toll on incoming calls. The consumer would have to be alerted to call beforehand for the call not to violate the Act.

[e] Repossession or Threats of Repossession Are Prohibited When There Is No Right or Intent to Repossess or When the Property Is Exempt From Repossession

This provision prohibits threats to dispossess property or actual dispossession of property in the absence of an enforceable security interest or when the property is exempt from dispossession. n122

[f] Using a Postcard to Communicate With a Consumer Regarding a Debt Is Prohibited

This section n123 protects a consumer's privacy by prohibiting "communicating information about a debt by postcard."

[g] All Language and Symbols on Envelopes Used for Collection Are Prohibited Except for the Collector's Address and Name if the Name Does Not Indicate the Collector's Business

Using symbols on an envelope that indicate a debt collection purpose is prohibited by this provision. n124 If a debt collector's name contains a variant of the word "debt" or "collect," the collector may not use its name in the return address or elsewhere on its collection envelopes. Noncollection names may appear on the envelope. The Fifth n125 and Eighth n126 Circuits have stated that they do not consider this provision to prohibit benign messages on envelopes unless threatening or embarrassing.

[6] Validation of a Debt

[a] Congress Considered Debt Validation Significant

The Act gives consumers the right to obtain verification of a debt from the collector. n127 This is intended to minimize instances of mistaken identity of a debtor or mistakes over the amount or existence of a debt. It is an informal method of dispute resolution that conserves tax dollars and judicial resources. It is a strict liability provision; an unintentional violation of the validation requirements violates the Act. n128

Another federal statute, the Servicer Act, may provide even greater rights to a consumer to determine the charges and payments on their mortgage. n129 The Fair Credit Reporting Act may also provide strong remedies for disputes that involve an inaccurate credit report. n130

[b] The FDCPA Regulates the Content, Placement, and Provision of the Validation Rights Notice

The Act requires that:

> (a) Within five days after the initial communication with a consumer in connection with the collection of any debt, a debt collector shall, unless the following information is contained in the initial communication or the consumer has paid the debt, send the consumer a written notice containing--
>
> (1) the amount of the debt;
>
> (2) the name of the creditor to whom the debt is owed;
>
> (3) a statement that unless the consumer, within thirty days after receipt of the notice, disputes the validity of the debt, or any portion thereof, the debt will be assumed to be valid by the debt collector;
>
> (4) a statement that if the consumer notifies the debt collector in writing within the thirty-day period that the debt, or any portion thereof, is disputed, the debt collector will obtain verification of the debt or a copy of a judgment against the consumer and a copy of such verification or judgment will be mailed to the consumer by the debt collector; and
>
> (5) a statement that, upon the consumer's written request within the thirty-day period, the debt collector will provide the consumer with the name and address of the original creditor, if different from the current creditor. n131

[i] Placement and Provision of Validation Rights Notice

[A] Placement of the Validation Rights Notice

The notice must be large enough to be easily read and sufficiently prominent to be noticed, even by the least sophisticated debtor. And the notice must not be undermined by inconsistent and contradictory language which eviscerated its message. n132

[B] Providing Validation Rights Notices to Consumers

[1] Overview

The validation rights notice need not be provided until there is a "communication" from the debt collector to the consumer. n133 Notice of validation rights may be sent with or separately from the initial communication. n134 When not provided with the initial communication or when the first contact is not a formal pleading, the validation notice must be given within five days of the initial contact. n135 A 2006 amendment to the FDCPA provided a new exception: a formal legal pleading is not a communication triggering the obligation to provide the debt validation rights notice, postponing the requirement of providing of the notice. n136 Most courts require that each new debt collector must send a debt validation notice, and others make exceptions for lawyers hired by a collection agency that had sent the notice. n137 If the consumer is represented by an attorney, the Fourth Circuit noted the notice should be sent to the attorney, n138 while another case found there was no communication with the consumer necessitating a validation rights notice when the letters all went to the consumer's attorney. n139 If the consumer requests at the same time the validation of the debt and that the debt collector cease debt collection activities, the debt collector should honor both requests by providing the validation of the debt and not requesting payment except by legal action. n140

[2] Providing the Notice Before Formal Pleadings

The FTC staff indicated that a validation notice written on a separate sheet of paper, but sent with the initial communication, technically violated this section because it was not "contained in the initial communication." n141 The first court to look at this issue disagreed and found that the debt validation notice on a separate page sent to plaintiff in the same envelope as a collection letter was effectively provided because there was no concealment of the notice where it was the same size as the collection letter, was marked "Notice," was addressed to plaintiff, and named the creditor and amount of the debt. n142 The Tenth Circuit held in an unpublished decision that the validation notice provided on a separate page in the same envelope as a summons and foreclosure complaint was not obscured by the summons and complaint. n143

According to at least one district court, nothing prohibits a debt collector from sending subsequent validation notices even if the thirty-day period in the initial notice has expired. n144 Another court considering a subsequent, partial debt validation rights notice sent by the collector, held that the consumer was entitled to the rights embodied in the notice. n145

The FTC staff has indicated that a creditor may send a validation notice on behalf of a collection agency if the notice makes clear that the creditor is acting on behalf of the collection agency. n146 If an attorney is hired as a collection agency's agent, he or she must provide the validation notice. n147

Notice should be sent after judgment if that is when a collector begins to collect a debt. n148 A credit reporting agency must provide the notice if it acts as a debt collector. n149 A creditor must provide the notice when the creditor is covered by the Act. n150 The notice requirements of *15 U.S.C. § 1692g* cannot be avoided by "verifying" the debt in advance of a request. n151 FTC staff believes the notice need not be given to a consumer's attorney (who may be unaware of validation rights), n152 but the safer course is to provide the notice to a consumer's attorney. n153

A collector must send a separate validation notice for each debt it seeks to collect from a consumer. n154 A collection agency may not evade the notice requirements of the FDCPA by sending its letters in the creditor's name. n155 A repossession company that was a debt collector covered by the FDCPA n156 may need to provide a validation notice.

n157 A collector who fails to properly provide the validation notice violates the FDCPA. n158 The burden is on the consumer to establish the violation. n159 The consumer need not dispute the validity of the debt to recover for a validation notice violation. n160

One court held that a collection attorney, who before he learned of the bankruptcy mailed a collection letter to a chapter 13 debtor, was prohibited by the automatic stay under the Bankruptcy Code from subsequently mailing a validation notice under *15 U.S.C. § 1692g* and was not liable for his FDCPA violation. n161

The consumer bears the burden of proving that the validation notice was not sent. The consumer's testimony that she did not receive the notice may be considered evidence of the failure of the collector to mail it. n162 However, where the debt collector's records show that the validation rights notice was returned to the collector as undeliverable, the consumer rebutted the mailbox rule by testifying that he had not lived for five years at the address to which the validation rights notice was mailed and prevailed on the claim that the debt collector subsequently failed to send the notice to the current address. n163

[3] Providing the Notice After Initiating Debt Collection with Formal Pleadings

A 2006 amendment to the FDCPA provided this new language to section 1692g:

> (d) LEGAL PLEADINGS.--A communication in the form of a formal pleading in a civil action shall not be treated as an initial communication for purposes of subsection (a). n164

A formal legal pleading is not a communication triggering the obligation to provide the debt validation rights notice, postponing the requirement to provide the notice. n165 This amendment overruled in part the FTC's only formal FDCPA advisory opinion n166 and holdings in Second and Seventh Circuit decisions. n167 While the amendment should put an end to the confusing practice of some debt collectors to provide the debt validation rights notice in or with a summons and complaint, it may raise some legal uncertainty. For example, the term, "formal pleading" is not defined. Its ordinary meaning would apply to complaints, answers, and counterclaims. n168 This should mean that the notice must be provided at the discovery stage or motion stage of the litigation unless settlement discussions trigger the notification requirement before that. It is common for consumers to call debt collectors upon receipt of a debt collection complaint to discuss their options. This call would trigger the requirement that the notice be provided.

[4] Exception for Certain Legal Notices

A 2006 amendment to *15 U.S.C. § 1692g* states:

> (e) NOTICE PROVISIONS.--The sending or delivery of any form or notice which does not relate to the collection of a debt and is expressly required by the Internal Revenue Code of 1986, title V of Gramm-Leach-Bliley Act, or any provision of Federal or State law relating to notice of data security breach or privacy, or any regulation prescribed under any such provision of law, shall not be treated as an initial communication in connection with debt collection for purposes of this section. n169

The most likely tax code notice is a 1099 notice of discharge of indebtedness income. The notices are not exempt if they are sent with a request for payment.

[ii] Content of Validation Notice

An incomplete statement of the *15 U.S.C. section 1692g(a)(1) through (5)* rights violates the Act. n170 And a photocopy of *15 U.S.C. section 1692g* is not a clear notice of the consumer's validation right since the language of the statute was not written to be understandable to unsophisticated consumers. The language of the validation notice must be substantively the same as the statutory language and must not impose additional burdens on the consumer. The

validation notice should be placed and written so as to effectively communicate validation rights to unsophisticated consumers. Additionally, the collector's address should be contained in the communication in which the validation notice is given. The validation notice should not state that the consumer must use a writing to raise a dispute that overcomes the § 1692g(3) assumption that the debt is valid. The consumer is entitled to dispute a debt orally to overcome a collector's assumption that a debt is valid, although only a written dispute of the debt triggers the collector's duty to provide verification of the debt. n171 The notice must include the name of the creditor, n172 and the amount of the debt, as well as the debt collector's address, the right to the name of the original creditor, and an explanation of the procedure for exercising the right.

[iii] Collection Activities May Not Obscure the Validation Notice

A controversial issue is what debt collection activities are permitted during the period in which the consumer may request verification of the debt or the original creditor's name and address.

The FDCPA provides little support for the idea that a consumer has a right to be free from *all* collection activities even before he or she requests validation of the debt or requests the collector to cease collection contacts pursuant to *15 U.S.C. section 1692c(c)*. n173 However, the FDCPA may be violated by a threat to file suit or a credit report within the thirty-day period made so strongly as to suggest that the collector will not cease collection efforts while validating the debt pursuant to the consumer's request. One court has required collectors in Oklahoma to refrain from taking a default judgment during the thirty-day validation period to avoid a state law conflict with the FDCPA. n174 Courts have found a collector's demand for payment within a short time frame, e.g., five days, misleading when made in same letter as the notice, or in another letter sent in close proximity to the notice that the consumer has thirty days to request validation of the collector's claim. n175 The FDCPA does not require the debt collector to inform the consumer of the obligation to stop collection until the requested verification has been provided, n176 although they may disclose that requirement. n177

In its first formal advisory opinion on the FDCPA, the FTC determined that collection activities may continue during the thirty-day period that validation may be requested. n178 With the regard to this issue, the FTC reasoned:

> The Commission continues to believe that the thirty-day time frame set forth in Section 809 is a dispute period within which the consumer may insist that the collector verify the debt, and not a grace period within which collection efforts are prohibited. In response to the ACA's question, therefore, the Commission opines that Section 809(b) does permit a collection agency to either demand payment or take legal action during the thirty-day period for disputing a debt when a consumer from whom the collection agency is attempting to collect a debt has not notified the collection agency that the debt is disputed. The collection agency must ensure, however, that its collection activity does not overshadow and is not inconsistent with the disclosure of the consumer's right to dispute the debt specified by Section 809(a).

The FTC's opinion is in accord with the weight of judicial authority on this issue. n179 The consumer must dispute the debt in writing before the debt collector is required to stop its collection efforts and not resume collection until it has verified the debt. On the other hand, the debt collector must not engage in activities during the thirty-day period that may undermine the effectiveness of the validation notice. So the collector should not threaten collection activities in a way that could confuse the consumer about the right to obtain verification of the debt.

The FDCPA provides that an act done in good faith conformity with an advisory opinion of the FTC is insulated from FDCPA liability. n180 This is in contrast with the hundreds of FTC Informal Staff Letters on the FDCPA that are not binding on the FTC or the courts and do not provide a defense. n181

Any debt collection activities during the validation period should not contradict, obscure or confuse an unsophisticated

consumer about the legal right to obtain verification of the debt to such an extent that the notice provided of the consumer's legal right to obtain validation is ineffectively conveyed. n182

[iv] Additions to Validation Notice to Avoid Deception or Confusion

Two appellate decisions have suggested additional language should be added to validation rights notices to avoid confusion or deception when the debt collector is demanding payment or threatening suit or the consumer's credit rating during the period the consumer has the right to the debt validation process. In *Savino v. Computer Credit, Inc.*, the collection agent's violation of the FDCPA "consisted of its decision to ask for immediate payment without also explaining that its demand did not override the consumer's rights under Section 1692g to seek validation of the debt." n183 The court explained that CCI could have both sought immediate payment and complied with the Act simply by inserting into the text of its letter transitional language that referred the addressee to the validation notice. n184

In a Seventh Circuit case, Judge Posner announced a "safe haven" debt validation notice for the Seventh Circuit that unfortunately has a number of errors in it along with its good ideas. n185

Judge Posner's decision is troubling in that it provides a flawed, model validation notice and dunning letter that the court described as a "safe haven" for debt collectors in the Seventh Circuit. While the model letter has many salutary features, it fails to clearly inform the consumer that a dispute of a part of the debt, e.g., a mysterious service charge or the method by which the current balance was determined, triggers the obligation of the collector to validate that part of the debt. Such an omission would violate the FDCPA, at least in other circuits. In addition to clarifying that the collector would suspend or terminate collections if requested to validate a disputed debt, the Posner letter breaks up the notice of other aspects of the validation into simpler sentences increasing its readability for unsophisticated consumers. It also places the validation notice on the front of the letter following the description of the collector's intended collection activities so that it is clearer that the validation process will be followed if it is requested and the intended collection activities will be suspended or terminated.

[c] Verification of a Debt

15 U.S.C. section 1692g(b) provides:

> If the consumer notifies the debt collector in writing within the thirty-day period described in subsection (a) that the debt, or any portion thereof, is disputed, or that the consumer requests the name and address of the original creditor, the debt collector shall cease collection of the debt, or any disputed portion thereof, until the debt collector obtains verification of the debt or a copy of a judgment, or the name and address of the original creditor, and a copy of such verification or judgment, or name and address of the original creditor, is mailed to the consumer by the debt collector.

[i] Consumers Should Request Verification in Writing

The 30-day period during which a consumer may request verification of a debt runs from the date of receipt of the notice of validation rights by the consumer and is not extended by the collector's subsequent action.

A collector cannot impose requirements for a request for verification beyond those contained in the FDCPA. A consumer's statement that, "I dispute the debt" is sufficient to dispute the validity of a debt under FDCPA. A debt collector may not use a validation notice that requires more. In Castro v. ARS National Services, Inc., n186 a district court in New York held that a debt collector violated the FDCPA n187 by including language in its validation notice that the least sophisticated consumer could read as imposing requirements beyond those set out in the FDCPA.

In *Castro*, the debt collector sent a validation letter to the consumer stating that she could notify its office by telephone that the debt or a portion of the debt was disputed. The court took issue with a list of six types of documents that the

debt collector listed as suitable for dispute purposes. According to the collection letter, suitable dispute documentation included the following:

- A copy of the front and back of the processed payment;
- A final billing statement (with the original account number referenced) showing a zero balance;
- A dated letter from the original creditor advising the balance is zero;
- A letter from the original creditor or credit bureau agency stating the debt has been removed form their records; or
- Legal document(s) showing a discharge bankruptcy.

The court found that, by listing the examples, the least sophisticated consumer could reasonably conclude that some form of documentation was necessary to dispute the debt. The court further found that providing a list of "suitable" documentation suggested that some types of documentation might be "unsuitable." Since all that is required under the FDCPA is a writing stating that all or a portion of a debt is disputed, a consumer need only send a letter n188 stating, "I dispute the debt" in order to dispute a debt. Because the letter could hamper a consumer's effort to communicate a dispute of a debt, the court held that the letter deprived the consumer of the statutory protection given to those who notify a debt collector that the validity of a debt is contested.

[ii] A Debt Collector Verifies a Debt by Providing Information That Is Responsive to the Consumer's Request

The FDCPA does not define "verification." Verification requirements vary depending upon the reason for the dispute over the alleged debt. Simply repeating the second- or third-hand information in the debt collector's file was insufficient validation under the FDCPA. n189

The FTC staff has generally refused requests to provide a definitive position on what information is sufficient to verify a debt under *15 U.S.C. § 1692g*, given the variety of possible transactions and disputes. n190 However, it has indicated that where the dispute involved the mistaken identity of the debtor, a copy of the note and mortgage along with a statement of principal, interest and other charges may be sufficient. n191 However, simply providing a copy of the original signed contract may not be sufficient for other disputes, since it does not include any information about payments made or interest or fees charged. n192

Where the amount of the debt was disputed, the collector must verify the amount. n193 Where the balance of the debt is disputed, monthly statements of the amount owed may be probative and verify the debt. n194 Responding to a consumer's request to validate a debt pursuant to *15 U.S.C. § 1692g* with incomplete information may be deceptive and unfair. n195 Verification regarding a car deficiency claim that included a retail installment contract, a loan application, and a notice of sale and an accounting of the sale was sufficient. n196 Copies of original billing statements that verified that the amount demanded and showed the dates on which charges were incurred, together with a supporting "Affidavit of Claim and Certification of Amount Due," were sufficient verification. n197 A debt collector properly validated the account by informing the consumer that it had acquired the account from Discover Card, and providing the account application with the consumer's signature, and the relevant account statements in response to her request for verification that it was her debt. n198 One court held that billing statements alone were sufficient. n199

A debt collector would violate another provision of the Act by charging a fee for verification. n200 If the debt collector has reason to know the consumer is represented, the verification should be sent to the consumer's lawyer. n201 The Seventh and the Ninth Circuits disagree on whether the debt collector's verification to the consumer's lawyer must

comply with the FDCPA. n202

[iii] Debt Collector Must Cease Collecting From Time of Receipt of Verification Request Until Debt Verified

The collector must cease collection activities on the date it receives the request for verification, n203 and will be held liable if it continues to communicate with the debtor. n204 The collector may not resume collection activities, or file suit, until it mails verification to the consumer, even if the consumer was already aware of the basis of the claim. n205

In its first formal advisory opinion on the FDCPA, the FTC has advised that collectors may undertake collection activities during the thirty-day period during which a consumer may request the collector to validate debt as long as the collection activities do not overshadow or are not inconsistent with the notice of validation rights. n206

The Eleventh Circuit has joined the Seventh Circuit holding that a debt validation request during a suit requires the collector to put the collection suit on hold. The Eleventh Circuit n207 summarily adopted the opinion of a Florida federal district court that a debt validation notice was confusing and not effective. The notice was placed on page 8 of a 16 page package which began with a summons in a foreclosure action informing the consumer of dire consequences if the consumer did not file an answer in the suit in thirty days. n208 The lower courts had looked to the Seventh Circuit decision by Judge Posner in *Bartlett v. Heibl*, n209 which recognized the confusion created by the threat to bring suit during the period that the consumer could request validation of the debt, because the consumer's validation request would force a suspension of collection efforts until validation of the debt was provided. More recently the Eleventh Circuit acknowledged that the FDCPA prohibited the debt collector from taking further steps to collect the debt until it had validated the debt once the consumer requested debt validation. However, the court found that the debt collector had no obligation to stop the clerk from recording the previously filed lien against the condominium after receiving the consumer's request for validation. n210

Subsequently, in the *Thomas* case, Judge Posner may have backtracked from his *Bartlett* position when he provided this validation notice language to collection lawyers who planned to file suit during the period for the consumer to request validation: "As a lawyer, I may file papers in the suit according to the court's rules and the judge's instructions." n211 However, it is not clear what this sentence means. It could simply mean that the collection attorney may plan to file suit before the expiration of the period for the consumer to request validation of the debt.

The FDCPA provides that an act done in good faith conformity with an advisory opinion of the FTC is insulated from FDCPA liability. n212 Recent amendments to the FCRA require that a dispute of any debt be reported to a credit reporting agency when the furnisher knows of the dispute. n213

If the debt collector verifies the debt, it is required by section 1692g(b) to mail the verification to the consumer. A debt collector's record that the verification was mailed to the consumer creates a presumption that it was mailed. n214 The consumer may rebut that presumption by evidence that it was sent to the wrong address. n215

[d] Failure by a Consumer to Exercise Validation Rights May Not Be Taken as an Admission of Liability

The failure of a consumer to dispute the validity of a debt under this section may not be construed by any court as an admission of liability by the consumer. n216

[7] Consumer May Direct Application of Payments When a Collector Holds Multiple Accounts

This provision n217 gives a consumer the right to decide how to allocate payments among multiple debts being collected by the same collector. A consumer in this situation may thus choose to give preference, for example, to a secured debt over an unsecured debt. The section also requires that a collector apply a consumer's payments to debts not disputed by the consumer.

[8] Restrictions Against Bringing Suits in Inconvenient Forums

[a] Suit Must Be Filed Where Consumer Resides or Signed Contract or Where Property Located

This section n218 prohibits a debt collector, including attorneys, from taking legal action to collect a consumer obligation in a "judicial district or similar legal entity" other than where the consumer resides or signed the contract n219 or, in the cases of real estate, where the property is located. n220

When suit is filed in state court, state court geographical boundaries, rather than federal districts, are determinative of appropriate venue. n221 When the court has multiple divisions within a district, the division is the appropriate guide for determining venue. n222

[b] Enforcing a Judgment in a Jurisdiction Where the Consumer Does Not Reside or Did Not Sign the Contract

Until Congress or the FTC acts more definitively, debt collectors may not safely file attachment or garnishment actions except in the districts where the consumer resides or signed the contract, except to enforce a real estate security interest. n223 Where there was no signed contract, suit may be brought only where the consumer resides.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Debt CollectionGeneral OverviewBanking LawConsumer ProtectionFair Debt CollectionCommunicationsBanking LawConsumer ProtectionFair Debt CollectionLiabilityBanking LawConsumer ProtectionFair Debt CollectionUnfair PracticesReal Property LawLandlord & TenantTenant's Remedies & RightsFair Debt Collection Practices Act

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1692-1692 o*. For additional analysis of the Fair Debt Collection Practices Act and related statutes, see National Consumer Law Center, Fair Debt Collection (6th ed. 2008).

(n2)Footnote 2. *Russell v. Equifax A.R.S., 74 F.3d 30, 35 (2d Cir. 1996); Taylor v. Perrin, Landry, de Launay & Durand, 103 F.3d 1232 (5th Cir. 1997)* ; *Thomas v. National Bus. Assistants, Inc., 1984 U.S. Dist. LEXIS 24876* (D. Conn. Oct. 5, 1984) (inconspicuous and grossly overshadowed notice did not notify recipients of their validation of debts rights, incorporating the "least sophisticated" consumer standard). *See also Sims v. GC Servs. L.P., 445 F.3d 959 (7th Cir. 2006)* (Seventh Circuit added additional gloss by noting that a letter cannot be confusing as a matter of law unless a significant fraction of unsophisticated consumers would be confused).

(n3)Footnote 3. *See, e.g., Bentley v. Great Lakes Collection Bureau, 6 F.3d 60 (2d Cir. 1993)* ; *Kaplan v. Assetcare, Inc., 88 F. Supp. 2d 1355 (S.D. Fla. 2000)* (FDCPA is strict liability statute, knowledge or intent need not be pled); *Irwin v. Mascott, 94 F. Supp. 2d 1052 (N.D. Cal. 2000)* (since the FDCPA is a strict liability statute, no showing of intent was necessary to establish liability); *Borcherding-Dittloff v. Transworld Sys., Inc. 58 F. Supp. 2d 1006 (W.D. Wis. 1999)* (argument that no harm was done was unavailing because FDCPA is a strict liability statute). *Randolph v. IMBS, Inc., 368 F.3d 726 (7th Cir. 2004)* (no knowledge required for claims under §§ 1692e(a)(1) and 1692f, unlike § 1692c(a)(2)); *Becker v. Montgomery, Lynch, 2003 U.S. Dist. LEXIS 24992* (N.D. Ohio Feb. 26, 2003) ; *Johnson v. Equifax Risk Mgmt. Servs., 2004 U.S. Dist. LEXIS 4245* (S.D.N.Y. Mar. 17, 2004) (that the consumer failed to object at the time to the offending dun "is beside the point, as the FDCPA strictly imposes liability for violations of the statute, without regard to whether the consumer was actually confused."). *But see Cooper v. Litton Loan Servicing (In re Cooper), 253 B.R. 286 (Bankr. N.D. Fla. 2000)* (lawyer who filed a proof of claim in consumer's bankruptcy in good faith, without knowledge of an error by creditor in calculating claim was not in violation of FDCPA and consumer was limited to bankruptcy remedies; attorneys may reasonably rely in good faith on information provided by creditor, and

are not liable for filing a claim which is ultimately unsuccessful). *See Padilla v. Payco Gen. Am. Credits, Inc., 161 F. Supp. 2d 264 (S.D.N.Y. 2001)* ; *Micare v. Foster & Garbus, 132 F. Supp. 2d 77 (N.D.N.Y. 2001)* ; *Clark v. Capital Credit & Collection Servs., Inc., 460 F.3d 1162, 1176 (9th Cir. 2006)* ("We are convinced that this reading of the FDCPA is more in harmony with the remedial nature of the statute, which requires us to interpret it liberally;" collection agency and its lawyer are strictly liable for falsely stating amount of debt under § 1692e(2)(A) without regard to intent or knowledge of mistake; § 1692k(c) bona fide error defense might shield collectors but they were not entitled to summary judgment where there was evidence that mistakes in medical bills of particular health care provider had come to their attention and consumer was entitled to more discovery on reasonableness of collectors' procedures to avoid such errors).

(n4)Footnote 4. *Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995)* .

(n5)Footnote 5. *See Picht v. Hawks, 77 F. Supp. 2d 1041, 1043 (D. Minn. 1999)* (FDCPA "... remedial, strict liability statute which was intended to be applied in a liberal manner."); *accord Ross v. Commercial Fin. Serv. Inc., 31 F. Supp. 2d 1077, 1079 (N.D. Ill. 1999)* ; *Harrison v. NBD, Inc., 968 F. Supp. 837, 844 (E.D.N.Y. 1997)* (court declined an expanded construction of the FDCPA while recognizing "... the FDCPA is a remedial statute which should be liberally construed."); *Cirkot v. Diversified Fin. Sys., Inc., 839 F. Supp. 941, 944 (D. Conn. 1993)* .

(n6)Footnote 6. *15 U.S.C. § 1692c*.

(n7)Footnote 7. *E.g., 15 U.S.C. § 1692b* (acquisition of location information); *15 U.S.C. § 1692c* (communication with third parties); *15 U.S.C. § 1692d(5)* (repeated phone calls).

(n8)Footnote 8. *15 U.S.C. § 1692c(a)(1)*.

(n9)Footnote 9. *Horkey v. J.V.D.B. & Assocs., Inc., 333 F.3d 769 (7th Cir. 2003)* .

(n10)Footnote 10. *Florence v. National Sys., 1983 U.S. Dist. LEXIS 20344* (N.D. Ga. Oct. 14, 1983) . *See Herbert v. Monterey Fin. Servs., Inc., 863 F. Supp. 76 (D. Conn. 1994)* (sending a dunning letter five days after receiving notice that the consumer was represented violated the FDCPA); *see also Burger v. Risk Mgmt. Alternatives, 94 F. Supp. 2d 291 (N.D.N.Y. 2000)* (plaintiff alleged that defendant communicated with him knowing of his representation by counsel; complaint would not be dismissed because of failure to articulate whether he meant actual or constructive knowledge); *Simmons v. Miller & Steeno, P.C., 2002 WL 31898324* (E.D. Mo. Dec. 30, 2002) (collector's letter to the consumer after learning that the consumer was represented by counsel violated the FDCPA). *See Harding v. Regent, 347 F. Supp. 2d 334* (N.D. Tex. Nov. 23, 2004) ; *Zaborac v. Mutual Hosp. Serv., Inc., 2004 U.S. Dist. LEXIS 23324* (S.D. Ind. Oct. 7, 2004) . *See also Eads v. Wolpoff & Abramson, L.L.P., 538 F. Supp. 2d 981 (W.D. Tex. 2008)* (consumer stated a legally cognizable claim against the collection law firm by alleging it violated *15 U.S.C. §§ 1692b(6)* and *1692c(a)* by serving a state court motion on the consumer when it knew the consumer was represented); *Bianchi v. The Bureaus, Inc., 2008 U.S. Dist. LEXIS 15976* (N.D. Ill. Feb. 27, 2008) (collector violated *15 U.S.C. § 1692c(a)(2)* when it telephoned the consumer more than two months after she had filed for bankruptcy and it was evident that a certificate of service with plaintiff's attorney information was available in the court giving rise to the presumption that the bankruptcy notice with all information had been mailed to the collector and he had received it).

(n11)Footnote 11. FTC Official Staff Commentary § 807(a) 3; Zubalsky, FTC Informal Staff Letter (Jan. 8, 1980).

(n12)Footnote 12. *Schmitt v. FMA Alliance, 2005 U.S. App. LEXIS 2026* (8th Cir. Feb. 9, 2005) . *See also, Randolph v. IMBS, Inc., 368 F.3d 726 (7th Cir. 2004)* (collection agency's letter to the debtor who was represented by counsel did not violate the FDCPA where the collector did not know of the representation).

(n13)Footnote 13. *See Micare v. Foster & Garbus, 132 F. Supp. 2d 77 (N.D.N.Y. 2001)* (unless debt collector had a procedure in place by which it asked creditors whether debtor was represented by counsel and creditor suppressed the information, creditor's knowledge may be imputed to debt collector); *Alexander v. Unlimited Progress Corp., 2003 U.S.*

Dist. LEXIS 5560 (N.D. Ill. Mar. 21, 2003) , *vacated*, *Randolph v. IMBS, Inc., 368 F.3d 726, 2004 U.S. App. LEXIS 9295 (7th Cir. Ill. 2004)* . *But see Hubbard v. National Bond & Collection Assoc., Inc., 126 B.R. 422 (Bankr. D. Del. 1991)* (consumer must demonstrate actual knowledge by debt collector), *aff'd without op., 947 F.2d 935 (3d Cir. 1991)* .

(n14)Footnote 14. *See Salsbury v. Trac A Chec, Inc., 365 F. Supp. 2d 939* (C.D. Ill. Apr. 18, 2005) (collector's telephone call to consumer made after consumer had filed bankruptcy; collector did not mention debt during call, which was placed simply to inform consumer that collector had verified attorney's representation and would not be contacting consumer again; call was not communication "in connection with the collection" of debt and therefore did not violate § 1692c(a)(2)).

(n15)Footnote 15. *15 U.S.C. § 1692c(a)(3). Horkey v. J.V.D.B. & Assocs., Inc, 333 F.3d 769 (7th Cir. 2003)* (protections of Section 1692c(a)(3) may be invoked simply by the consumer's statement that she could not talk at work and that she would return the call from her home. This statement was sufficient to place the collector on notice that the employer did not allow such collection calls). *See also Chiverton v. Fed. Fin. Group, Inc., 399 F. Supp. 2d 96* (D. Conn. Sept. 30, 2005) (debt buyer violated § 1692c(a)(1) and (3) by repeatedly calling after consumer expressly requested collector not to do so because he was not permitted to receive personal calls at work).

(n16)Footnote 16. *15 U.S.C. § 1692c(b). See Stewart v. Salzman, 1987 U.S. Dist. LEXIS 16865* (D. Conn. Nov. 2, 1987) (attorney debt collector may not contact sister of debtor even though sister telephoned attorney).

(n17)Footnote 17. *See Hernandez v. Midland Credit Mgmt., Inc., 2007 U.S. Dist. LEXIS 16054* (N.D. Ill. Mar 6, 2007) . *See also Balogun v. Midland Credit Mgmt., Inc., 2007 U.S. Dist. LEXIS 74845* (S.D. Ind. Oct. 5, 2007) (certifying a class where a collection letter was alleged to evidence a violation § 1692c(b) by sharing information about the consumer's debt with a credit card issuer).

(n18)Footnote 18. *15 U.S.C. § 1692c(d).*

(n19)Footnote 19. *15 U.S.C. § 1692c(d).*

(n20)Footnote 20. *15 U.S.C. § 1692c(d).*

(n21)Footnote 21. *15 U.S.C. § 1692c(d).*

(n22)Footnote 22. *See Pearce v. Rapid Check Collection, 738 F. Supp. 334 (D.S.D. 1990)* (no violation to contact bank on which dishonored check was drawn because collector believed the bank may be an obligor on check).

(n23)Footnote 23. *15 U.S.C. §§ 1692a(7), 1692b.*

(n24)Footnote 24. Termed "location information." *15 U.S.C. § 1692a(7).*

(n25)Footnote 25. *15 U.S.C. § 1692b(1), (2).*

(n26)Footnote 26. *See Zanayed v. Gertler & Gertler, Ltd., 2000 U.S. Dist. LEXIS 5827* (N.D. Ill. Mar. 17, 2000) (*15 U.S.C. § 1692c(b)* clearly excludes communications which are necessary to "effectuate a postjudgment judicial remedy"--in this instance, a wage deduction summons to the employer of a judgment debtor).

(n27)Footnote 27. FTC Official Staff Commentary § 805(b) 4.

(n28)Footnote 28. *15 U.S.C. § 1692b(1)* and *(2).*

(n29)Footnote 29. *See Belin v. Litton Loan Serv., L.P., 2006 U.S. Dist. LEXIS 47953* (M.D. Fla. July 14, 2006) (claim stated against collector requested mother to have debtor return his calls, and left only his company name and phone number; this was indirect communication to the mother to collect debt).

(n30)Footnote 30. *See Leyse v. Corporate Collection Servs., Inc., 2006 U.S. Dist. LEXIS 67719* (S.D.N.Y. Sept. 18, 2006) ("CCS has been cornered between a rock and a hard place, not because of any contradictory provisions of the FDCPA, but because the method they have selected to collect debts [prerecorded calls] has put them there."); *Fed. Trade Comm'n v. Check Enforcement, 2005 U.S. Dist. LEXIS 34349* (D.N.J. July 18, 2005) (collector violated Act by harassing unobligated family members and by leaving messages on answering machines that children and parents could hear).

(n31)Footnote 31. *See West v. Nationwide Credit, Inc., 998 F. Supp. 642 (W.D.N.C. 1998)* (debt collector that left message with neighbor for consumer to return the call violated *15 U.S.C. § 1692c(b)*, even though it did not mention that debt was owed). *See also Fed. Trade Comm'n v. Check Enforcement, 2005 U.S. Dist. LEXIS 34349* (D.N.J. July 18, 2005) (collector violated Act by harassing unobligated family members and by leaving messages on answering machines that children and parents could hear); *Blair v. ShermanAcquisition, 2004 U.S. Dist. LEXIS 25106* (N.D. Ill. Dec. 13, 2004) ; *Henderson v. Eaton, 2001 U.S. Dist. LEXIS 13243* (E.D. La. Aug. 23, 2001) (citing the West v. Nationwide Credit, Inc. holding with approval). *But cf. Horkey v. J.V.D.B. & Assocs., Inc., 179 F. Supp. 2d 861, 868 (N.D. Ill. 2002) , aff'd on other grounds, 333 F.3d 769 (7th Cir. 2003)* (holding that there can be no liability under § 1692c(b) where there is no discussion of the debt).

(n32)Footnote 32. *Foti v. NCO Fin. Sys., Inc., 424 F. Supp. 2d 643 (S.D.N.Y. 2006) . See also Belin v. Litton Loan Servicing, L.P., 2006 U.S. Dist. LEXIS 47953* (M.D. Fla. July 14, 2006) ; *Hosseinzadeh v. M.R.S. Assocs., Inc., 387 F. Supp. 2d 1104 (C.D. Cal. 2005) .*

(n33)Footnote 33. *Foti v. NCO Fin. Sys., Inc., 424 F. Supp. 2d 643, 2006 U.S. Dist. LEXIS 13857* (S.D.N.Y. Mar. 25, 2006) (prerecorded message left on consumer's voicemail was communication, even though it did not mention debt: "Good day, we are calling from NCO Financial Systems regarding a personal business matter that requires your immediate attention. Please call back 1-866-701-1275 once again please call back, toll-free, 1-866-701-1275, this is not a solicitation."); *Hosseinzadeh v. M.R.S. Assocs., Inc., 387 F. Supp. 2d 1104 (C.D. Cal. 2005)* (messages debt collector left on consumer's answering machine not asking for payment or mentioning debt, but which stated that there was important matter regarding which consumer should contact named person were each "communication" as defined by FDCPA; accordingly, failure of collector to disclose that messages were from debt collector violated § 1692e(11)). *See also Joseph v. J.J. Mac Intyre Cos., L.L.C., 281 F. Supp. 2d 1156 (N.D. Cal. 2003)* (summary judgment for collection agency denied where debt collector left recorded message leaving individual's name and debt collector's number; jury must decide whether *15 U.S.C. § 1692d(6)* was violated); *Wright v. Credit Bureau, Inc., 548 F. Supp. 591, 597 , on reconsideration, 555 F. Supp. 1005 (N.D. Ga. 1983)* ("The 'meaningful disclosure' required by section 1692d(6) has been made if an individual debt collector who is employed by a debt collection company accurately discloses the name of her employer and the nature of her business and conceals no more than her real name.").

(n34)Footnote 34. *15 U.S.C. § 1692a(2)* ("The term 'communication' means the conveying of information regarding a debt directly or indirectly to any person through any medium.").

(n35)Footnote 35. *15 U.S.C. § 1692b(1).*

(n36)Footnote 36. *15 U.S.C. §§ 1692b(1), 1692e(14)* (use of true name).

(n37)Footnote 37. *15 U.S.C. § 1692b(1). See also* Charest, FTC Informal Staff Letter (Sept. 13, 1996) (asking for consumer to call an 800-number about "an important matter" violated *15 U.S.C. § 1692b* when the purpose was to confirm or correct location information: the consumer's home telephone number).

(n38)Footnote 38. *15 U.S.C. § 1692b(2).*

(n39)Footnote 39. *See Shaver v. Trauner, 1998 U.S. Dist. LEXIS 19647* (C.D. Ill. May 29, 1998) (motion to dismiss denied where simultaneously with the initial demand letter, the attorney faxed consumer's employer seeking information about his employment such as his date of hire, his position, whether he was a full- or part-time employee,

whether he was salaried or on commission, and the address of the employer's payroll department).

(n40)Footnote 40. *15 U.S.C. § 1692b(4).*

(n41)Footnote 41. *15 U.S.C. § 1692b(5).*

(n42)Footnote 42. *15 U.S.C. § 1692c(a)(1).*

(n43)Footnote 43. *15 U.S.C. § 1692c(a)(2).*

(n44)Footnote 44. *15 U.S.C. § 1692c(a)(3).*

(n45)Footnote 45. *15 U.S.C. § 1692c(b). See Stewart v. Salzman, 1987 U.S. Dist. LEXIS 16865* (D. Conn. Nov. 2, 1987) (consent to the conversation could not be implied).

(n46)Footnote 46. *See Herbert v. Monterey Fin. Servs., Inc., 863 F. Supp. 76 (D. Conn. 1994)* (phone call, after receiving a letter from the consumer's attorney stating the consumer refused to pay the debt, violated the FDCPA).

(n47)Footnote 47. *15 U.S.C. § 1692c(c)* (last sentence).

(n48)Footnote 48. *Clark v. Capital Credit & Collection Servs., Inc., 460 F.3d 1162 (9th Cir. 2006) . See also Cohen v. Beachside Two-I Homeowners' Ass'n, 2006 U.S. Dist. LEXIS 44978* (D. Minn. June 29, 2006) (collection attorneys may verify debt after cease notice and respond to settlement offer made by the *pro se* consumer in the cease letter). *See Johnson v. Equifax Risk Mgmt. Servs., 2004 U.S. Dist. LEXIS 4245* (S.D.N.Y. Mar. 17, 2004) (consumer's written demand to the collector that it verify the debt pursuant to § 1692g and otherwise cease all other communication effectively invoked the § 1692c(c)'s cease communication remedy and did not improperly attempt to "have it both ways," and the collector's subsequent communications other than to provide verification, comprised of an additional dun and affidavits of forgery for the consumer to sign, violated § 1692c(c)). *See also Clark v. Capital Credit & Collection Servs., L.L.C., 2004 U.S. Dist. LEXIS 11349* (D. Or. Jan. 23, 2004) (collector may respond to a request for verification, and initiate suit, even after the consumer requests that letters and phone calls cease); *Harvey v. Great Seneca Fin. Corp., 2005 U.S. Dist. LEXIS 37002* (S.D. Ohio July 18, 2005) (court held that consumer's allegation that defendant debt collector filed state court collection lawsuit without means of proving debt could not be abusive because "filing a lawsuit to attempt to collect a debt is not the kind of conduct that was intended to be covered by section 1692d").

(n49)Footnote 49. *15 U.S.C. § 1692d.*

(n50)Footnote 50. *See Hart v. Universal Fid. L.P., 2007 U.S. Dist. LEXIS 6203* (N.D. Ga. Jan. 26, 2007) (allegations that debt collector "called plaintiff a 'thief', told plaintiff, among other things, that she had 'stolen,' told plaintiff to 'get a job' to pay the debt, stated a false amount that was being collected, demanded full payment within forty-eight hours, and stated that Universal Fidelity was 'getting ready to file a judgment' " stated claim under FDCPA for abusive, deceptive, or unfair debt collection); *Belin v. Litton Loan Serv., L.P., 2006 U.S. Dist. LEXIS 47953* (M.D. Fla. July 14, 2006) (allegations that collector telephoned third party multiple times, was rude, and then abruptly hung up stated claim for harassment or abuse prohibited by § 1692d). *But see Thomas v. LDG Fin. Servs., Inc., 463 F. Supp. 2d 1370, 2006 U.S. Dist. LEXIS 95272* (N.D. Ga. Nov. 28, 2006) (complaint failed to state claim under *15 U.S.C. § 1692d* for conversations arising from telephone calls that included some shouting and threats). *See Fox v. Citicorp Credit Servs., 15 F.3d 1507 (9th Cir. 1994)* (consumer's allegations that debt collector improperly threatened to garnish their wages and continued to call them at their place of employment after being requested not to call stated claim); *Cirkot v. Diversified Fin. Sys., 839 F. Supp. 941, 947 (D. Conn. 1993)* (collector's hand-written note warning, "My special agents will remain in your area to *collect. Believe me*," was a threatening, harassing, and abusive attempt to collect a debt); *Grassley v. Debt Collectors, Inc., 1992 U.S. Dist. LEXIS 22782* (D. Or. Dec. 14, 1992) (collector's threat to have debtor "picked up" was violation).

(n51)Footnote 51. *15 U.S.C. § 1692d(1).*

(n52)Footnote 52. *15 U.S.C. § 1692d(2).*

(n53)Footnote 53. *15 U.S.C. § 1692d(3).*

(n54)Footnote 54. *15 U.S.C. § 1681b(3).*

(n55)Footnote 55. *15 U.S.C. § 1681b(3). See* Ch. 16, "Fair Credit Reporting Act," *§ 16.02[5] infra* .

(n56)Footnote 56. *15 U.S.C. § 1692d(4).*

(n57)Footnote 57. *15 U.S.C. § 1692d(5). See also Joseph v. J.J. Mac Intyre Cos., L.L.C., 281 F. Supp. 2d 1156 (N.D. Cal. 2002)* (collection agency's motion for summary judgment on claim that it made repeated phone calls that were therefore harassing denied where evidence showed over 200 calls during a nineteen month period, including calls following the consumer's express request that all calls cease and calls made immediately after the consumer hung up on the collector. Whether a collector's series of telephone calls constitute illegal harassment depends on both the volume and pattern of the calls. Defendant had no defense to the evidence that its repeated phone calls were harassing based on the fact that it was collecting multiple debts from the consumer.). *See e.g. Clark v. Quick Collect, Inc., 2005 WL 1586862* (D. Or. June 30, 2005) (summary judgment denied to collector where it had called multiple times without leaving messages. "Whether there is actionable harassment or annoyance turns on the volume of calls made and on the pattern of calls" within § 1692d.); *Chiverton v. Fed. Fin. Group, Inc., 399 F. Supp. 2d 96 (D. Conn. 2005)* (debt buyer violated § 1692d(5) by repeatedly calling to collect paid debt after consumer had hung up phone); *Hosseinzadeh v. M.R.S. Assocs., Inc., 387 F. Supp. 2d 1104* (C.D. Cal. Mar. 3, 2005) (content and context of series of 6 telephone messages from debt collector left on consumer's answering machine made issue of whether messages were harassing, unfair, or deceptive question of fact for jury).

(n58)Footnote 58. *15 U.S.C. § 1692d(6).*

(n59)Footnote 59. *Compare United States v. Century Adjustment Bureau, Inc., 823 F.2d 880 (5th Cir. 1987)* (use of assumed name authorized), *Gostony v. Diem Corp., 320 F. Supp. 2d 932 (D. Ariz. 2003)* (use of pseudonym by a debt collector was not a violation). *with Supan v. Medical Bureau of Econ., Inc., 785 F. Supp. 304 (D. Conn. 1991)* (magistrate's opinion) (collector violated FDCPA by misrepresenting that the names on its letters were those of its employees when they were actually of nonexistent persons); Kreiger, FTC Informal Staff Letter (undated) (use of aliases by phone violates the first sentence of *15 U.S.C. § 1692e* and possibly *15 U.S.C. § 1692e(10)*). *See also Youngblood v. GC Servs. Ltd. P'ship, 186 F. Supp. 2d 695 (W.D. Tex. 2002)* (given name of the employee from whose desk the letter was sent was immaterial, and the use of a professional name or desk name was not a violation of § 1692e).

(n60)Footnote 60. *See Knoll v. Intellirisk Mgmt., 2006 U.S. Dist. LEXIS 77467* (D. Minn. Oct. 16, 2006) (debt collector used the false name as the Caller ID).

(n61)Footnote 61. *15 U.S.C. § 1692e(11)* requires the collector also to disclose the collection purpose and that information provided by the consumer will be used for debt collection.

(n62)Footnote 62. A discussion of the courts' early disagreement on the applicable standard can be found in Annot., *What Constitutes False, Deceptive, or Misleading Representation or Means in Connection with Collection of Debt Proscribed by Provisions of Fair Debt Collection Practices Act (15 U.S.C. § 1692e 15 U.S.C. § 1692e), 67 A.L.R. Fed. 974 (1984) . See Gammon v. GC Servs. Ltd. P'ship, 27 F.3d 1254 (7th Cir. 1995)* (applied "unsophisticated consumer standard"); *Clomon v. Jackson, 988 F.2d 1314 (2d Cir. 1993)* ; *Bentley v. Great Lakes Collection Bureau, 6 F.3d 60 (2d Cir. 1993)* ; *Berrios v. Sprint Corp., 1998 U.S. Dist. LEXIS 22833* (E.D.N.Y. Sept. 10, 1998) . *See also Spinarski v. Credit Bureau, 1996 U.S. Dist. LEXIS 22547* (D.N.M. Sept. 19, 1996) (purpose of the "least sophisticated"

consumer standard was to protect "the consumer who is uninformed, naive, or trusting, with consideration given to an objective element of reasonableness which shields complying debt collectors from liability for unrealistic or peculiar interpretations of collection letters"). *But see Francisco v. Doctors & Merchs. Credit Serv., 1998 U.S. Dist. LEXIS 12234 (N.D. Ill. 1998)* (some evidence of actual deception was required before a literally true but potentially misleading statement could be held to violate § 1692e).

(n63)Footnote 63. *15 U.S.C. §§ 1692e* and *1692e(10)* and, depending on the circumstances, *15 U.S.C. § 1692e(4)*, *(5)* and *(10)*. *See Herbert v. Monterey Fin. Servs., Inc., 863 F. Supp. 76, 80 (D. Conn. 1994)* (requesting "settlement prior to possible legal action" by a collection agency with no authority to sue or retain counsel was deceptive). *United States v. National Fin. Servs., Inc., 820 F. Supp. 228 (D. Md. 1993)* , *aff'd*, *98 F.3d 131 (4th Cir. 1996)* . *But see Madonna v. Academy Collection Serv., 1997 U.S. Dist. LEXIS 13315* (D. Conn. Aug. 12, 1997) (threat of legal action was not false or deceptive where creditor sued sometimes under similar circumstances and litigation had not been ruled out with regard to the particular consumer, though probability of suit was very low).

(n64)Footnote 64. Currently the Westlaw path for the database is Databases--Public Information--Civil Litigation--Illinois or --Lawsuits.

(n65)Footnote 65. *See Lamb v. M & M Assoc., Inc., 1998 U.S. Dist. LEXIS 13773* (S.D. Ohio Sept. 1, 1998) (collection letter that informed consumer that she could be sued if debt remained unpaid, that she could be served with a summons and complaint, and that suit could be filed within the 30 day period to request validation could be interpreted by the least sophisticated consumer as threatening legal action). *But see Owsley v. Coldata, Inc., 104 Fed. Appx. 994* (5th Cir. July 29, 2004) (not for publication) (statement in dunning letter that account was "scheduled to be returned to [her] creditor who may [inter alia] ... secure advice of counsel regarding appropriate steps to be taken to enforce payment.", although suggesting that collector had counsel on retainer and that stakes might be raised in the future, would not lead recipient to believe that legal action was imminent; letter did not imply that lawsuit was imminent or that collector had any say in whether legal action would be taken).

(n66)Footnote 66. *See Gervais v. Riddle & Assoc., P.C., 363 F. Supp. 2d 345 (D. Conn. 2005)* .

(n67)Footnote 67. *E.g., Wilhelm v. Credico, Inc., 426 F. Supp. 2d 1030 (D.N.D. 2006)* .

(n68)Footnote 68. For a fuller discussion of the cases finding these threats to be deceptive, see National Consumer Law Center, Fair Debt Collection, § 5.5.2.9 (5th ed. and Supp.)

(n69)Footnote 69. *Kimber v. Federal Fin. Corp., 668 F. Supp. 1480 (M.D. Ala. 1987)* . *See also Stepney v. Outsourcing Solutions, Inc., 1997 U.S. Dist. LEXIS 18264* (N.D. Ill. Nov. 4, 1997) (collector's attempts to collect time-barred debts violated the FDCPA); *Norris v. Miller, 926 F. Supp. 776 (N.D. Ill. 1996)* ; *Martinez v. Albuquerque Collection Servs., 867 F. Supp. 1495 (D.N.M. 1994)* (attempts to collect time-barred debts violated FDCPA); *Canterbury v. Columbia Gas, 2000 U.S. Dist. LEXIS 21740* (S.D. Ohio Sept. 25, 2001) (threatening pursuit of legal means, referral to an attorney, and firm collection action on a time barred debt was deceptive as an unsophisticated consumer would infer that suit was threatened.). *But see Simmons v. Miller, 970 F. Supp. 661 (S.D. Ind. 1997)* (no intentional violation of *15 U.S.C. §§ 1692d*, *1692e*, *1692e(2)(A)* or *1692f(1)* where a claim on a NSF check was filed more than three years but less than six years after the check was written and it was not clear that a six-year, rather than a three-year, statute of limitations applied); *Peter v. GC Servs. L.P., 310 F.3d 344 (5th Cir. 2002)* (language, "SHOULD YOU FAIL TO PAY THIS ACCOUNT IN FULL, GC SERVICES WILL REVIEW YOUR ACCOUNT AND MAKE RECOMMENDATIONS TO THE DEPARTMENT OF EDUCATION FOR THE MOST EFFECTIVE COLLECTION METHOD ALLOWABLE UNDER FEDERAL LAW" did not violate § 1692e).

(n70)Footnote 70. *See Freyermuth v. Credit Bureau Servs., 248 F.3d 767 (8th Cir. 2001)* (effort to collect time-barred checks did not violate the FDCPA when it was not accompanied by a threat of suit); *Walker v. Cash Flow Consultants, Inc., 200 F.R.D. 613 (N.D. Ill. 2001)* (attempting to collect a time-barred debt was not an FDCPA violation

absent an express or implied threat of litigation where state law barred the remedy but did not extinguish the debt); *Reese v. Arrow Fin. Servs., LLC, 202 F.R.D. 83 (D. Conn. 2001)* .

(n71)Footnote 71. *Klewer v. Cavalry Invs., LLC, 2002 U.S. Dist. LEXIS 1778* (W.D. Wis. Jan. 30, 2002) (Wisconsin's six-year statute of limitations for contract, *Wis. Stat. § 893.43*, had run effectively extinguishing the debt according to Wisconsin decisions, not just the judicial remedies available to collect the debt as in most states. Thus, the collection letter misrepresented the legal status of the debt in violation of the FDCPA.).

(n72)Footnote 72. *See McCollough v. Johnson, Rodenberg & Lauinger, 610 F. Supp. 2d 1247 (D. Mont. 2009)* (debt collector violated the FDCPA by using the courts to attempt to collect a time-barred debt).

(n73)Footnote 73. *15 U.S.C. § 1692e(1)*.

(n74)Footnote 74. *15 U.S.C. § 1692e(2)(A). See Kojetin v. C U Recovery, Inc., 212 F.3d 1318 (8th Cir. 2000)* (imposition of percentage-based collection fee violated FDCPA where state law prohibited percentage-based fee and required that any such fee must be based on actual costs of collection); *Heard v. Bonneville Billing & Collections, 216 F.3d 1087* , *reported in full at 2000 U.S. App. LEXIS 14625 (10th Cir. 2000)* (check collector violated the FDCPA and an unfair and deceptive acts and practices [hereinafter UDAP] statute by persisting to collect on bad checks against the check writer's mother after the collector was informed that she was not the signer nor any longer on the joint account); *Jones v. Kunin, 2000 U.S. Dist. LEXIS 6380* (S.D. Ill. May 1, 2000) (court denied the motion to dismiss a complaint which alleged that a collection letter was deceptive where it stated that the consumers were liable under a fraudulent check statute because the statute did not apply to the postdated payday loan checks the consumers wrote; a postdated check implies there are insufficient funds in the account); *Grassley v. Debt Collectors, Inc., 1992 U.S. Dist. LEXIS 22782* (D. Or. Dec. 14, 1992) (unrebutted testimony, that collector told debtor's wife that she was obligated for her husband's debt when she was not, established violation of *15 U.S.C. § 1692e(2)(A)*). *Porter v. Fairbanks Capital Corp., 2003 U.S. Dist. LEXIS 8636* (N.D. Ill. May 20, 2003) (misrepresentation of the character of a debt may occur when the collector labels the charge in a confusing way; complaint stated a claim for relief under § 1692e for demanding payment for attorney fees to reinstate the loan under the heading "recoverable corporate advances" when the same document contained a heading "legal fees" reading zero); *Scott v. Riddle, 2000 U.S. Dist. LEXIS 22161* (D. Utah Dec. 1, 2000) (seeking penalties under a shoplifting statute inapplicable to bad checks misrepresented the character, amount, and legal status of a debt); *Bernstein v. Howe, 2003 U.S. Dist. LEXIS 5284* (S.D. Ind. Mar. 31, 2003) (demanding a specific amount "plus interest and attorneys fees" violated § 1692e(2)(a) because no attorney fees were actually owed at the time of the letter. At most, attorneys fees may be awarded in the future). *See also Shula v. Lawent, 359 F.3d 489 (7th Cir. 2004)* (where no judgment for costs had been entered against consumer, attorney's letter demanding payment of costs was false and misleading in violation of § 1692e, as well as § 1692f(1)); *Goins v. JBC & Assocs., P.C., 2004 U.S. Dist. LEXIS 18413* (D. Conn. Sept. 3, 2004) (check collector's pre-suit demand for maximum civil penalty that court might award in future collection suit violated FDCPA, since that was not the current amount of debt required by § 1692g;); *Axtell v. Collections U.S.A. Inc., 2002 U.S. Dist. LEXIS 23019* (D. Ariz. Oct. 22, 2002) (where entitlement to fees in underlying agreement only permitted fees to "prevailing party" in any "legal action to enforce compliance," collector's demand for payment of sum for attorney fees incurred prior to and outside of litigation was unlawful). *Cf. Bennett v. Arrow Fin. Servs., Inc., 2004 U.S. Dist. LEXIS 6617* (N.D. Ill. Apr. 15, 2004) (because plaintiff submitted no evidence that the interest charged was unauthorized, that claim failed). *But see Collins v. Sparacio, 2004 U.S. Dist. LEXIS 4362* (N.D. Ill. Mar. 19, 2004) (prayer in collection suit for unspecified amount for court costs was not confusing statement of the amount of the debt since the amount of the court costs that might be awarded was not knowable when suit was filed). *See also* National Consumer Law Center, Fair Debt Collection, § 5.5.4 (5th ed. 2004) for further discussion of other types of misrepresentation prohibited by this section.

(n75)Footnote 75. *See Nichols v. Northland Groups, Inc., 2006 U.S. Dist. LEXIS 15037* (N.D. Ill. Mar. 31, 2006) (Northland's settlement offer would mislead and confuse unsophisticated consumer as it stated specific sum for which it would settle its claim and then made statement suggesting that amount would vary with the addition of interest). *But cf. Ruth v. M.R.S. Assocs., Inc., 2006 U.S. Dist. LEXIS 28868* (N.D. Ill. Apr. 4, 2006) (disclosure that interest may accrue

on unpaid balances was truism and not deceptive or misleading).

(n76)Footnote 76. *15 U.S.C. § 1692e(2)(B).*

(n77)Footnote 77. *See Strange v. Wexler, 796 F. Supp. 1117 (N.D. Ill. 1992)* ; *West v. Costen, 558 F. Supp. 564 (W.D. Va. 1983)* (collector and its employees violated § 1692e(2)(A) and (B) by attempting to collect an illegal $15 service charge on bad checks). *But cf. Van Westrienen v. Americontinental Collection Corp., 94 F. Supp. 2d 1087 (D. Or. 2000)* (where the debt collector threatened the consumer with attorneys fees which may have been available under law but without explaining the steps to recover such fees, it violated § 1692e(10) but not § 1692e(2)).

(n78)Footnote 78. *15 U.S.C. § 1692e(3).*

(n79)Footnote 79. *Young v. Citicorp Retail Servs., 159 F.3d 1349 (2d Cir. 1998)* (unpublished disposition), *reported in full, 1998 U.S. App. LEXIS 20268 (2d Cir. 1998)* (oversight of the computer system was not sufficient to establish that a collection letter was issued from an attorney who did not review the consumer's file but signed a high volume of collection letters; a large number of computer-generated letters purporting to be from an attorney violated *15 U.S.C. §§ 1692e(3)* and *(10)*); *Masuda v. Thomas Richards & Co., 759 F. Supp. 1456 (C.D. Cal. 1991)* (collector's practice of sending form letter signed by an independent attorney who had no knowledge of the debt and who had not consulted with the collector is unfair in violation of *15 U.S.C. §§ 1692f* and *1692e(3)*). *See also § 8.02[1][f][iv] supra. But see Zaborac v. Phillips and Cohen Assocs., Ltd., 330 F. Supp. 2d 962 (N.D. Ill. 2004)* (use of the word "associates" in business name did not denote law firm); *Tromba v. M.R.S. Assocs., Inc., 323 F. Supp. 2d 424 (E.D.N.Y. 2004)* (court viewed FDCPA as a harsh statute and "harbors grave doubts as to whether any reasonable trier of fact, even under the least sophisticated consumer standard, could conclude that 'Senior Legal Associate' was equivalent with 'attorney at law' or 'lawyer'").

(n80)Footnote 80. *Greco v. Trauner, Cohen & Thomas, L.L.P., 412 F.3d 360, 363 (2d Cir. 2005)* .

(n81)Footnote 81. *Id. at 364* .

(n82)Footnote 82. *539 F.3d 218 (3d Cir. 2008)* (rejecting argument that it was per se deceptive to use the label "Legal Department" without the presence of lawyers).

(n83)Footnote 83. *15 U.S.C. § 1692e(4). See Tenuto v. Transworld Sys., Inc., 2002 U.S. Dist. LEXIS 1764* (E.D. Pa. Feb. 2, 2002) (in class action where consumers alleged that the collection agency sent a form letter deceptively suggesting that the recipient's wages could be garnished if the debt was not paid and the creditor chose to pursue judicial action, settlement was approved); *Kort v. Diversified Collection Servs., Inc., 2001 U.S. Dist. LEXIS 11701* (N.D. Ill. July 31, 2001) (complaint stated claim for relief where student loan collector's letter plausibly suggested to unsophisticated consumer that garnishment could be initiated with less than 30-days notice required by applicable federal regulations), *class certification granted, in part, denied, in part, 2001 U.S. Dist. LEXIS 20988* (N.D. Ill. Dec. 17, 2001) . *See also Weiss v. Collection Ctr., 2003 ND 128, 667 N.W.2d 567 (2003)* (least sophisticated consumer could interpret a letter advising that the debt collector had sought information from the motor vehicle department regarding his vehicle as a threat to repossess it); *Oglesby v. Rotche, 1993 U.S. Dist. LEXIS 15687* (N.D. Ill. Nov. 4, 1993) (letter stating "once judgment has been entered, it is our intent to proceed with the court ordered attachment and garnishment of all wages, property, and other financial assets, all at additional expense to you" violated *15 U.S.C. § 1692e* by (1) misrepresenting the breadth of garnishment and attachment and (2) despite the phrase "once judgment has been entered," implying that garnishment of *all* wages and attachment of property was unavoidable once court action had been initiated).

(n84)Footnote 84. *15 U.S.C. § 1692e(5). See Duffy v. Landberg, 215 F.3d 871 (8th Cir. 2000)* (demanding a $100 civil penalty for small bounced checks was deceptive and unfair violating § 1692e, e(5) and f where the state law allowed a penalty *up to* $100 and provided that a smaller penalty was available if the consumer settled the claim before it reached the court; referring to the imposition of attorney fees when state law did not authorize them for small checks

violated § 1692e(5)); *Tenuto v. Transworld Sys., 2000 U.S. Dist. LEXIS 14344* (E.D. Pa. Sept. 29, 2000) (class certification granted as to persons sent letters threatening wage garnishment, not normally not available in Pennsylvania). *See also Picht v. Jon R. Hawks, Ltd., 236 F.3d 446 (8th Cir. 2001)* (attorney debt collector's use of state pre-judgment garnishment statute violated state law and therefore FDCPA). *See also Blair v. Sherman Acquisition, 2004 U.S. Dist. LEXIS 25106* (N.D. Ill. Dec. 13, 2004) (if Gramm-Leach-Bliley notice was communication in an effort to collect a debt, requiring consumers to affirmatively notify Sherman that they do not want their information shared is a misstatement of consumers' Gramm-Leach-Bliley privacy rights that violated § 1692e(5)&(10)); *Maxwell v. Arrow Fin. Servs., L.L.C., 2004 U.S. Dist. LEXIS 5462* (N.D. Ill. Mar. 31, 2004) (court certified class where evidence showed that more than 500 persons received form letter that stated that payment of debts which were more than seven years old would result in collector informing credit bureaus that debts were fully paid, thus allegedly suggesting that non-payment would result in reporting obsolete debts in violation of the Fair Credit Reporting Act).

(n85)Footnote 85. *See Weber v. Goodman, 9 F. Supp. 2d 163 (E.D.N.Y. 1998)* (creditor violated § 1692e by creating misleading impression that a third party was collecting debt when the third party was not meaningfully involved in collection process); *Herbert v. Monterey Fin. Servs., Inc., 863 F. Supp. 76 (D. Conn. 1994)* (threat of "final demand" in the first of a series of dunning letters was deceptive because it was false).

(n86)Footnote 86. *See Gonzalez v. Arrow Fin. Servs., 2005 U.S. Dist. LEXIS 19712* (S.D. Cal. July 25, 2005) (debt collector violated § 1692e(5) & (10), notwithstanding disclaimer "if we are reporting account"; court stated "least sophisticated debtor could likely believe his debt is reportable just because the letters indicate the credit bureaus will be notified").

(n87)Footnote 87. *15 U.S.C. § 1692e(6).*

(n88)Footnote 88. *15 U.S.C. § 1692e(7). See Gradisher v. Check Enforcement Unit, Inc., 210 F. Supp. 2d 907 (W.D. Mich. 2002)* (notices which stated "Failure to Make Payment Can Result in a Warrant for Your Arrest" would lead even a sophisticated debtor to conclude that the sheriff's department had determined that the debtor committed a crime and arrest or criminal prosecution was certain to occur if the debt was not paid violating *15 U.S.C. § 1692e(4)* and *(5)*). *But see Goswami v. Am. Collections Enter., 280 F. Supp. 2d 624 (S.D. Tex. 2003)* ("Settlement Offer & Amnesty Period" did not imply that nonpayment would result in criminal or other government prosecution).

(n89)Footnote 89. *15 U.S.C. § 1692e(8). See Perez v. Telecheck Servs., Inc., 208 F. Supp. 2d 1153 (D. Nev. 2002)* (collector's communication to Walmart that Perez had an outstanding unpaid check when that was contested by Perez stated a claim under *15 U.S.C. § 1692e(8)*. The defendant was a debt collector and the alleged conduct was proscribed by the FDCPA.); *see also Sullivan v. Equifax, Inc., 2002 U.S. Dist. LEXIS 7884* (E.D. Pa. Apr. 19, 2002) (allegations that the debt collector knowingly reported false information about the debt to the credit bureau after it knew that the consumer disputed the debt and failed to inform the credit bureau that the debt was "disputed" stated a claim under the FDCPA).

(n90)Footnote 90. *15 U.S.C. § 1692e(9).*

(n91)Footnote 91. An attorney who owned both a law firm and a collection agency that were intertwined violated this provision by allowing mass mailings of letters to be sent on his law firm letterhead and over his facsimile signature. The lawyer had insufficient involvement in the cases to avoid the deceptive implication that he was involved in the account as a lawyer because he did not review debtor files, did not decide which letters to send and did not see particular letters before they were sent. "The attorney letter implies that the attorney has reached a considered, professional judgment that the debtor is delinquent and is a candidate for legal action." This was not the case. *Avila v. Rubin, 84 F.3d 222, 229 (7th Cir. 1996)* .

(n92)Footnote 92. *15 U.S.C. § 1692e(10). See Florence v. National Sys., 1983 U.S. Dist. LEXIS 20344* (N.D. Ga. Oct. 14, 1983) ; *United States v. First Fed. Credit Control Inc., 1982 U.S. Dist. LEXIS 17964* (N.D. Ohio Mar. 11,

1982) . *See also Pleasant v. Risk Management Alternatives, Inc., 2003 U.S. Dist. LEXIS 890* (N.D. Ill. Jan. 23, 2003) (plaintiff's complaint alleged that the collection agency's "one time" settlement offer of 1/2 the debt balance if paid in a few weeks, was not, in fact, a "one time" offer at all stating a claim under *15 U.S.C. § 1692e*); *Silva v. National Telewire Corp., 2000 U.S. Dist. LEXIS 13986* (D.N.H. Sept. 22, 2000) (class of upwards of 300 certified on letter which allegedly created false sense of urgency). *See Nielsen v. United Creditors Alliance Corp., 1999 U.S. Dist. LEXIS 13267* (N.D. Ill. Aug. 19, 1999) (consumer alleged that the statement "take advantage of this opportunity to repair your credit" was false in violation of this section because a settlement of a debt would not "repair" one's credit).

(n93)Footnote 93. *See Krueger v. Ellis, Crosby and Assocs., Inc., 2006 U.S. Dist. LEXIS 96981* (D. Conn. Nov. 9, 2006) (defendant violated FDCPA by not having state license to collect).

(n94)Footnote 94. *15 U.S.C. § 1692e(11)* (as amended 1996). *See Knight v. Schulman, 102 F. Supp. 2d 867 (S.D. Ohio 1996)* (letter identifying amount of debt, enclosing copy of real estate lien, and notifying debtor of title search in preparation for foreclosure was a communication made to collect a debt, but letter acknowledging receipt of payment and notifying debtor of dismissal of suit and release of judgment was not). *See also Young v. Manley, 2000 U.S. Dist. LEXIS 13035* (N.D. Ill. Sept. 6, 2000) (defendant law firm sent a letter to plaintiff's bankruptcy attorney threatening a nondischargeability proceeding based on the amount of credit card charges incurred just before bankruptcy; court held letter was n ot collection effort because it was sent to debtor's attorney); *Buckley v. Bass & Assocs., P.C., 2000 U.S. Dist. LEXIS 10306, at 10* (N.D. Ill. July 14, 2000) (letter inquiring about bankruptcy status, with no demand for payment, and not giving the § 1692e(11) or § 1692g notices was not an effort to collect a debt. "[T]he inclusion of the language plaintiff claims is required under the FDCPA was forbidden by the Bankruptcy Code."), *aff'd, 249 F.3d 678 (7th Cir. 2001) . See generally Degonzague v. Weiss, Neuren & Neuren, 89 F. Supp. 2d 282 (N.D.N.Y. 2000)* (collector's letter, which clearly stated that the "above-captioned matter" had been referred to this office for immediate attention by People's Bank in an attempt to collect a debt and any information obtained would be used for that purpose, satisfied § 1692e(11)).

(n95)Footnote 95. For discussion of the 1996 amendment, see National Consumer Law Center, Fair Debt Collection, § 5.5.14.1 (5th ed. and Supp.)

(n96)Footnote 96. *15 U.S.C. § 1692e(11).*

(n97)Footnote 97. *15 U.S.C. § 1692c(b).*

(n98)Footnote 98. *15 U.S.C. § 1692e(11).*

(n99)Footnote 99. *15 U.S.C. § 1692e(12). See Hartman v. Asset Acceptance Corp., 2004 U.S. Dist. LEXIS 24845* (S.D. Ohio Sept. 29, 2004) (FDCPA claims that affidavit misrepresented that debt buyer was a holder in due in state collection action on purchased Mastercard account violated § 1692e(2) and (12) but not §§ 1692e(6)(A) and 1692d).

(n100)Footnote 100. *15 U.S.C. § 1692e(13).*

(n101)Footnote 101. *15 U.S.C. § 1692e(14). See Hartman v. Meridian Fin. Servs., Inc., 191 F. Supp. 2d 1031 (W.D. Wis. 2002)* (third party debt collector's communication with consumers in the name of the creditor was a false representation in violation of § 1692e).

(n102)Footnote 102. *Cf. Moore v. National Account Systems, Inc.,1991 U.S. Dist. LEXIS 18137* (D. Conn. Nov. 13, 1991) (magistrate's opinion) (parent corporation, Payco American Corp., not legally responsible for the unlicensed activities of its subsidiary corporation without proof of the parent's participation in the collection or dominance of the subsidiary).

(n103)Footnote 103. *See* Kizer v. American Credit & Collection, Clearinghouse No. 45,928 (D. Conn. 1991) (licensed trade name, required to be used by Connecticut statute, was the collector's "true" name required by *15 U.S.C. §*

1692e(14)); *Moore v. National Account Systems, Inc., 1991 U.S. Dist. LEXIS 18137* (D. Conn. Nov. 13, 1991) (magistrate's opinion) (collector's use of the name National Business Division when its Connecticut collector's license permitted it to collect only in the name of National Account Systems, Inc. violated *15 U.S.C. §§ 1692e* and *1692e(10)*, prohibiting deception generally and requiring the use of a true name).

(n104)Footnote 104. *See Orenbuch v. N. Shore Health Sys., 250 F. Supp. 2d 145 (E.D.N.Y. 2003)* (debt collector who utilized the name by which it was known to the public and was registered with the Department of State used its "true name" and did not violate *15 U.S.C. § 1692e(14)*. The FDCPA does not require disclosure of the debt collector's corporate affiliation.). *See also Johnson v. Statewide Collections, 778 P.2d 93 (Wyo. 1989)* (collection agency did not violate the FDCPA by using a part of its registered business name rather than its true corporate name).

(n105)Footnote 105. *See Hartman v. Meridian Fin. Servs., 191 F. Supp. 2d 1031 (W.D. Wis. 2002)* (third party debt collector's communication with consumers in the name of the creditor); Bergstrom, FTC Informal Staff Letter (Nov. 17, 1995); Zager, FTC Informal Staff Letter (Nov. 10, 1992) (law firm sending letters on hospital's letterhead); Knobel, FTC Informal Staff Letter (Oct. 5, 1987) (a collector sending letters in the creditor's name). *Cf. Everst v. Credit Prot. Ass'n, 2003 U.S. Dist. LEXIS 14692* (N.D. Ill. Aug. 22, 2003) (where Communications and Cable of Chicago, Inc. consistently acted in the names A. T. & T. Broadband or other names licensed to it by its parent corporation, there was no misrepresentation of the involvement of a third party collector or use of a name that was not the collector's true name.). *But see Johnson v. NCB Collection Servs., 799 F. Supp. 1298 (D. Conn. 1992)* (settled upon collector's payment of $4000 for consumer to withdraw appeal); *Anthes v. Transworld Sys., Inc., 765 F. Supp. 162 (D. Del. 1991)* (letter sent by outside attorney retained by debt collector was neither impersonation of attorney, nor use of a name other than its own).

(n106)Footnote 106. *Gradisher v. Check Enforcement Unit, Inc., 210 F. Supp. 2d 907 (W.D. Mich. 2002)* (although the debt collector was an independent contractor with the county, its notices purporting to be from the sheriff's department gave the false impression that they were from the sheriff in violation of *15 U.S.C. §§ 1692e(9)* and e(14)).

(n107)Footnote 107. *15 U.S.C. § 1692e(15)*.

(n108)Footnote 108. *See Lawson v. Management Adjustment Bureau, Inc., 1997 U.S. Dist. LEXIS 7275* (N.D. Ill. May 8, 1997) (student loan administrative garnishment notice, which included broadly stated reasons why a debtor could not request a wage-garnishment hearing (e.g., the school was unsatisfactory), could deter a debtor from pursuing a hearing in which she might be able to provide a valid reason why her wages should not be garnished, and, therefore, debtor's complaint stated a claim under § 1692e(2)(A), (6) & (10)).

(n109)Footnote 109. *15 U.S.C. § 1692e(16)*.

(n110)Footnote 110. *See Pettit v. Retrieval Masters Creditors Bureau, Inc., 211 F.3d 1057 , reh'g denied, 2000 U.S. App. LEXIS 12848* (7th Cir. June 7, 2000) (use of the name "Retrieval Masters Creditors Bureau, Inc." in a letter that stated its debt collection purpose did not create the false impression in the mind of a careful, unsophisticated consumer that the collector was a credit bureau; survey evidence on the issue might have raised an issue of fact avoiding summary judgment); Dankowski, FTC Informal Staff Letter (Mar. 6, 2000). *See also Shrestha v. State Credit Adjustment Bureau, Inc., 117 F. Supp. 2d 142 (D. Conn. 2000)* (collector's name was not misleading about it being a credit bureau, particularly in view of its written disclaimer stating that it was a debt collector and not a credit reporting agency).

(n111)Footnote 111. *15 U.S.C. § 1692f*.

(n112)Footnote 112. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 4.4 (7th ed. 2008).

(n113)Footnote 113. *Turner v. J.V.D.B. & Assocs., Inc., 330 F.3d 991 (7th Cir. 2003)* .

(n114)Footnote 114. *15 U.S.C. § 1692f(1). See Duffy v. Landberg, 215 F.3d 871 (8th Cir. 2000)* (demanding a $100 civil penalty for small bounced checks was deceptive and unfair violating § 1692e, e(5), and f where the state law allowed a penalty *up to $100* and provided that it was available if the consumer settled the claim before it reached the court; referring to the imposition of attorney fees when state law did not authorize them for small checks violated § 1692e(5); attempts to collect very small interest overcharges violated the plain language of § 1692f(1)); *Ballard v. Equifax Check Servs., 158 F. Supp. 2d 1163 (E.D. Cal. 2001)* (service charge added by collector to dishonored check which was not authorized by state law or contract creating debt violated *15 U.S.C. § 1692e* and *§ 1692f* and California Unfair Business Practices Act); *Hart v. GMAC (In re Hart), 246 B.R. 709 (Bankr. D. Mass. 2000)* (loan servicer's unilateral adjustment of the consumer's mortgage payments and misrepresentation that the adjustment was required by the creditor violated *15 U.S.C. §§ 1692e(5)* and *1692f(1)*); *see also Shula v. Lawent, 2002 U.S. Dist. LEXIS 24542* (N.D. Ill. Dec. 23, 2002) (Illinois statutes make court costs "recoverable," but where the debt collector failed to request a court order imposing such costs, demand for payment of those amounts was not "permitted by law" and violated *15 U.S.C. §§ 1692f(1)* and *1692e*.); *Johnson v. Riddle, 305 F.3d 1107 (10th Cir. 2002)* (Utah shoplifting penalty which the collector sought was not an amount permitted by law; Utah Supreme Court had held that specific statutes, such as the dishonored check statute, trumped general statutes, such as in the shoplifting statute, and it was clear from the text of the Utah statutory law that shoplifting penalties were unavailable in the collection of dishonored checks.); *Lee v. CBC Co., 1996 U.S. Dist. LEXIS 21993* (S.D. Ohio Sept. 26, 1996) (whether the consumer consented to $25 bad check charge raised a question of fact for trial where the consumer stated she did not see the merchant's sign providing for the charge but was aware that other merchants collected such charges). *See Palmer v. Stassinos, 348 F. Supp. 2d 1070 (N.D. Cal. 2004)* (remedies under the state's comprehensive check recovery statute providing for fees and treble damages were the exclusive remedies allowed for writing a dishonored check and therefore did not allow the collector to also assess interest under generally applicable law; therefore, consumer's allegation that the collector attempted to collect interest in violation of state law stated an FDCPA claim); *Connor v. Howe, 344 F. Supp. 2d 1164 (S.D. Ind. 2004)* (attorney, who attempted to collect a payday loan which was void due to the excessive interest charged, violated § 1692f(1) by attempting to collect an amount of interest which was not permitted by law). *See Neild v. Wolpoff & Abramson, 453 F. Supp. 2d 918 (E.D. Va. 2006)* (consumer's claims that she was charged by defendant for items not specifically contained in underlying agreement stated a cause of action for violation of *15 U.S.C. § 1692f* and *1692f(1)*); *Foster v. D.B.S. Collection Agency, 463 F. Supp. 2d 783 (S.D. Ohio 2006)* (because defendants did not have legal capacity to bring suit, they violated § 1692f(1) by seeking court costs, fees, and interest).

(n115)Footnote 115. *See* Ch. 6, "The Cost of Credit," *supra*. *See Pollice v. National Tax Funding, L.P., 225 F.3d 379 (3d Cir. 2000)* (interest and late charges imposed by the collection agency exceeded a state limitation of 10% and violated § 1692f(1)). *See Nance v. Ulferts, 282 F. Supp. 2d 912* (N.D. Ind. Aug. 19, 2003) (attempting to collect usurious interest and treble check charges inapplicable to a payday loan violated §§ 1692e, 1692e(2)(A), 1692f, and 1692f(1)).

(n116)Footnote 116. *See Spagner v. Latham, Stall, Wagner, Steel & Lehman, P.C., 2005 WL 1950364* (W.D. Okla. Aug. 15, 2005).

(n117)Footnote 117. *See Cole v. Noonan & Lieberman, Ltd., 2005 U.S. Dist. LEXIS 26045* (N.D. Ill. Oct. 26, 2005) .

(n118)Footnote 118. *15 U.S.C. § 1692f(2), (3), (4).*

(n119)Footnote 119. *15 U.S.C. § 1692f(4).*

(n120)Footnote 120. *15 U.S.C. § 1692f(2).*

(n121)Footnote 121. *15 U.S.C. § 1692f(5).*

(n122)Footnote 122. *15 U.S.C. § 1692f(6). But see Plummer v. Gordon, 193 F. Supp. 2d 460 (D. Conn. 2002)*

(despite repossessor's agreement to hold the car for the consumer, it did not violate the FDCPA by turning it over to the creditor, since the creditor's lien was valid); *Akerlund v. TCF Nat'l Bank, 2001 U.S. Dist. LEXIS 22816* (D. Minn. June 11, 2001) (repossession company did not violate FDCPA because the creditor still had the present right of repossession, even though company breached the peace by criminal trespass in the course of repossession).

(n123)Footnote 123. *15 U.S.C. § 1692f(7).*

(n124)Footnote 124. *15 U.S.C. § 1692f(8). See Peter v. GC Servs. L.P., 310 F.3d 344 (5th Cir. 2002)* (use of the U.S. Department of Education's name and address as the return address on the envelope, as well as a statement that the envelope was not to be used for private communication, violated §§ 1692e(14) and 1692f(8)).

(n125)Footnote 125. *See Goswami v. American Collections Enterprise, Inc., 377 F.3d 488 (5th Cir. 2004)* (FDCPA did not bar the innocuous "priority letter" markings on a collection envelope. Nothing about the marking "priority letter" intimated that the contents of the envelope related to collection of delinquent debts, and thus the language was neither threatening nor embarrassing. The court purported to find ambiguity in *15 U.S.C. § 1692f* only by completely ignoring the clear and plain language of the second sentence of that section: "the following conduct is a violation of this section ... ." It did not cite its decision in *Peter v. GC Servs. L.P., 310 F.3d 344 (5th Cir. 2002)* , which avoided the issue of a benign language exception.).

(n126)Footnote 126. *Strand v. Diversified Collection Serv., Inc. [rule] F.3d [rule], 380 F.3d 316* (8th Cir. Aug. 12, 2004) (avoiding what it perceived as an absurd result by applying the plain language of the FDCPA, the court held that § 1692f(8) permitted such benign language on the envelop as the collection agency's initials, "DCS," corporate logo, and the statements, "PERSONAL AND CONFIDENTIAL" and "IMMEDIATE REPLY REQUESTED" as these words did not indicate the letter was to collect a debt).

(n127)Footnote 127. *15 U.S.C. § 1692g.*

(n128)Footnote 128. *See Booth v. Collection Experts, Inc., 969 F. Supp. 1161 (E.D. Wis. 1997)* .

(n129)Footnote 129. *12 U.S.C. § 2605(e). See* National Consumer Law Center, Foreclosures, § 5.2 (2005).

(n130)Footnote 130. *See* Ch. 16 *infra. See also* National Consumer Law Center, Fair Credit Reporting Ch. 6 (6th ed. 2006 and Supp.).

(n131)Footnote 131. *15 U.S.C. § 1692g(a).*

(n132)Footnote 132. *Avila v. Rubin, 84 F.3d 222 (7th Cir. 1996) . See also Law Office of David J. Stern, P.A. v. Martinez, 271 B.R. 696 (S.D. Fla. 2001) , aff'd, 311 F.3d 1272 (11th Cir. 2002)* (validation notice was confusing where it was inserted as page 8 of a 16 page foreclosure suit package); *Colmon v. Payco-G.A.C., Inc., 1992 U.S. Dist. LEXIS 22733* (D. Conn. Jan. 22, 1992) (even though a notice may contain the requisite statutory language, the strident demand of communication for payment through the use of format, type size, juxtaposition of provisions, conspicuousness, color and background may negate and overshadow the effective communication of the debtor's rights). *See also Jacobson v. Healthcare Fin. Serv., Inc., 516 F.3d 85 (2d Cir. 2008)* (language unlawfully overshadowed or contradicted the debt validation rights notice when it would make the least sophisticated consumer uncertain as to his/her rights, regardless of whether the plaintiff was actually confused).

(n133)Footnote 133. *15 U.S.C. §§ 1692g(a), 1692a(2). See, e.g., Robinson v. TSYS Total Debt Mgmt., Inc., 447 F. Supp. 2d 502 (D. Md. 2006)* (collector's request for collection probability score from credit reporting agency did not trigger requirement to provide validation rights notice because it was not communication with consumer); *Acosta v. Campbell, 2006 U.S. Dist. LEXIS 4088* (M.D. Fla. Jan. 18, 2006) (FDCPA does not impose on debt collector obligation to disclose to consumer right to dispute debt prior to filing suit).

(n134)Footnote 134. Cranmer, FTC Informal Staff Letter (Apr. 25, 1989) (validation notice should be sent with, or within five days, of mortgage servicing company's notice to consumers of its acquisition of obtaining loan servicing); Rahe, FTC Informal Staff Letter (Aug. 6, 1980).

(n135)Footnote 135. *See Cirkot v. Diversified Sys., Inc., 839 F. Supp. 941 (D. Conn. 1993)* . *See also Phillips v. North Am. Capital Corp., 1999 U.S. Dist. LEXIS 7000* (N.D. Ill. Apr. 30, 1999) (oral demand for immediate payment, which preceded validation notice by no more than five days, did not violate the FDCPA).

(n136)Footnote 136. *15 U.S.C. § 1692g(d) added by* Pub. L. No. 109-351 § 802, *120 Stat. 2006* (Oct. 16, 2006).

(n137)Footnote 137. *See Turner v. Shenandoah Legal Group, P.C., 2006 U.S. Dist. LEXIS 39341* (E.D. Va. June 12, 2006) (collection attorney required to provide validation rights notice although it may have been provided by earlier debt collector); *Horkey v. J.V.D.B. & Assocs., 179 F. Supp. 2d 861 (N.D. Ill. 2002)* (provision of validation notice by collector's attorney did not excuse collection agency from providing debt validation notice, as attorney's notice did not refer to the agency), *aff'd, 333 F.3d 769 (7th Cir. 2003)* ; *Tipping-Lipshie v. Riddle, 2000 U.S. Dist. LEXIS 2477* (E.D.N.Y. Mar. 1, 2000) (initial communication from each collector must contain notice); FTC Official Staff Commentary § 809(a), 7. *But see Nichols v. Byrd, 435 F. Supp. 2d 1101, 2006 U.S. Dist. LEXIS 44628* (D. Nev. June 13, 2006) ; *Senftle v. Landau, 390 F. Supp. 2d 463 (D. Md. 2005)* (when collection agency had provided validation rights notice, collection law firm that subsequently collected debt was not required to send its own validation rights notice).

(n138)Footnote 138. *Chaudhry v. Gallerizzo, 174 F.3d 394 (4th Cir. 1999)* .

(n139)Footnote 139. *See Baiser v. Braje & Nelson, L.L.P., 2006 WL 1285143* (N.D. Ind. May 5, 2006).

(n140)Footnote 140. *See Clark v. Capital Credit & Collection Services, Inc., 460 F.3d 1162 (9th Cir. 2006)* .

(n141)Footnote 141. Mezines, FTC Informal Staff Letter (Mar. 4, 1980). *See also Sylvester v. Laks, 1991 U.S. Dist. LEXIS 21777* (N.D. Ohio Aug. 1, 1991) (follow-up letter violated § 1692e(11) notice requirement because 1692e(11) notice on separate paper should have been referred to in dunning letter).

(n142)Footnote 142. *Cavallaro v. Law Office of Shapiro & Kriesman, 933 F. Supp. 1148 (E.D.N.Y. 1996)* .

(n143)Footnote 143. *Ferree v. Marianos, 129 F.3d 130 (10th Cir. 1997)* (unpublished).

(n144)Footnote 144. *DiRosa v. North Shore Agency, 56 F. Supp. 2d 1039 (N.D. Ill. 1999)* ; *Trull v. GC Servs. Ltd. P'ship, 961 F. Supp. 1199 (N.D. Ill. 1997)* (validation notice received twice in letters less than 30 days apart, where each notice informed debtor that 30-day validation period commenced upon receipt of initial notice, would not confuse unsophisticated consumer into believing that validation period had been extended).

(n145)Footnote 145. *Holsinger v. Wolpoff & Abramson, L.L.P., 2006 U.S. Dist. LEXIS 55406* (N.D. Cal. July 27, 2006) (unpublished) (failure of second notice to state amount of debt would not be violation). *See also Arend v. Total Recovery Servs., 2006 U.S. Dist. LEXIS 50479* (E.D.N.Y. July 24, 2006) (it was not false or deceptive for debt collector to offer consumer additional time to exercise his right to obtain verification of debt).

(n146)Footnote 146. FTC Official Staff Commentary § 809(a), 1; FTC Informal Staff Letter (Mar. 7, 1979). *See also* Connelly, FTC Informal Staff Letter (Dec. 10, 1980) (company that merely supplies collection forms to creditor was not communicating with debtor and was not required to provide notice). *But cf.* Fuhr, FTC Informal Staff Letter (Jan. 9, 1987) (when required, attorney must furnish notice even if creditor had sent similar information).

(n147)Footnote 147. *Frey v. Gangwish, 970 F.2d 1516 (6th Cir. 1992)* ; *Sampson v. Banchek, 1991 U.S. Dist. LEXIS 21815* (N.D. Ohio Jan. 8, 1991) (attorney violated validation notice requirement when he failed to send the

notice after a phone call regarding a debt); FTC Official Staff Commentary § 809, 1; Udell, FTC Informal Staff Letter (Jan. 20, 1987); Goldfarb, FTC Informal Staff Letter (Jan. 16, 1987); Cathcart, FTC Informal Staff Letter (Aug. 6, 1981).

(n148)Footnote 148. *Frey v. Gangwish, 970 F.2d 1516 (6th Cir. 1992)* ; Goldfarb, FTC Informal Staff Letter (Nov. 23, 1988).

(n149)Footnote 149. Sutton, FTC Informal Staff Letter (Oct. 23, 1986).

(n150)Footnote 150. Grammatico v. Sterling, Inc., Clearinghouse No. 47,976 (N.D.N.Y. 1991); Raff, FTC Informal Staff Letter (Sept. 11, 1986).

(n151)Footnote 151. Xiao-lin, FTC Informal Staff Letter (Aug. 3, 1987).

(n152)Footnote 152. Goldfarb, FTC Informal Staff Letter (Nov. 23, 1988).

(n153)Footnote 153. *See Spencer v. Hendersen-Webb, 81 F. Supp. 2d 582 (D. Md. 1999)* (debt collector's fax of bill to father of consumer's boyfriend in response to request for information was attempt to collect debt since collector believed he was consumer's attorney and that information would reach consumer indirectly; fax was initial communication and thus failure to provide validation notice violated FDCPA).

(n154)Footnote 154. *Gradisher v. Check Enforcement Unit, Inc., 210 F. Supp. 2d 907 (W.D. Mich. 2002)* (debt collector violated *15 U.S.C. § 1692g(a)* by failing to provide validation notice to the debtor); *Hartman v. Meridian Fin. Servs., Inc., 191 F. Supp. 2d 1031 (W.D. Wis. 2002)* (third party debt collector's initial communications with consumers in name of creditor failed to contain validation notice, violating § 1692g).

(n155)Footnote 155. *See Dowling v. Kucker Kraus & Bruh, L.L.P., 2005 U.S. Dist. LEXIS 11000* (S.D.N.Y. June 6, 2005) (debt collectors could not evade notice requirements of FDCPA merely by having creditor sign demand for rent that collector prepared and mailed).

(n156)Footnote 156. *15 U.S.C. § 1692a(6)*.

(n157)Footnote 157. *See* Rios v. River City Adjustors, Inc., Clearinghouse No. 36,823 (W.D. Mich. 1984) (stipulated settlement and dismissal) (repossession company settled FDCPA and state claims without admitting wrongdoing; complaint alleged that company violated FDCPA by failing to provide validation notice and by communicating with consumer known to be represented by lawyer in violation of *15 U.S.C. § 1692c(a)(2)*).

(n158)Footnote 158. *Shula v. Lawent, 2002 U.S. Dist. LEXIS 24542* (N.D. Ill. Dec. 23, 2002) , *aff'd, 359 F.3d 489 (7th Cir. 2004)* (collector's letter demanding payment of court costs was required to include statutory validation notice pursuant to *15 U.S.C. § 1692g*). *See also* Beal, FTC Informal Staff Letter (May 22, 1987). *But see Schnitzspahn v. F.A.B., Inc., 156 F.3d 1232 (6th Cir. 1998)* (unpublished) (text at *1998 U.S. App. LEXIS 17658*) (summarily finding no FDCPA violations: defendant's debt validation notice contained all information required by § 1692g).

(n159)Footnote 159. *See Mahon v. Credit Bureau, 171 F.3d 1197 (9th Cir. 1999)* (debt collector must prove only that § 1692g notice was sent, not received by consumer; absent any evidence other than consumer's bare denial of receipt, common law mailbox rule controlled); *McGinley v. Law Office of Shapiro & Kreisman, 2003 U.S. Dist. LEXIS 10765* (N.D. Ill. June 24, 2003) (summary judgment granted to debt collector on consumer's claim that debt collector failed to send validation notice, where consumer's only evidence was that he did not receive notice, and debt collector produced electronic records showing that it was in fact mailed to consumer).

(n160)Footnote 160. *Baker v. G.C. Servs. Corp., 677 F.2d 775 (9th Cir. 1982)* .

(n161)Footnote 161. *Maloy v. Phillips, 197 B.R. 721 (M.D. Ga. 1996) . See also Buckley v. Bass & Assocs., P.C.,*

249 F.3d 678 (7th Cir. 2001) (letter inquiring about bankruptcy status, with no demand for payment, and not giving the §§ 1692e(11) or 1692g notices was not an effort to collect a debt; "the inclusion of the language plaintiff claims was required under the FDCPA was forbidden by the Bankruptcy Code.").

(n162)Footnote 162. *See Beuter v. Canyon State Prof'l Servs., 2005 U.S. Dist. LEXIS 12281* (D. Ariz. June 13, 2005) (disputed issues of fact precluded summary judgment where consumer denied she received initial dun containing validation notice and collector submitted only conclusory statement that it had sent initial dun without any evidence of ordinary business practices through which dun was purportedly sent).

(n163)Footnote 163. *Johnson v. Midland Credit Mgmt. Inc., 2006 U.S. Dist. LEXIS 60133* N.D. Ohio Aug. 24, 2006).

(n164)Footnote 164. *15 U.S.C. § 1692g(d).*

(n165)Footnote 165. Pub. L. No. 109-351, § 802(a), *120 Stat. 2006* (Oct. 13, 2006).

(n166)Footnote 166. Mezines, F.T.C. Formal Advisory Opinion (Mar. 31, 2000).

(n167)Footnote 167. *Goldman v. Cohen, 445 F.3d 152 (2d Cir. 2006)* ; *Thomas v. Law Firm of Simpson & Cybak, 392 F.3d 914 (7th Cir. 2004)* .

(n168)Footnote 168. *See* Black's Law Dictionary (8th ed. 2004), "pleading."

(n169)Footnote 169. Added by Pub. L. No. 109-351, § 802(b), *120 Stat. 2006* (Oct. 13, 2006).

(n170)Footnote 170. *Grief v. Wilson, Elser, Moskowitz, Edelman & Dicker, LLP, 217 F. Supp. 2d 336 (E.D.N.Y. 2002)* (failure of the collector's initial notice to state that any request for verification of the debt or the identity of the original creditor must be in writing violated the verification disclosure requirements; statement in the initial dun that the amount of the debt was the underlying balance plus a sum for "attorneys' fees up to" a stated dollar amount presented the least sophisticated consumer with "a variety of amounts of the debt" and therefore failed to disclose the specific amount of the debt owing, in violation of § 1692g(a)(1)); *McCabe v. Crawford & Co., 2002 U.S. Dist. LEXIS 17997* (N.D. Ill. Sept. 25, 2002) (claim was stated where the collector's letter failed to inform the consumer that a dispute must be "in writing;" claim was stated where the collector's letter failed to inform the consumer that he may dispute "any portion" of the debt. The court granted plaintiff's motion for class certification pursuant to Rule 23(a) and (b)(3).).

(n171)Footnote 171. *See Camacho v. Bridgeport Fin. Inc., 430 F.3d 1078 (9th Cir. 2005)* (collectors who send out a debt verification notice cannot require that the consumer dispute the debt only in writing; instead, the consumer's oral notification is sufficient to overcome the debt collector's assumption that the debt is valid, although a written request is required to obtain validation of the debt or a response to the dispute); *Ong v. American Collections Enter., Inc., 1999 U.S. Dist. LEXIS 409* (E.D.N.Y. Jan. 15, 1999) (collection agency's letter to consumer violated § 1692g(a)(3), requiring that consumer notify collection agency in writing that he disputes validity of the debt). *See also Spearman v. Tom Wood Pontiac-GMC, Inc., 2002 U.S. Dist. LEXIS 24389* (S.D. Ind. Nov. 4, 2002) (court parts with the Third Circuit position in *Graziano* in the current split on whether a proper § 1692g notice may require that any dispute must be in writing and holds in a comprehensive analysis that the validation notice must disclose the consumer's right to dispute orally.); *In re Risk Mgmt. Alternatives, Inc., 208 F.R.D. 493 (S.D.N.Y. 2002)* (court declined to follow *Graziano v. Harrison, 950 F.2d 107 (3d Cir. 1991)* , and held that a jury must determine whether the least sophisticated consumer could believe that any challenge to the debt must be in writing.). One court has held that a debt collector is not required to provide debtors with a telephone number in order to assist debtors in disputing the debt orally. *Nasca v. GC Servs., Ltd., 2002 U.S. Dist. LEXIS 16992* (S.D.N.Y. Sept. 12, 2002) .

(n172)Footnote 172. *See Sparkman v. Zwicker & Assocs., P.C., 374 F. Supp. 2d 293 (E.D.N.Y. 2005)* (collector failed to clearly identify current creditor). *Cf. Dikun v. Streich, 369 F. Supp. 2d 781 (E.D. Va. 2005)* (debt collector's

identification of its creditor in its initial dun by name that differed slightly from creditor's actual name was not inaccurate as tested by least sophisticated consumer standard).

(n173)Footnote 173. *But see Rabideau v. Management Adjustment Bureau, 805 F. Supp. 1086 (W.D.N.Y. 1992)* (statement that immediate payment would avoid further contact contradicts the validation notice because it would mislead the consumer to believe payment was the only way to avoid future contact).

(n174)Footnote 174. *Mendus v. Morgan & Assocs., 994 P.2d 83 (Okla. Civ. App. 1999) . See also Shaver v. Trauner, 1998 U.S. Dist. LEXIS 19647* (C.D. Ill. May 29, 1998) (motion to dismiss denied where the attorney's letter allegedly violated the validation notice requirement by including "the Federal Trade Commission has stated that the Fair Debt Collection Practices Act does not preclude institution of a legal action prior to the expiration of the aforementioned thirty-day period. Legal action may be instituted forthwith in the absence of payment or satisfactory payment arrangements.").

(n175)Footnote 175. *See Johnson v. Revenue Mgmt. Corp., 169 F.3d 1057 (7th Cir. 1999)* ; *Rhoades v. West Virginia Credit Bureau Reporting Servs., 96 F. Supp. 2d 528, 532 (S.D. W. Va. 2000)* (dun which demanded "immediate payment," said "[p]ay the full amount today," and "[c]all us today" in large type overshadowed and contradicted "tiny-type rendering of the validation notice."). *But see Kramsky v. Mark L. Nichter, P.C., 166 F. Supp. 2d 912, 913 (S.D.N.Y. 2001)* (validation notice was not overshadowed by language that law firm "has been engaged to proceed against you because of your failure to make payment," that it "will not permit this debt to be ignored," and that "[i]t would definitely be in your best interest to satisfy in full your outstanding balance"); *Kramsky v. Trans-Continental Credit, 166 F. Supp. 2d 908, 910 (S.D.N.Y. 2001)* (validation notice was not contradicted or overshadowed by: "This past due statement reflects a balance due the above stated creditor. This account has been referred to collection and we must ask that you remit the balance shown in full using the enclosed envelope.").

(n176)Footnote 176. *See Peter v. GC Servs. L.P., 310 F.3d 344 (5th Cir. 2002) .*

(n177)Footnote 177. *See Bartlett v. Heibl, 128 F.3d 497 (7th Cir. 1997) .*

(n178)Footnote 178. Mezines, FTC Advisory Opinion (Mar. 31, 2000), *available at* http://www.ftc.gov/os/2000/04/fdcpaadvisoryopinion.htm.

(n179)Footnote 179. *See Sprouse v. City Credits Co., 126 F. Supp. 2d 1083 (S.D. Ohio 2000)* (only if the consumer disputes debt is collector barred from filing suit under § 1692g; since consumer did not so dispute, collector was free to file suit within the 30-day validation period.). *But see Spears v. Brennan, 745 N.E.2d 862 (Ind. App. 2001)* (scheduling a hearing date in small claims court and obtaining a default judgment within the 30-day validation period infringed on the consumer's right to have the complete 30 days in which to dispute the debt), *reh'g denied, 2001 Ind. App. LEXIS 1171* (Ind. Ct. App. June 28, 2001) .

(n180)Footnote 180. *15 U.S.C. § 1692k(e).*

(n181)Footnote 181. *See § 8.01[2][b] supra.*

(n182)Footnote 182. *See, e.g., Bartlett v. Heibl, 128 F.3d 497 (7th Cir. 1997) , reh'g, en banc, denied, 104 F.3d 1534 (7th Cir. 1997) . See also Renick v. Dun & Bradstreet Receivable Mgmt. Servs., 290 F.3d 1055 (9th Cir. 2002)* (FDCPA thirty-day validation notice was not overshadowed by collector's letter stating "send your payment today" and "PROMPT PAYMENT was REQUESTED" because it was in the same font as the surrounding text, was not emphasized in any other way, was in the nature of a request rather than a demand, and carried no sense of urgency); *see also Taylor v. Cavalry Inv., LLC, 210 F. Supp. 2d 1001 (N.D. Ill. 2002)* (collector's initial dun which recited the required § 1692g verification language and also instructed the consumer to "act now to satisfy this debt" did not violate the FDCPA since the latter statement was not accompanied by any threat of action and did not demand payment with a threat of action if the debt was not satisfied in a certain amount of time). *Bernstein v. Howe, 2003 U.S. Dist. LEXIS*

5284 (S.D. Ind. Mar. 31, 2003) (payment arrangements should be made by a date prior to the expiration of the thirty-day validation period not violation); *Taylor v. Cavalry Invest., L.L.C., 210 F. Supp. 2d 1001 (N.D. Ill. 2002)* ("act now to satisfy this debt" did not violate the FDCPA); *Young v. Meyer & Njus, P.A., 183 F.R.D. 231 (N.D. Ill. 1998)* (by "return mail" did not mean immediate payment); *Keen v. Omnibus Int'l, 1998 U.S. Dist. LEXIS 12619* (N.D. Ill. Aug. 7, 1998) (notify us in writing immediately if the debt invalid or discharged in bankruptcy did not contradict or overshadow); *Wollert v. Client Servs., 1998 U.S. Dist. LEXIS 12241* (N.D. Ill. Aug. 3, 1998) (not contradicted nor overshadowed by call our office immediately); *Gammon v. Belzer, 1997 U.S. Dist. LEXIS 5170* (N.D. Ill. Apr. 9, 1997) (immediate attention to this matter is in your best interest); *Vasquez v. Gertler & Gertler, Ltd., 987 F. Supp. 652 (N.D. Ill. 1997)* (request for immediate attention by payment or contacting the collection attorney); *Burns v. Accelerated Bureau of Collections, Inc., 828 F. Supp. 475 (E.D. Mich. 1993)* . *See Palmer v. Stassinos, 348 F. Supp. 2d 1070 (N.D. Cal. 2004)* (debt collector was not required to suspend debt collection activities, including pursuing litigation options, during the period for requesting validation.). *But cf. Palmer v. Stassinos, 348 F. Supp. 2d 1070 (N.D. Cal. 2004)* (threat of litigation made within the validation period did not cause a debtor confusion regarding her right to validate the amount of debt where there was no statement that could be construed to shorten the 30-day validation period); *Gostony v. Diem Corp., 320 F. Supp. 2d 932 (D. Ariz. 2003)* (suggestion, twenty days into dispute period, that the consumer consult with an attorney, and threat of litigation, did not contradict validation notice or create a false sense of urgency). *See also Foti v. NCO Fin. Sys., Inc., 424 F. Supp. 2d 643, 2006 U.S. Dist. LEXIS 13857* (S.D.N.Y. Mar. 25, 2006) (denying collector's motion to dismiss claim that collector's telephone calls overshadowed or contradicted § 1692g disclosures since allegations that collector repeatedly demanded payment and threatened continuous demands for payment absent immediate payment during 30-day validation period stated claim for relief).

(n183)Footnote 183. *164 F.3d 81, 86 (2d Cir. 1998)* .

(n184)Footnote 184. *Id.*

(n185)Footnote 185. See *Bartlett v. Heibl, 128 F.3d 497, 501-502 (7th Cir. 1997)* .

(n186)Footnote 186. *2000 U.S. Dist. LEXIS 2618* (S.D.N.Y. Mar. 8, 2000) . *See also Mendez v. M.R.S. Assocs., 2005 U.S. Dist. LEXIS 13705* (N.D. Ill. June 27, 2005) (consumer's motion for summary judgment was granted where collector's letter instructed consumer to contact sender and "explain nature of dispute" because that statement erroneously suggested that consumer must have specific reason in order to demand verification of debt).

(n187)Footnote 187. *15 U.S.C. § 1692.*

(n188)Footnote 188. In dicta, the court stated that a consumer could also orally dispute the validity of a debt.

(n189)Footnote 189. *See Semper v. JBC Legal Group, 2005 U.S. Dist. LEXIS 33591* (W.D. Wash. Sept. 6, 2005) . *See also Clark v. Capital Credit & Collection Servs., Inc., 460 F.3d 1162 (9th Cir. 2006)* ; *Chaudhry v. Gallerizzo, 174 F.3d 394, 406 (4th Cir. 1999)* .

(n190)Footnote 190. *Erickson v. Johnson, 2006 U.S. Dist. LEXIS 6979* (D. Minn. Feb. 22, 2006) (where debt collector provided statements of account sent to plaintiff and his spouse, and canceled checks drawn on marital joint account, verification was "minimally sufficient" since FDCPA does not require investigation and does not require collector to ascertain legality of the debt; where plaintiff did not request verification of attorney fee component of amount demanded, collector had no obligation to verify it; dismissing verification claims).

(n191)Footnote 191. Bingham, FTC Informal Staff Letter (Jan. 12, 1987). *But cf.* Xiao-lin, FTC Informal Staff Letter (Aug. 3, 1987) (a verification of a deficiency claim from a mortgage foreclosure would be an itemization of the amount due; the verification should address the facts of the dispute raised by the consumer).

(n192)Footnote 192. Bingham, FTC Informal Staff Letter (Jan. 12, 1987) (no mention of the credit application which would contain identification information). *See also* FTC Official Staff Commentary § 809(a), 8 (providing proof

of debt in initial communication not sufficient to verify debt since consumer may dispute his or her identity as the debtor), *discussed in* § 3.2.6, *supra, reprinted at* Appx. C, *infra* .

(n193)Footnote 193. *Spears v. Brennan, 745 N.E.2d 862 (Ind. Ct. App. 2001)* (providing a copy of the original signed contract was not a sufficient verification to a general § 1692g dispute, since it did not show basic necessary information such as accounting of payments made and interest and fees charged; therefore, attorney collector's continuing to collect the debt by procuring a default judgment after the dispute and inadequate verification violated § 1692g(b)).

(n194)Footnote 194. Glover, FTC Informal Staff Letter (June 23, 1986) (*15 U.S.C. § 1692g* requires a statement of the amount of the debt and, upon request disputing the amount, a verification of the debt). *See Bey v. Daimler Chrysler Servs., L.L.C., 2006 U.S. Dist. LEXIS 8261* (D.N.J. Feb. 15, 2006) (verification that was higher than amount initially demanded did not violate FDCPA, since higher amount was merely interim accrued attorney fees).

(n195)Footnote 195. *See Bascom v. Dubin, 2007 U.S. Dist. LEXIS 5349* (W.D.N.Y. Jan. 25, 2007) (bank's collection attorney adequately provided verification of debt where he provided plaintiffs copies of original billing statements that showed that amount being demanded was what was claimed to be owed and that showed dates on which charges were incurred, together with current bank's supporting "Affidavit of Claim and Certification of Amount Due").

(n196)Footnote 196. *Young v. Meyer & Njus, P.A., 1997 U.S. Dist. LEXIS 11469* (N.D. Ill. Aug. 6, 1997) (refusing to dismiss allegation that *15 U.S.C.§§ 1692e* and *1692f* were violated by an attorney who verified complaint based on the review of a computer print-out from the creditor which provided insufficient information to prove the debt at trial).

(n197)Footnote 197. *See Blome v. Johnson, Rodenburg & Lauinger, 2007 U.S. Dist. LEXIS 91000* (D. Mont. Dec. 11, 2007) .

(n198)Footnote 198. *See Bascom v. Dubin, 2007 U.S. Dist. LEXIS 5349* (W.D.N.Y. Jan. 25, 2007) .

(n199)Footnote 199. *See Palisades Collection, L.L.C. v. Besthorne, 2007 N.J. Super. Unpub. LEXIS 1334* (N.J. Super. Ct. App. Div. Feb. 20, 2007) .

(n200)Footnote 200. Matthews, FTC Informal Staff Letter (May 17, 1993); Krisor, FTC Informal Staff Letter (Mar. 3, 1992).

(n201)Footnote 201. *See § 8.03[2][c].*

(n202)Footnote 202. *Evory v. Nat'l Action Fin. Servs., Inc., 505 F.3d 769 (7th Cir. 2007)* ("[w]e conclude that any written notice sent to the lawyer must contain the information that would be required by the Act if the notice were sent to the consumer directly." (*citing* National Consumer Law Center, *Consumer Credit Law Manual § 8.02[5][b]* (2004); Cf. *Heintz v. Jenkins, 514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995).* Contra *Guerro v. RJM Acquisitions L.L.C., 499 F.3d 926 (9th Cir. 2007)* .

(n203)Footnote 203. *Clark's Jewelers v. Humble, 823 P.2d 818 (Kan. Ct. App. 1991)* (debt collector violated § 1692g(b) where it failed to provide verification of the debt, but continued to send dunning letters in care of consumers' attorney). *See also* Cass, FTC Informal Staff Letter (Dec. 23, 1997) (may not report debt to credit reporting agency after a dispute during the validation period until the debt is verified).

(n204)Footnote 204. *Spencer v. Hendersen-Webb, Inc., 81 F. Supp. 2d 582 (D. Md. 1999)* (offer to settle was deemed an effort to collect the debt; therefore, collector violated § 1692g(b) by making the offer and by failing to cease collection until debt was verified); *Johnson v. Statewide Collections, Inc., 778 P.2d 93 (Wyo. 1989)* .

(n205)Footnote 205. *See In re Young, 280 B.R. 864 (Bankr. S.D. Ala. 2001)* (consumer awarded $1000 where the

collector violated § 1692g(b) by taking an administrative garnishment without responding to a debt dispute letter); Taylor v. Fink, Case No. 93 C 4941, *1994 U.S. Dist. LEXIS 16821* (N.D. Ill. Nov. 23, 1994) . *See also* Castle, FTC Informal Staff Letter (June 13, 1995) (debt collector may not attempt to reduce a disputed claim to judgment without providing the verification required by *15 U.S.C. § 1692g(b)*). *See Zaborac v. Mutual Hosp. Serv., Inc., 2004 U.S. Dist. LEXIS 22816* (S.D. Ind. Oct. 7, 2004) (once the consumer's attorney has requested verification of the debt, the collector has two choices: (1) provide verification to the attorney or (2) cease attempts to collect the debt. The collector may continue settlement negotiations initiated by the consumer's attorney.).

(n206)Footnote 206. Mezines, FTC Advisory Opinion (Mar. 31, 2000), *available at* http://www.ftc.gov/os/2000/04/fdcpaadvisoryopinion.htm.

(n207)Footnote 207. *Law Offices of David Stern, P.A. v. Martinez, 311 F.3d 1272 (11th Cir. 2002)* .

(n208)Footnote 208. *In re Martinez, 271 B.R. 696* (S.D. Fla. Dec. 28, 2001) , *aff'g 266 B.R. 523* (Bankr. S.D. Fla. May 30, 2001) .

(n209)Footnote 209. *128 F.3d 497 (7th Cir. 1997)* .

(n210)Footnote 210. *Shimek v. Forbes, 374 F.3d 1011 (11th Cir. 2004)* .

(n211)Footnote 211. *Thomas v. Law Firm of Simpson & Cybak, 392 F.3d 914, 920 (7th Cir. 2004)* .

(n212)Footnote 212. *15 U.S.C. § 1692k(e)*.

(n213)Footnote 213. *See* National Consumer Law Center, Fair Credit Reporting Ch. 6 (6th ed. 2006).

(n214)Footnote 214. *See Mahon v. Credit Bureau, 171 F.3d 1197 (9th Cir. 1999)* .

(n215)Footnote 215. *See Campbell v. Credit Bureau Sys., Inc., 2009 WL 211046* (E.D. Ky. Jan. 27, 2009) (*pro se* consumer adequately rebutted the debt collectors' affidavits that they had mailed a debt verification notice with his affidavit that he was changing addresses at the time of the mailing; debt collectors' affidavits failed to say the notices were not returned by the post office).

(N216)Footnote 216. *15 U.S.C. § 1692g(c)*.

(n217)Footnote 217. *15 U.S.C. § 1692h*.

(n218)Footnote 218. *15 U.S.C. § 1692i*.

(n219)Footnote 219. *Fox v. Citicorp Credit Servs., Inc., 15 F.3d 1507 (9th Cir. 1994)* ; *Scott v. Jones, 964 F.2d 314 (4th Cir. 1992)* ; *Crawford v. Credit Collection Servs., 898 F. Supp. 699 (D.S.D. 1995)* . *See also Addison v. Braud, 105 F.3d 223 (5th Cir. 1997)* (attorney who failed to bring action in the judicial district where the debtors resided or had signed the promissory note violated *15 U.S.C. § 1692i*), *amended, reh'g denied, 1997 U.S. App. LEXIS 5570* (5th Cir. Mar. 21, 1997) ; *Wadlington v. Credit Acceptance Corp., 76 F.3d 103 (6th Cir. 1996)* (attorneys who filed suit on behalf of a financier were debt collectors and subject to liability under the FDCPA for filing suit in venue not permitted by *15 U.S.C. § 1692i(a)(2)*, but court remanded on issue of whether venue protection was waived by the sales contract).

(n220)Footnote 220. *Shapiro & Meinhold v. Zartman, 823 P.2d 120 (Colo. 1992)* , *aff'g Zartman v. Shapiro & Meinhold, 811 P.2d 409 (Colo. Ct. App. 1990)* .

(n221)Footnote 221. *Newsom v. Friedman, 76 F.3d 813 (7th Cir. 1996)* (the term "judicial district or similar legal entity" meant the trial court of original jurisdiction, not the subdivisions of the trial court); *Fox v. Citicorp Credit Servs., Inc., 15 F.3d 1507 (9th Cir. 1994)* (state provided a formal transfer mechanism between courts in different counties,

thus, county was the "judicial district or similar legal entity"); *Blakemore v. Pekay, 895 F. Supp. 972 (N.D. Ill. 1995)* ; *Crawford v. Credit Collection Servs., 898 F. Supp. 699 (D.S.D. 1995)* ; *Dutton v. Wolhar, 809 F. Supp. 1130 (D. Del. 1992)* .

(n222)Footnote 222. *Dutton v. Wolhar, 809 F. Supp. 1130 (D. Del. 1992)* (although the State of Delaware provided for statewide jurisdiction of civil actions, suit must be brought by an attorney collector in the county in which the consumer resided or where the contract was signed to avoid violation of *15 U.S.C. § 1692i(2)*).

(n223)Footnote 223. *Fox v. Citicorp Credit Servs., Inc., 15 F.3d 1507 (9th Cir. 1994)* (application for a writ of garnishment is a "legal action on a debt" covered by *15 U.S.C. § 1692i* restrictions). *See 15 U.S.C. § 1692i(a)(1). See also Dale v. Johnson, 1997 U.S. Dist. LEXIS 20277* (N.D. Cal. Dec. 12, 1997) (*pro se*) (claim under *15 U.S.C. § 1692i*--that the court action to enforce an arbitration award should have been instituted in another county--should have been raised in the state court proceeding and not in federal court).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 8 Fair Debt Collection

1-8 Consumer Credit Law Manual § 8.04

§ 8.04 Availability of a Private Fair Debt Collection Practices Act Cause of Action

[1] Private Remedy Is Primary Enforcement Mechanism

A debt collector who violates the FDCPA while collecting a consumer debt is usually subject to suit by "any person" affected by the violation. The Act grants federal and state jurisdiction, and the successful plaintiff may recover actual damages, statutory damages, attorney fees, costs, and, perhaps, punitive damages and injunctive relief. A plaintiff may also maintain a class action, if the requirements of the Act and the applicable state or federal procedural rules for class action are met. Congress intended private action to be the main vehicle for enforcing the Act. Thus consumers enforcing compliance with the Act are acting as "private attorneys general." n1

[2] Cases and Parties Must Be Carefully Evaluated

[a] FDCPA Awards Increasing

A survey of FDCPA cases indicates that actual damages awarded averaged $1,000 to $3355, statutory damages averaged $850 to $1632, and attorney fees averaged $3948 to $6334. The high award of actual damages was $15,500, statutory damages was $27,000, and attorney fees was $40,000. Comparing recent awards to the earliest FDCPA awards, there appears to be a decided upward trend in the size of the awards.

There is a growing number of class actions under the FDCPA.

[b] A Wide Range of Parties Plaintiff May Be Named Under the Act

There are abundant possibilities for multiple plaintiffs in private actions under the Act because the private right of action is available not only to "consumers," but also to "any person" affected by a violation; most provisions of the Act protect everyone, not just consumers, affected by violations occurring during the collection of consumer debts. Therefore, friends, relatives, neighbors, a debtor's executor or an employer, even though not obligated or alleged to be obligated on a debt, might be properly joined as plaintiffs in an action under the Act. n2 The equities of a case may be improved with the joinder as plaintiffs of nondebtors whose claims may create additional sympathy.

[c] A Wide Range of Parties Defendant May Be Named Under the Act

There are also numerous possibilities for multiple defendants in private actions under the Act. The definition of "debt collector" includes a debt collector's employees who violate the Act, as well as their attorney. n3

If a forms supplier designs a letter giving the false impression that the designer or another third party, such as a government agency, is involved in collecting the debt, the forms supplier is liable for violating *15 U.S.C. section 1692j*.

Corporate officers may be named as defendants where they are involved in establishing or carrying out the violative policies of the corporation. n4 If a law partner is liable under the FDCPA, the partnership may also be liable under state partnership principles. n5

By piercing the corporate veil, the owner of a collection agency may be held liable for FDCPA violations committed by agency employees. n6 A franchisor may be liable for those acts of its franchisee debt collector which it controls. A state claim is usually the best course regarding creditor's debt collection activities.

[d] Parties to a Private FDCPA Action Are Entitled to a Trial by Jury

The *Seventh Amendment to the United States Constitution* guarantees the right to a jury trial in FDCPA private actions. n7 Since an FDCPA action is similar to types of actions recognized at common law and Congress did not address the issue, the *Seventh Amendment* guarantees the right to a jury trial to any party in an FDCPA action.

[3] Actual Damages Are Available to Any Person Injured by a Violation of the Act

This provision n8 establishes a cause of action for actual damages sustained by any person as a result of a failure of a collector to comply with any provision of the FDCPA.

[a] "Actual Damages" Are Defined Broadly by the Courts

Actual damages commonly include pecuniary losses, such as lost wages, the cost of obtaining an unlisted telephone number, and physical injuries, such as heart attacks, ulcers, vomiting, and insomnia. In addition, the courts commonly allow recovery of damages for emotional distress n9 and relational injuries under the FDCPA.

[b] Some Proof of Actual Damages Must Be Offered

Nonpecuniary damages must be based on evidence. n10

The FDCPA does not establish a legal limitation on compensable injuries that were caused in fact by a violation of the Act. The words "sustained ... as a result of" in *15 U.S.C. section 1692k(a)(1)* imply that only causation in fact (a showing that the injury suffered was in fact caused by the violation proved) must be established by direct connection to the violation.

When seeking summary judgment on liability involving multiple violations, consumer's counsel generally seek partial summary judgment on liability only postponing a decision on damages. This conserves court and litigation resources by dealing with only those damage claims supported by the summary judgment. Damages may be the subject of a later motion for summary judgment or trial. n11

[c] Class Actions for Actual Damages May Be Maintained

[i] Common Questions Required for Class Actions

Some violations of the FDCPA raise common questions of fact and law as to liability; these questions must predominate

over individual questions of liability. This predominance is a major requirement for class actions seeking damages, whether actual or statutory. n12 Predominance is present when, for example, one of the routine form letters sent by a collector violates the Act (e.g., because it falsely threatens legal action or simulates legal process), and this violation is the only one for which recovery is sought.

Commonality, predominance, and typicality are more problematic when a collector's practices or policies vary from consumer to consumer.

Predominance of common questions may be shown by evidence that the named plaintiff's injury resulted from the collector's routine business policy, pattern, or practice. A collector with many employees may have training materials or instructions for new employees. A collector that has many branch offices may have an operations manual or instructions for its local managers. Former employees of the collector, having little reason to protect the collector from liability, may provide evidence of its business practice.

Typicality of the named plaintiff's claim is largely an issue of standing. n13 The named plaintiff's claim must be typical of the claims of the class, and the named plaintiff must have standing to assert the claim.

[ii] Manageability of Class Action

The manageability of the class, required by Federal Rules of Civil Procedure Rule ("FRCP") 23(c)(3) and similar state laws, is another likely issue. The most common manageability problem is the need for individual proofs of damages caused by a common violation. This need arises because most FDCPA violations produce different kinds and amounts of actual damages, depending upon the circumstances and susceptibility of each victim.

Individual proofs of damages do not preclude a class action, although they do pose administrative difficulties. n14

Counsel should consider an FDCPA class action for damages when:

- The common factual and legal questions regarding liability predominate over individual questions;

- One of the management tools for dealing with individual proofs of damages is appropriate to the case or individual proofs of damages are unnecessary; and

- The victim's attorney has adequate resources to commit to the case. If there are manageability or resource problems with a class action for actual damages, counsel might consider a class action limited to statutory damages or injunctive relief.

[4] Statutory Damages

[a] Statutory Damages Up to $1,000 Are Available in an Individual Action

These provisions n15 permit courts to award any person affected by noncompliance statutory damages of up to $1,000. To the extent that these parallel provisions of the TILA n16 (after which this provision was modeled), cases decided under that Act may be helpful in construing these provisions.

[b] A Court Must Grant Statutory Damages When a Violation Contravenes the Purposes of the Act and Some Basis Is Provided for Statutory Damages

Generally, statutory damages are not discretionary: "A debt collector who violates the Act is liable for ... any additional damages the court deems appropriate, not exceeding $1,000. In assessing damages, the court must take into account the nature of the violation, the degree of willfulness, and the debt collectors persistence." n17

The legislative history also suggests that individual statutory damages need not be awarded or may be nominal in amount (less than $100) only if the violation is technical (that is, only if it does not affect the Act's purposes). Where the statutory factors of frequency, persistence, nature of violation, and intent are not demonstrated, statutory damages may be denied. Recovery of actual damages is not a prerequisite to an award of statutory damages. n18 Even in the rare case where no actual or statutory damages are awarded, attorney fees and costs are mandatory if the plaintiff has proven a violation of the FDCPA. n19

[c] In Determining Statutory Damages, Courts Must Consider the Intent, Frequency, Persistence, and Nature of the Noncompliance

This section n20 requires courts to consider these four factors in determining the amount of statutory liability in individual action. It also permits the courts to consider other relevant factors. Three of the required factors were borrowed from the class action provisions of the TILA n21 and the punitive damages provisions of the Equal Credit Opportunity Act ("ECOA"). n22 The "nature of such noncompliance" n23 is a factor unique to the FDCPA.

[i] Enhancing Statutory Damages

The courts award higher amounts when they view the violation as aggravated or egregious n24 and lower amounts when the violation is considered less serious. n25

Factors which courts have mentioned or which appear to play a role in increasing statutory awards are:

- The collector's intent to do the act which violated the FDCPA or to evade the FDCPA's protections;
- The collector's intent that its illegal action injure the consumer;
- The collector's sophistication, giving it reason to know the FDCPA's requirements;
- The clarity of the requirements the collector violated;
- The collector's persistent denial of its violative act;
- A failure to bring its action within compliance despite ample time to do so;
- Prior violations and liability of the collector for the same illegal act;
- Multiple violations;
- Multiple consumers affected by the same type of violations;
- Multiple debts whose collection involved the same violation;
- Repetition of the illegal act;
- The importance attached to deterrence by the court;
- Publicity or potential publicity connected with the violation;
- The consumer's injury;

- Egregiousness of the violation; and
- The existence of collector's liability insurance.

Minimum statutory damages often may be awarded where the only violation is the failure to provide statutorily required notices and no consumer injury is alleged.

[ii] Factors Reducing Statutory Damage

Additional factors mentioned by the courts as reducing the amount of statutory awards include:

- A single violation;
- The technical nature of the violation;
- Cessation of the violation when first brought to the collector's attention;
- A collector's seeking to comply by obtaining legal advice;
- Lack of persistent, frequent violations;
- The lack of consumer injury;
- The absence of intent to deceive or harass the consumer;
- The recent passage of the statutory requirement; and
- Seeking less than maximum statutory damages.

[d] An Award of Statutory Damages Is Not Necessarily Related to an Award of Actual Damages

An award of actual damages is not a prerequisite to the recovery of FDCPA statutory damages. n26

[e] Multiple Statutory Damages

[i] Each Person Affected by Violation of the FDCPA May Be Entitled to Recover a Separate Statutory Award for Each Violation

Generally, awards of damages under FDCPA are limited to $1,000 per action, not $1,000 per communication or per violation. n27

[ii] Multiple Statutory Damages for Multiple Violations

Years after the passage of the Act, there is still no definitive law, except in the Sixth and Eleventh Circuits, on whether the FDCPA maximum statutory damages of $1,000 applies to each violation, contact, injured person, debt, or suit. The major reasons are that multiple maximum FDCPA statutory damages are seldom sought and that some courts award less than the maximum for multiple, less egregious violations. Other courts allow multiple, maximum statutory damages on the basis of multiple injured persons. However, many courts in dictum indicate that the maximum statutory damages apply to each suit. n28

[iii] Multiple Statutory Damages for Multiple Victims

Judicial limitation of the $1,000 maximum statutory damages to each consumer in each FDCPA suit produces anomalous results. Some courts have limited the recovery of statutory damages to a maximum of $1,000 regardless of the circumstances, while others have avoided deciding this issue.

The limitation to only $1,000 statutory damages to each plaintiff in each suit regardless of the number of violations and violators also contravenes the express congressional purpose of improving consumer redress and eliminating abusive collection practices. n29 The legislative history of *15 U.S.C. section 1692k(a)* is entirely consistent with allowing each consumer to recover up to $1,000 in statutory damages against each debt collector for each violation of the FDCPA.

It only makes sense, given this legislative history and purpose, that a debt collector who engages in a series of serious FDCPA violations be subject to greater potential sanctions than one who commits fewer, less serious violations. This can best be accomplished by tying the $1,000 maximum to each violation and violator rather than to each consumer, suit or debt. Since the FDCPA gives the courts discretion in setting the amount of statutory damages, the danger of awards disproportionate to the degree of collector culpability is minimized.

Courts should respond to congressional intent and the explicit purposes of the FDCPA by granting each consumer a separate statutory damage award for each violation of the Act.

[5] Punitive Damages

[a] Punitive Damages May Be Recovered in Addition to Actual or Statutory Damages in a Supplemental State Claim

The FDCPA does not specifically mention the availability of punitive damages in appropriate cases for FDCPA violations. In many states, the easier approach is simply to seek punitive damages in a tort or state statutory claim n30 as a supplemental claim or separate claim from the FDCPA claim.

[b] Punitive Damages in Supplemental State Claim

Punitive damages have been awarded by courts for violation of a state's debt collection laws or of a state's consumer protection statute. n31 A consumer may also recover both three times actual damages on a UDAP claim and statutory damages under the FDCPA. n32

[c] Punitive Damages Under the FDCPA

While a good argument may be made for awarding punitive damages under the FDCPA, the first court to address the issue in detail rejected the availability of FDCPA punitive damages. n33 In the absence of specific federal statutory guidance, federal courts may determine that it is within their authority to award punitive damages in appropriate cases. There is no evidence of congressional intent to prohibit punitive damages and permitting punitive damages furthers the purposes of the FDCPA.

Congress intended the FDCPA to eliminate abusive collection practices. n34 Awards of punitive damages in egregious cases further this purpose by making an example of violators, thus deterring emulation of their practices by other collectors.

However, punitive damages, in addition to a statutory award, may be inappropriate in a class action under the Act as a form of double recovery.

[6] FDCPA Provides Statutory Damages in Class Actions

[a] Rule 23 and FDCPA Requirements for FDCPA Class Statutory Damages

Particularly where the FDCPA action arises from the collector's standardized forms or practices, n35 class action treatment is appropriate. n36 These provisions, along with Rule 23 of the FRCP, provide for class actions seeking statutory damages. Under the FDCPA, each named plaintiff in a class action is entitled to the same statutory award as in an individual action; the maximum recovery for class is the lesser of $500,000 or one percent of the net worth of the debt collector.

Rule 23 of the FRCP must be met for a case to proceed as a class action. Failure to meet any of the four requirements of Rule 23(a), i.e., numerosity, commonality, typicality, or representativeness, will result in denial of certification. n37 At the urging of defendants courts have recently exercised their discretion to bifurcate class certification from the merits and ordered the class certification stayed until resolution of liability, which plaintiffs asserted would require them to develop expensive expert testimony earlier than planned. n38

[b] Increasing Class Recovery of Statutory Damages

One method of increasing a class' recovery in a manner consistent with the FDCPA's net worth limitation is to increase the number of defendants to include an owner-operator or parent corporation.

Another problem in recovering one percent of the debt collector's net worth is accurately determining the collector's net worth. If the debt collector's shares of stock are traded publicly, some indication of the collector's net worth may be determined from financial reports prepared for investors. In some states, financial information on a particular debt collector may be available from a state regulator or licensor. The courts have been reluctant to consider a collector's fair market value, preferring book value, to determine net worth. n39 Discovery of "net worth" of debt collector is appropriate in FDCPA class action. n40

[c] Factors Determining Amount of Class Statutory Damages

Once a court determines the maximum amount of class statutory damages, it must consider the six factors listed in the FDCPA to determine whether the maximum recovery or some lesser amount is appropriate. These factors are:

- The frequency of the debt collector's noncompliance;
- The persistence of its noncompliance;
- The nature of its noncompliance;
- The debt collector's resources;
- The number of persons adversely affected; and
- The extent to which the debt collector's noncompliance was intentional. n41

The trier of fact determining these issues may be either a judge or a jury. It may also consider other factors in arriving at a suitable award, but is not required to do so. Courts may consider such factors as the amount recovered by each class member and the defendant's failure to comply with the Act despite prior suits.

The six required factors are similar to those used in determining punitive damages (malice or intent, outrageousness of the conduct, and resources of the defendant). Courts will probably not award punitive damages to a class on top of statutory damages.

FDCPA class actions seeking statutory awards must also conform to the requirements of Rule 23(a) and (b)(3) of the FRCP.

[7] Proof of Debt Collector's Intent Is Not Required

The FDCPA, like the TILA, is a strict liability statute (that is, a statute that imposes liability for any failure to comply, without regard to the violator's intent). n42 However, "the extent to which the debt collector's noncompliance was intentional" is one factor to be considered in setting the amount of statutory (but not actual) damages in both class and individual actions. n43 The debt collector can defend itself from liability for violations only by showing that they were unintentional, that they resulted from good faith error, and that the debt collector maintained procedures reasonably adapted to avoid such errors. n44

[8] Successful Plaintiffs Are Entitled to Awards of Costs and Reasonable Attorney Fees

This provision n45 establishes an entitlement to awards of costs and reasonable attorney fees to prevailing plaintiffs. The Seventh Circuit explained: "The reason for mandatory fees is that Congress chose a 'private attorney general' approach to assume enforcement of the FDCPA." n46 However, the Fourth and Fifth Circuits have indicated that the consumer's attorney fee may be greatly reduced where there is little success n47 or no award of FDCPA damages. n48

[a] Attorney Fee Awards

[i] Truth in Lending Act and Civil Rights Precedents

The FDCPA attorney fee provision is identical to that found in the TILA, n49 so the numerous Truth in Lending ("TIL") cases should be important in interpreting attorney fees under the FDCPA. In addition, federal court decisions interpreting the Civil Rights Attorney's Fees Award Act n50 and other federal laws providing attorney fees for prevailing plaintiffs are frequently relevant. n51

[ii] Who Is Entitled to the Fee Award: The Attorney or the Client?

The FDCPA, like the TILA, states that the creditor "is liable to such person [i.e., the consumer] in an amount equal to the sum of ... [the damage award and the] attorney's fee." n52 Thus fees are usually paid directly to the consumer and not the consumer's attorney, allowing the consumer and his or her attorney to determine the attorney's compensation. n53

[iii] Individuals Appearing *Pro Se*

Courts award no fees for work done by *pro se* litigants, irrespective of whether that litigant is an attorney. n54

[iv] Calculating the Attorney Fee Award

[A] Determining Entitlement to an Award and the Lodestar

While the award of attorney's fees to a successful FDCPA litigant is mandatory, the amount of court-awarded attorney fees is in the trial court's discretion, and an appellate court will only review the amount for an abuse of discretion or a misapplication of the law. n55 The U.S. Supreme Court and the circuit courts have developed standards for calculating these awards, and failure to follow these standards or even failure to show clearly that these standards were followed may be an abuse of discretion.

In calculating fees, courts begin with a "lodestar." The lodestar is the number of allowable hours times an hourly rate.

There is a strong presumption that the lodestar amount represents an adequate and appropriate fee award. n56

With the exception of delay in receiving award proceeds, upward adjustments to the lodestar are largely unavailable. n57 The lodestar may still be adjusted downward in cases of meager success on significant fee-shifting issues, discrepancies in billing documentation, overreaching on hours or rates claimed, or similar doubts regarding attorney credibility and billing judgment. n58 While most of this publication's discussion of attorney fees focuses on the lodestar method of awarding attorney fees, it is important to note that many courts use a common fund approach to awarding attorney fees in class actions. Stressing the freedom of clients to contract with the attorneys, the Supreme Court held that a $406,000 contingent fee (40% of the total recovery) that exceeded the $117,000 lodestar fee determined by the court was permissible and not inconsistent with the federal civil rights statute's fee shifting policies. n59 While the Supreme Court did not rule on ethical issues, other courts have allowed a contingent fee in a claim involving a fee shifting statute. n60 Some courts have approved of the fee agreement providing the greater of the loadstar award or a percentage contingent fee but have disallowed fee agreements for both a contingency and the loadstar award. n61

Where the consumer action involves a class action with recovery of attorney fees from a common fund, the normal percentage used is twenty to thirty percent, n62 with forty to fifty percent being the upper limit. n63 Smaller percentages are on occasion used in cases involving large funds. n64

[B] Determining the Allowable Hours

The allowable hours are those hours claimed and documented by the attorney that were reasonably expended. Excessive, non-productive or duplicative time will not be allowed, just as an attorney in private practice should not bill such time to his or her client. n65 An expert's affidavit on the reasonableness of the hours may be useful to the court determination of the reasonableness of the hours expended. n66

The total number of hours spent on the case will also be reduced where the consumer failed to prevail on non-FDCPA claims that were unrelated to the successful FDCPA claim where these claims are based on different facts and legal theories so that work on one claim does not help the attorney prepare for the other. n67 But where there is a common core of facts or where the legal theories are related, fees will be awarded.

[C] Establishing the Hourly Rate

Once the number of allowable hours are determined for each attorney and paralegal, an hourly rate must be determined for each advocate. That hourly rate is based on the prevailing rate in the community for that level of legal skill and experience. n68 Rates of $300 to 400 per hour were reasonable in 2002 for a lawyer with a great deal of experience handing FDCPA cases. n69

[v] Fee Applications

The FRCP require motions for attorney fees and expenses to be filed and served no later than 14 days after judgment. n70 However, all that is required in this time period is notice to the court and to the opponent that fees will be sought and a fair estimate of the total fees and expenses claimed. A detailed record of hours and rates, affidavits, time records, fee surveys, and other supporting evidence and briefs may be submitted following the motion for fees, "in due course."

[vi] Appealing Attorney Fee Awards

[A] Attorney May Pursue Appeal on Adequacy of Attorney Fee Award

If the action is successful, but the attorney fee award is inadequate, this issue alone may be appealed. n71 This is the case even if the consumer does not wish to pursue the award; the attorney has standing to pursue the appeal. An appeal of a low award needs to be carefully considered because the lower court's decision is reversed only for an abuse of

discretion. n72 However, if the lower court failed to state the valid legal reasons for the reduction from the lodestar, the decision will be remanded for an explanation. n73 Time spent on such a successful appeal, and also spent before the trial court justifying fees, should also be included in the attorney fee award.

[B] Fourth and Seventh Circuit Courts of Appeal Differ on Approach to FDCPA Attorney Fee Awards

In two cases involving the appropriate measure and standard of review of consumer's FDCPA attorney fees where the collection attorney omitted the *15 U.S.C. section 1692e(11)* debtor warning, the Fourth and Seventh Circuit went in different directions. The Seventh Circuit reversed the district court, which had reduced the lodestar to $10,132.50 by using an hourly rate of $150 instead of the requested rates of $275 and $225 for the consumer's two counsel. The Appellate Court remanded, requiring the requested rate be used to calculate the attorney fees. n74

The Fourth Circuit affirmed the district court's award of $500 in attorney fees n75 in a case which had previously been reviewed by the Fourth Circuit, and in which the U.S. Supreme Court had denied certiorari. n76 The consumer's attorney had sought an award of $9783.63 in fees. In contrast to the decision of the Seventh Circuit in *Tolentino*, the Fourth Circuit paid scant attention to the congressional intent to encourage private enforcement. Rather, it found that other factors should be given significant weight: deference to the discretion of the district court and the low level of success. n77

[b] Tactical and Ethical Factors in Negotiating Settlement Containing Attorney Fees

Obtaining a settlement which satisfactorily resolves both the merits and the attorney fee award requires close attention.

The safest route, if the collector's attorney is flexible, is to settle the substantive claims with an explicit provision that the issue of the consumer's attorney fees will be specifically reserved for the court or for subsequent negotiations between the parties. However, some adversaries may be unwilling to agree to such terms without significant concessions, as fees in FDCPA cases may constitute the greater part of the overall liability for the collector.

It is dangerous to leave the settlement agreement silent on the issue of attorney fees, and then to go into court post-settlement seeking attorney fees. Although the Third and Ninth Circuits find no waiver of attorney fees implicit in the settlement's silence on this topic, n78 other circuits take the opposite view. n79

Evans v. Jeff D. n80 thus suggests that, if there are special reasons to avoid simultaneous negotiation of the merits and fees, the plaintiff's attorney could seek the court's assistance before any settlement, not after.

[9] Declaratory or Injunctive Relief in Individual and Class Actions

Consumers have obtained class injunctive relief for FDCPA violations in the form of consent decrees, despite significant case law holding that no private injunctive relief is available under the FDCPA.

Declaratory relief is available under the FDCPA. n81 The basis for declaratory relief is found at *28 U.S.C. sections 2201* and *2202*.

The FDCPA is silent on the availability of injunctive relief in private actions enforcing the Act. The FTC, the principal enforcement agency, is empowered to pursue violations by means of cease and desist orders and injunctions. n82

The prudent cause of action may be to seek declaratory relief under the FDCPA and to request injunctive relief pursuant to a pendent state statute. n83 The Third Circuit found private injunctions were not available under the FDCPA and went on to state that FDCPA declaratory relief was not available either. n84

The Ninth Circuit affirmed a judgment of contempt against a check collection agency in *Irwin v. Mascott*, n85 awarding $10,000 in sanctions and an additional amount of attorney fees for the consumers. The decision illustrates the advantage of a state supplemental claim for injunctive relief to assure a small debt collector's future compliance with the law where the small collector's illegal debt collection methods seemed entrenched and its resources were very limited. n86

The consumers had brought a class action against the check collector some years before. n87 The consumers had won partial summary judgment including prevailing on FDCPA claims and a supplemental state claim for restitution and injunctive relief. n88 Subsequently the parties agreed to settle the case, including injunctive relief, with substantial damages distributed to the class and substantial attorney fees to their counsel. The settlement was approved by the court. When it became apparent that the defendant was not complying with the injunction, the consumers sought civil contempt sanctions and additional attorney fees.

The core claim that was later the subject of the contempt proceeding involved the collection fees sought by the collector. The collector generally sought to recover dishonored checks. It routinely sought interest which was not permitted by state law. It sought postal expenses in excess of the actual postal expense permitted by state law. It sought treble the check amount without complying with the state requirements of first demanding the amount of the check in a certified letter. The court also found that labeling an amount significantly in excess of the face amount of the check as the "Assignment amount" or the "Claim amount" was deceptive violating the FDCPA. n89 These deceptive collection fee practices also violated California law, and the consumers obtained restitution of those fees under state law. n90 Declaratory and injunctive relief was granted for both the state and FDCPA violations. n91

Consent decrees have sometimes included prophylactic measures to prevent violations of the FDCPA. As such, these may apply more detailed requirements to the collector than the usual reading of the FDCPA.

Declaratory or injunctive remedies for class relief are desirable when the collector's violations are part of a pattern or practice affecting a large number of people. Class action requirements for declaratory or injunctive relief are considerably less than those for damages. The problems encountered in proving and distributing damages or identifying class members are not raised by class actions seeking declaratory or injunctive relief. n92

The named plaintiff must be subject to the same substantial, immediate threat of irreparable injury as the class seeking the injunction.

[10] FDCPA Provides a One-Year Statute of Limitations for Private Actions

For many victims of FDCPA violations, such as recipients of abusive phone calls, the one year period n93 for bringing suit is not a problem because they generally complain to a lawyer at the time of the abuse or not at all. n94 Victims of other violations may not initially be aware of the violations' existence. These include consumers falsely threatened with suit or with being reported to a credit reporting agency, and consumers not provided with a validation notice. n95 In such cases, the ordinary rule in fraud cases, that the limitation period should not commence until the consumer should have known of the violation, should arguably apply.

A time-barred claim may, nevertheless, be useful for establishing a pattern of abuse. n96 While some courts have held that the statute of limitations may be tolled, for instance, by the filing of a subsequently dismissed class action, by the plaintiff refraining from commencing suit at the defendant's inducement, or by the defendant fraudulently concealing the violation, n97 decisions that the FDCPA limitations period is jurisdictional lead them to reject equitable tolling rules. n98

The Eighth Circuit held that the FDCPA statute of limitations is jurisdictional and that the *Fed. R. Civ. P. 6(a)* counting rule should be disregarded for purpose of deciding whether to count the day of the violation for calculating the one-year limitation period. n99 Courts have held that the one-year limitation period in the FDCPA is not subject to waiver or

tolling. n100

The Seventh Circuit rejects the notion that the FDCPA statute of limitations is jurisdictional and can be raised for the first time on appeal. n101 The Sixth Circuit recently held in an unreported decision that each monthly report by a debt buyer to a credit reporting agency is a separate act that could violate the FDCPA and start a new statute of limitations period. n102 The Sixth Circuit noted that section 1692g requires the debt buyer to cease collecting the debt until it verified the debt. Each subsequent communication before the debt was verified was a separate violation of the FDCPA for purposes of the statute of limitations. Each monthly report to the consumer reporting agency gave rise to separate violations of the FDCPA. The fact that some of the violations were time-barred did not mean the same type of violations arising from the more recent reports were time-barred. Each credit report was an opportunity for a new set of discrete violations.

[11] Jurisdiction Over Violations of the FDCPA

[a] State and Federal Courts Have Concurrent Jurisdiction Over Private Civil Actions Under the FDCPA

This provision n103 establishes concurrent jurisdiction in United States district courts and in competent state courts over FDCPA actions, regardless of the amount of money in controversy.

State courts that are competent to hear claims analogous to FDCPA claims, such as tort claims, cannot refuse to hear an FDCPA claim simply because it is based on a federal statute. A defendant may, however, remove an FDCPA suit from state court to federal court if the federal courts would have original jurisdiction over it. n104 Bankruptcy courts may have jurisdiction over an FDCPA claim listed as an asset of the estate.

[b] Personal Jurisdiction and Venue May Be Obtained Over Out-of-State Collectors

A state long-arm statute subjects nonresident individuals or corporations to the *in personam* jurisdiction of local courts on the basis of their having performed some act affecting the state. Federal procedure uses the long-arm statute of the forum state, n105 which may allow fairly extensive service on nonresidents. Long-arm statutes commonly allow jurisdiction over anyone who engages in "the transaction of any business within this State" or "the commission of a tortious act within this State" related to the cause of action. Collecting debts from state residents qualifies as transacting business within the state.

[i] U.S. District Court Venue

Proper venue over a suit by a consumer against a corporate defendant is likely to arise in conjunction with long-arm jurisdiction issues. Venue is generally proper where the consumer received a dunning message alleged to violate the FDCPA.

[c] State Law Claims Closely Related to an FDCPA Claim May Be Joined in Federal Suits

Supplemental jurisdiction, defined in *United Mine Workers v. Gibb*, n106 allows a federal court considering a federal claim to hear a closely related state claim that lacks an independent basis for federal jurisdiction. Thus, a federal court considering a substantial federal claim should exercise its power to assume supplemental jurisdiction over a closely related state claim requiring little or no additional commitment of court resources and raising no novel issues of state law or policy.

Courts will probably allow supplemental jurisdiction over claims arising from provisions of debt collection statutes that parallel those of the FDCPA and that are based on closely related FTC and state tort law. A supplemental state claim may provide greater relief to a consumer than the FDCPA claim.

The likelihood that a federal court will exercise its power to hear a supplemental state claim is ultimately a function of two variables: the extent to which evidence of the state claim intertwines with evidence of the federal claim and the quantity of judicial resources required to handle the supplemental state claim. When a district court has dismissed all federal claims within a complaint, and diversity jurisdiction did not exist over the remaining state statutory and/or common law claims, the court had discretion to retain, dismiss, or remand the remaining state law claims pursuant to *28 U.S.C. section 1367*. n107

[d] Federal Courts May Permit Joinder of Parties Subject to a State Law Claim Closely Related to an FDCPA Claim

Supplemental party jurisdiction might allow the consumer to join a creditor in a state claim closely related to an FDCPA claim, but the doctrine gives the same basis to decline to exercise it. n108

[12] Federal Agencies Responsible for Administrative Enforcement of the FDCPA

[a] Administrative Enforcement

The FTC is the primary administrative enforcer of the FDCPA because it oversees debt collection agencies, finance companies, retailers, certain mortgage companies, state-chartered savings banks, and state credit unions. A court may treat an FDCPA violation as a violation of the Federal Trade Commission Act. n109 This enables the FTC to issue an administrative cease and desist order or to obtain a consent decree for a violation of the FDCPA. A court may also treat an FDCPA violation as a violation of an FTC trade regulation rule, permitting the FTC to go to a federal district court to obtain restitution, damages, n110 or a civil penalty of up to $10,000 for each knowing violation. n111 Various federal financial agencies enforce the FDCPA among the financial institutions they regulate. n112

[b] FTC Informal Staff Letters and Formal Advisory Opinions

Since the FDCPA became law, the FTC Division of Credit Practices has written hundreds of public informal staff letters interpreting the Act's application to particular people and collection practices. The letters respond to questions from both industry and consumers, but are not binding.

[13] Relation of the FDCPA to State Laws

[a] FDCPA Preempts Inconsistent State Law Provisions

The FDCPA does not preempt state laws providing greater protection to consumers than it provides. n113 Thus, the FDCPA establishes federal minimum standards for debt collectors that state law may supplement or increase. n114 Tort actions for debt collection abuse are not preempted by the Fair Debt Collection Practices Act. The only judge to have found that a state debt collection harassment tort claim was preempted by the FDCPA n115 later overruled himself n116 and found there was no preemption, after his earlier decision was criticized and not followed. n117 Tort actions for debt collection harassment are frequently pursued because they offer the consistent, more protective remedy of punitive damages in egregious cases. The FDCPA was intended "... to promote consistent State action to protect consumers against debt collection abuses." n118

[b] FTC Must Exempt States With Substantially Similar, Adequately Enforced Laws

To date, only the state of Maine has been granted n119 an FDCPA exemption. n120

Legal Topics:

For related research and practice materials, see the following legal topics:

Banking LawConsumer ProtectionFair Debt CollectionGeneral OverviewBanking LawConsumer ProtectionFair Debt CollectionCommunicationsBanking LawConsumer ProtectionFair Debt CollectionLiabilityBanking LawConsumer ProtectionFair Debt CollectionUnfair PracticesReal Property LawLandlord & TenantTenant's Remedies & RightsFair Debt Collection Practices Act

FOOTNOTES:

(n1)Footnote 1. *Jacobson v. Healthcare Fin. Serv., Inc., 516 F.3d 85, 91, 96 (2d Cir. 2008)* ("FDCPA permits and encourages parties who have suffered no loss to bring civil actions for statutory violations. Jacobson's subjective reaction to the letter, therefore, is neither here nor there."); *Nelson v. Select Fin. Servs., Inc., 2006 U.S. Dist. LEXIS 42637* (E.D. Pa. June 9, 2006) ; *Diamond v. Corcoran, 1992 U.S. Dist. LEXIS 22793* (W.D. Mich. Aug. 3, 1992) ; *Phillips v. Amana Collection Serv., 1992 U.S. Dist. LEXIS 13558* (W.D.N.Y. Aug. 25, 1992) .

(n2)Footnote 2. *See Heard v. Bonneville Billing & Collections, 216 F.3d 1087 , reported in full at 2000 U.S. App. LEXIS 14625 (10th Cir. 2000)* (check collector violated the FDCPA and a UDAP statute by persisting to collect on bad checks against the check writer's mother after the collector was informed that she was not the signer nor any longer on the joint account; but the consumer's mother failed to show harm to herself and therefore lacked standing to assert the collector's receiving part of its attorney fee violated FDCPA or UDAP based on ethical rules prohibiting a lawyer from splitting a fee with a nonlawyer).

(n3)Footnote 3. *Martinez v. Albuquerque Collection Servs., 867 F. Supp. 1495 (D.N.M. 1994)* ; *Littles v. Lieberman, 90 B.R. 700 (Bankr. E.D. Pa. 1988)* (collection lawyer was jointly and severally liable with collection agency since his violation was separate; the release of the agency did not release the lawyer). *See also Flamm v. Sarner & Assocs., P.C., 2002 U.S. Dist. LEXIS 22255* (E.D. Pa. Nov. 6, 2002) (attorney debt collector who hired a process server, who was exempt from FDCPA coverage, may be liable for the abusive and harassing misconduct of that process server). *See also Albanese v. Portnoff Law Assocs., Ltd., 301 F. Supp. 2d 389 (E.D. Pa. 2004)* (law firm's president, with duties of supervision and overall responsibility, and the attorney who signed the letters could both be liable under the FDCPA); *Cashman v. Ricigliano, 2004 U.S. Dist. LEXIS 17027* (D. Conn. Aug. 25, 2004) (partnership may be sued under the FDCPA since it is responsible for the acts of its partners). *But see Perovich v. Humphrey, 1997 U.S. Dist. LEXIS 16949* (N.D. Ill. Oct. 23, 1997) (complaint suggested that all corporate executive officers were personally liable for all corporate actions, and that was simply not the law; consumers failed to allege any facts in their complaint indicating that the collector's officers personally violated the FDCPA, requiring dismissal of the claim against the officers); *Friedman v. Anvan Corp., 1997 U.S. Dist. LEXIS 15977* (N.D. Ill. Sept. 25, 1997) (complaint stated a claim against a corporate signer of a dunning letter even though that corporation was not further identified; individual signing for that corporation was only a representative, and the claim against him was dismissed for that reason). *See Thinesen v. JBC Legal Group, P.C., 2005 U.S. Dist. LEXIS 21637* (D. Minn. Sept. 26, 2005) (allegations that defendant collection agency employees were persons responsible for agency's illegal collection efforts stated claim for relief against those employees individually).

(n4)Footnote 4. *Brujis v. Shaw, 876 F. Supp. 975 (N.D. Ill. 1995)* (California corporate officers were subject to Illinois long-arm statute because they allegedly committed, in the name of collection agency, tortious acts against Illinois residents in violation of FDCPA). *See Newman v. CheckRite Cal., Inc., 912 F. Supp. 1354 (E.D. Cal. 1995)* (managing officer of the check collection agency was personally responsible for the FDCPA violations of his employees under California corporation law and as a debt collector indirectly collecting a debt under the FDCPA). *See also Williams v. Collection Team, Inc., 1997 U.S. Dist. LEXIS 24101* (S.D. Fla. Oct. 31, 1997) (motion to dismiss the case as to collection agency's officers denied, based on allegation that they were "at all material times, aware of, and/or had ultimate responsibility for, and/or created or approved the various letters, or the basic forms used for the various letters, sent by Collection Team"); *Pikes v. Riddle, 38 F. Supp. 2d 639 (N.D. Ill. 1998)* (corporate officer personally involved in the debt collection practices of his company was a "debt collector" within the FDCPA); *Gottlieb v. Green Oil, Inc., 1998 WL 468849 (S.D. Fla. 1998)* (magistrate judge recommended that complaint not be dismissed against president of Advanced Recovery Associates who signed letter; officers and employees of the debt collector may be jointly and

severally liable with the agency); *Slater v. Credit Sciences, Inc., 1998 U.S. Dist. LEXIS 8497* (N.D. Ill. May 28, 1998) (complaint which alleged the direct participation of the president of a corporate debt collector in the collection efforts stated a claim for relief against him).

(n5)Footnote 5. *Miller v. McCalla, Raymer, Padrick, Cobb, Nichols, & Clark, L.L.C., 214 F.3d 872 (7th Cir. 2000) . See also Peter v. GC Servs. L.P., 310 F.3d 344 (5th Cir. 2002)* (general partners were liable for all obligations of the partnership; thus, GC Financial and DLS Enterprises were liable for the FDCPA violations of GC Services).

(n6)Footnote 6. *Avila v. Van Ru Credit Corp., 1995 U.S. Dist. LEXIS 1502* (N.D. Ill. Feb. 6, 1995) , *aff'd on other grounds sub nom. Avila v. Rubin, 84 F.3d 222 (7th Cir. 1996) . See also Pope v. Vogel, 1998 U.S. Dist. LEXIS 2868* (N.D. Ill. Mar. 4, 1998) (person who was the sole stockholder of out-of-state collection business as well as its sole officer, one of two employees, and who directed the specific operations of the business that collected the debt in the forum state had sufficient contacts with forum state for the court to exercise personal jurisdiction, and was a "debt collector" by virtue of his indirect efforts to collect the debt); *but cf. Stepney v. Outsourcing Solutions, Inc., 1997 U.S. Dist. LEXIS 18264* (N.D. Ill. Nov. 4, 1997) (complaint against parent corporation was dismissed where it was devoid of allegations to support a finding that it so completely dominated the collector's practices as to constitute a single economic enterprise allowing the piercing of the corporate veil; the consumer alleged only the parent's financial interest in the subsidiary's collection activities and its approval of the practice of purchasing and attempting to collect old debts); *Ernst v. Jesse L. Riddle, P.C., 964 F. Supp. 213 (M.D. La. 1997)* (an officer of a corporate debt collector may only be held liable if sufficient facts are established to pierce the corporate veil); *Byes v. Accelerated Cash Flow, Inc., 1996 U.S. Dist. LEXIS 7523* (E.D. La. May 23, 1996) (claims against owner and an executive in the collection agency were dismissed for lack of personal jurisdiction where the consumer failed to allege that either had participated in the FDCPA violation, or that the corporation was an "alter ego" of the owner; there was no evidence that the corporation was undercapitalized or lacked assets to satisfy a possible judgment).

(n7)Footnote 7. *Kobs v. Arrow Serv. Bureau, Inc., 134 F.3d 893 (7th Cir. 1998) .*

(n8)Footnote 8. *15 U.S.C. § 1692k(a)(1).*

(n9)Footnote 9. *Vidrine v. American Prof'l Credit, Inc., 477 S.E.2d 602 (Ga. Ct. App. 1996) . See Hart v. GMAC Mortgage Co. (In re Hart), 246 B.R. 709* (Bankr. D. Mass. Mar. 27, 2000) (consumer was entitled to $3000 damages for emotional distress caused by the FDCPA violation); *Grassley v. Debt Collectors, Inc., 1992 U.S. Dist. LEXIS 22782* (D. Or. Dec. 14, 1992) ; *Florence v. National Sys., 1983 U.S. Dist. LEXIS 20344* (N.D. Ga. Oct. 14, 1983) ; *McHugh v. Check Investors, Inc., 2003 U.S. Dist. LEXIS 9065* (W.D. Va. May 21, 2003) . *See generally* National Consumer Law Center, Fair Debt Collection, § 6.3.2 (5th ed. 2004). *Lee v. Javitch, Block & Rathbone, L.L.C., 2008 U.S. Dist. LEXIS 34166* (S.D. Ohio Apr. 25, 2008) (upholding jury's award of emotional distress damages; emotional distress damages for FDCPA violation do not require proof of the elements of intentional infliction of emotional distress). *Cf. Baruch v. Healthcare Receivable Mgmt., Inc., 2007 U.S. Dist. LEXIS 80429* (E.D.N.Y. Oct. 30, 2007) (consumer's description of anxiety, sleeplessness, and depression was credible considering the duration and persistence of harassment; but claim that emotional distress caused or aggravated physical illness fails in absence of evidence of doctor visits or prescriptions, or expert testimony as to causation).

(n10)Footnote 10. *See Bish v. Credit Control Sys. Inc., 1991 WL 165035 (W.D.N.Y. 1991)* (default judgment) (request for $500 actual damages denied where no evidence whatsoever offered of actual damages); *Smith v. Law Offices of Mitchell N. Kay, 124 B.R. 182 (Bankr. D. Del. 1991)* (proof of elements of state tort law for intentional infliction of emotional distress, e.g., physical injury, severity, outrageous conduct, etc., was unnecessary to establish FDCPA actual damages for stress-related injury); *see also Bartlett v. Heibl, 128 F.3d 497 (7th Cir. 1997)* (consumer's admission that he did not read the collection letter violating *15 U.S.C. § 1692g* did not affect his claim for statutory damages but would have defeated a claim for actual damages had they been sought), *reh'g, en banc, denied, 1997 U.S. App. LEXIS 33970* (7th Cir. Wis. Dec. 1, 1997) ; *O'Connor v. Check Rite, 973 F. Supp. 1010 (D. Colo. 1997)* (because no damages arising from a *15 U.S.C. § 1692c(b)* violation could be shown, judgment in the amount of $0.01 was

entered against the defendant).

(n11)Footnote 11. *See Johnson v. Equifax Risk Mgmt. Servs., 2004 U.S. Dist. LEXIS 4245* (S.D.N.Y. Mar. 17, 2004) (amount of statutory damages is best decided at trial and not on summary judgment).

(n12)Footnote 12. *Fed. R. Civ. P. 23(b)(3)*; Newberg & Conte, Newberg on Class Actions §§ 21.11-21.13 (3d ed. 1992); 5 Moore's Federal Practice--Civil § 23.23 (3d ed.).

(n13)Footnote 13. *See* National Consumer Law Center, Consumer Class Actions: A Practical Litigation Guide § 9.2 (6th ed. 2006).

(n14)Footnote 14. *See* Newberg & Conte, Newberg on Class Actions § 21.15 (3d ed. 1992).

(n15)Footnote 15. *15 U.S.C. § 1692k(a)(2)(A).*

(n16)Footnote 16. Truth in Lending Act [hereinafter TILA] § 130(1), (2)(A), *15 U.S.C. § 1640(1), (2)(A).*

(n17)Footnote 17. S. Rep. No. 95-382, at 5. *See also Hartman v. Meridian Fin. Servs., Inc., 191 F. Supp. 2d 1031 (W.D. Wis. 2002)* (FDCPA was a strict liability statute, and proof of one violation was sufficient to support summary judgment; however, the number of separate violations was a factor in determining statutory damages, thus requiring adjudication of remaining theories of liability). *See King v. International Data Servs. (IDS), 100 Fed. Appx. 681 (9th Cir. 2004)* (not for publication) (district court did not abuse its discretion in awarding maximum statutory damages). *See also Mann v. Acclaim Fin. Servs., Inc., 348 F. Supp. 2d 923 (S.D. Ohio 2004)* (court awarded the maximum statutory damages of $1000 pursuant to the FDCPA and $200 pursuant to the Ohio Consumer Sales Practices Act (OCSPA) for dun that overshadowed the notice of validation rights).

(n18)Footnote 18. *See Hill v. Priority Fin. Servs., Inc., 2001 U.S. Dist. LEXIS 16900* (S.D. Ind. Sept. 28, 2001) (consumers may be entitled to statutory damages under the FDCPA regardless of actual harm), *related proceeding, 2003 U.S. Dist. LEXIS 7812* (S.D. Ind. Mar. 26, 2003) .

(n19)Footnote 19. *Emanuel v. American Credit Exch., 870 F.2d 805 (2d Cir. 1989)* ; *Pipiles v. Credit Bureau of Lockport, Inc., 886 F.2d 22 (2d Cir. 1989) . But see Johnson v. Eaton, 80 F.3d 148 (5th Cir. 1996)* .

(n20)Footnote 20. *15 U.S.C. § 1692k(b)(1).*

(n21)Footnote 21. TILA § 130(a)(3), *15 U.S.C. § 1640(a)(3). See § 1.10[4] supra.*

(n22)Footnote 22. Equal Credit Opportunity Act [hereinafter ECOA] § 706(b), *15 U.S.C. § 1691e(b). See* Ch. 5, "Credit Discrimination," *§ 5.11[3] supra* .

(n23)Footnote 23. *15 U.S.C. § 1692k(b)(1).*

(n24)Footnote 24. *E.g., Watkins v. Peterson Enters., 57 F. Supp. 2d 1102 (E.D. Wash. 1999)* (consumers were entitled to full statutory damages where collection agency improperly included costs of unsuccessful writs of garnishment in debt demanded); *Miele v. Sid Bailey, Inc., 192 B.R. 611 (S.D.N.Y. 1996)* (maximum award of $1,000 statutory damages was warranted because of the collection agency's numerous communications with the consumer after being advised by the consumer and his counsel that the debt had been discharged in bankruptcy; $1,153.43 actual and $60,000 punitive (for a state law claim) damages also awarded); *Masuda v. Thomas Richards & Co., 759 F. Supp. 1456 (C.D. Cal. 1991)* ($1,000 awarded for misrepresenting lawyer's involvement and an ineffective debt validation notice). *See Jones v. Vest, 2000 U.S. Dist. LEXIS 19026* (E.D. Va. Dec. 27, 2000) (three prior FDCPA claims against the collector in only four years indicated that its noncompliance was frequent and persistent requiring $1,000 statutory damages); *Chapman v. ACB Bus. Servs., 1997 U.S. Dist. LEXIS 23743* (S.D. W. Va. Feb. 13, 1997) (letter purporting to demand full payment within 72 hours and which contradicted and overshadowed validation notice in small print on the

reverse side warranted statutory damages of $1,000 as well as statutory damages under a state consumer statute). *See Berndt v. Fairfield Resorts, Inc. 337 F. Supp. 2d 1120 (W.D. Wis. 2004)* (proof of one violation is sufficient to show liability, but the court may consider the number of violations in assessing statutory damages); *Becker v. Montgomery, Lynch, 2003 U.S. Dist. LEXIS 24992* (N.D. Ohio Feb. 26, 2003) (court awarded full statutory damages for embarrassing language).

(n25)Footnote 25. *E.g., Baker v. G.C. Servs. Corp., 677 F.2d 775 (9th Cir. 1982)* ($100.00 awarded). *See Laster v. Cole, 2000 U.S. Dist. LEXIS 3771* (E.D.N.Y. Mar. 20, 2000) ($100 awarded to each of two plaintiffs, absent evidence that the violation was intentional, frequent, persistent, or abusive). *See also Berndt v. Fairfield Resorts, Inc. 337 F. Supp. 2d 1120 (W.D. Wis. 2004)* (after the collector is determined to be liable, its unintentional errors may be relevant to reducing the amount of statutory damages).

(n26)Footnote 26. *See Harper v. Better Bus. Servs., Inc., 961 F.2d 1561 (11th Cir. 1992)* ; *Baker v. G.C. Servs. Corp., 677 F.2d 775 (9th Cir. 1982)* ; *Sibersky v. Borah, Goldstein, Altschuler & Schwartz, P.C., 2000 U.S. Dist. LEXIS 14043* (S.D.N.Y. Sept. 22, 2000) (an FDCPA complaint need not allege actual damages).

(n27)Footnote 27. *Harper v. Better Bus. Servs., Inc., 961 F.2d 1561 (11th Cir. 1992)* ; *Wright v. Financial Serv. of Norwalk, Inc., 22 F.3d 647 (6th Cir. 1994)* .

(n28)Footnote 28. *See also Barber v. National Revenue Corp., 932 F. Supp. 1153 (W.D. Wis. 1996)* (statutory damages under *15 U.S.C. § 1692k(a)(2)(A)* were limited to $1,000 per proceeding rather than for each statutory violation); *Dewey v. Associated Collectors, Inc., 927 F. Supp. 1172 (W.D. Wis. 1996)* (court found that, under *15 U.S.C. § 1692k*, plaintiffs were limited to the statutory damages per proceeding instead of per violation); *White v. Bruck, 927 F. Supp. 1168 (W.D. Wis. 1996)* (statutory damages under *15 U.S.C. § 1692k(a)(2)(A)* were limited to $1,000 per proceeding, rather than $1,000 per statutory violation). *See Dowling v. Kucker Kraus & Bruh, L.L.P., 2005 U.S. Dist. LEXIS 11000* (S.D.N.Y. June 6, 2005) (maximum statutory damages is limited to $1000 per plaintiff per proceeding; that maximum did not increase with multiple defendants; court awarded $1100, $550 per plaintiff). *Cf. Ganske v. Checkrite, Ltd., 1997 U.S. Dist. LEXIS 4345* (W.D. Wis. Jan. 6, 1997) (each defendant who independently violated FDCPA is liable for separate award of maximum $1000 statutory damages even if they are sued by consumer in same case).

(n29)Footnote 29. *15 U.S.C. § 1692(b)* and *(e)*.

(n30)Footnote 30. *See, e.g., Boyce v. Attorney's Dispatch Serv., 1999 U.S. Dist. LEXIS 12970* (S.D. Ohio Apr. 27, 1999) (court declined to award punitive damages under FCDPA, ruling that they were not expressly authorized under the Act and would be duplicative of statutory damages; court did award each plaintiff $5000 in punitive damages under Ohio law); *Miele v. Sid Bailey, Inc., 192 B.R. 611 (S.D.N.Y. 1996)* (maximum award of $1,000 statutory damages was warranted because of the collection agency's numerous communications with consumer after being advised by consumer and his counsel that the debt had been discharged in bankruptcy; actual and punitive state law damages also awarded); *Kuhn v. Account Control Tech., Inc., 865 F. Supp. 1443 (D. Nev. 1994)* (punitive damages were available for collector's unreasonable intrusion upon consumer's seclusion).

(n31)Footnote 31. *See Barker v. Tomlinson, 2006 U.S. Dist. LEXIS 37050* (M.D. Fla. June 7, 2006) (awarded damages in amount of $22,000 under Florida Consumer Collection Practices Act (FCCPA) and FDCPA, including: statutory damages of $1000 under FCCPA, statutory damages of $1000 under FDCPA, actual damages of $10,000 under both FCCPA and FDCPA, and punitive damages of $10,000 under FCCPA); *In re Lisenby, 2006 Bankr. LEXIS 428* (Bankr. M.D. Ala. Mar. 22, 2006) (where violation of both bankruptcy automatic stay and FDCPA for continuing to withdraw funds from consumer's bank account after they were notified of the bankruptcy filing, consumer awarded actual damages of $287.50, $1000 punitive damages for violation of the automatic stay, $1000 additional FDCPA damages, plus fees and costs).

(n32)Footnote 32. *Malone v. Hecker, 2007 U.S. Dist. LEXIS 86910* (D. Mass. Nov. 27, 2007) .

(n33)Footnote 33. *Thomas v. Pierce, Hamilton, & Stern, Inc., 967 F. Supp. 507 (N.D. Ga. 1997)* .

(n34)Footnote 34. *15 U.S.C. § 1692(c).*

(n35)Footnote 35. *15 U.S.C. § 1692k(a)(2)(B).*

(n36)Footnote 36. *See Mace v. Van Ru Credit Corp., 109 F.3d 338 (7th Cir. 1997)* ; *Harrison v. Great Springwaters of Am., Inc., 1997 U.S. Dist. LEXIS 23267* (E.D.N.Y. June 18, 1997) ; *Avila v. Van Ru Credit Corp., 1995 U.S. Dist. LEXIS 1502* (N.D. Ill. Feb. 6, 1995) , sub nom. *Avila v. Rubin, 84 F.3d 222 (7th Cir. 1996)* .

(n37)Footnote 37. *See Keele v. Wexler, 149 F.3d 589 (7th Cir. 1998)* (because the injury under the FDCPA was the receipt of the letter threatening suit if an illegal $12.50 collection fee was not paid to the collection law firm, the consumer met the commonality and typicality requirements to represent the class of consumers receiving the letter and seeking actual damages in the amount of the fee, regardless of whether she had paid the fee which she alleged she paid involuntarily); *Littledove v. JBC & Assocs., 2001 U.S. Dist. LEXIS 139* (E.D. Cal. Jan. 10, 2001) (Rule 23b(2) and (3) classes certified under the FDCPA and state consumer protection laws against check collector who sent form collection letters seeking excessive fees; individual questions of the consumer purpose of their check or the amount of excessive fees paid did not predominate); *Sanders v. OSI Educ. Servs., 2001 U.S. Dist. LEXIS 12578 (N.D. Ill. 2001)* (evidence that at least 91 persons qualified as class members met numerosity requirement; defendant's standardized conduct met commonality and typicality requirements; defendant's claim to the contrary involved inquiry into plaintiff's method of proof, an inquiry that was not allowed at class certification stage); *Connor v. Automated Accounts, Inc., 2001 U.S. Dist. LEXIS 10458* (E.D. Wash. Aug. 10, 2001) (class action alleging that collector sent initial dun demanding payment in 15 days in violation of § 1692g certified as a (b)(3) but not as a (b)(2) class over collector's objections that named plaintiff incurred no actual damages and that class members could not be determined to have incurred consumer versus commercial debts); *Fuller v. Becker & Poliakoff, P.A., 197 F.R.D. 697 (M.D. Fla. 2000)* (showing allegedly deceptive dunning letters were sent to 200 families satisfied numerosity, commonality and typicality requirements). *See, e.g., Byes v. Telecheck Recovery Servs., Inc., 173 F.R.D. 421 (E.D. La. 1997)* ; *Hall v. National Recovery Sys., 1996 U.S. Dist. LEXIS 11992* (M.D. Fla. Aug. 9, 1996) (class certification denied for lack of typicality); *Villareal v. Snow, 1996 U.S. Dist. LEXIS 660* (N.D. Ill. Jan 16, 1996) . *See also Wilkerson v. Bowman, 2001 U.S. Dist. LEXIS 4719* (N.D. Ill. Mar. 27, 2001) (whether form collection letter violated FDCPA was common question of law and fact. Where there is genuine question of whether debts are for business or consumer purposes, class members can be asked a single question to determine their eligibility for class membership.); *In re Risk Mgmt. Alternatives, Inc., 208 F.R.D. 493 (S.D.N.Y. 2002)* (court certified a class action defined as "All persons to whom Defendant and its agents sent initial communications in the form of the April 9, 2001 letter mailed to plaintiff Gerda Schaake, or otherwise containing the identical subject language, in an attempt to collect a consumer debt, as reflected by Defendant's records, on or after May 23, 2000." "Suits brought under the FDCPA such as this case regularly satisfy the superiority requirement of Rule 23.").

(n38)Footnote 38. *Stavroff v. Midland Credit Mgmt., 2005 U.S. Dist. LEXIS 11640* (N.D. Ind. June 8, 2005) ; *Sheets v. Nat'l Action Fin. Servs., 2005 U.S. Dist. LEXIS 8439* (N.D. Ind. May 9, 2005) .

(n39)Footnote 39. *See Sanders v. Jackson, 209 F.3d 998 (7th Cir. 2000)* (to calculate FDCPA class statutory damages, the debt collector's net worth should be determined by book value, not the fair market value; goodwill was not part of net worth; conclusion was based on the ordinary meaning of the term net worth, generally accepted accounting principles, the protection of debt collectors from insolvency, construction of analogous statutes, and the deterrence provided by FDCPA fee shifting and actual damages).

(n40)Footnote 40. *Scott v. Universal Fid. Corp., 42 F. Supp. 2d 837 (N.D. Ill. 1999)* (court overruled defendants' objections to plaintiff's motion to compel defendants to answer discovery requests related to the net worth of defendants); *see also Mailloux v. Arrow Fin. Servs., LLC, 2002 U.S. Dist. LEXIS 3314* (E.D.N.Y. Feb. 21, 2002)

(plaintiff in class action was entitled to discover defendant's tax returns and other financial information relevant to statutory damage determination of the defendant's net worth, notwithstanding defendant's offer to provide an affidavit of net worth, since the plaintiff was entitled to examine the underlying data to test the defendant's calculations. Motion to compel granted.).

(n41)Footnote 41. *15 U.S.C. § 1692k(b)(2).*

(n42)Footnote 42. *See Baker v. G.C. Servs. Corp., 677 F.2d 775 (9th Cir. 1982) .*

(n43)Footnote 43. *15 U.S.C. § 1692k(b).*

(n44)Footnote 44. *15 U.S.C. § 1692k(c).*

(n45)Footnote 45. *15 U.S.C. § 1692k(a)(3).*

(n46)Footnote 46. *Tolentino v. Friedman, 46 F.3d 645, 651 (7th Cir. 1995) . See also Riter v. Moss & Bloomberg, Ltd., 2000 U.S. Dist. LEXIS 14470* (N.D. Ill. Sept. 26, 2000) . *See also Jacobson v. Healthcare Fin. Serv., Inc., 516 F.3d 85 (2d Cir. 2008)* (attorney fees to the prevailing consumer is mandatory: "In this way, the FDCPA enlists the efforts of sophisticated consumers like Jacobson as 'private attorneys general' to aid their less sophisticated counterparts, who are unlikely themselves to bring suit under the Act, but who are assumed by the Act to benefit from the deterrent effect of civil actions brought by others").

(n47)Footnote 47. *Carroll v. Wolpoff & Abramson, 53 F.3d 626 (4th Cir. 1995) .*

(n48)Footnote 48. *Johnson v. Eaton, 80 F.3d 148 (5th Cir. 1996) .*

(n49)Footnote 49. *Compare 15 U.S.C. § 1692k(a)(3), with 15 U.S.C. § 1640(a)(3).*

(n50)Footnote 50. *42 U.S.C. § 1988.*

(n51)Footnote 51. *See, e.g., Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983)* ; *DeJesus v. Banco Popular, 918 F.2d 232 (1st Cir. 1990)* (successful plaintiff entitled under TILA to award of attorney fees, and only amount of award is left to trial court's determination).

(n52)Footnote 52. *Compare 15 U.S.C. § 1692k(a)(3), with 15 U.S.C. § 1640(a)(3).*

(n53)Footnote 53. *See generally* National Consumer Law Center, Materials for Fourth Annual National Consumer Rights Litigation Conference (1995) (retainer agreements in consumer cases).

(n54)Footnote 54. *See Kay v. Ehrler, 499 U.S. 432, 111 S. Ct. 1435, 113 L. Ed. 2d 486 (1991)* (civil rights claim); *In re Vasquez, 221 B.R. 222 (Bankr. N.D. Ill. 1998)* (successful *pro se* attorney plaintiff not entitled to award of attorney fees).

(n55)Footnote 55. *Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983) .*

(n56)Footnote 56. *Hensley v. Eckerhart, 461 U.S. 424, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983)* ; *see also Tenuto v. Transworld Sys., Inc., 2002 U.S. Dist. LEXIS 1764* (E.D. Pa. Jan. 31, 2002) (attorney fee of $140,950 or 35% of total settlement fund minus administrative costs was reasonable where lodestar was between $131,000 and $146,518).

(n57)Footnote 57. *See Pennsylvania v. Delaware Valley Citizen's Council for Clean Air, 483 U.S. 711, 727-28, 107 S. Ct. 3078, 97 L. Ed. 2d 585 (1987)* (Delaware II); *Vandzura v. C & S Adjusters, Inc., 1997 U.S. Dist. LEXIS 1254* (E.D. Pa. Feb. 6, 1997) .

(n58)Footnote 58. *See Laster v. Cole, 2000 U.S. Dist. LEXIS 8672* (E.D.N.Y. June 23, 2000) (where counsel admitted that he overstated his hours for preparing for summary judgment by three hours, his fee would be reduced by that amount, any multiplier for success was denied, and he was ordered to show why the court should not sanction him in that amount for falsely certifying his hours; fee was also reduced by amount paid by client); Gary Smith, *Federal Statutory Attorney Fees: Common Issues and Recent Cases*, *28 Clearinghouse Rev. 744, 756 (Nov. 1994)* (recent cases indicate an increasing judicial impatience with excessive, outrageous, or inadequately supported fee claims). *See also* Dechert *ex rel. Estate of Oyler v. The Cadle Co., 2004 U.S. Dist. LEXIS 25837* (S.D. Ind. Nov. 10, 2004) (plaintiff was awarded fees at the market rate in the local community. Despite substantial reduction, the court awarded some $54,000 in fees on a $1000 statutory recovery).

(n59)Footnote 59. *Venegas v. Mitchell, 495 U.S. 82, 110 S. Ct. 1679, 109 L. Ed. 2d 74 (1990)* .

(n60)Footnote 60. *See, e.g., Cambridge Trust Co. v. Hanify & King, P.C., 721 N.E.2d 1 (Mass. 1999)* (in a fee disagreement between a commercial client with a UDAP claim and its lawyer, the court upheld the lawyer's claim that it was ethically and contractually entitled to a fee of about 30% of the combined compensatory damages ($2,032,301) and the lodestar fee award ($409,200) less some expenses and credits. The client argued that was excessive). *See also* State *ex rel. Oklahoma Bar Ass'n v. Weeks, 1998 OK 83, 83, 969 P.2d 347, 354* (Okla. Jul 14, 1998) (dual recovery of both a lodestar and proportional contingent fee unreasonable).

(n61)Footnote 61. *See, e.g., Laster v. Cole, 2000 U.S. Dist. LEXIS 8672* (E.D.N.Y. June 23, 2000) ($200 per hour was a reasonable rate and $5490 a reasonable fee for the case, but the retainer agreement that the client would pay 50% of the recovery to the attorney provided double payment and the attorney fee was reduced by the $100 the consumer was to pay out of the recovery). *But see Gobert v. Williams, 323 F.3d 1099 (5th Cir. 2003)* (permitted dual recovery where result of employment discrimination case was extraordinary).

(n62)Footnote 62. In *Paul, Johnson, Alston & Hunt v. Graulty, 886 F.2d 268, 272 (9th Cir. 1989)* , the Ninth Circuit held that a trial court could use the "percentage" method as well as the "lodestar," and that "[w]e note with approval that one court has concluded that the 'bench mark' percentage for the fee award should be 25 percent." In *Bebchick v. Washington Metropolitan Area Transit Comm'n, 805 F.2d 396, 406-407 (D.C. Cir. 1986)* , the District of Columbia Circuit Court of Appeals held that "[w]here the fees, as here, will come out of a 'common fund,' 'a reasonable fee is based on a percentage of the fund bestowed on the class.' " [Citation omitted.] The court held that 25% was "a reasonable percentage for otherwise uncompensated attorneys."

(n63)Footnote 63. Both "lodestar" and "percentage" cases have awarded fees in the higher range. *See, e.g., In re Ampicillin Antitrust Litigation, 526 F. Supp. 494 (D.D.C. 1981)* (45%); *Clark v. Cameron-Brown Co., 1981 U.S. Dist. LEXIS 12824,* [1981] Fed. Sec. L. Rptr. (CCH) P 98.014 (M.D.N.C. Apr. 6, 1981) (30% of $3 million settlement fund) (lodestar).

(n64)Footnote 64. In *Brown v. Phillips Petroleum Co., 838 F.2d 451, 454, 456 (10th Cir. 1988)* , *cert. denied, 488 U.S. 822 (1988)* , the Tenth Circuit approved a trial court's award of a flat 16.5% of a $75 million "common fund" class action recovery, giving weight to "the amount involved and the results obtained."

(n65)Footnote 65. *See Davis v. City & County of San Francisco, 976 F.2d 1536, 1544 (9th Cir. 1992)* ; *Jones v. Vest, 2000 U.S. Dist. LEXIS 19026* (E.D. Va. Dec. 27, 2000) (seventy-six attorney hours and eleven paralegal hours investigating, negotiating and obtaining summary judgment was reasonable in an FDCPA case; attorney fee award of $17,766.49 allowed); *Riter v. Moss & Bloomberg, Ltd., 2000 U.S. Dist. LEXIS 14470* (N.D. Ill. Sept. 26, 2000) (five hours was a reasonable time to spend to draft a five-page complaint that was similar to one filed before); *Norton v. Wilshire Credit Corp., 36 F. Supp. 2d 216 (D.N.J. 1999)* . *See also* Dechert *ex rel. Estate of Oyler v. The Cadle Co., 2004 U.S. Dist. LEXIS 25837* (S.D. Ind. Nov. 10, 2004) (fees were reduced for duplication, "given that this was a matter arising under a strict liability statute and given that there are an ample number of local practitioners well versed and experienced in the FDCPA ... ."); *Gervais v. O'Connell, Harris & Assocs., Inc., 297 F. Supp. 2d 435 (D. Conn. 2003)*

(twenty-seven hours was a reasonable amount of time to obtain a default judgment in a case involving punitive and actual damages; $5000 in attorney fees awarded for 27 hours at $200); *Caputo v. Professional Recovery Servs., Inc., 2004 U.S. Dist. LEXIS 12478* (D. Kan. June 9, 2004) (court adjusted prevailing plaintiff's fee request in the exercise of discretion and awarded over $87,000 in fees to plaintiff on an offer of judgment of $15,000.); *Shula v. Lawent, 2004 U.S. Dist. LEXIS 17662* (N.D. Ill. Sept. 2, 2004) (consumer's attorneys were awarded reasonable fees for their work on their successful defense of the defendant's appeal. The award for the appellate work was $15,350 ($12,375 covering the 55 hours reasonably expended by one attorney, plus $2975 covering the 8.5 hours reasonably expended his co-counsel in a case considered rather simple by the court). $32,165 in fees were awarded before the appeal.).

(n66)Footnote 66. *See Dunaway v. JBC & Assocs., Inc., 2005 U.S. Dist. LEXIS 37885* (E.D. Mich. Dec. 19, 2005) .

(n67)Footnote 67. *See Cooper v. Sunshine Recoveries, Inc., 2001 U.S. Dist. LEXIS 8938* (S.D.N.Y. June 27, 2001) (elimination of the time spent on unsuccessful class claims was warranted); *Cook v. VFS, Inc., 2000 U.S. Dist. LEXIS 15621* (S.D. Ohio Sept. 27, 2000) (court declined to reduce fee application merely because plaintiff did not prevail on all claims; however, it applied a 50% reduction to the time distinctly spent on a losing issue); *Jackson v. Bellsouth Telecomms., Inc., 2000 U.S. Dist. LEXIS 7674* (N.D. Ill. June 1, 2000) (fee application of $12,500 reduced more by than half, by reducing hourly rate, eliminating time spent on meritless venue dispute, and eliminating other hours); *Vandzura v. C & S Adjusters, Inc., 1997 U.S. Dist. LEXIS 1254* (E.D. Pa. Feb. 10, 1997) . *Mann v. Acclaim Fin. Servs., Inc., 348 F. Supp. 2d 923 (S.D. Ohio 2004)* (where the consumer achieved only partial success, the court reduced the award of attorney fees by one-third).

(n68)Footnote 68. *Blum v. Stenson, 465 U.S. 886, 104 S. Ct. 1541, 79 L. Ed. 2d 891 (1984)* ; *Hollis v. Roberts, 984 F.2d 1159 (11th Cir. 1993)* ; *Purnell v. Kovitz, Shifrin & Waitzman, 1996 U.S. Dist. LEXIS 13239 (N.D. Ill. 1996)* (consumer was successful in settling his FDCPA claim and was entitled to attorneys fees of $19,867.50 based on the "lodestar" method; rates of $180 to $240 per hour were reasonable for the consumer's counsel, but some hours were trimmed by the court); *Edwards v. National Bus. Factors, Inc., 897 F. Supp. 458 (D. Nev. 1995)* ($175 per hour). *See Norton v. Wilshire Credit Corp., 36 F. Supp. 2d 216 (D.N.J. 1999)* (consumer's counsel sought fees and costs of $67,697.56 and was awarded $57,206.34 at his current rate of $215 per hour; counsel's rate was $200 at the beginning of the case but the entire award was based on the current rate to compensate for the delay in payment); *Arevalo v. National Credit Sys., Inc., 1998 U.S. Dist. LEXIS 12098* (N.D. Ill. July 29, 1998) . *See also Bass v. Stolper, Koritzinsky, Brewster & Neider, S.C., 1997 U.S. App. LEXIS 41397* (7th Cir. June 6, 1997) ($275 per hour was a reasonable fee for an attorney specializing in consumer law with a national reputation and experience); *Jones v. Vest, 2000 U.S. Dist. LEXIS 19026* (E.D. Va. Dec. 27, 2000) (consumer attorney's 24 years' experience in public interest law justified the rate of $200 per hour).

(n69)Footnote 69. *Gradisher v. Check Enforcement Unit, Inc., 2003 U.S. Dist. LEXIS 753* (W.D. Mich. Jan. 22, 2003) (although an hourly rate of $400 was approved by another court for one counsel, the court believed the $300 rate originally sought was more in line with local rates; fees in the amount of $69,872.00 (out of a $92,401 lodestar) and expenses in the amount of $7808.44 were awarded in case where consumers prevailed on summary judgment but decertified their class action when it became apparent that the debt collector's net worth for calculating class damages was negligible).

(n70)Footnote 70. *Fed. R. Civ. P. 54(d)(2)(B).*

(n71)Footnote 71. *Carroll v. Wolpoff & Abramson, 53 F.3d 626 (4th Cir. 1995)* .

(n72)Footnote 72. *See, e.g., Savino v. Computer Credit, Inc., 164 F.3d 81 (2d Cir. 1998)* .

(n73)Footnote 73. *Savino v. Computer Credit, Inc., 164 F.3d 81 (2d Cir. 1998)* .

(n74)Footnote 74. *Tolentino v. Friedman, 46 F.3d 645, 651 (7th Cir. 1995)* . *See also Norton v. Wilshire Credit Corp., 36 F. Supp. 2d 216 (D.N.J. 1999)* . In an FDCPA jury trial, plaintiff won $5800 on a *15 U.S.C. § 1692g* claim,

and defendant won $1651.53 on its counterclaim for the debt. Plaintiff's counsel sought fees and costs of $67,697.56, and was awarded $57,206.34 at his current rate of $215 per hour. The court rejected the argument that there must be proportionality between the damages and the fee.

(n75)Footnote 75. *Carroll v. Wolpoff & Abramson, 53 F.3d 626 (4th Cir. 1995)* .

(n76)Footnote 76. *Carroll v. Wolpoff & Abramson, 961 F.2d 459 (4th Cir. 1992)* , *cert. denied, 506 U.S. 905, 113 S. Ct. 298, 121 L. Ed. 2d 222 (1992)* .

(n77)Footnote 77. *Carroll v. Wolpoff & Abramson, 53 F.3d 626 (4th Cir. 1996)* .

(n78)Footnote 78. *Holland v. Roeser, 37 F.3d 501, 503 (9th Cir. 1994)* ; *Muckleshoot Tribe v. Puget Sound Power & Light Co., 875 F.2d 695 (9th Cir. 1989)* ; *Ashley v. Atlantic Richfield Co., 794 F.2d 128 (3d Cir. 1986)* .

(n79)Footnote 79. *Bell v. Schexnayder, 36 F.3d 447, 450 (5th Cir. 1994)* ; *Elmore v. Shuler, 787 F.2d 601, 252 U.S. App. D.C. 45 (1986)* ; *Young v. Powell, 729 F.2d 563 (8th Cir. 1984)* ; *Jennings v. Metropolitan Gov't of Nashville, 715 F.2d 1111 (6th Cir. 1983)* .

(n80)Footnote 80. *475 U.S. 717, 106 S. Ct. 1531, 89 L. Ed. 2d 747 (1986)* .

(n81)Footnote 81. *Ballard v. Equifax Check Servs., 27 F. Supp. 2d 1201 (E.D. Cal. 1998)* (the Declaratory Judgment Act, *28 U.S.C. § 2201(a)*, permits the court to enter declaratory judgment notwithstanding the absence of corresponding injunctive relief); *Young v. Meyer & Njus, P.A., 183 F.R.D. 231 (N.D. Ill. 1998)* (motion by defendant to decertify class, who had previously stipulated to class certification, was denied because the requirements for Rule 23(b)(2) class certification had been met). *But cf. Sibley v. Diversified Collection Servs., 1998 U.S. Dist. LEXIS 9969* (N.D. Tex. June 30, 1998) (class certification pursuant to Rule 23(b)(2) of a proposed FDCPA national class was denied because declaratory relief did not predominate; the declaratory relief was for declaring defendant's act violative of the FDCPA, not for an injunctive-like purpose, and the lawsuit sought actual damages); *Gammon v. GC Servs. Ltd. P'ship, 162 F.R.D. 313 (N.D. Ill. 1995)* ; *Sparkman v. Zwicker & Assocs., P.C., 374 F. Supp. 2d 293 (E.D.N.Y. 2005)* (neither injunctive nor declaratory relief is available to private litigants under FDCPA); *Petrolito v. Arrow Fin. Servs., L.L.C., 221 F.R.D. 303 (D. Conn. 2004)* .

(n82)Footnote 82. *See 15 U.S.C. § 1692l(a)* (incorporating FTC powers under FTC Act, *15 U.S.C. §§ 1-77 (1976)*). *See also United States v. Trans Cont'l Affiliates, 1997 U.S. Dist. LEXIS 388* (N.D. Cal. Jan. 8, 1997) .

(n83)Footnote 83. *See, e.g., Asch v. Teller, Levit & Silvertrust, P.C., 2004 U.S. Dist. LEXIS 24048* (N.D. Ill. Nov. 24, 2004) (in 2003, the court found that defendant's practice of not crediting payments when received falsely represented the amount of the debtors' payment obligations by reporting a balance that was inflated by interest overcharges. The collector used those false representations to collect additional amounts which the debtors should not have had to pay. Since defendant had not adequately corrected its practices, an injunction issued under state law in favor of the class.).

(n84)Footnote 84. *Weiss v. Regal Collections, 385 F.3d 337* (3d Cir. Sept. 29, 2004) .

(n85)Footnote 85. *370 F.3d 924 (9th Cir. 2004)* .

(n86)Footnote 86. *See Irwin v. Mascott, 2001 U.S. Dist. LEXIS 3285* (N.D. Cal. Feb. 27, 2001) (collector's insurance limited to $2 million).

(n87)Footnote 87. *Irwin v. Mascott, 96 F. Supp. 2d 968 (N.D. Cal. 1999)* (class certified).

(n88)Footnote 88. *Irwin v. Mascott, 112 F. Supp. 2d 937* (N.D. Cal. Aug. 31, 2000) .

(n89)Footnote 89. *15 U.S.C. § 1692e(2).*

(n90)Footnote 90. *112 F. Supp. 2d 937, 955* /-/56.

(n91)Footnote 91. *Id. at 956* /-/57.

(n92)Footnote 92. *See Wilson v. Transworld Sys., Inc., 2002 U.S. Dist. LEXIS 10891* (M.D. Fla. Mar. 29, 2002) (because of "profound difficulties in defining and identifying the constituent members of the class, or possible subclasses, for purposes of an action for damages," and because allowing declaratory and injunctive relief was a superior remedy, the putative damages class was not certified but an injunctive class was certified). *But see Rogers v. Wexler, 2002 U.S. Dist. LEXIS 5457* (N.D. Ill. Mar. 28, 2002) (where the only remaining issue was whether the attorney's fee request was bona fide and reasonable, the consumer did not meet the predominance requirement of Rule 23(b)(3), and her motion for class certification was denied); *but cf. Goldberg v. Winston & Morrone, 1997 U.S. Dist. LEXIS 3521* (S.D.N.Y. Mar. 25, 1997) (finding that the FDCPA suit primarily sought damages, not declaratory relief, the court denied certification of a Rule 23(b)(2) class).

(n93)Footnote 93. *15 U.S.C. § 1692k(d).*

(n94)Footnote 94. *See Richmond v. Malad, 2001 U.S. Dist. LEXIS 10505* (S.D. Ind. July 6, 2001) (consumer's claims based on defendants' filing of state court collection action more than one year before filing of FDCPA suit were time barred; claims based on defendants' failure to provide validation notice within five days of its initial collection communication, i.e., the filing of state court collection action, however, were not time barred where FDCPA suit was filed more than one year but less than one year and five days from filing of that state court collection action); *Evanauskas v. Strumpf, 2001 U.S. Dist. LEXIS 14326* (D. Conn. June 27, 2001) (consumer's claims founded on alleged violations arising from defendants' filing of state court collection action more than one year before filing of FDCPA suit were time barred.). *But cf. Naas v. Stolman, 130 F.3d 892 (9th Cir. 1997)* (FDCPA claim filed more than one year after the filing of a state collection suit was barred by the statute of limitations where the FDCPA claim arose from the filing of the state claim and the period was not extended by a state appeal); *Chisolm v. Charlie Falk Auto Wholesalers Inc., 851 F. Supp. 739 (E.D. Va. 1994)* (the court had no jurisdiction to hear the consumer's FDCPA action which was filed more than one year after the date the violation occurred); *Maydwell v. Yoffe, 2001 U.S. Dist. LEXIS 13442* (E.D. Pa. Aug. 28, 2001) (*pro se* plaintiff's complaint was time barred and dismissed); *Heim v. California Fed. Bank FSB, 2001 Conn. Super. LEXIS 2355* (Conn. Super. Ct. Aug. 15, 2001) (*pro se* complaint dismissed as barred by the statute of limitations for failure to allege any activity that occurred less than one year prior to filing of suit).

(n95)Footnote 95. *James v. Ford Motor Credit Co., 842 F. Supp. 1202 (D. Minn. 1994)* (where repossession occurred on June 29, 1992, but FDCPA action was not filed until July 7, 1993, suit was not brought within the one year statute of limitations). *See also Naas v. Stolman, 130 F.3d 892 (9th Cir. 1997)* (complaint alleging FDCPA violation through collector's misconduct in initiating collection suit was barred by statute of limitations, which began to run on the date the collection suit was filed); *Friedman v. Anvan Corp., 1998 U.S. Dist. LEXIS 13579* (N.D. Ill. Aug. 27, 1998) (for the purpose of determining the beginning of the statute of limitations period, the FDCPA violation occurred when the debt collector mailed letter); *Calka v. Kucker, Kraus & Bruh, LLP, 1998 U.S. Dist. LEXIS 11868* (S.D.N.Y. Aug. 3, 1998) (FDCPA action filed more than one year after the collection action alleged to violate FDCPA was barred by the one year statute of limitations even though an amended complaint and motion for summary judgment containing the same violation had been filed by the debt collector within the one year).

(n96)Footnote 96. *See Pittman v. J.J. Mac Intyre Co, 969 F. Supp. 609 (D. Nev. 1997)* . Consumer's cause of action under the FDCPA was based only on those three communications by the defendant which occurred within one year of filing her original complaint. While the statute of limitations rendered those specific communications between the defendant and the plaintiff prior to that date inactionable, evidence of the prior communications was relevant to establishing whether the calls occurring within the limitations period were part of an abusive or harassing pattern violating *15 U.S.C. § 1692d.*

(n97)Footnote 97. *American Pipe & Constr. Co. v. Utah, 414 U.S. 538, 558-59, 94 S. Ct. 756, 38 L. Ed. 2d 713, 1974-1 Trade Cas. (CCH) P74862 (1974)* .

(n98)Footnote 98. *See Mattson v. U.S. W. Communications, Inc., 967 F.2d 259, 262 (8th Cir. 1992)* ; *Zhang v. Haven-Scott Assocs., Inc., 1996 U.S. Dist. LEXIS 8738* (E.D. Pa. June 21, 1996) (FDCPA claim was barred by the statute of limitations, which was considered jurisdictional); *Chisolm v. Charlie Falk Auto Wholesalers, Inc., 851 F. Supp. 739, 749 (E.D. Va. 1994)* (tolling for fraudulent concealment not permitted), *vacated, remanded sub nom. Chisolm v. TranSouth Fin. Corp., 95 F.3d 331 (4th Cir. 1996)* ; *Friedman v. HHL Fin. Serv., Inc., 1993 U.S. Dist. LEXIS 10362* (N.D. Ill. July 29, 1993) .

(n99)Footnote 99. *Mattson v. U.S. W. Communications, Inc., 967 F.2d 259, 262 (8th Cir. 1992)* ,*followed*, *Friedman v. HHL Fin. Serv., Inc., 1993 U.S. Dist. LEXIS 10362* (N.D. Ill. July 29, 1993) . *See also Johnson v. Riddle, 305 F.3d 1107 (10th Cir. 2002)* (consumer's claim of FDCPA violation arising from a collector's lawsuit did not occur until she was served with the collection action; the day of the FDCPA violation was not counted in calculating the statute of limitations; the one-year statute of limitations began to run on the day following the event violating the FDCPA).

(n100)Footnote 100. *See Sujing Zhang v. Haven-Scott Assocs., Inc., 1996 U.S. Dist. LEXIS 8738* (E.D. Pa. June 21, 1996) ; *Chisolm v. Charlie Falk Auto Wholesalers, Inc, 851 F. Supp. 739, 749 (E.D. Va. 1994)* , *vacated, remanded sub nom. Chisolm v. TranSouth Fin. Corp., 95 F.3d 331 (4th Cir. 1996)* . *See also Andrews v. TRW, Inc., 534 U.S. 19, 122 S. Ct. 441, 151 L. Ed. 2d 339 (2001)* (discovery rule rejected for FCRA claim). *But see Garrett v. Empire Cooler Serv., Inc., 2004 U.S. Dist. LEXIS 11369* (N.D. Ill. June 21, 2004) (because the FDCPA's limitation period is not jurisdictional and the *pro se* plaintiff's mental and physical illnesses prevented him, despite all due diligence, from obtaining vital information bearing on the existence of his claim, the court permitted equitable tolling of the otherwise time-barred claim).

(n101)Footnote 101. *Marshall-Mosby v. Corporate Receivables, Inc., 205 F.3d 323 (7th Cir. 2000)* . *See also Hooper v. Capital Credit & Collection Servs., Inc., 2004 U.S. Dist. LEXIS 19687* (D. Or. Jan. 16, 2004) (one-year statute of limitations is procedural, not jurisdictional, so suit filed on anniversary of date letter was sent was timely).

(n102)Footnote 102. *Purnell v. Arrow Fin. Servs., L.L.C., 2008 U.S. App. LEXIS 25488* (6th Cir. Dec. 16, 2008) (unpublished).

(n103)Footnote 103. *15 U.S.C. § 1692k(d)*.

(n104)Footnote 104. *28 U.S.C. § 1441*. *See McGilvray v. Hallmark Fin. Group, Inc., 891 F. Supp. 265 (E.D. Va. 1995)* (although FDCPA authorized filing FDCPA claims in state courts, collector's removal of the action to federal court was proper). *See also Dale v. Johnson, 1997 U.S. Dist. LEXIS 20277* (N.D. Cal. Dec. 12, 1997) (*pro se*) (court held, without an analysis of contrary authority, that a *15 U.S.C. § 1692i* claim--that the court action to enforce an arbitration award should have been instituted in another county--should have been raised in the state court proceeding and not in federal court).

(n105)Footnote 105. *Fed. R. Civ. P. 4(d)(7), (e)*. *See also Purco Fleet Servs., Inc. v. Dept. of Fin., 90 P.3d 346 (Idaho 2004)* (long-arm statute applied to out-of-state collector collecting claims in the state).

(n106)Footnote 106. *383 U.S. 715, 86 S. Ct. 1130, 16 L. Ed. 2d 218 (1966)* (referred to this aspect of supplemental jurisdiction as pendent jurisdiction).

(n107)Footnote 107. *Dawson v. DovenMuehle Mortgage, Inc., 2002 U.S. Dist. LEXIS 5688* (E.D. Pa. Mar. 28, 2002) .

(n108)Footnote 108. *See 28 U.S.C. § 1367(c)*.

(n109)Footnote 109. *See FTC v. Shaffner, 626 F.2d 32 (7th Cir. 1980)* ("the Act ... authorized the FTC ... to use all of its functions and powers to enforce the Act").

(n110)Footnote 110. *15 U.S.C. § 57a(b)*.

(n111)Footnote 111. *15 U.S.C. § 45(m)(1)(A)*.

(n112)Footnote 112. *15 U.S.C. § 1692l(b)*. The following lists the financial institutions and the corresponding federal regulatory agencies: banks (Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corporation, and Office of Thrift Supervision); federally chartered credit unions (National Credit Union Administration); interstate shippers and movers and airline companies (Secretary of Transportation); certain agricultural creditors (U.S. Department of Agriculture).

(n113)Footnote 113. *15 U.S.C. §§ 1692n*, *1692(e)*.

(n114)Footnote 114. *See Sibley v. Firstcollect, Inc., 913 F. Supp. 469 (M.D. La. 1995)* (state collection license requirement offered consumers greater protection and was thus expressly not preempted by *15 U.S.C. § 1692n*); *Citibank (S.D.) N.A. v. Jones, 184 Misc. 2d 63, 706 N.Y.S.2d 301 (Dist. Ct. 2000)* (FDCPA did not preempt the common law doctrine of account stated, which recognized an agreement between parties to prior transactions as to the account items and the balance due; § 1692g(c) did preclude a court finding that an account had been stated for failure of a consumer to dispute the validity of debt in response to a communication from a third party debt collector). *See also Irwin v. Mascott, 94 F. Supp. 2d 1052 (N.D. Cal. 2000)* (court must deny on preemption grounds debt collector's motion to add third-party malpractice claim against collector's legal counsel because the FDCPA preempts the state regulation of attorneys where the two conflict, and there was no express or implied right of contribution or indemnity under the FDCPA); Mezines, FTC Advisory Opinion (Mar. 31, 2000), *available at* http://www.ftc.gov/os/2000/04/fdcpaadvisoryopinion.htm (FDCPA does not preempt state laws that keep the FDCPA validation notice out of the summons because the FDCPA allows the validation notice to be separately sent). *See also Gonzalez v. Codilis & Assocs., P.C., 2004 U.S. Dist. LEXIS 5463* (N.D. Ill. Mar. 31, 2004) (because the state law voluntary-payment doctrine provided less protection to consumers than the FDCPA, it was preempted by § 1692n where the debt collector alleged it as a defense to an FDCPA overcharge claim).

(n115)Footnote 115. *Thrasher v. Cardholder Servs., 74 F. Supp. 2d 691 (S.D. Miss. 1999)* .

(n116)Footnote 116. *Virgil v. Reorganized M.W. Co., 156 F. Supp. 2d 624 (S.D. Miss. 2001)* .

(n117)Footnote 117. *Binion v. Franklin Collection Servs., 147 F. Supp. 2d 519 (S.D. Miss. 2001)* . *See also Albright v. Allied Intern. Credit Corp., 2003 WL 22350928* (C.D. Cal. Aug. 25, 2003) (FDCPA does not preempt state tort law claims, and is not inconsistent with them.); *Hage v. General Serv. Bureau, 2002 U.S. Dist. LEXIS 14443* (D. Neb. Aug. 5, 2002) (consumer protection statute not preempted by FDCPA). *See also Albanese v. Portnoff Law Assocs., Ltd., 301 F. Supp. 2d 389 (E.D. Pa. 2004)* ; *United States v. Sullivan, 1998 U.S. Dist. LEXIS 6288* (N.D. Tex. Apr. 28, 1998) (FDCPA did not preempt state debt collection statute that was more protective of the rights of consumers); *Sibley v. Firstcollect, Inc., 913 F. Supp. 469 (M.D. La. 1995)* (state collection license requirement offered consumers greater protection and was thus expressly not preempted by *15 U.S.C. § 1692n*). *See also Irwin v. Mascott, 186 F.R.D. 567 (N.D. Cal. 1999)* (FDCPA did not preempt state laws that provided consumers with greater protection in form of injunctive relief available for period of four years); *Premier Capital, Inc. v. Grossman, 2000 Conn. Super. LEXIS 3137* (Conn. Super. Ct. Nov. 22, 2000) (notice required by state law making demand for payment was effective even if notice failed to inform the debtors of their rights under the FDCPA), *rev'd in part, aff'd in part, remanded*, *789 A.2d 565 (Conn. App. 2002)* . *But see Thrasher v. Cardholder Servs., 74 F. Supp. 2d 691 (S.D. Miss. 1999)* (remand to state court denied; court held plaintiff's common law claims of intentional or negligent infliction of emotional distress were preempted by FDCPA under doctrine of conflict preemption), *overruled*, *Virgil v. Reorganized M.W. Co., 156 F. Supp. 2d 624 (S.D. Miss. 2001)* .

(n118)Footnote 118. *15 U.S.C. § 1692(e)*.

(n119)Footnote 119. *15 U.S.C. § 1692 o*. Each of the major bills leading to the FDCPA contained a similar provision.

(n120)Footnote 120. *60 Fed. Reg. 66,972* (Dec. 27, 1995) .

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 8 Fair Debt Collection

1-8 Consumer Credit Law Manual § 8.05

§ 8.05 Debt Collector's Defenses and Counterclaims Under the Fair Debt Collection Practices Act

[1] Only the Defenses Provided by the Act Are Available

Specific defenses available to FDCPA claims are provided by the Act. Nevertheless, defendants have frequently sought to invent new defenses to FDCPA claims, such as the "technicality" of their FDCPA noncompliance or the plaintiff's attorney's frequent representation of consumers with an FDCPA claim. The courts have refused to imply such defenses under this Act or under other titles of the Federal Consumer Protection Act. n1 However, it is clear that some courts are not favorably predisposed to FDCPA actions that appear on their face as claims not involving important federal policy or actual injury. The Seventh Circuit, for example, affirmed the dismissal of an FDCPA claim in part because the violation was not intentional. n2 Where the consumer's claim lacks merit, the consumer can expect a motion or a countersuit for sanctions or damages including the defendant's attorney fees. n3 Approval of the collector's forms or practices by a state official is not a defense to an FDCPA claim. n4 Actual damages are not required for standing under the FDCPA as the attempt to recover unlawful fees was made actionable by Congress without a requirement of actual damages to recover statutory damages. n5

[2] A Debt Collector May Recover Attorney Fees Upon Showing That an FDCPA Suit Was Brought to Harass the Collector

This language n6 provides for the discretionary awarding of attorney fees to a defendant in an FDCPA case if the court finds that the action was brought in bad faith and for the purpose of harassment. n7 This rule is more stringent than the federal common law rule that generally permits awarding attorney fees to the prevailing party when "the losing party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons. ... " n8 The FDCPA standard is also much more stringent than the Equal Employment Opportunity Act standard, which provides fees to a "prevailing party."

A defendant who claims attorney fees under FDCPA has the heavy burden of proving the plaintiff's subjective bad faith or malice and the plaintiff's harassing purpose in instituting the FDCPA action. The defendant must first prevail against the consumer's FDCPA claim claiming attorney fees. n9 To prove malice, the defendant must show not only that the plaintiff had no basis for believing that the defendant violated the Act, but also that the plaintiff did not entertain a subjective belief that such acts occurred. The defendant must then show that the plaintiff brought suit to harass the collector. n10 Finally, the award of fees to the defendant in a particular case must be consistent with the policies of the FDCPA and its attorney fee provision. The Ninth n11 and Seventh Circuits n12 have awarded Rule 11 attorney fees to a

collection lawyer without discussing the more stringent requirements of the FDCPA provision. A number of district courts have followed suit. n13

[3] Frivolous FDCPA Demand Letter Sparks Sanctions Award to Debt Collector

A consumer's demand letter asserting a violation of the FDCPA ended up costing the consumer's attorney $18,037 in sanctions for the debt collector's attorney fees. n14 The consumer attorney sent the debt collector an FDCPA demand letter claiming that its dunning language overshadowed the notice of the consumer's debt validation rights demanding $1000 damages and $2000 attorney fees.

The debt collector's attorney responded with a letter asserting that the FDCPA claim was frivolous because the debt collector's validation rights notice used the safe haven language established by Judge Posner in the *Bartlett* case, n15 demanding $500 for its attorney fees, and threatening to pursue its remedies. Some weeks later the debt collector filed suit against the consumer seeking a declaratory judgment that its debt validation notice fit within the *Bartlett* safe haven. The consumer opposed the debt collector's claim, filed a counterclaim against the debt collector for its false threat of a collection suit in its initial dunning letter, and a third-party claim against the debt collector's attorney for his letter seeking $500 attorney fees.

The debt collector obtained its declaratory judgment and then filed a motion for sanctions against the consumer's attorney under *28 U.S.C. § 1927*, which makes lawyers liable for vexatious multiplying of proceedings. The debt collector was granted sanctions.

The Seventh Circuit affirmed, pointing out that the consumer's attorney could have avoided the sanctions by either notifying the debt collector that it was withdrawing the meritless FDCPA claim before suit or by not opposing the declaratory judgment. The Seventh Circuit rejected the consumer's claim that the debt collector could not seek sanctions because it had initiated the declaratory judgment action when the consumer would have abandoned her FDCPA claim. The Seventh Circuit also awarded sanctions to the debt collector's attorney, reversing the district court. Hopefully this case reflects unusual facts and will not spark a new defense strategy in FDCPA cases.

[4] Federal Courts Usually Refuse Supplemental Jurisdiction Over a Debt Collector's Counterclaim to Collect the Underlying Debt

In many states, debt collection agencies are prohibited from filing suit by unauthorized practice of law statutes. n16 In these states, the state statute precludes debt collector counterclaims for the debt in any FDCPA action if the defendant is a collection agency; the courts thus never encounter the question of whether such a counterclaim is within a federal court's supplemental jurisdiction.

In states that interpret their laws to permit suits by debt collectors, a debt collector may file a counterclaim for the underlying debt. Federal courts usually have not taken supplemental jurisdiction n17 over such a counterclaim. Formerly, this was because the counterclaim was not so related to the FDCPA claim to be within the court's pendent (now supplemental) jurisdiction and was required to be dismissed. n18 The courts generally found that the collection claims did not involve the same controversy, the same evidence, or federal law and policy. Furthermore, the counterclaim would impede the expeditious enforcement of the policies of the FDCPA and chill the raising of FDCPA claims. More recently, however, a court found that it could exercise supplemental jurisdiction over debt counterclaims against the consumer and the potential consumer class, but declined to use its discretion to exercise expanded jurisdiction because of the chilling effect this would have on the exercise of FDCPA claims and because of the impact it would have on administrative workflow of the federal court. n19

[5] A Debt Collector Is Not Liable for Unintentional Violations Resulting From Bona Fide Error if the Collector Maintained Procedures to Avoid Such Errors

This narrow provision n20 provides a complete defense to a debt collector's violation of the FDCPA. The language of this provision appears to have been borrowed from nearly identical language in the TIL Act, which also is narrowly construed. n21 To establish a defense under this provision, a debt collector must plead and prove by a preponderance of evidence n22 that:

- The error was unintentional;
- The error was made in good faith;
- The error resulted from a clerical mistake, not a mistaken interpretation of law; and
- The collector maintained procedures reasonably adapted to check for and avoid such errors. n23

Until recently, courts generally rejected bona fide error defenses. n24 In recent years, however, debt collectors have become more adept at presenting the defense and some courts have broadened the defense.

The Tenth Circuit in its second decision in the case of *Johnson v. Riddle*, n25 provided its analysis of the elements to establish the bona fide error defense. The defendant has the burden of proof that the violation was (1) unintentional, (2) a bona fide error, and (3) made despite the maintenance of procedures reasonably adapted to avoid the specific error. The first test is subjective; the second and third tests are objective. The debt collector must show that the violation was unintentional, not that the underlying act itself was unintentional, by showing lack of subjective intent to violate the FDCPA. The extent to which a defendant should have objectively realized that its actions were in violation of law may be inferentially probative of the subjective intentional nature of that violation. Whether the debt collector's mistake was bona fide will often turn on the debt collector's due diligence practices. The debt collector must actually maintain procedures, that is, employ or implement procedures to prevent errors, and the procedures employed or implemented must be specific procedures designed to avoid the error at issue. Where a mistake of law is involved, such procedures might include researching the relevant case law, bringing test cases, or seeking guidance from an objective third party. Where it is a close question as to whether the collector satisfies the bona fide error defense, the trier of fact makes the determination.

The Seventh Circuit has indicated in dicta that it would apply the bona fide error defense to errors of law. n26 The Seventh Circuit has also found that an attorney's procedures were not reasonable when the procedures included review of legal summaries prepared by the American Creditor Association and the Debt Bar Association, submission of form letters to the ACA, and regularly reading excerpts of the relevant Wisconsin statutes. The court concluded:

> "AFNI never consulted an attorney in Wisconsin on state law issues, nor did it ask a Wisconsin governmental agency whether it was entitled to charge a collection fee as the owner of the debt ... . In the end, AFNI is not arguing that it relied on an informed, but mistaken, legal opinion. It is saying that its ignorance of the law should be excused because it attempted to keep itself informed about the law through the various trade association communications. This is not enough, in our view, to support the bona fide error defense. n27

[6] Res Judicata or Estoppel May Bar an FDCPA Action That Should Have Been Raised as a Compulsory Counterclaim to an Already Adjudged Action on the Underlying Debt

Two rules of judicial economy may combine to bar certain FDCPA claims. The first is the doctrine of res judicata, which prevents a party from relitigating any matter of fact or law that was or should have been adjudicated in a prior proceeding. n28 This doctrine supports judicial economy by avoiding repetitious adjudications of identical matters in different suits. The second is the compulsory counterclaim rule, which is found in the FRCP n29 and in many state

procedural codes.

Compulsory counterclaim rules require joinder of counterclaims bearing a close logical or evidentiary relationship to the main claim.

In the context of the FDCPA, the two rules determine whether an earlier judgment on the underlying debt bars an FDCPA claim that may have been a compulsory counterclaim to the prior action. n30

[7] Other Rules May Bar FDCPA Claims in Specific Situations

Another barrier to subsequent FDCPA suits, the *Rooker-Feldman* doctrine, was explained in an FDCPA decision: n31

> Under the Rooker-Feldman doctrine, lower federal courts do not have subject matter jurisdiction over claims seeking review of state court judgments. *See Rooker v. Fidelity Trust Co., 263 U.S. 413, 415-16, 44 S. Ct. 149, 68 L. Ed. 362 (1923)* ; *District of Columbia Court of Appeals v. Feldman, 460 U.S. 462, 482-86, 103 S. Ct. 1303, 75 L. Ed. 2d 206 (1983)* . The doctrine applies not only to claims that were actually raised before the state court, but also to claims that are inextricably intertwined with state court determinations. *See Feldman, 460 U.S. at 482 n.16* .

In 2005, a unanimous Supreme Court in *Exxon Mobil Corp. v. Arabia, Inc.* n32 provided fresh analysis of the *Rooker-Feldman* doctrine. The *Exxon Mobil* decision clarifies that *Rooker-Feldman* does not apply where a federal action is filed before a state judgment is entered. If a concurrent state court action results in a judgment while the federal action is pending, the federal court looks to the state's law on preclusion of claims to determine if any part of the federal action may proceed. All but one of the courts to look at the preclusion issue have held that an FDCPA claim was not a compulsory counterclaim to a state collection action, largely because completely different evidence is involved in the two claims. n33

Rooker-Feldman limits federal court jurisdiction over a suit attacking a state court judgment by a party to that action. The Court explained that the doctrine does not displace concurrent state and federal court jurisdiction where it exists, e.g., in the case of FDCPA claims. While a federal court might abstain or stay its proceeding on the basis of comity, Rooker-Feldman does not deny the federal court jurisdiction if the action is brought before the state court enters final judgment.

If there is state court judgment before the federal action is instituted, the federal court lacks jurisdiction if the federal action attacks the state judgment. The standard from *Feldman* was that there was no jurisdiction if the issues in the federal action were "inextricably intertwined" with the decision of the state court. n34 In *Exxon Mobil* the Court explained that the district court does not have jurisdiction "to overturn an injurious state-court judgment" n35 or over later federal action "complaining of an injury caused by a state court judgment and seeking review and rejection of that judgment." n36

The Court also noted that *Rooker-Feldman* is the product of statute, not a constitutional doctrine. "Congress, if so minded, may explicitly empower district courts to oversee certain state court judgments and has done so, most notably, in authorizing federal *habeas* review of state prisoners' petitions." n37 This exception to *Rooker-Feldman* also applies to the FDCPA because many of its provisions were written to apply to or exempt state court debt collection suits. The prohibition of debt collectors filing suit in distant forums, n38 exempting process servers, n39 contacting third parties, n40 the pleading exception to the debt collector notice, n41 or misleading the consumer about the need to take steps to avoid a default judgment n42 all contemplate the FDCPA applying to prior collection litigation or requiring an exemption for prior debt collection litigation. Further, the Court in *Heintz v. Jenkins* n43 clarifies that the FDCPA applies to misconduct in the course of litigation such as misrepresenting the amount owed.

The Tenth Circuit has held that when the state court decision at issue was a default judgment, *Rooker-Feldman* did not apply. n44 Similarly, claims regarding a post-judgment collection letter would not be barred by the *Rooker-Feldman* doctrine. n45 When a state court would allow a new proceeding to set aside or reverse the judgment, *Rooker-Feldman* may not bar that action in federal court. n46

The Seventh Circuit upheld a *Rooker-Feldman* defense in a post-*Exxon* case arising out of attorney fees awarded in connection with medical debt collections actions in small claims court. n47 The FDCPA plaintiffs claimed that the debt collector's attorneys had made deceptive representations and requests to the small claims court in seeking fees to which they were not entitled. The Seventh Circuit found that these claims were not independent of the state court judgment for the attorney fees. n48 The plaintiffs were "the types of plaintiffs that *Exxon Mobil* anticipates and guards against: state court losers, who, in effect, are challenging state court judgments." n49 The court also rejected the plaintiffs' argument that *Rooker-Feldman* did not apply because the plaintiffs did not have a reasonable opportunity to litigate their FDCPA claims in state small claims court. The result may have been different if the plaintiffs had merely sought statutory damages and not actual damages in the amount of the state court judgments.

In addition, claims arising from Bankruptcy proceedings may have to be raised in bankruptcy court. n50

[8] Good Faith Conformity With a Formal FTC Advisory Opinion Later Ruled Invalid Is a Defense to an FDCPA Suit

In order to assert successfully the defense permitted by this provision, a debt collector must show that its violation of the FDCPA was committed in good faith reliance on an FTC advisory opinion. n51 "Advisory opinion of the Commission" is a term of art in FTC practice and procedure; a debt collector must follow specific FTC procedures to obtain an advisory opinion. n52 The FTC has issued only one formal advisory opinion since the Act took effect. n53 Informal FTC staff letters are not "advisory opinions" and cannot serve as the basis for a defense under this provision. n54 The FTC staff has compiled a commentary to the FDCPA, but this also is not an "advisory opinion."

[9] Offers of Judgment

Encouraged by isolated victories in the lower courts, n55 debt collectors are regularly filing offers of judgments under *Rule 68 of the Federal Rules of Civil Procedure* to named plaintiffs soon after the filing of FDCPA class actions and moving to dismiss the action as moot. Most decisions have rejected this tactic as inconsistent with the class action device. n56 Class counsel in FDCPA suits should anticipate this strategy by starting their discovery on class issues promptly, particularly numerosity, so that they are prepared to file their motion to certify the class immediately after the defendant files an offer of judgment. Only one of the recent FDCPA cases on this issue found that a motion to certify the class did not have to be filed during the ten-day period after the filing of the offer of judgment as long as the motion to certify was filed as soon as practicable after the filing of the class complaint. n57 The unfavorable decisions are also notable for failing to deal with Supreme Court precedent favoring the maintenance of the class action in this situation. n58

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Debt CollectionGeneral OverviewBanking LawConsumer ProtectionFair Debt CollectionCommunicationsBanking LawConsumer ProtectionFair Debt CollectionLiabilityBanking LawConsumer ProtectionFair Debt CollectionUnfair PracticesReal Property LawLandlord & TenantTenant's Remedies & RightsFair Debt Collection Practices Act

FOOTNOTES:
(n1)Footnote 1. *Nunez v. Etan Indus., Inc., 1999 U.S. Dist. LEXIS 245* (N.D. Ill. Jan. 6, 1999) ; *Ditty v. Check Rite, Ltd., 182 F.R.D. 639 (D. Utah 1998)* ; *Crawford v. Equifax Payment Servs., Inc., 1998 U.S. Dist. LEXIS 15719* (N.D.

Ill. Sept. 30, 1998) ; *Phillips v. Amana Collection Servs., 1992 U.S. Dist. LEXIS 13558* (W.D.N.Y. Aug. 25, 1992) . *See also Irwin v. Mascott, 94 F. Supp. 2d 1052 (N.D. Cal. 2000)* (denial of debt collector's motion to serve third-party malpractice complaint against its legal counsel was appropriate because the FDCPA was a strict liability statute, a plaintiff was not required to establish intentional conduct on the part of the debt collector, there was no affirmative defense of reliance on counsel under the FDCPA, and there was no express or implied right of action for either contribution or indemnity under the FDCPA). Counsel for consumers can respond to the "technicality" argument by pointing out the care that Congress took in crafting each protection of the FDCPA, the important consumer protection goals of the asserted technical provision, and the requirement that the courts enforce the plain language of the Act and not substitute their judgment for Congress's.

(n2)Footnote 2. *See Jenkins v. Heintz, 124 F.3d 824 (7th Cir. 1997) , cert. denied, 523 U.S. 1022, 118 S. Ct. 1304, 140 L. Ed. 2d 469 (1998) .*

(n3)Footnote 3. *See Eagan v. Williams, 709 A.2d 1057 (R.I. 1998)* ; *Ziobron v. Crawford, 667 N.E.2d 202 (Ind. Ct. App. 1996) , reh'g denied* (Aug. 29, 1996). *See also Cooper v. Litton Loan Serv. (In re Cooper), 253 B.R. 295 (Bankr. N.D. Fla. 2000)* (sanctions of $5000 granted to creditor's attorney against the consumers' attorney under *Bankr. R. 9011* for the costs of defending against a groundless FDCPA claim). *But see Emanuel v. American Credit Exch., 870 F.2d 805 (2d Cir. 1989)* ; *Boyce v. Computer Credit, Inc., 1997 U.S. Dist. LEXIS 14879* (S.D. Ohio Sept. 2, 1997) (motion for sanctions was dismissed where it was based on an attack on consumer's counsel bringing numerous FDCPA suits against various debt collectors and not on the factual and legal merits of the consumer's claims; the collector's counsel was admonished not to make ad hominem attacks in the future in that court).

(n4)Footnote 4. *See Simeon Mgmt. Corp. v. FTC, 579 F.2d 1137, 1978-2 Trade Cas. (CCH) P62282 (9th Cir. 1978) .*

(n5)Footnote 5. *See Robey v. Shapiro, Marianos & Cejda, L.L.C., 434 F.3d 1208 (10th Cir. 2006)* (Constitutional Art. III standing satisfied).

(n6)Footnote 6. *15 U.S.C. § 1692k(a)(3).*

(n7)Footnote 7. *Torres v. American Tel. & Tel. Co., 914 F.2d 260 (7th Cir. 1990) , reported in full, 1990 U.S. App. LEXIS 16116* (7th Cir. Sept. 12, 1990) , *aff'g* Civ. Action No. 88 C-2030 (N.D. Ill. 1989) (district court did not abuse its discretion in ordering Fed. R. Civ. R. 11 sanctions for meritless FDCPA claim). *See Chevy Chase F.S.B. v. Lane, 277 A.D.2d 545, 716 N.Y.S.2d 110* (3d Dep't 2000) (trial court's sanctions against attorney in asserting baseless TILA and FDCPA defenses to credit card collection action was supported by record and therefore was not an abuse of discretion); *Clayton v. Bryan, 753 So. 2d 632 (Fla. Dist. Ct. App. 2000)* (a debt collector could not recover his attorney fees under a state offer of judgment statute because it was preempted by the FDCPA which only authorizes fees to the defendant when the plaintiff's case was brought in bad faith and for the purpose of harassment); *White v. Myers, 2001 Tenn. App. LEXIS 814* (Tenn. Ct. App. Oct. 31, 2001) (trial court did not abuse its discretion in imposing Rule 11 sanctions against consumer's attorney for bringing frivolous FDCPA case against opposing counsel from mortgage foreclosure dispute where defendant did not engage in debt collection at all and consumer's attorney failed to investigate law or facts prior to filing suit). *See also Conley v. KCA Fin. Servs., Inc., 145 Or. App. 567, 931 P.2d 808 (1997)* (awarding attorney fees to the creditor and its collection agency was improper as there was no finding that the FDCPA action was brought by consumers in bad faith and for the purpose of harassment).

(n8)Footnote 8. *See Alyeska Pipeline Serv. v. Wilderness Soc'y, 421 U.S. 240, 258-59, 95 S. Ct. 1612, 44 L. Ed. 2d 141 (1975) .*

(n9)Footnote 9. *See Horkey v. J.V.D.B. & Assocs., Inc., 333 F.3d 769 (7th Cir. 2003)* ; *Blum v. Lawent, 2003 U.S. Dist. LEXIS 16050* (N.D. Ill. Sept. 8, 2003) (collector who defeated one of three claimed violations of the FDCPA is not entitled to attorney fees under § 1692k(a)(3)). *See Gonzalez v. Lawent, 2004 U.S. Dist. LEXIS 18241* (N.D. Ill. Sept. 10,

2004) (debt collector's motion for attorney fees was premature where the collector had prevailed on one issue but other issues remained unresolved, since a finding of bad faith and harassment must be based on the entire lawsuit and cannot be granted if the consumer prevails on a single claim). *See also* Dechert *ex rel. Estate of Oyler v. The Cadle Co., 2004 U.S. Dist. LEXIS 25837* (S.D. Ind. Nov. 10, 2004) (court had no authority to grant attorney fees to defendant where the consumer prevailed on her FDCPA claims, despite plaintiff's loss of class certification on appeal and unsuccessful sanctions motions.).

(n10)Footnote 10. *See Degrosiellier v. Solomon & Solomon, P.C., 2001 U.S. Dist. LEXIS 15254* (N.D.N.Y. Sept. 27, 2001) (collector's motion for award of attorney fees denied based on absence of proof that consumer commenced action in bad faith or for purpose of harassment); *Csugi v. Monterey Fin. Servs., Inc., 2001 U.S. Dist. LEXIS 21255* (D. Conn. Oct. 30, 2001) (§ 1691k does not permit award of costs to prevailing defendant unless defendant shows that plaintiff brought the action in bad faith and for purpose of harassment); *Riebe v. Juergensmeyer & Assocs., 979 F. Supp. 1218 (N.D. Ill. 1997)* (collector's motion for award of attorney fees denied where consumer, though the losing party, did not bring action in bad faith to harass in view of unique nature of the claim and the current debate as to the scope of FDCPA coverage and the definition of the term "debt"); *Villarreal v. Snow, 1997 U.S. Dist. LEXIS 2852 (N.D. Ill. 1997)* (creditor's motion for an award of attorney fees pursuant to the FDCPA and the Illinois Consumer Fraud Act was denied because there was no improper purpose or bad faith in bringing the claims). *See also Clayton v. Bryan, 753 So. 2d 632 (Fla. Dist. Ct. App. 2000)* (only where there was an express finding of bad faith and purpose of harassment may attorney fees be awarded to the prevailing defendant under the FDCPA; Florida offer of judgment statute providing for fee award was preempted by FDCPA attorney fee provisions; court refused to award defendant's attorney fees for defending an unsuccessful FDCPA action); *Jones v. Weiss, 95 F. Supp. 2d 105 (N.D.N.Y. 2000)* (inadequate evidence that FDCPA suit was instituted only to harass).

(n11)Footnote 11. *See Terran v. Kaplan, 109 F.3d 1428 (9th Cir. 1997)* (collector had to defend an FDCPA claim for which there had been an inadequate investigation).

(n12)Footnote 12. *See Huff v. Dobbins, Fraker, Tennant, Joy & Perlstein, 1999 U.S. App. LEXIS 12055* (7th Cir. June 2, 1999) (consumer's attorney (who was her daughter) abused legal process by repeated, vague, unclear filings and persistent re-argument of already litigated issues; abuse of process was grounds for Rule 11 sanctions).

(n13)Footnote 13. *See Savino v. Computer Credit, 164 F.3d 81 (2d Cir. 1998)* ; *Argentieri v. Fisher Landscapes, 15 F. Supp. 2d 55* , *later opinion, 27 F. Supp. 2d 84 (D. Mass. 1998)* (consumer's attorney held liable for Rule 11 sanctions for not withdrawing FDCPA complaint after collectors' corrective action).

(n14)Footnote 14. *Riddle & Assoc., P.C. v. Kelly, 414 F.3d 832 (7th Cir. 2005)* .

(n15)Footnote 15. *Bartlett v. Heibl, 128 F.3d 497, 501 (7th Cir. 1997)* .

(n16)Footnote 16. *See also* Kolker v. Sanchez, Clearinghouse No. 46,774 (D.N.M. 1991) (attorney, who filed suit in name of collection agency rather than in name of true creditor, engaged in the unauthorized practice of law in violation of *15 U.S.C. § 1692e*); *Kolker v. Duke City Collection Agency, 750 F. Supp. 468 (D.N.M. 1990)* .

(n17)Footnote 17. *28 U.S.C. § 1367*. *See generally* 16 Moore's Federal Practice--Civil Ch. 106 (3d ed.). *See Evans v. American Credit Sys., Inc., 2003 U.S. Dist. LEXIS 22433* (D. Neb. Dec. 10, 2003) (court dismissed the defendant's counterclaim to collect the underlying debt because it was permissive and therefore lacked an independent basis for federal jurisdiction). *But cf. Gervais v. Riddle & Assocs., P.C., 2004 U.S. Dist. LEXIS 5557* (D. Conn. Mar. 23, 2004) (court held that the consumer failed to provide any support for his premature motion to strike the collector's counterclaim for declaratory relief that its collection efforts were all lawful and did not violate the federal and state laws that the complaint alleged were violated).

(n18)Footnote 18. *Hart v. Clayton-Parker & Assocs., Inc., 869 F. Supp. 774 (D. Ariz. 1994)* ; *see also Berrios v. Sprint Corp., 1998 U.S. Dist. LEXIS 6579* (E.D.N.Y. Mar. 16, 1998) (court noted that all reported decisions have found

that a defendant's counterclaims for payment of an overdue debt are distinct from and not logically related to a plaintiff's FDCPA claim based on improper debt collection practices). *But cf. Krutchkoff v. Fleet Bank, 960 F. Supp. 541 (D. Conn. 1996)* (FDCPA does not apply to a bank seeking to collect on its own line of credit; court granted bank its cross-claim for the amount due on the account, costs and attorney fees).

(n19)Footnote 19. *See Ballard v. Equifax Check Servs., Inc., 186 F.R.D. 589 (E.D. Cal. 1999) . See also Cabrera v. Courtesy Auto, Inc., 192 F. Supp. 2d 1012 (D. Neb. 2002)* (analogizing to an FDCPA case, creditor's counterclaim for the underlying debt in TILA case was permissive, not compulsory, and court dismissed it because it did not have an independent jurisdictional basis); *Crawford v. Equifax Payment Servs., Inc., 1998 U.S. Dist. LEXIS 14095* (N.D. Ill. Sept. 1, 1998) (defendants' counterclaims to collect on dishonored checks could be heard under the court's supplemental jurisdiction because there was a loose connection between two claims; however, due to the chilling effect on FDCPA claims and the burden which would be placed on the court by such counterclaims, the court declined to exercise jurisdiction over the counterclaims; a setoff of the alleged debt against the FDCPA claim was allowed).

(n20)Footnote 20. *15 U.S.C. § 1692k(c).*

(n21)Footnote 21. *Cf. 15 U.S.C. § 1640(c).*

(n22)Footnote 22. *Clark's Jewelers v. Humble, 823 P.2d 818 (Kan. Ct. App. 1991)* (debt collector failed to demonstrate by a preponderance of the evidence a bona fide error defense).

(n23)Footnote 23. *Fox v. Citicorp Credit Servs., Inc., 15 F.3d 1507 (9th Cir. 1994) . See Picht v. Jon R. Hawks, Ltd., 236 F.3d 446 (8th Cir. 2001)* ; *Wilkerson v. Bowman, 200 F.R.D. 605 (N.D. Ill. 2001)* (bona fide error defense not available to collector who failed to state amount of debt as required by § 1692g even though the collector's policy was to not collect more than amount stated; mistaken view of obligations imposed by FDCPA would not support bona fide error defense); *Campion v. Credit Bureau Servs., Inc., 2000 U.S. Dist. LEXIS 20233* (E.D. Wash. Sept. 19, 2000) (defendant's misapprehension of applicable state law was not a result of an official interpretation of state law and therefore was only an error of law that did not amount to bona fide error defense); *Gill v. Kostroff, 82 F. Supp. 2d 1354 (M.D. Fla. 2000)* (whether defendant attorney had reasonable procedures to avoid suing wrong consumer in wrong venue was issue of fact for the jury); *Sutton v. Law Offices of Alexander L. Lawrence, 1992 U.S. Dist. LEXIS 22761* (D. Del. June 17, 1992) (bona fide error defense did not apply where defendant law office failed to provide any evidence that the requisite disclosure under § 1692e(11) or § 1692(g) were normally included in correspondence directed at debtors); *Hubbard v. National Bond & Collection Assocs., 126 B.R. 422, 427 (D. Del. 1991)* , *aff'd, 947 F.2d 935 (3d Cir. 1991)* ("bona fide error" defense was an affirmative defense applicable where debt collector's violation arose from an unintentional clerical error despite maintaining reasonable preventative measures). *See also Nielsen v. Dickerson, 307 F.3d 623 (7th Cir. 2002)* (held that the FDCPA's bona fide error defense was not available to a creditor which claimed it had relied on its collection lawyer's opinion that his letters complied with the FDCPA, because creditor was on notice, by *Avila*, that its conduct violated FDCPA principles); *Johnson v. Riddle, 305 F.3d 1107 (10th Cir. 2002)* ; *Frye v. Bowman, Heintz, Boscia & Vician, P.C., 193 F. Supp. 2d 1070 (S.D. Ind. 2002)* ; *Shapiro v. Haenn, 222 F. Supp. 2d 29 (D. Me. 2002)* ; *Hill v. Priority Fin. Servs., Inc., 2001 U.S. Dist. LEXIS 16900* (S.D. Ind. Sept. 28, 2001) (bona fide error defense does not shield those who simply misunderstand obligations imposed by the FDCPA), *related proceeding, 2003 U.S. Dist. LEXIS 7812* (S.D. Ind. Mar. 26, 2003) . *See also Alexander v. Unlimited Progress Corp., 2003 U.S. Dist. LEXIS 5560* (N.D. Ill. Mar. 21, 2003) (though debt collector alleged that the creditor had not informed it of the consumer's bankruptcy or about the fact that she was represented by counsel, the court held that the creditor's knowledge could be imputed to the debt collector, and rejected the bona fide error defense, finding that the debt collector here maintained no procedures to avoid contacting debtors who are represented by counsel). *Dunaway v. JBC & Assocs., Inc., 2005 U.S. Dist. LEXIS 37885* (E.D. Mich. June 20, 2005) (collection agency's assertion of bona fide error defense for its collector's abusive and deceptive telephone calls was rejected as matter of law since there was no evidence that collector acted unintentionally); *Hernandez v. Affiliated Group, Inc., 2006 U.S. Dist. LEXIS 2557* (E.D.N.Y. Jan. 12, 2006) (defendant had a bona fide error defense based on a coding glitch in a mail merge letter, resulting in misplacement, not elimination, of required information, and coding error was genuinely unintentional). *But*

see Hyman v. Tate, 2003 U.S. Dist. LEXIS 4822 (N.D. Ill. Mar. 24, 2003) . *See also McDaniel v. South & Assocs., P.C., 325 F. Supp. 2d 1210 (D. Kan. 2004)* (whether collector's computerized case management system was reasonably adapted to avoid collection action after notice of dispute, and whether continued collection was a clerical error, were questions of fact for the jury); *Hooper v. Capital Credit & Collection Servs., Inc., 2004 WL 825619* (D. Or. Apr. 13, 2004) (consumer's motion for summary judgment was denied where debt collector presented sufficient evidence of bona fide error defense to create material issues of fact); *Johnson v. Equifax Risk Mgmt. Servs., 2004 U.S. Dist. LEXIS 4245* (S.D.N.Y. Mar. 17, 2004) (despite the collector's uncontroverted affidavits that violations occurred notwithstanding maintenance of reasonable procedures to avoid them, the court refused on summary judgment to sustain the bona fide error defense on grounds that "procedures were clearly inadequate given the numerous errors and violations of the FDCPA" and instead consigned the issue to trial as a disputed fact). *See McCollough v. Johnson, Rodenberg & Lauinger, 610 F. Supp. 2d 1247 (D. Mont. 2009)* (bona fide error defense does not protect a debt collector whose reliance on its creditor's representations is unreasonable).

(n24)Footnote 24. *But see Jenkins v. Heintz, 124 F.3d 824 (7th Cir. 1997)* , *cert. denied, 523 U.S. 1022, 118 S. Ct. 1304, 140 L. Ed. 2d 469 (1998)* ; *Smith v. Transworld Sys., Inc., 953 F.2d 1025 (6th Cir. 1992)* (collector's assertion of bona fide error defense upheld where collector sent letter to consumer after receiving request to cease communication because the court found collector did not intend to violate act); *Danielson v. Hicks, 1996 WL 767290 (D. Minn. 1996)* (bona fide error established based on new computer system). *See also Shula v. Lawent, 2002 U.S. Dist. LEXIS 24542* (N.D. Ill. Dec. 23, 2002) (although the collector failed to plead the bona fide error defense, use of a former lawyer's letterhead was not a violation of the FDCPA where the consumer failed to demonstrate any prejudice or harm suffered as a result of the erroneous substitution).

(n25)Footnote 25. *443 F.3d 723 (10th Cir. 2006)* .

(n26)Footnote 26. *See Nichols v. Northland Groups, Inc., 2006 U.S. Dist. LEXIS 15037* (N.D. Ill. Mar. 31, 2006) .

(n27)Footnote 27. *Seeger v. AFNI, Inc., 548 F.3d 1107, 1114 (7th Cir. 2008)* .

(n28)Footnote 28. *See* 18 Moore's Federal Practice--Civil P 131.10 (3d ed.). *See, e.g., Whitaker v. Ameritech Corp., 129 F.3d 952 (7th Cir. 1997)* , *reh'g denied*, *1998 U.S. App. LEXIS 500* (7th Cir. Ill. Jan. 9, 1998) ; *Metzenbaum v. Huntington Nat'l Bank, 124 F.3d 198 (6th Cir. 1997)* (unpublished decision), *reported in full*, *1997 U.S. App. LEXIS 25335* (6th Cir. Ohio Sept. 17, 1997) ; *Rosendale v. Citibank, 1996 U.S. Dist. LEXIS 4700* (S.D.N.Y. Apr. 12, 1996) (*pro se*) (FDCPA claim dismissed on grounds of *res judicata* because it had already been decided on the merits in a state action); *Cornett v. Bank of New York, 1992 U.S. Dist. LEXIS 5140* (S.D.N.Y. Apr. 17, 1992) (*pro se* plaintiff's FDCPA and other claims, which had been previously litigated in small claims court, were dismissed on the basis of *res judicata*).

(n29)Footnote 29. *Fed. R. Civ. P. 13(a).*

(n30)Footnote 30. *See McDuffy v. DeGeorge Alliance, Inc., 2000 U.S. Dist. LEXIS 4879, at 27 n.15* (D. Del. Mar. 31, 2000) (plaintiffs' FDCPA claims were litigated in an earlier state court decision on the merits and were precluded by *res judicata*). *Sheahy v. Primus Automotive Financial Services, Inc., 284 F. Supp. 2d 278 (D. Md. 2003)* (plaintiff's FDCPA and other claims regarding the voluntary repossession of a motor vehicle were dismissed based on res judicata where the state court had previously entered default judgment, the claims could have been raised there, and allowing the claims would have the effect of nullifying the prior judgment). *See also Cousins v. Duane St. Assocs., 2001 U.S. App. LEXIS 5645* (2d Cir. Apr. 2, 2001) (unpublished) (FDCPA claims not barred as res judicata since they could not have been asserted defensively in state landlord-tenant proceeding.); *Spears v. Brennan, 745 N.E.2d 862 (Ind. Ct. App. 2001)* (FDCPA claim does not arise out of transaction creating the debt and was not a compulsory counterclaim), *reh'g denied, 2001 Ind. App. LEXIS 1171* (Ind. Ct. App. June 28, 2001) . *Clabault v. Shodeen Mgmt., 2006 U.S. Dist. LEXIS 1536* (N.D. Ill. Jan. 6, 2006) (consumer's current federal FDCPA claims were not barred by res judicata since state court action to collect debt and FDCPA action for unlawful collection activity were different causes of action, contrary to rule

that res judicata requires that there two cases share "an identity of cause of action"); *Watson v. Auto Advisors, Inc., 822 N.E.2d 1017 (Ind. Ct. App. 2005)* (FDCPA claim was not precluded by judgment on debt in a suit in which FDCPA claim could have been but was not required to be brought). *But see Egge v. Healthspan Servs. Co., 115 F. Supp. 2d 1126 (D. Minn. 2000)* (state debt collection suit did not bar, on *res judicata* grounds, claim that defendant violated the FDCPA by threatening to collect usurious interest; FDCPA claim was not a mandatory counterclaim in state court and did not arise from the underlying debt, but from a different transaction, its collection).

(n31)Footnote 31. *Long v. Shorebank Dev. Corp., 182 F.3d 548, 554-55 (7th Cir. 1999)* (tenant whose state court eviction was allegedly procured by fraud by collector was not precluded by *Rooker-Feldman* doctrine from pursuing FDCPA damages for resulting loss of her job, loss of custody of her daughter, and 6 months of homelessness. "The counts in Long's complaint alleging violations of the FDCPA are independent from the eviction, order and, therefore, Rooker-Feldman does not apply to these claims."). *See also Ellis v. Cac Fin. Corp., 2001 U.S. App. LEXIS 4961* (10th Cir. Mar. 26, 2001) (unpublished) (*Rooker-Feldman* doctrine prevented *pro se* FDCPA claim in federal court arising out of collector's alleged fraud and perjury in the preceding state court action on the debt); *Hill v. Priority Fin. Servs., Inc., 2001 U.S. Dist. LEXIS 16900* (S.D. Ind. Sept. 28, 2001) (challenge to court awarded attorney fees must be addressed to applicable trial court, not fashioned as an FDCPA claim, because such a challenge represents a collateral attack on the state court judgment), *related proceeding, 2003 U.S. Dist. LEXIS 7812* (S.D. Ind. Mar. 26, 2003) . *But see Brooks v. Auto Sales & Servs. Inc., 2001 U.S. Dist. LEXIS 8059* (S.D. Ind. June 15, 2001) (*Rooker-Feldman* doctrine did not preclude *pro se* consumer's claim that attorney sought excessive attorney fees in state court action which had gone to judgment, because FDCPA claim arose before judgment was entered; consumer was not estopped from litigating issue because there was no showing that validity of fee amount was actually litigated in state court action). *See* National Consumer Law Center, Fair Debt Collection § 7.4.4 (6th ed. 2008) for further discussion of *Rooker-Feldman* doctrine.

(n32)Footnote 32. *125 S. Ct. 1517* (Mar. 30, 2005) .

(n33)Footnote 33. *See § 8.05[5], supra.*

(n34)Footnote 34. *Exxon Mobil* at 1523 .

(n35)Footnote 35. *Id. at 1521-22* .

(n36)Footnote 36. *Id. at 1526* .

(n37)Footnote 37. *Id.* at p.7, n.8 (citation omitted).

(n38)Footnote 38. *15 U.S.C. § 1692i.*

(n39)Footnote 39. *15 U.S.C. § 1692a(6)(D).*

(n40)Footnote 40. *15 U.S.C. § 1692c(a).*

(n41)Footnote 41. *15 U.S.C. § 1692e(11).*

(n42)Footnote 42. *15 U.S.C. § 1692e(15).*

(n43)Footnote 43. *514 U.S. 291, 115 S. Ct. 1489, 131 L. Ed. 2d 395 (1995)* .

(n44)Footnote 44. *Johnson v. Riddle, 305 F.3d 1107 (10th Cir. 2002)* (*Rooker-Feldman* doctrine did not apply to consumer's FDCPA claim because she was not a party to the default judgment in state court and collection action against her had been dismissed).

(n45)Footnote 45. *See Kropelnicki v. Siegel, 290 F.3d 118 (2d Cir. 2002)* (claims regarding post-judgment letter are not barred by *Rooker-Feldman* because they are not inextricably intertwined with the state court determination,

since consumer did not have the opportunity to litigate them in debt collection action); *Resler v. Messerli & Kramer, P.A., 2003 U.S. Dist. LEXIS 1741* (D. Minn. Jan. 23, 2003) (FDCPA claim that the state court garnishment notice did not contain state required disclosure of exemptions did not affect the state judgment and was not barred).

(n46)Footnote 46. *See Fontana Empire Ctr. v. City of Fontana, 307 F.3d 987 (9th Cir. 2002) . See also Todd v. Weltman, Weinberg & Reis, Co., L.P.A., 348 F. Supp. 2d 903 (S.D. Ohio 2004)* (neither Rooker-Feldman nor issue- or claim-preclusion barred FDCPA claims based on the defendant collection attorneys' false oath in their affidavits in support of state court garnishments misrepresenting the state of the debtors' non-exempt assets, when in fact the attorneys had no information or knowledge whatsoever concerning the matter, since the FDCPA case was based on the attorneys making false representations to that court, not the substance of any underlying state court ruling).

(n47)Footnote 47. *Kelley v. Med-1 Solutions, L.L.C., 548 F.3d 600 (7th Cir. 2008) .*

(n48)Footnote 48. *Id. at 605 .*

(n49)Footnote 49. *Id. at 606* , 607.

(n50)Footnote 50. *Gray-Mapp v. Sherman, 100 F. Supp. 2d 810, 814 (N.D. Ill. 1999)* (debtor's FDCP claim could not be based on a proof of claim filed during bankruptcy proceeding because "[n]othing in either the Bankruptcy Code or the FDCPA suggests that a debtor should be permitted to bypass the procedural safeguards in the Code in favor of asserting potentially more lucrative claims under the FDCPA."). *See* National Consumer Law Center, Fair Debt Collections, §§ 2.2.5 (6th ed. and supp.).

(n51)Footnote 51. *15 U.S.C. § 1692k(e).*

(n52)Footnote 52. *16 C.F.R. §§ 1.1-1.4(1996).*

(n53)Footnote 53. *See § 8.01[2][c] supra.*

(n54)Footnote 54. *Scott v. Jones, 964 F.2d 314 (4th Cir. 1992) .*

(n55)Footnote 55. *See, e.g., Letellier v. First Credit Servs., 2001 U.S. Dist. LEXIS 10288* (N.D. Ill. July 19, 2001) (case moot where motion for class certification not filed for almost two months after offer of judgment made); *Person v. Stupar, Schuster & Cooper, S.C., 2001 U.S. Dist. LEXIS 18203* (E.D. Wis. July 6, 2001) (offer of judgment to named plaintiff mooted class action where no motion to certify the class had been filed; acceptance of offer of $1000 statutory damages to named plaintiff could not be accepted as an offer of $1000 to each member of the class). For further discussion of offers of judgment, see National Consumer Law Center, Fair Debt Collection, § 2.4.13 (5th ed. 2004). and National Consumer Law Center, Consumer Law Pleadings (2001 Cumulative CD-Rom and Index Guide) (memorandum of law on this issue).

(n56)Footnote 56. *See Parker v. Risk Mgmt. Alternatives, Inc., 2001 U.S. Dist. LEXIS 18061* (N.D. Ill. Nov. 5, 2001) , *class certification granted, 206 F.R.D. 211 (N.D. Ill. 2002)* ; *Whitten v. ARS Nat'l Servs., 2001 U.S. Dist. LEXIS 15472* (N.D. Ill. Sept. 27, 2001) , *summ. judg. granted, 2002 U.S. Dist. LEXIS 9385* (N.D. Ill. May 23, 2002) .

(n57)Footnote 57. *Liles v. American Corrective Counseling Servs., Inc., 201 F.R.D. 452 (S.D. Iowa 2001) .*

(n58)Footnote 58. *E.g., Deposit Guaranty Nat'l Bank v. Roper, 445 U.S. 326 (1980)* ; *United States Parole Comm'n v. Geraghty, 445 U.S. 388 (1980) .*

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 8 Fair Debt Collection

1-8 Consumer Credit Law Manual § 8.06

§ 8.06 Federal Trade Commission Debt Collection Law: Using FTC Law and Remedies

[1] FTC Decisions as Precedents for Actions Under the Federal Fair Debt Collection Practices Act and State Laws

The FTC has been active for many decades in bringing administrative actions against debt collectors using "unfair or deceptive acts or practices" prohibited by the FTC Act. n1 The FTC formerly published its decisions and orders (but not decisions issued by the courts) in *FTC Decisions*, but hard copy publication ceased in 2003. The volumes are now available on-line at www.ftc.gov/os/decisions/index.shtm. The FTC website permits full-text searches of these decisions. FTC actions against debt collection abuses are summarized in the *Commerce Clearinghouse Trade Regulation Reporter*, the *Antitrust and Trade Regulation Report of the Bureau of National Affairs, Inc*., the Federal Register, and sometimes in the *CCH Consumer Credit Guide*. Recent actions are also posted on the FTC's website, n2 which includes a search feature for locating actions against specific defendants or that use specific words. The FTC also has one trade regulation rule--the Credit Practices Rule n3 --that specifically affects debt collection by restricting certain creditor remedies.

Most FTC decisions are "consent orders," agreements by respondents not to engage in the practice listed in the orders, without admitting any wrongdoing. While the precedential value of a consent order is probably less than that of a more fully litigated case, all initial complaints and consent orders are officially approved by the Commission, subject to public comment, and reflect the policy and interpretative positions of the FTC.

FTC decisions are useful to consumer lawyers in a variety of ways. Many of the proscriptions in the FDCPA were modeled on FTC decisions proscribing the same types of conduct. Another major use of FTC precedent is in interpreting the terms of state consumer protection acts that broadly proscribe unfair or deceptive acts and practices. Often the statutory language of such acts or local case law specifically refers to interpretations of the FTC Act as authority for interpreting the local law.

FTC precedents may also be useful in tort actions and actions under other state statutes.

[2] FTC Requires Creditor to Oversee Its Collection Agencies' FDCPA Compliance

The FTC gave final approval to a consent agreement with the American Family Publishers ("AFP")--one of the largest

sellers of magazine subscriptions in the United States--settling charges that it violated the FTC Act when it hired collection firms and knowingly approved or assisted their use of deceptive debt collection practices. n4 This consent decree is the first decision extending an obligation to a creditor to oversee its collection agencies' FDCPA compliance.

The consent order requires AFP to instruct any debt collector it retains, engages, or employs to comply fully with all the provisions of the FDCPA.

[3] Filing Complaints About Debt Collectors' Practices With the FTC

When dealing with the FTC's Washington, D.C. headquarters, the Office of Credit Practices should be contacted. n5 When filing a complaint with a regional FTC office, it is best to determine in advance the name of a staff attorney or paralegal who is interested in FDCPA or FTC debt collection enforcement and to deal directly with that person.

[4] FTC Decisions on Debt Collection Abuses

The following cases of debt collection abuse have been found to violate the FTC Act and to warrant FTC cease and desist orders (or consent decrees where specifically noted) prohibiting future similar deception or unfair practices. Many of the cases involved other prohibited misconduct, omitted from discussion here. The list of practices set forth is not exhaustive, but provides a framework for measuring the legality of debt collector conduct.

[a] Threats Misrepresenting a Collector's Intention to Take Legal Action Are Prohibited by the FTC Act

Debt collectors make frequent threats that they will bring suit, refer the matter to an attorney, garnish wages, or repossess furniture. These have been found deceptive in numerous FTC decisions. n6

Such threats of legal action violate the FTC Act if they are deceptive. They may be deceptive for any of a variety of reasons. One reason may be that the collector does not intend to pursue legal action against the consumer to whom the threat is sent.

Even the threat of legal action by a collector who sometimes does pursue such action may be deceptive in certain situations, such as legal action was not intended in the particular case or the legal action was not as imminent as the threat implied. n7

A false threat to refer a claim to an attorney is deceptive and prohibited by the FTC Act.

[b] It Is Deceptive for Collectors to Design Their Dunning Letters to Appear to Be Telegrams

The FTC has found it to be deceptive and violative of the FTC Act for a collector to send dunning letters which simulate the appearance of telegrams because such letters misrepresent the nature, importance, cost, purpose, and urgency of the communication. n8

[c] Misrepresenting the Existence of a Debt or the Amount Due Is Prohibited by the FTC Act

FTC decisions dealing with firms mailing unsolicited merchandise to consumers have developed the principle that it is deceptive to misrepresent the existence or nature of a consumer's obligation. n9

[d] The Use of Harassing or Abusive Telephone Calls or Letters Is an Unfair Practice Violating the FTC Act

In one case, a door-to-door magazine subscription seller agreed not to "harass or intimidate" consumers by telephone calls and other communications in collecting debts. n10 Other collectors have agreed not to harass customers by using repeated phone calls, abusive language, and telephone calls at late hours. n11

[e] Contacting or Threatening to Contact Third Parties Is Unfair and Deceptive

Several FTC cases have resulted in agreements by collectors not to misrepresent that they will contact consumer's employers in connection with their collection efforts. n12 Several FTC decisions prohibit third-party contacts altogether. n13

[f] Filing Collection Suits in Courts Distant From the Consumer's Residence Is an Unfair Practice Prohibited by the FTC Act

The FTC moved against several companies that engaged in the practice of suing their delinquent customers in forums distant from the customers' residences. The FTC found this practice "unfair," and the finding was upheld on appeal. n14

[g] Misrepresenting the Adverse Impact of Nonpayment Upon a Consumer's Creditworthiness Is Prohibited by the FTC Act

Creditors and debt collection agencies sometimes threaten consumers with adverse credit reports if debts are not paid. Reporting a debt to a credit bureau is "a powerful tool designed, in part, to wrench compliance with payment terms. ..." n15 Such threats, when not carried out, are deceptive. Debt buyers often buy up debts that are so old that they cannot be listed on the consumer's credit report. n16 It is deceptive for a debt buyer to threaten to hurt a consumer's credit rating by reporting such a debt. n17

[h] Misrepresenting a Fictitious Collection Agency as an Entity Separate From the Collector Is Deception Prohibited by the FTC Act

Misrepresentations that accounts are being collected by a separate collection agency that is, in fact, fictitious or that accounts will be referred to a collection agency when they will not be so referred are the subject of numerous FTC consent orders. n18

[i] Misrepresenting That a Claim Has Been or Will Be Transferred to an Attorney or Separate Department of a Collector Is Prohibited by the FTC Act

Collectors sometimes attempt to mislead consumers into believing that their collection efforts have entered into a more serious stage by misrepresenting that their claims have been transferred to attorneys or to the legal or other department of the collector's company. Letters misrepresenting that the account has been transferred to an attorney usually include an attorney's letterhead and often contain explicit threats of legal action. They are deceptive when the decision to send the letters is made without the attorney's supervision. n19

[j] Misrepresenting a Collector's Affiliation With the Government Is Prohibited by the FTC Act

Collectors sometimes fashion collection letters or communications to give consumers the impression that they are affiliated with or a part of the government. This violates the FTC Act. n20

[k] Using Subterfuge to Obtain a Consumer's Current Address or Place of Employment Is Prohibited

The FTC has brought a great many actions against companies that use ruses designed to trick consumers into providing current addresses or places of employment. n21

[l] Collection Letters That Simulate Legal Process Are Prohibited by the FTC Act

Collectors sometimes fashion their collection letters so that they appear to be some type of legal process. Such practices may deceive consumers regarding the urgency, seriousness, authority, or source of the collection letters and undermine

respect for the courts and the law.

There have been a number of FTC cases in which companies were ordered not to use collection forms simulating legal process. n22

[m] Advertising "Easy Credit" While Using Rigorous Collection Methods Against Delinquent Consumers Is Deceptive

Rigorous enforcement of credit claims against consumers makes a creditor's advertisement of "easy credit" false and deceptive. n23

[5] FTC Informal Guides and Prospective Regulations

[a] Creditors and Other Collectors Should Look to the Fair Debt Collection Practices Act for Standards to Comply With the FTC Act

In 1995, the FTC repealed its informal "Guides Against Debt Collection Deception" n24 because they had been superseded and subsumed by the FDCPA. n25

[b] FTC Credit Practices Rule Restricts Six Creditor Remedies

[i] Scope of the Rule

The FTC's Trade Regulation Rule Concerning Credit Practices (16 C.F.R. Part 444) restricts six creditor remedies. n26 The FTC Rule thus prohibits the following six practices:

- Confessions of judgment, cognovits, and other waivers of the right to notice and opportunity to be heard in the event of suit (this provision does not apply to executory process in Louisiana);

- The debtor's waiver of protections concerning property exempt from attachment or execution, such as waiver of a homestead exemption (this provision does not prohibit security interests in exempt property);

- Assignment of wages or other earnings before judgment;

- Non-purchase money security interests in household goods, but creditors can still take security interests in works of art, items acquired as antiques, jewelry (except wedding rings), and electronic entertainment equipment (except one television and one radio); n27

- Pyramiding late charges by assessing more than one delinquency charge for one late payment (pyramiding late charges for a *missed* payment is not prohibited); and

- The failure to provide co-signers with a specified warning indicating the potential obligations of a cosigner.

The best source for understanding the FTC's Credit Practices Rule are the FTC's Statement of Basis and Purpose for the Rule. n28

The FTC Rule applies to finance companies, retailers, and other creditors within the FTC's jurisdiction. The FTC Rule does not apply to most banks which parallel rules issued by the Office of Thrift Supervision n29 and the Federal Reserve Board. n30 Credit unions are covered by a comparable rule enacted by the National Credit Union

Administration. n31

[ii] Private Remedies for FTC Credit Practices Rule Violations

There is generally no direct private right of action for a violation of an FTC Rule. However, it seems clear that a consumer can challenge an FTC Credit Practices Rule violation under the almost 40 state unfair and deceptive acts and practices ("UDAP") statutes that prohibit "unfair" and/or "unconscionable" practices.

Even in states where the UDAP statute prohibits only "deceptive" practices, it may be deceptive for a creditor to violate the Rule because including illegal provisions in a credit agreement misrepresents the consumer's legal rights.

[iii] Security Interests in Household Goods

Finance companies now wishing to take consumer goods as collateral can no longer identify the property as "all household goods," but must identify each specific item. Many creditors will use a preprinted form listing the types of collateral falling outside the FTC Rule's definition of "household goods," and then just check appropriate items. For example, a creditor might check "jewelry," "stereo," and "tools." But a valid security agreement must identify collateral with particularity so a sheriff or other party knows precisely what property to seize. n32

[iv] Challenging Other Creditor Remedies

The Statement of Basis and Purpose is also significant because it provides an "unfairness" approach which can apply to many kinds of adhesive consumer credit provisions, and not just the six creditor remedies prohibited by the Rule. The FTC defines an unfair practice as one that (1) causes substantial injury; (2) not outweighed by any countervailing benefits to consumers or competition; and (3) that consumers themselves could not reasonably have avoided. n33

Additionally, a number of creditor remedies have been found unconscionable under the *UCC section 2-302*. These unconscionable creditor remedies include cross-collateral or waiver-of-defense clauses, attorney fee provisions, consent to breach of the peace on self-help repossession, waiver of interest in repossessed personal property unless the creditor is notified, and authorizing venue or jurisdiction in distant forums. Practices found unconscionable under the UCC can be argued to be unfair or unconscionable pursuant to a UDAP statute.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Debt CollectionGeneral OverviewBanking LawConsumer ProtectionFair Debt CollectionCommunicationsBanking LawConsumer ProtectionFair Debt CollectionLiabilityBanking LawConsumer ProtectionFair Debt CollectionUnfair PracticesReal Property LawLandlord & TenantTenant's Remedies & RightsFair Debt Collection Practices Act

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 45(a)(1).*

(n2)Footnote 2. www.ftc.gov. Lexis and Westlaw databases include selected judicial decisions under the FTC Act, litigated decisions issued by the Commission itself, and FTC announcements of consent decrees and orders. The FTC website, www.ftc.gov, has a search function that enables the user to find complaints, consent orders, and decisions involving particular collectors.

(n3)Footnote 3. 16 C.F.R. § 444.

(n4)Footnote 4. *58 Fed. Reg. 8762* (Feb. 17, 1993) .

(n5)Footnote 5. Division of Credit Practices, Federal Trade Commission, Washington, D.C. 20580, (202) 326-3224.

(n6)Footnote 6. *See* U.S. v. United Recovery Sys., Inc., (S.D. Tex. Apr. 17, 2002) (FDCPA consent decree) (prohibiting threats unless action is legal and collector or creditor intends to take it); United States v. Allied Publishers Service, Inc., *45 Antitrust & Trade Reg. Rep. (BNA) 329 (E.D. Cal. 1983)* (consent order) (magazine subscription seller agreed not to misrepresent its intent to institute legal proceedings). *See also Cooke, 9 F.T.C. 283 (1925)* (false threats of suit by vocational school scam); FTC v. Check Investors, Inc., Civ. No. 03-2115 (JWB) (D.N.J. Aug. 14, 2003), *available at* www.ftc.gov/opa/2003/05/nccfinal.htm (complaint and preliminary injunction under FDCPA and FTC Act against collector that threatened imminent arrest and civil suit).

(n7)Footnote 7. *Trans World Accounts, Inc. v. FTC, 594 F.2d 212, 1979-1 Trade Cas. (CCH) P62583 (9th Cir. 1979)* .

(n8)Footnote 8. *Trans World Accounts, Inc. v. FTC, 594 F.2d 212, 1979-1 Trade Cas. (CCH) P62583 (9th Cir. 1979)* (collection agency mailed deceptive letters in yellow window envelopes with the word "TELEGRAM" printed in large black type over the window and on the reverse side; the notice inside was a yellow printed form with the word "TELEGRAM" printed on it; collector later used the deceptive word "Trans-O-Gram" in blue and white envelope and computer type).

(n9)Footnote 9. United States v. Bally's Health & Tennis Corp., 5 *Trade Reg. Rep. (CCH) P 23,588 (D.D.C. 1994)* (proposed consent decree) (health club chain harassed customers for payment although they canceled their contracts; health club also procured unauthorized charges on consumer's credit cards and bank accounts). *See also,* U.S. v. Fairbanks Capital Corp., Civil No. 03-12219 (D. Mass. Nov. 12, 2003), *available at* www.ftc.gov/opa/2003/11/fairbanks.htm (consent order prohibiting mortgage servicer from misrepresenting amount consumer owes or that fees are allowed; also prohibits charging for demand letters and restricts other default charges); FTC v. AKOA, Inc., 5 *Trade Reg. Rep. (CCH) P 24,408 (C.D. Cal. 1998)* (consent decree) (aggressively pursuing collection after sending unordered merchandise); *Fed. Trade Comm'n v. Check Enforcement, 2005 U.S. Dist. LEXIS 34349* (D.N.J. July 18, 2005) (collector violated FTC Act by inflating amount of dishonored check claim).

(n10)Footnote 10. *Hearst Corp., 82 F.T.C. 218, 230 (1973)* (consent order).

(n11)Footnote 11. *Avco Fin. Servs., Inc., 104 F.T.C. 485 (1984)* (consent order).

(n12)Footnote 12. *Royal Furniture Co., 93 F.T.C. 422 (1979)* (consent order) (furniture retailer agreed not to communicate or threaten to communicate with consumer's employer except to obtain location information or confirm earnings).

(n13)Footnote 13. *Avco Fin. Servs., Inc., 104 F.T.C. 485 (1984)* (consent order) (lender agreed not to contact employer where the employer objected to or prohibited such contact; and not to contact others, except the consumer's attorney, other creditors or collection agencies, or third parties for the purpose of obtaining location information, determining assets, or pursuant to court order); *Aldens, Inc., 98 F.T.C. 790 (1981)* (consent order) (agreed to promise in its contracts not to contact or threaten to contact unobligated third parties except the consumer's attorney, to obtain location information, or to place the debt for collection). *See also In re Applied Card Systems, Inc., 2004 WL 1942064* (F.T.C. Aug. 25, 2004) (complaint and proposed consent order), www.ftc.gov/os/caselist/0323040/04/041008do032340.pdf (F.T.C. Oct. 6, 2004) (final consent order) (prohibiting harassment of third parties with abusive or obscene language or repeated calls).

(n14)Footnote 14. *Spiegel, Inc. v. FTC, 540 F.2d 287, 1976-2 Trade Cas. (CCH) P61006 (7th Cir. 1976) . J.C. Penney Co., 109 F.T.C. 54 (1987)* (consent order); *Marathon Oil Co., 92 F.T.C. 422 (1978)* (consent order) (credit card seller of oil and other consumer products agreed not to sue its customers except in the judicial district where the individual customer currently resided or signed the contract; all pending suits not in such forums were to be terminated

and credit reporting agencies were to be notified); *S.S. Kresge Co., 90 F.T.C. 222 (1977)* (consent order) (collection agencies, attorneys, and other agents of this retailer were alleged to have brought collection suits in distant forums; Kresge agreed not to bring such suits, to terminate any such suits pending, and to vacate any default judgments taken in unreasonably distant forums); *Montgomery Ward Co., 84 F.T.C. 1337 (1974)* (consent order) (this retailer agreed not to sue its customers except in an appropriate court in the county nearest their current residence or their residence at the time the contract was signed). *See also* FTC v. Leasecomm Corp., Civ. No. 03-11034RFK (D. Mass. May 29, 2003), *available at* www.ftc.gov/os/2003/05/leasecommstip.htm.)

(n15)Footnote 15. *Miranda Rivera v. Bank One, 145 F.R.D. 614 (D.P.R. 1993)* ; *accord In re Sommersdorf, 139 B.R. 700, 701 (Bankr. S.D. Ohio 1991)* .

(n16)Footnote 16. *15 U.S.C. § 1681c*. See National Consumer Law Center, Fair Credit Reporting § 5.2 (6th ed. 2006).

(n17)Footnote 17. Fed. Trade Comm'n v. Capital Acquisitions & Mgmt. Corp., Civil Action No. 04-C-7781 (N.D. Ill. Apr. 11, 2005) (amended complaint), (N.D. Ill. Nov. 30, 2006) (consent order against corporate defendants), (N.D. Ill. Jan. 24, 2007) (consent order against individual defendant).

(n18)Footnote 18. *Hearst Corp., 82 F.T.C. 218 (1973)* (consent order); *Edison Sewing Mach. & Vacuum Cleaner Co., 71 F.T.C. 319 (1967)* (consent order); Annot., *Use of Fictitious Collection Agency to Coerce Payment as Unfair or Deceptive Practice Prohibited by Sect. 5 of Federal Trade Commission Act*, *25 A.L.R. Fed. 390 (1975)* . *See also* FTC v. Capital City Mortg. Corp., Civil Action No. 98CV-237 (D.D.C. May 14, 2004), *available at* www.ftc.gov/os/caselist/capitalcitymortgage/040514condecree.pdf (consent decree barring company's former general counsel from participating in any debt collection business; complaint alleged that he sent letters falsely claiming to be from a third party collector).

(n19)Footnote 19. *Grolier, Inc., 91 F.T.C. 315 (1979)* .

(n20)Footnote 20. *Royal Furniture Co., 93 F.T.C. 422 (1979)* (consent order) (retailer's collectors misrepresented themselves as New York City marshals, sheriffs, attorneys, or other state and local officials). *See also* Crouch, FTC Informal Staff Letter (Sept. 10, 1996) (name "Credit Bureau of Connecticut," without exculpatory language in its letter, could mislead consumer into believing affiliation with State of Connecticut existed); *but cf.* Chesworth, FTC Informal Staff Letter (Sept. 16, 1997) (name "Law Enforcement Systems, Inc." permitted). *See also Slough v. FTC, 396 F.2d 870, 1968 Trade Cas. (CCH) P72500* (5th Cir.) , *cert. denied*, *393 U.S. 980 (1968)* (collector *also* mailed its forms seeking location information from mail drops in appropriate state capitals and used official-sounding titles, such as "County Agent"; it made no difference that owner of the firm changed his first name from "Earl" to "State"); *Bennett v. FTC, 200 F.2d 362, 1952 Trade Cas. (CCH) P67372 (D.C. Cir. 1952)* (using name "National Service Bureau" and title "Disbursement Officer" with a District of Columbia mailing address, the sender created the impression that it was connected with the Veterans Administration or the U.S. government).

(n21)Footnote 21. *See* United States v. Allied Publishers Serv., Inc., *45 Antitrust & Trade Reg. Rep. (BNA) 329 (E.D. Cal. 1983)* (consent decree) (magazine subscription seller agreed not to misrepresent the purpose of an inquiry to secure information of a consumer's location).

(n22)Footnote 22. *Neighborhood Periodical Club, Inc., 81 F.T.C. 93 (1972)* (consent order).

(n23)Footnote 23. *Tashof v. FTC, 437 F.2d 707, 1971 Trade Cas. (CCH) P73417 (D.C. Cir. 1970)* .

(n24)Footnote 24. 16 C.F.R. § 237 (1991), *32 Fed. Reg. 15,539* (Nov. 8, 1967), as amended at *33 Fed. Reg. 5661* (Apr. 12, 1968) .

(n25)Footnote 25. *15 U.S.C. §§ 1692-1692 o*.

(n26)Footnote 26. The Rule and the accompanying Statement of Basis and Purpose may be found at *49 Fed. Reg. 7740* (Mar. 1, 1984) . National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 6.11 (7th ed. 2008).

(n27)Footnote 27. See National Consumer Law Center, Repossessions § 3.4.2 (6th ed. 2005) for a discussion of this prohibition.

(n28)Footnote 28. *49 Fed. Reg. 7740* (Mar. 1, 1984) . *See also* Ch. 4, "Unfair and Deceptive Credit Practices," *§ 4.04[1][i] supra* .

(n29)Footnote 29. 12 C.F.R. § 535.

(n30)Footnote 30. *12 C.F.R. § 227.*

(n31)Footnote 31. *See* 12 C.F.R. § 706.

(n32)Footnote 32. *See* Ch. 10, "Repossessions," *§ 10.02 infra* .

(n33)Footnote 33. *See § 4.04[1][i] supra.*

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 8 Fair Debt Collection

1-8 Consumer Credit Law Manual § 8.07

§ 8.07 Regulation of Federal Administrative Agencies' Collection Practices

[1] Congress Strengthens Federal Government's Debt Collection Powers

Throughout the 1980s, Congress passed numerous laws to strengthen the tools available to the United States when it has a claim against a person.

Each federal agency is responsible for its own prelitigation collection efforts. Those efforts are governed by two statutes--the Federal Claims Collection Act n1 and the Debt Collection Act, umbrella federal regulations called the Joint Regulations, n2 and the agency's own debt collection regulations, implementing those laws. In addition, the agency's authorizing statutes may expand or contract its debt collection powers. Suits to collect federal claims are governed by the Federal Debt Collection Procedures Act, n3 as well as the FRCP.

Commercial credit reporting agencies and debt collection agencies and attorneys hired by the federal administrative agencies remain subject to the consumer protection laws that generally apply to them. Consumer claims against the federal administrative agencies for the abusive debt collection tactics of their federal employees may be made as a civil rights or Federal Tort Claims Act claim.

[2] Prelitigation Activities Governed by the Federal Claims Collection Act, the Debt Collection Act, and the Joint Regulations

[a] Overview

The extra-judicial collection of debts by United States administrative agencies has been governed since 1966 by the Federal Claims Collection Act. n4 The Act mandates that federal agencies must attempt to collect overdue obligations, and the Act permits agencies to settle, abandon or suspend claims when appropriate. The Federal Claims Collection Act calls for the collection of debts to be carried out under guidelines promulgated jointly by the Attorney General and the Secretary of the Treasury (the Joint Regulations), n5 which detail the procedure to be followed by an agency in its collection efforts.

The Debt Collection Act of 1982 toughens the debt collection and debt prevention procedures available to federal agencies. In particular, the Debt Collection Act permits the release to commercial credit reporting agencies of obligors'

names, addresses and amounts owing, n6 and gives agencies access to the Internal Revenue Service records of overdue tax claims for existing obligors and prospective borrowers. n7 Later amendments allowed agencies to hire collection agencies, n8 intercept consumers' federal tax refunds, or other sums owed by the government to consumers, and hire private collection attorneys. n9

[i] The Debt Collection Improvement Act of 1996

In 1996, Congress further strengthened the debt collection powers of federal agencies in ways likely to weigh heavily on some low-income households. The Debt Collection Improvement Act of 1996: n10

- Permits administrative offset against formerly exempt Social Security and Veterans Benefits. n11 An annual amount of $9000 of benefits are exempt.

- Allows wage garnishment of up to 15% of earnings, "notwithstanding state law." The CCPA limitation of 30 times minimum wage should apply. An employer may not terminate an employee because of a federal agency's garnishment and may be subject to punitive damages for doing so. n12

- Denies federal loans, loan insurance, or guarantees to debtors delinquent on federal, non-tax and non-disaster, claims. This subsection may be waived by an agency head, as to an individual debtor, or a class of claims. n13

- Mandates a computer match to locate federal employees who owe debts to federal agencies.

The provision which permits agencies to compromise debts and suspend or end collection if the debtor lacks "present or prospective ability to pay" or if the cost of collection is likely to exceed the recovery was not altered by the 1996 legislation.

[b] The Federal Agency Must Make Proper Written Demand for Payment

Until 2000, the Joint Regulations required federal agencies, in most cases, to make three written demands for payment before taking further action against the debtor, other than charging interest. n14 That requirement has now been reduced to a single demand letter. n15 The demand letter must inform the debtor of the basis for the indebtedness, the debtor's right to seek review within the agency, the standards for imposing interest, penalties, or administrative costs, the date by which payment should be made to avoid late charges and enforced collection (usually thirty days from mailing), and the name, address, and phone number of a contact person or office within the agency. n16 The Joint Regulations specify that agencies should take steps to insure that all demand letters are mailed on the same day they are dated, n17 thus insuring the consumer the maximum time to respond before the deadline. In addition, agencies are directed to respond promptly to communications from the debtor. n18 The agency can also sue or take other action before sending a written demand when a statute of limitations is about to run or prompt action is necessary to protect the government's interest for other reasons. n19

Notice to the debtor is also required if the agency or the Treasury Department is going to offset the debt against a payment owed to the debtor. n20 The pre-offset notice can be combined with the initial demand letter. n21

[c] Release of Information to Credit Reporting Agencies

The Debt Collection Act amended the Federal Claims Collection Act to authorize federal agencies to disclose debtor information to credit reporting agencies. n22 This authority does not apply to tax debts, debts arising under the Social Security Act (other than certain overpayments), or debts for tariffs. n23 Information which may be released is limited to the name, address and social security number of the obligor, the amount of the claim, and the agency involved.

[d] Contracts With Private Debt Collection Agencies, Credit Reporting Agencies, and Collection Lawyers

Federal agencies can contract with a private collection agency to collect debts owed the federal agency, n24 but the federal agency cannot relinquish control of the final determination of the claim. n25

The private collection attorneys retained must comply with the Fair Debt Collection Practices Act and may not claim any exemption from that Act. n26

[e] Interest Charges for Late Payment

The Debt Collection Act requires federal agencies to charge interest on overdue claims at a minimum rate of the annual average investment rate for Treasury tax and loan accounts. n27 Also, interest, penalties, and collection costs may be waived, in whole or in part, if it is determined that the charges "would be against equity and good conscience or not in the best interests of the United States." n28 The interest rate is to be a fixed rate, determined when the agency first notifies the debtor of the amount due. n29

[f] Collections Against Federal Employees

Federal agencies can collect on debts owed them by any federal employee through an offset against the employee's pay or other compensation. n30 As of 2003, the Treasury Department was processing offsets against salaries paid by the Agriculture, Defense, and Interior Departments and the Postal Service, and was planning to add other agencies in future years. n31 In late 2003, the General Services Administration adopted a new rule establishing procedures for offsets against salaries it pays. n32

Salary offset is limited to 15% of the employee's disposable income unless the employee agrees otherwise in writing. n33 The regulation takes the position that the 15% limitation on salary offset does not apply to final and lump sum payments to employees leaving federal service n34 The 1996 Debt Collection Improvement Act mandates a computer match to identify federal employees who owe debts to the federal government for the purpose of offsetting the debts against their earnings. n35 The agency that holds the debt must give the employee, at least, a thirty-day advance written notice, stating the nature and amount of the debt, that the agency plans to use salary offset, that the employee may inspect and copy the agency's record of the debt, that the employee may obtain a review of the debt within the agency, and that the employee may enter into a written contract with the agency to repay the debt. n36

According to a report to Congress, the Treasury Department began phasing in federal salary payment offsets only in 1991. n37 By the end of 2002, the Department of Agriculture and the Department of the Interior were participating, and the U.S. Postal Service and the Department of Defense were expected to begin participating soon.

[g] Installment Plans and Other Settlements

The Joint Regulations allow federal agencies to try to reach a compromise with obligors who are financially unable to pay claims. n38 Installment repayment plans are specifically authorized, if the debtor documents an inability to pay in a lump sum. n39

[h] Intercept of Consumer's Federal Income Tax Refunds

31 U.S.C. section 3720A allows federal agencies that are owed past-due, legally enforceable debts (other than any Social Security overpayments and past-due support) to refer borrowers' names to the Internal Revenue Service ("IRS") for interception of their tax refunds. n40 The statute provides n41 that before a tax intercept the creditor agency must:

- Notify the borrower that the agency intends to take such action; n42

- Give the consumer at least 60 days to present evidence that the debt is not "past due" or "legally enforceable";

- Consider any evidence and determine that an amount is "past due" and "legally enforceable"; and

- Satisfy relevant treasury regulations. n43

In addition, an agency may not participate in the tax intercept program unless it has adopted its own set of regulations. n44

Consumers may be able to attack a tax intercept or other administrative offset when the statutory and regulatory preconditions to intercept have not been met, due process requirements have been violated, or the debt is not legally enforceable. n45 The Joint Regulations provide that "the failure of an agency to comply with the provisions of this chapter shall not be available as a defense to any debtor." n46 However, this regulation can be interpreted to mean that failure to comply with the regulations is not a defense to the underlying debt, but can still be a basis for quashing the particular collection method. n47 Even if the regulation is interpreted to bar raising noncompliance with the Joint Regulations as a defense to the offset itself, it should be remembered that many agencies have their own regulations about offset procedures. Failure of the creditor agency to follow its own regulations may be a defense. n48 In addition, many of the steps required by the Joint Regulations are duplicated in the statute, and failure to follow the steps that the statute requires before offset should be a defense to the offset. Further, to the extent that the regulations set forth due process requirements failure to comply with them or to follow other procedures that would afford due process would be a defense to the offset. n49 Especially difficult problems are presented when a debtor has filed bankruptcy and claimed the tax refund as exempt. If the IRS is seeking to set off a tax debt against a refund, the interaction of the Tax Code and the Bankruptcy Code raises complex questions beyond the scope of this manual. n50

[3] Department of Education: Student Loans

When collection agencies or attorneys are collecting a student loan, the student is protected by the FDCPA n51 and may have remedies under Department of Education regulations. n52 Congress had granted the Department of Education additional debt collection powers which may raise any number of issues, e.g., administrative wage garnishment, exemption from statutes of limitations, and authority to collect reasonable collection fees. Wage garnishments to collect student loans are limited to 15% of the debtor's disposable wages if the Department is initiating garnishment and 10% if a guaranty agency is garnishing, notwithstanding the general authority in the Debt Collection Procedure Act for a 25% garnishment. n53 Until 2003, the Department of Education operated its administrative wage garnishment program under the authority of the Higher Education Act. n54 In 2003, it issued new rules allowing the Department's wage garnishment program to operate instead pursuant to the Debt Collection Improvement Act (DCIA) n55 which allows garnishment of up to 15% of a borrower's wages, rather than the 10% allowed by the Higher Education Act. n56 At least one court has found authority to reduce the garnishment below 10% in cases of hardship. n57 Student loans are also denied discharge in bankruptcy except upon showing of undue hardship. n58 The Department also has authority to offset Social Security and other federal benefits to collect student loan debts. n59 The statute allowing offset n60 states that it does not apply to claims that have been outstanding for more than ten years. The Supreme Court, in *Lockhart v. United States*, held that there was no statute of limitations on the offset of Social Security benefits to pay a student loan. n61 The Department has taken the position that the general abrogation of statutes of limitations for student loan collections in *20 U.S.C. section 1091a(a)* means that it can offset Social Security benefits even for student loan debts that have been outstanding longer than ten years. This argument ignores the Social Security anti-alienation statute, *42 U.S.C. section 407(b)*, which states that it can only be overridden by a statute that makes express reference to it. In decisions issued only a few weeks apart, the Eighth and Ninth Circuits came to different conclusions on this issue. Neither court provided much analysis. The Eighth Circuit ruled in favor of the borrower, thus affirming the reasoning of the lower court. n62 The Ninth Circuit came to the opposite conclusion. n63 The Supreme Court resolved this issue in *Lockhart v. United States*. n64

[4] Debtor Remedies for Illegal Agency Collection Practices

The Joint Regulations expressly prohibit raising agency misconduct as a defense to a claim. In addition, debt collection by United States officers and employees is excluded from the protection of the FDCPA, n65 but there are a number of judicial remedies available to those illegally harassed for debts they owe to federal agencies. In *Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics*, n66 the Supreme Court determined that a federal employee otherwise entitled to qualified immunity from suit loses this defense in the face of unreasonable conduct. Under the *Bivens* doctrine, consumers may, for example, sue IRS agents for violations of their *Fourth* or *Fifth Amendment* rights. n67 Faced with a flurry of " *Bivens* suits," the Supreme Court has narrowed the doctrine's scope. It has held that a *Bivens* remedy does not lie (1) where Congress has provided an equally effective alternative remedy and declared it to be a substitute for recovery under the Constitution, and (2) where, in the absence of affirmative action by Congress, "special factors counsel hesitation." n68 Consumers unable to assert *Bivens* claims may nonetheless pursue monetary and, in some cases, injunctive relief against federal actors when their due process rights under specific federal laws have been violated. If the debtor seeks review of a tax refund intercept, federal tax law prevents federal courts from exercising jurisdiction over the Treasury Department. n69 That statute, however, does not preclude federal court jurisdiction over the agency to which the offset was paid. n70

Other potential remedies may be available to consumers under the Privacy Act, n71 the Administrative Procedures Act, n72 and the Federal Tort Claims Act. n73

[a] Collection of Taxes by Private Debt Collection Agencies

In late 2004, Congress enacted a new law that allows the Internal Revenue Service to outsource the collection of federal tax debts to private debt collection agencies. n74 Pursuant to this law, the IRS may enter into "qualified tax collection contracts" with private agencies. The law allows the IRS to pay private collectors up to 25% of the amount of tax debt collected. n75

An important issue in the outsourcing of federal tax debts is whether private tax collectors will safeguard the confidentiality of taxpayer information. Another issue is the competence of private collectors in dealing with tax issues. Many tax debtors do not realize that there are a host of remedies and options available to consumers who owe federal tax debts. These include the ability to negotiate the amount of the debt or seek a temporary suspension of collection due to financial hardship. n76

The new law does include some safeguards. The only activities that the law authorizes private debt collectors to perform are locating and contacting taxpayers, requesting full payment or offering installment agreements lasting up to five years, and obtaining financial information about the taxpayer. n77

Additional safeguards include strict limits on the activities that a private collector can subcontract out. n78 In addition, any amount collected from a taxpayer will be fully credited toward the taxpayer's tax debt; in other words, collection fees will not be deducted from the amount paid by the taxpayer. n79

Any contract between IRS and a private collection agency must prohibit the collector from committing any act or omission that IRS employees are prohibited from committing in the performance of similar duties. n80 Existing law imposes certain FDCPA-like restrictions on IRS employees when they are collecting tax debts: they cannot communicate at inconvenient times and places; contact represented debtors (with certain exceptions); or call the debtor at work if they know the debtor's employer prohibits such calls; and various types of harassment and abuse are also prohibited. n81

In addition, the new law provides that "[t]he provisions of the Fair Debt Collection Practices Act shall apply to any qualified tax collection contract." n82 The FDCPA does not apply, however, to the extent superseded by (1) the

FDCPA-like prohibitions already in the tax code, (2) tax code restrictions on contact with third parties, and (3) "any other provision" of the tax code. n83 In other words, private tax collectors must comply with the FDCPA except where the tax code specifies conflicting duties.

As part of this new law, Congress specifically created a private cause of action against a debt collector who recklessly, intentionally, or negligently disregards any provision of the tax code or any regulation under it. n84 The taxpayer has the right to bring suit in federal court for "actual, direct economic damages," with a cap of $1,000,000 ($100,000 in the case of negligence), plus costs. n85 Unlike suits where the misdeeds are committed by IRS employees, the plaintiff need not exhaust administrative remedies. However, the new law insulates the IRS from any misconduct by the private collector, permitting suit to be brought against the private tax collector only, not against the United States. n86

It is also clear that private collectors are liable for common law torts committed in the course of collecting tax debts. The new law explicitly provides that the civil remedy it creates "shall not be an exclusive remedy." n87

[5] Federal Debt Collection Procedures Act

[a] Civil Procedure and Exemptions for Collection of Federal Government's Claims

In 1990, Congress passed the FDCPA. n88 Congress intended the Act to create a new statutory framework for the judicial enforcement of most debts owed to the U.S. government. The sponsors believed this would facilitate the collection of U.S. government debts and serve to reduce the federal budget deficit. n89

Rather than defer to state judicial remedies, as does *Fed. R. Civ. P. 64*, the FDCPA establishes a federal judicial collection scheme that, in large part, preempts and replaces state law when the United States is collecting a debt it originated or guaranteed. n90

[b] Prejudgment and Postjudgment Remedies

The FDCPA establishes both prejudgment and postjudgment remedies. The prejudgment remedies are only available upon a showing of extraordinary circumstances. The prejudgment remedies are attachment, receivership, garnishment (of nonearnings), and sequestration of income from property. n91

The subchapter on postjudgment remedies provides for judgment liens, notice of exempt property rights, execution of judgments, installment payment orders against self-employed persons or persons concealing substantial earnings, and garnishment, including garnishment of earnings. n92

[c] Property Exempt From Seizure

The law provides debtors with a choice between the federal exemptions provided in the Bankruptcy Code n93 or the combination of state exemptions and non-Bankruptcy Act federal exemptions. n94

[d] Distant Filings of Collection Suits Possible

Perhaps the most draconian measure in the FDCPA is the establishment of nationwide service of process, n95 with the resulting specter that the federal government could sue in a forum thousands of miles from the alleged debtor's current residence. This provision, however, is somewhat ameliorated by the defendant's right to transfer the case to the district where he or she resides n96 and the requirement that the debtor be given notice of the right to transfer. n97 In *United States v. Sutton* n98 a Connecticut district court noted that the analysis of personal jurisdiction in a nationwide service of process case is not governed by the minimum contacts test set forth in *International Shoe Co. v. Washington*, n99 but rather by the five-factor "reasonableness" test enunciated in *Asahi Metal Indus. Co. v. Superior Court*. n100 Applying the *Asahi* test and noting that "dismissals resulting from the application of the reasonableness test should be few and far

between," the district court found jurisdiction reasonable despite the fact that the 64-year-old New Hampshire defendant lived five hours away from the Connecticut courthouse. n101

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionFair Debt CollectionGeneral OverviewGovernmentsFederal GovernmentGeneral OverviewGovernmentsFederal GovernmentClaims By & Against

FOOTNOTES:
(n1)Footnote 1. *31 U.S.C. §§ 3711-3719.*

(n2)Footnote 2. 31 C.F.R. pts. 900-904. The notice of the adoption of these rules states that they supersede the rules found at 4 C.F.R. pts. 101-105, and that the Secretary of the Treasury, rather than the Comptroller General, is the co-promulgator of the new rules. *See 65 Fed. Reg. 70,390* (Nov. 22, 2000) .

(n3)Footnote 3. *28 U.S.C. §§ 3001-3308.*

(n4)Footnote 4. *31 U.S.C. §§ 3711-3719.*

(n5)Footnote 5. 31 C.F.R. pts. 900-904. The notice of the adoption of these rules states that they supersede the rules found at 4 C.F.R. pts. 101-105, and that the Secretary of the Treasury, rather than the Comptroller General, is the co-promulgator of the new rules. *See 65 Fed. Reg. 70,390* (Nov. 22, 2000) .

(n6)Footnote 6. *31 U.S.C. § 3711(f).*

(n7)Footnote 7. *26 U.S.C. § 6103(l).*

(n8)Footnote 8. *See 31 U.S.C. § 3718.*

(n9)Footnote 9. *31 U.S.C. § 3718.*

(n10)Footnote 10. Pub. L. No. 104-134, ch. 10.

(n11)Footnote 11. *31 U.S.C. § 3716(c)(3)(A)(i).*

(n12)Footnote 12. *31 U.S.C. § 3720D(e).*

(n13)Footnote 13. *31 U.S.C. § 3720B.*

(n14)Footnote 14. 4 C.F.R. § 102.2(a), *superseded by* 31 C.F.R. pts. 900-904, *as published at 65 Fed. Reg. 70,390* (Nov. 22, 2000) .

(n15)Footnote 15. *31 C.F.R. § 901.2(a), as published at 65 Fed. Reg. 70,390* (Nov. 22, 2000) ("Generally, one demand letter should suffice," although agencies have discretion to determine the number of demand letters).

(n16)Footnote 16. *31 C.F.R. § 901.2(b).*

(n17)Footnote 17. *31 C.F.R. § 901.2(c).*

(n18)Footnote 18. *31 C.F.R. § 901.2(e).* It may also be appropriate for the debtor to make a Freedom of Information Act request to obtain information about the claimed debt. *5 U.S.C. § 552.*

(n19)Footnote 19. *31 C.F.R. § 901.2(a). See also United States v. Golden Elevator, 868 F. Supp. 1063 (C.D. Ill.*

1994) .

(n20)Footnote 20. National Consumer Law Center, Collection Actions, Ch. 11 (1st ed. 2008). *See also Amoco Prod. Co. v. Fry, 118 F.3d 812 (D.C. Cir. 1997)* (temporary withholding of sum owed by government, during four years of litigation to determine amount of mutual debts, was not an administrative offset; agency not required to follow procedures of Debt Collection Act, though due process required). *See also Omegbu v. United States Dep't of Treasury, 118 Fed. Appx. 989 (7th Cir. 2004)* (procedure for offsetting Social Security Disability for student loan satisfied due process; one letter to last known address, stating that debt would be referred for offset, and disclosing right to hearing; six years later, debtor approved for SSDI and informed that 15% would be offset).

(n21)Footnote 21. *31 C.F.R. § 901.3(b)(4)(iv).*

(n22)Footnote 22. *31 U.S.C. § 3711(f).*

(n23)Footnote 23. *31 C.F.R. § 901.12(a).*

(n24)Footnote 24. *31 U.S.C. § 3718.*

(n25)Footnote 25. *31 U.S.C. § 3718(a)(1).*

(n26)Footnote 26. *31 U.S.C. § 3718(b)(1)(B)(6).*

(n27)Footnote 27. *31 U.S.C. § 37.*

(n28)Footnote 28. 4 C.F.R. § 102.13(g) ("equity and good conscience" is construed analogously to the term in 4 C.F.R. § 91.5(c)); *5 U.S.C. § 5584* (debt result of administrative error with no fault, fraud, misrepresentation, or lack of good faith by debtor). *But see Titan Wheel Corp. v. U.S. Environmental Protection Agency, 291 F. Supp. 2d 899, 933 (S.D. Iowa 2003)* (upholding agency's discretion not to waive interest), *aff'd without op., 113 Fed. Appx. 734 (8th Cir. 2004)* .

(n29)Footnote 29. *31 U.S.C. § 3717(c).* See *Precision Pine & Timber, Inc. v. United States, 75 Fed. Cl. 80* (Fed. Cl. Dec. 22, 2006) .

(n30)Footnote 30. *5 U.S.C. § 5514. See also Doko Farms v. United States, 956 F.2d 1136 (D.C. Cir. 1992)* (government could use administrative offset to collect on claims (here, alleged overpayment of cotton subsidies) even though a suit on those claims was barred by the statute of limitations).

(n31)Footnote 31. U.S. Dept. of the Treasury, Office of Legislative and Public Affairs, Fact Sheet: Delinquent Debt Collection, Fiscal Year 2003 (available at fms.treas.gov).

(n32)Footnote 32. *41 C.F.R. §§ 105-56.024 to 105-56.033, adopted by 68 Fed. Reg. 68750* (Dec. 10, 2003) .

(n33)Footnote 33. *5 U.S.C. § 5514(a)(1).*

(n34)Footnote 34. C.F.R. § 285.7(a)(6).

(n35)Footnote 35. *5 U.S.C. § 5514.*

(n36)Footnote 36. U.S.C. § 5514(a)(2); *31 C.F.R. § 285.7(d)(iv)*; *5 C.F.R. § 550.1104(d)* (specifying details that agencies must include in their notices).

(n37)Footnote 37. Testimony of Commissioner Richard L. Gregg, Fiscal Management Service--U.S. Department of the Treasury, *Federal Debt Collection--Significant Progress Made During the Last Year* (Nov. 13, 2002), *available*

at http://fms.treas.gov/news/reports/testimony-nov13-2002.html.

(n38)Footnote 38. 31 C.F.R. pt. 902. *See also 31 U.S.C. § 3711(a)(2).*

(n39)Footnote 39. *31 C.F.R. § 901.8(a).*

(n40)Footnote 40. *31 U.S.C. § 3716* provides for "administrative offset," which is the withholding of money payable by the United States, to or on behalf of a person, to satisfy a debt owed the United States by that person.

(n41)Footnote 41. *31 U.S.C. § 3720A(a)(b).*

(n42)Footnote 42. *But see In re Shortt, 277 B.R. 683 (Bankr. N.D. Tex. 2002)* (notice of intent to set off tax refund, sent to debtors' last known address, sufficient even though never received; debtors had not notified creditor of address change). *See also In re Huff, 317 B.R. 679 (Bankr. W.D. Pa. 2004)* (notice failed to meet requirements of *31 U.S.C. § 3720A*; bankruptcy court denied set-off of tax refund for Rural Housing Mortgage loan; new notice, and new 60-day period to contest, required for each tax year in which offset was sought).

(n43)Footnote 43. *26 C.F.R. § 301.6402-6.*

(n44)Footnote 44. *26 C.F.R. § 301.6402-6. See U.S. Dep't of Agriculture v. Huff (In re Huff), 343 B.R. 136, 142 (W.D. Pa. 2006)* .

(n45)Footnote 45. For a discussion of claims and defenses available against tax intercept actions to offset debts, see M. Rigg, *Intercept of Tax Refunds to Offset Debts Owed Federal Agencies: Part II, 20 Clearinghouse Rev. 702 (Oct. 1986). See Blake v. Cisneros, 837 F. Supp. 834 (S.D. Tex. 1993) . See also Davis v. N.C. Dep't of Human Resources, 349 N.C. 208, 505 S.E.2d 77 (1998)* . Interception of federal tax refund was improper where father was not "delinquent" on his child support payments within meaning of the federal tax intercept statute. Father was current on payments ordered by court following adjudication of paternity, and was also making payments toward a public assistance reimbursement debt which accrued prior to the paternity adjudication. State tax refund could be intercepted if Department obtained opinion of Attorney General that the court-ordered support plan was inadequate for collection of the arrears. *See also Abbe v. Bochert, 2001 Ohio App. LEXIS 2618* (Ohio Ct. App. June 13, 2001) (if obligor current on payments of current support and court-ordered installments of arrearage, no amount past due, despite existence of debt, and tax refund offset cannot be authorized, but *pro se* litigant failed to preserve issue for review).

(n46)Footnote 46. *31 C.F.R. § 900.8.*

(n47)Footnote 47. *See Ramirez v. Dept. of the Army, 86 M.S.P.B. 211 (2000)* (creditor agency cannot deduct debt from retirement pay until it has complied with its own regulations by completing hearing requested by debtor).

(n48)Footnote 48. *See Id.; But cf. Brannum v. Gaddy, 2003 U.S. App. LEXIS 1900* (D.C. Cir. Feb. 3, 2003) (agency's failure to follow statutory notice requirements exactly not a defense, where debtor received actual notice); *Lewis v. Glickman, 104 F. Supp. 2d 1311 (D. Kan. 2000)* (flawed preliminary hearing not prejudicial where debtor subsequently had full evidentiary hearing and administrative appeal; agency's violation of own rule re stay not prejudicial where its right to offset was ultimately upheld), *aff'd, 2002 U.S. App. LEXIS 13269* (10th Cir. July 3, 2002) (unpublished, citation limited).

(n49)Footnote 49. *See* National Consumer Law Center, Fair Debt Collection, § 13.2.8.3 (5th ed. 2004).

(n50)Footnote 50. *See, e.g., United States v. Luongo, 255 B.R. 424 (Bankr. N.D. Tex. 2000)* (IRS may set off tax refund against earlier tax liability even if old debt has been discharged in bankruptcy), *aff'd, 259 F.3d 323 (5th Cir. 2001)* ; *Unites States v. Munson, 248 B.R. 343 (Bankr. C.D. Ill. 2000)* (IRS allowed to set off refund against old debt, even though refund was claimed as exempt); *Ramirez v. Minnesota Dep't of Revenue, 266 B.R. 441 (Bankr. D. Minn.*

2001) (state DOR could set off prepetition tax liability against prepetition tax refund, even if tax obligation discharged in bankruptcy); *United States v. Holden, 258 B.R. 323 (Bankr. D. Vt. 2000)* (IRS violated automatic stay, and was in contempt of bankruptcy court order when it froze chapter 13 debtor's $2000 post-petition tax refund for $200 pre-petition tax debt, which would be paid in chapter 13 plan; right of setoff does not allow IRS to coerce payment of prepetition debt by withholding payment of post-petition debt to debtor); *United States v. Killen (In re Killen), 249 B.R. 585 (Bankr. D. Conn. 2000)* (no offset of tax refund for HUD loan where tax refund claimed exempt); *In re Bourne, 262 B.R. 745 (Bankr. E.D. Tenn. 2001)* (setoff allowed); *In re Martinez, 258 B.R. 364 (Bankr. W.D. Tex. 2000)* (setoff allowed; detailed discussion of cases on both sides of question); *Stewart v. Army & Air Force Exch. Serv., 253 B.R. 51 (Bankr. E.D. Ark. 2000)* (no violation of automatic stay to hold tax refund pending determination of right to setoff). *See further* National Consumer Law Center, Fair Debt Collection § 13.3.7.1, 13.3.8 (4th ed. and supp.)

(n51)Footnote 51. *See 31 U.S.C. § 3718(a)(2)*. The Department of Education and the student loan lender are exempt under different provisions of the FDCPA, *15 U.S.C § 1692a(6)(C)* and *(A)* respectively.

(n52)Footnote 52. *See, e.g.*, Ch. 12, "Student Loans and Trade School Abuses," §§ 12.06[2] (the closed school discharge), 12.06[3] (false certification discharge), 12.08 (student's claims against the school), 12.05[1] (deferrals), 12.05[3] (loan consolidation) *infra*. *See also* National Consumer Law Center, Student Loan Law § 6.2 (closed school discharge), § 6.3 (false certification discharge), § 6.4 (unpaid refund discharge), § 6.6 (disability discharge), § 8.2 (loan consolidation), Ch. 9 (borrower's claims against the school) (3d ed. 2006).

(n53)Footnote 53. *20 U.S.C. § 1095a* (HEA authority for wage garnishment should still apply when guaranty agencies are garnishing wages); *31 U.S.C. § 3720D(b)(1)* (Debt Collection Improvement Act authorizing 15% garnishment should apply when the Department of Education is garnishing). *See* National Consumer Law Center, Student Loan Law § 5.3 (3d ed. 2006). *See also United States v. George, 144 F. Supp. 2d 161 (E.D.N.Y. 2001)* ; *United States v. Reid, 2000 U.S. Dist. LEXIS 2187* (E.D.N.Y. Jan. 21, 2000) ; *Green v. Kentucky Higher Education Assistance Authority, 78 F. Supp. 2d 1259 (S.D. Ala. 1999)* .

(n54)Footnote 54. *20 U.S.C. § 1095a*.

(n55)Footnote 55. *68 Fed. Reg. 8142* (Feb. 19, 2003) .

(n56)Footnote 56. *31 U.S.C. § 3720D(b)(1)*. *See* National Consumer Law Center, Student Loan Law § 5.3 (3d ed. 2006 and Supp.).

(n57)Footnote 57. *United States v. Reid, 2000 U.S. Dist. LEXIS 2187* (E.D.N.Y. Jan. 21, 2000) , *motion to vacate judgment denied, 2000 U.S. Dist. LEXIS 17444* (E.D.N.Y. Oct. 31, 2000) .

(n58)Footnote 58. *11 U.S.C. § 523(a)(8)*. *See* Consumer Bankruptcy Law and Practice, § 14.4.3.8 (8th ed. 2006).

(n59)Footnote 59. *See* National Consumer Law Center, Student Loan Law § 5.4 (3d ed. 2006 and Supp.).

(n60)Footnote 60. *31 U.S.C. § 3716(e)(1)*.

(n61)Footnote 61. *126 S. Ct. 699 (2005)* .

(n62)Footnote 62. *Lee v. Paige, 276 F. Supp. 2d 980 (W.D. Mo. 2003)* , *aff'd, 376 F.3d 1179 (8th Cir. 2004)* (finding that the ten-year limit does apply). *See also Guillermety v. Secretary of Educ., 241 F. Supp. 2d 727 (E.D. Mich. 2002)* (ten-year limit applies).

(n63)Footnote 63. *Lockhart v. U.S., 376 F.3d 1027 (9th Cir. 2004)* . In December 2004, the borrower in this case filed for *certiorari* with the U.S. Supreme Court.

(n64)Footnote 64. *126 S. Ct. 699 (2005)* .

(n65)Footnote 65. *15 U.S.C. § 1692a(6)(C).*

(n66)Footnote 66. *403 U.S. 388, 91 S. Ct. 1999, 29 L. Ed. 2d 619 (1971) , on remand, 456 F.2d 1339 (2d Cir. 1972) .*

(n67)Footnote 67. *See, e.g., National Commodity & Barter Ass'n v. Archer, 31 F.3d 1521, 1527 (10th Cir. 1994) .*

(n68)Footnote 68. *Carlson v. Green, 446 U.S. 14, 18-19, 100 S. Ct. 1468, 64 L. Ed. 2d 15 (1980) .*

(n69)Footnote 69. *26 U.S.C. § 6402(f). See Albert v. OSI Educ. Servs., 2004 U.S. Dist. LEXIS 3821* (D. Minn. Mar. 11, 2004) .

(n70)Footnote 70. *26 U.S.C. § 6402(f).*

(n71)Footnote 71. *5 U.S.C. § 552a(g).*

(n72)Footnote 72. *5 U.S.C. § 704.*

(n73)Footnote 73. *28 U.S.C. §§ 2671-2680, as amended by* the Federal Employees Liability Reform and Tort Compensation Act of 1988 (FELRTCA, or the Westfall Act), Pub. L. No. 100-694, *102 Stat. 4564 (1988).* See National Consumer Law Center, Collection Actions, Ch. 11.2.12.5 (1st ed. 2008), for further discussion of each of these claims.

(n74)Footnote 74. Pub. Law No. 108-357, § 881 (Oct. 22, 2004).

(n75)Footnote 75. *26 U.S.C. § 6306(c).*

(n76)Footnote 76. For a discussion of the remedies and options available to consumers who owe federal tax debts, see NCLC Guide to Surviving Debt, Ch. 19 (2005).

(n77)Footnote 77. *26 U.S.C. § 6306(b).*

(n78)Footnote 78. *26 U.S.C. § 6306(b)(3), (4).*

(n79)Footnote 79. *26 U.S.C. § 6306(c).*

(n80)Footnote 80. *26 U.S.C. § 6306(b)(2).*

(n81)Footnote 81. *26 U.S.C. § 6304.*

(n82)Footnote 82. *26 U.S.C. § 6304(e).*

(n83)Footnote 83. *Id., cross-referencing 26 U.S.C. §§ 6304, 7602(c).*

(n84)Footnote 84. *26 U.S.C. §§ 7433A, 7433(a).*

(n85)Footnote 85. *26 U.S.C. § 7433*, incorporated by reference in § 7433A(a).

(n86)Footnote 86. *26 U.S.C. § 7433A(b)(1), (4). See also 26 U.S.C. § 6306(d)* (no federal liability for acts or omissions of private tax collectors).

(n87)Footnote 87. *26 U.S.C. § 7433A(b)(3). Cf. to 26 U.S.C. § 7433(a)* (cause of action created for collection abuses by IRS employee is exclusive remedy for recovering damages resulting from such action).

(n88)Footnote 88. Title XXXVI of Pub. L. No. 101-647, *104 Stat. 4933-4966, 28 U.S.C. §§ 3001-3308. See also*

Schueler v. Rayjas Enters., Inc., 847 F. Supp. 1147 (S.D.N.Y. 1994) .

(n89)Footnote 89. H.R. Rep. No. 736, 101st Cong., 2d Sess. 23, *reprinted in* 1990 U.S.C.C.A.N. 6630, 6631.

(n90)Footnote 90. *28 U.S.C. § 3001(a), (b). See Markham v. Fay, 74 F.3d 1347 (1st Cir. 1996)* .

(n91)Footnote 91. *28 U.S.C. §§ 3102-3105.*

(n92)Footnote 92. *28 U.S.C. §§ 3201-3205.*

(n93)Footnote 93. *11 U.S.C. § 522(d). See* Collier Consumer Bankruptcy Practice Guide Ch. 13 (Matthew Bender 1997).

(n94)Footnote 94. *28 U.S.C. § 3014.*

(n95)Footnote 95. *28 U.S.C. § 3004(b).*

(n96)Footnote 96. *28 U.S.C. § 3004(b)(2).*

(n97)Footnote 97. *28 U.S.C. §§ 3101(d), 3201(b).*

(n98)Footnote 98. *2005 U.S. Dist. LEXIS 1349* (D. Conn. Jan. 10, 2005) .

(n99)Footnote 99. *326 U.S. 310 (1945)* .

(n100)Footnote 100. *480 U.S. 102, 113-14, 107 S. Ct. 1026, 94 L. Ed. 2d 92 (1987)* (the five factors of *Asahi* are: (1) the burden that the exercise of jurisdiction will impose on the defendant; (2) the interests of the forum state in adjudicating the case; (3) the plaintiff's interest in obtaining convenient and effective relief; (4) the interstate judicial system's interest in obtaining the most efficient resolution of the controversy; and (5) the shared interest of the states in furthering substantive social policies).

(n101)Footnote 101. *2005 U.S. Dist. LEXIS 1349* (D. Conn. Jan. 10, 2005) (citations omitted).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 8 Fair Debt Collection

1-8 Consumer Credit Law Manual § 8.08

§ 8.08 Other Federal Laws Affecting Debt Collection

[1] Fraudulent or Defamatory Use of Mails

Some state debt collection statutes specifically incorporate prohibitions established in the federal postal laws. n1 The mail fraud statute n2 may apply when a collector uses a fraudulent scheme to collect a debt and uses the mails in some way. n3 This statute has been broadly interpreted to prohibit deceitful statements, half-truths, and the concealment of material facts in mailed items. It arguably prohibits letters threatening to seize, sell, or garnish the debtor's property, when no such action has or will be taken.

[2] Collecting for Unordered Merchandise May Be Illegal

A section of the Postal Reorganization Act ("PRA") n4 prohibits billing or dunning for unordered, mailed merchandise (unless mailed by a charitable organization soliciting contributions). It provides that the recipient of unordered, mailed merchandise has a right to treat it as a gift. The mailing of unordered merchandise is declared to be a violation of the FTC Act n5 and, thus, actionable under many state unfair and deceptive trade practices statutes. n6

[3] Telephone Harassment

Under the Federal Communications Act ("FCC") Act, interstate telephone companies file proposed tariff regulations with the FCC; n7 when approved by the FCC, these become binding on the companies and their subscribers. Tariff regulations have generally prohibited the use of the telephone "in a manner reasonably expected to frighten, abuse, torment or harass another," for calls that unreasonably interfere with the use of telephone service by one or more customers, or for calls having an unlawful purpose. Given this broad regulatory language, many types of debt collection calls may be illegal as violative of the tariff. State tariffs often contain similar prohibitions. Enforcement of these violations would ordinarily be done by complaining to the telephone company and, if no relief was forthcoming, to the regulatory body.

The Communications Act of 1934, as amended by the Federal Telecommunications Act of 1996, n8 prohibits interstate or foreign communications (e.g., phone calls, and e-mail n9), for anyone:

- Making a telephone call or using a telecommunications device, without disclosing his or her identity,

with intent to annoy, abuse, threaten, or harass any person at the number called or who receives the communications (e.g., e-mail);

- Causing the telephone of another to ring repeatedly, with intent to harass any person at the number called;

- Making repeated calls or repeatedly initiating communication with a telecommunications device (e.g., e-mail) in which the ensuing conversation or communication serves only to harass any person at the called number or who receives the communication; or

- Knowingly permitting any telecommunications facility under his or her control to be used for any of the above purposes. with the intent that it be used for such activity. n10

The caller or the sender of e-mail (or other telecommunications contact) can be fined in accordance with Title 18 and be imprisoned for up to two years. n11 Statutes duplicating or expanding these criminal prohibitions can be found in nearly every state. Consumers may not have a private cause of action under these criminal statutes against collectors and creditors, but violations of these criminal statutes will constitute torts and violations of the FDCPA and state UDAP and debt collection laws. n12

For many years, local- and long-distance service has been regulated by tariffs setting forth the rates and terms of service. Interstate long-distance companies filed tariffs with the FCC while companies providing in-state phone service (including local phone service and in-state long-distance) file with the state public utility commissions ("PUC"), which, once approved by the FCC or PUC, become binding on the company and its subscribers. n13

This tariff requirement has changed for interstate long-distance service. As of July 31, 2001, interstate long-distance companies are no longer required or allowed to file tariffs with the FCC. n14 Instead, pursuant to the authority granted by Congress in the Telecommunications Act of 1996, n15 the rates and terms of service are to be governed by the contract between the company and the customer. Companies are required to make these contracts available for consumers to inspect, and if the company has a website it must post changes to the rates immediately. n16

Some states may follow the FCC's lead and "detariff" the telephone service that they regulate. State PUCs that retain tariff requirements do not have the authority to require interstate service providers to file tariffs, however, so they cannot replace the FCC's role for those companies.

For in-state harassing calls in states that have not detariffed, and for abuses in interstate calls that occurred before the federal detariffing, the FCC or the state PUC has authority to enforce the tariffs filed with it. The FCC has documented collectors' telephone abuses, n17 and the federal tariffs have generally included protections against such abuses. Tariff regulations have generally prohibited the use of the telephone "in a manner reasonably expected to frighten, abuse, torment or harass another," n18 for calls that unreasonably interfere with the use of telephone service by one or more customers, or for calls having an unlawful purpose.

Tape recording a collector's harassing telephone has been used as a way to develop evidence against a collector. Consumers who do so, however, should examine whether they may be violating state criminal eavesdropping statutes that prohibit the electronic recording of a telephone conversation without consent of both conversing parties. n19 In states where the caller's consent to have his or her conversation electronically recorded is required by criminal eavesdropping laws, a consumer has little to lose in requesting consent. A lawyer may not ethically participate in a tape recording without the consent of all parties to the conversation. n20

Tariff regulations similar to the FCC's may be imposed at the state level. Local telephone companies often incorporate the FCC-required standards in their own tariff regulations, which are filed with state utility authorities and, in effect,

become the terms of the relationship between the phone company and its consumers.

There is a private cause of action against interstate phone companies for violation of certain provisions of the Federal Communications Act and the FCC tariffs, and for negligence or breach of the telephone contract. n21 The statute allows the consumer to choose either the courts or the FCC as a forum, but after proceeding in one forum the consumer cannot pursue the claim later in the other forum. n22 Even if the consumer exercises the option to file in court, the court may hold that the FCC has primary jurisdiction and defer to it. n23 Consumers can file complaints with the FCC n24 through the FCC's web site. n25

Tariff regulations also provide criminal sanctions and empower the telephone companies to suspend temporarily, discontinue, or refuse phone service to violators. Consumers may request the companies to exercise these powers against collectors who abusively employ their telephone service. Tariff regulations may also provide a useful basis for an action under the broad standards in federal and state consumer protection laws.

Even though interstate long-distance providers will no longer file tariffs with the FCC, the FCC retains general enforcement authority over them. In its decision to forbear from requiring these companies to file tariffs, the FCC reaffirmed its pledge to use its complaint process to enforce statutory and regulatory safeguards "against carriers that attempt to take unfair advantage of American consumers." n26

Another issue that may arise is the use of the caller ID service that allows a subscriber to view automatically the telephone numbers from which incoming telephone calls are placed, including unlisted numbers. n27 This technology is particularly troublesome for a consumer who may wish to preserve the privacy of his or her telephone number and location.

The FCC responded to this problem by requiring carriers to provide calling parties with a method of blocking caller ID. A caller who wishes to conceal his or her number should dial 67 (1167 for rotary phones) before dialing the number. FCC rules require carriers to advise customers of this option, and to honor the request for privacy. n28 In many states, telephone companies also offer line blocking, which blocks caller ID for all calls from that line.

Consumers should be aware of a major loophole in this rule. Line blocking or 67 will not protect the privacy of callers who dial an 800, 888, 887, or 866 number. n29 Because the called party pays for the call, carriers may provide calling parties' numbers for billing purposes. Telephone companies are also required to notify subscribers that 67 or line blocking does not protect caller privacy for calls to 800 or 888 numbers. n30

A service set up by Western Union for collection agencies and creditors to capitalize on this privacy loophole has been held to be covered by the FDCPA. n31 Under its scheme, Western Union sent a message asking the consumer to call it. Then, it used Caller ID technology to obtain the consumer's unlisted telephone number for its client, the collection agency or creditor. The Ninth Circuit agreed with FTC staff that this activity, which amounted to an indirect attempt to collect a debt, was covered by the FDCPA. n32 The circuit court also noted Western Union's probable violation of the FCC regulations governing automatic number identification. n33

Consumers who wish to preserve the privacy of their phone numbers should use pay phones for calls to creditors' toll-free numbers. If dunning phone calls to unpublished numbers follow consumers' use of a creditor's 800 number, the consumers' attorney should consider whether the creditor or the telephone company has violated the FCC rules governing automatic number identification.

[4] Truth in Lending Disclosures

The TIL laws may require a debt collector to provide the consumer with a new TIL disclosure statement if the two agree on a new debt payment schedule (known as a "workout agreement") or the amount financed or the finance charges are

increased. The Federal Reserve Board ("FRB") has taken the position, binding on the courts, n34 that a TIL disclosure statement must be provided to the consumer before consummation of a written, prelitigation workout agreement, allowing the consumer to pay the obligation if the annual percentage rate, amount financed, or finance charges are increased. n35 If a debt collector fails to provide a required TIL disclosure statement, the debt collector is subject to TIL civil liability of twice the finance charge (but not less than $100 nor more than $1,000 in any individual action) and attorney fees. n36

[5] Extortionate Collection Methods

The Federal Racketeering Influenced and Corrupt Organizations Act ("RICO") n37 is a broad statute prohibiting specific types of illegal conduct by an enterprise, including excessive collection conduct.

[6] The Fair Credit Reporting Act

The FCRA n38 is a comprehensive regulatory act that should be consulted whenever a consumer is adversely affected by improper or inaccurate information on file with a credit bureau or reporting agency or is threatened with such reports being filed. The FCRA gives a consumer the right to be informed of the substance of his or her file at a credit reporting agency and the right to know who sent and received the information. n39 In addition, the Fair and Accurate Credit Transactions Act of 2003 (FACTA), n40 which was enacted in 2003 as an amendment to the Fair Credit Reporting Act, imposes special duties upon collectors and those who furnish information to credit reporting agencies in cases of debts arising from fraud or identity theft. Using these rights, a consumer can verify whether the collector made a report to a credit reporting agency as threatened.

[7] UCC Article 3 and the Electronic Funds Transfers Act

Sometimes debt collectors withdraw payments directly from a bank account belonging to the debtor or a friend or family member of the debtor. Typically the collector claims that the account owner gave oral authorization for the withdrawal in a telephone call.

What law governs the withdrawal depends on how the collector processes it. If the collector prepares and submits a paper check (a "preauthorized draft" or "demand draft"), the UCC governs. This is the more typical procedure. But if the collector withdraws money from the account by means of an electronic fund transfer, the Electronic Funds Transfers Act ("EFTA") applies. n41

[a] Preauthorized Drafts and UCC Article 3

To obtain money from a consumer's account by a preauthorized draft, the collector prepares a paper check, signs the account holder's name to it, and submits it to the account holder's bank. The UCC has a very loose definition of signature n42 and provides that drawers can authorize another party to sign for them as their agents. n43

If a collector submits a preauthorized draft without the account holder's authorization, the UCC provides that the account holder is not liable on the draft as long as he or she has examined the bank statements or checks with reasonable promptness and notified the bank promptly. n44 If the collector has placed the account holder's signature on more than one draft without authorization, however, the account holder is liable on all but the first draft unless he or she examined the account statement and reported the problem to the bank within thirty days after the bank mailed out the statement. n45

Even if the account holder has authorized the draft, the UCC provides the consumer the right to stop payment. n46

[b] Electronic Funds Transfers

In the alternative to a preauthorized draft, money can be withdrawn from a person's bank account by an electronic fund transfer. Transfers to and from accounts established primarily for personal, family, or household purposes n47 are governed by the federal Electronic Fund Transfers Act (EFTA). n48

To obtain an electronic fund transfer, the creditor or collector does not submit a check to the account holder's bank. Instead, the account holder authorizes the financial institution to transfer money to the creditor or collector, either by telephone or by debit card. n49 A consumer can also initiate an electronic fund transfer by giving a merchant a check that the merchant uses to capture routing, account, and serial numbers, usually then returning the check to the consumer. n50

For periodic recurring transfers, EFTA requires the account holder's authorization to be in writing, n51 though an electronic signature is acceptable. n52 A recent amendment removed the former prohibition of obtaining authorization by means of tape recording and deferred to the E-Sign Act's interpretation of whether a tape recorded telephone authorization is an electronic signature. n53 The authorization must be identifiable as such to the consumer and the terms must be clear and readily understandable. n54 The consumer must be given a copy of the authorization. n55

EFTA limits a consumer's liability for an unauthorized electronic fund transfer to $50, n56 as long as the consumer reports the unauthorized transfer within sixty days of transmittal of the monthly statement n57 and as long as the consumer did not receive any benefit from the transfer. n58 The consumer also has the right to stop payment of one or more of a series of electronic fund transfers by notifying the financial institution orally or in writing at any time up to three business days prior to the scheduled date of the transfer. n59

Any person who violates EFTA is liable to the consumer in the amount of actual damages, statutory damages of $100 to $1000, costs, and attorney fees. n60 There are specific provisions for statutory damages in class actions. n61 Like the FDCPA, the EFTA gives defendants several defenses such as bona fide error, n62 and it also excuses any errors that were resolved pursuant to the financial institution's error resolution procedure. n63

While EFTA primarily imposes duties on financial institutions, it also requires the payee of a series of electronic fund transfers to give the consumer a copy of the authorization that he or she signed and in some circumstances to give the consumer advance notice of the amount that will be withdrawn. n64 The payee can be subject to liability under EFTA if it violates one of these duties. n65

[c] Electronic Fund Transfers and NACHA Rules

Virtually all financial institutions are members of the Automated Clearing House (ACH) network, and electronic transactions must comply with the rules of that network, called the National Automated Clearing House Association (NACHA) rules. For more detail on the ACH network and NACHA rules, see National Consumer Law Center, Consumer Banking and Payments Law (3rd ed. and Supp.). Some key aspects of these rules are described in this section.

NACHA rules vary depending on the type of electronic funds transfer. Most likely a debt collector's use of a consumer's account information to initiate an electronic transfer would be considered a "TEL" transaction, which is the NACHA terminology for a Telephone Initiated Entry. This refers to situations where consumers authorize debits from their accounts orally over the telephone. n66

NACHA rules permit a telephone entry only when the consumer has initiated the telephone call or when there is an existing relationship between the merchant and the consumer. TEL entries can only be made for single transfers; these are one time transfers that are initiated by the merchant (in this case a collector acting as an agent for the merchant) in accordance with the consumer's authorization. n67

The collector is required either to tape record the telephone authorization or provide the consumer with a written notice confirming the order prior to the settlement date. n68 The authorization must include the date on or after which the debit to the consumer's account will take place, the amount of the debit, the merchant's name, a telephone number that the consumer can call if she has questions, the date of the authorization, and a statement by the collector that the authorization is for a single entry ACH debit, that is, a one time debit to the consumer's account.

In order to prevent fraud and control risk, n69 effective June 13, 2003, the NACHA rules were amended to give NACHA "the right to request" the merchant's bank to provide detailed information about businesses n70 making TEL entries where NACHA believes the return rate for those businesses exceeds 2.5%. n71

If the consumer claims a debit was unauthorized, the consumer's bank must promptly recredit the consumer's account. n72 Consumers must report unauthorized transfers within fifteen days from when the consumer's bank provides information about the disputed entry. The consumer's notice must be in writing and under penalty of perjury, n73 while under Regulation E the notice can be oral and need not be under the penalty of perjury. n74

Under the NACHA rules, an unauthorized debit entry is defined to include three situations: n75 where the collector did not properly obtain the consumer's authorization; n76 where the debit is in a greater amount than authorized; or where the debit was initiated for settlement earlier than the consumer authorized.

[d] Other Remedies for Unauthorized Withdrawals

A collector who withdraws money from an account without the account holder's authorization should be liable for a deceptive or unfair practice under the state UDAP statute. An unauthorized withdrawal should also be considered the use of a false representation or deceptive means to collect a debt, prohibited by the FDCPA. n77

[8] Discrimination in Choice of Collection Tactics on the Basis of Consumer's Race, Religion, Sex, or Age

If discriminatory collection tactics are used against protected persons, such as African-Americans or Native Americans, the collector may be violating several federal laws. If the collector is a "debt collector" as defined by the FDCPA (usually limited in its application to debt collection agencies), the invidious discrimination should be treated as an "abuse" n78 or an "unfair or unconscionable" n79 means of collecting a debt.

The ECOA n80 provides that it "shall be unlawful for any creditor to discriminate against any applicant, *with respect to any aspect* of a credit transaction" on the basis of race, color, religion, national origin, sex, marital status, age, receipt of public assistance, or exercise of rights under the Consumer Credit Protection Act. n81 The Act's broad language can be construed to prohibit discriminatory collection tactics by a creditor. n82 The FRB regulations promulgated under the ECOA merely repeat this prohibition. n83 The ECOA provides a private action for actual and punitive damages, attorney fees to a successful plaintiff, and federal court jurisdiction. n84

An action under section 1983 of the Civil Rights Act n85 may be available when a collector uses a public official to assist in collecting a debt. To succeed on a section 1983 claim, the plaintiff must show that he or she was denied a federally secured right by a defendant acting under color of state law. n86

[9] Bankruptcy

The U.S. Bankruptcy Code has been extensively amended and renumbered by Public Law 109-8, popularly known as the Bankruptcy Reform Act. Changes become fully effective October 17, 2005. This section retains the existing Bankruptcy Code numbering, but notes several changes relating to the amendments. For more detailed information on these changes, see the forthcoming NCLC's *Consumer Bankruptcy Law and Practice* (2005 Supplement). Until the supplement is available, see NCLC's guide to the bankruptcy amendments, to be released in September, 2005, or NCLC

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The 1978 Bankruptcy Code provides for an automatic stay of all collection efforts at the time of filing a petition for bankruptcy n87 and a similar injunction at the time of discharge of debts. n88 Actions taken in violation of the stay, whether or not the collector has notice, are void and may result in charges of contempt or damages. n89 Courts are divided on whether actions which violate the discharge injunction give rise to a private cause of action which can be asserted outside of bankruptcy court. n90 Upon completion of the bankruptcy case, the automatic stay is replaced by the discharge order. The discharge operates as an injunction that is enforceable in a contempt proceeding, punishable by awards of damages and attorney fees. n91 Although some courts have held otherwise, the discharge provisions may also be enforced through equitable relief available under *11 U.S.C. § 105(a)*. n92

[10] Special Regulations Affecting Military Personnel and Veterans

[a] Increasing Protections for Military Personnel

In early 1994, a statute authorized garnishment of federal employee pay checks. n93 That law provided that the Consumer Credit Protection Act protection, and many more protective state exemptions, are available to federal employees. n94 Regulations by the several branches of government and the military were authorized to implement this new debt collection tool, n95 which adopt some of the protections provided to consumers by other laws.

[b] Servicemembers Civil Relief Act

The Servicemembers Civil Relief Act (SCRA) n96 limits collection tactics and enforcement of claims against active duty military personnel.. Among its most significant protections are protections against default judgments, n97 tolling of statutes of limitations, n98 a reduction of the interest rate on pre-active duty obligations to 6%, n99 prohibitions against self-help repossession and non-judicial foreclosure, n100 restrictions on eviction from residential premises, n101 and the right to terminate residential or vehicle leases. n102 This law should be reviewed in detail whenever a current or former member of the military, or a dependent, is represented in a debt collection matter. A number of states have similar laws. n103

The Act was originally adopted in 1940 as the Soldiers' and Sailors' Civil Relief Act. In 1991, Congress amended it to provide extra protections for military personnel called to active duty during the Desert Storm campaign. n104 In 2003, Congress rewrote the law completely and renamed it the Servicemembers Civil Relief Act. n105 While the new law preserves most of the features of the existing law, it expands some protections, modernizes the language, updates the caps on coverage of certain types of obligations, and applies existing protections to new situations. It also requires the military services to give written notice to servicemembers of the protections provided by the Act (previously notice did not have to be written). n106

The Act prohibits issuing an adverse credit report, denying, revoking, or changing the terms of a credit transaction, or taking certain other specified adverse actions because of the assertion of rights under the Act. n107 Waivers of the protections relating to modification, termination, or cancellation of contracts, leases, bailments, or mortgage debts, or to repossession, retention, foreclosure, sale, or forfeiture of property, are ineffective unless made by a written agreement signed during or after active duty. n108 In addition to the protections against enforcement of debts and obligations discussed in this subsection, the Act contains a variety of protections relating to taxes, life and health insurance, professional liability insurance, powers of attorney, and other topics.

The Act must be liberally construed to protect members of the armed forces. n109 Since the rewritten law preserves the substance of many existing provisions, decisions under the former law remain relevant. An excellent and detailed JAG Corps manual analyzing the pre-2003 version of the Act may be found on-line. n110 The ABA also has an on-line collection of materials on the Act, n111 including a judge's guide with sample stay motions. n112

[c] Veteran's Home Loan Debt Collections

Federal laws provide for the reduction of veterans' liability on veterans' home loans. This may provide some protections from collection. *38 U.S.C. section 3713* authorizes the Department of Veterans Affairs ("VA") to release from liability a veteran, who has financed his or her home purchase with a VA-guaranteed loan, when the veteran sells the home to a third party buyer who agrees to assume the veteran's VA loan.

[11] Other Federal Restrictions on Debt Collection

Antitrust laws may also limit collection practices.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionTruth in LendingGeneral OverviewCommunications LawFederal ActsCommunications ActGeneral OverviewGovernmentsFederal GovernmentU.S. Postal Service

FOOTNOTES:
(n1)Footnote 1. The FDCPA also makes the threat of illegal conduct and criminal debt collection conduct actionable. *15 U.S.C. §§ 1692d(1), 1692e(5).* States remain free to forbid mailings which, although they conform to federal requirements, are nonetheless deceptive. *See, e.g., Syndicated Publ'ns, Inc. v. Montgomery County, 921 F. Supp. 1442 (D. Md. 1996)* .

(n2)Footnote 2. *18 U.S.C. § 1341.*

(n3)Footnote 3. *See United States v. Federal Record Serv. Corp., 1999 U.S. Dist. LEXIS 7719* (S.D.N.Y. May 21, 1999) (creation of false impression of governmental affiliation by means of paper, print styles, format and language is mail fraud despite printed disclaimer; failure to disclose material fact that defendant's service was available free from Social Security Administration was also violation).

(n4)Footnote 4. *39 U.S.C. § 3009.*

(n5)Footnote 5. *15 U.S.C. § 45.*

(n6)Footnote 6. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.7.2 (7th ed. 2008).

(n7)Footnote 7. *47 U.S.C. § 203.*

(n8)Footnote 8. *47 U.S.C § 223(a)(1)(C)-(E).*

(n9)Footnote 9. *See, e.g., United States v. Cope, 24 Fed. Appx. 414 (6th Cir. 2001)* (affirming sentence of 24 months in jail, $1300 fine and $2100 in restitution under *47 U.S.C. § 223(a)(1)(C)* for defendant who used victim's account to send annoying and harassing e-mail).

(n10)Footnote 10. *47 U.S.C. § 223(a)(2).*

(n11)Footnote 11. *47 U.S.C. § 223(a)(1)* and *U.S. Sentencing Guidelines, § 2A6.1* in 18 U.S.C., re: Threatening or Harassing Communications.

(n12)Footnote 12. *See Moore v. Principal Credit Corp., 1998 U.S. Dist. LEXIS 6917 (N.D. Miss. 1998)* (no private cause of action was available for telephone harassment under either state or federal criminal laws, but debtors stated

claims under FDCPA and for intentional infliction of emotional distress).

(n13)Footnote 13. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 2.3.1.4 (7th ed. 2008) for a discussion of the filed rate doctrine.

(n14)Footnote 14. Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of 254(g) of the *Communications Act of 1934, CC Docket No. 96-61, Second Report and Order, 11 F.C.C. Rcd. 20730 , 61 Fed. Reg. 59,340 (1996)* (Detariffing Order); Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the *Communications Act of 1934, CC Docket No. 96-61, Order on Reconsideration, 12 F.C.C.R. 15014 (1997);* Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the *Communications Act of 1934, CC Docket No. 96-61, Second Order on Reconsideration and Erratum, 14 F.C.C. Rcd. 6004 (1999)* ; Common Carrier Bureau Extends Transition Period for Detariffing Consumer Domestic Long Distance Services, CC Docket No. 96-61, Public Notice, DA 01-282.

(n15)Footnote 15. *47 U.S.C. § 160* (forbearance authority granted in § 10 of the Telecommunications Act of 1996). See Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of 254(g) of the Communications Act of 1934, *61 Fed. Reg. 59,340, 59,352* (Nov. 22, 1996) , for a discussion of the statutory authority for detariffing.

(n16)Footnote 16. *47 C.F.R. § 42.10.*

(n17)Footnote 17. *See* Federal Communications Comm'n [hereinafter FCC], Release No. 70-609, *35 Fed. Reg. 9873* (June 16, 1970) . *See also Maller v. New England Tel. & Tel. Co., 44 F.C.C.2d 614 (1973)* (FCC ordered telephone company either to obtain assurances from collector that its abusive telephone practices had ceased and that reasonable steps would be taken to assure that no abusive telephone calls would be made to anyone in the future, or to suspend the collector's telephone service, after complaint by consumer who had taped collector's harassment; taping conversation without beep tone did not violate the telephone company's tariffs, recording was admissible evidence (if not prohibited by state law)).

(n18)Footnote 18. AT&T Tariff, FCC Nos. 159, 263 (issued Nov. 12, 1968, revised Aug. 16, 1971), *reprinted in the Debt Collection Practices Act: Hearings on H.R. 11969 Before the Subcomm. on Consumer Affairs of the House Comm. on Banking, Currency and Housing*, 94th Cong., 2d Sess. 279 (1976). *See* National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 9.6.4.5 (7th ed. 2008) (telemarketing fraud). *See also 47 U.S.C. § 223(a)* (prohibiting certain harassing conduct).

(n19)Footnote 19. *E.g., Mass. Gen. Laws Ann. ch. 272, § 99.*

(n20)Footnote 20. *See* National Consumer Law Center, Fair Debt Collection, § 2.4.1 (6th ed. 2008 and supp.).

(n21)Footnote 21. *See 47 U.S.C. § 207*; *Ivy Broadcasting Co. v. Am. Tel. & Tel. Co., 391 F.2d 486 (2d Cir. 1968)* ; *MCI Telecomms. Corp. v. Mr. K's Foods, Inc., 1989 WL 10939 (S.D.N.Y. 1989). See also MCI Communications Corp. v. Russell, 861 F. Supp. 280, 281 (S.D.N.Y. 1994)* (in dicta stated FCC-approved tariffs require "that debts due be collected with an [sic] view to fairness to both debtor and creditor"; MCI required to introduce bills before default judgment may be entered). *But cf. Maydak v. Bonded Credit Co., 892 F. Supp. 1304 (D. Or. 1995)* (consumer claims under the Federal Communications Act lie against carrier but not its collection agency), *aff'd, 96 F.3d 1332 (9th Cir. 1996)* .

(n22)Footnote 22. *47 U.S.C. § 207.*

(n23)Footnote 23. *Lee v. Contel Cellular of the South, 1996 U.S. Dist. LEXIS 19636* (S.D. Ala. Nov. 21, 1996) .

(n24)Footnote 24. *47 U.S.C. § 208.*

(n25)Footnote 25. www.fcc.gov/cib/ccformpage.html. For more information on filing a complaint with the FCC go to www.fcc.gov/cib/consumerfacts/howtofile.html.

(n26)Footnote 26. Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of 254(g) of the *Communications Act of 1934, CC Docket No. 96-61, Second Report and Order, 11 FCC Rcd. 20730 , 61 Fed. Reg. 59,340 (1996)* (Detariffing Order) PP 5, 38.

(n27)Footnote 27. *Caller I.D.: Whose Privacy Needs Protection?*, 43 NACAA News 1 (Washington, D.C.: National Ass'n of Consumer Agency Administrators Mar. 1990).

(n28)Footnote 28. *47 C.F.R. §§ 64.1600/-/64.1603*.

(n29)Footnote 29. *47 C.F.R. § 64.1601(b)*. Note that the FCC may also add 866 and 855 as toll-free exchanges in the future.

(n30)Footnote 30. *47 C.F.R. § 64.1603*.

(n31)Footnote 31. *Romine v. Diversified Collection Servs., Inc., 155 F.3d 1142 (9th Cir. 1998) . Accord Silva v. National Telewire Corp., 2000 U.S. Dist. LEXIS 338* (D.N.H. Jan. 3, 2000) (where Telewire sent a letter stating that a high priority voice telegram was waiting, and captured phone number when debtor called to receive telegram, this went beyond "mere information gathering or message delivery" and "created a sense of urgency" so as to make Telewire a debt collector within the meaning of the FDCPA). *See also Lockemy v. Comprehensive Collection Servs., Inc., 1998 U.S. Dist. LEXIS 18887* (N.D. Ill. Nov. 17, 1998) (where defendant did not request debtors receiving its "Priority Gram" to contact defendant, and did not obtain information from debtors, it was not a debt collector).

(n32)Footnote 32. LeVine, FTC Informal Staff Letter (Mar. 20, 1998) ("Telewire Electronic Message" sent to consumer- debtors serves a collection function); Stanley, FTC Informal Staff Letter (Sept. 13, 1996) ("Telegram Notification" sent to consumer-debtors serves a collection function). *See also* Bergstrom, FTC Informal Staff Letter (Nov. 17, 1995) (to the extent that letter which proposes to obtain alleged debtors' telephone numbers to pass on to collection agencies serves a collection function, albeit indirectly, company sending letter would be covered by FDCPA).

(n33)Footnote 33. *Romine v. Diversified Collection Servs., 155 F.3d 1142, 1148-49 (9th Cir. 1998) .*

(n34)Footnote 34. *Milhollin v. Ford Motor Co., 444 U.S. 555, 100 S. Ct. 790, 63 L. Ed. 2d 22 (1980) .*

(n35)Footnote 35. The new amount financed may include earned finance charges and charge continuation of credit insurance without triggering the new disclosure requirement. *12 C.F.R. § 226.20(a)(4)*.

(n36)Footnote 36. *See* Ch. 1, "Truth In Lending," *§ 1.10 supra .*

(n37)Footnote 37. *18 U.S.C. §§ 1961-1968*, *reprinted in* Vol. 1B *infra*.

(n38)Footnote 38. *15 U.S.C. §§ 1681-1681u*, *reprinted in* Vol. 1B *infra*. *See generally* National Consumer Law Center, Fair Credit Reporting (6th ed. 2006 and Supp.).

(n39)Footnote 39. *15 U.S.C. § 1681g*. *See* Ch. 16, "Fair Credit Reporting," *§§ 16.03*, *16.04 infra .*

(n40)Footnote 40. Fair and Accurate Credit Transactions Act of 2003, Pub. L. No. 108-159 (Dec. 4, 2003). NCLC's complete analysis of FACTA is available at www.consumerlaw.org/initiatives/facta/nclc_analysis.html.

(n41)Footnote 41. *See generally* National Consumer Law Center, Consumer Banking and Payments Law (3rd ed. 2005 and Supp.).

(n42)Footnote 42. *U.C.C. §§ 1-201(39), 3-401(b).*

(n43)Footnote 43. *U.C.C. §§ 3-401(a), 3-402, 4-401(a). See* National Consumer Law Center, Consumer Banking and Payments Law § 1.4.1 (3rd ed. 2005 and Supp.).

(n44)Footnote 44. *U.C.C. § 4-406(c).*

(n45)Footnote 45. *U.C.C. § 4-406(d).*

(n46)Footnote 46. *U.C.C. § 4-403. See* National Consumer Law Center, Consumer Banking and Payments Law § 1.6.1 (2d ed. 2002).

(n47)Footnote 47. *See 15 U.S.C. § 1693a(2)* (definition of "account").

(n48)Footnote 48. *15 U.S.C. § 1693.* The Act, the regulations under it, and the Official Staff Interpretations relating to it are reproduced in National Consumer Law Center, Consumer Banking and Payments Law, App. D (2d ed. 2002).

(n49)Footnote 49. *See* Official Staff Interpretations Regarding Regulation E, §§ 205.3(b)-1(iii), (vi), 205.3(c)(6).

(n50)Footnote 50. *See* Official Staff Interpretations Regarding Regulation E, §§ 205.3(b)-1(v).

(n51)Footnote 51. *15 U.S.C. § 1693e(a).*

(n52)Footnote 52. FRB Official Staff Interpretation Regarding Regulation E, § 205.10(b)-5.

(n53)Footnote 53. *71 Fed. Reg. 1638, 1649-1650* (Jan. 10, 2006) .

(n54)Footnote 54. FRB Official Staff Interpretation Regarding Regulation E, § 205.10(b)-6.

(n55)Footnote 55. *12 C.F.R. § 205.10(b).*

(n56)Footnote 56. The cap is higher if the unauthorized fund transfer resulted from loss or theft of a card or other means of access that the consumer did not report promptly. *See* National Consumer Law Center, Consumer Banking and Payments Law § 4.5 (2d ed. 2002).

(n57)Footnote 57. *15 U.S.C. § 1693g(a).*

(n58)Footnote 58. *15 U.S.C. § 1693a(11)* (definition of "unauthorized electronic fund transfer").

(n59)Footnote 59. *15 U.S.C. § 1693e(a). See Broxton-King v. La Salle Bank, 2001 U.S. Dist. LEXIS 14653* (N.D. Ill. Sept. 19, 2001) (denying motion to dismiss where bank refused to stop payment because consumer had failed to pay prior overdraft fee).

(n60)Footnote 60. *15 U.S.C. § 1693m(a).*

(n61)Footnote 61. *15 U.S.C. § 1693m(a)(2)(B), (b)(2).*

(n62)Footnote 62. *15 U.S.C. § 1693m(c), (d), (e).*

(n63)Footnote 63. *15 U.S.C. §§ 1693m(a), 1693f.*

(n64)Footnote 64. *15 U.S.C. § 1693e.*

(n65)Footnote 65. FRB Official Staff Interpretations Regarding Regulation E, § 205.10(b)-2 (third party payee commits violation by failing to obtain authorization for preauthorized transfers in writing or failing to give a copy to the consumer).

(n66)Footnote 66. ACH Rules 2.1.5 and 13.1.58.

(n67)Footnote 67. ACH Rule 13.1.57.

(n68)Footnote 68. The settlement date is the date an entry is reflected on the books of the Federal Reserve Bank. ACH Rule 13.1.55. *See* ACH Rules, App. Two, at OR 78.

(n69)Footnote 69. *Notice of Amendment to the 2003 ACH Rules* (Supp. #1, Mar. 2003).

(n70)Footnote 70. The rules apply whether the business uses a bank directly or through a third party service provider. OR 2.11.3.

(n71)Footnote 71. OR 2.11.3.

(n72)Footnote 72. ACH Rule 7.6.1. The rules discussed in this section do not apply to ARC, POP, or RCK entries. *See also* National Consumer Law Center, Consumer Banking and Payments Law (2d ed. 2002 and Supp.).

(n73)Footnote 73. ACH Rule 7.6.5.

(n74)Footnote 74. Under Reg. E, the notice can be either oral or in writing, although if it is oral, the bank may require a written confirmation of the oral notice within 10 business days of the oral notice. Reg. E § 205.11(b)(2).

(n75)Footnote 75. ACH Rule 7.6.6.

(n76)Footnote 76. ACH Rule 2.1.2 contains those requirements. See Part 1.4.1.

(n77)Footnote 77. *15 U.S.C. § 1692e(10)*.

(n78)Footnote 78. *15 U.S.C. § 1692d*.

(n79)Footnote 79. *15 U.S.C. § 1692f*.

(n80)Footnote 80. *15 U.S.C. § 1691*.

(n81)Footnote 81. *15 U.S.C. § 1691a* (emphasis added).

(n82)Footnote 82. *Sharp v. Chartwell Fin. Servs., 2000 U.S. Dist. LEXIS 3143* (N.D. Ill. Feb. 28, 2000) (collector's use of racial and gender-based epithets during collection phone calls held actionable); *FDIC v. Allen, 1988 U.S. Dist. LEXIS 17565* (W.D. Okla. Nov. 3, 1988) . *Accord Roseman v. Premier Fin. Servs., L.P., 1997 U.S. Dist. LEXIS 13836* (E.D. Pa. Sept. 3, 1997) .

(n83)Footnote 83. FRB Reg. B, *12 C.F.R. § 202.4*.

(n84)Footnote 84. *15 U.S.C. § 1691e*. *See* Ch. 5, "Credit Discrimination," *§ 5.11 supra* .

(n85)Footnote 85. *42 U.S.C. § 1983*.

(n86)Footnote 86. *Owens v. Swan, 962 F. Supp. 1436 (D. Utah 1997) , citing Flagg Bros., Inc. v. Brooks, 436 U.S. 149, 98 S. Ct. 1729, 56 L. Ed. 185 (1978) . See also Audio Odyssey, Ltd. v. Brenton First Nat'l Bank, 245 F.3d 721* (storeowner stated claim for *Fourth Amendment* violations where deputies locked up store, although replevin writ

authorized seizure only of movable property), *related proceeding, 255 F.3d 512 (2001)* , *reinstated on reh'g, 286 F.3d 498 (8th Cir. 2002)* , *cert. denied, 154 L. Ed. 2d 359 (U.S. 2002)* ; *Taunt v. Barman (In re Barman), 252 B.R. 403 (Bankr. E.D. Mich. 2000)* (*Fourth Amendment* applies to inspection by bankruptcy trustee). *Cf.* National Consumer Law Center, Fair Debt Collections, § 9.12 (6th ed. and supp.) for a full discussion of 1983 claims and other constitutional torts.

(n87)Footnote 87. *11 U.S.C. § 362(a)(6).*

(n88)Footnote 88. *11 U.S.C. § 524(a)(2).*

(n89)Footnote 89. *See* Collier Consumer Bankruptcy Practice Guide Ch. 8 (Matthew Bender); Collier Consumer Bankruptcy Forms Pt. CS6, §§ CS6.31, CS6.32 (Matthew Bender); National Consumer Law Center, Consumer Bankruptcy Law and Practice § 9.6 (7th ed. 2004). *Section 342 of the Bankruptcy Code*, as amended by Pub. L. No. 109-8 and effective for cases filed on or after October 17, 2005, contains new requirements for notice to creditors, and provides that a monetary penalty may not be imposed on a creditor if effective notice is not given by the debtor. *See also*, National Consumer Law Center, Fair Debt Collection, § 2.2.5 (5th ed. 2004), for discussion of relationship between Bankruptcy Code and claims brought under state and federal debt collection statutes.

(n90)Footnote 90. *Compare Pertuso v. Ford Motor Credit Co., 233 F.3d 417 (6th Cir. 2000)* (holding that there is no private right of action other than contempt), *with Bessette v. Avco Fin. Servs., Inc., 230 F.3d 439 (1st Cir. 2000)* (holding that there is class action remedy for violation of discharge injunction), *amended, reh'g denied, 2000 U.S. App. LEXIS 33737* , *cert. denied, mot. granted, 532 U.S. 1048 (2001)* . *See also Bolen v. Bass & Assocs., P.C., 2001 U.S. Dist. LEXIS 16964* (N.D. Ill. Oct. 18, 2001) (consumer may not proceed under FDCPA for violation of *Bankruptcy Code § 524(c)* because only remedy was to seek contempt sanctions in bankruptcy court); *Vogt v. Dynamic Recovery Servs., 257 B.R. 65 (Bankr. D. Colo. 2000)* (FDCPA claim for violating bankruptcy discharge dismissed without prejudice as outside bankruptcy court's jurisdiction five years after discharge was granted; demand by creditor for payment, as condition to dropping debt from debtor's credit report, was not an "act" to extract payment); *DuBois v. Ford Motor Credit Co., 2001 U.S. Dist. LEXIS 5138* (D. Minn. Jan. 19, 2001) (consumers' motion to refer their claim under FDCPA and Bankruptcy Code to bankruptcy court was denied as named plaintiffs' discharge was more than four years old), *subs. appeal, 276 F.3d 1019 (8th Cir. 2002)* ; *Howell v. Ocwen Fed. Bank, FSB, 2001 U.S. Dist. LEXIS 15710* (N.D. Ill. Sept. 27, 2001) (since alleged FDCPA violations occurred during course of bankruptcy, court ruled that matter should be dealt with by bankruptcy court using remedies allowed by Bankruptcy Code, rather than the FDCPA; decision surveys case law regarding the FDCPA's interplay with bankruptcy). *See also Diamante v. Solomon & Solomon, P.C., 2001 U.S. Dist. LEXIS 14818* (N.D.N.Y. Sept. 18, 2001) (state and FDCPA claims arising from freezing of bank account in effort to collect discharged debt preempted by bankruptcy law); *Tate v. NationsBanc Mortg. Corp. (In re Tate), 253 B.R. 653 (Bankr. W.D.N.C. 2000)* (federal bankruptcy law preempts UDAP and state debt collection statute claims based on creditor's addition of attorney fees to Chapter 13 proof of claim). *See generally* National Consumer Law Center, Fair Debt Collections, § 2.2 (6th ed. and supp.).

(n91)Footnote 91. *See* National Consumer Law Center, Consumer Bankruptcy Law and Practice § 14.5.1.4 (8th ed. 2006 and Supp.).

(n92)Footnote 92. *See* National Consumer Law Center, Consumer Bankruptcy Law and Practice § 14.5 (8th ed. 2006 and Supp.); *R. Van Meter v. American State Bank, 89 B.R. 32, 1988-2 Trade Cas. (CCH) P68318 (W.D. Ark. 1988)* (repayment agreement not a voluntary payment under *11 U.S.C. § 524(f)* where creditor bank required borrower to obtain an additional advance to repay a discharged debt as a condition to the bank's approval of a home mortgage loan); *In re Esposito, 119 B.R. 305 (Bankr. M.D. Fla. 1990)* (where creditor promised debtors post-petition that it would reinstate business relation and sell debtor's equipment on open account if debtors paid $8000 toward discharged debt but then failed to sell debtors the equipment after they paid, creditor was required to repay $8000 and attorney fees); *In re Bowling, 116 B.R. 659 (Bankr. S.D. Ind. 1990)* (where post-discharge transaction was not deemed a "voluntary payment" of the discharged debt but rather an agreement to reaffirm the debt, debtors could recover attorney fees for

violation of Bankruptcy Code).

(n93)Footnote 93. *5 U.S.C. § 5520a* (allows garnishment of federal employees' wages including employees of executive, judicial and legislative agencies, members of Congress and military personnel).

(n94)Footnote 94. *15 U.S.C. § 5520a*(b).

(n95)Footnote 95. 32 C.F.R. §§ 112-113 (1995).

(n96)Footnote 96. *50 U.S.C. app. §§ 501*-596.

(n97)Footnote 97. *50 U.S.C. app. §§ 521, 522. See also* National Consumer Law Center, Collection Actions, Ch. 7 (1st ed. 2008).

(n98)Footnote 98. *50 U.S.C. app. § 526. See also* National Consumer Law Center, Collection Actions, Ch. 7.6 (1st ed. 2008).

(n99)Footnote 99. *50 U.S.C. app.§ 527. See also* National Consumer Law Center, Collection Actions, Ch. 7.7 (1st ed. 2008).

(n100)Footnote 100. *50 U.S.C. app.§ 532. See also* National Consumer Law Center, Collection Actions, § 7.8 (1st ed. 2008).

(n101)Footnote 101. *50 U.S.C. app.§ 531. See also* National Consumer Law Center, Collection Actions, § 7.11.1 (1st ed. 2008).

(n102)Footnote 102. *50 U.S.C. app. § 535. See also* National Consumer Law Center, Collection Actions, § 7.11.2 (1st ed. 2008).

(n103)Footnote 103. *See, e.g., N.Y. Military Law § 300 et seq.*

(n104)Footnote 104. Soldiers' and Sailors' Civil Relief Act Amendments of 1991, Pub. L. No. 102-12, *105 Stat. 34* (Mar. 18, 1991).

(n105)Footnote 105. Pub. L. 108-189, *117 Stat. 2835* (Dec. 19, 2003).

(n106)Footnote 106. § 105 (*50 U.S.C. app. § 515*) (compare to former *50 U.S.C. app. § 515*).

(n107)Footnote 107. § 108 (*50 U.S.C. app. § 518*). *See Cathey v. First Republic Bank, 2001 U.S. Dist. LEXIS 13150* (W.D. La. July 6, 2001) (provision of former version of Act barring changes in credit terms does not forbid new loan to cover cost overruns which occur while commercial borrower is serving abroad).

(n108)Footnote 108. § 107 (*50 U.S.C. app. § 517*).

(n109)Footnote 109. *Boone v. Lightner, 319 U.S. 561 (1943)* ; *Engstrom v. First National Bank, 47 F.3d 1459, 1462 (5th Cir. 1995)* ; *Antioch Co. v. Scrapbook Borders, Inc., 210 F.R.D. 645 (D. Minn. 2002)* ; *Cathey v. First Republic Bank, 2001 U.S. Dist. LEXIS 13150,* at *12 (W.D. La. July 6, 2001) ("Any doubts that arise as to the scope and application of the Act should be resolved in favor of the military person"); *In re Burrell, 230 B.R. 309 (Bankr. E.D. Tex. 1999)* ; *Murdock v. Murdock, 338 S.C. 322, 526 S.E.2d 241 (App. 1999) . But cf. Chace v. Lopez, 89 S.W.3d 788 (Tex. App. 2002)* (Act to be liberally construed but cannot be stretched to prohibit prejudgment interest on tort claim where nothing in Act addresses this topic).

(n110)Footnote 110. www.jagcnet.army.mil/TJAGSA (Publication JA 260).

(n111)Footnote 111. www.abanet.org/family/military.

(n112)Footnote 112. Mark E. Sullivan, A Judge's Guide to the Servicemembers Civil Relief Act.

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PART I Consumer Credit
CHAPTER 8 Fair Debt Collection

1-8 Consumer Credit Law Manual § 8.09

§ 8.09 Other State Remedies

There are a variety of other state laws that can come into play in fighting abusive debt collectors. n1 While there are some patterns, each state has a somewhat unique legal framework that bears close analysis. The FDCPA contains broad non-preemption language, which applies to "the laws of any state with respect to debt collection." n2 This language makes it clear that the FDCPA is intended only to set minimum standards; states are free to provide greater protection to the consumer. A collector may nonetheless raise the issue whether the non-preemption language protects a common law cause of action. One court has held that common law claims are preempted, n3 but a better-reasoned opinion holds that they are not. n4

[1] Identity Theft

Victims of identity theft, an increasingly common crime, are often vigorously dunned for debts they do not owe, despite their efforts to clear their records. Their credit is often ruined by false reports to credit bureaus, and they may even be subject to criminal prosecution. These consumers may have several tort causes of action available to them. The key question will be, given the increasing frequency of this crime, what investigation should a reasonable creditor make before dunning a consumer, referring a claim to a collector, reporting a debt to a credit bureau or instituting a criminal prosecution? n5 Failure to reasonably investigate will be probative on the issues of malice, recklessness, lack of probable cause, and reckless disregard for truth--elements of several of the causes of action discussed in this chapter. A consumer may also have a cause of action for negligence against the creditor who let the thief get away with the deception.

[2] Consumer Protections Under State Debt Collection Statutes and Regulations

[a] Overview

State debt collection statutes may provide the primary consumer remedy for debt collection abuse in many instances, particularly as to creditors who are not covered by the Federal FDCPA. In some states, statutory damages and court-awarded attorney fees for successful consumers are available.

All but eight states have statutes specifically dealing with abuses by debt collectors.

Although state debt collection statutes are varied, certain common forms exist, such as setting standards for licensing and regulating collection agencies, consumer protection laws, and/or criminal penalties against misconduct, such as simulating legal process. Eleven states have more than one type of statute; twenty-six states license some debt collectors; twenty-five state debt collection statutes provide an express private right of action for consumers. A private right of action is implied under some of the other statutes.

[b] Validity of State Debt Collection Statutes Upheld

Although cases are few, these laws have been upheld by courts. n6

[c] State Debt Collection Statutes' Coverage

Some debt collection statutes apply only to collection agencies, while others also include creditors collecting their own debts. Debt collection statutes are frequently limited in their coverage to "debt," "credit," or "consumer" transactions. Some "consumer" laws, such as state debt collection statutes, may protect tenants as well. While landlords are often "creditors" who are immune from liability under the Federal FDCPA, *15 U.S.C. sections 1692a(4)* and *(6)(A)*, they may be subject to debt collection and other state consumer protection statutes. Landlord's servicing agents, e.g., attorneys, collection agencies, and realty companies, may be subject to FDCPA liability. n7 One court allowed a state debt collection act claim to go forward against a "settlement service" that dunned a consumer who was being sued by a record company for copyright infringement by file sharing. n8

Some state debt collection statutes may apply to business as well as consumer transactions. Some debt collection statutes cover out-of-state debt collectors who collect debts from residents of the legislating states; the constitutionality of such provisions has been upheld. n9 Consumers being dunned by an out-of-state collector may also be protected by the debt collection laws of the collector's home state. n10 State debt collection statutes may also apply different substantive standards than the FDCPA. One court, for example, has held that the Oregon debt collection statute does not apply the FDCPA's "least sophisticated consumer" standard. n11 Government entities are generally exempted from state debt collection laws, either by statutory provision, or by sovereign immunity, but collection agencies hired to collect government debts do not receive this exemption. n12 Some states have special provisions covering private child support collectors. Illinois, for example, excuses compliance with some but not all of the limitations that apply to other collectors. n13 The debt collection provisions of the Colorado Uniform Consumer Credit Code explicitly exempt the collection of student loans. n14

On the other hand, the coverage of some UDAP statutes is patchy. Some exclude certain types of creditors such as banks or utility companies. Some UDAP statutes also have special preconditions to suit or create special statutory defenses.

[d] State Debt Collection Statutes' Protections

[i] Privacy

Some debt collection statutes protect privacy by prohibiting undue publicity of a consumer's debt. Employer contacts are prohibited by some statutes' protecting the consumer's job as well as privacy. n15 Where state statutes provide a cause of action for damage to reputation resulting from a creditor's inaccurate or incomplete reporting to a credit reporting agency, state law is preempted by the FCRA, which requires a showing of malice--that is, a knowing falsehood or reckless disregard for truth. n16 A prohibition on contacting a represented consumer may be violated by contacting the consumer to reaffirm a debt discharged in bankruptcy. n17

[ii] Abusive Collection Activities Prohibited

Abusive debt collection conduct is proscribed by many state debt collection statutes and has been addressed by several

courts. n18

[iii] Unfair and Deceptive Debt Collection Activities Prohibited

Deceptive debt collection tactics have been the subject of frequent decisions under state debt collection statutes. Presumably, the standards developed under the Federal Trade Commission Act, the Fair Debt Collection Practices Act, and UDAP statutes will be applied under these provisions. n19

Many statutes prohibit unfair collection activities. n20 UDAP statutes offer various advantages over other debt collection claims. They generally cover creditors as well as collectors. Most have attractive remedies such as treble damages, statutory damages, and attorney fees. UDAP statutes usually have more relaxed proof requirements than tort claims. Many offer a longer statute of limitations than the FDCPA. n21 In a number of states, a violation of a state debt collection statute is a per se violation of the UDAP statute. n22

On the other hand, the coverage of some UDAP statutes is patchy. Some exclude certain types of creditors such as banks or utility companies. Some UDAP statutes also have special preconditions to suit or create special statutory defenses.

[e] State Debt Collection Statutes' Remedies

The remedies provided by state debt collection statutes vary widely, allowing recovery for actual damages, statutory damages, attorney fees, punitive damages, revocation, termination, or denial of a debt collection license, injunctive relief, etc. n23

[3] General State Consumer Protection Statutes Prohibiting Unfair and Deceptive Acts and Practices (UDAP)

[a] UDAP Coverage of Debt Collection Activities

During the late 1960s and the 1970s, almost every state passed laws protecting consumers from deceptive sales practices. These statutes are referred to as "Little FTC Acts," "Consumer Protection Acts," or "UDAP" (unfair and deceptive acts and practices) statutes. They are often interpreted to prohibit unfair or deceptive practices by debt collectors.

Whether collection agencies, creditors, attorneys, loans, and debt collection activities in general are covered by a particular state's UDAP statute depends upon the language of the statute and its interpretation by the courts. n24

[b] Deceptive Debt Collection Activities

Numerous collection activities have been found to be "deceptive" under state UDAP statutes, including: sending consumers dunning letters that appeared to have been issued by the government; misrepresenting the imminence of suit; falsely implying that a referral to an attorney would occur; misrepresenting contact with the consumer's employer; threatening to enforce illegal contractual provisions; exaggerating the creditor's contractual or legal remedies; collecting an amount greater than actually owed; disguising usurious lending as a "check cashing service," failing to disclose the interest rate; threatening to criminally prosecute debtors under NSF laws; and attempting to collect a debt barred by the statute of limitations. Dunning the consumer for attorney fees that are not actually owed is deceptive. n25

[c] Unfair and Unconscionable Debt Collection Activities Under UDAP Statutes

State UDAP statutes have also been held to disallow debt collection activities that are "unfair" or "unconscionable." Some statutes provide for injunctive relief. As with some debt collection statutes, some UDAP statutes require a

showing of actual damages to pursue a private action.

[d] UDAP Remedies for Debt Collection Violations

All UDAP statutes except Iowa's provide a private cause of action for at least actual damages resulting from a violation. n26 Relief may include return of funds collected. n27 Emotional distress damages are recoverable in some but not all jurisdictions. n28 Many UDAP statutes provide for multiple or punitive damages and reasonable attorney fees n29 in successful consumer actions. Some statutes provide for injunctive relief.

Many UDAP statutes require a showing of actual damages as a precondition of suit. n30 In states that merely require the consumer to be "aggrieved," it may be sufficient to show that the collection activities imposed a burden or obligation on the consumer. n31 In other states, the loss must be of money or property, or must be "pecuniary," so a debtor who has suffered only emotional distress may have difficulty making a UDAP claim. n32 Even in these states, however, the loss of money or property may be small in amount, n33 and it may not be necessary to prove the exact amount. n34

[4] State Credit Repair Organization Statutes

[a] Introduction

Most states have passed statutes to deal with abuses by credit repair organizations. n35 These statutes, often termed the state Credit Services Organization Act, offer strong remedies and have the potential of applying to certain debt collection activities. They typically follow the federal Credit Repair Organizations Act n36 closely in some respects, but differ in significant ways, often imposing additional requirements such as registration and bonding.

[b] Coverage

Like the federal Credit Repair Organizations Act, all or nearly all state credit repair statutes cover organizations that offer to improve an individual's credit rating, in return for the payment of money or other valuable consideration. This language should be interpreted consistently with the federal statute to cover debt collectors who represent to debtors that payment will improve their credit records. n37

In addition, most state credit repair statutes cover organizations that assist or offer to assist consumers in obtaining extensions of credit. These statutes may cover debt collectors who offer to assist the consumer in obtaining credit to pay the debt. n38 Again, the assistance must be offered or provided in return for the payment of money or other valuable consideration, but the collector's receipt of the proceeds of the extension of credit may meet this requirement. n39

State credit repair laws typically exempt non-profit organizations; licensed real estate brokers and attorneys when acting within the scope of their licenses; broker-dealers registered with the SEC or the Commodity Futures Trading Commission ("CFTC"); consumer reporting agencies; credit unions; banks eligible for FDIC or FSLIC insurance; banks and other lenders authorized under federal or state law; and lenders approved by HUD for participation in federal mortgage insurance. A smaller number exempt debt collectors, debt adjusters, mortgage brokers, accountants, holders of other licenses, or other entities.

[c] Substantive Prohibitions

Debt collectors that fall under state credit repair statutes are likely to have made no attempt to comply with the statute's substantive requirements. Typical requirements of state credit repair statutes include:

- Registration and bonding, requirements that go beyond the federal statute;
- Disclosures to the consumer about rights available under the FCRA;

- Written contracts with specified provisions, including a description of the services to be provided;

- A prohibition against charging the consumer for a referral to a retail seller who will or may extend credit to the consumer on the same terms as those available to the general public;

- A three- or five-day right to cancel.

Most, like the federal statute, also prohibit certain misrepresentations and deceptive acts. A number of state statutes explicitly prohibit waivers of the statutory protections.

Some state credit repair statutes, like the federal statute, prohibit organizations from accepting payment from the buyer before performing services. Many allow advance payment once the organization has posted a bond, however.

[d] Private Remedies

Almost all state credit repair statutes provide a private right of action to consumers. Some do so both by making a violation actionable under the state UDAP statute n40 and by creating a special cause of action.

The special causes of action offered by state credit repair laws are often broader than those authorized by the state UDAP statute or the state debt collection practices statute. Usually the statutes that create special causes of action authorize punitive damages and attorney fees. Many, like the federal statute, n41 set as minimum damages the total amount paid by the consumer. n42 A few set a dollar amount, such as $1000, as minimum damages.

[5] Unauthorized and Unethical Practice of Law by Creditors, Lawyers, and Collection Agencies

[a] Unauthorized Practice of Law by Creditors

Every state has laws restricting the practice of law to licensed lawyers. While most unauthorized practice of law cases in the debt collection context have involved the unauthorized practice of law by collection agencies, some cases have involved creditors whose officer or employee represented them in court. n43

[b] Unethical Practice of Law by Lawyers

The collection activities of a lawyer may be unethical, such as lending one's name to a collection agency letterhead and failing to authorize or supervise personally court proceedings brought by the collection agency in the lawyer's name.

A lawyer's interstate collection letters must avoid misrepresenting the lawyer's authority to sue where he or she is not admitted to practice.

Lawyers may also violate legal ethics when attempting to collect their own fees. Lawyers have been sanctioned for debt collection harassment, n44 and for revealing client secrets in the course of a fee dispute. n45 A lawyer's retainer agreement which called for a 1% per month late fee, plus costs and attorney fees if collection efforts were required, was held unenforceable because it was unfair and violated the rules of professional conduct. n46

[c] Unauthorized Practice of Law by Collection Agencies

States have taken very different positions as to what activities of a collection agency constitute unauthorized practice of law, but many states have such laws. Some bar associations and bar committees have issued advisory opinions defining activities of collection agencies or creditors that may constitute unauthorized practice of law. Such acts are also UDAP violations. n47 A lawyer who fails to properly supervise non-lawyer employees will be responsible for their

unauthorized practice, or other misconduct. n48 Some states prohibit a contingent fee collector from filing suit in its own name. n49 Collection agencies may not file suit on behalf of creditors. n50

[d] Remedies for Unauthorized Practice of Law

Courts are divided as to what remedies are available to consumers affected by a collection agency's or creditor's unauthorized practice of law.

Some courts, however, allow suits by consumers to enjoin debt collectors' unauthorized practice of law. The FTC staff considers unauthorized practice of law (as determined by state law) by a debt collector to violate the provision of the FDCPA prohibiting "unfair" practices, if the collector is covered by the Act. An Ohio statute was recently revised to allow a private right of action for unauthorized practice, but only if the state supreme court had made a finding of such practice. n51

[6] State Criminal Statutes

A debt collector's misconduct may be so extreme that it violates state criminal statutes or local criminal ordinances. Local criminal law may prohibit telephone abuse, unauthorized practice of law, and larceny by trick, extortion, and other crimes.

[a] Other State Causes of Action

Debt collection activities may support common law causes of action such as trespass, breach of peace, etc. n52 Collection of debts for most types of utility service is governed by specific state laws and regulations. n53

[7] Tort Remedies

Abusive collection activity may give rise to a variety of tort claims, including intentional or negligent infliction of emotional distress, invasion of privacy, intentional interference with employment relationships, defamation, malicious prosecution, and abuse of process. n54 Ordinary tort actions against governmental creditors will, however, raise special problems: the consent to suit found in federal and state tort claims acts generally excludes certain collection activities, i.e., taxes, and the complexities of municipal liability law are beyond the scope of this treatise. n55

[8] Consumer Protection Defenses to Medical Bills

A few states recognizing the special burden created by health care debts, have enacted statutes limiting health care debt collection, or otherwise assisting debtors facing health problems. n56 For example, Nevada and Ohio forbid execution on the primary residence for health care debts during the lifetime of the debtor and certain specified dependents; a lien may be created which may be foreclosed only after the residence ceases to be occupied by the protected persons. n57 West Virginia provides a larger homestead exemption for debts resulting from "catastrophic illness or injury." n58 Illinois limits the percentage of a personal injury recovery which may be subject to a lien by certain health care providers. Kansas forbids wage garnishments for two months after the return to employment of a debtor after an illness of the debtor or of a family member which has kept the debtor out of work for two or more weeks. n59

Connecticut has a comprehensive law to protect medical debtors. n60 California also prohibits health facilities from detaining a patient for non-payment of a medical debt. n61

California enacted a new statute requiring hospitals to make a copy of its "charge description master" publicly available. The "charge description master" is the schedule of gross or "retail" prices for services or items charged by the hospital. n62 The intent of the statute was both to enable consumers to comparison shop and to provide an impetus for hospitals limit their markups. n63

New Jersey prohibits collection activities against patients found eligible for charity care. n64 In addition, New Jersey has established a "Hospital Care Payment Commission" to which hospitals can voluntarily assign medical debt. n65 The Commission has the power to set-off state tax refunds and other state refunds to collect medical debts, n66 but the hospital agrees to first determine that patients are not eligible for charity care. n67

In addition, the full panoply of laws that protect consumers in general from abusive debt collection tactics should also protect health care consumers who are subject to abusive collection tactics by health care providers and their agents, including the FDCPA, state debt collection statutes, and other common law claims such as duress, as well as special defenses under statutes creating a duty to provide free or reduced cost care. n68

[9] Enjoining Abusive Debt Collection Practices

Injunctive relief is available in most states to persons suffering or about to suffer irreparable injury for which there is no adequate remedy at law. The unauthorized practice of law and violations of state statutes prohibiting unfair and deceptive acts and practices may also be subjects of injunctive relief.

[10] State Restrictions on the Recovery of Collection Expenses

[a] Overview

The common law strictly limits the damages a creditor may recover from debtors for failing to timely pay a debt to the interest provided in the contract or by statute. Dissatisfied with this limitation on their profits, creditors and collectors have through their adhesion contracts and legislation sought additional charges from consumers allegedly to compensate for their collection expenses.

The most common inroad on the common law rule prohibiting recovery of more than interest for the failure of a consumer to pay a debt on time is the allowance by some courts of an attorney fee award for a creditor if it is authorized by the contract.

Generally, in the absence of a contractual or state statutory provision providing for the recovery of collection expenses or attorney fees, collection expenses are not recoverable as damages for the collection of a debt, and many state statutes and cases prohibit or limit the recovery of collection expenses even when apparently authorized by a consumer credit contract.

[b] Charging Collection Fees Proportional to Debt and Other Excessive Fees Penalize Consumers

Creditors and collectors often seek to recover the collection fees they pay their lawyers from the consumers pursued by their lawyers. Most often they seek a fee calculated as a percentage of the debt rather than based on the actual amount of the time and effort by the lawyers. When the debt is large, the fees generated by the percentage method may greatly exceed the actual cost of recovery for the particular debt.

Frequently, there are grounds to challenge these fees. Some jurisdictions prohibit creditors from recovering their attorney fees from consumers entirely, while others allow the creditor to recover only the actual collection costs incurred or limit recovery to only "reasonable" attorney fees.

[c] State Legislation Limiting Recovery of Collection Expenses

There are numerous state statutory restrictions on a collector's recovery or attempted recovery of its collection expenses from the debtor. n69 Statutory restrictions may be contained in statutes that may apply only to specific creditors, to certain types of credit, or to special collection expenses.

A few states permit recovery of collection fees in certain circumstances even when such fees are not authorized by the consumer credit contract. Thus, statutes may provide that a collector of dishonored checks may add a small, e.g., $5.00 to $15.00, collection charge even in the absence of a contractual basis for the charge. More recent state legislation allows larger bad check charges, in the $20 to $30 range, or as a percentage of the amount of the check. Some courts have found authority for service charges on returned checks in a provision of Article 2 of the UCC that allows a person in the position of the seller to recover incidental damages for nonpayment of the price of goods. n70 Courts that are less anxious to find authority for returned check charges correctly hold that Article 3, not Article 2, applies to collection of dishonored checks that have been sold to a third party. n71 And some states have statutorily overruled the American Rule on attorney fees by generally permitting courts to award attorney fees to prevailing parties in many types of civil suits. Many state statutes also expressly permit the recovery of a limited amount of attorney or collection fees in collection suits if the fees are authorized by the consumer credit contract. A few states allow attorney fee awards in a suit on an "account stated" or "open account" where there is no question raised as to the amount owed.

Some state debt collection statutes allow fees only where expressly permitted by law. Other statutes expressly prohibit the recovery of any attorney or collection fees.

[d] Case Law: Noncontractual Collection Fees

Unless the credit agreement or state statute provides for collection expenses or unless the debtor's defense is frivolous, attorney fees or other collection expenses may not be awarded as damages or taxed as costs in a collection action.

[e] Case Law: Contractual Collection Fees

[i] General

There is a vast amount of case law dealing with the collector's recovery of one type of collection expense--attorney collection fees that are provided by the credit contract, but only a few cases deal with collection expenses of nonattorneys or with attorney fees when they are not specifically authorized by the credit agreement. Consequently, the numerous cases limiting court-awarded attorney fees are usually the best precedent for other collection expense issues, either directly or by analogy. n72

Courts have divided into three main camps regarding the validity and construction of clauses in credit contracts providing for the recovery of collection expenses, including attorney fees. The three main camps are: 1) Freedom of Contract Approach (these courts generally enforce contractual provisions for attorney fees or collection expenses on the premise that the parties are free to contract without judicial interference); 2) Indemnity Approach (these courts uphold the validity of such clauses as binding agreements by the debtor to indemnify the creditor's attorney fees, but limit the enforcement of such clauses in ways consistent with indemnification theory); and 3) Invalid Contract Approach (these courts hold that contract clauses providing for the recovery of collection fees are invalid in the absence of statutory authorization of such fees).

[11] Threats to Criminally Prosecute Consumer Under Bad Check Laws

A troublesome debt collection tactic is to threaten consumers with prosecution under criminal bad check statutes.When a consumer writes a check which is dishonored (bounced) because the consumer's account has nonsufficient funds (NSF) or credit to cover the check, or was closed, the person holding the check may threaten to initiate a bad check criminal prosecution against the consumer. Some collectors may solicit checks from financially distressed consumers and are indifferent to the sufficiency of funds to cover the check, knowing that the possibility of a bad check prosecution provides the collector with powerful collection leverage. Payday lenders, who provide small, short term loans, often at triple-digit interest rates, commonly use this method of coercion. n73

However, constitutional and judicial limitations often limit the apparent breadth of bad check laws. Most state constitutions contain a prohibition against the imprisonment for debt, although this is not a protection explicitly provided by the U.S. Constitution. Some state bad check laws have been declared facially unconstitutional under such provisions, while courts have indicated that other statutes would be unconstitutional if fraudulent intent was not construed to be an essential element of the crime.

Many courts also have held that bad check laws do not apply to post-dated checks or to checks given for preexisting debts. n74

Many states have enacted civil bad check penalty laws, which encourage bounty hunters by providing for attorney fees and multiple or inflated damages for acts which may violate a criminal bad check statute.

[12] Arbitration and Use of Alternative Dispute Mechanism to Collect Debts

[a] Creditors Increasingly Using Arbitration to Collect Consumer Debts

Including compulsory arbitration clauses in standard form loan contracts may become a trend among banks and finance companies.

While there may be many valid reasons to encourage truly voluntary and non-binding Alternative Dispute Resolution ("ADR") mechanisms in consumer cases, there are several ways in which compulsory and binding ADR procedures, especially arbitration and judicial reference, impact negatively on consumers. The most important result to consumers is the loss of the right to have a jury decide their dispute with the creditor or merchant, particularly when this right is not knowingly given up.

Another consequence of ADR may be the loss of an opportunity to appeal. There is often little or no right to appeal from an arbitration or judicial reference decision. And the arbitrator or other decision-maker is not necessarily bound to follow judicial precedent.

The arbitrator also has broader discretion to choose a remedy, and arbitrators have a tendency to use this discretion only to award actual damages and only under basic common law notions. This tendency often results in failure to award multiple statutory or punitive damages and attorney fees under consumer protection statutes.

There is generally little discovery beyond basic document production in an ADR procedure and some of these procedures may cost more than bringing an action in court.

A few court cases have found such programs to be unconscionable on a number of grounds.

[b] Validity and Scope of Arbitration Clauses

The Federal Arbitration Act ("FAA") broadly preempts any state law which singles out arbitration clauses for special treatment, for example by restricting their use in consumer transactions or requiring that they be conspicuous. The FAA applies to any transactions "involving" interstate commerce. Where the Act applies, a state may apply to arbitration clauses only those requirements which apply to contracts in general.

An important threshold question when dealing with any arbitration clause is the scope: who may compel arbitration of what causes of action. Another question, which has divided courts, is whether non-signing consumers, such as spouses or third-party beneficiaries, are bound by arbitration clauses. Broadly worded arbitration clauses have been construed to include a wide range of statutory and common law causes of action, including tort, but more limited clauses may be construed to exclude the consumer's claim. Questions may arise whether the document containing the arbitration clause

is part of the contract.

Still another difficult issue is whether the court or the arbitrator should resolve challenges to an arbitration clause. Courts may draw fine distinctions between fraud in the execution, which prevents the signer from knowing what he or she was signing, and voids the entire contract, which is a question for the court, and fraud in the inducement, a misrepresentation which makes the contract voidable, which is arbitrable. A claim that a party's signature was forged must be decided by the court. n75

[c] Arbitration Is Unenforceable Where It Violates State Collection or Credit Law

While the Federal Arbitration Act may preempt a state's attempt to prohibit collection via arbitration, the state can regulate collections and credit in a way that does not single out arbitration, but still has the effect of restricting arbitration agreements. n76 For example, if a state statute limits the consumer's liability for attorney fees and collection costs, then an arbitration agreement should not be able to require the consumer to pay more than this amount. n77

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionFair Debt CollectionGeneral OverviewBanking LawConsumer ProtectionState LawGeneral Overview

FOOTNOTES:
(n1)Footnote 1. For discussion of other common law claims that debt collection abuse may give rise to, such as intentional infliction of emotional distress, and invasion of privacy, see National Consumer Law Center, Fair Debt Collection Ch. 10 (6th ed. and supp.).

(n2)Footnote 2. *15 U.S.C. § 1692n. See* National Consumer Law Center, Fair Debt Collection, § 6.13 (6th ed. and supp.).

(n3)Footnote 3. *Thrasher v. Cardholder Servs., 74 F. Supp. 2d 691, 694 (S.D. Miss. 1999)* (non-preemption language does not apply to state tort action for intentional infliction of emotional distress, because this not a state law "with respect to debt collection;" state common law which allows punitive damages conflicts with and is preempted by section of FDCPA which limits noncompensatory damages to $1,000). *See also Binion v. Franklin Collection Servs., 147 F. Supp. 2d 519 (S.D. Miss. 2001)* (FDCPA does not completely preempt state tort causes of action, so as to allow removal to federal court, but *Trasher* conflict preemption may be a defense to state tort claim).

(n4)Footnote 4. *Williams v. Northcut & Edwards, P.C., 1999 U.S. Dist. LEXIS 12980, at 10* (S.D. Ohio July 7, 1999) (Ohio common law action for invasion of privacy not preempted by FDCPA; statute and common law "further the same purpose," i.e., protecting the consumer from abusive debt collection practices, and common law does not "in any way limit" the FDCPA).

(n5)Footnote 5. *Nicholl v. A & P, 238 Ga. App. 30, 517 S.E.2d 561 (1999)* (malice and lack of probable cause shown where store's investigation inadequate, and it did not even follow its own standard procedure before criminally prosecuting identity theft victim). *See also Gill v. Kostroff, 82 F. Supp. 2d 1354 (M.D. Fla. 2000)* (malicious prosecution: issue of material fact whether suit was brought without probable cause, where not clear what information creditor had when it sued identity theft victim); *Dornhecker v. Ameritech Corp., 99 F. Supp. 2d 918 (N.D. Ill. 2000)* (defamation); *Arcaro v. Silva, 77 Cal. App. 4th 152, 91 Cal. Rptr. 2d 433 (1999)* (malicious prosecution: lack of probable cause, where alleged debtor informed creditor and collection agency that signature was forged, provided handwriting exemplars, and pointed out that former officemate had access to personal information which would enable him to open account in alleged debtor's name).

(n6)Footnote 6. *Harris v. Beneficial Fin. Co., 338 So. 2d 196 (Fla. 1976) , cert. denied, 430 U.S. 950, 97 S. Ct. 1591, 51 L. Ed. 2d 800 (1977)* ; *but see Brannan v. United Student Aid Funds, Inc., 94 F.3d 1260 (9th Cir. 1996) , cert. denied, 521 U.S. 1106, 117 S. Ct. 2484, 138 L. Ed. 2d 992 (1997)* (state debt collection statute preempted by federal Department of Education collection regulations). *See also* Annot., *Validity, Construction, and Application of State Statutes Prohibiting Abusive or Coercive Collection Practices, 87 A.L.R.3d 786 (1978). See generally* National Consumer Law Center, Student Loan Law (2001).

(n7)Footnote 7. *See Liles v. American Corrective Counseling Servs., 131 F. Supp. 2d 1114 (S.D. Iowa 2001)* (genuine issue of fact whether independent contractor hired by county attorney to process NSF checks, who sent out misleading notices about criminal prosecution, was debt collector under Iowa debt collection statute), *mot. denied, 201 F.R.D. 452 (Iowa Dist. Ct. 2001) . Cf. Gradisher v. Check Enforcement Unit, 133 F. Supp. 2d 988* (declining jurisdiction over novel and complex question whether Michigan collection agency statute applies to independent contractor hired by county to send out bad check notices), *class certification granted, in part, 203 F.R.D. 271 (W.D. Mich. 2001)* ; *Rhoades v. West Virginia Credit Bureau Reporting Servs., Inc., 96 F. Supp. 2d 528 (S.D. W. Va. 2000)* (West Virginia debt collection statute applies to any consumer debt; fact question whether debtor was consumer, where she owned an interior design business, but claimed that potted plants from creditor-florist were intended for her home); *Ford v. The City State Bank of Palacios, 44 S.W.3d 121 (Tex. App. 2001)* (no cause of action under Texas Debt Collection Act, where rancher's purchase of cattle not for personal, household, or family purposes). For coverage of attorneys under state debt collection statutes, see *Campion v. Credit Bureau Services, Inc., 2000 U.S. Dist. LEXIS 20233* (E.D. Wash. Sept. 19, 2000) (collector's lawyer, who was not collector within meaning of Washington Collection Agency Act, not liable for violations of Act for failure to follow proper garnishment procedure; lawyer also exempt under state UDAP statute, which regulates only entrepreneurial aspects of law practice); *Universal Bank v. Machnic (In re Machnic), 2002 Bankr. LEXIS 39* (Bankr. S.D. W. Va. Jan. 10, 2002) (attorneys not exempt, even in their litigation activities, from debt collection provisions of W. Va. Consumer Credit Protection Act, and creditor itself is liable for acts of its attorney); *Cooper v. Litton Loan Servicing (In re Cooper), 253 B.R. 286 (Bankr. N.D. Fla. 2000)* (lawyer who relies in good faith on information given by creditor not liable under FDCPA or Florida Consumer Collection Practices Act); *Davis Lake Cmty. Ass'n v. Feldmann, 138 N.C. App. 292, 530 S.E.2d 865 (2000)* (following *Reid v. Ayers*); Tennessee Attorney General, Opinion No. 00-105, *2000 Tenn. AG LEXIS 107* (June 8, 2000) (company that purchases and collects upon unpaid judgments is a collection service even though it is owned by attorneys, who would be exempt if acting on behalf of clients).

(n8)Footnote 8. *Leadbetter v. Comcast Cable Communications, Inc., 2005 U.S. Dist. LEXIS 45365* (W.D. Wash. Aug. 22, 2005) .

(n9)Footnote 9. *Norton v. Local Loan Co., 251 N.W.2d 520 (Iowa 1977) .*

(n10)Footnote 10. *Mlynek v. Household Fin. Corp., 2000 U.S. Dist. LEXIS 13783* (N.D. Ill. Sept. 11, 2000) (Florida Consumer Collection Practices Act protects out-of-state consumer being dunned by Florida collector).

(n11)Footnote 11. *Van Westrienen v. Americontinental Collection Corp., 94 F. Supp. 2d 1087 (D. Or. 2000)* (Oregon debt collection statute does not use "least sophisticated debtor" standard; technically correct statements which would tend to mislead unsophisticated debtor violate the FDCPA but not the state statute).

(n12)Footnote 12. *Piper v. Portnoff Law Assocs., 274 F. Supp. 2d 681 (E.D. Pa. 2003)* (government entities' exemption did not extend to contractor hired by municipality to collect delinquent water bills); *University of Houston Main Campus v. Simons, 2002 Tex. App. LEXIS 7598* (Tex. App. Oct. 24, 2002) (unpublished; citation limited) (sovereign immunity barred state debt collection act and intentional tort claims against state university).

(n13)Footnote 13. *See Blair v. Supportkids, Inc., 222 F. Supp. 2d 1038 (N.D. Ill. 2002)* (claim stated for violation of Collection Agency Act; that Act does not exempt collector from sections forbidding simulated process, disseminating false information, falsely claiming association with government, and conduct likely to deceive the public).

(n14)Footnote 14. *Colo. Rev. Stat. § 5-1-202(1)(f).*

(n15)Footnote 15. *See Van Westrienen v. Americontinental Collection Corp., 94 F. Supp. 2d 1087, 1099 (D. Or. 2000)* (single call to consumer at work violated Oregon Unfair Debt Collection Practices Act, which requires that collector first make reasonable efforts to contact debtor at home; consumer's home phone number was listed).

(n16)Footnote 16. *Greenwood Trust Co. v. Conley, 938 P.2d 1141 (Colo. 1997)* .

(n17)Footnote 17. *See Matter of O'Brien, 1997 WL 698008 (Bankr. S.D. Iowa 1997).*

(n18)Footnote 18. *See also Greenpoint Credit Corp. v. Perez, 2002 Tex. App. LEXIS 263* (Tex. App. Jan. 16, 2002) (affirming award of $5 million in compensatory damages where creditor threatened elderly identity theft victim with jail, used rude and obscene language, and refused to believe her denials even when reiterated by sheriff), *pet. for rev. granted by 2003 Tex. LEXIS 15* (Tex. Feb. 13, 2003) , *vacated by, remanded by 2003 Tex. LEXIS 50* (Tex. Apr. 24, 2003) *vacated on other grounds, 2003 Tex. LEXIS 50* (Apr. 24, 2003) (vacating decision pursuant to parties' settlement). *See also Bruce v. Home Depot, U.S.A., 308 F. Supp. 2d 72 (D. Conn. 2004)* (persistent phone calls and threats, while creditor was egregiously failing to provide the goods and services for which it sought payment, violated Connecticut Creditors' Collection Practices Act and UDAP statute); *Akalwadi v. Risk Management Alternatives, 336 F. Supp. 2d 492 (D. Md. 2004)* (must consider number and pattern of calls to determine if "reasonably calculated to abuse or harass"); *Harris v. American Gen. Fin., Inc., 2005 U.S. Dist. LEXIS 33260* (D. Kan. July 6, 2005) (allegation that collector called 17 times in one week not sufficient to state claim for harassing calls; must allege the content of the calls); *First N. Am. Nat'l Bank v. Superior Court, 2005 Cal. App. Unpub. LEXIS 356* (Cal. Ct. App. Jan. 13, 2005) (consumers stated claim under California debt collection act; alleged numerous calls at home, some at inappropriate times, calls at work, contact with consumers known to be represented by counsel; issue of fact whether 80 contacts in 230 days unreasonable). *See also Dowling v. I.C. Sys., Inc., 2005 U.S. Dist. LEXIS 35018* (M.D. Fla. Oct. 20, 2005) (FDCPA and Florida Collection Practices Act claims arising from dunning phone calls; genuine issue of fact regarding number and content of calls).

(n19)Footnote 19. *Forsyth Mun. Hosp. v. Contreras, 421 S.E.2d 167 (N.C. Ct. App. 1992)* (court assumed without deciding that the "least sophisticated consumer" standard would be applied in cases under the state debt collection statute; found no deception); *Russey v. Rankin, 911 F. Supp. 1449 (D.N.M. 1995)* (statement that agency could file suit within thirty days was deceptive within the meaning of New Mexico debt collection statute, where agency was not licensed in New Mexico, and agency's usual practice of taking assignments of debts and suing on them was forbidden by New Mexico law); *In re* Belile (Belile v. Allied Medical Accounts Control Associated Bureaus), *209 B.R. 658 (Bankr. E.D. Pa. 1997)* (letter which threatened immediate suit, although no employee of collector was admitted in Pennsylvania, threatened action which could not be taken and violated both FDCPA and Pennsylvania Debt Collection Trade Practices Act); *Wilkes Nat'l Bank v. Halvorsen, 126 N.C. App. 179, 484 S.E.2d 582 , rev. denied, 346 N.C. 557, 488 S.E.2d 826 (1997)* (letter from bank to delinquent borrower, acknowledging receipt of information that borrower was suffering prolonged illness, and inviting her to discuss an alternate repayment schedule, was not "a communication attempting to collect a debt" within meaning of state debt collection statute; a later letter, which accelerated the loan and demanded repayment, clearly indicated its debt collection purpose; a letter need not quote the statutory language, provided its meaning is clear). *But see Chapman v. Ontra, Inc., 1997 U.S. Dist. LEXIS 8331 , RICO Bus. Disp. Guide P 9319* (N.D. Ill. June 3, 1997) (violations of the FDCPA were not *per se* violations of the Illinois debt collection statute), *dismissed, 1998 U.S. Dist. LEXIS 9426* (N.D. Ill. June 11, 1998) .

(n20)Footnote 20. *See Van Westrienen v. Americontinental Collection Corp., 94 F. Supp. 2d 1087 (D. Or. 2000)* (collector whose dunning letter referred consumers to a website containing egregious misrepresentations violated the Oregon Unfair Debt Collection Practices Act; website of one-man collection firm claimed that agency had a staff of private investigators, with offices in three states and 13 foreign countries); *Sandlin v. Shapiro & Fishman, 919 F. Supp. 1564 (M.D. Fla. 1996)* (state statute which forbids attempt to collect debt which is not "legitimate" applied to a charge imposed for verifying the debt when that charge was a pre-payment penalty not permitted by the contract); *Patzka v. Viterbo College, 917 F. Supp. 654 (W.D. Wis. 1996)* (collection fee was not permitted by the Wisconsin Consumer Act);

Waterfield Mortgage Co. v. Rodriguez, 929 S.W.2d 641 (Tex. App. 1996) .

(n21)Footnote 21. *See, e.g., Tenuto v. Transworld Sys., 2000 U.S. Dist. LEXIS 14344* (E.D. Pa. Sept. 29, 2000) (class action split into subclasses, those who received allegedly deceptive letter within one year, who have claims under both FDCPA and Pennsylvania UDAP, and those who received letters within four years, who have claims only under Pennsylvania statute). *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 7.3 (6th ed. 2004 and Supp.).

(n22)Footnote 22. *Daniels v. Baritz, 2003 U.S. Dist. LEXIS 7707* (E.D. Pa. Apr. 30, 2003) ; *Hansen v. Ticket Track, Inc., 280 F. Supp. 2d 1196 (W.D. Wash. 2003)* ; *Watkins v. Peterson Enterprises, 57 F. Supp. 2d 1102 (E.D. Wash. 1999)* (violation of Washington debt collection statute is per se UDAP violation); *Wagner v. American Nat'l Educ. Corp., 1983 U.S. Dist. LEXIS 10287* (D. Conn. Dec. 30, 1983) ; *Ai v. Frank Huff Agency, Ltd., 61 Haw. 607, 607 P.2d 1304 (1980)* ; *Wiginton v. Pacific Credit Corp., 2 Haw. App. 435, 634 P.2d 111 (1981)* ; *Western Acceptance Corp. v. Jones, 117 Idaho 399, 788 P.2d 214 (1990)* (debt collector also subject to Idaho Consumer Protection Statute); *Baldassari v. Public Fin. Trust 369 Mass. 33, 337 N.E.2d 701 (1975)* ; *Evergreen Collectors v. Holt, 60 Wash. App. 151, 803 P.2d 10 (1991)* (violation of the Collection Agency Act is a per se UDAP violation); *Connelly v. Puget Sound Collections, Inc., 16 Wash. App. 62, 553 P.2d 1354 (1976) . See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 3.2 (6th ed. 2004 and Supp.).

(n23)Footnote 23. *See Peters v. Quinney, 2001 Tex. App. LEXIS 8395* (Tex. App. Dec. 20, 2001) (not for publication) (punitive damages appropriate; lender filed criminal charge although told by county attorney and justice of peace that matter was civil); *Siemer v. Nangle (In re Nangle), 257 B.R. 276 (B.A.P. 8th Cir. 2001)* (punitive damages available under Illinois Consumer Fraud and Deceptive Practices Act for debt collector's willful and wanton misconduct); *Greenpoint Credit Corp. v. Perez, 2002 Tex. App. LEXIS 263* (Tex. App. Jan. 16, 2002) (affirming compensatory damage award of $5 million under Texas Debt Collection Act where plaintiff suffered fear, embarrassment, skin eruptions, heart palpitations, shortness of breath, nausea, sleeplessness, panic attacks, difficulty in concentrating, irritability, reclusiveness and elevated blood pressure due to defendant's abusive collection tactics), *pet. for rev. granted by 2003 Tex. LEXIS 15* (Tex. Feb. 13, 2003) , *vacated by, remanded by 2003 Tex. LEXIS 50* (Tex. Apr. 24, 2003) *vacated on other grounds, 2003 Tex. LEXIS 50* (Apr. 24, 2003) (vacating decision pursuant to parties' settlement). *See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 13.3.3 (7th ed. 2008).

(n24)Footnote 24. *Compare Griffin v. Security Pac. Auto. Fin. Servs. Corp., 33 F. Supp. 2d 926 (D. Kan. 1998)* (misrepresentations and omissions of material fact in a debt collection matter violate the Kansas Consumer Protection Act); *DeBerry v. First Gov't Mortgage & Investors Corp., 743 A.2d 699 (D.C. 1999)* (D.C. UDAP statute, which forbids "unconscionable terms or provisions of sales or leases" applies to predatory home equity lending); *Norwest Mortgage, Inc. v. Salinas, 999 S.W.2d 846, 855 (Tex. App. 1999)* (buyers of home were consumers as to mortgage company, where company was intertwined with builder which advertised "financing available by Norwest" and where mortgage company itself violated the Deceptive Trade Practices Act by making advances to builder without determining that work was properly done, not obtaining release of liens, etc., and meanwhile requiring payments on the mortgage), *with Zanayed v. Gertler & Gertler, Ltd., 2000 U.S. Dist. LEXIS 5827* (N.D. Ill. Mar. 17, 2000) (attorneys collecting debts not covered by state UDAP statute); *King v. Cashland, Inc., 2000 Ohio App. LEXIS 3943* (Sept. 1, 2000) (payday lender was exempt from state UDAP statute as a "dealer in intangibles," so its collection activities were not covered); *Taylor v. First State Bank of Smithville, 1999 Tex. App. LEXIS 6329* (Aug. 26, 1999) (unpublished, not to be cited as authority) (a loan is not a good or service within the meaning of Texas Deceptive Trade Practices Act). *See also Edwards v. McCormick, 136 F. Supp. 2d 795 (S.D. Ohio 2001)* (attorney collecting debts for health care provider was "supplier" covered by the Ohio Consumer Sales Practices Act); *Evanauskas v. Strumpf, 2001 U.S. Dist. LEXIS 14326* (D. Conn. June 27, 2001) (Connecticut UDAP statute applies only to commercial aspects of legal practice; no cause of action against lawyer who sent improper dunning letter on behalf of client-creditor); *Smith v. Short Term Loans, LLC, 2001 U.S. Dist. LEXIS 1554* (N.D. Ill. Feb. 9, 2001) (Illinois Consumer Fraud Act regulates lenders, and also their employees if employees direct or permit violations; consumer stated a claim against attorney who sent out dunning letters on his own letterhead, leading unsophisticated consumer to think third party was involved); *Campion v. Credit Bureau Servs.,*

2000 U.S. Dist. LEXIS 20233 (E.D. Wash. Sept. 19, 2000) (lawyer who failed to follow proper garnishment procedure when collecting debt for client not liable under Washington UDAP statute which covers only entrepreneurial aspects of law practice); *Campos v. Brooksbank, 120 F. Supp. 2d 1271 (D.N.M. 2000)* (alleged misconduct of creditor's lawyer subject to New Mexico Unfair Practices Act; exemption for actions or transactions permitted under laws administered by regulatory body did not apply where acts complained of, i.e., filing a false affidavit and abusing discovery, were not permitted rules of professional conduct). *DirecTV, Inc. v. Karpinsky, 269 F. Supp. 2d 918 (E.D. Mich. 2003)* (UDAP statute did not apply to collection activities against person who had not entered into transaction, but was falsely accused of intercepting satellite transmissions), *vacated in part on other grounds, 274 F. Supp. 2d 918 (E.D. Mich. 2003)* .

(n25)Footnote 25. *Davis Lake Cmty. Ass'n v. Feldmann, 138 N.C. App. 292, 530 S.E.2d 865 (2000)* . *District Cablevision Ltd. v. Bassin, 828 A.2d 714 (D.C. 2003)* (collecting late fees in violation of common law was UDAP violation); *Davis Lake Community Ass'n v. Feldmann, 530 S.E.2d 865 (N.C. App. 2000)* (representing that attorney fees in excess of a statutory cap had to be paid to satisfy an obligation is deceptive).

(n26)Footnote 26. National Consumer Law Center, Unfair and Deceptive Acts and Practices § 13.3 (7th ed. 2008). Each state's UDAP statute is cited and summarized in National Consumer Law Center, Unfair and Deceptive Acts and Practices Appx. A (6th ed. 2004).

(n27)Footnote 27. *Irwin v. Mascott, 112 F. Supp. 2d 937 (N.D. Cal. 2000)* (California Unfair Business Practices Act entitles consumers to restitution of any funds acquired as a result of illegal practices, with prejudgment interest);. *See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices §§ 8.2, 8.3 (6th ed. 2004).

(n28)Footnote 28. *Bank of New Orleans & Trust Co. v. Phillips, 415 So. 2d 973 (La. App. 1982)* ("actual" damages means "real," "genuine," and "existing in fact" and accordingly includes damages for humiliation and mental anguish); *Ausley v. Bishop, 133 N.C. App. 210, 515 S.E.2d 72, 1999-1 Trade Cas. (CCH) P72531 (1999)* (emotional distress damages recoverable for UDAP violation, where distress resulted in a hospital visit). *But see Wenrich v. Robert E. Cole, P.C., 2000 U.S. Dist. LEXIS 18687* (E.D. Pa. Dec. 22, 2000) (emotional distress damages available under FDCPA but not state UDAP statute or former debt collection regulations); *Ashley v. Edwards, 626 S.W.2d 107 (Tex. Civ. App. 1981)* . *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 13.3.3.9 (7th ed. 2008).

(n29)Footnote 29. *See Siemer v. Nangle (In re Nangle), 274 F.3d 481 (8th Cir. 2001)* (punitive damages available under Illinois Consumer Fraud and Deceptive Practices Act for debt collector's willful and wanton misconduct); *Lowe v. Surpas Resource Corp., 253 F. Supp. 2d 1209 (D. Kan. 2003)* (debtor may be entitled to enhanced statutory damages as elderly person); *Caputo v. Professional Recovery Servs., Inc., 261 F. Supp. 2d 1249 (D. Kan. 2003)* (debtor entitled to special statutory damage award as disabled person). *But cf.* DuBose v. General Motors Acceptance Corp., Clearinghouse No. 829 (D. Conn. 1989) (evidence must reveal reckless indifference or intentional and wanton violation to award UDAP punitive damages). *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices §§ 13.4.3 (7th ed. 2008).

(n30)Footnote 30. *Veach v. Sheeks, 316 F.3d 690 (7th Cir. 2003)* (alleged debtor who received debt collection letter misstating amount of debt owed could not show that he sustained pecuniary loss, as required to establish claim under Indiana's deception law); *Sambor v. Omnia Credit Services, Inc., 183 F. Supp. 2d 1234 (D. Haw. 2002)* (summary judgment denied where actual damages not shown); *Smith v. Short Term Loans, L.L.C., 2001 U.S. Dist. LEXIS 1554* (N.D. Ill. Feb. 9, 2001) (claim under Illinois Consumer Fraud Act must allege actual damages). *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices §§ 12.5.2 (7th ed. 2008).

(n31)Footnote 31. *Lowe v. Surpas Resource Corp., 253 F. Supp. 2d 1209 (D. Kan. 2003)* (consumer was aggrieved by having to obtain the assistance of third parties to respond to collection calls, even though she herself did not hear the calls); *Caputo v. Professional Recovery Servs., Inc., 261 F. Supp. 2d 1249 (D. Kan. 2003)* (consumer who suffered emotional and intangible injuries was "aggrieved").

(n32)Footnote 32. National Consumer Law Center, Unfair and Deceptive Acts and Practices §§ 13.3.3.9 (7th ed. 2008).

(n33)Footnote 33. *Id*. § 7.5.2.4.

(n34)Footnote 34. *Id*. § 7.5.2.2.

(n35)Footnote 35. *See* National Consumer Law Center, Fair Credit Reporting Appx. H (6th ed. 2006).

(n36)Footnote 36. *15 U.S.C. §§ 1679 et seq*. *See* National Consumer Law Center, Fair Debt Collection, § 9.9 (5th ed. 2004) (summary of debt collection applications of federal Act). *See generally* National Consumer Law Center, Fair Credit Reporting Act, Ch. 15 (6th ed. 2006).

(n37)Footnote 37. *See Bigalke v. Creditrust Corp., 162 F. Supp. 2d 996 (N.D. Ill. 2001)* (denial of motion to dismiss) (debt collector that sent similar letter was covered by CROA), *later op. at 2001 U.S. Dist. LEXIS 14591* (N.D. Ill. Sept. 11, 2001) (certifying class); *Nielsen v. United Creditors Alliance Corp., 1999 U.S. Dist. LEXIS 13267* (N.D. Ill. Aug. 18, 1999) (denying motion to dismiss). *But see White v. Financial Credit Corp., 2001 U.S. Dist. LEXIS 21486* (N.D. Ill. Dec. 20, 2001) (collector that offered to have debtor's credit report amended if debtor paid debt was not credit repair organization).

(n38)Footnote 38. *See Arnold v. United Cos. Lending Corp., 511 S.E.2d 854 (W. Va. 1998)* (finding loan broker covered by state credit repair statute).

(n39)Footnote 39. *See* National Consumer Law Center, Fair Credit Reporting Act, § 15.3 (6th ed. 2006).

(n40)Footnote 40. *See Illinois v. National Credit Mgmt. Group, 1996 U.S. Dist. LEXIS 8722* (N.D. Ill. June 20, 1996) (violation of state credit repair law is UDAP violation); *Barker v. Altegra Corp. (In re Barker), 251 B.R. 250 (Bankr. E.D. Pa. 2000)* (any violation of state credit repair law is UDAP violation).

(n41)Footnote 41. *15 U.S.C. § 1679g(a)(1)(B)*.

(n42)Footnote 42. *See Barker v. Altegra Corp. (In re Barker), 251 B.R. 250 (Bankr. E.D. Pa. 2000)* (amount paid must be awarded regardless of amount of actual damages).

(n43)Footnote 43. *See Cole v. Price, 758 A.2d 231, 2000 Pa. Super. 255 (Pa. Super. 2000)* (creditor engaged in unauthorized practice of law when, after filing suit *pro se* he transferred his interest in claim to another; former creditor enjoined from further court appearances but case not dismissed). *But see George Shima Buick, Inc. v. Ferencak, 1999 Ohio App. LEXIS 6132* (Dec. 17, 1999) (Ohio statute which allowed non-lawyer corporate officer to represent corporation in small claims court did not violate separation of powers and was not unconstitutional), *review granted, 88 Ohio St. 3d 1501, 727 N.E.2d 924 (2000) , vacated, appeal dismissed, cert. dismissed, 91 Ohio St. 3d 1211, 741 N.E.2d 138 (2001) .*

(n44)Footnote 44. *In re Boydell, 760 So. 2d 326 (La. 2000)* (three-year suspension for lawyer who viciously harassed client in dispute over fee which lawyer had improperly calculated and disbursed to self). *See also Ratcliff v. Boydell, 674 So. 2d 272 (La. App. 1996) .*

(n45)Footnote 45. *In re Conduct of Huffman, 328 Or. 567, 983 P.2d 534 (1999)* (lawyer wrote angry letter to client's new lawyer, threatening criminal prosecution over matters which first lawyer could only have learned about while representing client; these were "client secrets" within the meaning of rule forbidding the disclosure of client secrets or the use of client secrets to the advantage of the lawyer or the disadvantage of the client; also violated rule against threatening criminal prosecution to gain advantage in a civil matter).

(n46)Footnote 46. *Lustig v. Horn, 315 Ill. App. 3d 319, 732 N.E.2d 613 (App. Ct. 2000) .*

(n47)Footnote 47. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 7.2.8.6 (7th ed. 2008); National Consumer Law Center, Consumer Bankruptcy Law and Practice § 15.6 (8th ed. 2006 and Supp.).

(n48)Footnote 48. *In re Lustig, 2001 Ariz. LEXIS 160* (Ariz. Sept. 7, 2001) (non-lawyer employees held selves out as lawyers, and assisted in "dishonesty, fraud, deceit, or misrepresentation and conduct prejudicial to the administration of justice"; attorney publicly censured); *In re Suspended Member of the Arizona Bar, Klahr, 2002 Ariz. LEXIS 71* (Ariz. May 1, 2002) (allowing office manager to make threatening calls to collect debts).

(n49)Footnote 49. *Iowa Supreme Court Comm'n on Unauthorized Practice of Law v. A-1 Associates, 623 N.W.2d 803 (Iowa 2001)* (company that took assignments, sued in small claims court, then kept agreed percentage and forwarded rest to creditor was rendering legal services for profit "under the guise of trying its own case"); *State v. Hunt, 880 P.2d 96 (Wash. App. 1994)* (paralegal, who took assignments of debts and sued, while charging the creditors for his services, was criminally convicted of the unauthorized practice of law); *State v. Isner, 285 S.E.2d 641 (W. Va. 1981)* (collection agency may not sue on debt assigned to it for collection).

(n50)Footnote 50. *Withers v. Eveland, 988 F. Supp. 942 (E.D. Va. 1997)* (under Virginia law, non-lawyer was not authorized to file suit to collect debt owed by another; non-lawyer collector who threatened to sue violated the FDCPA by threatening to take action that cannot legally be taken or is not intended to be taken). *See Conn. Gen. Stat. Ann. § 36a-805(a)(3)* (collection agencies may not "purchase or receive assignments of claims for the purpose of collection or institute suit thereon in any court"). *See also Petrolito v. Arrow Fin. Servs., 221 F.R.D. 303 (D. Conn. 2003)* (declining to rule at class certification stage on application of statute to purchaser of written-off debts, and whether purchaser's misrepresentation of self as credit-card issuer violated FDCPA or state UDAP). *But see Idaho Code § 26-2243* (a permit holder shall have a property right in any account assigned to it for collection; provided, however, no right herein granted shall authorize such permit holder to engage in the practice of law); *Tenn. Code Ann. § 62-20-127* (agency may take assignment of debts and sue in own name; statute establishes procedural requirements for suits on assigned debts); *In re UPL Advisory Opinion No. 2001-1, 591 S.E.2d 822 (Ga. 2004)* (if suit on assigned debt is in creditor's interest, i.e., if creditor gets paid only if agency wins, this is unauthorized practice; if creditor makes "actual and legal transfer of all interest in the account" then collector is lawfully representing itself).

(n51)Footnote 51. *Ohio Rev. Code § 4705.07. See Greenspan v. Third Fed. Sav. & Loan, 894 N.E.2d 1250 (Ohio Ct. App. 2008)* (amendment not retroactive; consumers could raise unauthorized practice defense to lender's document preparation fee without seeking state supreme court opinion), *review granted, 897 N.E.2d 651 (Ohio 2008)* .

(n52)Footnote 52. *See, e.g., Lingross v. Heilig-Meyers Furniture, 1999 U.S. Dist. LEXIS 3986* (N.D. Miss. Mar. 17, 1999) (consumers stated claim for assault and trespass, where repossessors pounded on door at 6 a.m., one repossessor backed consumer up against wall, and repossessor wearing SWAT uniform placed his hand on his holster).

(n53)Footnote 53. *See* National Consumer Law Center, Access to Utility Service, Chs. 11, 12 (3rd ed. and Supp.).

(n54)Footnote 54. *See* National Consumer Law Center, Fair Debt Collection Ch. 10 (6th ed. 2008). *Caputo v. Professional Recovery Servs., Inc., 2002 U.S. Dist. LEXIS 6514* (D. Kan. Mar. 11, 2002) (complaint alleged sufficient basis for claim against collection agency for employee's torturous actions during collection attempts. Case discussed elements of claim for intentional infliction of emotional distress under Kansas law.). *See also Flamm v. Sarner & Assocs., P.C., 2002 U.S. Dist. LEXIS 22255* (E.D. Pa. Nov. 6, 2002) (telling a coworker that the consumer owed a large medical bill, was a thief and would be arrested was odious but not outrageous; claim of intentional infliction of mental distress dismissed; claim of slander stated).

(n55)Footnote 55. *Silver v. United States, 1999 U.S. Dist. LEXIS 10285* (D.N.M. June 22, 1999) (fraud and intentional infliction of emotional distress claims against IRS barred by sovereign immunity; tort claims act specifically excepts tax collection); *Soghomonian v. United States, 82 F. Supp. 2d 1134 (E.D. Cal. 1999)* (negligence and negligent infliction of emotional distress claims against IRS barred). The problems of government debt collection are discussed in

National Consumer Law Center, Fair Debt Collection Ch. 13 (4th ed. and Supp.).

(n56)Footnote 56. *See* National Consumer Law Center, Collection Actions, Ch. 10 (1st ed. 2008 and supp.)

(n57)Footnote 57. *Nev. Rev. Stat. § 21.095*; *Ohio Rev. Code Ann. §§ 2329.66A(1)(b)* and *2329.661*.

(n58)Footnote 58. *W. Va. Code § 38-9-3(b)*.

(n59)Footnote 59. *Kan. Stat. Ann. § 60-2310*.

(n60)Footnote 60. *See Conn. Gen Stat. § 19a-673*. A Connecticut trial court has held there is a private right of action to enforce this section under the pre-2003 version of this statute. *Ahmad v. Yale New Haven Hosp., 2004 Conn. Super. LEXIS 2765* (Sept. 29, 2004) .

(n61)Footnote 61. Cal. Health & Safety § 1285.

(n62)Footnote 62. Cal. Health & Safety § 1339.51(a)(1).

(n63)Footnote 63. Cal. Health & Safety § 1339.51(b)(1).

(n64)Footnote 64. The new statute has already revealed startling disparities between what hospitals charge for certain items and services. For example, one hospital charges $9 for a single tablet of Tylenol and another charges $5.50, whereas another hospital charges just 12 cents--the retail prices of Tylenol is about 8 or 9 cents a tablet. For a series of blood tests called a 'comprehensive metabolic panel,' one hospital charged $1733 while another charged $576 and a third only charged $97. Lucette Lagnado, *Medical Markup: California Hospitals Open Books, Showing Huge Price Differences*, Wall Street Journal, Dec. 27, 2004.

(n65)Footnote 65. *N.J. Stat. 17B:30-41 et seq* .

(n66)Footnote 66. *N.J. Stat. 17B:30-45*. In return, hospitals let the state keep 50% of the amount collected, plus administrative and collection costs. *N.J. Stat. 17B:30-44*.

(n67)Footnote 67. *N.J. Stat. 17B:30-47*.

(n68)Footnote 68. *See* National Consumer Law Center, Collection Actions, Ch. 10 (1st ed. 2008) *See also* National Consumer Law Center, In Sickness and In Debt: Using Consumer Law to Help Elders Facing Overwhelming Medical Bills (2001).

(n69)Footnote 69. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices §§ 5.1.1.2, 5.1.1.3 (6th ed. 2004). National Consumer Law Center, The Cost of Credit, § 10.8.2 (3rd ed. and Supp.).

(n70)Footnote 70. *Tuttle v. Equifax Check Servs., 190 F.3d 9 (2d Cir. 1999)* ($20 service charge); *Charles v. Check Rite, Ltd., 1998 U.S. Dist. LEXIS 22512* (D. Ariz. Dec. 14, 1998) ($25 fee was incidental damages under UCC Article 2).

(n71)Footnote 71. *Ballard v. Equifax Check Servs., 27 F. Supp. 2d 1201 (E.D. Cal. 1998)* (only seller, not check guarantee service, can claim Article 2 incidental damages [note that California has since enacted statutory authority for $25 to $35 charges]).

(n72)Footnote 72. Annot., *Validity of provision in promissory note or other evidences of indebtedness for payment as attorneys' fees, expenses and costs of collection, of specified percentage of note, 17 A.L.R.2d 288 (1951). See also* National Consumer Law Center, Fair Debt Collection, § 15.2.5 (5th ed. and supp.) for discussion of case law on contractual and noncontractual collection fees. *E.g., Sunbelt Rentals v. Corbridge, 171 F. Supp. 2d 14 (D. Me. 2001)*

(contractual attorney fees available only where permitted by statute; maximum of 15%, where note collected by an attorney after maturity); *Universal Bank, N.A. v. Machnic (In re Machnic), 271 B.R. 789* (Bankr. S.D. W. Va. Jan. 10, 2002) (credit card issuer violated W. Va. Consumer Credit and Protection Act when it sought attorney fees for collection where not explicitly permitted by Act even though authorized by contract).

(n73)Footnote 73. *Jones v. Kunin, 2000 U.S. Dist. LEXIS 6380, at 3* (S.D. Ill. May 1, 2000) (FDCPA claim stated against payday lender that threatened liability under bad check law which requires "intent to defraud," where lender solicited post-dated checks and it was clear that borrower did not have sufficient funds); *Turner v. E-Z Check Cashing, Inc., 35 F. Supp. 2d 1042 (M.D. Tenn. 1999)* (describing payday lender's practice of threatening criminal bad check prosecution as means of collecting debt and finding that it was a UDAP violation since there was no basis for prosecution). *But see Smith v. Cash Store Mgmt., Inc., 195 F.3d 325 (7th Cir. 1999)* (payday lender could lawfully assert that your "check is security for this loan," where check entitled holder to seek remedies under civil bad check statute). *See generally* National Consumer Law Center, Fair Debt Collection, § 15.3.1 (5th ed. and supp.) for further discussion of collector threats to criminally prosecute under bad check laws, and civil bad check statutes.

(n74)Footnote 74. *See State v. Braham, 567 S.E.2d 624 (W. Va. 2002)* (West Virginia bad check statute explicitly did not apply to post-dated checks; post-dated check may support larceny by fraudulent scheme conviction, but fraudulent intent not shown merely by NSF check). *But see Thompson v. Adcox, 63 S.W.3d 783 (Tenn. Ct. App. 2001)* (post-dated check becomes check, for purposes of civil bad check statute, on post-dated date; *Stooksbury* distinguished because it construed criminal statute); *State v. Brotzman, 108 Wash. App. 1042* (Wash. Ct. App. Oct. 18, 2001) (unpublished) (post-dated check may support conviction for larceny by check).

(n75)Footnote 75. For discussion of other challenges to arbitration agreements and awards, see National Consumer Law Center, Collection Actions, Ch. 8 (1st ed. 2008).

(n76)Footnote 76. *See* National Consumer Law Center, Consumer Arbitration Agreements Ch. 2 (4th ed. 2004).

(n77)Footnote 77. *See* Louisiana Department of Justice Opinion # 98-380, Clearinghouse No. 53554 (Mar. 28, 1999).

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Appendix 8A FEDERAL TRADE COMMISSION STAFF COMMENTARY ON THE FAIR DEBT COLLECTION PRACTICES ACT

1-8A Consumer Credit Law Manual Appendix 8A.syn

§ 8A.syn Synopsis to Appendix 8A: FEDERAL TRADE COMMISSION STAFF COMMENTARY ON THE FAIR DEBT COLLECTION PRACTICES ACT

Section 801 Short Title

Section 802 Findings and Purpose

Section 803 Definition

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Section 805 Communication in Connection With Debt Collection

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1-8A Consumer Credit Law Manual Section 801

§ **801 Short Title**

Section 801 names the statute the "Fair Debt Collection Practices Act."

The Fair Debt Collection Practices Act (FDCPA) is Title VIII of the Consumer Credit Protection Act, which also includes other federal statutes relating to consumer credit, such as the Truth in Lending Act (Title I), the Fair Credit Reporting Act (Title VI), and the Equal Credit Opportunity Act (Title VII).

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§ 802 Findings and Purpose

Section 802 recites the Congressional findings that serve as the basis for the legislation.

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1-8A Consumer Credit Law Manual Section 803

§ **803 Definition**

Section 803(1) defines "Commission" as the Federal Trade Commission.

1. *General*. The definition includes only the Federal Trade Commission, not necessarily the staff acting on its behalf.

Section 803(2) defines "communication" as the "conveying of information regarding a debt directly or indirectly to any person through any medium."

1. *General*. The definition includes oral and written transmission of messages which refer to a debt.

2. *Exclusions*. The term does not include formal legal action (e.g., filing of a lawsuit or other petition/pleadings with a court; service of a complaint or other legal papers in connection with a lawsuit, or activities directly related to such service). Similarly, it does not include a notice that is required by law as a prerequisite to enforcing a contractual obligation between creditor and debtor, by judicial or nonjudicial legal process.

The term does not include situations in which the debt collector does not convey information regarding the debt, such as:

- A request to a third party for a consumer to return a telephone call to the debt collector, if the debt collector does not refer to the debt or the caller's status as (or affiliation with) a debt collector.

- A request to a third party for information about the consumer's assets, if the debt collector does not reveal the existence of a debt.

- A request to a third party in connection with litigation (e.g., requesting a third party to complete a military affidavit that must be filed as a prerequisite to enforcing a default judgment, if the debt collector does not reveal the existence of the debt[)].

Section 803(3) defines "consumer" as "any natural person obligated or allegedly obligated to pay any debt."

1. *General*. The definition includes only a "natural person" and not an artificial person such as a corporation or other entity created by statute.

Section 803(4) defines "creditor" as "any person who offers or extends credit creating a debt or to whom a debt is owed". However, the definition excludes a party who "receives an assignment or transfer of a debt in default solely for the purpose of facilitating collection of such debt for another."

General. The definition includes the party that actually extended credit or became the obligee on an account in the normal course of business, and excludes a party that was assigned a delinquent debt only for collection purposes.

Section 803(5) defines "debt" as a consumer's "obligation ... to pay money arising out of a transaction in which the money, arising out of a transportation in which the money, property, insurance, or services (being purchased) are primarily for personal, family, or household purposes. ..."

1. *Examples*. The term includes:

- Overdue obligations such as medical bills that were originally payable in full within a certain time period (e.g., 30 days).

- A dishonored check that was tendered in payment for goods or services acquired or used primarily for personal, family, or household purposes.

- A student loan, because the consumer is purchasing "services" (education) for personal use.

2. *Exclusions*. The term does not include:

Unpaid taxes, fines, alimony, or tort claims, because they are not debts incurred from a "transportation (involving purchase of) property * * * or services * * * for personal, family or household purposes."

- A credit card that a cardholder retains after the card issuer has demanded its return. The cardholder's account balance is the debt.

- A non-pecuniary obligation of the consumer such as the responsibility to maintain adequate insurance on the collateral, because it does not involve an "obligation * * * to pay money."

Section 803(6) defines "debt collector" as a party "who uses any instrumentality or interstate commerce or the mails in * * * collection of * * * debts owed * * * another."

1. *Examples*. The term includes:

- Employees of a debt collection business, including a corporation, partnership, or other entity whose business is the collection of debts owned another.

- A firm that regularly collects overdue rent on behalf of real estate owners, or periodic assessments on behalf of condominium associations, because it "regularly collects * * * debts owned or due another."

- A party based in the United States who collects debts owned by consumers residing outside the United States, because he "uses * * * the mails" in the collection business. The residence of the debtor is irrelevant.

- A firm that collects debts in its own name for a creditor solely by mechanical techniques, such as (1) placing phone calls with pre-recorded messages and recording consumer responses, or (2) making computer-generated mailings.

- An attorney or law firm whose efforts to collect consumer debts on behalf of its clients regularly include activities traditionally associated with debt collection, such as sending demand letters (dunning notices) or making collection telephone calls to the consumer. However, an attorney is not considered to be a debt collector simply because he responds to an inquiry from the consumer following the filing of a lawsuit.

2. *Exclusions*. The term does not include:

- Any person who collects debts (or attempts to do so) only in insolated [sic] instances, becuause [sic] the definition includes only those who "regularly" collect debts.

- A credit card issuer that collects its cardholder's account, even when the account is based upon purchases from participating merchants, because the issuer is collecting its own debts, not those "owed or due another."

- An attorney whose practice is limied [sic] to legal activities (e.g., the filing and prosecution of lawsuits to reduce debts to judgment).

3. *Application of definition to creditor using another name*. Creditors are generally excluded from the definition of "debt collector" to the extent that they collect their own debts in their own name. However, the term specifically applies to "any creditor who, in the process of collecting his own debts, uses any name other than his own which would indicate that a third person is" involved in the collection.

- He uses a name other than his own to collect his debts, including a fictitious name.

- His salaried attorney employees who collect debts use stationery that indicates that attorneys are employed by someone other than the creditor or are independent or separate from the creditor (e.g., ABC Corp. sends collection letters on stationery of "John Jones, Attorney-at-Law").

- He regularly collects debts for another creditor; however, he is a debt collector only for purposes of collecting these debts, not when he collects his own debt in his own name.

- The creditor's collection division or related corporate collector is not clearly designated as being affiliated with the creditor; however, the creditor is not a debt collector if the creditor's correspondence is clearly labeled as being from the "collection unit of the (creditor's name)," since the creditor is not using a "name other than his own" in that instance.

Relation to other sections.

A creditor who is covered by the FDCPA because he uses a "name other than his own" also may violate section 807(14), which prohibits using a false business name. When he falsely uses an attorney's name, he violates section 807(3).

4. *Specific exemptions from definition of debt collector*.

(a) *Creditor employees*. Section 803(6)(A) provides that "debt collector" does not include "any officer or employee of a creditor while, in the name of the creditor, collecting debts for such creditor".

The exemption includes a collection agency employee, who works for a creditor to collect in the creditor's name at the creditor's office under the creditor's supervision, because he has become the de facto employee of the creditor.

The exemption includes a creditor's salaried attorney (or other) employee who collects debts on behalf of, and in the name of, that creditor.

The exemption does not include a creditor's former employee who continues to collect accounts on the creditor's behalf, if he acts under his own name rather than the creditors's [sic].

(b) *Creditor-controlled collector*. Section 803(6)(B) provides that "debt collector" does not include a party collecting for another, where they are both "related by common ownership or affiliated by corporate control, if the (party collects) only for persons to whom it is so related or affiliated and if the principal business of such person is not the collection of debts".

The exemption applies where the collector and creditor have "common ownership or * * * corporate control." For example, a company is exempt when it attempts to collect debts of another company after the two entities have merged.

The exemption does not apply to a party related to a creditor if it also collects debts for others in addition to the related creditors.

(c) *State and federal officials*. Section 803(6)(C) provides that "debt collector" does not include any state or federal employee "to the extent that collecting or attempting to collect any debt is in the performance of his official duties".

The exemption applies only to such governmental employees in the performance of their "official duties" and, therefore, does not apply to an attorney employed by a county government who also collected bad checks for local

merchants where that activity is outside his official duties.

The exemption includes a state educational agency that is engaged in the collection of student loans.

(d) *Process servers*. Section 803(6)(D) provides that "debt collector" dos [sic] not include "any person while serving or attempting to serve legal process on any other person in connection with the judicial enforcement of any debt".

The exemption covers marshals, sheriffs, and any other process servers while conducting their normal duties relating to serving legal papers.

(e) *Non-profit counselors*. Section 803(6)(E) provides that "debt collector" does not include "any nonprofit organization which, at the request of consumers, performs bona fide consumer credit counseling and assists consumers in the liquidation of their debts by receiving payments from such consumers and distributing such amounts to creditors".

This exemption applies only to non-profit organizations; it does not apply to for-profit credit counseling services that accept fees from debtors and regularly transmit such funds to creditors.

(f) *Miscellaneous*. Section 803(6)(F) provides that "debt collector" does not include collection activity by a party about a debt that "(i) is incidental to a bona fide fiduciary obligation or * * * escrow arrangement; (ii) * * * was originated by such person; (iii) * * * was not in default at the time it was obtained by such person; or (iv) (was) obtained by such person as a secured party in a commercial credit transaction involving the creditor."

The exemption (i) for bona fide fiduciary obligations or escrow arrangements applies to entities such as trust departments of banks, and escrow companies. It does not include a party who is named as a debtor's trustee solely for the purpose of conducting a foreclosure sale (i.e., exercising a power of sale in the event of default on a loan).

The exemption (ii) for a party that originated the debt applies to the original creditor collecting his own debts in his own name. It also applies when a creditor assigns a debt originally owed to him, but retains the authority to collect the obligation on behalf of the assignee to whom the debt becomes owed. For example, the exemption applies to a creditor who makes a mortgage or school loan and continues to handle the account after assigning it to a third party. However, it does not apply to a party that takes assignment of retail installment contracts from the original creditor and then reassigns them to another creditor but continues to collect the debt arising from the contracts, because the debt was not "originated by" the collector/first assignee.

The exception (iii) for debts not in default when obtained applies to parties such as mortgage service companies whose business is servicing current accounts.

The exemption (iv) for a secured party in a commercial transaction applies to a commercial lender who acquires a consumer account that was used as collateral, following default on a loan from the commercial lender to the original creditor.

(g) *Attorneys*. A provision of the FDCPA, as enacted in 1977 (former section 803(6)(F)), providing that "debt collector" does not include "any attorney-at-law collecting a debt as an attorney on behalf of and in the name of a

client," was repealed by Pub. L. 99-361, which became effective in July 1986. Therefore, an attorney who meets the definition set forth in section 803(6) is now covered by the FDCPA.

Section 803(7) defines "location information" as "a consumer's place of abode and his telephone number at such place, or his place of employment."

This definition includes only residence, home phone number, and place of employment. It does not cover work phone numbers, names of supervisors and their telephone numbers, salaries or dates of paydays.

Section 803(8) defines "state" as "any State, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any political subdivision of any of the foregoing."

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1-8A Consumer Credit Law Manual Section 804

§ **804 Acquisition of Location Information**

Section 804 requires a debt collector, when communicating with third parties for the purpose of acquiring information about the consumer's location to "(1) identify himself, state that he is confirming or correcting location information concerning the consumer, and, only if expressly requested, identify his employer," (2) not refer to the debt, (3) usually make only a single contact with each third party, (4) not communicate by post card, (5) not indicate the collection nature of his business purpose in any written communication, and (6) limit communications to the consumer's attorney, where the collector knows of the attorney, unless the attorney fails to respond to the communication.

1. *General*. Although the FDCPA generally protects the consumer's privacy by limiting debt collector communications about personal affairs to third parties, it recognizes the need for some third party contact by collectors to seek the whereabouts of the consumer.

2. *Identification of debt collector (section 804(1))*. An individual employed by a debt collector seeking location information must identify himself, but must not identify his employer unless asked. When asked, however, he must give the true and full name of the employer, to comply with this provision and avoid a violation of 807(14).

An individual debt collector may use an alias if it is used consistently and if it does not interfere with another party's ability to identify him (e.g., the true identity can be ascertained by the employer).

3. *Referral to debt (section 804(2))*. A debt collector may not refer to the consumer's debt in any third party communication seeking location information, including those with other creditors.

4. *Reference to debt collector's business (section 804(5))*. A debt collector may not use his actual name in his letterhead or elsewhere in a written communication seeking location information, if the name indicates collection activity (such as a name containing the word "debt", "collector", or "collection"), except when the person contacted has expressly requested that the debt collector identify himself.

5. *Communication with consumer's attorney (section 804(6))*. Once a debt collector learns a consumer is represented by an attorney in connection with the debt, he must confine his request for location information to the attorney. (See also comments on section 805(a)(2)).

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1-8A Consumer Credit Law Manual Section 805

§ **805 Communication in Connection With Debt Collection**

Section 805(a) Communication with the consumer. Unless the consumer has consented or a court order permits, a debt collector may not communicate with a consumer to collect a debt (1) at any time or place which is unusual or known to be inconvenient to the consumer (8AM-9PM is presumed to be convenient), (2) where he knows the consumer is represented by an attorney with respect to the debt, unless the attorney fails to respond to the communication in a reasonable time period, or (3) at work if he knows the consumer's employer prohibits such contacts.

1. *Scope*. For purposes of this section, the term "communicate" is given its commonly accepted meaning. Thus, the section applies to contacts with the consumer related to the collection of debt, whether or not the debt is specifically mentioned.

2. *Inconvenient or unusual times or places (section 805(a)(1))*. A debt collector may not call the consumer at any time, or on any particular day, if he has credible information (from the consumer or elsewhere) that it is inconvenient. If the debt collector does not have such information, a call on Sunday is not per se illegal.

3. *Consumer represented by attorney (section 805(a)(2))*. If a debt collector learns that a consumer is represented by an attorney in connection with the debt, even if not formally notified of this fact, the debt collector must contact only the attorney and must not contact the consumer.

A debt collector who knows a consumer is represented by counsel with respect to a debt is not required to assume similar representation on other debts; however, if a consumer notifies the debt collector that the attorney has been retained to represent him for other debts placed with the debt collector, the debt collector must deal only with that attorney with respect to such debts.

The creditor's knowledge that the consumer has an attorney is not automatically imputed to the debt collector.

4. *Calls at work (section 805(a)(3))*. A debt collector may not call the consumer at work if he has reason to know the employer forbids such communication (e.g., if the consumer has so informed the debt collector).

Section 805(b) Communication with third parties. Unless the consumer consents, or a court order or section 804 permits, "or as reasonably necessary to effectuate a postjudgment judicial remedy," a debt collector "may not communicate, in connection with the collection of any debt, with any person other than the consumer, his attorney, a consumer reporting agency if otherwise permitted by law, the creditor, the attorney of the creditor, or the attorney of the debt collector."

1. *Consumer consent to the third party contact*. The consumer's consent need not be in writing. For example, if a third party volunteers that a consumer has authorized him to pay the consumer's account, the debt collector may normally presume the consumer's consent, and may accept the payment and provide a receipt to the party that makes the payment. However, consent may not be inferred only from a consumer's inaction when the debt collector requests such consent.

2. *Location information*. Although a debt collector's search for information concerning the consumer's location (provided in 804) is expressly excepted from the ban on third party contacts, a debt collector may not call third parties under the pretense of gaining information already in his possession.

3. *Incidental contacts with telephone operator or telegraph clerk*. A debt collector may contact an employee of a telephone or telegraph company in order to contact the consumer, without violating the prohibition on communication to third parties, if the only information given is that necessary to enable the collector to transit the message to, or make the contact with, the consumer.

4. *Accessibility to third party*. A debt collector may not send a written message that is easily accessible to third parties. For example, he may not use a computerized billing statement that can be seen on the envelope itself.

A debt collector may use an "in care of" letter only if the consumer lives at, or accepts mail at, the other party's address.

A debt collector does not violate this provision when an eavesdropper overhears a conversation with the consumer, unless the debt collector has reason to anticipate the conversation will be overheard.

5. *Non-excepted parties*. A debt collector may discuss the debt only with the parties specified in this section (consumer, creditor, a party's attorney, or credit bureau). For example, unless the consumer has authorized the communication, a collector may not discuss the debt (such as a dishonored check) with a bank, or make a report on a consumer to a non-profit counseling service.

6. *Judicial remedy*. The words "as reasonably necessary to effectuate a postjudgment judicial remedy" mean a communication necessary for execution or enforcement of the remedy. A debt collector may not send a copy of the judgment to an employer, except as part of a formal service of papers to achieve a garnishment or other remedy.

7. *Audits or inquiries*. A debt collector may disclose his files to a government official or an auditor, to respond to an inquiry or conduct an audit, because the disclosure would not be "in connection with the collection of any debt."

8. *Communications by attorney debt collectors*. An attorney who represents either a creditor or debt collector that has previously tried to collect an account may communicate his efforts to collect the account to the debt collector. Because the section permits a debt collector to communicate with "the attorney of the creditor, or the attorney of the debt collector", communications between these parties (even if the attorney is also a debt collector) are not forbidden.

An attorney may communicate with a potential witness in connection with a lawsuit he has filed (e.g., in order to establish the existence of a debt), because the section was not intended to prohibit communications by attorneys that are necessary to conduct lawsuits on behalf of their clients.

Section 805(c) Ceasing communication. Once a debt collector receives written notice from a consumer that he or she refuses to pay the debt or wants the collector to stop further collection efforts, the debt collector must cease any further communication with the consumer except "(1) to advise the consumer that the debt collector's further efforts are being terminated; (2) to notify the consumer that the debt collector or creditor may invoke specified remedies which are ordinarily invoked by such debt collector or creditor; or (3) where applicable, to notify the consumer that the debt collector or creditor intended to invoke a specified remedy."

1. *Scope*. For purposes of this section, the term "communicate" is given its commonly accepted meaning. Thus, the section applies to any contact with the consumer related to the collection of the debt, whether or not the debt is specifically mentioned.

2. *Request for payment*. A debt collector's response to a "cease communication" notice from the consumer may not include a demand for payment, but is limited to the three statutory exceptions.

Section 805(d) "consumer" definition. For section 805 purposes, the term "consumer" includes the "consumer's spouse, parent (if the consumer is a minor), guardian, executor, or administrator."

1. *Broad "consumer" definition*. Because of the broad statutory definition of "consumer" for the purposes of this section, many of its protections extend to parties close to the consumer. For example, the debt collector may not call the

consumer's spouse at a time or place known to be inconvenient to the spouse. Conversely, he may call the spouse (guardian, executor, etc.) at any time or place that would be in accord with the limitations of section 805(a).

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1-8A Consumer Credit Law Manual Section 806

§ **806 Harassment or Abuse**

Section 806 prohibits a debt collector from any conduct that would "Harass, oppress, or abuse any person in connection with the collection of a debt." It provides six examples of harassement [sic] or abuse.

1. *Scope*. Prohibited actions are not limited to the six subsections listed as examples of activities that violate this provision.

2. *Unnecessary calls to third parties*. A debt collector may not leave telephone messages with neighbors when the debt collector knows the consumer's name and telephone number and could have reached him directly.

3. *Multiple contacts with consumer*. A debt collector may not engage in repeated personal contacts with a consumer with such frequency as to harass him. Subsection (5) deals specifically with harassment by multiple phone calls.

4. *Abusive conduct*. A debt collector may not pose a lengthy series of questions or comments to the consumer without giving the consumer a chance to reply. Subsection (2) deals specifically with harassment involving obscene, profane, or abusive language.

Section 806(1) prohibits the "use or threat of use of violence or other criminal means to harm * * * any person."

1. *Implied threat*. A debt collector may violate this section by an implied threat of violence. For example, a debt

collector may not pressure a consumer with statements such as "We're not playing around here--we can play tough" or "We're going to send somebody to collect for us one way or the other."

Section 806(2) prohibits the use of obscene, profane, or abusive language.

1. *Abusive language*. Abusive language includes religious slurs, profanity, obscenity, calling the consumer a liar or a deadbeat, and the use of racial or sexual epithets.

Section 806(3) prohibits the "publication of a list of consumers who allegedly refuse to pay debts," except to report the items to a "consumer reporting agency", as defined in the Fair Credit Reporting Act or to a party otherwise authorized to receive it under that Act.

Section 806(4) prohibits the "advertisement for sale of any debt to coerce payment of the debt."

2. *Shaming prohibited*. These provisions are designed to prohibit debt collectors from "shaming" a customer into payment, by publicizing the debt.

3. *Exchange of lists*. Debt collectors may not exchange lists of consumers who allegedly refuse to pay their debts.

Information to creditor subscribers. A debt collector may not distribute a list of alleged debtors to its creditor subscribers.

4. *Coded lists*. A debt collector that publishes a list of consumers who have had bad debts, coded to avoid generally disclosing the consumer's identity (e.g., showing only the drivers license number and first three letters of each consumer's name) does not violate this provision, because such publication is permitted under the Fair Credit Reporting Act.

5. *List for use by investigator*. A debtor collector does not violate these provisions by providing a list of consumers against whom judgments have been entered to a private investigator in order to locate such individuals, because section 805(b) specifically permits contacts "reasonably necessary to effectuate a postjudgment judicial remedy."

6. *Public notice required by law*. A debt collector does not violate these provisions by providing public notices that are required by law as a prerequisite to enforcement of a security interest in connection with a debt.

Section 806(5) prohibits contacting the consumer by telephone "repeatedly or continuously with intent to annoy, abuse, or harass any person at the called number."

1. *Multiple phone calls*. "Continuously" means making a series of telephone calls, one right after the other. "Repeatedly" means calling with excessive frequency under the circumstances.

Section 806(6) prohibits, except where section 804 applies, "the placement of telephone calls without meaningful disclosure of the caller's identity."

1. *Aliases*. A debt collector employee's use of an alias that permits identification of the debt collector (i.e., where he uses the alias consistently, and his true identity can be ascertained by the employer) constitutes a "meaningful disclosure of the caller's identity."

2. *Identification of caller*. An individual debt collector must disclose his employer's identity, when discussing the debt on the telephone with consumers or third parties permitted by section 805(b).

3. *Relation to other sections*. A debt collector who uses a false business name in a phone call to conceal his identity violates section 807(14), as well as this section.

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1-8A Consumer Credit Law Manual Section 807

§ 807 False or Misleading Representations

Section 807 prohibits a debt collector from using any "false, deceptive, or misleading representation or means in connection with the collection of any debt." It provides sixteen examples of false or misleading representations.

1. *Scope*. Prohibited actions are not limited to the sixteen subsections listed as examples of activities that violate this provision. In addition, section 807(10), which prohibits the "use of any false representation or deceptive means" by a debt collector, is particularly broad and encompasses virtually every violation, including those not covered by the other subsections.

Section 807(1) prohibits "the false representation or implication that the debt collector is vouched for, bonded by, or affiliated with the United States or any State * * *"

1. *Symbol on dunning notice*. A debt collector may not use a symbol in correspondence that makes him appear to be a government official. For example, a collection letter depicting a police badge, or the scales of justice, normally violates this section.

Section 807(2) prohibits falsely representing either "(A) the character, amount, or legal status of any debt; or (B) any services rendered or compensation which may be lawfully received by" the collector.

1. *Legal Status of debt*. A debt collector may not falsely imply that legal action has begun.

2. *Amount of debt*. A debt collector may not claim an amount more than actually owed, or falsely assert that the debt

has matured or that it is immediately due and payable, when it is not.

3. *Judgment*. When a debt collector provides the validation notice required by section 809(a)(4), the notice may include the words "copy of a judgment" whether or not a judgment exists, because section 809(a)(4) provides for a statement including these words. Compliance with section 809(a)(4) in this manner will not be considered a violation of section 807(2)(A).

Section 807(3) prohibits falsely representing or implying that "any individual is an attorney or that any communication is from an attorney."

1. *Form of legal correspondence*. A debt collector may not send a collection letter from a "Pre-Legal Department," where no legal department exists. An attorney may use a computer service to send letters on his own behalf, but a debt collector may not send a computer-generated letter deceptively using an attorney's name.

2. *Named individual*. A debt collector may not falsely represent that a person named in a letter is his attorney.

3. *Relation to other sections*. If a creditor falsely uses an attorney's name rather than his own in his collection communications, he both loses his exemption from the FDCPA's definition of "debt collector" (Section 803(6)) and violates this provision.

Section 807(4) prohibits falsely representing or implying to the consumer that nonpayment "will result in the arrest or imprisonment of any person or the seizure, garnishment, attachment, or sale of any property or wages of any person * * *"

Section 807(5) prohibits the "threat to take any action that cannot legally be taken or that is not intended to be taken."

1. *Debt collector's statement of his own definite action*. A debt collector may not state that he will take any action unless he intends to take the action when the statement is made, or ordinarily takes the action in similar circumstances.

2. *Debt collector's statement of definite action by third party*. A debt collector may not state that a third party will take any action unless he has reason to believe, at the time the statement is made, that such action will be taken.

3. *Statement of possible action*. A debt collector may not state or imply that he or any third party may take any action unless such action is legal and there is a reasonable likelihood, at the time the statement is made, that such action will be taken. A debt collector may state that certain action is possible, if it is true that such action is legal and is frequently taken by the collector or creditor with respect to similar debts; however, if the debt collector has reason to know there are facts that make the action unlikely in the particular case, a statement that the action was possible would be

misleading.

4. *Threat of criminal action*. A debt collector may not threaten to report a dishonored check or other fact to the police, unless he actually intends to take this action.

5. *Threat of attachment*. A debt collector may not threaten to attach a consumer's tax refund, when he has no authority to do so.

6. *Threat of legal or other action*. Section 807(5) refers not only to a false threat of legal action, but also a false threat by a debt collector that he will report a debt to a credit bureau, assess a collection fee, or undertake any other action if the debt is not paid. A debt collector may also not misrepresent the imminence of such action.

A debt collector's implication, as well as a direct statement, of planned legal action may be an unlawful deception. For example, reference to an attorney or to legal proceedings may mislead the debtor as to the likelihood or imminence of legal action.

A debt collector's statement that legal action has been recommended is a representation that legal action may be taken, since such a recommendation implies that the creditor will act on it at least some of the time.

Lack of intent may be inferred when the amount of the debt is so small as to make the action totally unfeasible or when the debt collector is unable to take the action because the creditor has not authorized him to do so.

7. *Illegality or threatened act*. A debt collector may not threaten that he will illegally contact an employer, or other third party, or take some other "action that cannot legally be taken" (such as advising the creditor to sue where such advice would violate such rules governing the unauthorized practice of law). If state law forbids a debt collector from suing in his own name (or from doing so without first obtaining a formal assignment and that has not been done), the debt collector may not represent that he will sue in that state.

Section 807(6) prohibits falsely representing or implying that a transfer of the debt will cause the consumer to (A) lose any claim or defense, or (B) become subject to any practice prohibited by the FDCPA.

1. *Referral to creditor*. A debt collector may not falsely state that the consumer's account will be referred back to the original creditor, who would take action the FDCPA prohibits the debt collector to take.

Section 807(7) prohibits falsely representing or implying that the "consumer committed any crime or other conduct in order to disgrace the consumer."

1. *False allegation of fraud*. A debt collector may not falsely allege that the consumer has committed fraud.

2. *Misrepresentation of criminal law*. A debt collector may not make a misleading statement of law, falsely implying that the consumer has committed a crime, or mischaracterize what constitutes an offense by misstating or omitting significant elements of the offense. For example, a debt collector may not tell the consumer that he has committed a crime by issuing a check that is dishonored, when the statute applies only where there is a "scheme to defraud."

Section 807(8) prohibits "Communicating or threatening to communicate to any person (false) credit information * * *, including the failure to communicate that a disputed debt is disputed."

1. *Disputed debt*. If a debt collector knows that a debt is disputed by the consumer, either from receipt of written notice (section 809) or other means, and reports it to a credit bureau, he must report it as disputed.

2. *Post-report dispute*. When a debt collector learns of a dispute after reporting the debt to a credit bureau, the dispute need not also be reported.

Section 807(9) prohibits the use of any document designed to falsely imply that it issued from a state or federal source, or "which creates a false impression as to its source, authorization, or approval."

1. *Relation to other sections*. Most of the violations of this section involve simulated legal process, which is more specifically covered by section 807(13). However, this subsection is broader in that it also covers documents that fraudulently appear to be official government documents, or otherwise mislead the recipient as to their authorship.

Section 807(10) prohibits the "use of any false representation or deceptive means to collect or attempt to collect any debt or to obtain information concerning a consumer."

1. *Relation to other sections*. The prohibition is so comprehensive that violation of any part of section 807 will usually also violate subsection (10). Actions that violate more specific provisions are discussed in those sections.

2. *Communication format*. A debt collector may not communicate by a format or envelope that misrepresents the nature, purpose, or urgency of the message. It is a violation to send any communication that conveys to the consumer a false sense of urgency. However, it is usually permissible to send a letter generated by a machine, such as a computer or other printing device. A bona fide contest entry form, which provides a clearly optional location to enter employment information, enclosed with request for payment, is not deceptive.

3. *False statement or implications*. A debt collector may not falsely state or imply that a consumer is required to assign his wages to his creditor when he is not, that the debt collector has counseled the creditor to sue when he has not, that adverse credit information has been entered on the consumer's credit record when it has not, that the entire amount is due when it is not, or that he cannot accept partial payments when in fact he is authorized to accept them.

4. *Misrepresentation of law*. A debt collector may not mislead the consumer as to the legal consequences of the consumer's actions (e.g., by falsely implying that a failure to respond is an admission of liability).

A debt collector may not state that federal law requires a notice of the debt collector's intent to contact third parties.

5. *Misleading letterhead*. A debt collector's employee who is an attorney may notuse [sic] "attorney-at-law" stationery without referring to his employer, so as to falsely imply to the consumer that the debt collector had retained a private attorney to bring suit on the account.

Section 807(11) requires the debt collector to "disclose clearly in all communications made to collect a debt or to obtain information about a consumer, that the debt collector is attempting to collect a debt and that any information obtained will be used for that purpose", except where section 804 provides otherwise.

1. *Oral communications*. A debt collector must make the required disclosures in both oral and written communications.

2. *Disclosure to consumers*. When a debt collector contacts a consumer and clearly discloses that he is seeking payment of a debt, he need not state that all information will be used to collect a debt, since that should be apparent to the consumer. The debt collector need not repeat the required disclosure in subsequent contacts.

A debt collector may not send the consumer a note saying only "please call me right away" unless there has been prior contact between the parties and the collector is thus known to the consumer.

3. *Disclosures to third parties*. Except when seeking location information, the debt collector must state in the first communication with a third party that he is attempting to collect the debt and that information will be used for that purpose, but need not do so in subsequent communications with that party.

Section 807(12) prohibits falsely representing or implying that "accounts have been turned over to innocent purchasers for value."

1. *Relation to other sections*. Section 807(6)(A) prohibits a false statement or implication that threatening to affect the consumer's rights may be affected by transferring the account; this subsection forbids falsely stating or implying that a transfer to certain parties has occurred.

Section 807(13) prohibits falsely representing or implying that "documents are legal process."

1. *Simulated legal process*. A debt collector may not send written communications that deceptively resemble legal

process forms. He may not send a form or a dunning letter that, taken as a whole, appears to simulate legal process. However, one legal phrase (such as "notice of legal action" or "show just cause why") alone will not result in a violation of this section unless it contributes to an erroneous impression that the document is a legal form.

Section 807(14) prohibits the "use of any business, company, or organization name other than the (collector's) true name".

1. *Permissible business name*. A debt collector may use a name that does not misrepresent his identity or deceive the consumer. Thus, a collector may use its full business name, the name under which it usually transacts business, or a commonly-used acronym. When the collector uses multiple names in its various affairs, it does not violate this subsection if it consistently uses the same name when dealing with a particular consumer.

2. *Creditor misrepresentation of identity*. A creditor may not use any name that would falsely imply that a third party is involved in the collection. The in-house collection unit of "ABC Corp." may use the name "ABC Collection Division," but not the name "XYZ Collection Agency" or some other unrelated name.

A creditor violates this section if he uses the name of a collection bureau as a conduit for a collection process that the creditor controls in collecting his own accounts. Similarly, a creditor may not use a fictitious name or letterhead, or a "post office box address" name that implies someone else is collecting his debts.

A creditor does not violate this provision where an affiliated (and differently named) debt collector undertakes collection activity, if the debt collector does business separately from the creditor (e.g., where the debt collector in fact has other clients that he treats similarly to the creditor, has his own employees, deals at arms length with the creditor, and controls the process himself).

3. *All collection activities covered*. A debt collection business must use its real business name, commonly-used name, or acronym in both written and oral communications.

4. *Relation to other sections*. If a creditor uses a false business name, he both loses his exemption from the FDCPA's definition of "debt collector" (section 803(6)) and violates this provision. If a debt collector falsely uses the name of an attorney rather than his true business name, he violates section 807(3) as well as this section. When a debt collector uses a false business name in a phone call, he violates section 806(6) as well as this section.

When using the mails to obtain location information, a debt collector may not (unless expressly requested by the recipient to identify the firm) use a name that indicates he is in the debt collection business, or he will violate section 804(5). When a debt collector's employee who is seeking location information replies to an inquiry about his employer's identity under section 804(1), he must give the true name of his employer.

Section 807(15) prohibits falsely representing or implying that documents are not legal process forms or do not require action by the consumer.

1. *Disguised legal process*. A debt collector may not deceive a consumer into failing to respond to legal process by concealing the import of the papers, thereby subjecting the consumer to a default judgment.

Section 807(16) prohibits falsely representing or implying that a debt collector operates or is employed by a "consumer reporting agency" as defined in the Fair Credit Reporting Act.

1. *Dual agencies*. The FDCPA does not prohibit a debt collector from operating a consumer reporting agency.

2. *Misleading names*. Only a bona fide consumer reporting agency may use names such as "Credit Bureau," "Credit Bureau Collection Agency," "General Credit Control," "Credit Bureau Rating, Inc.," or "National Debtors Rating." A debt collector's disclaimer in the text of a letter that the debt collector is not affiliated with (or employed by) a consumer reporting agency, will not necessarily avoid a violation if the collector uses a name that indicates otherwise.

3. *Factual issue*. Whether a debt collector that has called itself a credit bureau actually qualifies as such is a factual issue, to be decided according to the debt collector's actual operation.

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1-8A Consumer Credit Law Manual Section 808

§ **808 Unfair Practices**

Section 808 prohibits a debt collector from using "unfair or unconscionable means" in his debt collection activity. It provides eight examples of unfair practices.

1. *Scope*. Prohibited actions are not limited to the eight subsections listed as examples of activities that violate this provision.

2. *Elements of unfairness*. A debt collector's act in collecting a debt may be "unfair" if it causes injury to the consumer that is (1) substantial, (2) not outweighed by countervailing benefits to consumers or competition, and (3) not reasonably avoidable by the consumer.

Section 808(1) prohibits collecting any amount unless the amount is expressly authorized by the agreement creating the debt or is permitted by law.

1. *Kinds of amounts covered*. For purposes of this section, "amount" includes not only the debt, but also any incidental charges, such as collection charges, interest, service charges, late fees, and bad check handling charges.

2. *Legality of charges*. A debt collector may attempt to collect a fee or charge in addition to the debt if either (a) the charge is expressly provided for in the contract creating the debt and the charge is not prohibited by state law, or (B) [sic] the contract is silent but the charge is otherwise expressly permitted by state law. Conversely, a debt collector may not collect an additional amount if either (A) state law expressly prohibits collection of the amount or (B) the contract does not provide for collection of the amount and state law is silent.

3. *Legality of fee under state law*. If state law permits collection of reasonable fees, the reasonableness (and consequential legality) of these fees is determined by state law.

4. *Agreement not in writing*. A debt collector may establish an "agreement" without a written contract. For example, he may collect a service charge on a dishonored check based on a posted sign on the merchant's premises allowing such a charge, if he can demonstrate that the consumer knew of the charge.

Section 808(2) prohibits accepting a check postdated by more than five days unless timely written notice is given to the consumer prior to deposit.

Section 808(3) prohibits soliciting any postdated check for purposes of threatening or instituting criminal prosecution.

Section 808(4) prohibits depositing a postdated check prior to its date.

1. *Postdated checks*. These provisions do not totally prohibit debt collectors from accepting postdated checks from consumers, but rather prohibit debt collectors from misusing such instruments.

Section 808(5) prohibits causing any person to incur telephone or telegram charges by concealing the true purpose of the communication.

1. *Long distance calls to the debt collector*. A debt collector may not call the consumer collect or ask a consumer to call him long distance without disclosing the debt collector's identity and the communication's purpose.

2. *Relation to other section*. A debt collector who conceals his purpose in asking consumers to call long distance may also violate section 807(11), which requires the debt collector to disclose his purpose in some communications.

Section 808(6) prohibits taking nonjudicial action to enforce a security interest on property, or threatening to do so, where (A) there is not [sic] present right to the collateral, (B) there is no present intent to exercise such rights, or (C) the property is exempt by law.

1. *Security enforcers*. Because the FDCPA's definition of "debt collection" includes parties whose principal business is enforcing security interests only for section 808(6) purposes, such parties (if they do not otherwise fall within the definition) are subject only to this provision and not to the rest of the FDCPA.

Section 808(7) prohibits "Communicating with a consumer regarding a debt by post card."

1. *Debt*. A debt collector does not violate this section if he sends a post card to a consumer that does not communicate

the existence of the debt. However, if he had not previously disclosed that he is attempting to collect a debt, he would violate section 807(11), which requires this disclosure.

Section 808(8) prohibits showing anything other than the debt collector's address, on any envelope in any written communication to the consumer, except that a debt collector may use his business name if it does not indicate that he is in the debt collection business.

1. *Business names prohibited on envelopes*. A debt collector may not put on his envelope any business name with "debt" or "collector" in it, or any other name that indicates he is in the debt collection business. A debt collector may not use the American Collectors Association logo on an envelope.

2. *Collector's name*. Whether a debt collector/consumer reporting agency's use of his own "credit bureau" or other name indicates that he is in the collection business, and thus violates the section, is a factual issue to be determined in each individual case.

3. *Harmless words or symbols*. A debt collector does not violate this section by using an envelope printed with words or notations that do not suggest the purpose of the communication. For example, a collector may communicate via an actual telegram or similar service that uses a Western Union (or other provider) logo and the word "telegram" (or similar word) on the envelope, or a letter with the word "Personal" or "Confidential" on the envelope.

4. *Transparent envelopes*. A debt collector may not use a transparent envelope, which reveals language or symbols indicating his debt collection business, because it is the equivalent of putting information on an envelope.

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1-8A Consumer Credit Law Manual Section 809

§ 809 Validation of Debts

Section 809(a) requires a collector, within 5 days of the first communication, to provide the consumer a written notice (if not provided in that communication) containing (1) the amount of the debt and (2) the name of the creditor, along with a statement that he will (3) assume the debt's validity unless the consumer disputes it within 30 days, (4) send a verification or copy of the judgment if the consumer timely disputes the debt, and (5) identify the original creditor upon written request.

1. *Who must provide notice*. If the employer debt collection agency gives the required notice, employee debt collectors need not also provide it. A debt collector's agent may give the notice, as long as it is clear that the information is being provided on behalf of the debt collector.

2. *Single notice required*. The debt collector is not required to provide more than one notice for each debt. A notice need not offer to identify the original creditor unless the name and address of the original creditor are different from the current creditor.

3. *Form of notices*. The FDCPA imposes no requirements as to the form, sequence, location, or typesize of the notice. However, an illegible notice does not comply with this provision.

4. *Alternate terminology*. A debt collector may condense and combine the required disclosures, as long as he provides all required information.

5. *Oral notice*. If a debt collector's first communication with the consumer is oral, he may make the disclosures orally at that time in which case he need not send a written notice.

6. *Legal action*. A debt collector's institution of formal legal action against a consumer (including the filing of a complaint or service of legal papers by an attorney in connection with a lawsuit to collect a debt) or transmission of a notice to a consumer that is required by law as a prerequisite to enforcing a contractual obligation is not a "communication in connection with collection of any debt," and thus does not confer section 809 notice-and-validation rights on the consumer.

7. *Collection activities by attorneys*. An attorney who regularly attempts to collect debts by means other than litigation, such as writing the consumer demand letters (dunning notices) or calling the consumer on the phone about the obligation (except in response to a consumer's call to him after suit has been commenced), must provide the required notice, even if a previous debt collector (or creditor) has given such a notice.

8. *Effect of including proof with first notice*. A debt collector must verify a disputed debt even if he has included proof of the debt with the first communication, because the section is intended to assist the consumer when a debt collector inadvertently contacts the wrong consumer at the start of his collection efforts.

Section 809(b) requires that, if the consumer disputes the debt or requests identification of the original creditor in writing, the collector must cease collection efforts until he verifies the debt and mails a response.

Section 809(c) states that a consumer's failure to dispute the validity of a debt under this section may not be interpreted by a court as an admission of liability.

1. *Pre-notice collection*. A debt collector need not cease normal collection activities within the consumer's 30-day period to give notice of a dispute until he receives a notice from the consumer. An attorney debt collector may take legal action within 30 days of sending the notice, regardless of whether the consumer disputes the debt. If the consumer disputes the debt, the attorney may still take legal action but must cease collection efforts until verification is obtained and mailed to the consumer.

A debt collector may report a debt to a credit bureau within the 30-day notice period, before he receives a request for validation or a dispute notice from the consumer.

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1-8A Consumer Credit Law Manual Section 810

§ 810 Multiple Debts

Section 810 provides: "If any consumer owes multiple debts and makes any single payment to any debt collector with respect to such debts, such debt collector my [sic] not apply such payment to any debt which is disputed by the consumer and, where applicable, shall apply such payment in accordance with the consumer's directions."

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1-8A Consumer Credit Law Manual Section 811

§ 811 Legal Actions by Debt Collectors

Section 811 provides that a debt collector may sue a consumer only in the judicial district where the consumer resides or signed the contract sued upon, except that an action to enforce a security interest in real property which secures the obligation must be brought where the property is located.

1. *Waiver*. Any waiver by the consumer must be provided directly to the debt collector (not to the creditor in the contract establishing the debt), because the forum restriction applies to actions brought by the debt collector.

2. *Multiple defendants*. Since a debt collector may sue only where the consumer (1) lives or (2) signed the contract, the collector may not join an ex-husband as a defendant to a suit against the ex-wife in the district of her residence, unless he also lives there or signed the contract there. The existence of community property at her residence that is available to pay his debts does not alter the forum limitations on individual consumers.

3. *Real estate security*. A debt collector may sue based on the location of a consumer's real property only when he seeks to enforce an interest in such property that secures the debts.

4. *Services without written contract*. Where services were provided pursuant to an oral agreement, the debt collector may sue only where the consumer resides. He may not sue where services were performed (if that is different from the consumer's residence), because that is not included as permissible forum location by this provision.

5. *Enforcement of judgments*. If a judgment is obtained in a forum that satisfies the requirements of this section, it may be enforced in another jurisdiction, because the consumer previously has had the opportunity to defend the original action in a convenient forum.

6. *Scope*. This provision applies to lawsuits brought by a debt collector, including an attorney debt collector, when the debt collector is acting on his own behalf or on behalf of his client.

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1-8A Consumer Credit Law Manual Section 812

§ 812 Furnishing Certain Deceptive Forms

Section 812 prohibits any party from designing and furnishing forms, knowing they are or will be used to deceive a consumer to believe that someone other than his creditor is collecting the debt, and imposes FDCPA civil liability on parties who supply such forms.

1. *Practice prohibited*. This section prohibits the practice of selling to creditors dunning letters that falsely imply that a debt collector is participating in collection of the debt, when in fact only the creditor is collecting.

2. *Coverage*. This section applies to anyone who designs, complies, or furnishes the forms prohibited by this section.

3. *Pre-collection letters*. A form seller may not furnish a creditor with (1) a letter on a collector's letterhead to be used when the collector is not involved in collecting the creditor's debts, or (2) a letter indicating "copy to (the collector)" if the collector is not participating in collecting the creditor's debt. A form seller may not avoid liability by including a statement in the text of a form letter that the sender has not yet been assigned the account for collection, if the communication as a whole, using the collector's letterhead, represents otherwise.

4. *Knowledge required*. A party does not violate this provision unless he knows or should have known that his form letter will be used to mislead consumers into believing that someone other than the creditor is involved in collecting the debt.

5. *Participation by debt collector*. A debt collector that uses letters as his only collection tool does not violate this section, merely because he charges a flat rate per letter, if he is meaningfully "participating in the collection of a debt." The consumer is not misled in such cases, as he would be in the case of a party who supplied the creditor with form letters and provided little or no additional service in the collection process. The performance of other tasks associated with collection (e.g., handling verification requests, negotiating payment arrangements, keeping individual records) is evidence that such a party is "participating in the collection."

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1-8A Consumer Credit Law Manual Section 813

§ **813 Civil Liability**

Section 813 (A) imposes civil liability in the form of (1) actual damages, (2) discretionary penalties, and (3) costs and attorney's fees, (B) discusses relevant factors a court should consider in assessing damages, (C) exculpates a collector who maintains reasonable procedures from liability for an unintentional error, (D) permits actions to be brought in federal or state courts within one year from the violation, and (E) shields a defendant who relies on an advisory opinion of the Commission.

1. *Employee liability*. Since the employees of a debt collection agency are "debt collectors," they are liable for violations to the same extent as the agency.

2. *Damages*. The courts have awarded "actual damages" for FDCPA violations that were not just out-of-pocket expenses, but included damages for personal humiliations, embarrassment, mental anguish, or emotional distress.

3. *Application of statute of limitation period*. The section's one year statute of limitations applies only to private lawsuits, not to actions brought by a government agency.

4. *Advisory opinions*. A party may act in reliance on a formal advisory opinion of the Commission pursuant to *16 CFR 1.1-1.4*, without risk of civil liability. This protection does not extend to reliance on this Commentary or other informal staff interpretations.

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1-8A Consumer Credit Law Manual Section 814

§ 814 Administrative Enforcement

Section 814 provides that the principal federal enforcement agency for the FDCPA is the Federal Trade Commission, but assigns enforcement power to other authorities empowered by certain federal statutes to regulate financial, agricultural, and transportation activities, where FDCPA violations relate to acts subject to those laws.

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1-8A Consumer Credit Law Manual Section 815

§ 815 Reports to Congress by Commission

Section 815 requires the Commission to submit an annual report to Congress which discusses its enforcement and other activities administering the FDCPA, assesses the degree of compliance, and makes recommendations.

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1-8A Consumer Credit Law Manual Section 816

§ 816 Relations to State Laws

Section 816 provides that the FDCPA preempts state laws only to the extent that those laws are inconsistent with any provision of the FDCPA, and then only to the extent of the inconsistency. A State law is not inconsistent if it gives consumers greater protection than the FDCPA.

1. *Inconsistent laws*. Where a state law provides protection to the consumer equal to, or greater than, the FDCPA, it is not pre-empted by the federal statute.

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1-8A Consumer Credit Law Manual Section 817

§ 817 Exemption For State Regulation

Section 817 orders the Commission to exempt any class of debt collection practices from the FDCPA within any State if it determines that State laws regulating those practices are substantially similar to the FDCPA, and contain adequate provision for enforcement.

1. *State exemptions*. A state with a debt collection law may apply to the Commission for an exemption. The Commission must grant the exemption if the state's law is substantially similar to the FDCPA, and there is adequate provision for enforcement. The Commission has published procedures for processing such applications (16 CFR 901).

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1-8A Consumer Credit Law Manual Section 818

§ 818 Effective Date

Section 818 provides that the FDCPA took effect six months from the date of its enactment.

1. *Key dates*. The FDCPA was approved September 20, 1977, and became effective March 20, 1978.

[FR Doc. 88-28573 Filed 12-12-88; 8:45 am]

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§ 9.01 Federal Garnishment Protectionsn1

[1] Introduction

Garnishment is a frequently used debt collection technique in which the collector seizes money someone else owes to the debtor. The debtor's wages from the employer or the debtor's deposits in a bank account from the bank are the most frequent targets. Garnishments today are used commonly to enforce only post-judgment debts.

Post-judgment garnishments must comply with federal due process standards, most significantly allowing debtors to assert that certain of their assets are exempt from execution, and, thus, may not be garnished. In addition, wage garnishments must comply with the Federal Consumer Credit Protection Act's ("CCPA") protection of a portion of earnings from garnishment, n2 the state law and/or court rules establishing garnishment procedures, and any other state restrictions, e.g., wage and personal property exemptions.

A variety of federal and state exemption laws may protect a debtor's assets. Federal laws protect federal benefits from garnishment, e.g., veteran's benefits, social security benefits, Employee Retirement Income Security Acts ("ERISA") pension plans, and proceeds of guaranteed student loans. State laws may also protect wages and welfare benefits. A creditor's right to garnish or attach a joint bank account may be limited by the state determinations of the debtor's interest in the account. The due process protections of notice of exemptions and right to a hearing on exemptions extends to execution on potentially exempt personal property.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishments

FOOTNOTES:
(n1)Footnote 1. For a fuller discussion of garnishment with numerous case citations, see National Consumer Law Center, Collection Actions, Ch. 12 (1st ed. 2008 and supp.). *See also* Ch. 8 *supra*.

(n2)Footnote 2. *15 U.S.C. §§ 1671 to 1677*, *reprinted in* Vol. 1B *infra*.

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1-9 Consumer Credit Law Manual § 9.02

§ 9.02 Due Process Protections From Garnishment of Exempt Property

[1] The Constitutional Balancing of Interests

Although it is clear that debtors have a significant property interest in assets which are exempt from garnishment, and that garnishment involves state action sufficient to invoke *Fourteenth Amendment* protections, n1 it is only since the late 1970s that courts have seriously considered the due process rights of judgment debtors.

The most prevalent due process analysis for post-judgment garnishment procedures and execution relating to exempt property was the balancing test set out by the Supreme Court in 1976 in *Matthews v. Eldridge*. n2 Under this "three-pronged" approach, a court considering the process due when a person is deprived of property bases its decision on the competing interests involved and the effect of state action on these interests; the risk of erroneous deprivation of property under the existing system and the probable value of additional or substitute procedures; and the cost and administrative burden of the new procedures in comparison to their probable value.

Applying the *Matthews* tests, courts generally hold that post-judgment garnishments must comply with four procedural requirements.

[2] Prompt Post-Garnishment Notice Is Required

Generally, state laws violate due process when they allow garnishment without any notice (other than the actual notice the debtor gets when, for example, he receives a smaller pay check). n3

Nevertheless, some courts have ruled that due process does not require notice prior to garnishment, based on the fear that, in cases involving the garnishment of bank accounts or moveable property, a debtor might remove the property to defeat a valid garnishment.

A recent district court decision, *Mayers v. New York Cmty. Bankcorp*, n4 takes a fresh look at the constitutionality of freezing the debtor's bank account in light of technological changes. In particular, the court noted that the Social Security Administration's requirement that beneficiaries receive payments electronically, unless they specifically opt out, has increased the risk and severity of erroneous deprivation and decreased the burden of determining whether bank accounts contain only exempt funds. Balancing these factors, along with the government's interest in avoiding clogging

up the courts with exemption claims, the *Mayers* court held that the plaintiffs had the right to proceed on their claim that the New York bank account garnishment procedures denies debtors procedural due process by allowing accounts that contain only exempt electronically-deposited Social Security funds to be frozen.

Instead of pre-garnishment notice, the courts have required that notice be contemporaneous with or immediately follow the garnishment.

[3] Garnishment Notice Must Inform Debtor of Exemptions

The notice must inform the debtor that garnishment has occurred, must describe major legal exemptions from garnishment, and must tell the debtor what procedures the debtor can follow to contest the garnishment. n5 Disclosing thisinformation places little burden on creditors or the state, since the information can be included in a pre-printed form. These disclosures, on the other hand, are very important to a debtor who often does not know of the existence of exemptions or how to contest improper garnishment.

The courts have not required garnishment notices to list exhaustively all the potential legal exemptions, but must at least include mention of some of the most important exemptions, such as Social Security, Aid to Families with Dependent Children ("AFDC"), and wage payments. n6 Other exemptions which may have to be listed include Supplementary Security Income ("SSI"), veteran's benefits, unemployment compensation, worker's compensation, alimony and child support, pensions, and lump sum state exemptions. The list will vary from state-to-state.

[4] Notice Must Inform Debtor of Procedures to Contest Garnishment

Courts have generally required that the notices state what action a debtor may take to contest garnishment. n7 However, a few courts have held that a mere citation to the statute or court rule governing procedures to contest garnishment was a sufficient description of those procedures.

[5] Debtor Has a Right to a Prompt Post-Garnishment Hearing

Due process also requires that debtors have the right to obtain a hearing to contest a garnishment within a reasonable period after the garnishment has occurred. The courts have widely recognized that delays can impose severe hardship on debtors, and that garnishment statutes allowing significant delay prior to a hearing are unconstitutional. As with the timing of notice of garnishment, however, no particular reasonable time before hearing has been agreed upon, although ten days or less seems common.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsConstitutional LawBill of RightsFundamental RightsProcedural Due ProcessGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See, e.g., Sniadach v. Family Fin. Corp., 395 U.S. 337, 89 S. Ct. 1820, 23 L. Ed. 2d 349 (1969)* ; *Doyle v. Schultz, 97 F. Supp. 2d 763 (W.D. La. 2000)* (creditor and attorney were state actors when they set in motion state execution procedure which was unconstitutional as applied); *Mayers v. New York Cmty. Bancorp, Inc., 2005 U.S. Dist. LEXIS 20279* (E.D.N.Y. Aug. 31, 2005) (procedure for pre-garnishment bank account freeze was state action; state coercion present because bank that disregarded notice could be sanctioned for contempt).

(n2)Footnote 2. *424 U.S. 319, 96 S. Ct. 893, 47 L. Ed. 2d 18 (1976)* .

(n3)Footnote 3. *See Dionne v. Bouley, 757 F.2d 1344 (1st Cir. 1985)* ; *Doyle v. Schultz, 97 F. Supp. 2d 763 (W.D. La. 2000)* (Louisiana procedure for executing judgments was unconstitutional as applied, where house was seized pursuant to Texas judgment without notice that judgment had been domesticated); *Department of Revenue, Child Support Enforcement Div. v. Maxwell, 6 P.3d 733 (Alaska 2000)* (child support order void for denial of due process, where obligor was given no opportunity to be heard before issuance of administrative order); *Romero v. Star Mkts., Inc., 82 Haw. 405, 922 P.2d 1018 (Ct. App. 1996)* ; *E.J. McKernan Co. v. Gregory, 643 N.E.2d 1370 (Ill. App. Ct. 1994)* (former version of Illinois non-wage garnishment law was unconstitutional because it failed to provide notice and hearing regarding possible exemptions, prior to issuance of garnishment summons); *Dorwart v. Caraway, 290 Mont. 196, 966 P.2d 1121 (1998)* , *op. withdrawn, reh'g denied, 1998 Mont. LEXIS 251 (1998)* , *cert. denied, 526 U.S. 1051, 119 S. Ct. 1358, 143 L. Ed. 2d 519 (1999)* (Montana post-judgment procedure found to violate due process by failing to require prompt post-seizure notice re: exemptions and how to assert them, and availability of hearings on claims of exemption). *But see Day v. Idaho Dep't of Corrections, 1999 U.S. App. LEXIS 34125* (9th Cir. Dec. 27, 1999) (unpublished opinion, court rules may limit citation). *Cf. Price v. Secretary, Dep't of Revenue & Taxation, 664 So. 2d 802 (La. App. 1995)* , *cert. denied*, *669 So. 2d 405 (La. 1996)* (under community property law, wages of non-debtor wife could be garnished without notice for tax debt of husband's corporation). *Cf. Savage v. Scales, 310 F. Supp. 2d 122 (D.D.C. 2004)* (due process requires only reasonable effort to provide notice; administrative garnishment for student loan upheld, where notice sent to last known address).

(n4)Footnote 4. *2005 U.S. Dist. LEXIS 20279* (E.D.N.Y. Aug. 31, 2005) .

(n5)Footnote 5. *See, e.g., Aacen v. San Juan County Sheriff's Dep't, 944 F.2d 691 (10th Cir. 1991)* ; *Imperial Bank v. Pim Elec., Inc., 39 Cal. Rptr. 2d 432 (App. Ct. 1995)* (detailed discussion of California procedure under the enforcement of judgments law; due process satisfied where notice of possible exemptions given at time of seizure); *Dorwart v. Caraway, 966 P.2d 1121 (Mont. 1998)* , *op. withdrawn, reh'g denied, 1998 Mont. LEXIS 251 (1998)* , *cert. denied*, *526 U.S. 1051, 119 S. Ct. 1358, 143 L. Ed. 2d 519 (1999)* . *See also First Union Nat'l Bank v. Knyal, 874 So. 2d 716 (Fla. App. 2004)* (Florida procedure requires notice of right to exemptions, procedure for claiming them, and right to hearing).

(n6)Footnote 6. *Aacen v. San Juan County Sheriff's Dep't, 944 F.2d 691 (10th Cir. 1991)* (due process violated where notice of exemptions listed only the homestead exemption and failed to reveal existence of others, or how to claim them). *But see Reigh v. Schleigh, 595 F. Supp. 1535 (D. Md. 1984)* (mere notice that there are federal and state exemptions was sufficient), *rev'd on other grounds*, *784 F.2d 1191 (4th Cir. 1986)* , *cert. denied*, *479 U.S. 847, 107 S. Ct. 167, 93 L. Ed. 2d 105 (1986)* .

(n7)Footnote 7. *See Washington v. Thompson, 339 Ark. 417, 6 S.W.3d 82 (1999)* (child support obligor who missed deadline was nonetheless allowed a hearing, where notice was confusing and inconsistent as to procedure for requesting hearing). *See also First Resolution Inv. Corp. v. Seker, 795 A.2d 868 (N.J. 2002)* (rejecting constitutional challenge, but ordering Civil Practice Committee to revise form notice to provide further information to debtor about how to challenge garnishment).

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1-9 Consumer Credit Law Manual § 9.03

§ 9.03 Federal Wage Garnishment Protections

The CCPA garnishment provisions n1 exempt a portion of a consumer's earnings from garnishment and prohibit employers from firing a worker due to garnishment resulting from a single indebtedness. The Federal Debt Collection Improvement Act of 1996 gave special garnishment powers to federal agencies to which delinquent debts are owed. They can garnish up to 15% of debtors' disposable wages "notwithstanding any provision of state law." n2

[1] Scope of Federal Wage Garnishment Protections

The CCPA protects earnings which are "subject to garnishment." The term "subject to garnishment" has been interpreted broadly to relate to any seizure flowing from judicial action, thus applying to proceedings in aid of execution and attachment proceedings. Most wage garnishments are made by court order, with a creditor seeking to satisfy a claim against the employee by reaching an employee's earnings before they are paid.

The CCPA garnishment provisions do not apply to seizures pursuant to contractual agreement, such as a wage assignment or a set-off procedure by a government agency. However, contractual wage assignment provisions have been broadly prohibited by the Federal Trade Commission's Credit Practices Rule. n3 The CCPA garnishment provisions do apply to wage assignments resulting from a judicial order.

The CCPA wage protections do not apply to bankruptcy court orders or to actions to collect state or federal taxes. n4 But, while the CCPA wage protections do not apply to a levy by the Internal Revenue Service ("IRS"), the Internal Revenue Code itself exempts from such seizure a portion of income that may be more generous than the CCPA for families and less generous for individuals without dependents. n5

The CCPA garnishment protections apply to debt incurred for a business, as well as a consumer, purpose.

[2] Earnings Subject to CCPA Garnishment Protections

[a] Earnings for Personal Services Protected

The CCPA garnishment provisions protect consumers from garnishment of "earnings," which means compensation paid or payable for personal services, whether denominated as wages, salary, commission, bonus, or other periodic payment

pursuant to a pension or retirement program. n6 The key question is whether payments are compensation "for personal services." Vacation pay is "earnings" within the scope of the statute and is thus protected; severance pay and tax refunds are not. Many courts have found that payments to independent contractors are not "earnings" and are not protected by the federal statute; however, courts applying state wage exemptions laws have ruled that similar provisions do extend to independent contractors. n7

[b] CCPA Protection Generally Not Extended to Paid or Deposited Earnings

Ignoring the CCPA's remedial purpose, the federal courts have generally not protected earnings of a wage earner after they are paid to the employee and hold that the exemption is lost once the earnings are deposited in a financial institution. n8

State wage exemptions commonly apply to wages after deposit, but state courts are split on this issue. n9 Courts recognized that the purpose of exemption statutes is to "protect funds intended primarily for maintenance and support of the debtor's family." n10 That purpose would be frustrated if wages lost their exempt character upon deposit in an account maintained to pay those necessary expenses.

Veteran's Benefits, Social Security benefits, n11 Workers' Compensation, and welfare benefits also retain their exempt status after deposit.

[3] Calculating Amount of Wages Protected

The CCPA garnishment provisions set a ceiling on the amount of a debtor's disposable earnings that may be garnished. "Disposable earnings" are that part of the employee's earnings remaining after the deduction of any amount required by law to be withheld. These deductions include federal, state, and local taxes, Social Security, and other governmental retirement programs required by law. n12 Deductions such as those for union dues, health and life insurance, charitable contributions, voluntary wage assignments, and savings bonds are usually not considered required by law to be withheld for calculating the exemption. n13

An existing garnishment for child support should not be treated as a deduction from income; instead, after the disposable earnings are calculated, the court should determine whether the child support garnishment and any creditors' garnishments fall within the statutory percentages. n14

The maximum amount of disposable earnings that may be garnished is *the lesser of*:

- Twenty-five percent of the disposable earnings for that workweek; or

- The amount by which disposable earnings for that week exceeds 30 times the federal minimum hourly wage. Greater amounts may be garnished for child support as discussed below.

In 2007, Congress adopted a law increasing the federal minimum wage from $5.15 to $5.85 per houras of July 24, 2007, from $5.85 to $6.55 per houras of July 24, 2008, and from $6.55 to $7.25 per houras of July 24, 2009. n15 State earning exemptions should also be checked because many are more generous to debtors, often using 40 times the minimum wage. n16

With a minimum wage of $6.55 per hour in effect during the period July 24, 2008 to July 23, 2009, no garnishment can be made if an employee's disposable earnings are $196.50 or less for the week in question. When an employee's disposable earnings exceed $196.50 but are less than $262.00, only the amount over $196.50 can be garnished. For example, an employee's gross earnings in a particular week are $250.00. After deductions required by law, the disposable earnings are $220.00. Because only the

amount over $196.50 may be garnished when disposable earnings are less than $262.00, only $23.50 may be garnished and $196.50 must be paid to the employee.

When an employee's disposable earnings are $262.00 or more in a given week, up to 25% of those earnings can be garnished. For example, an employee's gross earnings in a particular week are $350.00. After deductions required by law, the disposable earnings are $320.00.In this week, 25% of disposable earnings, or $80.00 could be garnished. $240.00 must paid to the employee.

After July 23, 2009, with a minimum wage of $7.25 per hour in effect,no garnishment can be made if an employee's disposable earnings are $217.50 or less forthe week in question. When an employee's disposable earnings exceed $217.50 but are less than $290.00, only the amount over $217.50 can be garnished. For example, an employee's gross earnings in a particular week are $250.00. After deductions required by law, the disposable earnings are $220.00. Because only the amount over $217.50 may be garnished when the disposable earnings are less than $290.00, only $2.50 may be garnished and $217.50 must be paid to the employee.

When an employee's disposable earnings are $290.00 or more in a given week, up to 25% of those earnings can be garnished. For example, an employee's gross earnings in a particular week are $350.00. After deductions required by law, the disposable earnings are $320.00.In this week, 25% of disposable earnings, or $80.00 could be garnished. $240.00 must be paid to the employee.

Some additional calculations are necessary where a worker is not paid weekly, but instead is paid bi-weekly, semi-monthly, or monthly. Department of Labor Regulations specify how to perform these calculations for these irregular pay periods:

- Assume a calendar month consists of four and one-third workweeks;

- Multiply the number of workweeks or fractions thereof in the irregular pay period times the weekly minimum wage. n17 n18

The CCPA garnishment provisions offer debtors less protection where the debt involves a court order for child support or alimony. n19 The maximum amount of disposable income that may be garnished for child support or alimony payments may not exceed:

- 50% for a debtor also supporting another spouse or child;

- 55% for such a debtor if support is twelve weeks or more in arrears;

- 60% for a debtor not supporting another spouse or child;

- 65% for such a debtor if support is twelve weeks or more in arrears. n20

[4] Remedies for Excessive Wage Garnishment

There are no specified penalties for court orders allowing excessive wage garnishments. There is also no explicit private right of action under the CCPA for excessive wage garnishment orders, although possible claims for abuse of process, violation of other federal or state debt collection laws, or for wrongful garnishment may be possible, including the possibility of punitive damages. n21 An employer who pays more to a creditor than the CCPA allows may be liable to the employee under the federal minimum wage laws. The excess amountgarnished does not count toward the minimum wage requirement. n22 If the excess amount of the garnishment brings the worker's wages below the minimum wage,

the worker has a private cause of action against the employer. n23 The worker may also have a cause of action against the employer under a state wage law, which may apply to any failure to pay wages that are legally due, regardless of whether there is a minimum wage violation. n24 One court has held that an employee may assert common law claims against her employer for wrongful wage deduction and conversion. n25 The CCPA's wage garnishment protections are intended to be self-executing and need not be affirmatively asserted by the debtor. n25.1

[5] Federal Protections Against Employee Discharge for Wage Garnishment

The CCPA provides that no employer may discharge an employee whose earnings have been subject to garnishment for any one indebtedness, n26 with criminal sanctions for violation. n27 The term "one indebtedness" refers to a single debt. Thus, an employee may not be discharged regardless of the number of levies or proceedings brought to collect a single debt. However, the CCPA restrictions do not protect the employee if his or her salary has been garnished for more than one debt.

The Secretary of Labor has the authority to seek injunctive and declaratory relief n28 and reinstatement of a wrongfully discharged employee. n29 However, enforcement by the Secretary of Labor is discretionary. n30

Courts are split as to whether there is a federal private right of action to enforce the CCPA garnishment protections against employee discharges. Garnishment-related discharges have also been challenged as racially discriminatory under other statutes such as *42 U.S.C. section 1983*, if a public employer is involved, or Title VII of the Civil Rights Act of 1964. n31

[6] Garnishment of Federal Employees Wages

Before 1994, sovereign immunity protected federal government employees from garnishment, but a 1994 statute authorized garnishment of federal employee pay checks. n32 It did not authorize the garnishment of federal pension benefits. n33 That law provided that the CCPA protection, and any more protective state exemptions, were available to federal employees. n34 Regulations by several branches of government and the military were authorized to implement this new debt collection tool.

[7] Relationship of the CCPA to State Law

The CCPA explicitly provides that its garnishment restrictions do not limit the operation of state law exempting a larger share of debtor's wages from garnishment or prohibiting employee discharge in cases where the CCPA does not prohibit discharge. n35 Congress enacted the CCPA to maximize debtor protections, and the CCPA has been construed as an exemption statute only preempting state law that is less protective to debtors. n36 Even if portions of a state law conflict with the federal provisions, the federal law will only preempt those portions of the state law that are less protective than the CCPA. n37

Consequently, practitioners should also be aware of state garnishment laws that provide debtors with added protections. n38 One state bans any wage garnishment arising from a consumer credit transaction. n39 Other state laws exempt such a high percentage of a debtor's wages that garnishment is no longer a practical collection method. n40 State personal property exemptions may protect wages oncedeposited in a bank account. In addition, some states have enacted legislation stronger than the CCPA by prohibiting discharge for multiple garnishments for multiple debts. n41 The state statute may also exempt more types of income than the federal statute. n42

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishments

FOOTNOTES:

(n1)Footnote 1. *15 U.S.C. §§ 1671 to 1677*, *reprinted in* Vol. 1B *infra*. *See* Annot., *Validity, Construction and Application of Secs. 301-307 of Consumer Credit Protection Act (15 U.S.C.S. Secs. 1671-1677) Placing Restrictions on Garnishment of Individuals' Earnings* Secs. 301-307 of Consumer Credit Protection Act *15 U.S.C.S. Secs. 1671-1677*, *14* A.L.R. Fed. 447 (1973).

(n2)Footnote 2. *31 U.S.C. § 3720D*.

(n3)Footnote 3. *16 C.F.R. § 444.2(a)(3)*; *see also* National Consumer Law Center, Unfair and Deceptive Acts and Practices §§ 6.11, 6.12 (7th ed. 2008).

(n4)Footnote 4. *15 U.S.C. § 1673(b)*.

(n5)Footnote 5. *26 U.S.C. § 6334(d)* provides for weekly exemption of the standard deduction provided by *26 U.S.C. § 63(c)* and the deduction provided for personal exemptions in *26 U.S.C. § 151* divided by 52. Other exemptions are provided by *26 U.S.C. § 6334*, including exemption of many government benefits and specified personal property.

(n6)Footnote 6. *15 U.S.C. § 1672(a)*. *See Kokoszka v. Belford, 417 U.S. 642, 651, 94 S. Ct. 2431, 41 L. Ed. 2d 374 , reh'g denied, 419 U.S. 886, 95 S. Ct. 160, 42 L. Ed. 2d 374 (1974)* (in holding that an income tax refund was not "earnings," the U.S. Supreme Court stated that it agreed with a court of appeals opinion that earnings are limited to periodic payment of compensation. However, the statute itself, *15 U.S.C. § 1672(a)*, defines earnings to include "bonus," which would not be a periodic payment. The Supreme Court's statement has been characterized as *dictum*, in that the issue before the Court was not the scope of the earnings exemption, but rather whether Congress intended the wage garnishment protections to override the bankruptcy laws). *See also State Treasurer v. Gardner, 564 N.W.2d 51 (Mich. Ct. App. 1997) , rev'd on other grounds, 459 Mich. 1, 583 N.W.2d 687 (1998)* (disability benefits were earnings within the meaning of the Consumer Credit Protection Act [hereinafter CCPA] because the payments would not have been made but for the recipient's past employment); *Funk v. Utah State Tax Comm'n, 839 P.2d 818 (Utah 1992)* (because of their nonperiodic nature, tax refunds did not constitute disposable earnings and were not protected). *See also In re Christy, 306 B.R. 611 (Bankr. C.D. Ill. 2004)* (genuine issue of fact what part of receivables of two-physician professional corporation was attributable to personal services of debtor-physician and therefore exempt as wages or salary under Illinois law); *In re Nelson, 2003 Bankr. LEXIS 1306* (Bankr. D. Colo. Oct. 1, 2003) (judgment for tortious interference with prospective economic relation, calculated as amount of earnings lost, was not earnings under Colorado exemption statute because plaintiff performed no personal services); *Rooney v. Rooney, 669 N.W.2d 362 (Minn. App. 2003)* (church was employer and payor within meaning of child support garnishment statute; it required members to give up all individual property, and provided for their needs; obligor was doing work for the church). *But see United States v. Armstrong, 2005 U.S. Dist. LEXIS 6844* (N.D. Tex. Apr. 21, 2005) (Social Security retirement benefits deposited in bank account not "earnings" and not protected by CCPA); *In re Rangel, 317 B.R. 553 (Bankr. D. Kan. 2004)* (tax refund not earnings within meaning of state garnishment exemption).

(n7)Footnote 7. *See, e.g., Massachusetts Mut. Life Ins. Co. v. Shoemaker, 849 F. Supp. 30 (S.D. Tex. 1994)* ; *In re Barnett, 214 B.R. 632 (Bankr. W.D. Okla. 1997)* ; *In re Marples, 266 B.R. 202 (Bankr. D. Idaho 2001)* ; *In re Atkinson, 258 B.R. 769 (Bankr. D. Idaho 2001)* (doctor's accounts receivables are compensation for personal services so are protected as earnings); *In re Price, 195 B.R. 775 (Bankr. D. Kan. 1996)* ; *In re Duncan, 140 B.R. 210 (Bankr. E.D. Tenn. 1992)* ; Genessee *County Friend of the Court v. GMC, 464 Mich. 44, 626 N.W.2d 395 (2001) . But see Lawrence v. Jahn (In re Lawrence), 219 B.R. 786 (Bankr. E.D. Tenn. 1998)* (Tennessee garnishment statute did not protect accounts receivable of podiatrist; it is not an exemption statute, but simply a restriction on use of a wage restriction order to reach earnings in hands of employer).

(n8)Footnote 8. *Usery v. First Nat'l Bank, 586 F.2d 107 (9th Cir. 1978)* (unrealistic to ask bank to determine which deposits traceable to employee pay check, therefore, bank not responsible for determining exemptions under the CCPA). One court made the distinction between compulsory and non- compulsory deposit of wages, holding that a

compulsory direct deposit as a condition of employment renders the earnings subject to the restrictions of the CCPA even after they are deposited in a bank. *Household Fin. Corp. v. Kinder, 3 Ohio Misc. 2d 3, 444 N.E.2d 99 (Mun. Ct. 1982)* .

(n9)Footnote 9. *Compare State Treasurer v. Schuster, 547 N.W.2d 332 (Mich. Ct. App. 1996)* , *rev'd on other grounds, 572 N.W.2d 628 (Mich. 1998)* (exemption for public school employees' retirement funds continues to protect funds after they are paid to recipient), *with Massachusetts Mut. Life Ins. Co. v. Shoemaker, 849 F. Supp. 30 (S.D. Tex. 1994)* (Texas exemption for "current wages" does not survive deposit).

(n10)Footnote 10. *Daugherty v. Century Trust Co., 28 Ohio St. 3d 441, 445 (1986)* .

(n11)Footnote 11. *Philpott v. Essex Cty. Welfare Bd., 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d 608 (1973)* .

(n12)Footnote 12. *15 U.S.C. § 1672(b).*

(n13)Footnote 13. Department of Labor's Fact Sheet #30, *available at* www.dol.gov/esa/regs/compliance/whd/whdfs30.htm.

(n14)Footnote 14. *Union Pac. R.R. v. Trona Valley Fed. Credit Union, 57 P.3d 1203 (Wyo. 2002)* .

(n15)Footnote 15. Pub. L. No. 110-28, §§ 8101-8104, *121 Stat. 112 (2007).*

(n16)Footnote 16. For example, the Uniform Consumer Credit Code § 5.105 provides for a weekly exemption of 40, instead of 30, times the minimum hourly wage.

(n17)Footnote 17. *29 C.F.R. § 870.10. See also Koethe v. Johnson, 328 N.W.2d 293 (Iowa 1982)* (describing formula for biweekly pay period; decision also holds that, where garnishment order arrives in middle of pay period, before entire period is earned, full pay for entire period should be used in CCPA calculations).

(n18)Footnote 18. [Reserved].

(n19)Footnote 19. *Cf. In re Marriage of Eklofe, 586 N.W.2d 357 (Iowa 1998)* (Iowa's $800 per year limitation on garnishment of certain low income debtor's wages applied towage garnishment for alimony, but not child support; discussion of complicated interrelationship of garnishment and family support law, which has changed since case decided); *In re Prade, 135 Ohio App. 3d 424, 734 N.E.2d 430 (Summit County 1999)* (court has power to order family support in amount greater than that which may be collected by garnishment); *Naedel v. Naedel, 115 Md. App. 347, 693 A.2d 60 (1997)* (family support exception to CCPA garnishment limitation narrowly construed: where the alimony obligation arose from a voluntary agreement, which was then "incorporated but not merged in" the divorce decree, and was non-modifiable by the court, even in response to major deterioration in husband's finances, the alimony was neither "ordered by a court" nor "subject to judicial review," so the 25% limitation would apply). *See also Laws v. Laws, 758 A.2d 1226, 2000 Pa. Super. 248* (maximum child support garnishment under CCPA could be based on obligor's earning capacity rather than lower actual earnings).

(n20)Footnote 20. *15 U.S.C. § 1673(b)(2). See also DiZazzo v. DiZazzo, 1992 Conn. Super. LEXIS 1178* (Conn. Super. Apr. 23, 1992) (65% disposable earnings, not 60%, may be garnished where child support or alimony in arrears).

(n21)Footnote 21. *Williams v. M.R.C. Polymers, 2000 U.S. Dist. LEXIS 14550* (N.D. Ill. Sept. 29, 2000) ; *Perkins v. Metropolitan Water Reclamation Dist., 1990 U.S. Dist. LEXIS 12594* (N.D. Ill. Sept. 24, 1990) (no private cause of action against employer for garnishing more than allowed by CCPA); *Whitney v. Chicago Transit Auth., 1987 U.S. Dist. LEXIS 4564* (N.D. Ill. June 3, 1987) (no private cause of action against employer for violating CCPA); *Oldham v. Oldham, 337 F. Supp. 1039 (N.D. Iowa 1972)* (granting unopposed motion to dismiss cause of action alleging wage garnishment in violation of CCPA). *See* Annot., *Recovery of Damages for Mental Anguish, Distress, Suffering, or the*

Like, In Action for Wrongful Attachments, Garnishment, Sequestration, or Execution, 83 A.L.R.3d 598 (1978) ; Annot., *What Constitutes Malice Sufficient To Justify An Award of Punitive Damages in Action for Wrongful Attachment or Garnishment, 61 A.L.R.3d 984 (1975)* . *See also Pinsky v. Duncan, 79 F.3d 306 (2d Cir. 1996)* (wrongful attachment may give rise to cause of action for malicious prosecution or abuse of process; where creditor relied in good faith on statute which was subsequently held unconstitutional, malice and lack of probable cause were not proven). *But cf. Brown v. Kennard, 94 Cal. App. 4th 40 (2001)* (litigation privilege prevents abuse of process claim based on wrongful post-judgment execution proceedings unless it is repeated). *See also In re* See, *301 B.R. 549 (Bankr. N.D. Iowa 2003)* (sanctions, including punitive damages, for bank's violation of automatic stay in continuing to garnish exempt wages; bank knew of bankruptcy, and exempt status of fund, and should be "well versed in the rights and duties of borrowers and lenders").

(n22)Footnote 22. *29 C.F.R. § 531.39*.

(n23)Footnote 23. *29 U.S.C. § 216(b)* (authorizing suit for unpaid minimum wages plus additional equal amount as liquidated damages, equitable relief, and attorney fees).

(n24)Footnote 24. *See, e.g., 43 Pa. Stat. § 260.9a. See also Cowart v. David J. Axelrod & Assocs., 2004 U.S. Dist. LEXIS 7228* (N.D. Ill. Apr. 26, 2004) (common law as well as statutory claim available for wrongful garnishment; employee--who was not the judgment debtor--allowed to amend complaint to add common law wrongful garnishment and conversion claims against employer who withheld wages without court order, based on garnishment notice with wrong name); *Giles v. General Motors Corp., 802 N.E.2d 858 (Ill. App. 2003)* (employee stated claims for gross negligence or wanton and willful misconduct against employer who continued to withhold wages for 2.5 years after expiration of court order; court order not a defense where it included termination date). *But see Broughton v. Magnetic Ticket & Label Corp., 2006 U.S. Dist. LEXIS 5084* (M.D. Tenn. Jan. 24, 2006) (employer owed no duty to child support obligor; even if delay in remitting funds withheld from wages was proximate cause of obligor being jailed for contempt, obligor failed to state a claim for negligent or intentional infliction of emotional distress).

(n25)Footnote 25. *Cowart v. David J. Axelrod & Assocs., 2004 U.S. Dist. LEXIS 7228* (N.D. Ill. Apr. 27, 2004) (plaintiff permitted to amend complaint to add common law claims where she alleged employer wrongfully withheld her wages after receiving garnishment notice for different employee).

(n26)Footnote 25.1. United States Dep't of Labor, Wage & Hour Div., Field Operations Handbook ch. 16, § 16a06, *available at* www.dol.gov/esa/whd/FOH/FOH_Ch16.pdf.

(n27)Footnote 26. *15 U.S.C. § 1674(a)*.

(n28)Footnote 27. *15 U.S.C. § 1674(b)*.

(n29)Footnote 28. *See, e.g., Donovan v. Hamilton Cty. Mun. Ct., 580 F. Supp. 554 (S.D. Ohio 1984)* ; *Hodgson v. Hamilton Mun. Ct., 349 F. Supp. 1125, 60 Ohio Op. 2d 309 (S.D. Ohio 1972)* .

(n30)Footnote 29. *Hodgson v. Consol. Freightways, Inc., 503 F.2d 797 (9th Cir. 1974)* (Secretary of Labor has an express grant of power to sue under *15 U.S.C. § 1674*; this constitutes a jurisdictional basis under *28 U.S.C. § 1345* for the Secretary's suit seeking reinstatement of employees discharged for multiple wage garnishments); *see also Martin v. Hawkeye Int'l Trucks, Inc., 782 F. Supp. 1320 (S.D. Iowa 1991)* (employee discharged because of an Internal Revenue Service [hereinafter IRS] wage levy protected by CCPA, but only entitled to five months back pay, not reinstatement, since employer would have discharged for poor performance in five months at the next scheduled performance evaluation); *Ellis v. Glover & Gardner Constr. Co., 562 F. Supp. 1054 (M.D. Tenn. 1983)* (Secretary of Labor asks court to award back pay for wages lost by wrongfully discharged employee).

(n31)Footnote 30. *McCabe v. City of Eureka, 664 F.2d 680, 684 n.1 (8th Cir. 1981)* .

(n32)Footnote 31. *42 U.S.C. §§ 2000e et seq.* ; *Johnson v. Pike, 332 F. Supp. 490 (C.D. Cal. 1971)* ; EEOC Dec. No. 74-27 (1983), Empl. Pract. Guide (CCH) P 6396; Annot., *26 A.L.R. Fed. 394 (1976)* .

(n33)Footnote 32. Hatch Act Reform Amendments of 1993, Pub. L. No. 103-94, § 9 (codified at *5 U.S.C. § 5520a*) (allows garnishment of federal employees' wages, including employees of executive, judicial and legislative agencies, members of Congress, and military personnel).

(n34)Footnote 33. *See 5 U.S.C. § 5520a(a)(4)(A).*

(n35)Footnote 34. *5 U.S.C. § 5520a(b). See* S. Rep. No. 103-57, at 6, *reprinted in* 1993 U.S.C.C.A.N. 1802, 1807.

(n36)Footnote 35. *15 U.S.C. § 1677.*

(n37)Footnote 36. *See, e.g., Benson v. Richardson, 537 N.W.2d 748 (Iowa 1995)* (federal CCPA did not preempt Iowa's more protective treatment of wages, which remained exempt for 90 days in checking or savings account, so long as reasonably traceable).

(n38)Footnote 37. *Kropf v. Kropf, 538 N.W.2d 496 (Neb. 1995)* (where Nebraska law did not limit amount of Social Security benefits which could be garnished for support of ex-wife, CCPA limits applied).

(n39)Footnote 38. For a detailed list of state wage protections, see National Consumer Law Center, Fair Debt Collection, §§ 12.4.3, 12.6 (5th ed. 2004).

(n40)Footnote 39. Texas.

(n41)Footnote 40. Among these states are North Carolina, Florida, and South Carolina.

(n42)Footnote 41. *E.g.,* Uniform Consumer Credit Code § 5.106 prohibits an employer from discharging any employee because his earnings have been subjected to garnishment to pay a judgment arising from a consumer credit sale, consumer lease or consumer loan. *See also* Annot., *Discharge Based on Garnishment, 41 A.L.R.5th 31 (1996)* .

(n43)Footnote 42. *See generally* National Consumer Law Center, Collection Actions, §§ 12.4.3, 12.4.4 (1st ed. 2008).

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PART I Consumer Credit
CHAPTER 9 Garnishment and Exemptions

1-9 Consumer Credit Law Manual § 9.04

§ 9.04 Creditors May Be Barred From Reaching Exempt Funds and Funds of Another in a Joint Bank Account

The statutes creating benefit programs, e.g., Veteran's benefits, n1 Social Security benefits, n2 workers' compensation benefits, and welfare benefits, generally exempt those benefits from attachment by creditors when those benefits are deposited into a bank account, as long as the funds are available on demand or for the support of the beneficiary and not converted into a permanent investment. n3 This is in accordance with the straightforward construction of exemption statutes to accomplish their purpose of protecting funds necessary for the support of the debtor and the debtor's family.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsPublic Health & Welfare LawGeneral OverviewWorkers' Compensation & SSDIGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See Porter v. Aetna Cas. & Sur. Co., 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962)* .

(n2)Footnote 2. *See Philpott v. Essex Cty. Welfare Bd., 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d 608 (1973)* . *See also S&S Diversified Servs. L.L.C. v. Taylor, 897 F. Supp. 549 (D. Wyo. 1995)* (Social Security benefits remained exempt, even after being commingled with other funds, so long as "readily traceable." Court warned of possible sanctions against creditors who attempt to garnish social security benefits.).

(n3)Footnote 3. *Porter v. Aetna Cas. & Sur. Co., 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962)* . *See also Beardsley v. Admiral Ins. Co., 647 So. 2d 327 (Fla. Dist. Ct. App. 1994)* (commingling exempt federal retirement funds and non-exempt funds did not destroy exemption; funds should be allocated or traced, if possible).

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PART I Consumer Credit
CHAPTER 9 Garnishment and Exemptions

1-9 Consumer Credit Law Manual § 9.05

§ 9.05 Protection of Exempt Funds From Creditors' Self-Help Remedy of Set-Off

[1] Bankers' Set-Off of Exempt Funds Deposited in Bank Account

The infrequently used bankers' right of a set-off can be a devastating remedy when employed against funds needed for a household's essential living expenses. While the majority rule is that otherwise exempt income (e.g., social security, welfare, disability, retirement funds) n1 is also exempt from set-off, a significant minority of courts, through a variety of rationales, allow a set-off against these same types of funds.

The most practical course for consumers to take to protect against the bankers' right of set-off, at least in the minority states and those without recent precedent, is not to maintain a checking or savings account at a bank or other depository institution to which they owe a debt or where they have cosigned for another debtor. Having a bank or credit union deposit account often facilitates obtaining lower priced credit from the bank holding the deposit. However, in those states which have not embraced the majority rule, once the credit is obtained, the only safe course is to transfer the deposit account to another depository which is not a creditor of the account holders. The alternative course of not maintaining a bank account may increase the risk of theft.

The bankers' right of set-off is generally limited by the duties of good faith and fair dealing, and commercial due diligence. n2

[a] Majority Rule Courts Protect Exempt Income Deposited in Checking or Savings Account

The leading modern case states the reasoning behind the majority rule of maintaining an exemption against a claim of set-off:

> The assertion of a banker's set-off has exactly the same effect as a third party's levy of execution on the account--it deprives the depositor of the income which the state provided him to meet subsistence expenses, compelling the state either to give him additional money or leave him without means of physical survival. n3

Exemption statutes often protect income or property from a list of court processes (e.g., execution, garnishment), but seldom specifically mention the self-help remedy of set-off, giving a basis for the minority position. Waiver of the

exemption and commingling of funds also support some decisions allowing the set-off.

The majority rule courts, on the other hand, have little trouble deflecting the above arguments by pointing out the remedial purpose of exemption statutes. These statutes are intended to protect households from deprivation of the means to meet the basic necessities of living. That purpose is entirely frustrated when the exemption is not maintained for deposited funds. Even when commingled with nonexempt funds in a bank account, by adopting a simple accounting tracing formula, the court may maintain the purpose of the exemption.

[b] Additional Limitations Upon Bankers' Right of Set-Off

When the set-off is exercised against a joint bank account, the debtor's equitable interest in the account should be determined. Many states limit the amount that may be reached by creditors on a joint account to the equitable interest or the actual contribution of each to the account. n4

The set-off prerequisite of "mutuality" often protects commercial accounts from set-offs. Under that rule, a special deposit account, e.g., for payroll payments, may not be offset for unrelated debts because of a lack of "mutuality." n5 That is, if the account is established for a special purpose known to the bank, the account is not subject to set-off for a debt unrelated to that purpose. Proof of the bank's knowledge of the purpose of the account may be problematic.

[2] Bankruptcy and Other Set-Off Situations

Attempts to set-off exempt property may arise in a variety of contexts other than bank accounts. They may arise also in the case of a government interception of a tax refund check made exempt by state law, a landlord-tenant dispute, an employer-employee relationship, or a retail layaway plan. In bankruptcy cases, many courts hold that the right of set-off established by the Bankruptcy Code n6 cannot be used against property exempted by the Bankruptcy Code. n7

A bankruptcy set-off may be denied for lack of mutuality between the claims and avoided in certain circumstances if occurring within 90 days of the bankruptcy filing. Funds deposited in an account after filing of a bankruptcy petition may not be set off against pre-petition debt, but in some jurisdictions a bank may be permitted to freeze an account pending a decision on its motion to lift the stay. n8

[3] Restriction on Card Issuers' Use of Set-Off

Many credit cards are issued by banks or other financial institutions which may also have a deposit account relationship with the card holders and users. Truth in Lending provides that the card issuer may not take funds out of a deposit account to satisfy a credit card debt except under an automatic payment plan previously authorized by the cardholder in writing. n9 Even then, the card issuer may not take an automatic payment for a properly disputed amount. n10

The card issuer, however, is permitted to attach or levy upon funds under procedures which are constitutionally available to other creditors. n11 What is restricted is the self-help, set-off remedy available only to financial institutions by reason of their relationship with their depositor.

The Official Staff Commentary to Regulation Z further prohibits putting a freeze on the deposit account, the functional equivalent of a set-off, for a credit card debt, except where a security agreement allows it, or where a bankruptcy court has issued a turnover order; n12 nor may the bank evade the statutory prohibition by intercepting money before it is formally deposited, n13 when the money was given to the bank by the cardholder with the intent to place it on deposit.

[4] Allowable Card Issuer Set-Offs Against Deposit Accounts

One (sometimes expensive) way for consumers with a poor credit record to get a credit card is to place funds on deposit with the card issuer in the amount of the credit limit on the account. Other customers may seek to take advantage of

lower interest rates offered by the card issuer by pledging their deposit accounts. In both situations, Truth in Lending Regulation Z allows the card issuer to take a consensual security interest in the deposit account, and to enforce that interest. n14 However, the security interest involved must be affirmatively agreed to by the consumer, be disclosed in the initial disclosures, and be taken and enforced only through procedures equally available to other creditors. n15

Therefore, security interests granted by the language routinely included in credit card agreements may not be construed to authorize a set-off of a deposit account.

Another basis for a set-off on credit card indebtedness is an automatic payment plan. n16 The cardholder's authorization for an automatic payment plan must be in writing and signed or initialed by the cardholder.

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsCommercial Law (UCC)Secured Transactions (Article 9)Third Party RightsBank RightsContracts LawNegotiable InstrumentsEnforcementSetoffs

FOOTNOTES:
(n1)Footnote 1. An extensive listing of state and federal exempt property statutes is found in National Consumer Law Center, Consumer Bankruptcy Law and Practice Ch. 10 (8th ed. 2006 and Supp.).

(n2)Footnote 2. *See, e.g., Banco de la Provincia de Buenos Aires v. Baybank Boston N.A., 985 F. Supp. 364 (S.D.N.Y. 1997)* (bank acted in good faith, and in compliance with the Uniform Commercial Code, when it froze account of insolvent commercial customer, then used set-off to recoup its loan proceeds from customer's account); *Peavy v. Bank S., N.A., 222 Ga. App. 501, 474 S.E.2d 690 (1996)* (case remanded to trial court for fact findings regarding good faith and due diligence, where bank set-off account three months after it had accepted deposit of a check with patently insufficient endorsement).

(n3)Footnote 3. *Tom v. First Am. Credit Union, 151 F.3d 1289, 1292 (10th Cir. 1998) , quoting from Kruger v. Wells Fargo Bank, 11 Cal. 3d 352, 113 Cal. Rptr. 449, 521 P.2d 441 (1974) . See also Miller v. Bank of America, 2004 WL 3153009* (Cal. App. Super. Dec. 30, 2004) (unpublished, citation limited.) (setoff of directly deposited Social Security for bank fees and overdrafts forbidden by California exemption law, and procedure violates state consumer protection statutes).

(n4)Footnote 4. *See § 9.06 infra.*

(n5)Footnote 5. B. Clark, The Law of Bank Deposits, Collections and Credit Cards P 14.06 (3d ed. 1989). *See Smaltz v. National City Bank, 736 N.E.2d 95 (Ohio App. 2000) .*

(n6)Footnote 6. *11 U.S.C. § 553.*

(n7)Footnote 7. *See, e.g., Malinowski v. New York State DOL (In re Malinowski), 156 F.3d 131 (2d Cir. 1998)* (bankruptcy prevents government from setting-off overpayment of unemployment benefits against unrelated unemployment claim; if claims arose from same transaction, however, recoupment might be allowed), *on remand, 1998 U.S. Dist. LEXIS 18397* (N.D.N.Y. Nov. 18, 1998) ; *United States v. Jones (In re Jones), 230 B.R. 875 (Bankr. M.D. Ala. 1999)* (court denied set-off against exempt property, noting that this is the majority rule). *But see In re Pieri, 86 B.R. 208 (B.A.P. 9th Cir. 1988)* (legislative construction requires bankruptcy set-off available against exempt property).

(n8)Footnote 8. *In re* Erickson (Erickson v. Citizens First Nat'l Bank), *216 B.R. 938 (Bankr. C.D. Ill. 1998) .*

(n9)Footnote 9. Truth in Lending Act [hereinafter TILA] § 169, *15 U.S.C. § 1666h.*

(n10)Footnote 10. Reg. Z, *12 C.F.R. § 226.13(d)(1)*.

(n11)Footnote 11. TILA § 169(b), *15 U.S.C. § 1666h(b)*; Reg. Z, *12 C.F.R. § 226.12(d)(2)*.

(n12)Footnote 12. Official Staff Commentary, *12 C.F.R. § 226.12(d)(1)-1*.

(n13)Footnote 13. Official Staff Commentary, *12 C.F.R. § 226.12(d)(1)-2*.

(n14)Footnote 14. Reg. Z, *12 C.F.R. § 226.12(d)(2)*.

(n15)Footnote 15. Official Staff Commentary, *12 C.F.R. § 226.12(d)(2)-1*.

(n16)Footnote 16. Reg. Z, *12 C.F.R. § 226.12(d)(3)*.

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PART I Consumer Credit
CHAPTER 9 Garnishment and Exemptions

1-9 Consumer Credit Law Manual § 9.06

§ 9.06 Creditor's Right to Seize Funds in a Joint Bank Account May Be Limited to Debtor's Contribution

[1] Introduction

It is not unusual for an individual to list another person, perhaps a relative or friend, jointly on a bank account even though only one of them deposits funds into the account. This may be done to facilitate care for an aging parent, avoid probate, or to give the nondepositor access to check cashing or other financial services. However, the arrangement can create problems when the noncontributor is a judgment-debtor. In some states, the entire account is subject to attachment or garnishment for the debts of either of the joint account holders, irrespective of the ownership of the funds. Other states offer protections to joint account holders from liability to each other's creditors.

A joint account with right of survivorship is often inappropriately used to enable an adult son or daughter to write checks for an aging parent. n1 Such a joint account may not be an acceptable substitute for a durable power of attorney. In most states, a durable power of attorney empowers the son or daughter to write checks for the parent's benefit, even if the parent becomes incompetent, while making clear the strictly fiduciary role of the offspring. Because the fiduciary may not write checks on the account to pay his or her own debts, the bank or other creditor may not set-off or attach the funds either.

Joint accounts are also inappropriately used as a short-cut for holding money in trust for a child. This is no substitute for a properly drawn trust, which satisfies a state's requirements for gifts to minors. If the donor retains control of the funds, as in a joint account, the funds may be set-off against his or her debts. n2

Both statutes and case law have recognized that nondebtors may have protectable interests in joint property which creditors seek to attach, but there is a great deal of variation among the states as to how, when, and to what extent these interests may be asserted against an attachment. In addition, unresolved constitutional due process issues may arise in some situations.

Most jurisdictions are in agreement that joint accounts are subject to legal process by the creditor of a single co-depositor, n3 but only to the extent of the debtor-depositor's equitable interest in the funds. In determining what portion of the account represents the debtor's interest, most courts have focused on one or more of three factors: (1) the agreement between the bank and the depositors; (2) the co-depositors' respective net contributions to the account; and

(3) statutes defining the rights in jointly held bank accounts. n4

n5-6

Married couples should be aware of the law of their state regarding joint accounts and marital property before deciding what use to make of joint accounts--especially if one spouse brings debts to the marriage. n7

The debtor's death may prevent set-off. A borrower's death is often an "event of default," but courts have reasoned that by the time this default occurs, the ownership of the account has already passed to the survivor. n8

[2] The Contract Approach

Some courts have found the agreement between the bank and the depositors to be determinative. These agreements (and/or the laws which regulate them) usually provide that, in the absence of customers' instructions to the contrary, each co-depositor has a right to withdraw any or all of the funds at any time. If, it is reasoned, a single co-depositor has an absolute right to withdraw funds without notice to co-depositors, and is able to use those funds for any purpose (including payment of the debt in question), a creditor should be able to "stand in the depositor's shoes" and attach the entire account. n9 However, when it wasclear to the bank that the debtor had only limited rights to the funds, the creditor could not assert greater rights. n10

[3] The Net Contribution Approach

In other jurisdictions, the net contribution of the joint depositors determines each depositors' proportional ownership rights. A joint account may be afforded additional protection in the jurisdictions which allow a debtor to present evidence of an intention to make a gift to co-depositors of another depositor's contributions to the account.

Absent clear evidence of co-depositors' respective ownership rights, courts typically rely on various presumptions. In some jurisdictions, a judgment-debtor presumptively holds the entire account, and unless he or she is able to establish otherwise, all monies in the account may be reached. n11 In other jurisdictions, it is presumed that co-depositors share equally in the ownership of the account. n12 A small minority of jurisdictions treat joint accounts held by a husband and wife as tenancies by the entireties. n13 Because the deposits belong to them as a unit and not as individuals, attachment or garnishment is precluded altogether where only one spouse is a debtor. n14

[4] Due Process Considerations

In addition to the substantive question of whether deposited funds belonging to a nondebtor may be attached, special procedural issues arise. Usually, the nondebtor co-depositor is not a party to the judicial or administrative proceeding where the creditor seeks to attach the funds contained in a joint bank account. Since the nonparty will not have had notice or an opportunity to defend the account, due process may not be provided.

Only a few jurisdictions place the burden of proving that the debtor owns all or part of the joint account on the seizing creditor. Equally rare is the requirement that nondebtor co-depositors be given preseizure notice and an opportunity to be heard. n15 Post-attachment relief (whether it be against co-depositors, the banking institution, or the creditor) is not always an adequate remedy, particularly in the case of low-income depositors who may suffer serious harm when deprived of subsistence funds for even a short period of time. n16

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawBank ActivitiesBank AccountsGeneral OverviewCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesAttachmentsCivil ProcedureRemediesProvisional

RemediesGarnishments

FOOTNOTES:

(n1)Footnote 1. *See Rives v. Krupzsield, 60 Ohio App. 3d 97, 573 N.E.2d 1199 (1989)* (set-off for son's debt improper where elderly depositor told bank officer she wanted son to be able to withdraw funds from her account "in case of an emergency," and bank officer provided joint account; once question of depositor's knowledge and understanding of joint account is raised, bank, with its superior knowledge and bargaining power, must show it provided correct information).

(n2)Footnote 2. *Farrell v. Coulter, 898 S.W.2d 139 (Mo. Ct. App. 1995) . Branch Banking Trust Co. v. Bartley, 2006 WL 1113632* (Ky. Ct. App. Apr. 28, 2006) (father sued bank that allowed creditor to garnish non-custodial account containing minor son's funds; bank raised genuine issue of fact on counterclaim that father breached fiduciary duty by setting up ordinary joint account and failing to respond to creditor's garnishment notice).

(n3)Footnote 3. Annot., *Attachment-Joint Bank Account, 11 A.L.R.3d 1465, 1468 (1967)* .

(n4)Footnote 4. 7 Am. Jur. 2d *Proof of Facts* 311, 343 (1975).

(n5)Footnote 5-6. [Reserved].

(n6)Footnote 7. *McNeilly v. Geremia (In re McNeilly), 249 B.R. 576 (B.A.P. 1st Cir. 2000)* (bank account owned in tenancy by entireties was exempt under Vermont law); *In re Mukhi, 246 B.R. 859 (Bankr. N.D. Ill. 2000)* (property held in tenancy by entireties will be treated as exempt as to debts of one spouse); *Sullivan v. Century Bank, 601 So. 2d 985 (Ala. 1992)* (wife had individual bank account before marriage; added husband's name; joint account with survivorship, and right of set-off for bank; husband's first wife defaulted on car loan, which both spouses had signed; bank allowed to set-off second wife's checking account). *See Fleet Bank of Conn., N.A. v. Carillo, 240 Conn. 343, 691 A.2d 1068 (1997)* (judgment creditor of one spouse may obtain bank execution, pursuant to Connecticut statute, against bank account of married couple to which both spouses had contributed: either spouse could withdraw entire balance, so by putting her money in joint account, non-debtor wife took risk that husband might use account to pay his individual debts).

(n7)Footnote 8. *Bank of Washington v. Koester, 939 S.W.2d 464 (Mo. Ct. App. 1996)* (joint tenants' rights terminate at death, and bank had no right of set-off after co-tenant, who pledged CD as collateral for his individual debt, died); *Lowery v. First Nat'l Bank of St. Louis, 895 S.W. 2d 200 (Mo. Ct. App. 1995)* .

(n8)Footnote 9. *See Fleet Bank of Conn., N.A. v. Carillo, 240 Conn. 343, 691 A.2d 1068 (1997) . See also In re Mastrofino,247 B.R. 330 (Bankr. M.D. Fla. 2000)* (car titled to husband or wife was available to creditors of one spouse since it could be sold by either owner; bank account with signature card showing joint tenancy also available to individual creditors). *See also Winecoff v. Compass Bank, 876 So. 2d 1145 (Ala. Civ. App. 2003)* (bank properly set off joint account for inadvertent overpayment to one depositor; account agreement permitted this; unconscionability of agreement may be raised only as defense, not as a claim for relief where depositors were suing bank).

(n9)Footnote 10. *Masotti v. Bristol Sav. Bank, 653 A.2d 179 (Conn. 1995)* .

(n10)Footnote 11. *Tayar v. Tayar, 208 A.D.2d 609, 618 N.Y.S.2d 35 (1994)* . 638 *Highsmith v. Department of Public Aid, 803 N.E.2d 652 (Ill. App. 2004)* (burden on non-debtor to show ownership of funds and lack of donative intent; where father funded account for son's education and son did not choose to be educated, this was at most a conditional gift, and could not be reached for son's child support obligation). *See also Food Servs. Corp. v. Rheam, 145 S.W.3d 484 (Mo. App. 2004)* (non-debtor tenants may show that debtor contributed nothing, and that they did not intend a gift; remanded to determine debtor's contributions and co-tenants' intentions). *In re Estate of Shea, 848 N.E.2d 185 (Ill. App. Ct. 2006)* (estate rebutted presumption that adding joint tenant was a gift where account owner had discussed, with lawyer and others, need for someone to pay bills, etc. if he became disabled).

(n11)Footnote 12. *In re Kondora, 194 B.R. 202 (Bankr. N.D. Iowa 1996)* (Joint accounts presumed to be owned in

equal shares by the co-tenants; presumption can be rebutted by "clear and convincing" evidence. Funds may be garnished only to the extent of the debtor's interest in the property.).

(n12)Footnote 13. Florida, Maryland, Missouri, and Pennsylvania.

(n13)Footnote 14. *See 11 A.L.R.3d 1465, 1484 (1967) .*

(n14)Footnote 15. *See 11 A.L.R.3d 1465, 1484 (1967) . See also FDIC v. Perry Bros., 854 F. Supp. 1248 (E.D. Tex. 1994)* (detailed discussion of due process issue).

(n15)Footnote 16. *See Sniadach v. Family Fin. Corp., 395 U.S. 337, 89 S. Ct. 1820, 23 L. Ed. 2d 349 (1969) .*

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PART I Consumer Credit
CHAPTER 9 Garnishment and Exemptions

1-9 Consumer Credit Law Manual § 9.07

§ 9.07 Exemption Laws Are Fundamental Protections for Low-Income Consumers From Debt Collectors

Exemption laws provide debtors with the ability to shield certain assets or possessions from attachment or garnishment. State and federal exemption laws, which exclude a wide variety of property from seizure by creditors, are a fundamental safeguard for the protection of low-income persons. n1 Some states provide for a "wild card" exemption that exempts any property specified by the debtor up to a certain amount. n2

When a debtor possesses *only* exempt assets, he or she is referred to as "judgment proof" or "collection proof." While a judgment may be taken against such a person, there is no way for the creditor to compel collection of the judgment from the debtor's income or assets unless the debtor's circumstances change. Because of this, judgment-proof debtors are seldom sued.

Under exemption statutes, property listed as collateral in a security agreement, mortgage, or deed of trust usually is *not* protected from the creditor who took it as collateral. Such creditors are referred to as secured creditors. Usually, secured creditors pursue any valuable collateral as their first collection option. Typically, secured transactions are car loans and mortgages to purchase a home. Exemption statutes often provide protection against general or unsecured creditors, e.g., most bank credit cards, most retailers who issue their own credit cards, and medical providers.

It is important to remember, however, that judgment-proof individuals are sometimes targets for debt collection abuse; since ordinary legal tactics are not effective, collectors attempt to scare these consumers into paying voluntarily. Representing a consumer in an affirmative suit against a debt collector for collection abuse may remove a source of grave stress for the client and provide some relief for the client's financial hardship.

In formulating a legal strategy, one must first determine which of the low-income client's assets are available to creditors. A client who has only exempt income and property may be more willing to take a risk on pursuing a claim for a less than certain legal theory because he or she would be immune from liability for court costs. A threat against nonexempt wages frequently suggests that the client should consider a chapter 7 (liquidating) bankruptcy if there are substantial debts and little other property available to creditors. n3 Nonexempt equity in a home threatened by creditors presents yet a different scenario and suggests that consideration should be given to a chapter 13 (installment payment plan) bankruptcy. While property exemption laws are fundamental to bankruptcy cases, many exemptions are also available outside of bankruptcy and a truly judgment proof debtor is not likely to need bankruptcy at all.

Legal Topics:

For related research and practice materials, see the following legal topics:
Bankruptcy LawGeneral OverviewBankruptcy LawExemptionsGeneral OverviewCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishments

FOOTNOTES:
(n1)Footnote 1. For a complete list of state exemption statutes, see National Consumer Law Center, Collection Actions, Ch. 12 (1st ed. 2008).

(n2)Footnote 2. *In re Arnold, 193 B.R. 897 (Bankr. W.D. Mo. 1996)* (wild card exemption may be used to exempt bank accounts).

(n3)Footnote 3. *See generally* Collier Consumer Bankruptcy Practice Guide Chs. 1, 4, P 4.05 (Matthew Bender).

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1-9 Consumer Credit Law Manual § 9.08

§ 9.08 Purpose of Exemption Laws

Exemption laws were established to protect a limited amount of a debtor's property from a forced sale for the payment of debts. The courts have enumerated the following purposes: (i) to provide the debtor with enough money to survive; (ii) to protect the debtor's dignity; (iii) to afford a means of financial rehabilitation; (iv) to protect the family unit from impoverishment; and (v) to spread the burden of a debtor's support from society to his creditors. It is settled that exemption laws are to be liberally construed in favor of the debtor and the debtor's family.

The initial exemption laws were provided by state statute and protected debtors against many judgment creditors. Many later federal statutes included exemption provisions, e.g., *42 U.S.C. section 407* and *38 U.S.C. section 3101*, and provide that social security and veterans benefits, respectively, are exempt from seizure by creditors. The Bankruptcy Code provides a federal exemption scheme in bankruptcy for states which do not provide their own bankruptcy exemptions. n1

Legal Topics:

For related research and practice materials, see the following legal topics:
Bankruptcy LawGeneral OverviewBankruptcy LawExemptionsGeneral OverviewCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishments

FOOTNOTES:
(n1)Footnote 1. A thorough analysis of exemptions provided under the Bankruptcy Code for people filing bankruptcy is found in Collier Consumer Bankruptcy Practice Guide Ch. 13 (Matthew Bender), and a broad overview of state law is found in Vukowich, *Debtor's Exemption Rights, 62 Geo. L.J. 779 (1974)*. A nearly exhaustive reprint of state and federal exemption statutes is in 7 Collier on Bankruptcy (15th ed. rev.). Summaries of state exemptions are found in National Consumer Law Center, Fair Debt Collection, Ch. 12 (5th ed. 2004 and Supp.).

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1-9 Consumer Credit Law Manual § 9.09

§ 9.09 Homestead Exemptions

[1] Scope

Homestead exemptions are designed to protect the home for the debtor and the debtor's family. The only states that do not provide for homestead exemptions are Delaware, Maryland, New Jersey, and Pennsylvania.

The remaining states each set a different amount that is exempt. New Hampshire allows $30,000; New York allows $50,000; Florida does not set a dollar amount and allows up to 160 acres outside a municipal area and a half-acre within a municipal area. Note that these dollar amounts generally refer to the debtor's equity in the property, *i.e.*, if a $200,000 property is encumbered by a $190,000 mortgage, then a $10,000 homestead exemption will make it completely exempt. n1 Many jurisdictions protect the marital home against seizure for debts of one spouse. n2 Some states provide a larger homestead exemption for elderly or disabled persons. n3

Many states distinguish between rural and urban homesteads, exempting much more land, n4 and sometimes allowing much higher value, n5 for rural homesteads, and may also provide a separate exemption for personal property used in agriculture. n6 The urban/rural distinction presents difficult problems where land uses are changing, municipalities are expanding into formerly unincorporated areas, and farmers turn to non-agricultural work to sustain themselves. Courts will generally consider first the character of the area, and then whether the individual parcel is used for traditionally rural activities that support the family. n7

The states' limitations on homestead exemptions and procedures for asserting them vary widely from state-to-state. Frequently, homesteads are available to heads of households, but not to an individual. Mortgages or deeds of trust areusually considered waivers or exclusions from homestead protections, although in some states where a married couple is involved, both spouses must sign. Frequently, debts for child support or alimony may be enforced against the homestead. Advocates should familiarize themselves with the specific limitations of their state homestead law.

[2] Homestead Exemption Limits in Bankruptcy

The extreme variation in state homestead amounts, and the existence of states with high or unlimited homesteads and narrow fraud exceptions, n8 led to concern about the use of homestead exemptions to shelter unreasonable amounts from creditors. Recent amendments to the Bankruptcy Code limit debtors from taking full advantage of state homestead

exemptions. n9 Section 522(o) limits debtor's state homestead exemption where the debtor converted non-exempt property into exempt homestead property within ten years before the filing of the petition and with the intent to hinder, delay, or defraud a creditor. n10 In addition, two new provisions cap state homestead exemptions at $125,000. Section 522(p) applies to homestead property acquired during the 1215-day period before filing a petition for bankruptcy. n11 However, the monetary cap does not apply to any interest transferred from a debtor's previous principal residence to the debtor's current principal residence if both are in the same state. n12 Section 522(q) limits a debtor's homestead exemption if the debtor has been convicted of felonies or owes debts arising from certain unlawful conduct.

Legal Topics:

For related research and practice materials, see the following legal topics:
Bankruptcy LawExemptionsState LawSpecific ExemptionsCivil ProcedureJudgmentsEntry of JudgmentsEnforcement & ExecutionExemptionsCivil ProcedureRemediesProvisional RemediesGarnishmentsReal Property LawHomestead ExemptionsReal Property LawMobilehomes & Mobilehome ParksExemptions

FOOTNOTES:
(n1)Footnote 1. *See, e.g., Martone-Rosato v. Guardiano-Neizwanger, 2001 Conn. Super. LEXIS 1294* (Conn. Super. Ct. April 11, 2001) (lien may be placed against property if owner's equity exceeds statutory exemption), *aff'd, 70 Conn. App. 909, 802 A.2d 927 , appeal denied, 261 Conn. 926, 806 A.2d 1060 (2002)* ; *Baumann v. Chaska Bldg. Ctr., Inc., 621 N.W.2d 795 (Minn. Ct. App. 2001)* (cap on homestead exemption applies to owner's equity, not fair market value); *Kipp v. Sweno, 629 N.W.2d 468* (Minn. Ct. App.) (remanded to determine if equity exceeded cap), *rev. denied, 2001 Minn. LEXIS 568* (Minn. Aug. 22, 2001) .

(n2)Footnote 2. For a discussion of state homestead exemptions, see National Consumer Law Center, Fair Debt Collection, § 12.5.2 (5th ed. 2004 and supp.).

(n3)Footnote 3. *In re Rolland, 317 B.R. 402 (Bankr. C.D. Cal. 2004)* (debtors not entitled to increased exemption for "physically or mentally disabled;" must show inability to engage in gainful employment; wife, although diagnosed with depression, claimed monthly income from self-employment and monthly expense for self-employment tax); *In re LaHaye, 2003 WL 22764771* (Bankr. N.D. Cal. Sept. 10, 2003) (standard for disability same as for Social Security disability; burden of proof on objector; where evidence inconclusive, enhanced exemption allowed); *In re Davis, 681 N.W.2d 452 (S.D. 2004)* (increased homestead for the elderly permissible, but unlimited exemption violates state constitutional requirement of reasonableness); *In re Sweitzer, 332 B.R. 614 (Bankr. C.D. Cal. 2005)* (investment losses may be deducted in calculating gross income to determine eligibility for enhanced homestead exemption available to debtors age 55 or over with gross annual income below $15,000). *In re Bush, 346 B.R. 207 (Bankr. S.D. Cal. 2006)* (explaining method of calculating income, for California statute granting enhanced homestead exemption to low-income debtors age 55 and older: sole proprietor of small business may deduct cost of goods and any legitimate business expenses, but not "investment losses").

(n4)Footnote 4. *See, e.g., Ark. Code Ann. § 16-66-210* (1/4 acre or 80 acres); *La. Rev. Stat. Ann. § 20:1* (5 acres or 200 acres); *Tex. Prop. Code Ann. § 41.002* (10 acres or 100 acres for individual; 200 acres for family).

(n5)Footnote 5. *See, e.g., Minn. Stat. Ann. § 510.02* ($500,000 agricultural; otherwise $200,000).

(n6)Footnote 6. *See generally* National Consumer Law Center, Fair Debt Collection, § 12.5.2.3.1, 12.5.2.3.2 (5th ed. 2004 and supp.).

(n7)Footnote 7. *Painewebber Inc. v. Murray, 260 B.R. 815 (Bankr. E.D. Tex. 2001)* (head of household allowed to exempt three contiguous parcels used for residence, agriculture and family recreation; where parcels non-contiguous, more than pure aesthetic enjoyment must be shown, but activity need not generate a profit); *In re McLachlan, 266 B.R. 220 (Bankr. M.D. Fla. 2001)* (homeowner in rural area could exempt contiguous lot with palm grove from which he

occasionally sold palm trees; land used for rural purposes, *i.e.*, citrus groves, ranching or farming, and not leased to another, is part of rural homestead).

(n8)Footnote 8. *See, e.g., Havaco of America v. Hill, 790 So. 2d 1018 (Fla. 2001)* .

(n9)Footnote 9. *See* National Consumer Law Center, Consumer Bankruptcy Law and Practice,§ 10.2.2.2 (9th ed. 2009).

(n10)Footnote 10. *See In re Maronde, 332 B.R. 593 (Bankr. D. Minn. 2005)* (homestead exemption limited where debtor paid down home equity line with proceeds of non-exempt property on eve of bankruptcy).

(n11)Footnote 11. Most courts that have construed this section conclude that it applies in opt-out states as well as those where debtors may choose between federal and state exemptions. *In re Kaplan, 331 B.R. 483* (Bankr. S.D. Fla. Oct. 6, 2005) ; *In re Virissimo, 332 B.R. 201 (Bankr. D. Nev. 2005) . Contra In re McNabb, 326 B.R. 785 (Bankr. D. Ariz. 2005)* .

(n12)Footnote 12. *11 U.S.C. § 522(p)(2)(b). See In re Wayrynen, 332 B.R. 479 (Bankr. S.D. Fla. 2005)* (debtor entitled to full homestead exemption even though debtors purchased properties within 40-month period where funds came from proceeds of first homestead bought prior to 40-month period, plus appreciation due to increased property values).

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1-9 Consumer Credit Law Manual § 9.10

§ 9.10 State Restrictions on Wage Garnishment

[1] General

Most states have statutes that duplicate the protections of the CCPA, *15 U.S.C. sections 1671-1677*, which sets the maximum amount of wages that can be garnished by most creditors at 25% of weekly wages, but no more than a flat amount, $154.50. Many states that set their own exemption statutes set higher amounts that may not be garnished by creditors, thus offering more protection for the debtor. Checking current state law is essential. n1

North Carolina and Texas completely exempt the wages of the head of the household from garnishment. Alaska exempts $438 of weekly net earnings, increased to $688 if the debtor's wages are the sole support of the household. n2 Missouri allows 10% of the head of household's wages to be garnished. n3 A repealed Ohio statute limits garnishments for health care debts to 12% of income; n4 other creditors may garnish up to 25%. The courts split on the constitutionality of this provision. State laws also vary as to the extent of protection provided to the earnings of independent contractors. In addition, several state statutes make provision for hardship in addition to the percentage limitations on garnishment. Some states provide additional protection for certain present or former recipients of needs-tested benefits. The court may also have discretion to limit garnishment. n5

State wage exemptions commonly follow wages after deposit. n6

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureRemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishments

FOOTNOTES:
(n1)Footnote 1. For a discussion of state wage exemption laws, see National Consumer Law Center, Collection Actions § 12.4.3 (1st ed. 2008 and supp.).

(n2)Footnote 2. *Alaska Stat. §§ 09.38.030*, *09*.38.115; 8 Alaska Admin. *Code 95*.030.

(n3)Footnote 3. Mo. Stat. Ann. § 523.030.

(n4)Footnote 4. *Ohio Rev. Code § 2716.051* (repealed in 1995).

(n5)Footnote 5. *LaFreniere-Nietz v. Nietz, 547 N.W.2d 895 (Minn. Ct. App. 1996)* (statute permitted garnishments of less than statutory maximum; court which allowed garnishment for child support arrearage and forbade further garnishments properly exercised its equitable powers, where larger garnishment might cause father to lose car or apartment, which would likely result in losing job, and where father's financial problems were adversely affecting his visitation with child). *But see Hartford Postal Employees Credit Union v. Rosemond, 33 Conn. App. 395, 635 A.2d 876 (1994)* (power to "modify" wage execution does not include power to vacate it; issuance of wage execution was "mandatory" if judgment debtor did not keep up installment payments).

(n6)Footnote 6. *See In re Arnold, 193 B.R. 897 (Bankr. W.D. Mo. 1996)* (under Missouri law, exempt wages did not lose their exemption by being commingled with other funds in bank account); *Benson v. Richardson, 537 N.W.2d 748 (Iowa 1995)* (under Iowa statute, exempt wages remained exempt for 90 days after deposit in checking or savings account). *But cf. Massachusetts Mut. Life Ins. Co. v. Shoemaker, 849 F. Supp. 30 (S.D. Tex. 1994)* (Texas exemption for "current" wages did not survive deposit); *Frazer, Ryan, Goldberg, Keyt & Lawless v. Smith, 907 P.2d 1384 (Ariz. Ct. App. 1995)* (Arizona wage garnishment statute modelled on federal wage garnishment law did not protect wages after payment).

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1-9 Consumer Credit Law Manual § 9.11

§ 9.11 Protection of Public Assistance Payments

Most public assistance payments made to both single adults and to families are exempt from garnishment under state law. Many states now receive federal funding pursuant to the recently-enacted Temporary Aid to Needy Families ("TANF") statute, *42 U.S.C. sections 601 et seq*. One of the many purposes of the statute, which provides block grant funding to state programs that temporarily assist needy families and has replaced the former Aid to Families with Dependent Children program, is to strengthen the family unit. n1 It would be contrary to the statute's goals if creditors were allowed to attach payments received pursuant to the block grants.

Old age, survivors, and disability benefits are exempt under the Social Security Act. n2 SSI payments are generally exempt under the Social Security Act. n3 Veteran's benefits are generally exempt under the Veteran's Administration Act even after deposit in a checking account. n4 Some states may exempt tax refunds with "earned income tax credit." In addition, at least five states exempt the wages, as well as the benefits, of certain present or former recipients of means-tested benefits. n5 Some states may also exempt tax refunds that consist of the "earned income tax credit." n6

Most, but not all, public assistance exemption provisions continue to protect the funds after payment to the beneficiary. The Social Security Act, which applies to old age, survivors' and disability benefits, n7 and to SSI, n8 explicitly protects both the "right to receive" benefits, and funds "paid or payable" from attachment, garnishment, and "other legal process." The "paid or payable" language clearly exempts the funds in the hands of the recipient. The less explicit language governing Veterans' Disability and Civil Service Retirement benefits has also been construed to exempt funds paid to the recipient. n9 Many states' workers' compensation statutes continue to protect funds in the hands of the beneficiary. In at least a few states, exemption protection is given to real or personal property purchased with benefit payments. n10 Various other state exemptions also survive deposit to the beneficiary's bank account. n11 In at least a few states, exemption protection is also given to real or personal property purchased with benefit payments. n12

[1] FEMA Disaster Relief Assistance

One of the primary federal programs available to help individuals victims of disaster is the Individuals and Households Program (IHP) administered by the Federal Emergency Management Agency. n13 The IHP consists of Housing Assistance, n14 which may be used to pay for rent, repair, or housing construction, and Other Needs Assistance, n15 which may be provided to replace personal property (clothing, furnishings, appliances, etc.) or meet other

disaster-related necessary expenses (e.g., medical, dental, funeral, transportation).

The implementing federal regulation makes all assistance provided through the IHP "exempt from garnishment, seizure, encumbrance, levy, execution, pledge, attachment, release or waiver." n16 The regulation also prohibits recipients from transferring or assigning their rights under the program. However, these limitations do not apply to FEMA recovering assistance fraudulently obtained or misapplied.

While there are no reported cases to date related specifically to the exemption of FEMA benefits, the unprecedented amount of disaster relief distributed by FEMA in the wake of Hurricanes Katrina and Rita may drive abusive creditor practices with respect to these benefits. n17

[2] Deposit of Exempt Funds in Bank Accounts

[a] Key Issues

The continuing protection of exempt funds deposited in bank accounts is especially critical today, as paper checks are being replaced by direct deposit and electronic benefit transfer. The key issues are:

- whether funds remain exempt when deposited in a checking, savings, CD, or similar account
- the amount of exempt funds that may be accumulated before they lose protection
- whether the exemption is lost by commingling with non-exempt funds of the beneficiary or another
- whether the deposited funds are protected against the bank's self-help remedy of set-off for debts owed to the bank
- whether exempt funds are subject to a claim for maintenance or child support or other favored claim.

[b] Are Benefits Exempt Once Deposited in Bank Account?

In *Porter v. Aetna Casualty & Surety Co.*, n18 the Supreme Court held that veterans' disability benefits deposited in a bank account remained exempt so long as they were readily traceable and "retain the quality as moneys," that is, they were readily available for the day to day needs of the recipient and had not been converted into a "permanent investment." This rationale has been widely applied to other exempt benefits, to hold that exempt funds remain exempt when deposited in checking, savings, or CD accounts so long as these are "usual means of safekeeping" for money used for daily living expenses. n19

[c] Accumulation of Excessive Funds

The exemption, even of Social Security and SSI benefits, will be lost if the funds are accumulated beyond the amount needed for daily care and maintenance. n20

[d] Commingling of Exempt and Non-Exempt Funds

Commingling of exempt funds with non-exempt funds, or funds of another, raises the problem of traceability. Most courts will continue to protect such funds, generally applying a first-in, first-out accounting method. n21 However, a minority of courts find that the exemption is lost when funds are commingled. n22

[e] Set-Off

The banker's set-off is a self-help remedy based on the rule that funds deposited in a bank account are a debt owed by the bank to the depositor. This "debt" may then be "set off" against a debt owed by the depositor to the bank. n23 A bank's set-off can devastate a low-income household, if funds required for necessities are removed from their bank account without prior warning.

Very few exemption statutes explicitly mention set-off. A majority of courts, however, consider that the effect of a set-off is the same as that of garnishment, attachment, or other process mentioned in the statute, namely the loss of funds intended to prevent absolute destitution. They then reason that because this is precisely what exemption statutes were designed to prevent, the statutory purpose will best be served by including set-off. n24

[f] Maintenance, Child Support, and Other Claims May Be Allowed Against Exempt Funds

Many exempt funds may be reached for maintenance or child support. The Social Security Act provides a specific exception to the *42 U.S.C. section 407* exemption for these debts, which applies to old age, survivors' and disability benefits, but apparently not to SSI. n25 Veterans' benefits, n26 civil service, military retirement, n27 and workers' compensation benefits may also be reached. n28 However, workers' compensation provided to pay medical expenses may remain exempt. n29

Especially difficult problems arise where the state seeks reimbursement for services provided to benefit recipients, sometimes involuntarily, such as mental hospital expenses or costs of imprisonment, n30 or the services of a guardian or conservator. n31 Exempt property may also be reachable for taxes n32 or for restitution ordered by a criminal court under the Victim and Witness Restitution Act. n33

[g] Liability for Wrongful Seizure of Bank Account Funds

Just as judgment creditors and employers may be liable to their employees for excessive wage garnishment, judgment creditors and banks may be liable for wrongfully seizing funds from the debtor's bank account. For example, in *Cruthis v. Firstar Bank*, N.A., n34 the court upheld a jury determination that the bank had illegally converted funds from plaintiff's checking account. Acting on a letter from plaintiff's employer requesting the return of payroll deposits, the bank withdrew funds from the plaintiff's account without notice. While acknowledging that banks generally have a right to setoff, the court stated that the bank could not "offset" debts owed by the depositor to third parties. However, the court also found that the bank's lack of good judgment did not rise to the level of willful and wanton conduct such that it would support the jury's punitive damages award.

The more difficult question arises where a bank takes exempt funds from a depositor's account pursuant to writ of execution or other court order served by the judgment creditor. Courts have been reluctant to impose liability on banks to determine independently whether funds in an account are exempt. n35 However, given the relative ease with which banks can now determine the source of electronic deposits and whether the accounts contain only exempt funds, n36 more diligence may be required of them to satisfy an ordinary standard of care. Indeed, a California statute requires the garnishee bank to do exactly that. n37

Creditors and creditors' attorneys wrongfully seizing bank account funds may be subject to common law claims such as conversion, negligence, or intentional infliction of emotional distress and to statutory claims for violations of the Fair Debt Collection Practices Act and state UDAP statutes. n38 A recent decision raises the stakes for attorneys submitting affidavits to initiate bank account garnishments. In *Todd v. Weltman*, n39 a collection attorney had obtained a bank account garnishment order by submitting an affidavit stating that "the affiant has a reasonable basis to believe that the [bank] may have property, other than personal earnings, of the judgment debtor that is not exempt under the law of this state or the United States." n40 In fact, according to the complaint, the bank account contained solely Social Security benefits. The plaintiffs alleged that the collection attorney had not conducted a debtor's exam, undertaken discovery, or had any factual basis for believing that the bank account contained non-exempt funds. The Sixth Circuit denied the

attorney's immunity claim and affirmed the district court's order allowing the plaintiff to proceed on his claim that the collection attorney violated the Fair Debt Collection Practices Act by using unfair methods and false, deceptive, and misleading representations to collect the debt.

[h] Counselling Clients to Keep Exempt Funds in Separate Account

Consumers who wish to protect their exempt benefits should keep their funds in banks to which they do not owe money, and should segregate their public assistance funds in special purpose accounts clearly designated as such. If the consumer becomes a judgment debtor, the bank should be immediately reminded, and the creditor informed, of the purpose of the account. If the account is nonetheless garnished or set-off, the consumer may have a cause of action against the creditor for wrongful garnishment. n41

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureRemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsPublic Health & Welfare LawGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *42 U.S.C. § 601(a)(4).*

(n2)Footnote 2. *42 U.S.C. § 407. See Philpott v. Essex Cty. Welfare Bd., 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d 608 (1973)* . For further discussion of exempt status of Social Security and SSI benefits see National Consumer Law Center, Collection Actions § 12.5.5.3 (1st ed. 2008 and supp.).

(n3)Footnote 3. *42 U.S.C. § 1383(d)(1). See also Anderson Boneless Beef v. Sunshine Ctr., 852 P.2d 1340 (Colo. Ct. App. 1993)* (creditor not entitled to garnish Social Security and supplemental security income checks deposited by debtor for care and maintenance of beneficiaries). *Hambrick v. First Security Bank, 336 F. Supp. 2d 890 (E.D. Ark. 2004)* (protects all benefits, lump sum as well as periodic payments); *Binder & Binder, P.C. v. Barnhart, 281 F. Supp. 2d 574 (E.D.N.Y. 2003)* (anti-alienation clause prevented attachment of attorney's charging lien to SSI benefits recovered in proceeding where attorney represented claimant), *vacated on other grounds*, *399 F.3d 128* (2d Cir. Feb. 17, 2005) (jurisdictional grounds).

(n4)Footnote 4. *Porter v. Aetna Cas. & Sur. Co., 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962)* (deposited VA benefits retain exempt characteristic so long as they remain subject to demand and use for needs of recipient for maintenance and support, and not converted to permanent investment); *Strong v. Strong (In re Strong), 2000 MT 178, 8 P.3d 763 (2000)* (VA disability benefits cannot be treated as marital property or otherwise counted in division of property upon divorce, but can be considered in child support determination).

(n5)Footnote 5. Rhode Island, Minnesota, Vermont, New York and Connecticut. For a discussion of state exemptions, see National Consumer Law Center, Fair Debt Collection, § 12.5.5 (5th ed. 2004 and supp.).

(n6)Footnote 6. *See In re Barnett, 214 B.R. 632 (Bankr. W.D. Okla. 1997)* (earned income credit was "earnings from personal services" which may be exempted under provision which permits exemption "by reason of undue hardship" of "that portion of any earnings from personal services necessary for the maintenance of a family or other dependents supported wholly or in part by the earnings of a debtor"); *In re* George (Kirtley v. George), *199 B.R. 60 (Bankr. N.D. Okla. 1996) , magistrate's recommendation, 1997 U.S. Dist. LEXIS 22830* (N.D. Okla. May 27, 1997) , *adopted, rev'd, remanded, 1997 U.S. Dist. LEXIS 22829, 2000-1 U.S. Tax Cas. (CCH) P 50135 (N.D. Okla. 1997)* (federal tax refund consisting of earned income tax credit, for married couple with dependents, was exempt under state exemption for "alimony, support, separate maintenance or child support"so far as reasonably necessary for support of debtors and their children). *Contra In re Fish, 40 C.B.C.2d 1021, 224 B.R. 82 (Bankr. S.D. Ill. 1998)* (earned income

credit was exempt under Illinois exemption for "public assistance"); *In re* McCourt, *217 B.R. 998 (Bankr. S.D. Ohio 1997)* (earned income credit was exempt under Ohio exemption for Aid to Dependent Children); *In re Rutter, 204 B.R. 57 (Bankr. D. Or. 1997)* (earned income credit was not exempt under Oregon exemptions for "general" or "public" assistance, which refer to specific Oregon welfare programs, or for "spousal support, child support or separate maintenance" all of which are defined to refer to specific kinds of court or administrative orders); *In re Goertz, 202 B.R. 614 (Bankr. W.D. Mo. 1996)* (earned income credit was not exempt under Missouri exemption for "local public assistance benefits"); *In re Kurilich, 199 B.R. 161 (Bankr. N.D. Ohio 1996)* (tax refund attributable to earned income credit was not exempt under Ohio's public assistance exemption, which was narrowed by Ohio's elimination of the general relief category of welfare); *In re Beagle, 200 B.R. 595 (Bankr. N.D. Ohio 1996)* (earned income credit was not protected by Ohio exemptions for Aid to Families with Dependent Children [hereinafter AFDC] and disability funds; it had been exempt under former provision exempting "poor relief" which was repealed when Ohio eliminated general relief). *But see Asset Acceptance Corp. v. Hughes, 706 N.W.2d 446 (Mich. Ct. App. 2005)* (state homestead property tax credit not a public assistance benefit).

(n7)Footnote 7. *42 U.S.C. § 407(a).*

(n8)Footnote 8. *42 U.S.C. § 1383(d)(1).*

(n9)Footnote 9. *Porter v. Aetna Cas. & Sur. Co., 370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962)* ; *Tom v. First Am. Credit Union, 151 F.3d 1289 (10th Cir. 1998)* ; *Crawford v. Gould, 56 F.3d 1162 (9th Cir. 1995)* ; *Waggoner v. Game Sales Co., 288 Ark. 179, 702 S.W.2d 808 (1986)* ; Missouri *ex rel. Nixon v. McClure, 969 S.W.2d 801 (Mo. Ct. App. 1998)* ; *Joseph v. Giacalone, 224 A.D.2d 391, 637 N.Y.S.2d 771 (1996)* ; *Gray v. Gray, 922 P.2d 615 (Okla. 1996)* ; *Sears, Roebuck & Co. v. Harris, 854 P.2d 921 (Okla. Ct. App. 1993)* .

(n10)Footnote 10. *See, e.g., In re Ladomer, 215 B.R. 265 (Bankr. S.D. Fla. 1997)* ; *In re Williams, 171 B.R. 451 (Bankr. D.N.H. 1994)* (workers' compensation lump sum deposited in bank account remained exempt, and so did car purchased with lump sum; court noted that workers' compensation proceeds are "meant to be put to useful purposes"); *In re Nelson, 179 B.R. 811 (Bankr. W.D. Va. 1994)* (mobile home and lot purchased with workers' compensation funds); *Broward v. Jacksonville Med. Ctr., 690 So. 2d 589 (Fla. 1997) . But see In re Burchard, 214 B.R. 494 (Bankr. D. Neb. 1997)* (proceeds of personal injury judgment remained exempt while they were "cash or cash equivalent" but exemption did not protect personal property bought with the proceeds); *SSM Health Care Sys. v. Bartel, 914 S.W.2d 8 (Mo. Ct. App. 1995)* ; *Gray v. Gray, 922 P.2d 615 (Okla. 1996)* (veterans' disability funds lost quality of moneys when used to purchase property; specially adapted vehicle was jointly acquired property which could be divided up by divorce judgment).

(n11)Footnote 11. *E.g., Minn. Stat. Ann. § 550.37(14)* and *(20)* (needs-based assistance explicitly protected from set-off or security interest by bank); *Or. Rev. Stat. § 23.166* (exempt funds remain exempt in bank account); *Vt. Stat. Ann. tit. 12, § 2740(19)* (property traceable to debtor's right to receive a long list of exempt funds, including insurance, crime victim's benefits, family support, personal injury recoveries, as well as government benefits); *In re Lazin, 217 B.R. 332 (Bankr. M.D. Fla. 1998)* (proceeds of an annuity); *In re Nye, 210 B.R. 857 (Bankr. D. Colo. 1997)* (earnings of independent contractor); *In re Ryzner, 208 B.R. 568 (Bankr. M.D. Fla. 1997)* (police disability retirement benefits); *In re Norris, 203 B.R. 463 (Bankr. D. Nev. 1996)* ; *Parl v. Parl, 699 So. 2d 765 (Fla. Dist. Ct. App. 1997)* (disability benefits from private insurance).

(n12)Footnote 12. *See In re Williams, 171 B.R. 451 (Bankr. D.N.H. 1994)* (workers' compensation lump sum deposited in bank account remained exempt, as did car purchased with lump sum).

(n13)Footnote 13. The IHP is statutorily authorized under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. *42 U.S.C. §§ 5121-5206*. The Stafford Act authorizes the President to issue major disaster declarations thereby triggering the assistance available through the Act. Through executive orders, the President has delegated responsibility for administering the major provisions of the Act to FEMA. *See* Exec. Order No. 12673, *54 Fed. Reg.*

12571 (Mar. 23, 1989) .

(n14)Footnote 14. *42 U.S.C. § 5174(c)*; *44 C.F.R. § 206.117(b).*

(n15)Footnote 15. *42 U.S.C. § 5174(e)*; *44 C.F.R. § 206.119(a), (b).*

(n16)Footnote 16. *44 C.F.R. § 206.110(g).*

(n17)Footnote 17. As of February 2006, FEMA has committed $6.7 billion in IHP assistance to victims of Hurricane Katrina. *See Hurricane Katrina: What Government is Doing, available at* www.dhs.gov/interweb/assetlibrary/katrina.htm.

(n18)Footnote 18. *370 U.S. 159, 82 S. Ct. 1231, 8 L. Ed. 2d 407 (1962)* .

(n19)Footnote 19. *See In re Radford, 265 B.R. 827 (Bankr. W.D. Mo. 2000)* (lump-sum Social Security Disability payment, received by debtor and deposited in bank account, exempted by "paid or payable" language; no need to determine whether funds necessary for support); *In re Smith, 242 B.R. 427 (Bankr. E.D. Tenn. 1999)* (proceeds of veterans' life insurance policy remained exempt when widow used them to purchase CD, and funds were not commingled with other funds); *E.W. v. Hall, 260 Kan. 99, 917 P.2d 854 (1996)* .

(n20)Footnote 20. *United States v. Devall, 704 F.2d 1513* , *reh'g denied, 714 F.2d 1068 (11th Cir. 1983)* ; *In re Lazin, 217 B.R. 332 (Bankr. M.D. Fla. 1998)* ; *In re Gardiner, 332 B.R. 891 (Bankr. S.D. Cal. 2005)* (asset acquired, in part, with workers' compensation award retained exempt status, subject to tracing requirements).

(n21)Footnote 21. *E.g., In re Mix, 244 B.R. 877 (Bankr. S.D. Fla. 2000)* (workers' compensation settlement remains exempt when deposited in checking account, even if commingled with non-exempt funds, so long as traceable).

(n22)Footnote 22. *E.g., Bernardini v. Century Bank, 223 Va. 519, 290 S.E.2d 863 (1982)* , *superseded by statute as stated in In re Meyer, 211 B.R. 203 (Bankr. E.D. Va. 1997)* .

(n23)Footnote 23. *See Daugherty v. Central Trust Co., 28 Ohio St. 3d 441, 504 N.E.2d 1100 (1986)* .

(n24)Footnote 24. *E.g., Tom v. First Am. Credit Union, 151 F.3d 1289 (10th Cir. 1998)* ; *Marengo v. First Mass. Bank, N.A., 152 F. Supp. 2d 92 (D. Mass. 2001)* (banker's set-off is "other legal process" within the meaning of anti-alienation provisions of Social Security and SSI law); *Kruger v. Wells Fargo Bank, 11 Cal. 3d 352, 113 Cal. Rptr. 449, 521 P.2d 441 (1974)* ; *Atlantic Life Ins. Co. v. Ring, 167 Va. 121, 187 S.E. 449 (1936)* .

(n25)Footnote 25. *See Becker Cty. Human Servs. v. Peppel, 493 N.W.2d 573 (Minn. Ct. App. 1992)* ; Tennessee Dep't of Human Servs. *ex rel. Young v. Young, 802 S.W.2d 594 (Tenn. 1990)* ; Department of Public Aid *ex rel. Lozada v. Rivera, 755 N.E.2d 548 (Ill. App. Ct. 2001)* (SSI benefits already paid to recipient exempt from child support order; where only source of income is SSI, order vacated). *Contra Whitmore v. Kenney, 426 Pa. Super. 233, 626 A.2d 1180 (1993)* , *reh'g denied*, (June 28, 1993), *appeal denied*, *537 Pa. 621, 641 A.2d 587 (1994)* .

(n26)Footnote 26. *Loving v. Sterling, 680 A.2d 1030 (D.C. 1996)* .

(n27)Footnote 27. *42 U.S.C. § 659(f).*

(n28)Footnote 28. *E.g., Cameron v. Hughes, 825 P.2d 882 (Alaska 1992)* .

(n29)Footnote 29. Department of Health & Welfare *ex rel. Lisby v. Lisby, 126 Idaho 776, 890 P.2d 727 (1995)* .

(n30)Footnote 30. *See Bennett v. Arkansas, 485 U.S. 395, 108 S. Ct. 1204, 99 L. Ed. 2d 455 (1988)* ; *Crawford v. Gould, 56 F.3d 1162 (9th Cir. 1995)* ; *Fetterusso v. State of New York, 898 F.2d 322 (2d Cir. 1990)* .

(n31)Footnote 31. *Guardianship of Freida, 43 Mass. App. Ct. 45, 680 N.E.2d 949 (1997)* ; *Conservatorship of Lambert, 143 Cal. App. 3d 239, 191 Cal. Rptr. 725 (1st Dist. 1983)* .

(n32)Footnote 32. *Sills v. Department of the Treasury, IRS (In re Sills), 82 F.3d 111 (5th Cir. 1996)* .

(n33)Footnote 33. *United States v. Eggen, 984 F.2d 848 (7th Cir. 1993)* .

(n34)Footnote 34. *822 N.E.2d 454 (Ill. App. Ct. 2005)* .

(n35)Footnote 35. *See, e.g., Gorstein v. World Sav. Bank, 110 Fed. Appx. 9 (9th Cir. 2004)* (bank has no duty to determine whether portion of funds in account were exempt).

(n36)Footnote 36. *See Mayers v. New York Cmty. Bancorp, Inc., 2005 U.S. Dist. LEXIS 20279* (E.D.N.Y. Aug. 31, 2005) (recent changes in technology, i.e., electronic direct deposit of Social Security benefits and ease of identifying deposits as exempt funds, require a re-evaluation of New York procedure allowing pre-judgment freeze of bank accounts).

(n37)Footnote 37. *Cal. Civ. Proc. Code § 704.080* (West); *see Chung v. Bank of Am., 2004 WL 1938272 (Cal. Ct. App. 2004)* (bank garnishee had duty to verify whether funds were exempt).

(n38)Footnote 38. *See Todd v. Weltman, 434 F.3d 432 (6th Cir. 2006)* ; *Rahaman v. Weber, 2005 Minn. App. LEXIS 32 (Minn. Ct. App. 2005)* (procedure for claiming exemption, including damages if creditor seized exempt property, did not preclude common law causes of action for conversion against creditor and its attorneys). *But see Chung v. Bank of Am., 2004 Cal. App. Unpub. LEXIS 8092 (Cal. Ct. App. 2004)* (stating that bank garnishee had duty to verify whether funds were exempt, not creditor). *But see Beler v. Blatt, Hasenmiller, Liebsker & Moore, LLC, 2006 U.S. Dist. LEXIS 31762* (C.D. Ill. May 18, 2006) (law firm that served citation on bank seeking freeze of "all non-exempt property" and gave examples of exempt property, including SSI, not liable when bank froze account containing only SSI, even though creditor knew that SSI was debtor's only source of income).

(n39)Footnote 39. *434 F.3d 432 (6th Cir. 2006)* .

(n40)Footnote 40. *Id.*; *see also Rahaman v. Weber, 2005 Minn. App. LEXIS 32* (Minn. Ct. App. Jan. 19, 2005) ; *Contact Res. Services, L.L.C. v. Gregory, 806 N.Y.S.2d 407 (N.Y. City Ct. 2005)* (protective order requires creditor to include in pre-judgment restraining notice statement that notice ineffective as to accounts containing only exempt SSI and SSD benefits).

(n41)Footnote 41. *See S&S Diversified Servs., L.L.C. v. Taylor, 897 F. Supp. 549 (D. Wyo. 1995)* (court warns creditor that sanctions can be imposed for an attempt to garnish Social Security funds in bank account).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 9 Garnishment and Exemptions

1-9 Consumer Credit Law Manual § 9.12

§ 9.12 Exemptions for Pensions and Retirement Benefits

[1] Purpose

The purpose of the ERISA, *29 U.S.C. sections 1003(b)*, *1144(a) (1988)*, and the Social Security Act, *42 U.S.C. section 301 (1988)*, is to provide for workers in their old age and to protect workers against hardships created by loss of earnings due to old age or illness. Therefore, federal law and most states exempt at least a portion of benefits received under various employee retirement or pension plans. n1 Sometimes a state's exemption is found in the statute creating or regulating the retirement or pension plan, rather than in a general exemption law. The exemption may continue after the benefits are paid out. n2 The Social Security Act exempts all benefits paid out under the Act and the exemption follows the funds deposited into a checking account. n3 Generally, the courts extend an exemption for employee pension plans to tax-qualified Individual Retirement Accounts ("IRAs"). n4

State exemptions seek to balance the need for security in old age against the possible abuse of retirement accounts to shelter unreasonable amounts from creditors. Some statutes exempt retirement funds so far as "reasonably necessary" for the retiree's needs, n5 others set limits on the amounts which may be transferred into an individual retirement account. These limits may create a hardship for long-term employees who lose their jobs and must roll over substantial sums from their former employer's pension fund into an IRA. As with other exempt property, retirement funds may be subject to garnishment for child support and delinquent taxes. n6 Practitioners are encouraged to refer to state law to determine the available exemptions.

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsPensions & Benefits LawGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See Patterson v. Shumate, 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992)* (Employee Retirement Income Security Accounts [hereinafter ERISA] qualified pension plan funds are not available to creditors in or out of bankruptcy); *Rousey v. Jacoway, 544 U.S. 320, 125 S. Ct. 1561, 161 L. Ed. 2d 563 (2005)* (tax-qualified IRAs, funded by distributions from employer's pension plan, covered by federal bankruptcy exemption for "similar plan ... on

account of ... age" where tax penalty for withdrawal before age 591/2 was "substantial barrier" to early withdrawal); *In re Quinn, 327 B.R. 818 (W.D. Mich. 2005)* (state university retirement plan was an exempt trust; strong anti-alienation language in both plan documents and state statute governing retirement system); *In re Sforzo, 332 B.R. 294 (Bankr. N.D. Ohio 2005)* (ERISA-qualified tax-sheltered annuity was exempted by *Ohio Rev. Code Ann. § 2329.66(a)(17)* "property that is specifically exempted from execution, attachment, garnishment, or sale by federal statutes other than" the bankruptcy law).

(n2)Footnote 2. *In re Meyer, 211 B.R. 203 (Bankr. E.D. Va. 1997)* (military retirement payisexempt under federal law because itisnot listed among the types of federal employee compensation made subject to garnishment by *5 U.S.C. § 5520*, nor listed in regulations as subject to "involuntary allotment"; the payretainsexempt status when directly deposited in Navy Federal Credit Union, but not when transferred to debtor'snon-special purposechecking account in another institution); *In re Bresnahan, 183 B.R. 506 (Bankr. S.D. Ohio 1995)* (retirement pension, exempt under Ohio law so far as reasonably necessary for the support of debtor and dependents,retains its exempt character when deposited in checking account); *Dowling v. Chicago Options Associates, Inc., 847 N.E.2d 741 (Ill. App. Ct. 2006)* (401(k) funds remain exempt after payout if "periodic payments for support" but not if "lump sum available for investment"). *But see Hoult v. Hoult, 373 F.3d 47 (1st Cir. 2004)* (ERISA does not exempt funds in hands of beneficiary; anti-alienation clause not violated by court order requiring judgment debtor to deposit all his income, including ERISA funds, in one bank account, from which he could withdraw only court-approved sum for monthly expenses); *In re McDonald, 2003 WL 23211570* (Bankr. M.D.N.C. Sept. 27, 2003) (funds in ERISA plan lose exemption when paid to beneficiary; funds borrowed from plan and deposited in credit union not exempt, so credit union could set off account); *In re Ryzner, 208 B.R. 568 (Bankr. M.D. Fla. 1997)* (former police officer's disability payments retain their exempt character when deposited in a bank account, so long as they remain traceable); *Briceno v. Briceno, 2007 Tenn. App. LEXIS 719* (Tenn. Ct. App. Nov. 21, 2007) (ERISA exemption ends once funds are disbursed, so family court may impose constructive trust on pension payments after their payment).

(n3)Footnote 3. *42 U.S.C. § 407 (1988). See Philpott v. Essex Cty. Welfare Bd., 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d 608 (1973)* .

(n4)Footnote 4. *See In re Hasse, 246 B.R. 247 (Bankr. E.D. Va. 2000)* (Virginia law allows unlimited exemption for Individual Retirement Account [hereinafter IRA] only if debtor does not have employer-sponsored retirement plan established pursuant to certain sections of the internal revenue code; plan that was similar but not identical to such plans did not bar exemption for IRA); *Hermes v. Ribitwer (In re Hermes), 239 B.R. 491 (Bankr. E.D. Mich. 1999)* (tax-qualified IRA which allowed withdrawals before age 59 subject to a penalty was similar to other plans providing income on account of age, disability, etc. and was exempt); *In re Luttge, 204 B.R. 259 (Bankr. S.D. Fla. 1997)* (tax-qualified IRA was exempt under Florida law, even though it was not covered by ERISA; *C.P. v. Piscataway Township Bd. of Educ., 681 A.2d 105 (N.J. Super. Ct. App. Div. 1996)* (New Jersey statute which exempted "pension funds" covered tax-qualified IRAs). *See also Premier Capital, Inc. v. Decarolis (In re Decarolis), 259 B.R. 467 (B.A.P. 1st Cir. 2001)* (tax-qualified retirement plan is exempt under New Hampshire law, even if amounts deposited in account exceed tax exempt amount, except if fraudulent transfer); *In re Pepmeyer, 273 B.R. 782 (N.D. Iowa 2002)* ("individual retirement annuity," funded with rollover from IRA, a $2000 inheritance, and $2000 per year contributions from debtor, was exempt under Iowa law); *In re Stewart, 246 B.R. 134 (Bankr. D.N.H. 2000)* (tax-qualified IRA fully exempt under N.H. law, but only as to debts incurred after effective date of statute; this limitation does not apply in bankruptcy); *In re MacLean, 2000 Bankr. LEXIS 1796* (Bankr. D.N.H. Mar. 1, 2000) (same); *In re Bissell, 255 B.R. 402 (Bankr. E.D. Va. 2000)* (Virginia debtor had IRA, Simplified Employee Pension [hereinafter SEP] and ERISA pension; Virginia cap cannot be applied to ERISA, and amount in ERISA plan may not be considered in applying cap). *But cf. Lampkins v. Golden, 28 Fed. Appx. 409, 2002 U.S. App. LEXIS 900* (6th Cir. Jan. 17, 2002) (SEP is not protected by ERISA's exemption provision, and ERISA preempts state exemption law that might have applied to it).

(n5)Footnote 5. *See In re* Spenler (Spenler v. Siegel), *212 B.R. 625 (B.A.P. 9th Cir. 1997)* (IRA was not reasonably necessary for debtor's support within California exemption where debtor's Social Security and ERISA pension would provide over $5,000/month after retirement and 55-year old single male debtor was currently earning enough from his

medical practice to enable him to build up a significant amount in his retirement fund over the next 10 years before retirement); *In re Webb, 189 B.R. 144 (Bankr. S.D. Ohio 1995)* (52-year old debtor allowed to exempt all of her IRA as reasonably necessary to support her in retirement, where her ability to save for retirement was limited and average Social Security payment would fall far short of her expenses).

(n6)Footnote 6. *See Sills v. Department of the Treasury, IRS (In re Sills), 82 F.3d 111 (5th Cir. 1996)* (court declined to decide whether house purchased with Workers' Compensation lump sum settlement was exempt from IRS levy; held that even if it was exempt from levy, it remained subject to IRS lien); *Erb v. Erb, 91 Ohio St. 3d 503, 747 N.E.2d 230 (2001)* (anti-alienation provision in police and firefighters' pension fund did not bar court-ordered payments directly to ex-wife, as divorce decree gave wife property interest in pension; statute has since been amended to expressly permit direct payments), *recons. denied, 92 Ohio St. 3d 1451, 751 N.E.2d 487 (2001)* ; *Duke v. Duke, 675 A.2d 822 (R.I. 1996)* (statute forbidding attachment of police and firefighters' pensions did not bar family court from ordering withdrawal of pension funds for child support arrearages; statute applied only to ordinary creditors, not debtors' families).

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PART I Consumer Credit
CHAPTER 9 Garnishment and Exemptions

1-9 Consumer Credit Law Manual § 9.13

§ 9.13 Exemptions for Unemployment and Worker's Compensation Payments

The purpose of the unemployment compensation and workers compensation laws is to provide a substitute for wages lost during a period of unemployment that is not the fault of the employee. State statutes generally exempt this income. n1 Courts have held that the exemption applies both to benefits deposited in bank accounts, and to property purchased with the benefits. n2

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsLabor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationGeneral OverviewWorkers' Compensation & SSDIGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See Gagne v. Christians, 172 B.R. 50 (Bankr. D. Minn. 1994)* (lump sum workers compensation settlement, which served the same purpose as periodic payments, exempt under Minnesota law).

(n2)Footnote 2. *See, e.g., In re Ladomer, 215 B.R. 265 (Bankr. S.D. Fla. 1997)* (Florida exemption for Workers' Compensation benefits protected workers' compensation claims which had been filed but not yet decided, as well as at all later stages through and including deposit in a bank account); *In re Williams, 171 B.R. 451 (Bankr. D.N.H. 1994)* (car; court noted that workers' compensation benefits were "meant to be put to useful purposes").

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1-9 Consumer Credit Law Manual § 9.14

§ 9.14 State Statutes Specifically Limiting Health Care Debt Collection

A few states, recognizing the special burden created by health care debts, have enacted statutes limiting health care debt collection, or otherwise assisting debtors facing health problems. Nevada and Ohio forbid execution on the primary residence for health care debts during the lifetime of the debtor and certain specified dependents; n1 a lien may be created which may be foreclosed only after the residence ceases to be occupied by the protected persons. n2 West Virginia provides a larger homestead exemption for debts resulting from "catastrophic illness or injury." n3 Illinois limits the percentage of a personal injury recovery which may be subject to a lien by certain health care providers. n4

Kansas forbids wage garnishments for two months after the return to employment of a debtor after his/her illness or that of a family member which has kept the debtor out of work for two or more weeks. n5 Wyoming exempts from garnishment contributions to a qualified medical savings account (except for health care debts) to the extent the contributions are allowable under the Internal Revenue Code. n6

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsHealthcare LawGeneral OverviewHealthcare LawInsuranceGeneral OverviewHealthcare LawInsurancePatient Obligations

FOOTNOTES:
(n1)Footnote 1. *Edwards v. McCormick, 136 F. Supp. 2d 795 (S.D. Ohio 2001)* (lawyer-collector violated FDCPA and Ohio Consumer Sales Practices Act by threatening foreclosure on real property owned by Ohio health-care debtors).

(n2)Footnote 2. *Nev. Rev. Stat. § 21.095*; *Ohio Rev. Code Ann. §§ 2329.66A(1)(b)* and *2329.661*.

(n3)Footnote 3. *W. Va. Code § 38-9-3(b)* provides a blanket $5,000 exemption which increases to $7,500 for hospital or medical expenses for catastrophic illness or injury.

(n4)Footnote 4. *But see Burrell v. S. Truss, 176 Ill. 2d 171, 223 Ill. Dec. 457, 679 N.E.2d 1230 (1997)* (where

Illinois had five different health care lien statutes for hospitals, physicians, home health care, etc., limit was construed to mean 1/3 per group, allowing the liens to cumulate to devour the entire recovery).

(n5)Footnote 5. *Kan. Stat. Ann. § 60-2310.*

(n6)Footnote 6. *Wyo. Stat. § 1-20-111.*

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1-9 Consumer Credit Law Manual § 9.15

§ 9.15 Exemptions for Insurance Benefits

Each state exempts a certain amount of insurance benefits from creditors. n1

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureJudgmentsEntry of JudgmentsEnforcement & ExecutionExemptionsCivil ProcedureRemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsHealthcare LawInsuranceGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *In re Romp, 249 B.R. 853 (Bankr. E.D.N.C. 2000)* (proceeds of insurance policy, exempt for deceased spouse's debts, not exempt for joint debts; debtor's insurance policies, the beneficiaries of which are debtor's adult, non-dependent offspring, are exempt). *See also In re Fick, 249 B.R. 108 (Bankr. W.D.N.C. 2000)* (North Carolina exemption for group insurance protects proceeds against creditors of the insured, but not against creditors of the beneficiary). *See, e.g., Society of Lloyd's v. Collins, 284 F.3d 727 (7th Cir. 2002)* (life insurance policy of which spouse was beneficiary exempt under Illinois law, even as to premium payments made after debt accrued, where no showing of fraudulent intent; policies purchased long before debt accrued and debtor simply continued to pay usual premiums); *In re Morehead, 283 F.3d 199 (4th Cir. 2002)* (payments from private disability insurance policy exempt only as needed for support of debtor); *In re Sloss, 279 B.R. 6 (Bankr. D. Mass. 2002)* (exemption for insurance lost when divorce decree made wife, formerly the beneficiary, trustee for the children); *In re Portal, 45 P.3d 891 (N.M. 2002)* (uninsured motorist policy is "accident" policy within the meaning of New Mexico exemption for "payments of every kind from any life, accident or health insurance policy... ."). *But see In re Selfe, 260 B.R. 463 (Bankr. E.D. Mo. 2001)* (proceeds of Federal Employees' Group Life Insurance policy not exempt; life insurance not exempt in Missouri); *In re Ashley, 317 B.R. 352 (Bankr. C.D. Ill. 2004)* (history of Illinois' "convoluted" insurance exemption provisions; widow allowed to exempt proceeds without showing of need). *See also In re Andrews, 301 B.R. 211 (Bankr. N.D. Ohio 2003)* (annuities "upon the life of any person" are fully exempt under Ohio law, but they must serve same purpose as life insurance, i.e., compensate the beneficiary for death of insured and be worth more in hands of beneficiary; not shown where, in case of retiree's early death, beneficiary received same payments as would have gone to retiree). *Plastipak Packaging, Inc. v. DiPasquale, 2003 WL 22120971* (3d Cir. Sept. 12, 2003) (Pa. law) (insurance policy naming spouse as beneficiary is

exempt as to debts of insured even if purchased with intent to hinder creditors); *In re Ashley, 317 B.R. 352 (Bankr. C.D. Ill. 2004)* (widow allowed to exempt proceeds without showing of need). *See also In re Payne, 323 B.R. 723 (B.A.P. 9th Cir. 2005)* (criteria for deciding whether an annuity is exempt life insurance or a non-exempt investment); *In re Kennedy, 2005 Bankr. LEXIS 1994* (B.A.P. 10th Cir. Oct. 19, 2005) (unpublished) (*Colo. Rev. Stat. § 10-7-106* exemption applicable only where life insurance policy or annuities contain anti-alienation provisions).

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1-9 Consumer Credit Law Manual § 9.16

§ 9.16 Exemptions for Personal Property

[1] Purpose

Most states have statutes which exempt a debtor's basic possessions, such as basic furniture, clothes, bedding, cooking utensils, books, tools, heirlooms, and often a vehicle. The purpose of these statutes is to allow the debtors to retain basic necessities for living. The specific items exempted under each state statute differ, usually as a result of the antiquity of the statutes, the geography, and the local economy. For example, states in the north frequently exempt a certain amount of products that are to be used as fuel. Other states with a strong agricultural community allow for a certain amount of crops and farm animals to be retained, in order to allow the debtor to continue to earn a living. In Utah, based on the state's Mormon tradition, food storage programs advocated by that church are protected. n1

Where a statute exempts "necessary" household goods, the question of what is necessary will depend on local usage, and may change over time. For example, televisions and VCRs have become so common that they are likely to be considered necessary. n2 In addition, as personal computers become less a luxury than a fixture in many homes, courts must consider whether they, too, should be exempted. n3

A useful exemption found in many state statutes protects "tools of a trade." This may be used, for example, to exempt a vehicle which is necessary to the debtor's livelihood--although something more than commuting must often be shown. n4 A computer system was found to be a tool of a trade where the employer furnished software so debtor could work at home, even though work at home was not mandatory.

Exemptions for personal property generally do not apply to purchase money debts n5 or criminal forfeitures. n6

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureJudgmentsEntry of JudgmentsEnforcement & ExecutionExemptionsCivil ProcedureRemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishments

FOOTNOTES:

(n1)Footnote 1. For a discussion of state personal property exemption laws, see National Consumer Law Center, Collection Actions, § 12.5.3 (1st ed. 2008 and supp.).

(n2)Footnote 2. *In re Szydlowski, 186 B.R. 907 (Bankr. N.D. Ohio 1995)* (TV, VCR and, for debtor with custody of a child, a video game); *In re Kinnemore, 181 B.R. 516 (Bankr. D. Idaho 1995)* (TV and VCR); *In re Biancavilla, 173 B.R. 930 (Bankr. D. Idaho 1994)* (former luxury items might become so common as to be reasonably necessary household goods--TV and VCR were exempt; recreational equipment and computer system were not household goods, but computer system was tool of trade); *In re Hicks, 276 B.R. 84 (Bankr. W.D. Va. 2001)* (television and VCR exempt; court considered "the standard of living ordinarily enjoyed by a majority of citizens" and "the present state of our technological society").

(n3)Footnote 3. *See In re Ratliff, 209 B.R. 535 (Bankr. W.D. Okla. 1997)* (computer and printer used by children to do homework, and by one debtor who was a student, was exempt under "household and kitchen furniture" exemption); *In re Larson, 203 B.R. 176 (Bankr. W.D. Okla. 1996)* (court declined to exempt a "relatively sophisticated" and "not inexpensive" computer system, but noted that computer is now "a virtual necessity which can be purchased for relatively little").

(n4)Footnote 4. *In re Moore, 251 B.R. 380 (Bankr. W.D. Mo. 2000)* (where Missouri motor vehicle exemption did not explicitly exclude recreational all terrain vehicles, principle of liberal construction required inclusion); *In re Lyall, 193 B.R. 767 (Bankr. E.D. Va. 1996)* (automobile was "necessary" within the meaning of the Virginia "tools of a trade" exemption if debtor would be unable to compete effectively without it; where self-employed architect used car frequently to visit job sites and attend meetings with municipal officials, it was exempt).

(n5)Footnote 5. *See Coonts v. Potts, 316 F.3d 745 (8th Cir. 2003)* ; *In re Johnson, 179 B.R. 800 (Bankr. E.D. Va. 1995)* (where consumer borrowed money from credit union for stated purpose of buying car, but never listed lien on title certificate, debt was purchase money and car was not exempt). *See also In re Rushdi, 174 B.R. 126 (Bankr. D. Idaho 1994)* (where borrowers refinanced several debts, some purchase money, some not, new security interests were all non-purchase money).

(n6)Footnote 6. *State v. One 1965 Red Chevrolet Pickup, 37 P.3d 815 (Okla. 2001)* (exemption from "every other species of forced sale" not broad enough to shield personal property from criminal forfeiture).

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1-9 Consumer Credit Law Manual § 9.17

§ 9.17 Exempt Assets in Bank Accounts

Some states provide for a small amount of money held in a bank account to be exempt, ranging from $100 up to $7500. Also, exempt property, e.g., social security income, that is deposited in a bank account is generally held to remain exempt under state laws if it is not so commingled with nonexempt funds as to be untraceable. n1

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawBank ActivitiesBank AccountsGeneral OverviewBanking LawDepository InstitutionsGeneral OverviewCivil ProcedureJudgmentsEntry of JudgmentsEnforcement & ExecutionExemptionsCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishments

FOOTNOTES:
(n1)Footnote 1. *E.g., In re Smith, 242 B.R. 427 (Bankr. E.D. Tenn. 1999)* (proceeds of veterans' life insurance policy remained exempt when widow used them to purchase CD, and funds were not commingled with other funds).

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1-9 Consumer Credit Law Manual § 9.18

§ 9.18 Personal Injury Judgments

Some states exempt personal injury recoveries. The Maryland exemption for "money payable in the event of sickness, injury or death" was applied to exempt a structured settlement with a present value of $4,000,000 for a debtor who was permanently disabled by his injuries. n1 Some states exempt recoveries onlyso far as reasonably necessary for the support of the debtor. n2 Courts are divided on the question of whether payments for loss of consortium are exempt. n3 Monies stemming from other causes of action may be exempt under a state "wild card" exemption. n4

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureJudgmentsEntry of JudgmentsEnforcement & ExecutionExemptionsCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsTortsDamagesGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *In re Butcher, 189 B.R. 357 (Bankr. D. Md. 1995) . See also In re Hernandez, 272 B.R. 178 (Bankr. D. Md. 2001)* (personal injury recovery exempt only insofar as it compensates for injury to the person, future medical expenses, etc., but not for pre-petition medical expenses sought to be discharged in this bankruptcy; debtor given thirty days to clarify how personal injury settlement allocated).

(n2)Footnote 2. *See In re Gose, 308 B.R. 41 (B.A.P. 9th Cir. 2004)* ; *In re Constantino, 274 B.R. 580 (Bankr. N.D.N.Y. 2002)* (monthly payments under annuity that funded structured settlement were exempt, but not"singular" every five year payments).

(n3)Footnote 3. *See In re Bippert, 311 B.R. 456 (Bankr. W.D. Tex. 2004)* (allowing husband to exempt loss of consortium claim).

(n4)Footnote 4. *See Ball v. Nationscredit Fin. Servs. Corp., 207 B.R. 869 (Bankr. N.D. Ill. 1997)* (Illinois wild card exemption may be used to exempt a cause of action under the Truth in Lending Act); *In re Ball, 201 B.R. 210 (Bankr. N.D. Ill. 1996)* (discussion of how to value claim, for purposes of exemption's $2,000 cap; court chose "settlement value," *i.e.,* amount arrived at by actual negotiations between bankruptcy trustee and defendant lender). *See also In re*

Key, 255 B.R. 217 (Bankr. D. Neb. 2000) (proceeds of cause of action for employment discrimination claim are exempt as "proceeds or benefits" of personal injury claims insofar as they compensate for psychological injury rather than back-pay, but cause of action itself is not exempt).

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1-9 Consumer Credit Law Manual § 9.19

§ 9.19 Internal Revenue Service Operates Under Its Own Exemption Scheme

The U.S. IRS collects federal income taxes subject to wage and property exemptions provided in the Internal Revenue Code. n1 It provides exemptions of income which may be more generous for families and less generous for individuals n2 than the federal wage garnishment protections in the CCPA. n3 It exempts other income, such as unemployment benefits, worker's compensation, and income to fulfill a child support obligation, from IRS seizure. n4 It exempts certain personal property, e.g., wearing apparel, a family's personal effects and furniture, and tools of the trade, from IRS seizure. A homestead exemption is provided to the principal residence unless the IRS district office approves a levy or the IRS Secretary finds collection of the tax is in jeopardy. n5 Other exemption laws are not applicable to the IRS. n6

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureJudgmentsEntry of JudgmentsEnforcement & ExecutionExemptionsCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsTax LawFederal Tax Administration & ProcedureGeneral OverviewTax LawState & Local TaxesAdministration & ProceedingsGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *26 U.S.C. § 6334.*

(n2)Footnote 2. *26 U.S.C. § 6334(d)* provides for weekly exemption of the standard deduction provided by *26 U.S.C. § 63(c)* and the deduction provided for personal exemptions in *26 U.S.C. § 151* divided by 52.

(n3)Footnote 3. *15 U.S.C. §§ 1671 to 1677.*

(n4)Footnote 4. *26 U.S.C. § 6334(a).*

(n5)Footnote 5. *26 U.S.C. § 6334(a)(13)* and *(e)*. Presumably, the IRS district office would have to have good cause as well for allowing a levy on a principle residence to avoid a challenge of arbitrary and capricious conduct. *See also Sills v. Department of Treasury, IRS (In re Sills), 82 F.3d 111 (5th Cir. 1996)* (tax lien can be placed on home even if exempt).

(n6)Footnote 6. *26 U.S.C. § 6334(c). See, e.g., In re* Jones (Jones v. IRS), *206 B.R. 614 (Bankr. D.D.C. 1997)* (broad anti-alienation provision of federal statute governing thrift savings plans did not protect a TSP from federal tax lien and levy; tax statute provided that "notwithstanding any other law of the United States," only property specifically listed in the tax statute--which did not include TSPs--was exempt); *United States v. Bollin, 264 F.3d 391 (4th Cir. 2001)* (federal forfeiture law preempts state law garnishment limitations, so entire IRA subject to forfeiture), *cert. denied, 535 U.S. 989 (2002)* .

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1-9 Consumer Credit Law Manual § 9.20

§ 9.20 Assertion of Exemptions

When creditors attach or execute upon the debtor's property, the debtor generally must assert the protections provided by the exemption statutes affirmatively. In Massachusetts and a few other states, a homestead exemption must have been filed with the recorder of deeds before the debt was incurred.

Different state procedures exist for asserting exemptions. Due process requires that debtors be given notice of the method for asserting major exemptions. Some states may provide a method for a debtor to identify exempt property prior to its seizure. Other states may only provide for the debtor to go into court after the seizure to obtain the return or release of exempt property; given the nature of exempt property, however, this latter approach works a hardship on low-income households. Finally, some states only provide information about exemptions in a post-seizure, pre-sale notice.

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureJudgmentsEntry of JudgmentsEnforcement & ExecutionExemptionsCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishmentsReal Property LawHomestead Exemptions

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1-9 Consumer Credit Law Manual § 9.21

§ 9.21 Proceeds From Sale of Exempt Property

Exemption statutes are not intended to restrict debtors' freedom to dispose of exempt property as they wish. Creditors have no right to complain of the disposition of exempt property. Transfers of exempt property cannot be attached by creditors. n1 Many decisions hold that the proceeds of the sale of exempt property deposited in a bank account are exempt, although commingling with nonexempt funds may present a problem of tracing for some courts. n2

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureJudgmentsEntry of JudgmentsEnforcement & ExecutionExemptionsCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishments

FOOTNOTES:
(n1)Footnote 1. *Anderson v. Odell, 51 Mich. 492, 16 N.W. 870 (1883) . See also Burns v. Miller, Hiersche, Martens & Hayward, P.C., 948 S.W.2d 317 (Tex. App. 1997) .*

(n2)Footnote 2. *See* Vukowich, *Debtors Exemption Rights, 62 Geo. L.J. 779, 826 (1974). But see In re Simpson, 238 B.R. 776 (Bankr. S.D. Ill. 1999)* (insurance payment for damage to vehicle did not fall within exemption for debtor's "interest in a motor vehicle"); *In re Ballato, 318 B.R. 205 (Bankr. M.D. Fla. 2004)* (ex-husband could claim homestead exemption in proceeds of marital home sold by court order during property division; non-occupancy not a bar, where it was required by restraining order); *In re Cumberbatch, 302 B.R. 675 (Bankr. C.D. Cal. 2003)* (court-ordered sale of home during property division was "forced sale to satisfy a money judgment" within meaning of California statute allowing automatic exemption, for six months, for proceeds); *In re Willoughby, 2003 WL 22849766* (Bankr. C.D. Ill. Dec. 2, 2003) (wife's court-ordered payment to husband as compensation for award to her of former marital home was exempt as proceeds of homestead); *Battin v. Bayside Fin. Corp., 2004 Cal. App. Unpub. LEXIS 9338* (Cal. App. Oct. 14, 2004) (unpublished, citation limited) (proceeds of sale of homestead exempt, even for debt that was non-dischargeable in bankruptcy for fraud); *General R.A.C., Inc. v. Coldwell Banker Residential Real Estate, Inc., 876 So. 2d 606 (Fla. App. 2004)* (buyer's deposit, held in escrow by realtor, was proceeds of seller's homestead, exempt for reasonable time).

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1-9 Consumer Credit Law Manual § 9.22

§ 9.22 Waiver of Exemptions

[1] General

Many states prohibit waivers of personal exemptions, considering them to be void and against public policy. n1 The states that do allow waivers generally require that they be in writing, signed by the appropriate parties, and acknowledged. Most exemption statutes provide exceptions for property given as collateral in a security agreement, making collateral subject to seizure by the secured creditors. A Federal Trade Commission rule prohibits waivers of exemptions in contracts other than security agreements. n2

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureJudgmentsEntry of JudgmentsEnforcement & ExecutionExemptionsCivil ProcedureRemediesProvisional RemediesGeneral OverviewCivil ProcedureRemediesProvisional RemediesGarnishments

FOOTNOTES:
(n1)Footnote 1. For a discussion of state laws regarding waiver of exemptions, see National Consumer Law Center, Collection Actions, § 12.8 (1st ed. 2008).

(n2)Footnote 2. *16 C.F.R. § 444.2(a)(2)*, *reprinted in* Vol. 1B *infra*. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 5.6.3.1 (7th ed. 2008 and supp.). For discussion of Federal Trade Commission rule on waivers of exemptions, see National Consumer Law Center, Collection Actions § 12.8.2 (1st ed. 2008 and supp.).

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[b] Consensual Liens vs. Statutory Liens

[c] Sources of Law

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[B] UCC Article 9

[C] UCC Article 2A.

[D] The UCC's Good Faith Requirement; Other Miscellaneous UCC Provisions in Other Articles

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[B] Remedies

[iii] State Deceptive Practices (UDAP) Statutes

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[B] UDAP Statutes' Coverage of Repossession

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[C] Unfair and Deceptive Repossession Practices

[1] Violation of Other Statute as Basis for UDAP Violation

[iv] Common Law Tort Claims

[v] Federal Civil Rights Law

[vi] Truth in Lending and the Consumer Leasing Act

[vii] Federal Fair Debt Collection Practices Act

[viii] State Debt Collection Laws

[ix] U.S. Bankruptcy Code

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PART I Consumer Credit
CHAPTER 10 Repossessions

1-10 Consumer Credit Law Manual § 10.01

§ 10.01 Overviewn1

Consumer rights in repossessions are governed by numerous different federal and state laws, particularly the Uniform Commercial Code Articles ("UCC") 1, 2A, and 9 where personal property is seized. Of almost equal importance are state retail installment sales acts, motor vehicle financing laws, and other state consumer credit legislation, state replevin and foreclosure procedures, state lien laws, state rent-to-own laws, state leasing statutes, state deceptive practices statutes, and state debt collection laws. Applicable federal laws include the U.S. Bankruptcy Code, Truth in Lending ("TIL"), the Federal Fair Debt Collection Practices Act ("FDCPA"), Federal Trade Commission ("FTC") Rules, Office of Thrift Supervision ("OTS") mobile home regulations, the Consumer Leasing Act ("CLA"), the Equal Credit Opportunity Act ("ECOA"), and Civil Rights Acts. Common law tort and contract law also provide consumer remedies.

[1] Key Scope Issues

[a] Personalty vs. Realty

[i] General

A critical first issue in any seizure case is whether the case involves personalty or realty, because very different laws govern the two. The UCC does not apply to real property. n2

In most consumer transactions, it is clear whether the collateral involves realty or personalty. Mobile homes occupy a middle position. The question arises whether it is realty or personalty once it becomes attached semi-permanently to land. The answer to this will vary with each state's law. n3 Personalty includes the proceeds of a contract for the sale of real property, so an Article 9 security interest can be taken in such proceeds. n4

[ii] Where Collateral Includes Both Personalty and Realty

If the creditor's collateral includes both personalty and realty, Revised *UCC section 9-604* [former section 9-501(4)] provides the creditor with an option. The creditor can proceed, upon debtor's default, against the personalty under UCC Article 9, or the creditor can proceed against the realty and personalty pursuant to state real estate law. n5

[b] Consensual Liens vs. Statutory Liens

The UCC explicitly excludes statutory liens from its coverage, n6 and appliesonly to consensual security interests (where the debtor signs an agreement granting the creditor an interest in the debtor's property).

A statutory lien, instead, is created by a specific state statute giving certain parties, such as automotive mechanics or towing companies, the right to seize specified property under certain statutory conditions, such as when the consumer fails to pay for work performed.

UCC section 1-201(35) [former 1-201(37)] specifies when a lease is treated as creating a security interest so that Article 9 applies.

[c] Sources of Law

[i] The Uniform Commercial Code

[A] The Model Code and State Variations

The general framework for repossession law dealing with personalty is set out in the UCC. While all fifty states, the District of Columbia, Guam, and the Virgin Islands have adopted the UCC in most respects, each version is different.

[B] UCC Article 9

UCC Article 9 is the fundamental law regulating security interests and repossession of personal property. Article 9 offers a framework for determining when the creditor has a valid security interest, when and how it can repossess and dispose of the collateral, and the rights of creditor and debtor after the collateral's disposition.

UCC Article 9 applies generally to consensual security interests in personal property and fixtures. n7 It covers pledges, assignments, chattel mortgages, trust deeds, factor's liens, conditional sales, lien contracts, title retention contracts, and leases intended as security. n8

When a secured party fails to comply with UCC Article 9, Revised *UCC section 9-625* specifies the debtor's remedies.

Article 9 of the UCC was substantially revised in 2001. All states and the District of Columbia have adopted Revised Article 9. The more important changes for consumers are noted where appropriate in this chapter.

[C] UCC Article 2A.

UCC Article 2A applies to leases of personal property not governed by Article 9. In general, where Article 9 does not apply to a lease, then Article 2A will be the major source of governing law.

Unlike Revised *UCC section 9-625* [former *UCC section 9-507(1)*], Article 2A provides no statutory damages or other explicit remedies where the lessor fails to comply with Article 2A in enforcing its default remedies. The only special consumer remedy is found in section 2A-108, dealing with unconscionability.

Article 2A also discusses the rules for determining whether a lease is a true lease, which will be governed by Article 2A, or a disguised security interest, in which case Article 9 will apply.

[D] The UCC's Good Faith Requirement; Other Miscellaneous UCC Provisions in Other Articles

One of the most significant and pervasive other sections of the UCC is Revised *UCC section 1-304* [former *UCC*

section 1-203], which states that "Every contract or duty within [this Code] imposes an obligation of good faith in its performances and enforcement."

[ii] State Consumer Credit Legislation

[A] Types of Statutes

The Uniform Consumer Credit Code ("UCCC") and other model credit codes pull together in one source many different pieces of legislation, providing somewhat uniform and coherent standards. n9 But only six states currently use all or most of the 1968 UCCC n10 and four states have adopted major provisions of the 1974 UCCC. n11 Wisconsin's consumer credit code, n12 based on the National Consumer Act, offers significantly more consumer protection than either UCCC version.

A state consumer credit statute is not preempted by the UCC even if not enumerated at Revised *UCC section 9-201*.

[B] Remedies

There is a large variation in the remedies found in state consumer credit legislation. A number of statutes provide for attorneys' fees and substantialstatutory damages, such as forfeiture of all or double the finance charge, plus forfeiture of "other charges."

[iii] State Deceptive Practices (UDAP) Statutes

[A] Overview

State deceptive practices statutes prohibit marketplace deception; many of these statutes also proscribe unfair or unconscionable conduct. Because many statutes prohibit unfair and deceptive acts and practices, these statutes are generally termed "UDAP" statutes. This volume will use the terms state deceptive practices and UDAP statutes interchangeably.

Deception and unfairness are broad, flexible standards; they apply to many forms of abusive repossession, foreclosure, and leasing practices. Even if a practice does not violate the UCC, state consumer credit legislation, state foreclosure laws, or other specialized legislation, aggressive consumer attorneys can often find deceptive or unfair aspects of the practice.

Every state has a deceptive practices statute that authorizes a private damage action. In addition, most deceptive practices statutes provide for attorneys' fees and either multiple, punitive, or statutory damages. n13

[B] UDAP Statutes' Coverage of Repossession

[1] Importance of Examining the Statutory Language

Consumer attorneys, when utilizing a state UDAP statute to challenge repossession, must always make sure that the practices fall within the statute's scope. While UDAP statutes have general applicability to almost all consumer transactions, coverage of repossessions will be an issue in at least certain states.

Absent case law directly considering the coverage of repossession practices, courts should generally follow a state's case law dealing with whether debt collection falls within a state UDAP statute's scope. Where a UDAP statute applies to conduct "in trade or commerce," the statute can be used to challenge debt collection activities. The same is generally the case even where the statute is not so broad, but applies more narrowly to the sale of goods or services or contains similar coverage. n14

Credit practices fall within a statute's scope if it covers practices "in trade or commerce," or if the statute does not specifically contain a limitation that could apply to credit.

[C] Unfair and Deceptive Repossession Practices

[1] Violation of Other Statute as Basis for UDAP Violation

Violation of a statute designed to protect the public is arguably a *per se* violation of a state's UDAP statute.

UDAP statutes may also be utilized to attack adhesion contracts that waive the debtor's right to challenge unlawful repossession practices, or that contain overreaching creditor remedies or unconscionable security arrangements.

[iv] Common Law Tort Claims

Common law tort law concerning conversion, negligence, trespass, assault, infliction of emotional distress, and invasion of privacy has applications when unsecured property is seized, when unlawful methods are used to seize secured or leased property, or when other improper repossession or foreclosure practices are committed.

The UCC preserves common law tort claims such as conversion. n15

For secured transactions that are not covered by Article 9, a court may apply the common law of the pledge, a transfer of property as security for a debt. n16 To create a pledge, there must be a debt, property must be offered to secure the debt, and the property must be transferred from the debtor (pledgor) to the creditor (pledgee). n17 Possession, either actual or symbolic, of the pledged property must be delivered to the pledgee in order to create the lien. n18 If the debtor retains control over the property, the creditor does not have possession, and there is no effective pledge. n19

When a common law pledge exists, the secured party is under a duty to exercise reasonable care to preserve the pledged property. n20 Wrongful disposition of the pledged property, so that it can not be returned to the debtor upon payment of the debt, is conversion. n21

[v] Federal Civil Rights Law

42 U.S.C. section 1983 provides debtors whose property has been seized unconstitutionally with a federal cause of action for actual and punitive damages and attorneys' fees if state action is present.

But consumers can raise such a cause of action relatively infrequently to challenge repossession practices. Sufficient state action is usually lacking for a self-help repossession due process attack, unless state or local officials are involved. Due process protections apply to replevin, but most state replevin procedures have been amended to meet due process requirements. Due process protections may also apply to the enforcement of common law or statutory liens, depending on the extent of state involvement.

[vi] Truth in Lending and the Consumer Leasing Act

The Federal Truth in Lending Act ("TILA") n22 and the Federal CLA n23 provide important consumer rights relevant to repossessions and foreclosures. n24

[vii] Federal Fair Debt Collection Practices Act

The Federal FDCPA n25 has several important applications to repossession practices. Since statutory violations can result in awards to the debtor of actual damages, up to $1000 statutory damages, and attorney fees, FDCPA claims

should be alleged whenever appropriate. n26

[viii] State Debt Collection Laws

The Federal FDCPA generally does not apply to the collection activities of creditors, but only to the collection efforts of independent collection agencies. On the other hand, state debt collection statutes often do apply to creditors, and typically provide private remedies for various forms of debt collection deception or abuse.

[ix] U.S. Bankruptcy Code

The U.S. Bankruptcy Code n27 offers some of the most effective consumer remedies to prevent foreclosures and repossessions. For most debtors, bankruptcy automatically stays all actions against the debtor's secured property. n28 (The 2005 amendments to the Bankruptcy Code have created some exceptions, primarily for repeat filers). It may also allow a debtor to obtain the return of property which has already been seized. n29

[x] State Lien Laws

UCC Article 9 applies only to security interests created by agreement, not to interests in consumers' property created by statute.

[xi] Replevin Procedures

State replevin laws and related court rules are important to repossession law. These state replevin laws, sometimes called detinue, claim and delivery, bail, or sequestration laws, regulate seizures of personal property through judicial action.

[xii] Rent-to-Own Legislation and State Leasing Statutes

Most states have enacted special legislation covering rent-to-own ("RTO") transactions. In many cases, this legislation explicitly ousts the applicability of UCC Article 9 and state consumer credit legislation to RTO transactions and replaces these statutes with only minimal protections for consumers. Remedies vary by statute.

[xiii] Preemption by Federal Law

The Office of the Comptroller of the Currency (OCC) has adopted regulations that broadly preempt certain state laws that interfere with the ability of national banks to operate under uniform federal standards. n30 These regulations do not preempt the UCC, which is a uniform law of general applicability on which parties rely in their daily commercial transactions. n31 Likewise, regulations of the Office of Thrift Supervision, which regulates federal savings and loan associations, specify that state contract and commercial laws are generally not preempted. n32 The OCC did issue an opinion, however, stating that federal law preempted a state law that prevented banks from using auctions open to the public when they disposed of repossessed leased vehicles was preempted. Under the state law, only a licensed motor vehicle dealer or salesperson could offer vehicles for sale at auctions open to the public.

A California state court opinion erroneously concluded that the Office of Thrift Supervision (OTS) regulations preempt a California law that requires a post-repossession notice setting forth the right to redeem, the right to reinstate the contract under state law, and other matters. n33 One problem with this decision is that it applies preemption to retail installment contracts that are generated by motor vehicle dealers and then later assigned to federal savings and loan associations. This interpretation would mean that a contract would be governed by state law at its initiation, but would be stripped of state law protections upon its assignment to the savings and loan, an odd and illogical result. Second, it applies preemption to state repossession protections, even though the OTS preemption regulation lists neither default remedies in general nor repossession in particular as one of the areas preempted. Finally, the decision fails to take

account of the OTS regulation's statement that state contract and commercial laws are not preempted. n34

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewCommercial Law (UCC)General OverviewCommercial Law (UCC)Leases (Article 2A)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionGeneral Overview

FOOTNOTES:
(n1)Footnote 1. For a more extensive treatment of the subject of Repossessions, see National Consumer Law Center, Repossessions (6th ed. 2005 and Supp.)

(n2)Footnote 2. Revised *U.C.C. § 9-109(d)(11)* [former *U.C.C. § 9-104(j)*]; *In re Anthony, 835 P.2d 811, 18 U.C.C. Rep. Serv. 2d 606 (N.M. 1992)* .

(n3)Footnote 3. *See* National Consumer Law Center, Consumer Warranty Law § 17.2 (3d ed. 2006 and Supp.).

(n4)Footnote 4. *U.C.C. § 9-102(a)(2)(i)*; *see In re Nittolo Land Dev. Ass'n, 58 U.C.C. Rep. Serv. 2d 313 (Bankr. S.D.N.Y. 2005)* .

(n5)Footnote 5. Revised *U.C.C. § 9-604* [former *U.C.C. § 9-501(4)*].

(n6)Footnote 6. Revised *U.C.C. § 9-109(d)(1)*, (2) [former *U.C.C. § 9-102(2)*].

(n7)Footnote 7. Revised *U.C.C. § 9-109(a)* [former *U.C.C. § 9-102(1)(a)*]. Selected U.C.C. Article 9 sections are reprinted in Vol. 1A *infra*.

(n8)Footnote 8. Former *U.C.C. § 9-102(2)*. Revised Article deleted this language as superfluous, but the Official Comments state that no change in meaning was intended. Official Comment 2 to Revised *U.C.C. § 9-109*. *See also In re Schwalb, 347 B.R. 726, 60 U.C.C. Rep. Serv. 2d 755 (D. Nev. 2006)* (Article 9 governs auto title pawn transaction).

(n9)Footnote 9. For a detailed discussion of the scope of consumer credit legislation, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses Chs. 2, 9 (4th ed. 2009).

(n10)Footnote 10. *Colo. Rev. Stat. § 5-1-101*; *Ind. Code § 24-4.5-1-101*; *Okla. Stat. Ann. tit. 14A, § 1-101*; *S.C. Code Ann. § 37-1-101*; *Utah Code Ann. § 70C-3-101*; *Wyo. Stat. § 40-14-101*.

(n11)Footnote 11. *Iowa Code Ann. § 537.1101*; *Idaho Code §§ 28-41-101 to 28-49-107*; *Kan. Stat. Ann. § 16a-1-101*; Me. Rev. Stat. Ann. tit. 9A, § 1-101.

(n12)Footnote 12. *Wis. Stat. § 421.101*.

(n13)Footnote 13. *See generally* Ch. 4, "Unfair and Deceptive Credit Practices," *supra*.

(n14)Footnote 14. *See In re Western Acceptance Corp., 117 Idaho 399, 788 P.2d 214 (1990)* .

(n15)Footnote 15. *U.C.C. § 1-103*; Official Comment 12 to Revised *U.C.C. § 9-620*; Official Comment 3 to Revised *U.C.C. § 9-625* ("principles of tort law supplement this subsection"); *see Fleet Capital Corp. v. Yamaha Motor Corp., 48 U.C.C. Rep. Serv. 2d 1137 (S.D.N.Y. 2002)* .

(n16)Footnote 16. *In re Alabama Land & Mineral Corp., 292 F.3d 1319, 48 U.C.C. Rep. Serv. 2d 379 (11th Cir.*

2002) (Kentucky law).

(n17)Footnote 17. *In re Alabama Land & Mineral Corp., 292 F.3d 1319, 48 U.C.C. Rep. Serv. 2d 379 (11th Cir. 2002)* (Kentucky law); *see In re Section 20 Land Group, Ltd., 261 B.R. 721 (Bankr. M.D. Fla. 2001) . See also In re Timothy Dean Restaurant & Bar, 342 B.R. 1, 59 U.C.C. Rep. Serv. 2d 485, 499 (D.D.C. 2006)* .

(n18)Footnote 18. *In re Alabama Land & Mineral Corp., 292 F.3d 1319, 48 U.C.C. Rep. Serv. 2d 379 (11th Cir. 2002)* (Kentucky law); *Ellefson v. Centech Corp., 606 N.W.2d 324 (Iowa 2000)* (pledge of bank accounts is effective only if pledgee has absolute, unequivocal, and exclusive possession and control); *Walton v. Piqua State Bank, 466 P.2d 316 (Kan. 1970)* (pledge of savings account ineffective without delivery of passbook).

(n19)Footnote 19. *In re Section 20 Land Group, Ltd., 261 B.R. 721 (Bankr. M.D. Fla. 2001)* (finding effective pledge when debtor did not retain control).

(n20)Footnote 20. *Premier Capital, Inc. v. Grossman, 789 A.2d 565 (Conn. App. Ct. 2002)* .

(n21)Footnote 21. *Premier Capital, Inc. v. Grossman, 789 A.2d 565 (Conn. App. Ct. 2002)* .

(n22)Footnote 22. *15 U.S.C. § 1601*. The Truth in Lending Act [hereinafter TILA] is reprinted in Vol. 1A *infra*.

(n23)Footnote 23. *15 U.S.C. § 1667*. The Consumer Leasing Act [hereinafter CLA] is reprinted in Vol. 1A *infra*.

(n24)Footnote 24. *See* Ch. 13 *supra*.

(n25)Footnote 25. *15 U.S.C. § 1692*. The Fair Debt Collection Practices Act [hereinafter FDCPA] is reprinted in Vol. 1A *infra*.

(n26)Footnote 26. *See* Ch. 8 *supra*.

(n27)Footnote 27. *11 U.S.C. §§ 101-1330*.

(n28)Footnote 28. *11 U.S.C. § 362*.

(n29)Footnote 29. *11 U.S.C. §§ 542*, *543*. See National Consumer Law Center, Repossessions Ch. 8 (6th ed. 2005 and Supp.), for discussion of using bankruptcy to prevent a repossession. *See also* National Consumer Law Center, Consumer Bankruptcy Law and Practice (8th ed. 2006 and supp.).

(n30)Footnote 30. *12 C.F.R. §§ 7.4007*, *7.4008*.

(n31)Footnote 31. Office of the Comptroller of the Currency, Interpretive Letter #1005 (June 10, 2004), *available at* www.occ.treas.gov/interp/sep04/int1005.pdf; *see also U.C.C. § 9-109(c)(1)* (Article 9 is inapplicable to the extent it is preempted by federal law); Official Comment 6 to *U.C.C. § 9-109* (Article 9 defers to federal law only when and to the extent that it must because of preemption).

(n32)Footnote 32. Office of the Comptroller of the Currency, Preemption Opinion, *66 Fed. Reg. 23,977* (May 10, 2001) .

(n33)Footnote 33. WFS Fin., Inc. v. Super. Ct., *44 Cal. Rptr. 3d 561 (Ct. App. 2006)* .

(n34)Footnote 34. *12 C.F.R. § 560.2(c)(1)*.

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PART I Consumer Credit
CHAPTER 10 Repossessions

1-10 Consumer Credit Law Manual § 10.02

§ 10.02 Enforceable Security Interests

[1] Valid Security Interest as Precondition to Seizure of Personal Property

[a] UCC Article 9 Authorizes Seizure of Property Only Where There Is a Valid Security Interest.

A valid security interest is a precondition to a creditor's right to seize collateral either through self-help repossession or through a court replevin procedure. Every state has enacted UCC Article 9, and, for transactions within its scope, Article 9 allows seizure of property where the property is subject to a security interest. n1

The security interest cannot be enforced unless the debtor has signed a security agreement describing the collateral (or the creditor has possession of the collateral pursuant to an agreement), value has been given, and the debtor has rights in the collateral. n2 In addition, security interests are not enforceable to the extent to which they are limited by another statute or regulation. n3

[b] Article 9 Applies to Credit Transactions No Matter How Structured

UCC Article 9 rules as to the enforceability of security interests apply generally to any type of creditor interest in property where the intent of that interest is to secure payment or performance of an obligation. No matter how a sale or loan is structured, or how a creditor labels the interest it retains in property, the creditor can only seize the property if the creditor has created a valid security interest in the property pursuant to Article 9.

[c] Where Article 9 Does Not Apply

[i] General

The exclusions to UCC Article 9 are set out in Revised *UCC section 9-109(d)* [former *UCC section 9-104*].

[ii] Statutory Liens

State legislation and common law principles give artisans, mechanics, warehousemen, and others liens in the consumer's property when the consumer has not paid for repairs, improvements, or storage. These liens, like security agreements,

authorize lien holders to dispose of the debtor's property without judicial process.

If the possessory interest is an artisan's lien created by statute or common law, the UCC does not govern that interest. n4

[iii] Interests in Realty

UCC Article 9 applies only to interests in personal property, and does not apply to interests in real estate. n5

[iv] Leases

Revised *UCC section 1-201(35)* [former *UCC section 1-201(37)*] sets out detailed standards as to whether a lease is really intended for security (in which case UCC Article 9 requirements apply), or whether the transaction is a true lease (in which case Article 9 does not apply).

[v] Consignments and Bailments

Consumers may obtain or relinquish possession of property pursuant to a consignment or bailment. The consumer's right to return of the property is thus not conditioned on the consumer creating a valid security interest in the property. Instead, the relationship is governed by other state law.

Under common law, a bailment contract, express or implied, is created when someone delivers personal property into the possession of another person in trust for a specific purpose, subject to agreement that the property will eventually be returned to the owner. n6 A classic example of a bailment would be turning possessions over to a moving company for the purpose of moving them to a new home. Most sale transactions do not contemplate that the buyer will return the property to the seller, and, therefore, a critical element of a bailment is missing. Accordingly, a security interest in that property should not be labeled a bailment. n7

Even if a transaction can fairly be characterized as a bailment, it still cannot escape Article 9's requirements if the seller intended to create a security interest: "The article does not in terms abolish existing security devices. The conditional sale or bailment-lease, for example, is not prohibited; but even though it is used, the rules of this article govern." n8 Thus, although a seller may expressly retain title to the conveyed property, if the circumstances show that the title was retained for the purpose of securing payment of a debt, the transaction falls squarely within Article 9. n9

In addition, Revised Article 9 will cover "consignments." n10 However, the definition of a consignment covered by Revised Article 9 includes a requirement that the goods being consigned "are not consumer goods immediately before delivery." n11 "Consumer goods," in turn, are "goods that are used or bought for use primarily for personal, family, or household purposes." n12 It seems likely, therefore, that the rights of consumers in consignment situations will continue to be governed by non-Article 9 law.

[2] Elements of a Valid Security Interest

[a] Uniform Standards Except for Possessory Security Interests

UCC Article 9 sets out one set of minimum standards for creation of any valid security interest.

The basic UCC requirements for creation of an enforceable security interest are:

- The creditor must give value;

- The debtor must have rights in the collateral or power to transfer rights in the collateral to a secured party; and

- With some exceptions, the debtor must have signed or otherwise authenticated a security agreement that describes the collateral. n13

No matter how a transaction is structured, if UCC Article 9 applies, the creditor must meet these minimum requirements to obtain an enforceable interest in the property.

The UCC rules as to the enforceability of security interests apply to all forms of security interests with one exception. The Article 9 requirement as to a signed security agreement describing the collateral does not apply to pawns, pledges, and other possessory security interests; that is, where the creditor has physical possession of the property. In addition, Revised Article 9, reflecting the rise of electronic commerce, now allows security agreements to be "authenticated" rather than signed. n14

[b] Written Agreement Must Specifically Grant Security Interest

[i] Agreement Must Be a Written or Electronic Document

For a security interest to attach (unless the creditor retains possession (or control under Revised Article 9) of the property), there must be a written agreement. However, Revised Article 9 allows the security agreement to be electronic, rather than paper, and the consumer's signature can be an electronic signature. n15 An oral security agreement is ineffective. n16

[ii] Agreement Must Specifically Grant the Security Interest

The writing must specifically grant, create, or provide for a security interest. n17 Security interests are not created by: a mere promissory note and sales contract; a simple bill of sale in which the seller is listed as a secured party; the indication on the certificate of title of the existence of a lien or security interest; the listing of the title in the creditor's name; a financing statement unless the financing statement in itself meets all the requirements of a security agreement; an application for a certificate of title, describing the collateral and signed by the debtor; a signed revolving credit application and agreement which does not granta security interest; charge slips granting a security interest in the items purchased with reference to a charge agreement that is not offered in evidence; or an "acknowledgment" that the debtor would not transfer title to the collateral.

[iii] Is Truth in Lending Disclosure an Adequate Grant?

The Federal TILA requires that creditors disclose any security interest they take in a credit transaction. n18 Creditors thus must comply with two separate requirements when they obtain a security interest: they must obtain from the consumer a written grant of the security interest, and they must then disclose that security interest to the consumer in a manner complying with TILA.

Typically, creditors use one document as a promissory note, Truth in Lending disclosure, and security agreement, and then pattern the Truth in Lending disclosures after the Federal Reserve Board model disclosure forms. Since the segregated disclosure is not signed by the debtor and often does not meet specificity requirements of Article 9, it may not meet the minimum preconditions for creation of a security interest.

If the TILA disclosure is not adequate to *grant* a security interest, and the interest is not granted elsewhere, there is no enforceable security interest. If the interest described in the TILA disclosure is not valid, the TIL disclosure of the interest is inaccurate, and this may be a TIL violation. Then, even if the invalid security interest is never enforced, the TILA violation will lead to statutory damages and attorney fees.

[c] Debtor Must Sign the Agreement

[i] General

The UCC requires that the written or electronic security agreement be authenticated by the debtor. n19 A signature is a type of "authentication," but the term also includes electronic signatures and other similar methods. n20 Failure to obtain the debtor's signature defeats the security interest, making it unenforceable against the debtor or third parties.

The signature requirement is in the nature of a statute of frauds and cannot be circumvented by showing an intent by the parties that the agreement be effective. n21

While requiring strict compliance with the signature rule, the UCC defines "signed" broadly as including "any symbol executed or adopted by a party with present intention to authenticate a writing." n22 The 1999 revisions to Article 9 contemplate electronic as well as paper security agreements, and allow electronic signatures. n23

For a valid security interest, the creditor must obtain the signature not of the person borrowing the money, but of the person that presently owns the collateral. n24

[d] Unchecked Boxes, Blanks, and Amendments

Because a security agreement must be in writing and signed, lenders are strictly held to the version of the security agreement that was signed by the debtor, which could include blank spaces or errors in marking boxes.

Leaving blanks in credit documents usually violates retail installment sales acts, motor vehicle financing acts, or other state legislation. In addition, where a security agreement is signed with blanks that are filled in later by the creditor, the security agreement is at best effective only as to its content with the blanks not filled in. Accordingly, if the description of the collateral was originally left blank, there is no security interest. n25

The strict signature requirement also applies to all changes or additions to the security agreement. If a debtor does not sign or initial subsequent changes to the agreement, those changes are not enforceable.

However, oral agreements may modify inessential terms of the security agreement.

[e] Creditor Must Give Value

A security interest does not attach until value has been given for the security interest. n26 The concept of value is broader than the contract concept of consideration. n27

[f] Debtor Must Have Rights in Collateral

Another precondition to the creation of a valid security interest is that the debtor has rights in the collateral. n28 A creditor cannot enforce a security interest in property if the debtor neither owns nor has an interest in that property. n29 Revised *UCC section 9-203(b)(2)* expands this precondition, saying that the debtor must have rights in the collateral or the power to transfer rights in the collateral to a secured party. If the debtor transfers the property after the creditor's security interest is created, however, the interest attaches.

[g] Security Agreement Must Identify the Collateral

[i] General Rule

UCC Article 9 requires that the security agreement describe the collateral. n30 The basic rule under the UCC is that a description of the collateral must be specific enough to allow creditors' agents, sheriffs, and others to distinguish between goods subject to a security interest and the debtor's other similar property not subject to the security interest.

n31

Creditors need not list with great specificity each item of collateral as long as the general description adequately and uniquely identifies the collateral. Identifying the collateral as "a type of collateral defined in" the UCC is also sufficient as a general rule. n32 It appears that "equipment," "inventory," and "commercial tort claim" are all examples of "types" of collateral defined in the UCC, n33 and that "type" is a broader term than "category." n34 However, there are important exceptions to the general rule that a description by type is sufficient. n35

[ii] Relationship to Collateral's Description in the Financing Statement

It is important to distinguish two questions: Is a description of collateral in a security agreement sufficient identification to create a valid security interest, and is the description in a financing statement adequate to put creditors on notice of a potential security interest. The security agreement signed by the consumer grants the security interest. The creditor can then insure its priority in that collateral as against other creditors by perfecting that security interest, such as by filing a financing statement that describes the collateral.

A description of collateral found in a financing statement may be adequate for purposes of perfecting a security interest, but may be inadequate for purposes of creating the security interest. n36 The security agreement requires specification of the collateral to allow identification. The financing statement need only contain enough of a description to put other creditors on notice that a further inquiry is necessary to determine the exact nature of the first creditor's security interest.

In addition, a financing statement that indicates more collateral than provided for in the security agreement is not effective to expand the collateral. n37 It is the security agreement, not the financing statement, that controls the extent of the collateral. n38

[iii] Where Collateral Identification Is Accidentally Omitted

The requirement that the collateral be described in the security agreement is a strict one. An unintentional omission can prevent the security interest from being enforceable. Creditors often get into trouble by indicating in the security agreement that collateral is described in an attachment which, in fact, is not attached. This defeats the security interest in the intended collateral. However, the creditor may be able to obtain a court order reforming the security agreement under the common law of mutual mistake. n39

[iv] Relationship to Truth in Lending Disclosure of Security Interest

The Federal TILA n40 requires that security interests in consumer transactions be clearly and conspicuously disclosed. This disclosure, along with certain other TIL disclosures, must be segregated from other information not required by TIL, and be in a form which the borrower may keep. n41

This requirement has at least four implications for consumer attorneys examining the validity of a security interest:

- Failure to properly disclose valid security interests subjects the creditor to TILA statutory damages, actual damages, and attorney fees whether or not the security interest is ever enforced;

- Where creditors rely solely on the TILA disclosure to create the security interest, the disclosure's description of the collateral may not meet UCC minimum standards for identifying the collateral;

- If the collateral description is different in the TILA disclosure than in the security agreement, this may lead not only to a TILA violation, but may even invalidate the security interest;

- If the interest described in the TILA disclosure turns out to be invalid, this may also be a TILA violation.

[h] Security Interest Must Not Otherwise Be Prohibited

The UCC sets out minimum standards for a valid security interest. But certain interests meeting these minimum standards are not valid security interests because of the operation of other law--tate statutes, federal rules, case law, and even UCC Article 9. n42 Revised Article 9 is more explicit about its subordinate relationship to other laws, recognizing that applicable consumer laws and regulations also apply to transactions subject to Article 9, and that, if there is a conflict, other law controls. n43

[i] Perfection of Security Interest Is Not Necessary

A common misunderstanding concerns the relationship between a creditor's right to repossess and the requirement that a creditor perfect a security interest through a financing statement, motor vehicle certificate of title, or otherwise. Perfection of a security interest is necessary only if the secured party wants to protect itself against the claims of other creditors and retain its special status when the debtor files for bankruptcy.

Perfecting a security interest neither gives a creditor further rights against its debtor nor assists it in repossessing the collateral. In the normal case, whether a security interest is perfected has no bearing on the creditor's right to repossess. n44

Revised Article 9 contains new choice-of-law rules with respect to the law governing perfection and priority. Among these changes are:

- The revisions change the choice-of-law rule governing perfection for most collateral to the law of the jurisdiction where the debtor is located. n45

- A "registered organization" is considered located in the state under whose law the debtor is organized, *e.g.,* a corporate debtor's state of incorporation. n46

- An individual debtor is located at his/her principal residence. n47

Revised Article 9 also enables states to move toward paperless filing systems, although it does not mandate such systems. n48

[3] Continued Enforceability After Security Interest Created

[a] Introduction

This section considers the continued enforceability of a security interest after the security interest is created, when the consumer transfers ownership of the collateral, the obligation is refinanced, the creditor assigns the security interest, or the consumer's obligation secured by the collateral has been extinguished.

[b] Secured Party's Interest in Proceeds of Collateral

Secured parties have a security interest in the proceeds of their collateral. Proceeds are whatever is received when collateral or proceeds from that collateral is sold, exchanged, or otherwise disposed. n49 Creditors do not have to specify in the security agreement that they are retaining an interest in proceeds. A securityinterest automatically "continues in any identifiable proceeds ... received by the debtor." n50 The secured party can only reach proceeds that are identifiable. n51

Upon default, creditors can repossess any replacement or substitute property that the debtor has exchanged for the secured property and any goods purchased from identifiable proceeds from the sale of the secured property.

The UCC specifically recognizes insurance payments on loss to collateral as proceeds if payable to a party to the security agreement. n52

[c] When Debtor Transfers Collateral to Third Party

[i] General

Creditors may agree that a consumer can transfer collateral to another party free and clear of the security interest, often in consideration of payment of all or part of the obligation. The creditor's authorization of the transfer terminates the creditor's security interest in the collateral, n53 although the creditor can obviously enter into a separate security agreement with the transferee.

Usually the security agreement will prohibit the debtor from transferring the collateral without the creditor's permission. Nevertheless, debtors may transfer secured property to third parties not realizing that they are breaching the security agreement. Other debtors faced with imminent repossession of their property may attempt to avoid seizure by transferring the property to a third party. The debtor, of course, will still owe the creditor on the obligation, but the creditor's leverage against the debtor will have diminished since there is no property to repossess.

The cash or property the debtor receives from the third-party transferee is "proceeds," which can be repossessed by the secured party, if those proceeds can be traced to the sale of the collateral.

[ii] Creditors With Unperfected Security Interests

Creditors with unperfected security interests are extremely vulnerable. A creditor with an unperfected security interest has rights subordinate to a buyer, even if the buyer is not in the ordinary course of business. n54

[iii] Creditors Whose Interests Are Automatically Perfected

When a creditor takes a purchase money security interest in consumer goods other than motor vehicles, the creditor's security interest is perfected automatically without the need for filing a financing statement. n55 Creditors with automatically perfected security interests have rights over all third-party transferees except buyers of consumer goods purchasing the goods without knowledge of the security interest, for value, and for the buyer's own personal, family, or household purposes. n56

Revised Article 9 lists various types of security interests as to which no public notice step is required for perfection. These security interests are perfected when they attach. n57

[iv] Perfection by Filing Financing Statement or Indicating Lien on Certificate of Title

A creditor that files a financing statement or fully complies with a state's motor vehicle certificate of title provisions has superior rights over all third-party transferees, assuming the creditor can find the collateral.

For items other than motor vehicles, creditors partially protected against third party transferees under an automatically perfected security interest can improve their priority over innocent consumer buyers by filing a financing statement to perfect their interest.

[d] Refinancing of Indebtedness

Many consumer credit transactions are refinanced. Case law is split on the issue of whether the old security agreement continues in force if a new security agreement drawn up at refinancing leaves out some collateral. n58

[e] Assignment of Security Agreement

Consumer credit agreements are often assigned. If the security agreement is not also properly assigned, the new creditor may not have the right to repossess.

[f] Where Underlying Obligation Is Extinguished

If the underlying obligation is extinguished, there is no security interest and there can be no repossession. If a security interest in consumer goods was perfected by a financing statement or a notation on the title, the 1999 revisions to Article 9 require the creditor to file a statement that the security interest is terminated within one month n59 after the obligation is extinguished by payment or otherwise. n60 Statutory damages of $500 are available for noncompliance. n61 The pre-1999 version of Article 9 was similar, but provided for only $100 statutory damages, required a quicker response by the creditor in some circumstances, and was less clear about whether it applied to security interest perfected by a notation on a certificate of title. n62 A consumer whose creditor wrongfully refuses to release a security interest may also have a UDAP claim or a common law claim of slander of title.

[4] Non-Purchase Money Security Interests

[a] General

Creditors taking these security interests rarely intend to enforce them, but only retain such collateral for the *in terrorem* effect and as an excuse to sell credit property insurance.

[b] FTC Rule Prohibits Non-Purchase Money Security Interests in Household Goods

[i] Introduction

The FTC's Trade Regulation Rule Concerning Credit Practices (and related federal rules) prohibits non-possessory, non-purchase money security interests in consumers' household goods. n63 The Rule has three important limitations.

- It does not apply to pawned items or other possessory security interests.
- It does not apply to purchase money security interests.
- It does not even apply to non-possessory, non-purchase money security interests in collateral other than household goods.

[ii] FTC Definition of Household Goods

[A] Items That Are Household Goods

The definition of household goods is critical to an understanding of the scope of the FTC Rule.

Household goods are defined in the FTC Rule as including clothing, furniture, appliances, linens, china, crockery, kitchenware, and "personal effects" of the consumer and the consumer's dependents. n64

[B] Limited Exceptions for Electronic Equipment, Jewelry, Antiques, and Art

The Rule explicitly excludes certain items from the definition of household goods. One radio and one television are considered household goods protected by the Rule, but the Rule does not prohibit a creditor from taking security interests in additional televisions or radios. n65 The Rule also excludes from the definition of household goods other types of "electronic entertainment equipment." n66 The FTC staff has interpreted this to exclude from the Rule's coverage VCRs, stereo equipment, tape players, home computers and computer equipment.

The Rule also explicitly excludes jewelry other than wedding rings, works of art and items *acquired* as antiques. n67

[C] Other Items That Are Not Household Goods

The FTC also excludes boats, snowmobiles, cameras, planes, and home workshops from the definition of household goods. Motor vehicles do not fall within the rule's definition of household goods. n68

[D] Comparison to Bankruptcy Code

A debtor in bankruptcy can avoid a non-possessory, non-purchase money security interest in household furnishings, household goods, wearing apparel, appliances, and certain other items held primarily for the personal, family, or household use of the debtor or a dependent of the debtor. n69 Until 2005, many bankruptcy courts declined to export the FTC's narrow definition of "household goods" into this lien avoidance provision. n70 As a result, a debtor who filedbankruptcy could free some items of personal property from security interests that the FTC Rule permitted.

Effective October 17, 2005, however, the Bankruptcy Code was amended to define "household goods" in a way nearly identical to the definition in the FTC Rule. n71 Some items that do not qualify as household goods under this narrowed definition may still qualify for lien avoidance as tools of the trade, books, musical instruments, or one of the other categories listed in the bankruptcy statute.

Bankruptcy law draws a distinction between non-purchase money security interests that are possessory and those that are non-possessory. n72 For example, a pawnbroker also takes a non-purchase money security interest in household goods, but this security interest is a possessory one. Automobile pawns, in which the lender usually does *not* take possession of the collateral, are discussed in *§ 10.02[5][e]*, *infra*.

[iii] Creditors Covered by the Rule

The FTC Rule applies to finance companies, credit unions, retailers, and other creditors within the FTC's jurisdiction. Though the FTC Rule does not apply to savings and loans and banks, the Office of Thrift Supervision and the Federal Reserve Board have adopted virtually the same rule for savings and loan institutions and all other banks, respectively. The FTC Rule also prohibits covered creditors from purchasing contracts containing the prohibited security interests. n73

The FTC Rule applies to lenders and also to "retail installment sellers," anyone who sells goods or services to consumers on a deferred payment basis or pursuant to a lease-purchase arrangement. n74

[iv] Remedies for FTC Rule Violations

Rule violations may lead to FTC enforcement actions. Courts consistently view that a security interest in violation of the FTC Rule is unenforceable. n75

[c] Other Restrictions on Non-Purchase Money Security Interests

Consumers in bankruptcy can avoid non-purchase money security interests in household goods to the extent that the property is otherwise exempt. A number of state laws provide various consumer protections concerning non-purchase

money security interests. n76

[d] Unfairness, Unconscionability, and Related Challenges

Even if the FTC Credit Practices Rule and state law do not prohibit a non-purchase money security interest in the consumer items, the creditor's conduct may still be challenged as unfair, deceptive, unconscionable, or in bad faith.

[e] Does Description Adequately Identify Non-Purchase Money Collateral?

[i] Introduction

Unless the creditor describes in detail each item of collateral, the creditor risks invalidating its security interest for failing to identify the collateral.

[ii] Does Collateral Description Distinguish After-Acquired Property?

[A] The UCC Limitation on After-Acquired Property

The UCC does not permit creditors to enforce security interests in consumer goods where the goods are acquired more than ten days after the secured party gives value. n77

[B] Loan Collateral Must Be Distinguished From After-Acquired Property

If the blanket description is inadequate to distinguish after-acquired property, the security interest should not attach and should not be enforceable for any of the consumer goods, even for goods acquired before the security agreement.

[iii] Identification of Televisions, Radios, Musical Instruments, and Antiques

The FTC Credit Practices Rule prohibits non-purchase money interests in one television and one radio. To effectively take an interest, the creditor will have to identify the collateral to distinguish it from the consumer's other television or radio (similarly with musical instruments and antiques).

[iv] Distinguishing Between Debtor's Property and That Owned by Other Household Members

The agreement must still allow sheriffs and repossessors to distinguish collateral owned by the signatory from similar property owned by others in the household.

[f] Is Negative Equity Owed on Trade-In Vehicle Part of Purchase Money Obligation for New Vehicle?

[i] Introduction

An increasingly common question is whether an obligation that covers not only the price of a car but also the trade-in vehicle's negative equity qualifies as a purchase money obligation. This question is particularly important in the bankruptcy context, as the "hanging paragraph" of *11 U.S.C. § 1325(a)* prohibits cram-down in certain circumstances in which the creditor has a purchase money security interest in a motor vehicle. If the negative equity portion of the debt does not qualify as a purchase money obligation, then the debtor can make use of the cram-down right for at least the negative equity portion, and possibly for the entire debt.

[ii] Is the Existence of a PMSI a State or Federal Law Question?

The Bankruptcy Code does not define the term "purchase money security interest" (PMSI). Most courts consider the definition for purposes of the Bankruptcy Code to be a question of state law. n78 However, one court has concluded that

the question should be resolved as a matter of federal common law. n79

[iii] UCC Definition of PMSI

Assuming that state law applies, most courts start by referring to *section 9-103 of the UCC*, which defines "purchase-money obligation" as one "incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used." n80

The terms "price of the collateral" and "value given to enable the debtor to acquire rights in the collateral" are not defined in the UCC itself. However, these terms are given further meaning by official comment 3, which states: "the 'price' of collateral or the 'value given to enable' includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative changes, expenses of collection and enforcement, attorney's fees, and other *similar* obligations" (emphasis added).

[iv] Courts Holding Negative Equity Is Not Part of Purchase Money Obligation

Many courts have applied the UCC definitions to hold that the negative equity in the trade-in vehicle is neither part of the "price" of the new vehicle nor "value given to enable the debtor to acquire rights" in it. n81 These courts note that negative equity is not one of the enumerated items in the official comment and is not similar to any of those items. Because negative equity is so commonly financed in vehicle sales, it would be odd for the drafters not to have mentioned it if they had intended to include it. n82

[v] Courts Holding Negative Equity Is Part of Purchase Money Obligation

Despite all this authority, other courts have found ways to hold that the negative equity in a trade-in vehicle is part of the price of the new vehicle. Some of these courts hold that negative equity meets the UCC definition of "purchase money obligation" because it is an integral part of the sales transaction or is part of the value that enables the debtor to acquire rights in the collateral. n83 Others have relied on a broad definition of purchase price in the state installment sales law. n84 However, the UCC should be construed *in pari materia* with other state statutes only if they concern the same subject matter, relate to the same person or class of persons, or have the same object or purpose. n85 Non-UCC state statutes may not meet these criteria. n86

[vi] Consequences If Negative Equity Is Not Part of Purchase Money Obligation: The Transformation Rule Versus the Dual Status Rule

If the court concludes that the negative equity portion of the obligation is not a purchase money obligation, the next question is what effect does that have on the applicability of the hanging paragraph. Some courts have held that the Bankruptcy Code itself requires the entire obligation to be non-PMSI in order for the debtor to be denied the right of cram-down. n87 This conclusion is consistent with the rule that an exception to an otherwise general rule, such as that created by the hanging paragraph, should be construed narrowly. n88 In addition, the hanging paragraph does not include the language "to the extent" that is found in other parts of the Bankruptcy Code, and allows cram-down to be denied only if a purchase money security interest secures "*the* debt," rather than "any part of the debt." n89

Other courts, though, have looked to whether state law adopts the "transformation" rule or the "dual status" rule. Courts applying the transformation rule to consumer transactions typically determine that the entire loan amount lacks purchase money status when a portion of the loan is not purchase money. n90 States applying the dual purpose rule hold that the purchase money portion of an obligation retains its purchase money status even though another portion of the obligation is not purchase money. n91

The UCC adopts the dual status rule for transactions other than consumer-goods transactions, but explicitly disclaims

any intention to establish a rule for consumer-goods transactions. n92 However Florida, Idaho, Indiana, Kansas, Maryland, Nebraska, North Dakota, and South Dakota adopted non-uniform amendments applying the dual status rule to consumer-goods transactions as well.

[5] Automobiles and Mobile Homes as Collateral

[a] Introduction

Automobiles, mobile homes, and related vehicles are the most important forms of personal property collateral in consumer loans.

[b] Minimum Requirements for Creation of Security Interests in Cars and Mobile Homes

Merely indicating a lien on the certificate of title does not create the security interest. n93 For either the title or the title application to create a security interest, the document must meet all the requirements of a security interest -- the consumer must grant the interest in writing, describe the collateral, and sign the writing. In some states, statutes provide that no court shall recognize the right, title, claim, or interest of any person in or to any motor vehicle or mobile home sold, disposed of, mortgaged, or encumbered, unless evidenced by the certificate of title. n94 In these states, there may be an argument that the failure of a creditor to indicate its name on the title as a lienholder not only means that the security interest is unperfected but also means that there is no security interest.

[c] Security Interests in Property Added to the Vehicle or Mobile Home

[i] Property Pre-Dating the Security Agreement

In general, when a loan is used to purchase not only the vehicle or home, but also additional items to be attached to the vehicle or home, the creditor can take a security interest in all of that property simply by adequately identifying it in the security agreement.

On the other hand, if the security agreement does not adequately identify all the items, then the creditor loses its interest in items not described, even if the interest would have been a purchase money interest.

[ii] Property Added After the Security Agreement Is Signed (Accessions)

Creditors can take a security interest in accessions (goods installed or affixed to other goods) even in consumer transactions and even if such property is acquired after the security agreement, if the security agreement specifically mentions accessions.

[d] Insurance Proceeds and Trade-Ins

Secured parties automatically have a security interest in any proceeds from the collateral. Consequently, when a consumer trades in a car or mobile home, the creditor with a security interest in the trade-in retains its security interest in the new vehicle or home.

[e] Auto Pawns

If an "auto pawn" actually transfers possession of the vehicle to the creditor, then a valid security agreement has been created as long as the transfer was pursuant to an agreement. If the lender does not have actual possession, then the lender must comply with UCC requirements on the creation of a valid security agreement. n95

Sometimes, an automobile dealer delivers the car to the consumer but keeps the certificate of title in the dealership's

name. Who owns the car in this situation? Whether title to a car transfers upon its delivery to a buyer raises issues under both the state's Certificate of Title statute and *UCC section 2-401* (Passing of Title; Reservation for Security).

Every state has a statute that provides for the transfer of a vehicle's certificate of title upon sale by a seller to a purchaser. The statutes of some states merely provide that the seller shall execute an assignment on the certificate of title to the transferee and deliver it at the time of delivery of the vehicle, without providing consequences for the failure to so deliver the certificate. n96 "Strict-title" states, however, have certificate of title statutes that provide that a sale without transfer of the certificate of title is ineffective or void. n97 Still other states have statutes that fall in between, providing that notwithstanding the failure to comply, the transfer is still good "as between the parties," but void otherwise, establishing the equivalent of a requirement for perfection of the security interest. n98 If the certificate of title statute does not dictate a conclusion about who owns the item, the rules of *UCC section 2-401* may determine the issue.

If the transaction is not voided by a "strict title" statute, and under the rules of section 2-401 title has passed to the buyer, then the most the dealer can claim is a security interest in the car, notwithstanding that it retained the car's title.

Alabama, Florida, Georgia, Idaho, Kentucky, Minnesota, Mississippi, Missouri, Montana, New Hampshire, Ohio, Oregon, South Carolina, South Dakota, Tennessee, and Utah have special auto title pawn laws, n99 but none of these statutes contains any specific exemption from Article 9, and the statutes of six states specifically say that Article 9 applies. n100 Florida's law, while not making a blanket exemption from Article 9 for title pawn transactions, provides that the title pawn law controls in the event of a conflict with Article 9. n101

[6] Credit Card Issuer's Interest in Goods Purchased With Card

[a] Introduction

Bank and other third party credit card issuers (*e.g.,* VISA, MasterCard, Discover, American Express, Diners) do *not* take security interests in the property purchased with the card. But some merchants, particularly sellers of consumer hard goods and electronics, issue store credit cards that attempt to take security interests in items purchased with the card. Examples are Sears and Radio Shack.

From the outset, the card issuer views the security interest as leverage in the event that the debtor runs into problems making payments.

Nevertheless, the FTC Rule does not apply to credit card purchases.

[b] Is There a Valid Security Agreement?

[i] UCC Requirements

The debtor must sign a security agreement granting the security interest. Creditors can use the charge slip to try to create a security agreement, as long as the consumer signs the slip, and the slip adequately identifies the collateral and specifically grants the security interest.

[ii] Can the Store Produce the Necessary Records?

In many cases, the store will not have records of the credit contract or the signed sales slip; they will be missing, illegible, or unintelligible as to the items purchased.

[c] Is the Collateral Adequately Described?

The creditor must identify the collateral being taken so that repossessors, sheriffs, and others know which property to seize and which to leave alone. n102

[d] Determining Which Collateral Is Paid Off First

Card issuers seeking security interests in the property being purchased must be able to identify which items have been paid in full (thus extinguishing the security interest in those items). The card issuer will have to specify in the security agreement the method of allocating the consumer's payments to various items purchased, this method must comply with state law, and the merchant must, in fact, have records reflecting its compliance with this method.

[e] State Laws Prohibiting Credit Card Security Interests

Security interests in store credit card purchases may be limited or prohibited by state law that limits the enforcement of such interests. For example, New York prohibits security interests in any item purchased for less than $200. n103

In addition, federal and state laws that prohibit collectors from threatening actions they do not intend to take may come into play here.

[7] Series of Purchases From the Same Merchant

[a] Introduction

Merchants attempt to extend their interest to all items purchased from that merchant through use of cross-collateral clauses (that take as security property previously purchased from that merchant), by consolidating the series of loans into one loan retaining all the collateral previously taken by individual loans, or by applying consumer payments on a pro rata basis to all outstanding loans (instead of applying payments in the order of purchase).

[b] Cross-Collateral Clauses

Such a clause states that the present credit-sale obligation is secured not only by the item being purchased, but also by any other item purchased from the same merchant in the past.

To take cross-collateral, the merchant has to properly draft the security agreement and be specific enough. The cross-collateral clause also runs into trouble with the FTC Credit Practices Rule to the extent that any of the earlier purchased goods fall within the Rule's definition of household goods. State retail installment sales acts may limit a merchant's security interest to the product being purchased, effectively prohibiting cross-collateral clauses. Some laws require that consumer payments be applied to the first item purchased, and that the security interest be extinguished once that item is paid off. This is the approach taken by the UCCC. Courts may find the provision unconscionable or unenforceable

[c] Loan Consolidations

Merchants can avoid the FTC Credit Practices Rule's restriction on cross-collateral clauses, while achieving the same result, by consolidating several different credit sales into one loan secured by all of the items purchased. The FTC Rule does not prohibit cross-collateral if the collateral is taken in a refinancing or consolidation of the original purchase money transaction.

Nevertheless, for the merchant to consolidate various consumer loans, the merchant must have authority to do this under state law. Consolidations also cannot take security interests in prior purchases that have already been paid off. Taking such paid-off purchases as security should run afoul of the FTC Credit Practices Rule.

Furthermore, some state laws specify that even when loans are consolidated, the security on the first-purchased items be released after that purchase has been repaid under a FIFO formula.

[d] Methods of Allocating Consumer Payments to Multiple Purchases

Pro rata application of payments also has the same effect as an after-acquired *property clause*. The leading case disapproving the pro rata payment method is *Williams v. Walker-Thomas Furniture Co.* n104

[8] Refinancings and Consolidations

[a] Introduction

Finance companies and other lenders often refinance or consolidate consumer obligations. The lender may attempt to retain security from an earlier loan as security for the loan that refinances or consolidates that earlier loan.

[b] Article 9 Requirements to Preserve Prior Collateral in a Refinancing

[i] Does the Security Interest Survive Automatically?

Courts generally find that a "renewal" of a loan automatically keeps preexisting collateral as security for the new loan, even if the security is not mentioned in the new loan.

On the other hand, a "novation," whereby the old loan is extinguished and a new loan created, does not automatically retain prior collateral. In that case, the old security interest is extinguished, and the only collateral for the new loan is that which is created pursuant to a new security agreement in conjunction with the new loan.

Unfortunately, there are no uniform standards to determine in a close case whether a loan is a renewal or a novation.

Assuming that a refinancing is treated as a novation, and not a renewal, the prior security interest is not automatically extended. Instead, the refinancing must include a new signed security agreement identifying the collateral.

[c] FTC Credit Practices Rule Generally Inapplicable

Purchase money interests in household goods are allowed, and the FTC finds that a refinancing or consolidation of a prior purchase money interest continues this purchase money interest for purposes of the FTC Rule, even if the refinancing extends new credit or consolidates additional loans.

State law restrictions on non-purchase money security interests could also apply.

[9] Future Advance and Antecedent Debt Clauses

[a] General

Future advance clauses, also known as dragnet or anaconda n105 clauses, allow creditors to continue their security interest not only in the present loan, but in future loans between that creditor and that debtor, even though the future loan does not explicitly grant the security interest. The clause in the first loan states that the collateral in that loan also secures any future indebtedness between the lender and the consumer.

Another variant is the preexisting or antecedent debt clause, where the loan states that its collateral secures not only that loan, but any *earlier* loan betweenthe lender and the consumer, even if that earlier loan had been unsecured. The courts, the FTC Credit Practices Rule, and other law severely restrict the use of future advance and antecedent debt clauses in

consumer transactions.

When future advances or antecedent debts take household goods as security, these are non-possessory, non-purchase money security interests violating the FTC Credit Practices Rule.

There are also Truth in Lending implications when lenders use future advance clauses in one loan. Subsequent loans with that lender must disclose under Truth in Lending that collateral securing the first indebtedness also secures that subsequent loan.

The 1999 revisions to Article 9 make no substantive changes in the language of Section 9-204 that authorizes future advance clauses. n106 Nonetheless, one of the comments states: "This Article rejects the holdings of cases decided under former Article 9 that applied other tests, such as whether a future advance clause or other subsequently incurred obligation was of the same or a similar type or class as earlier advances and obligations secured by the collateral." n107 In similar situations, courts have disregarded comments that are at variance with the language of the Code. n108 But even the test that the comment espouses -- "construing the parties' agreement under applicable law" -- is broad enough to include the factors courts have used in the past, including the parties' intent, whether the transactions are related, and whether the secured party relied on the collateral in issuing the otherwise unsecured loan. "Agreement" is defined as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or use of trade or course of performance. ..." (emphasis added). n109

[b] Judicial Reluctance to Enforce Future Advance Clauses

Despite the UCC's seeming validation of future advance clauses, some courts are reluctant to enforce such provisions. Many courts will, however, enforce these clauses provided that the terms are clear and unambiguous. n110 Courts are likely to show a similar reluctance to enforce antecedent or preexisting debt clauses, and will only do so where the preexisting debt is explicitly identified. The First Circuit has relied on the new Official Comment to hold, in a case involving sophisticated commercial entities, that a dragnet clause was valid regardless of whether it was restricted to advances of the same type as the original advance. n111

Some courts have held that a subsequent extension of credit constitutes a novation of the original debt, thereby extinguishing any future advance clause in the original loan. n112 Courts will look to the intent of the parties to determine if the new loan constituted a novation. Absent some explicit language or other showing of intent, most courts have been reluctant to find that a new extension of credit constitutes a novation. n113 Antecedent debt clauses may also be inapplicable if the subsequent loan involves different parties than the antecedent debt. In one case a court found that an antecedent debt clause in a note and security agreement signed by three co-makers did not secure the prior individual debt of one of the co-makers. n114

[c] Status of Negative Equity Trade-In as Antecedent Debt Rather Than Purchase Money Security Interest

Courts attempting to determine the purchase money status of loans that include negative equity in a trade-in vehicle often look to the state's version of Article 9 or other state law. The critical question is typically whether the state applies the dual purpose rule or the transformation rule to consumer transactions. States applying the transformation rule to consumer transactions often determine that the entire loan amount lacks purchase money status when a portion of the loan covers negative equity in a vehicle the consumer previously owned. n115 States applying the dual purpose rule have found that borrowing an amount in excess of the cash price of the new car in order to pay off the negative equity on the trade-in is not a requirement to gain a legal interest in the new vehicle but rather an accommodation on the part of the lender, and that therefore only the cash price portion is eligible for purchase money status. n116 Such courts have found that the money lent to pay off the trade-in is actually an antecedent debt. Some courts have looked to other state law in making this determination. n117 This determination can be especially important in the bankruptcy context.

[10] Consumer Remedies

[a] Remedies for Mere Inclusion of Invalid Security

[i] Introduction

The mere inclusion of an invalid security interest in the loan agreement can lead to significant consumer remedies even if the lender never enforces the invalid interest and never even threatens to enforce the interest.

[ii] Sale of Credit Property Insurance on Invalid Collateral

Lenders normally require consumers to purchase credit property insurance to protect the collateral, insurance the consumer would not purchase otherwise. This requirement can lead to significant violations of federal and state law where the lender requires that insurance be purchased on property that is not in fact collateral, including specific state insurance laws.

[iii] Unnecessary Filing Fees or Nonfiling Insurance

The mere inclusion of an invalid security interest also leads to the consumer being charged for unnecessary filing fees or nonfiling insurance. The practice may violate state credit legislation and state deceptive practices statutes.

[iv] Overinclusive Description of Collateral

Identification, in the security agreement and other loan documents, of a security interest that is in fact invalid may also lead to violation of federal and state laws concerned with accurate disclosures to consumers. Many of these statutes provide for minimum statutory damages and attorney fees even where actual damages are not proved.

[b] Remedies for Threats to Enforce an Invalid Security Interest

Where a lender threatens to enforce a security interest that is in fact invalid, the consumer has two types of remedies. The first is for the mere inclusion of the invalid interest in the loan documents. The second is for the false threat.

The threat to enforce a security interest that is in fact invalid and unenforceable violates several laws: the Federal FDCPA, state debt collection laws, and state deceptive practices statutes.

[c] Remedies for Enforcement of Invalid Security Interests

A valid security interest in secured property is a prerequisite to the seller's repossession of that property. When the security interest has not attached or is unenforceable, repossession is unlawful. The UCC provides the debtor with a number of remedies against the creditor who repossesses without a valid security interest, including restraining orders and damages.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Secured Transactions (Article 9)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionEnforcement

FOOTNOTES:
(n1)Footnote 1. Revised *U.C.C. § 9-609* [former *U.C.C. § 9-503*] authorizes the seizure of collateral which is defined in Revised *U.C.C. § 9-102(a)(12)* [former *U.C.C. § 9-105(c)*] as property subject to a security interest.

(n2)Footnote 2. Revised *U.C.C. § 9-203(b)* [former *U.C.C. § 9-203(1)*].

(n3)Footnote 3. Revised *U.C.C. § 9-109(c)* [former *U.C.C. § 9-201*].

(n4)Footnote 4. Revised *U.C.C. § 9-109(d)(2)* [former *U.C.C. §§ 9-102(2), 9-109(c)*].

(n5)Footnote 5. Revised *U.C.C. § 9-109(d)(11)* [former *U.C.C. § 9-104(j)*]. *Munson v. Countrywide Home Loans, Inc., 67 U.C.C. Rep. Serv. 2d 692 (E.D. Mich. 2008)* (Article 9 does not govern sales of foreclosed real property). *See generally* National Consumer Law Center, Foreclosures Appx. C (2d ed. 2007 and Supp.).

(n6)Footnote 6. *See, e.g., Sgro v. Getty Petroleum Corp., 854 F. Supp. 1164, 1174 (D.N.J. 1994)* , *aff'd per curiam, 96 F.3d 1434 (3d Cir. 1996)* ; *Pagliai v. Del Re, 2001 U.S. Dist. LEXIS 2195* (S.D.N.Y. Mar. 7, 2001) (defining elements of bailment; finding that gallery owner was bailee of plaintiff's painting), *aff'd as modified, 34 Fed. Appx. 36 (2d Cir. 2002)* ; *Kormi v. Kormi, 1998 U.S. Dist. LEXIS 3402* (E.D. Pa. Mar. 17, 1998) (elements); *see* 8A Am. Jur. 2d *Bailments* (1997).

(n7)Footnote 7. *Uni-Products, Inc. v. Bearse, 153 B.R. 764, 767 (Bankr. E.D. Mich. 1993)* (where no evidence that seller delivered the property to the debtor for any reason other than because the seller had sold it to the debtor, no issue for trial as to bailment); *see* 8 Am. Jur. 2d *Bailments* § 39 (1980) ("[a] conditional sale imports an absolute obligation on the part of the purchaser to pay the purchase price, while a bailee may relieve himself of further liability by surrender of the property, and in a bailment for hire by payment for use of the thing let or bailed").

(n8)Footnote 8. Former *U.C.C. § 9-102*, Official Comment 1. Revised Article 9 deleted this language as superfluous, butthe Official Comments state that no change in meaning was intended. Official Comment 2 to Revised *U.C.C. § 9-109. See Greene v. Assocs. (In re Greene), 248 B.R. 583 (Bankr. N.D. Ala. 2000)* ; *Uni-Products, Inc. v. Bearse, 153 B.R. 764 (Bankr. E.D. Mich. 1993)* (even if characterized as a bailment, U.C.C. Article 9 controlled when seller's purpose was to retain a security interest); *Tilghman Hardware v. Larrimore, 331 Md. 390, 628 A.2d 215 (1993)* (Article 9 applies to a bailment used as a security device); *Industrial Valley Bank & Trust Co. v. Nash, 349 Pa. Super. 27, 502 A.2d 1254 (1985)* (U.C.C. Article 9, not just Motor Vehicle Sales Finance Act, applied to repossession of automobile). In contrast, a true bailment is one where the bailee takes possession of the property expecting to either return it to the bailor or to dispose of it pursuant to the bailor's instructions. *See, e.g., Sgro v. Getty Petroleum Corp., 854 F. Supp. 1164 (D.N.J. 1994)* , *aff'd per curiam, 96 F.3d 1434 (3d Cir. 1996)* (defendant petroleum company loaned tanks and related equipment to plaintiff for the purpose of storing, handling and dispensing defendant's products; agreement specified that the equipment would permanently remain the property of the defendant).

(n9)Footnote 9. *Uni-Products, Inc. v. Bearse, 153 B.R. 764, 767 (Bankr. E.D. Mich. 1993)* ; *Cox Motor Co. v. Faber, 113 So. 2d 771, 773 (Fla. Dist. Ct. App. 1959)* (though sales contract for car stated that no "right, title or interest" in the vehicle would pass to the buyer until either the purchase price had been paid in full or a satisfactory financing agreement had been made, transaction was a conditional sale, not a bailment, even though it contemplated the execution of another contract to secure payment of the purchase price; stated language referred only to passage of legal title, not a beneficial interest, to the buyer). *But see Peak v. Ted Russell Enters., Inc., 2000 Tenn. App. LEXIS 120* (Tenn. Ct. App. Feb. 28, 2000) (bailment arose when plaintiffs signed a contract to purchase truck from defendant dealer conditioned upon approval of financing and dealer repossessed truck upon inability to find financing under the original terms contracted for; because the contract stated that defendant dealer retained ownership until the transaction was completed, no security interest arose and U.C.C. did not apply).

(n10)Footnote 10. Revised *U.C.C. § 9-104(a)(4)*.

(n11)Footnote 11. Revised *U.C.C. § 9-102(a)(20)(c). Cf. Tabar v. Charlie's Towing Serv., Inc., 97 Ohio App. 3d 423, 646 N.E.2d 1132 (1994)* (list of elements of bailment; no implied bailment where parties were not in privity).

(n12)Footnote 12. Revised *U.C.C. § 9-102(a)(23)*.

(n13)Footnote 13. *U.C.C. § 9-203(b).*

(n14)Footnote 14. Revised *U.C.C. § 9-203(b)(3)(A).*

(n15)Footnote 15. Revised *U.C.C. § 9-102(a)(7)(B)*, (a)(69) (definitions of "authenticate" and "record").

(n16)Footnote 16. *In re Miller, 320 B.R. 911, 56 U.C.C. Rep. Serv. 2d 499 (Bankr. E.D. Mo. 2005)* .

(n17)Footnote 17. *Expeditors Int'l v. Official Creditors Comm. of CFLC, Inc. (In re CFLC, Inc.), 166 F.3d 1012 (9th Cir. 1999)* , *aff'g 209 B.R. 508 (B.A.P. 9th Cir. 1997)* . *See Lashua v. La Duke, 272 A.D.2d 750, 707 N.Y.S.2d 542, 41 U.C.C. Rep. Serv. 2d 930 (2000)* (signed financing statement met all requirements for security agreement); *In re Stevens Point Associated, Inc., 1991 WL 11002287* (Bankr. W.D. Wis. Dec. 24, 1991) (document saying that title remained in seller did not create security interest in favor of auction, nor did language "this vehicle subject to a lien"); *Empresas Berrios v. Ortiz, 295 B.R. 158 (B.A.P. 1st Cir. 2003)* (decided under comparable provisions of Puerto Rico law); *In re Sabol, 337 B.R. 195, 58 U.C.C. Rep. Serv. 2d 756 (Bankr. C.D. Ill. 2006)* (unsigned financing statement that was not presented to debtor at closing is insufficient). *In re Schwalb, 347 B.R. 726, 742, 60 U.C.C. Rep. Serv. 2d 755 (D. Nev. 2006)* ("you are giving a security interest in [the vehicle]" is sufficient); *see also In re Verus Inv. Mgmt., L.L.C., 344 B.R. 536, 60 U.C.C. Rep. Serv. 2d 60 (Bankr. N.D. Ohio 2006)* (construing real estate lease as creating security interest in security deposit). *Ariza v. Long, 65 U.C.C. Rep. Serv. 2d 147 (Tex. App. 2008)* (letter to former roommate, stating that he could keep household goods as collateral for debt, was security agreement); *Flager, 63 U.C.C. Rep. Serv. 2d 22 (Bankr. M.D. Ga. 2007)* (construing promissory note, which did not mention any collateral, along with title application, which listed lender as lienholder, and concluding that they created security agreement).

(n18)Footnote 18. *15 U.S.C. § 1638(a)(9)*; *see generally* Ch. 1, "Truth in Lending," *§§ 1.05*, *1.07 supra* .

(n19)Footnote 19. *U.C.C. § 9-203(b)* [former *U.C.C. § 9-203(1)(a)*]; *cf. Falconbridge U.S., Inc. v. Bank One Ill., 227 F.3d 928 (7th Cir. 2000)* (under Illinois law, creditor need not sign security agreement when creditor "indicated acceptance through performance"). *Tyler v. Rapid Cash, L.L.C., 930 So. 2d 1135 (La. Ct. App. 2006)* (title pawn lender had no security interest when transaction was structured as a sale of the collateral with a side agreement that the debtor could repurchase it, and debtor never signed a security agreement).

(n20)Footnote 20. *U.C.C. § 9-102(a)(7)* (definition of authenticate); Official Comment 9(b) to *U.C.C. § 9-102*.

(n21)Footnote 21. Revised *U.C.C. § 9-203*, Official Comment 3.

(n22)Footnote 22. Former *U.C.C. § 1-201(39)*.

(n23)Footnote 23. Revised *U.C.C. § 9-203(b)(3)(A)*; *see* Revised *U.C.C. § 9-102(a)(7)* (definition of "authenticate").

(n24)Footnote 24. *Cargill Inc. v. Trico Steel Co. (In re Trico Steel Co.), 282 B.R. 318, 48 U.C.C. Rep. Serv. 2d 1004 (Bankr. D. Del. 2002)* (buyer of goods that had not yet been delivered did not have sufficient rights to grant security interest); *South Main St. v. CMB Assocs., 49 U.C.C. Rep. Serv. 2d 601 (Conn. Super. Ct. 2002)* (security interest in all personal property of tenant at the leased premises did not attach until tenant acquired personal property); *Conister Trust Ltd. v. Boating Corp., 2002 Tenn. App. LEXIS 183* (Tenn. Ct. App. Mar. 14, 2002) (buyer who has merely ordered goods does not have sufficient rights to give security interest); *Arcadia Fin., Ltd. v. Southwest-Tex Leasing Co., 78 S.W.3d 619, 47 U.C.C. Rep. Serv. 2d 1371 (Tex. App. 2002)* (when sale from wholesaler to retailer was not complete, retailer had no rights in the property and could not grant security interest).

(n25)Footnote 25. *In re Hein, 20 U.C.C. Rep. Serv. 745 (Bankr. W.D. Wis. 1976)* . *See also In re Hillman, 94 B.R. 18, 7 U.C.C. Rep. Serv. 2d 907 (Bankr. D. Conn. 1988)* (no security interest where blanks never filled in); *In re Kane, 20 B.R. 700, 34 U.C.C. Rep. Serv. 702 (Bankr. D.S.C. 1982)* .

(n26)Footnote 26. Revised *U.C.C. § 9-203(b)(1)* [former *U.C.C. § 9-203(1)(b)*].

(n27)Footnote 27. *In re Blackerby, 53 B.R. 649, 42 U.C.C. Rep. Serv. 1033 (Bankr. N.D. Ala. 1985)* .

(n28)Footnote 28. Revised *U.C.C. § 9-203(b)(2)* [former *U.C.C. § 9-203(1)(c)*]; *Rohweder v. Aberdeen Prod. Credit Ass'n, 765 F.2d 109 (8th Cir. 1985)* (mere possession of the collateral insufficient to give debtor sufficient rights in the collateral); *Cantor v. Anderson, 639 F. Supp. 364 (S.D.N.Y. 1986)* ; *Dzikowski v. Stoeppelwerth (In re Boca Arena, Inc.), 237 B.R. 221, 39 U.C.C. Rep. Serv. 2d 901 (Bankr. S.D. Fla. 1999)* (individual did not have "rights to collateral" when shares were held by individual in constructive trust for a corporation which did not consent to their use as collateral); *In re Atlantic Marble, Inc., 126 B.R. 463, 16 U.C.C. Rep. Serv. 2d 528 (Bankr. E.D. Pa. 1991)* (property debtor is holding belongs to another company); *Chartered Bank of London v. Chrysler Corp., 115 Cal. App. 3d 755, 171 Cal. Rptr. 748, 30 U.C.C. Rep. Serv. 1438 (1981)* ; *Milledgeville Cmty. Credit Union v. Corn, 307 Ill. App. 3d 8, 716 N.E.2d 864, 39 U.C.C. Rep. Serv. 2d 929 (1999)* (no security interest created because car dealer did not own car). *Matrix IV, Inc. v. Am. Nat'l Bank & Trust (In re S. M. Acquisition Co.), 2004 U.S. Dist. LEXIS 7485, 53 U.C.C. Rep. Serv. 2d (CBC) 665 (N.D. Ill. 2004)* (control of property insufficient); *Fifth Third Bank v. Comark, Inc., 51 U.C.C. Rep. Serv. 2d 533 (Ind. Ct. App. 2003)* (debtor had no rights in collateral that belonged to sister corporation); *In re SHC, Inc., 329 B.R. 438, 58 U.C.C. Rep. Serv. 2d 573 (Bankr. D. Del. 2005)* (when a third party overpaid debtor's tax debt, debtor could not grant security interest in refund that was owed).

(n29)Footnote 29. *Jerke Constr., Inc. v. Home Fed. Sav. Bank, 693 N.W.2d 59, 56 U.C.C. Rep. Serv. 2d 125 (S.D. 2005) . Manheim Auto. Fin. Services, Inc. v. Guthrie, 64 U.C.C. Rep. Serv. 2d 230 (D. Kan. 2007)* (question of fact whether debtor had rights in cars when certificates of title were in his name but he had bought them with post-dated checks and agreed with seller that sale was conditional upon payment).

(n30)Footnote 30. Revised *U.C.C. § 9-203(b)(3)(A)* [former *U.C.C. § 9-203(1)(a)*]. *See In re Stout, 284 B.R. 511, 49 U.C.C. Rep. Serv. 2d 626 (Bankr. D. Kan. 2002)* (security interest in crops unenforceable when agreement did not identify the land where they were growing, as required by former *U.C.C. § 9-203(1)(a)*).

(n31)Footnote 31. *In re LMJ, Inc., 159 B.R. 926, 22 U.C.C. Rep. Serv. 2d 343 (D. Nev. 1993)* (all "personal property" at leased premises insufficient description for financing statement under *U.C.C. § 9-402(1)*).

(n32)Footnote 32. *U.C.C. § 9-108(b)(3)*.

(n33)Footnote 33. *See U.C.C. § 9-102(a)(13)*, (33), (48).

(n34)Footnote 34. *See* Official Comment 5 to *U.C.C. § 9-108*.

(n35)Footnote 35. Revised *U.C.C. § 9-108(e)(2)*. *See In re Shirel, 251 B.R. 157 (Bankr. W.D. Okla. 2000)* ("all merchandise" insufficient); *Bank of Am. v. Case Credit Corp. (In re K & P Logging, Inc.), 272 B.R. 867, 47 U.C.C. Rep. Serv. 2d 731 (Bankr. D.S.C. 2001)* ("equipment" a sufficient description in commercial case). *See also In re Pickle Logging, Inc., 286 B.R. 181, 49 U.C.C. Rep. Serv. 2d 971 (Bankr. M.D. Ga. 2002)* (inaccurate serial number defeats security interest unless there is other information that provides a key to the identity of the collateral).

(n36)Footnote 36. *In re Softalk Publ'g Co., 856 F.2d 1328 (6th Cir. 1988)* (security agreement must be more explicit). *But see In re Batsell, 62 U.C.C. Rep. Serv. 2d 270 (Bankr. D. Or. 2007)* (construing security agreement, contract, and financing statement together when description of collateral on security agreement was left blank); *In re ACRO Bus. Fin. Corp., 357 B.R. 785, 61 U.C.C. Rep. Serv. 2d 619 (Bankr. D. Minn. 2006)* (court may refer to extrinsic evidence if security agreement is ambiguous).

(n37)Footnote 37. *In re Martin Grinding & Mach. Works, Inc., 793 F.2d 592 (7th Cir. 1986)* ; *Fulton State Bank v. Deutz-Allis Credit Corp., 701 F. Supp. 151 (N.D. Ill. 1988)* ; *General Motors Acceptance Corp. v. First Nat'l Bank, 139 B.R. 919, 16 U.C.C. Rep. Serv. 2d 892 (Bankr. D. Neb. 1991)* ; *In re Door Supply Ctr., Inc., 3 B.R. 103, 29 U.C.C Rep.*

318 (Bankr. D. Idaho 1980) ; *Allis-Chalmers Corp. v. Staggs, 117 Ill. App. 3d 428, 453 N.E.2d 145, 37 U.C.C. Rep. Serv. 262 (1983)* ; *C & H Farm Serv. Co. v. Farmers Sav. Bank, 449 N.W.2d 866, 10 U.C.C. Rep. Serv. 2d 528 (Iowa 1989)* (description of land in financing statement can not cure lack thereof in security agreement); *Dowell v. D.R. Kincaid Chair Co., 481 S.E.2d 670 (N.C. Ct. App. 1997)* ; *Landen v. Production Credit Ass'n, 737 P.2d 1325, 4 U.C.C. Rep. Serv. 2d 240 (Wyo. 1987)* .

(n38)Footnote 38. 718 *Arch St. Assocs., Ltd. v. Blatstein (In re Blatstein), 39 U.C.C. Rep. Serv. 2d 896 (E.D. Pa. 1999)* . *But see Dickason v. Marine Nat'l Bank, 898 So. 2d 1170 (Fla. Dist. Ct. App. 2005)* (when security agreement incorporated financing statement by reference, broader description of collateral in financing statement was effective).

(n39)Footnote 39. *In re Invenux, Inc., 298 B.R. 442 (Bankr. D. Colo. 2003)* .

(n40)Footnote 40. *15 U.S.C. §§ 1601 et seq*. The TILA is reprinted in Vol. 1A *infra*.

(n41)Footnote 41. *15 U.S.C. § 1632(a)*; *12 C.F.R. § 226.5(a)(1)* (open-end); *12 C.F.R. § 226.17(a)(1)* (closed-end).

(n42)Footnote 42. *See U.C.C. § 9-201*.

(n43)Footnote 43. Revised *U.C.C. § 9-201(b)*, (c); *see also* Revised *U.C.C. § 9-201*, Official Comment 3.

(n44)Footnote 44. *Anderson v. First Jacksonville Bank, 243 Ark. 977, 423 S.W.2d 273, 4 U.C.C. Rep. Serv. 1071 (1968)* ; *Bank of Am. N.T.S.A. v. Denver Hotel Ass'n P'ship, 830 P.2d 1138, 19 U.C.C. Rep. Serv. 2d 289 (Colo. Ct. App. 1992)* ; *First Galesburg Nat'l Bank & Trust Co. v. Martin, 58 Ill. App. 3d 113, 373 N.E.2d 1075, 23 U.C.C. Rep. Serv. 1328 (1978)* ; Kansas State Bank v. Overseas Motosport, Inc., 1 Kan. 2d 22, *563 P.2d 414, 21 U.C.C. Rep. Serv. 1451 (1977)* ; *Roberge v. Bankers Trust Co., 85 A.D.2d 8, 446 N.Y.S.2d 443, 32 U.C.C Rep. Serv. 1303 (1981)* .

(n45)Footnote 45. Revised *U.C.C. § 9-301*.

(n46)Footnote 46. Revised *U.C.C. § 9-307*. Additional changes governing perfection of security interests and agricultural liens are found in §§ 9-308 through 9-316 of Revised Article 9.

(n47)Footnote 47. Revised *U.C.C. § 9-307*.

(n48)Footnote 48. Revised *U.C.C. § 9-516(b)*; Official Comment 9(a) to Revised *U.C.C. § 9-102*.

(n49)Footnote 49. Revised *U.C.C. § 9-315* [former *U.C.C. § 9-306(1)*]. This generally includes the proceeds of involuntary dispositions, as well.

(n50)Footnote 50. Revised *U.C.C. § 9-315* [former *U.C.C. § 9-306(2)*]; *see In re Brantley, 286 B.R. 918, 49 U.C.C. Rep. Serv. 2d 976 (Bankr. S.D. Ga. 2002)* . *Cf. Ferris, Baker Watts, Inc. v. Stephenson (In re MJK Clearing, Inc.), 286 B.R. 109, 49 U.C.C. Rep. Serv. 2d 11 (Bankr. D. Minn. 2002)* (applying "lowest intermediate balance rule" but finding proceeds untraceable), *aff'd, 2003 U.S. Dist. LEXIS 5954* (D. Minn. Apr. 7, 2003) , *aff'd, 2004 U.S. App. LEXIS 11302* (8th Cir. June 9, 2004) .

(n51)Footnote 51. *Van Diest Supply Co. v. Shelby County State Bank, 425 F.3d 437 (7th Cir. 2005)* (secured party could not reach proceeds of sale of collateral that debtor had commingled with other inventory, when there were no records showing the proportion that was collateral).

(n52)Footnote 52. Revised *U.C.C. § 9-102(a)(64)(E)* [former *U.C.C. § 9-306(1)*].

(n53)Footnote 53. Revised *U.C.C. § 9-315(a)(1)* [former *U.C.C. § 9-306(2)*]. *See also Ronald V. Odette Family Ltd. P'ship v. AGCO Fin., Inc., 58 U.C.C. Rep. Serv. 2d 206 (Kan. Ct. App. 2005)* . *But cf. Smith v. PACCAR Fin. Corp., 2007 Minn. App. Unpub. LEXIS 1216 (Minn. Ct. App. 2007)* (creditor's perfected security interest in vehicle

survived sale when creditor did not expressly agree to sale and debtor did not comply with creditor's requirements for sale).

(n54)Footnote 54. Revised *U.C.C. § 9-317* [former *U.C.C. § 9-301(1)(c)*].

(n55)Footnote 55. Revised *U.C.C. § 9-309(1)* [former *U.C.C. § 9-302(1)(d)*].

(n56)Footnote 56. Revised *U.C.C. § 9-103* [former *U.C.C. § 9-307(2)*].

(n57)Footnote 57. Revised *U.C.C. § 9-309*.

(n58)Footnote 58. *See In re Cantrill Constr. Co., 418 F.2d 705 (6th Cir. 1969)* (a new note refinancing the old note is still secured by the same property), *cert. denied, 397 U.S. 990, 90 S. Ct. 1124, 25 L. Ed. 2d 398 (1970)* ; *In re Thayer, 38 B.R. 412, 38 U.C.C. Rep. Serv. 606 (1984)* , *later proceeding, 47 B.R. 90 (Bankr. D. Vt. 1985)* ; *In re Gibson, 16 B.R. 257, 33 U.C.C. Rep. Serv. 77 (Bankr. D. Kan. 1981)* ; *State Bank of Young Am. v. Vidmar Iron Works, Inc., 292 N.W.2d 244, 28 U.C.C. Rep. Serv. 1133 (Minn. 1980)* ; *First Dakota Nat'l Bank v. Maxon, 534 N.W.2d 37, 28 U.C.C. Rep. Serv. 2d 921 (S.D. 1995)* (two comakers on note not relieved of obligations by third comakers' execution of renewal note). *But see Safe Dep. Bank & Trust Co. v. Berman, 393 F.2d 401 (1st Cir. 1968)* (security for the initial note is not incorporated into subsequent notes if the first note is marked paid, even though subsequent notes are just refinancing the old note); *In re Tardy, 18 B.R. 36, 33 U.C.C. Rep. Serv. 1124 (Bankr. C.D. Ill. 1982)* ; *Smith v. Akers, 13 U.C.C. Rep. Serv. 2d 255 (Va. Cir. Ct. 1990)* ; *see also Hansford v. Burns, 526 S.E.2d 896, 40 U.C.C. Rep. Serv. 2d 592 (Ga. Ct. App. 1999)* . *In re D & K Aviation, Inc., 349 B.R. 169 (Bankr. S.D. Ohio 2006)* (noting Ohio presumption that renewal is intended when parties execute new note; question of fact here whether presumption rebutted).

(n59)Footnote 59. The time for the secured party to respond may be shorter if the debtor sends an authenticated demand. Revised *U.C.C. § 9-513(b)(2)*.

(n60)Footnote 60. Revised *U.C.C. § 9-513(a)*, (b). *See also* Revised *U.C.C. § 9-513*, Official Comment 2 (requirement applies to certificate of title unless superseded by a specific state law).

(n61)Footnote 61. Revised *U.C.C. § 9-625(e)(4)*. Note, however, that some states have adopted non-uniform amendments to this provision.

(n62)Footnote 62. Revised *U.C.C. § 9-404*.

(n63)Footnote 63. *16 C.F.R. § 444.2(a)(4)*. The Rule was upheld in *American Fin. Servs. Ass'n v. FTC, 767 F.2d 957 (D.C. Cir. 1985)* , *cert. denied*, *475 U.S. 1011, 106 S. Ct. 1185, 89 L. Ed. 2d 301 (1986)* . 16 C.F.R. pt. 444 is reprinted in Vol. 1A *infra*.

(n64)Footnote 64. *16 C.F.R. § 444.1(i)*.

(n65)Footnote 65. *16 C.F.R. § 444.1(i)*.

(n66)Footnote 66. *16 C.F.R. § 444.1(i)(2)*.

(n67)Footnote 67. *16 C.F.R. § 444.1(i)(1), (3)*.

(n68)Footnote 68. *Allegheny-Ludlum Brackenridge Fed. Credit Union v. Fassinger (In re Fassinger), 246 B.R. 513 (Bankr. W.D. Pa. 2000)* .

(n69)Footnote 69. *11 U.S.C. § 522(f)(B)*.

(n70)Footnote 70. *See In re Crawford, 226 B.R. 484 (Bankr. N.D. Ga. 1998)* ; *In re French, 177 B.R. 568 (Bankr.*

E.D. Tenn. 1995) ; *In re Reid, 121 B.R. 875 (Bankr. D. N.M. 1990)* ; *In re Vale, 110 B.R. 396 (Bankr. N.D. Ind. 1989)* ; *In re Boyer, 63 B.R. 153 (Bankr. E.D. Mo. 1986)* ; *Lawhon Farm Supply, Inc. v. Hayes, 870 S.W.2d 729, 23 U.C.C. Rep. Serv. 2d 290 (Ark. 1994)* ; *cf. In re Larson, 203 B.R. 176 (Bankr. W.D. Okla. 1996)* (reasonably sophisticated home computer valued at more than $1000 not reasonably necessary for maintenance of household); *In re Thomas, 2005 WL 2429963* (Bankr. C.D. Ill. Sept. 21, 2005) (pool table is neither a household good nor a furnishing, so creditor's non-purchase money security interest is not avoidable). *See generally* National Consumer Law Center, Consumer Bankruptcy Law and Practice § 10.4.2.4 (8th ed. 2006 and supp.).

(n71)Footnote 71. *11 U.S.C. § 522(f)(4)* (as amended by Pub. L. No. 109-8, *119 Stat. 23 (2005))*.

(n72)Footnote 72. *11 U.S.C. § 522(f)(1)(B)*.

(n73)Footnote 73. *16 C.F.R. § 444.2(a)*.

(n74)Footnote 74. *16 C.F.R. § 444.1(b)*.

(n75)Footnote 75. *See* United States v. Action Loan Co., Civil No. 3:00CV-511-H (W.D. Ky. 2000), *available at* www.ftc.gov/os/2000/08/actionloanccon.htm (consent decree extinguishing security interest in household goods that violated Credit Practices Rule, and forbidding future violations).

(n76)Footnote 76. For summary of state law restrictions on non-purchase money security interests, see National Consumer Law Center, Repossessions, § 3.4.3 (6th ed. 2005 and Supp.).

(n77)Footnote 77. Revised *U.C.C. § 9-204(b)(1)* [former *U.C.C. § 9-204(2)*].

(n78)Footnote 78. *Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252 (W.D.N.Y. 2007)* ; *In re Look, 383 B.R. 210, 65 U.C.C. Rep. Serv. 2d 158 (Bankr. D. Me. 2008)* ; *In re Dunlap, 383 B.R. 113, 65 U.C.C. Rep. Serv. 2d 166 (Bankr. E.D. Wis. 2008)* ; *In re Wear, 2008 Bankr. LEXIS 208 (Bankr. W.D. Wash. 2008)* ; *In re Johnson, 380 B.R. 236 (Bankr. D. Or. 2007)* ; *In re Pajot, 371 B.R. 139 (Bankr. E.D. Va. 2007)* ; *In re Acaya, 369 B.R. 564, 567 (Bankr. N.D. Cal. 2007)* ; *cf. In re Sanders, 377 B.R. 836, 64 U.C.C. Rep. Serv. 2d 245, 253 (Bankr. W.D. Tex. 2007)* (U.C.C. definition of PMSI is "starting point" but not binding on interpretation of Bankruptcy Code).

(n79)Footnote 79. *In re Westfall, 376 B.R. 210 (Bankr. N.D. Ohio 2007)* .

(n80)Footnote 80. "Purchase money obligation" is the key term in the *U.C.C. § 9-103* definition of PMSI.

(n81)Footnote 81. *See Americredit Fin. Servs. v. Penrod (In re Penrod), 392 B.R. 835 (B.A.P. 9th Cir. 2008)* ; *CitiFinancial Auto v. Hernandez-Simpson, 369 B.R. 36 (D. Kan. 2007)* (lending money for the purchase price of the new vehicle and lending money for the payoff of the negative equity in the trade-in were two separate transactions memorialized by one retail installment sales contract document, one an antecedent debt (paying off the trade-in) and one a purchase money transaction); *In re Look, 383 B.R. 210, 65 U.C.C. Rep. Serv. 2d 158 (Bankr. D. Me. 2008)* ; *In re Riach, 65 U.C.C. Rep. Serv. 2d 25 (Bankr. D. Or. 2008)* ; *In re Wear, 2008 Bankr. LEXIS 208 (Bankr. W.D. Wash. 2008)* ; *In re Mitchell, 379 B.R. 131, 64 U.C.C. Rep. Serv. 2d 483 (Bankr. M.D. Tenn. 2007)* (treating sale of car and financing of negative equity as two transactions, one with a PMSI and the other without; because security interest is not wholly PMSI, hanging paragraph does not apply); *In re Pajot, 371 B.R. 139 (Bankr. E.D. Va. 2007)* (negative equity is not part of "price of the collateral" or "value given to enable the debtor to acquire rights in" or use of the collateral); *In re Acaya, 369 B.R. 564, 568 (Bankr. N.D. Cal. 2007)* ; *In re Bray, 62 U.C.C. Rep. Serv. 2d 745, 758 (Bankr. W.D. Tenn. 2007)* ; *In re Vega, 344 B.R. 616 (Bankr. D. Kan. 2006)* ; *see also In re Westfall, 376 B.R. 210, 219 (Bankr. N.D. Ohio 2007)* (treating negative equity as not part of purchase price as matter of federal law).

(n82)Footnote 82. *Americredit Fin. Servs. v. Penrod (In re Penrod), 392 B.R. 835 (B.A.P. 9th Cir. 2008)* ; *In re Johnson, 380 B.R. 236, 245* /-/246 (Bankr. D. Or. 2007) ("Given that financing negative equity is increasingly common,

it was not an oversight that the legislature did not include negative equity in the list of 'expenses incurred in connection with acquiring rights in the collateral' set forth in Official Comment 3."). *See, e.g., CitiFinancial Auto v. Hernandez-Simpson, 369 B.R. 36, 47 (D. Kan. 2007)* ; *In re Johnson, 380 B.R. 236, 64 U.C.C. Rep. Serv. 2d 893 (Bankr. D. Or. 2007)* ; *In re Sanders, 377 B.R. 836 (Bankr. W.D. Tex. 2007)* ; *In re Blakeslee, 377 B.R. 724, 729 (Bankr. M.D. Fla. 2007)* . *See In re Sanders, 377 B.R. 836, 64 U.C.C. Rep. Serv. 2d 245, 262 (Bankr. W.D. Tex. 2007)* . *Americredit Fin. Servs. v. Penrod (In re Penrod), 392 B.R. 835 (B.A.P. 9th Cir. 2008)* ; *In re Mancini, 2008 Bankr. LEXIS 3739 (Bankr. M.D. Pa. 2008)* ; *In re Munzberg, 388 B.R. 529 (Bankr. D. Vt. 2008)* ; *In re Wear, 2008 Bankr. LEXIS 208 (Bankr. W.D. Wash. 2008)* .

(n83)Footnote 83. *GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008)* ; *Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252 (W.D.N.Y. 2007)* ; *In re Cohrs, 63 U.C.C. Rep. Serv. 2d 352 (E.D. Cal. 2007)* (negative equity is "value given to enable the debtor to acquire rights in" the collateral, so is part of purchase price; California automobile sales finance act also treats negative equity as part of the purchase price); *In re Dunlap, 383 B.R. 113, 65 U.C.C. Rep. Serv. 2d 166 (Bankr. E.D. Wis. 2008)* (negative equity is part of PMSI because of close nexus to acquisition by debtors of the new car); *In re* Vinson, 65 U.S.C. Rep. Serv. 2d 67 (Bankr. D.S.C. 2008); *In re Austin, 381 B.R. 892 (Bankr. D. Utah 2008)* (negative equity, but not GAP insurance, is part of "value given to enable" debtor to acquire rights in the collateral); *In re Schwalm, 380 B.R. 630 (Bankr. M.D. Fla. 2008)* ; *In re Weiser, 381 B.R. 263 (Bankr. W.D. Mo. 2007)* (concluding that negative equity is "value given to enable the debtor to acquire" the vehicle; there was close nexus to sale as debtor could not have bought new vehicle without including the trade-in's negative equity in the new contract); *In re Burt, 378 B.R. 352 (Bankr. D. Utah 2007)* (when required by seller, negative equity is part of purchase price); *In re Petrocci, 370 B.R. 489 (Bankr. N.D.N.Y. 2007)* ; *see also In re Graupner, 537 F.3d 1295 (11th Cir. 2008)* (citing U.C.C. commentary as supporting conclusion that state installment sales law makes negative equity part of PMSI; negative equity has close nexus to sale, and list of expenses in commentary is not exclusive).

(n84)Footnote 84. *See In re Graupner, 537 F.3d 1295 (11th Cir. 2008)* (although close call, negative equity has purchase money status in light of Georgia motor vehicle sales financing act, which defines "cash sale price" as including amounts used to pay off the trade-in); *GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008)* ; *Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252 (W.D.N.Y. 2007)* (relying in part on New York vehicle installment sales law's definition of "cash sale price" as including negative equity); *In re Cohrs, 63 U.C.C. Rep. Serv. 2d 352 (E.D. Cal. 2007)* (relying in part on California automobile sales finance act, which treats negative equity as part of "cash price"); *In re Schwalm, 380 B.R. 630 (Bankr. M.D. Fla. 2008)* (relying in part on Florida motor vehicle sales finance act's inclusion of negative equity in "total sale price" (although not in "cash price")).

(n85)Footnote 85. *In re Sanders, 377 B.R. 836, 64 U.C.C. Rep. Serv. 2d 245, 255 (Bankr. W.D. Tex. 2007)* .

(n86)Footnote 86. *Id.*; *In re Mancini, 2008 Bankr. LEXIS 3739 (Bankr. M.D. Pa. 2008)* (as a disclosure statute, state installment sales act can not be read *in pari materia* with U.C.C.); *In re Munzberg, 388 B.R. 529 (Bankr. D. Vt. 2008)* (same); *In re Blakeslee, 377 B.R. 724, 729 (Bankr. M.D. Fla. 2007)* (improper to refer to consumer protection statute to interpret U.C.C. definition of PMSI); *In re Pajot, 371 B.R. 139 (Bankr. E.D. Va. 2007)* (finding definitions in other statutes unpersuasive, because they were not intended to define scope of U.C.C. and U.C.C. includes its own gloss on meaning of "price"; truth in lending act definition of "total sales price" and Virginia statute allowing finance charge to be imposed on negative equity do not relate to definition of PMSI); *In re Acaya, 369 B.R. 564, 570 (Bankr. N.D. Cal. 2007)* (state disclosure statute was adopted for different purposes and is not helpful in interpreting "PMSI"); *see also Americredit Fin. Servs. v. Penrod (In re Penrod), 392 B.R. 835 (B.A.P. 9th Cir. 2008)* (declining to read U.C.C. *in pari materia* with California auto finance law, which was designed for disclosure). *In re Riach, 65 U.C.C. Rep. Serv. 2d 25 (Bankr. D. Or. 2008)* (state installment sales law, which distinguishes between "cash sale price" and "other benefits," and includes "discharge of a security interest" in the latter category, does not make negative equity part of the purchase price); *In re Wear, 2008 Bankr. LEXIS 208 (Bankr. W.D. Wash. 2008)* (finding installment sales law's failure to include negative equity in list of items that make up "sale price" persuasive); *In re Johnson, 380 B.R. 236, 244* /-/245 (Bankr. D. Or. 2007) (Oregon statutes require disclosure of negative equity as separate from "cash sale price"); *In re Sanders, 377 B.R. 836, 64 U.C.C. Rep. Serv. 2d 245, 257 (Bankr. W.D. Tex. 2007)* .

(n87)Footnote 87. *In re Johnson, 380 B.R. 236, 249* /-/250 (Bankr. D. Or. 2007); *In re Sanders, 377 B.R. 836, 64 U.C.C. Rep. Serv. 2d 245, 272 (Bankr. W.D. Tex. 2007) . But see In re Westfall, 376 B.R. 210, 219 (Bankr. N.D. Ohio 2007)* (applying dual status rule as matter of federal law).

(n88)Footnote 88. *See, e.g., Knight v. Comm'r of Internal Revenue, 128 S. Ct. 782, 789, 169 L. Ed. 2d 652 (2008) .*

(n89)Footnote 89. *11 U.S.C. § 1325(a).*

(n90)Footnote 90. *See In re Mitchell, 379 B.R. 131, 64 U.C.C. Rep. Serv. 2d 483 (Bankr. M.D. Tenn. 2007)* (treating sale of car and financing of negative equity as two transactions, one with a PMSI and the other without; because security interest is not wholly PMSI, hanging paragraph does not apply); *In re Huddle, 63 U.C.C. Rep. Serv. 2d 634 (Bankr. E.D. Va. 2007)* (listing federal circuits that follow transformation rule and those that follow dual status rule); *In re Price, 363 B.R. 734 (Bankr. E.D.N.C. 2007) .*

(n91)Footnote 91. *See Americredit Fin. Servs. v. Penrod (In re Penrod), 392 B.R. 835 (B.A.P. 9th Cir. 2008)* (applying dual purpose rule after determining that negative equity is not part of PMSI); *CitiFinancial Auto v. Hernandez-Simpson, 369 B.R. 36 (D. Kan. 2007)* (following non-uniform provision of Kansas U.C.C. that adopts dual status rule for consumer transactions); *In re Mancini, 2008 Bankr. LEXIS 3739 (Bankr. M.D. Pa. 2008)* ; *In re Munzberg, 388 B.R. 529 (Bankr. D. Vt. 2008)* ; *In re Riach, 65 U.C.C. Rep. Serv. 2d 25 (Bankr. D. Or. 2008)* (adopting dual status rule); *In re Wear, 2008 Bankr. LEXIS 208 (Bankr. W.D. Wash. 2008)* (*U.C.C. § 9-103* requires application of dual status rule, as this transaction does not qualify under Washington's nonconforming definition of "consumer-goods transaction"); *In re Pajot, 371 B.R. 139 (Bankr. E.D. Va. 2007)* (applying dual status rule, but reserving right to apply transformation rule if creditor accounts for trade-in in a way that obfuscates negative equity amount); *In re Acaya, 369 B.R. 564, 568 (Bankr. N.D. Cal. 2007)* (adopting dual status rule); *In re Vega, 344 B.R. 616, 622 n.29 (Bankr. D. Kan. 2006)* (relying on non-uniform provision of Kansas U.C.C. that applies dual status rule to consumer-goods transactions); *cf. In re Weiser, 381 B.R. 263 (Bankr. W.D. Mo. 2007)* (stating, in *dicta*, that Missouri applies dual status rule only if dual status aspect is properly documented so that it is clear what is and is not purchase money). *See generally* § 3.8.4, *infra*.

(n92)Footnote 92. *U.C.C. § 9-103(h)*; *see also In re Graupner, 537 F.3d 1295 (11th Cir. 2008)* (relying on state law to find that PMSI encompassed negative equity, but concluding that Congress probably also intended this result).

(n93)Footnote 93. *See Parker v. Elkins Welding & Constr., Inc. (In re Elkins Welding & Constr., Inc.), 42 U.C.C. Rep. Serv. 2d 597 (B.A.P. 10th Cir. 2000)* (mere notation on title is insufficient without a written security agreement), *later op. at 258 B.R. 216 (B.A.P. 10th Cir. 2001)* (possession of collateral by creditor may be sufficient basis for security interest to attach, but not if creditor is acting as debtor's agent); *see also Morin v. Galan (In re Lanzatella), 254 B.R. 84 (Bankr. W.D.N.Y. 2000)* (notice of lien form insufficient to create security interest).

(n94)Footnote 94. *See, e.g., Fla. Stat. Ann. § 319.22(1)*; *Ohio Rev. Code Ann. § 4505.04(B).*

(n95)Footnote 95. *See* National Consumer Law Center, Repossessions, § 3.5.5 (6th ed. 2005 and Supp.). *See also Commonwealth v. Car Pawn of Va., Inc., 37 Va. Cir. 412 (1995)* (to pawn an automobile, possession of the automobile, not merely the certificate of title, must be delivered as security; where the creditor holds the certificate of title only, the parties have merely created a loan with property listed as collateral, and loan is in violation of Consumer Finance Act).

(n96)Footnote 96. *See, e.g., Alaska Stat. § 28.10.271.*

(n97)Footnote 97. *See, e.g., Mo. Rev. Stat. § 301.210* (sale without assignment of certificate of title at time of delivery is "fraudulent and void"); *Ohio Rev. Code Ann. § 4505.04* ("[n]o person acquiring a motor vehicle from its owner, whether the owner is a manufacturer, importer, dealer, or any other person, shall acquire any right, title, claim, or interest in or to the motor vehicle until there is issued to the person a certificate of title to the motor vehicle").

(n98)Footnote 98. *See, e.g., Ala. Code § 32-8-44*; *see also Ranger Ins. Co. v. Whitlow, 514 So. 2d 1338 (Ala. 1987)* (nondelivery of a certificate of title at the time of the sale does not prevent the passage of title from the seller to the buyer).

(n99)Footnote 99. *Ala. Code §§ 5-19A-1 to 5-19A-20* (general pawnshop law, interpreted by state supreme court to allow auto title pawns); *Fla. Stat. §§ 537.001 to 537.018*.; *Ga. Code Ann. §§ 44-12-130 to 44-12-138*; *Idaho Code Ann. §§ 28-46-501 to 28-46-509*; *Ky. Rev. Stat. Ann. §§ 286.10-200 to 286.10-991* (West); *Minn. Stat. §§ 325J.01 to 325J.13*; *Miss. Code Ann. §§ 75-67-401 to 75-67-449* (Mississippi Title Pledge Act); *Mo. Rev. Stat. §§ 367.500 to 367.533* (Pawnbrokers and Small Loans); *Mont. Code Ann. §§ 31-1-801 to 31-1-827* (Title Loan Act); *N.H. Rev. Stat. Ann. §§ 398:1 to 398:14*, *399-A:14*; *Ohio Rev. Code Ann. § 4505.102* (West) (Certificate of Motor Vehicle Title Law; allows licensed pawnbrokers to make title pawn loans); *Ohio Rev. Code Ann. §§ 4727.01 to 4727.99* (West) (Pawnbrokers); *Or. Rev. Stat. §§ 725.600 to 725.625*; *S.C. Code Ann. §§ 37-3-413* (auto pawn statute; some Article 9 requirements are specifically incorporated by reference), 36-9-201 (S.C. Code Ann. tit. 37 overrides Article 9 in case of conflict); *S.D. Codified Laws §§ 54-4-36(15)*, *(16)*, *54-4-70 to 54-4-72*; *Tenn. Code Ann. §§ 45-15-101 to 45-15-120*; *Utah Code Ann. §§ 7-24-102 to 7-24-305*.

(n100)Footnote 100. *Ala. Code § 5-19A-20* (pawnshop act "shall not repeal or be construed to repeal any provision of the Uniform Commercial Code, Sections 7-1-101 *et seq.* "); *Ga. Code Ann. § 11-2-201(9)* (pawnbroker is excluded from definition of "buyer in ordinary course of business"); *Idaho Code Ann. § 28-46-502(2)/-/*(4); *Minn. Stat. § 325J.06(c)* (auto title pawn transactions subject to state U.C.C.); *Mo. Rev. Stat. § 367.521(1)* (U.C.C. applies); S.D. Codified Laws § 57-4-70.

Note that all of these statutes exclude title pawn lenders from the definition of "buyer in the ordinary course." This exclusion means that a title pawn lender that buys the vehicle acquires it subject to any pre-existing purchase money security interest but has no effect on the general applicability of Article 9 to these transactions. *See also S.C. Code Ann. § 37-3-413(5)* (making cross-reference to Article 9; implication is that it applies; *S.C. Code Ann. § 36-9-201(b)* and *(c)* make Article 9 subject to the title pawn law, but only in case of a conflict).

(n101)Footnote 101. *Fla. Stat. Ann. § 537.002*.

(n102)Footnote 102. *But see McLeod v. Sears, Roebuck & Co. (In re McLeod), 245 B.R. 518, 523, 41 U.C.C. Rep. Serv. 2d 302 (Bankr. E.D. Mich. 2000)* (citing Michigan's retail installment sales act, court rejects standard that description must enable a third party to distinguish the collateral from other property, all that was necessary was that the description "be sufficient for Debtors and [Creditor] to identify the goods at issue").

(n103)Footnote 103. N.Y. Pers. Prop. Law § 413.12. *See In re Beck, 248 B.R. 229 (Bankr. W.D.N.Y. 2000) . See generally* National Consumer Law Center, Repossessions, § 3.6.5 (6th ed. 2005 and Supp.).

(n104)Footnote 104. *350 F.2d 445 (D.C. Cir. 1965)* .

(n105)Footnote 105. "Mortgages of this character have been denominated 'Anaconda mortgages' and are well named thus, as ... they enwrap the unsuspecting debtor in the folds of indebtedness embraced and secured in the mortgage which he did not contemplate. ..." *Berger v. Fuller, 180 Ark. 372, 377, 21 S.W.2d 419, 421 (1929)* , *quoted in* Gilmore, Security Interests in Personal Property § 35.2 (1965).

(n106)Footnote 106. *Compare* former *U.C.C. § 9-204(3)*, *with* Revised *U.C.C. § 9-204(c)*.

(n107)Footnote 107. *See* Revised *U.C.C. § 9-204(c)*, Official Comment 5.

(n108)Footnote 108. *See, e.g., Frericks v. Gen. Motors Corp., 278 Md. 304, 363 A.2d 460 (1976) . See generally* National Consumer Law Center, Consumer Warranty Law § 1.4.2 (3d ed. 2006).

(n109)Footnote 109. Revised *U.C.C. § 9-102(c)* [former *U.C.C. § 1-201(3)*]. *But see Alcantar v. Windsor-Orange County Credit Union, 2000 Tex. App. LEXIS 1576* (Tex. App. Mar. 9, 2000) (refusing to allow parol evidence to establish that parties did not contemplate future advances when contract referred to future advances).

(n110)Footnote 110. *James v. Blackhawk Credit Union (In re James), 221 B.R. 760, 35 U.C.C. Rep. Serv. 2d 1345 (Bankr. W.D. Wis. 1998)* ; *In re Lewis, 212 B.R. 827 (Bankr. E.D. Va. 1997)* . *See also Alcantar v. Windsor-Orange County Credit Union, 2000 Tex. App. LEXIS 1576* (Tex. App. Mar. 9, 2000) (unpublished) (subsequent loan was secured by car purchased with first loan where both sets of loan documents contained dragnet clauses; when debtor defaulted on second loan, creditor could lawfully repossess car); *In re Nagata, 60 U.C.C. Rep. Serv. 2d 255 (Bankr. D. Haw. 2006)* (dragnet clause in note and security instrument providing that collateral vehicle also secures other loans, including credit card loans, was sufficient to include antecedent credit card debt).

(n111)Footnote 111. *Pride Hyundai v. Chrysler Fin. Co., 369 F.3d 603, 615 (1st Cir. 2004)* (Mass. law).

(n112)Footnote 112. *See Fanucchi & Limi Farms v. United Agri Products, 414 F.3d 1075 (9th Cir. 2005)* ; *In re Utke, 1990 WL 1239795* (Bankr. D.N.D. Nov. 19, 1990) ; *In re Averhoff, 18 B.R. 198 (Bankr. D. Iowa. 1982)* (when a creditor had a security interest in household goods and subsequently made additional loans to the borrower, each time obtaining a new security agreement covering all previous items plus additional personal property as collateral and marked the original loan as being "renewed by" the subsequent loan, each subsequent loan constituted a novation of the prior loan and rendered the future advance clause of the prior loans ineffective).

(n113)Footnote 113. *In re McAllister, 267 B.R. 614 (Bankr. N.D. Iowa 2001)* ; *Pallie v. Riggs Nat'l Bank, 697 A.2d 1239 (D.C. 1997)* ; *Cumberland County Bank v. Eastman, 2005 Tenn. App. LEXIS 533* (Tenn. Ct. App. Aug. 25, 2005) .

(n114)Footnote 114. *In re Yelverton, 2007 Bankr. LEXIS 897* (Bankr. M.D. Ala. Mar. 19, 2007) (citing Alabama law that requires cross-collateralization clauses be between the same parties).

(n115)Footnote 115. *See In re Westfall, 365 B.R. 755 (Bankr. N.D. Ohio 2007)* ; *In re Price, 363 B.R. 734 (Bankr. E.D.N.C. 2007)* .

(n116)Footnote 116. *See CitiFinancial Auto v. Hernandez-Simpson, 369 B.R. 36 (D. Kan. 2007)* (holding that lending money for the purchase price of the new vehicle and lending money for the payoff of the negative equity in the trade-in were two separate transactions memorialized by one retail installment sales contract document, one an antecedent debt (paying off the trade-in) and one a purchase money transaction); *In re Pajot, 371 B.R. 139* (Bankr. E.D. Va. July 17, 2007) ; *In re Vega, 344 B.R. 616 (Bankr. D. Kan. 2006)* .

(n117)Footnote 117. *See Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252* (W.D.N.Y. Aug. 15, 2007) ; *In re Graupner, 356 B.R. 907 (Bankr. M.D. Ga. 2006)* (looking to Georgia's Motor Vehicle Sales Financing Act, which defines price as including amounts used to payoff the trade-in, and determining that the total loan amount had purchase money status despite the payment of negative trade-in equity).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 10 Repossessions

1-10 Consumer Credit Law Manual § 10.03

§ 10.03 Default as Precondition to Seizure

[1] Default and Acceleration

[a] Default as Precondition to Repossession

Under the UCC, the debtor's default is necessary before the secured party may either repossess the collateral n1 or dispose of collateral already in the secured party's possession. n2

[b] Under UCC, Definition of Default Determined by Agreement

The UCC does not define the concept of "default." Unless other state law limits its definition, the parties are free under the UCC to define default as they please in the security agreement. n3

The typical security agreement defines default to include not only the debtor's late payment on an installment note, but also the debtor's failing to purchase insurance to cover the collateral, moving the collateral to another location without the creditor's permission, or violating any of a host of other restrictions set up by the creditor. When the debtor violates any of these conditions, even though the debtor is current on all payments due, the creditor can declare the obligation is in default. The creditor may then lawfully repossess the collateral.

Only the actual holder of the credit contract has the right to exercise the right of repossession of the collateral. Upon assigning a credit contract to another entity, the original creditor loses this right. n4

[c] Relationship of Default and Acceleration

It is important to understand the concept of acceleration as it relates to the various uses of the term "default." Creditors usually specify in the credit agreement that if the debtor is delinquent on an installment, or otherwise breaches a condition of the agreement, the creditor may accelerate the debt. The full unpaid balance of the loan becomes due immediately. Acceleration leads almost automatically to default on the total balance of the loan. Then the creditor can enforce its remedies to recover the total remaining balance of the loan, including repossession and sale of the collateral to satisfy the obligation to pay all remaining installments.

Many credit agreements also allow the creditor to accelerate even in the absence of default, for example when the creditor deems itself insecure. In such a situation the creditor would not have the right to repossess before acceleration, because there would be no default at that point. The creditor would only be able to repossess if the debtor failed to pay the accelerated amount.

Whether acceleration has occurred is also relevant to the creditor's right to repossess when the consumer catches up on the missed payments before repossession occurs. If the creditor did not accelerate the debt before the consumer paid the missed payments, repossession is clearly improper. n5 Even if the creditor did accelerate the debt before the consumer paid the missed payments, its acceptance of those payments may constitute a waiver.

Finally, the credit contract itself may require that acceleration occur before the creditor can repossess.

[d] Agreement to Accelerate Required; Strict Construction of Grounds to Accelerate

In order for the creditor to accelerate, the credit agreement must provide for the creditor's right to accelerate. This right must be stated clearly and with certainty, and may not be determined by mere inference.

[e] Validity Under the UCC of Contractual Grounds for Acceleration

The typical credit agreement provides a number of independent grounds for the creditor's acceleration of the note, such as missing a payment, damage to the collateral, failure to properly insure the collateral, etc. These are often similar to, but need not be identical to, grounds for default.

With the exception of a partial limitation on acceleration at will or when the secured party believes the prospect of payment is impaired, the UCC does not limit acceptable grounds for acceleration.

[f] UCC Restricts Acceleration at Will, When Creditor Insecure

[i] General

The UCC allows credit agreements to be accelerated "at will" or when the creditor "deems himself insecure" only if the creditor "in good faith" believes that the prospect of payment or performance is impaired. n6 This standard is broad and very generous to the creditor. Even so, litigants have successfully challenged the creditor's good faith. n7 State laws may impose stricter standards governing when impairment of the prospect of payment is sufficient grounds for acceleration. n8

[g] Where Consumer Does Not Waive Notice of Debt's Acceleration

Unless a contract specifically provides otherwise, before a creditor repossesses collateral, it must notify the debtor that it has accelerated the debt and that the full amount is due; the creditor must also give the debtor a reasonable opportunity to pay.

[h] Contract Provisions Waiving Debtor's Right to Notice of Acceleration

[i] Waiver of Notice Usually Found Valid

Creditors frequently draft their credit agreements to avoid the requirement that, before repossessing the collateral, they notify the debtor that the note has been accelerated.

Despite the harshness and one-sided nature of credit provisions allowing secured parties to repossess collateral without making any kind of demand and without notifying the debtor that the note has been accelerated, the majority of courts

considering the issue enforce such provisions. n9

Courts will strictly interpret contractual language which allows creditors to repossess without demand or notice. n10

[ii] Where Notice Required Despite Waiver

Despite waivers in the credit agreement, there are a number of situations where the consumer must receive some form of notice before acceleration. The most important such situation is where a state right to cure law requires the creditor to notify the consumer of a default and provide a time frame to cure the default before the note can be accelerated.

When a creditor habitually accepts late payments, the creditor may not be able to suddenly and without notice accelerate the note because payments are late. The terms of payment may have been modified, and the creditor will have to warn the consumer that prompt payment must be made in the future. n11

[iii] Waiver Provisions May Be Unconscionable or Violate State Deceptive Practices Statutes

Courts are divided about the unconscionability of these waiver provisions, but may be vulnerable to an attack as "unfair" under state deceptive practices statutes.

[2] State and Federal Credit Statutes May Limit Grounds for Default and Acceleration

[a] Distinction With Right to Cure Laws

The most significant limitations on the right to accelerate are state and federal right to cure laws which provide consumers with thirty days (or some similar period) to cure a default.

This section describes another type of statute: laws that restrict the basis upon which a note can be accelerated.

[b] Federal Limitations

Federal law provides few restrictions on when a creditor can accelerate the loan, but the few limits that do exist are important because they apply to all credit transactions in all states. The United States Bankruptcy Code declares of no effect a contract provision declaring the debtor in default if the debtor files for bankruptcy. n12 Similarly, the Bankruptcy Code's automatic stay prevents the creditor from accelerating the note or taking any action against the collateral without first seeking the court's permission.

The Federal ECOA prohibits creditors from declaring a note in default or accelerating a loan just because the consumer has exercised rights under the TIL, Fair Credit Reporting, Consumer Leasing, Fair Credit Billing ("FCBA"), FederalGarnishment, Fair Debt Collection, Electronic Funds Transfer Acts or the ECOA itself. n13

The ECOA also prohibits a creditor from declaring a default or accelerating a loan sooner against certain debtors than others if the basis of the disparate treatment is race, color, religion, national origin, sex, marital status, age, or public assistance status. n14 Not only are creditors prohibited from discriminating in accelerating loans, they also can not establish policies that have the effect of discriminating on these bases. n15

For members of the armed forces on active duty, the Soldiers' and Sailors' Civil Relief Act requires creditors to reduce interest rates on pre-active duty obligations to six percent unless the creditor goes to court and proves that the service member's active duty does not materially affect her ability to pay. n16 The creditor must forgive any interest over six percent that would otherwise have accrued during the period of active duty. n17 The creditor should reduce the monthly payment to reflect the lower interest rate. n18 A debtor who is on active duty and makes the reduced payments that the Act allows can not be considered in default, and any repossession should therefore be wrongful.

[c] State Law Limitations

In some states, motor vehicle installment sales acts, state retail installment sales acts, and the UCCC prohibit clauses that allow arbitrary or unreasonable acceleration, acceleration because the holder deems itself insecure, or acceleration in the absence of default (which effectively prohibits acceleration based on the holder feeling insecure). n19

[d] Notice of Assignment

Obligations are often assigned from one creditor to another. Under Article 9, the debtor can continue paying the original creditor until it or the assignee sends the debtor an authenticated notification that the debt has been assigned and that payment is to be made to the assignee. n20 Such payment discharges the debtor's obligations, n21 so failure to pay the assignee would not be a default.

If requested by the debtor, the assignee must "seasonably" furnish reasonable proof that the assignment has been made. n22 Until the assignee provides proof, the debtor can continue paying the assignor, even if the debtor has received a notification of the assignment. n23

[3] Creditor's Waiver of Right to Declare Default

[a] Habitual Acceptance of Late Payments Prevents Sudden Acceleration

Acceleration is not favored in the law. A creditor who has not insisted upon strict compliance with due dates in the past, but who has instead accepted late payments, must give reasonable notice to the debtor that it will insist on strict compliance in the future. n24

To reach this conclusion, courts have relied upon either waiver or estoppel.

Creditors can also waive their right to declare a default on grounds other than just delinquent payments.

[b] Other Creditor Conduct Preventing Acceleration

Misrepresenting that making a payment will prevent repossession may violate the state's deceptive practices statute. n25 The Alabama Supreme Court has held that a creditor's agreement to extend a payment's due date did not prevent repossession because it was unsupported by consideration, but a concurring justice pointed out that an estoppel theory would not have required consideration. n26

The Fourth Circuit upheld a jury's finding that a car buyer had a good reason not to make payments on a car loan. The bank had delayed over six months in recording the loan. When the buyer tried to arrange to make payments, it repeatedly insisted that he owed nothing. After six months, upon discovering the existence of the loan, the bank declared the buyer in default, accelerated the loan, and refused to allow him to make payments unless he agreed to pay late fees and penalties. The court upheld a jury's award of $1000 in statutory damages and $80,000 punitive damages against the bank for refusing to correct negative credit reports it had submitted regarding this transaction. n27

[c] Effect of Contractual Antiwaiver Provisions

A number of courts, particularly in commercial cases, find that antiwaiver clauses effectively cut off the debtor's rights and that the creditor can use the clause to accelerate without notice, even after accepting late payments in the past. The majority of courts in consumer cases, however, find various ways of avoiding the effect of this provision inserted in the credit agreement, such as creditor's subsequent conduct as modification or estoppel by conduct.

[4] Creditor's Obligation to Seek Credit Insurance Payments Before Declaring Default

Creditors frequently sell credit insurance in connection with credit transactions. The insurance may cover the death, disability, or loss of employment of the borrower or theft or other loss of the collateral. n28 Creditors will sometimes declare a default for nonpayment even when they know that an event has occurred (*e.g.*, the debtor's death or disability) that will trigger payments under the credit insurance policy. Some courts have found this wrongful. n29

Not only might the creditor have an obligation to seek credit insurance payments prior to repossession, but the insurance carrier also may be acting in bad faith if it denies a claim on a credit disability policy without even limited investigation simply because the borrower fails to supply all the completed forms required by the policy. n30 While this duty of the insurer will not affect the borrower's default status, any proceeds from the policy would be available to prevent default or a deficiency.

[5] Yo-Yo (Spot Delivery) Sales

Yo-yo sales, also known as "spot delivery," "take back sales," or "gimmee back sales," can lead to serious repossession abuses. In these sales, the dealer delivers the car to the consumer "on the spot," before financing is firmly arranged. If the dealership is unable to arrange financing on the terms originally quoted, it requires the consumer either to return the car or to sign a new contract with different, less favorable terms. If the consumer does not return the car, the dealer may try to repossess it.

A yo-yo sale is often the result of a deliberate sales tactic. The dealer baits the consumer with financing terms that it does not intend to deliver, and then, after the consumer has become committed to the car, moves the consumer to less favorable terms. If the consumer tries to get out of the deal, the dealer may claim that the consumer's trade-in has been sold, that the agreement to purchase the car is binding, or that the consumer will have to forfeit a down payment.

In most dealer-arranged automobile financing, the dealer will first get a creditor to approve the deal, and then have the consumer sign a credit contract with the dealer, which the dealer then assigns to the creditor. If the creditor declines to accept assignment of the contract from the dealer, the sale and the credit terms should still be binding on the dealer unless the contract included a legally effective clause making the contract contingent on financing.

If the contract does not have a contingency clause and the consumer is making the payments and performing any other contractual obligations, the dealer has no grounds for repossession. Default by the consumer is required before the dealer can repossess. n31 Repossession when there has been no default is conversion and a breach of contract. n32 It also triggers the UCC's statutory damages remedy. n33

Some dealers do not sign the credit contract and then argue that the deal is not final for this reason. But the filled-in contract should be viewed as the dealer's offer, and the consumer's signature is acceptance, so the contract is binding. n34 The dealer's argument that the contract is not binding is stronger if the contract explicitly states that it is not binding unless signed by the dealer, but the consumer should not accept at face value the dealer's claim about whether and when it signed the contract. The dealer may have had to show a signed contract to potential assignees. Also, the contract would not be binding on the consumer until the dealer signed it, so the dealer may have done so to prevent the consumer from canceling the sale.

Even if the contract states that it is not binding until signed by the dealer, the dealer may have conveyed title to the consumer, reserving only a security interest to itself, by delivering the vehicle to the consumer. *UCC section 2-401(1)* provides: "Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest."

Many dealers insert an explicit clause in their yo-yo sales contracts that makes the deal contingent on the dealer's ability to arrange financing on the terms stated in the contract. State law governs the validity of such clauses. n35 If the car

salehas not been explicitly conditioned on final credit approval, then the dealer has no right to undo the sale. n36 If the contingency clause is invalid, the contract is binding on the dealer, and repossession is a violation of Article 9 if the consumer has not defaulted.

A rider should not conflict with the main document either. For example, when an installment sales agreement states that the dealer has sold the vehicle to the consumer, and that the transaction is final, then a separate document should not indicate that the transaction is *not* final. For a rider to be effective in establishing a bailment agreement until financing is complete, the installment sales agreement must clearly state that it is a condition precedent agreement, that it is not a final agreement.

Washington state outlaws contingent sales unless the dealer either accepts or cancels the sale within three business days. n37 Utah law only accepts contingency clauses that give the dealer seven days to cancel, n38 and Louisiana law requires the contingency to allow the dealer only twenty-five days. n39 Alaska requires the contingency to be disclosed in a separate document, signed by both parties, that clearly and conspicuously discloses the contingency, the proposed financing terms, the consumer's obligation to complete the deal on those terms, if approved, and the fact that the deal is voided if financing can not be found on those terms. Certain contingency clauses may be drafted so poorly or be so one-sided as to raise issues of enforceability. n40 Other contingency clauses may be so poorly drafted as to make it difficult to determine if the contingency has occurred. For example, clauses may state that the contract may be cancelled if financing is not obtained within three or ten days. n41 If the dealer waits well beyond the specified time period to notify the consumer, can it still cancel the sale if it alleges that financing was not obtained during those three or ten days?

Even if the contingency clause is valid, there may be significant factual questions about whether the contingency occurred. Often the dealer actually is able to secure the financing set forth in the contract, but rejects it because it wants a larger hidden commission or "yield spread premium" than the creditor is willing to pay. n42 In such a case, the contract would still be binding and the dealer would have no right to repossess.

When the dealer repossesses a motor vehicle because a yo-yo sale has fallen through, not only may the repossession itself be wrongful, but the dealer may also be liable for failing to follow the Article 9 rules regarding reselling the vehicle. If the dealer's interest in the vehicle was a security interest, and if some action or inaction by the buyer constitutes a default that gave the dealer the right to repossess, then it must give the buyer notice of the repossession sale and account to the buyer for any surplus. n43 Violation of these requirements gives the consumer the right to actual and statutory damages.

[a] Did Financing Really Fall Through?

Automobile paper is often sold with a yield-spread premium, being the difference between what the finance company will accept (the buy rate) and the rate at which the dealer writes up the loan. The dealer pockets most or all of the yield spread as a kickback. n44 Consider whether financing really fell through where the rate specified in the installment sales agreement is 15%, but the loan is offered to the assignee not at that rate, but at a buy rate of 11%. In addition, the Equal Credit Opportunity Act requires lenders to provide written notice of any adverse action on the consumer's credit application, and the lender must retain for twenty-five months all documents evidencing this denial of credit. n45

Has the dealer made a good faith effort to finance the 15% paper when it is only offering it to other lenders at 11%? Before canceling the sale, must the dealer instead seek a buyer for the paper at 15%? The contingency clause does not specify that the dealer can cancel if it cannot find a lender to purchase the paper at a significant profit to the dealer. In any event, it is surely deceptive to state that financing can not be arranged for a 15% loan where the dealer never sought a lender out to purchase the loan at 15%. And it surely should be a UDAP violation to fail to disclose, when selling a vehicle pursuant to a contingency clause, that the sale is not contingent on a lender purchasing the paper at 15%, but instead at 11%.

A New Hampshire statute references cancellation where "approval of the terms of the retail installment contract cannot be obtained." n46 This would seem to allow cancellation only if the dealer can not obtain financing at the rate described in the contract, not at some lower interest rate selected by the dealer.

[6] Relationship of Default to Consumer's Defenses or Counterclaims

[a] Introduction

The existence of various consumer defenses or counterclaims also affects the creditor's ability to declare a default and accelerate the loan. Valid defenses and counterclaims can certainly reduce the amount the creditor can recover in a collection lawsuit.

[b] If Consumer's Obligation Is Extinguished

The creditor does not have the right to declare a default or repossess the collateral if the consumer's obligation underlying the security is extinguished for two reasons. First, the consumer has not defaulted on an obligation if the consumer has fully satisfied the obligation. Second, the security interest is no longer valid because the UCC definition of a security interest is an interest securing payment of an obligation. n47 The security interest should cease to exist if the underlying obligation is extinguished. The 1999 revisions to Article 9 add a provision that, until the debtor is notified of an assignment, the debtor can discharge the obligation by paying the assignor. n48 Consequently, a seizure is wrongful if the consumer has already paid off the loan in full. This may happen, for example, where a loan is assigned and the assignor does not communicate effectively with the assignee as to which consumer payments have been received. An obligation can also be terminated if the underlying contract is void or voidable.

In addition, a consumer who revokes acceptance has the right under the UCC to cancel the sales contract. n49

[c] Seller's Breach of Contract May Prevent Default

[i] UCC § 2-717 Right to Deduct Payments.

Consumers can prevent a default even where the obligation is not satisfied, if the consumer has a claim for breach of contract damages against the seller, such as a breach of warranty claim. Even without first receiving a court determination, consumers have the right to notify the seller of their damages for the seller's breach of the sales agreement and deduct those damages from installment payments.

[ii] Potential Consequences of Stopping Payments

Consumer lawyers differ on whether it is wise to advise clients to stop payments prior to filing suit and/or during the pendency of litigation. The question is not whether a consumer has the right to do so, but whether it is worth risking potential consequences such as negative credit references or repossessions. n50

Many lawyers address potential problems by warning lenders' counsel that the debt is clearly disputed and that credit reports should reflect that. Another strategy is to seek a restraining order prohibiting the lender from making unfavorable credit reports or repossession while the case is in dispute.

Conversion, FCRA, UDAP and other tort claims may be appropriate if lenders repossess goods or make negative credit reports when consumers have properly withheld payments and given notice to lenders.

[iii] Against Which Payments May Damage Claims Be Deducted?

UCC section 2-717 states that the consumer can deduct the damages "from *any* part of the price still due" (emphasis added). The words "any part of" would be superfluous if they did not mean it is the consumer's choice to determine against which part of the still due amount to apply the deduction. n51

[iv] Consumer Must Notify the Seller

UCC section 2-717 requires the buyer to notify the seller of the intention to deduct damages before the buyer can deduct those damages.

[v] Damages That May Be Deducted; Relationship to Third Party Lender

UCC section 2-717 allows consumers to withhold payments on a sales contract if the consumer has a claim for breach of that same contract. The most common type of breach of contract claim will be breach of warranty. The section 2-717 remedy is available not only for damages for reduced value of the goods, but also for incidental and consequential damages. In addition, the remedy is available for nonwarranty breach of contract claims, such as imposition of credit terms or charges not in the contract, delay in delivery, or breach of the seller's duty of good faith.

[d] Consumer's Revocation of Acceptance May Prevent a Default

[i] General

If the consumer revokes acceptance of the collateral and cancels the sale before a repossession, the consumer's position with the creditor is greatly improved, and the consumer may even have a greater chance of retaining the collateral. A consumer can cancel a sale if the goods are substantially impaired and the seller fails to cure the defect. After notice of revocation to the seller, the consumer is no longer obligated on the sales agreement, the seller must return payments already made, and the seller has the right to recover the goods.

[ii] Consumer May Have a Superior Security Interest in the Collateral

When the consumer rightfully revokes acceptance of the goods, the consumer has a UCC Article 2 security interest in the goods in the consumer's possession to secure those payments on the price of the goods already made and to secure certain expenses already incurred relating to the goods. n52 The security interest stays in effect as long as the consumer retains possession and as long as the creditor has not reimbursed the consumer for these payments and expenses.

This buyer's security interest gives the consumer a superior right to the goods unless the creditor fully reimburses the consumer.

Even if it is clear that the consumer has the right to retain possession of the vehicle as security for the seller's return of payments and reimbursement of expenses, the consumer should be prepared for repossession attempts. A strongly worded letter, explaining the basis for revocation of acceptance, the duties that revocation imposes upon the seller, and the consequences of a wrongful repossession, may act as a deterrent. n53

A buyer who revokes acceptance has the right under *UCC § 2-711(1)* to cancel the contract. If the buyer does so, then the buyer no longer has an obligation to the seller, so any security interest securing the obligation is automatically terminated. A proper revocation of acceptance and cancellation of the contract means that the debtor no longer has any obligation for the merchandise, so any security interest securing the obligation is automatically terminated.

[iii] Revocation of Acceptance After Repossession

There seems to be no legal impediment to revoking acceptance after a repossession. *UCC section 2-608* on revocation of acceptance does not require the consumer to be in possession of the goods to cancel. As long as the other

requirements for revocation are met, the cancellation should be proper. As *UCC § 2-711(3)* creates only a possessory security interest, which is lost once the consumer loses possession of the goods, revocation after repossession would not enable the consumer to claim a security interest in the goods. n54 But the consumer may have a more difficult time proving the goods substantial impairment if the consumer does not have possession.

[e] Effect of Debtor's Counterclaims

A debtor not revoking acceptance and not withholding payments pursuant to *UCC section 2-717* may have difficulty preventing a default merely by raising claims against the creditor or seller. While the consumer argues that the legal claims against the creditor off-set the amount of payments for which the debtor is delinquent, courts may distinguish between claims that dispute the amount of the debt and those that go to the right of the creditor to take possession of the collateral.

[7] Unconscionable and Bad Faith Acceleration

UCC section 2-302 allows courts to refuse to enforce unconscionable contracts in whole or in part. Former *UCC section 1-203* imposes upon the creditor an obligation of good faith in enforcement of the credit agreement's right to declare a default and accelerate the loan. An acceleration can violate this obligation when the creditor's actions, as opposed to the contract provisions, are inequitable.

[8] The Right to Cure a Default

[a] Introduction

Nothing in the UCC prevents the creditor, upon the debtor's delinquency, from immediately accelerating the note and repossessing the collateral. Credit agreements or state law may create a grace period during which delinquency will not lead to acceleration or repossession, and that provision is then enforceable against the creditor like any contract term.

Right to cure statutes should be distinguished from right to reinstate and right to redeem statutes. The UCC also gives debtors a right to redeem repossessed collateral by paying the entire obligation.

[b] State Statutory Rights to Cure

[i] General

A number of state statutes provide a right to cure defaults prior to acceleration or repossession for some or all consumer credit transactions. Generally, creditorsmust first send a written notice of default and right to cure, and then wait for a specified period prior to acceleration, repossession, or court enforcement of the security interest. n55 During that period, the debtor can reinstate the credit transaction as if the default had not occurred merely by paying any back payments plus delinquency charges.

Consumers also have the right to cure a default whenever the creditor offers the consumer that right.

Check carefully for creditor compliance with the notice requirements of the state right to cure statutes. The creditor should be held to the strictest compliance standard.

When a debtor properly offers to cure the delinquent installments, but a creditor wrongfully requires payment on the full accelerated debt, some debtors respond by making no payment at all. Courts may find the debtor's offer to cure sufficient to stop acceleration.

[c] Federal Right to Cure for Mobile Home First Mortgage Loans

[i] General

An important, but limited, federal right to cure provision for federally-related mobile home loans is found in OTS regulations, n56 which apply to first mortgages on residential mobile homes. The regulations provide debtors with a thirty-day right to cure defaults after notice.

The notice, in effect, gives the debtor a second chance, within thirty days of the notice's postmark, to cure any past delinquencies or other default before the total amount due may be accelerated or the home repossessed.

[ii] When Consumer Has Right to Cure

The OTS regulations do not provide consumers with the right to cure their mobile home loans. Instead, the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA") n57 provides lenders with certain incentives to provide this right to cure to consumers and to comply with other consumer safeguards specified in the OTS regulations. The incentive is that, if the lender provides the consumer with the right to cure notice and all the other consumer safeguards specified in the regulations, then the lender can avoid certain state usury laws. n58

The consumer only has a right to cure if the lender offers the consumer that right.

[iii] Mobile Home Lender Liability for Failure to Provide Right to Cure

In most cases, mobile home lenders failing to offer a right to cure and failing to comply with the other OTS consumer safeguards must comply with all applicable state usury law. The significance of this will vary state-by-state with the nature of the usury limits and usury remedies. There may be no consequence for lenders' failure to comply with the OTS regulations in states with high or nonexistent interest ceilings on mobile home loans. However, if a state has a low or moderate usury ceiling applicable to these transactions, a creditor that relied on the DIDA preemption to charge a higher rate will have violated the state usury law and will be subject to applicable penalties.

[iv] Does Credit Agreement Obfuscate Right to Cure, Leading to Statutory Damages?

The OTS regulations do not require that the lender mention the right to cure in the actual loan documents. Nevertheless, a number of courts have examined whether loan documents that might obfuscate the right to cure do violate the OTS regulations, leading to the lender losing its federal insulation from state usury laws, even if the consumer never defaults.

[9] Remedies

[a] Punitive Damages Under a Tort Theory

If the secured party repossesses property when the debtor is not in default, when the creditor is prevented from accelerating the note, or when the creditor has not made proper demand after accelerating the note, generally the most important remedial strategy is to seek punitive damages under a tort theory. The most common tort theories for creditor liability are conversion, trespass, and negligence. n59

If a tort violation is found, and the creditor's actions meet a state's standards for punitive damages, then punitive damages should be awarded. Courts often award punitive damages in the $20,000 to $30,000 range or even higher where creditors wrongfully repossess or accelerate, or even where creditors merely do not properly notify the debtor of an impending acceleration or repossession. n60

[b] Other Remedies

Where creditors repossess property without a proper default or illegally accelerate a loan, the creditor may also be

subject to statutory damages under the UCC, n61 under applicable RISA, MVRISA, or other state consumer credit legislation that may be violated, or under state deceptive practices statutes. In addition, an independent repossession agency (but not the creditor unless its employee impersonates a third party) n62 will be liable for statutory damages up to $1000 under the Federal FDCPA.

The FDCPA prohibits independent repossession agencies (but not creditors) from seizing collateral when there is no present right to the collateral. n63

The major opportunity for multiple damages and attorney fees is a claim under a state deceptive practices statute. Finally, it may be that the creditor's improper action releases a surety or guarantor from any further obligation on the note.

[c] Effect of Federal and State Electronic Signature Laws on State Right-to-Cure Statutes

[i] Coverage

In early 2000, Congress passed the Electronic Signatures in Global and National Commerce Act ("E-Sign"), which took effect October 1, 2000. n64 At the same time, a number of states were adopting the Uniform Electronic Transactions Act ("UETA"). n65 Both statutes affect state right-to-cure laws. Neither E-Sign nor UETA applies to a contract or other record (electronic document) "to the extent that it is governed by" Article 9. n66

Thus, neither affects notices, such as the notice of the repossession sale, that are required by Article 9. These notices must still be provided in accordance with the requirements of Article 9, although, in states that have adopted the 1999 revisions to Article 9, electronic notices will be authorized in many circumstances. n67 E-Sign also exempts right-to-cure notices that relate to an individual's primary residence, such as a mobile home. n68 Both statutes do, however, appear to apply to other state right-to-cure laws. n69 Additionally, both statutes allow electronic notices even if the consumer did not enter into the transaction electronically, as long as the consumer consents in a way that satisfies the statute's requirements. E-Sign preempts state laws that require that contracts or other documents be written, signed, or in nonelectronic form. n70 It allows states to supersede its substantive requirements, however, by enacting UETA or by enacting other laws that are technologically neutral and consistent with it. n71 The state law must specifically say that it is modifying, limiting, or superseding the federal law. n72

[ii] Substantive Provisions of E-Sign

In states that have not adopted UETA or another law that is consistent with E-Sign, the federal statute controls. Assuming that it applies to right-to-cure notices, it allows electronic rather than paper notices if the consumer consents. n73

E-Sign does not affect requirements concerning the content or timing of notices. n74 Format requirements for right-to-cure notices, *e.g.*, type size or conspicuousness, should be considered part of the "content" requirements that creditors must still follow.

[iii] Substantive Provisions of UETA

Section 101 of E-Sign (which contains most of its substantive rules) n75 maynot apply in the few states n76 that have adopted a conforming version of UETA and specifically expressed an intent to supersede the federal statute. Even in these states, there is still a question of how much of E-Sign's section 101 is displaced, and the consumer consent provisions may still apply. n77 In that case, the question whether a right to cure notice can be sent electronically is determined by UETA rather than by E-Sign.

UETA is different in many ways from E-Sign. First, it does not have any of E-Sign's confirmation of consent

procedures. It merely requires that the parties agree to conduct transactions by electronic means. n78 The only nod it gives to consumer protection in the consent process is that "[w]hether the parties agree to conduct a transaction by electronic means is determined from the context and surrounding circumstances, including the parties' conduct."

If the state adopted UETA before E-Sign was passed, n79 adopted a non-uniform version of UETA or other state law inconsistent with E-Sign after E-Sign was passed, n80 or has not specifically expressed an intent to supersede E-Sign, n81 then the federal protections apply as in addition to UETA's rules on consumer consent. n82 Creditors in such states will have to give the disclosures and follow the confirmation of consent procedures that E-Sign requires.

UETA does not override any substantive provisions of state law and clearly preserves state law requirements regarding format of notices. n83

[iv] Manner of Delivery of Notices Under E-Sign and UETA

Some state right-to-cure laws require certified mail notice to the debtor. E-Sign provides that, if a pre-existing law requires something to be made available by a specified method that requires verification or acknowledgement of receipt, it can be provided electronically only if the method used provides verification or acknowledgement of receipt. n84

UETA also does not override state laws about how information is to be "sent, communicated, or transmitted." n85 For example, the official comments state that, if a state law requires information to be sent to the consumer by mail, mail must be used, although the creditor can mail an electronic disk instead of a letter. Section 8(d) provides that state law requirements for use of first class mail can be varied by agreement, to the extent permitted by other law, but there is no similar provision for state law requirements that certified mail be used.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Secured Transactions (Article 9)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionGeneral Overview

FOOTNOTES:

(n1)Footnote 1. Revised *U.C.C. § 9-609* [former *U.C.C. § 9-503*]. *See, e.g., Christie's Inc. v. Davis, 247 F. Supp. 2d 414, 49 U.C.C. Rep. Serv. 2d 684 (S.D.N.Y. 2002)* ; *Corbin v. Regions Bank, 258 Ga. App. 490, 574 S.E.2d 616, 49 U.C.C. Rep. Serv. 2d 1328 (2002)* (inducing debtor to surrender collateral when he was not in default was wrongful repossession and conversion); *Ansley v. Conseco Fin. Serv. Corp., 2002 Mich. App. LEXIS 2033* (Mich. Ct. App. Dec. 17, 2002) (unpublished).

(n2)Footnote 2. Revised *U.C.C. § 9-609* [former *U.C.C. § 9-504(1)*].

(n3)Footnote 3. *See* Revised *U.C.C. § 9-601* [former *U.C.C. § 9-501(1)*]. *See also Manufacturers Hanover Leasing Corp. v. Ace Drilling Co., 726 F. Supp. 966 (S.D.N.Y. 1989)* ; *Brockbank v. Best Capital Corp., 341 S.C. 372, 534 S.E.2d 688 (2000)* (court held that creditor was required to treat alleged abandonment as default). *See, e.g., Kahwaty v. Potter, 57 U.C.C. Rep. Serv. 2d 1000 (Wash. Ct. App. 2005)* (failure to maintain insurance as required by contract was default even though contract did not list it as one of grounds for default).

(n4)Footnote 4. *Goodwin v. Harmon, 34 U.C.C. Rep. Serv. 2d 551 (Minn. Ct. App. 1997)* (unpublished).

(n5)Footnote 5. *See, e.g., Chrysler Credit Corp. v. Barnes, 126 Ga. App. 444, 191 S.E.2d 121, 11 U.C.C. Rep. Serv. 327 (1972)* (repossession improper when debtor tendered the missed payment before repossession occurred and creditor had not given notice of acceleration of debt); *Fontaine v. Indus. Nat'l Bank, 298 A.2d 521 (R.I. 1973)* (debtor

was not in default on current payment; creditor could not claim that it had accelerated because of debtor's lateness in making other payments when it had not given notice of acceleration and demanded the accelerated amount).

(n6)Footnote 6. Revised *U.C.C. § 1-309* [former U.C.C. § 1-208]. Note that the Uniform Consumer Credit Code places the burden of establishing the prospect of significant impairment upon the creditor. *See* National Consumer Law Center, Repossessions, § 4.1.6 (6th ed. 2005 and Supp.).

(n7)Footnote 7. *See, e.g., In re Progressive Farmers Ass'n, 50 B.R. 525, 536 (Bankr. W.D. Mo. 1985)* .

(n8)Footnote 8. *Meredith v. Pathfinders Detective & Recovery, Inc., 1983 U.S. Dist. LEXIS 20367* (D.S.C. Nov. 9, 1983) (South Carolina defines default only as nonpayment or "significant impairment" of prospect of payment, performance, or realization of collateral; consumer's statement that creditor would never take his car insufficient because he was merely asserting his legal rights, and creditor had already accelerated the debt and threatened to repossess).

(n9)Footnote 9. *See Williamson v. Nissan Motor Acceptance Corp., 631 So. 2d 241 (Ala. 1993)* ; *Anderson v. Mobile Disc. Corp., 595 P.2d 203, 26 U.C.C. Rep. Serv. 248 (Ariz. Ct. App. 1979)* ; *Ford Motor Credit Co. v. Hunt, 241 Ga. 342, 245 S.E.2d 314, 24 U.C.C. Rep. Serv. 251 (1978)* ; *Fulton Nat'l Bank v. Horn, 239 Ga. 648, 238 S.E.2d 358, 22 U.C.C. Rep. Serv. 1302 (1977)* ; *Oak Mountain Dev. Corp. v. Harrell, 162 Ga. App. 186, 290 S.E.2d 177, 34 U.C.C. Rep. Serv. 407 (1982)* ; *Van Bibber v. Norris, 419 N.E.2d 115, 31 U.C.C. Rep. Serv. 1522 (Ind. 1981)* ; *King v. South Jersey Nat'l Bank, 30 A.2d 1, 15 U.C.C. Rep. Serv. 969 (N.J. 1974)* .

(n10)Footnote 10. *See Hence v. Indian Cave Park P'ship, 2007 U.S. Dist. LEXIS 29329* (S.D. Tex. Apr. 20, 2007) (foreclosure case; requiring notice prior to acceleration when contract clause is not clear and unequivocal).

(n11)Footnote 11. *Cf. Wallace v. Sunstar Acceptance Corp., 2000 Ohio App. LEXIS 2008* (Ohio Ct. App. May 12, 2000) (where a consumer was not habitually late but, instead, justifiably relied on creditor's mistaken representation that payments were not owed, the creditor could not accelerate the note without any notice prior to the repossession; the creditor was equitably estopped from holding consumer in default on her installment loan).

(n12)Footnote 12. *11 U.S.C. § 541(c)(1).*

(n13)Footnote 13. *15 U.S.C. § 1691(a)(3).*

(n14)Footnote 14. National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, Ch. 8 (6th ed. 2005).

(n15)Footnote 15. National Consumer Law Center, Credit Discrimination § 3.4.4 (5th ed. 2009).

(n16)Footnote 16. *50 U.S.C. app. § 526. See Rodriguez v. Am. Express, 2006 U.S. Dist. LEXIS 17727* (E.D. Cal. Apr. 7, 2006) (reduction of interest charges must be effective as of date of entry into active duty, not date lender received notice); *cf. Linscott v. Vector Aerospace, 2007 U.S. Dist. LEXIS 55841* (D. Or. July 27, 2007) (servicemember's obligation to provide creditor with written notice and copy of military orders within 180 days of termination or release from military service is not excused by "substantial compliance").

(n17)Footnote 17. *Moll v. Ford Consumer Fin. Co., 1998 U.S. Dist. LEXIS 3638,* at *4 (N.D. Ill. Mar. 16, 1998) .

(n18)Footnote 18. OCC Advisory Letter, No. AL 2001-10 (Oct. 25, 2001).

(n19)Footnote 19. *See Rubin v. Gallery Auto Sales, 1997 WL 1068459* (Ohio C.P. June 23, 1997) (repossessing and demanding payment of accelerated balance when default had lasted less than 30 days is RISA violation and amounts to conversion).

(n20)Footnote 20. Revised *U.C.C. § 9-406(a)*. These rights apply to an account debtor on an account, chattel paper, or a payment intangible, terms that are defined in Revised *U.C.C. § 9-102*. The comparable provision of the pre-1999 version of Article 9 was § 9-318.

(n21)Footnote 21. *Id*.

(n22)Footnote 22. Revised *U.C.C. § 9-406(c)*.

(n23)Footnote 23. Revised *U.C.C. § 9-406(c)*.

(n24)Footnote 24. *Saice v. Mid-America Bank, 1999 U.S. Dist. LEXIS 20845* (D. Minn. Sept. 20, 1999) (for electronic publication only) (creditor's motion for summary judgment denied where debtor alleged that the creditor failed to provide notice that late payments were no longer acceptable); *Williamson v. Wanlass, 545 P.2d 1145, 18 U.C.C. Rep. Serv. 1116 (Utah 1976) . See also In re Valentine, 292 B.R. 164 (Bankr. S.D. Ohio 2003)* (creditor who accepted late payments was estopped from declaring debtor in breach of reaffirmation agreement). *But see Parker v. Genco Fed. Credit Union, 1999 Tex. App. LEXIS 6455* (Tex. App. Aug. 26, 1999) (unpublished) (where contract included provision allowing for creditor to delay enforcement of its rights under the agreement without losing the ability to accelerate the note, creditor did not waive its rights to strict compliance by accepting late payments) *Wright v. Wells Fargo Auto Fin., Inc., 59 U.C.C. Rep. Serv. 2d 8 (Iowa Dist. Ct. 2005)* (mailing letters demanding strict compliance, and then continuing to accept late payments, was not waiver when consumers did not receive the letters**);** *Catron v. Citizens Union Bank, 229 S.W.3d 54 (Ky. Ct. App. 2006)* (bank could accelerate despite past acceptance of late payments when note so provided and also waived notice of default).

(n25)Footnote 25. *Williams v. Precision Recovery, Inc., 2004 U.S. Dist. LEXIS 6190* (N.D. Ill. Apr. 7, 2004) (denial of motion to dismiss).

(n26)Footnote 26. *Callaway v. Whittenton, 52 U.C.C. Rep. Serv. 2d 525 (Ala. 2003)* .

(n27)Footnote 27. *Saunders v. Branch Banking & Trust Co., 526 F.3d 142 (4th Cir. 2008)* .

(n28)Footnote 28. National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses Ch. 8 (4th ed. 2009).

(n29)Footnote 29. *See Wiley v. General Motors Acceptance Corp., 624 So. 2d 518 (Ala. 1993)* (repossession wrongful if creditor knows of insurance and of debtor's disability, and debtor takes steps to make insurance claim; "at least an implied promise" not to repossess); *Corbin v. Regions Bank, 574 S.E.2d 616 (Ga. Ct. App. 2002)* (conversion and wrongful repossession; genuine issue of fact whether creditor had right to declare default and repossess when file contained copy of insurance certificate naming creditor as loss payee; failure to pay resulted from disability, but debtor never filed insurance claim); *Elyria Sav. & Trust Nat'l Bank v. Santiago, 1991 WL 771242* (Ohio Mun. Ct. Dec. 10, 1991) (before declaring default or acceleration, creditor must ascertain extent of coverage and nature of any possible claim, and give consumer fair and reasonable opportunity to establish and maintain eligibility and collect benefits).

(n30)Footnote 30. *See McCormick v. Sentinel Life Ins. Co., 153 Cal. App. 3d 1030 (1984)* (insurance carrier had a duty to conduct at least a limited investigation when borrower filed a claim against a credit disability policy but submitted subsequent claim forms to secured party believing secured party was the insurer); National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses Ch. 8 (4th ed. 2009).

(n31)Footnote 31. Revised *U.C.C. § 9-609* [former *U.C.C. § 9-501*].

(n32)Footnote 32. *Heltzel v. Mecham Pontiac, 152 Ariz. 58, 730 P.2d 235 (1986)* .

(n33)Footnote 33. See Revised *U.C.C. § 9-625(c)(2)* [former *U.C.C. § 9-507(1)*], which applies whenever the

secured party is not proceeding in accordance with the provisions of Part 5. Part 5 includes the requirement that there be a default prior to repossession.

(n34)Footnote 34. *See Cannon v. Metro Ford, Inc., 242 F. Supp. 2d 1322 (S.D. Fla. 2002)* (consumer's signature consummates the transaction even if dealer does not sign agreement). In addition, the dealer's notations on the contract may be sufficient to show a signature. In particular, see if the dealer's name is typed below the signature line. The *U.C.C. § 1-201(39)* defines "signed" as "any symbol executed or adopted by a party with present intention to authenticate a writing." The Official Comment notes that the signature may be printed, stamped, or written, and may even be found in the letterhead. *See* Official Comment 39 to *U.C.C. § 1-201*. Revised Section 1-201(b)(37), so far adopted by only three jurisdictions, preserves this definition. *But cf. Brewer v. Stokes Kia, 613 S.E.2d 802 (S.C. Ct. App 2005)* (failure to find financing is a default if the contract so specifies).

(n35)Footnote 35. *See Peak v. Ted Russell Enters., Inc., 2000 Tenn. App. LEXIS 120* (Tenn. Ct. App. Feb. 28, 2000) (contingency clause created condition precedent and buyer was a mere bailee); *Scott v. Forest Lake Chrysler-Plymouth-Dodge, 611 N.W.2d 346 (Minn. 2000)* (use of separate document with contingency clause did not violate state credit act). *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.4.5 (5th ed. 2002).

(n36)Footnote 36. *See Daenzer v. Wayland Ford, Inc., 2002 U.S. Dist. LEXIS 8409* (W.D. Mich. May 7, 2002) ; *Braucher v. Mariemont Auto, 2002 Ohio App. LEXIS 3522* (Ohio Ct. App. June 28, 2002) (deceptive to fail to disclose financing contingency); *Cardwell v. Tom Harrigan Oldsmobile, Inc., 1984 Ohio App. LEXIS 10104* (Ohio Ct. App. June 27, 1984) (dealer violated UDAP statute by refusing to transfer title unless buyer paid charges beyond those required by contract).

(n37)Footnote 37. *Wash. Rev. Code § 46.70.180(4)(b).*

(n38)Footnote 38. *Utah Code Ann. § 41-3-401.*

(n39)Footnote 39. *La. Rev. Stat. Ann. § 32:1254(N)(3)(f)* (as amended by 2004 La. Acts 670).

(n40)Footnote 40. *Couture v. G.W.M., Inc., 2002 WL 31962752* (N.H. Super. Ct. Dec. 3, 2002) (dealer used a contingency clause that required the consumer to agree in advance to an unspecified higher interest rate if the contract at the stated rate could not be assigned to a financer; allowed the case to go forward to determine if this clause violated the installment sales statute)

(n41)Footnote 41. *See Fox v. Montell Corp., 2001 U.S. Dist. LEXIS 3403* (N.D. Ill. Mar. 19, 2001) ; *Williams v. Thomas Pontiac-GMC-Nissan-Hyundai, 1999 U.S. Dist. LEXIS 15045* (N.D. Ill. Sept. 24, 1999) .

(n42)Footnote 42. *See Pescia v. Auburn Ford-Lincoln Mercury, Inc., 68 F. Supp. 2d 1269 (M.D. Ala. 1999)* .

(n43)Footnote 43. *See Williams v. Thomas Pontiac-GMC-Nissan-Hyundai, 1999 U.S. Dist. LEXIS 15045* (N.D. Ill. Sept. 22, 1999) (dealer did not have duty to proceed under *U.C.C. § 9-504* in yo-yo sale because buyer was not in default; court allows other claims). *See also Padin v. Oyster Point Dodge, 397 F. Supp. 2d 712, 724-725 (E.D. Va. 2005)* (repossession was wrongful in yo-yo sale when buyer had made all required payments); *Love v. O'Connor Chevrolet, Inc.,2006 U.S. Dist. LEXIS 52612* (N.D. Ill. July 11, 2006) (repossession is wrongful following yo-yo sale when consumer's actions did not satisfy the contractual grounds for default; wrongful repossession following yo-yo sale can also be UDAP violation).

(n44)Footnote 44. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 7.3.9 (7th 2d. 2008).

(n45)Footnote 45. *See* National Consumer Law Center, Credit Discrimination Ch. 10 (4th ed. 2005 and Supp.).

(n46)Footnote 46. N.H. Stat. § 361-A:10-b (effective July 23, 2004).

(n47)Footnote 47. Former *U.C.C. § 1-201(37)*. Revised *U.C.C. § 1-201(b)(35)*, so far adopted only by three jurisdictions, preserves this definition without substantive change.

(n48)Footnote 48. Revised *U.C.C. § 9-406*.

(n49)Footnote 49. *U.C.C. § 2-711(1)*.

(n50)Footnote 50. A related issue is whether a consumer can continue to use a car after revocation. Although it is safer to advise a client not to do so, there are circumstances under which continued use is not inconsistent with revocation. *See* National Consumer Law Center, Consumer Warranty Law §§ 8.4.6.1, 8.4.6.3 (3d ed. 2006).

(n51)Footnote 51. *See Detroit & N. Sav. & Loan Ass'n v. Woodworth, 54 Mich App. 517, 221 N.W.2d 190, 15 U.C.C. Rep. Serv. 403 (1974)* (consumer entitled to show that damages should be off-set against first ten installment payments).

(n52)Footnote 52. Revised *U.C.C. § 9-110* [former *U.C.C. § 2-711(3)*]. *See* Revised *U.C.C. § 9-110*, Official Comment 4.

(n53)Footnote 53. *See* National Consumer Law Center, Consumer Warranty Law Appx. J.2 (3d ed. 2006 and Supp.) (sample letter).

(n54)Footnote 54. *U.C.C. § 2-711(3)*.

(n55)Footnote 55. Notice requirements of state right to cure statutes have been affected by the federal Electronic Signatures in Global and National Commerce Act [hereinafter E-Sign] law, and state Uniform Electronic Transactions Acts [hereinafter UETAs]; *see § 10.03[9][c] infra*. These two statutes are also discussed in detail in National Consumer Law Center, Consumer Banking and Payments Law Ch. 9 (2d ed. 2002). *See Meredith v. Pathfinders Detective & Recovery, Inc., 1983 U.S. Dist. LEXIS 20367* (D.S.C. Nov. 9, 1983) (repossession without having provided notice of right to cure required by state statute was conversion and Fair Debt Collection Practices Act violation).

(n56)Footnote 56. *12 C.F.R. § 590.4*. *See 12 C.F.R. § 590.2(b)* (definition of "federally-related").

(n57)Footnote 57. *12 U.S.C. § 1735f-7a*.

(n58)Footnote 58. But note that if a mortgage loan is secured both by a first lien on the residential mobile home and by a first lien on real property, one court has held that the Depository Institutions Deregulation and Monetary Control Act of 1980 [hereinafter DIDA] applies even if the consumer safeguards specified in the regulations are not followed. In *Nelson v. River Valley Bank & Trust, 334 Ark. 172, 971 S.W.2d 777 (1998)* , the Arkansas Supreme Court reasoned that a historical note following the codification of DIDA directs that if more than one DIDA provision applies to a loan, the loan may be made at the highest applicable rate. Here, the provision governing a first lien on real property does not require consumer safeguards in order to trigger DIDA preemption, and thus permits an interest rate higher than state usury limits would allow.

(n59)Footnote 59. *Farmers & Merchs. Bank v. Hancock, 506 So. 2d 305, 3 U.C.C. Rep. Serv. 2d 1983 (Ala. 1987)* (upholding $30,000 punitive damages and $26,000 damages for mental anguish where no good faith in acceleration of note and debtor voluntarily turned over collateral).

(n60)Footnote 60. *Winkle Chevy-Olds Pontiac v. Condon, 830 S.W.2d 740 (Tex. App. 1992)* (debtor not in default awarded damages for lost value of repossessed vehicle, lost business income and $25,000 punitive damages on conversion claim, in addition to $5,000 treble damages and $5,000 for mental anguish under state unfair and deceptive acts and practices [hereinafter UDAP] claim).

(n61)Footnote 61. Statutory damages under Revised *U.C.C. § 9-625* [former *U.C.C. § 9-507(1)*] are 10% of the principal plus the whole finance charge.

(n62)Footnote 62. *15 U.S.C. § 1692a(6)*.

(n63)Footnote 63. *15 U.S.C. §§ 1692(f)(6)*, *1692(a)*.

(n64)Footnote 64. Pub. L. No. 106-229, *114 Stat. 464 (2000)*. Key excerpts of the act's legislative history are posted on the Consumers Union website, http://www.consumersunion.org.

(n65)Footnote 65. Unif. Elec. Transactions Act, 7A U.L.A. 20 (Supp. 2000) (UETA). The text of UETA is reprinted as Appx. I.2.2 of National Consumer Law Center, Consumer Banking and Payments Law (4th ed. 2009). It is also available from the website of the National Conference of Commissioners on Uniform State Laws (NCCUSL), www.nccusl.org, as is an up-to-date list of those states which have adopted the uniform act.

(n66)Footnote 66. E-Sign, *15 U.S.C. § 7003(a)(3)*; UETA § 3(b).

(n67)Footnote 67. Revised Article 9 defines "record" to include both written and electronic documents, and "authenticate" is defined to include traditional signatures and electronic signatures. Revised *U.C.C. § 9-102(a)(7)* and (a)(69). *See generally* National Consumer Law Center, Repossessions, § 4.8.3.2 (6th ed. 2005).

(n68)Footnote 68. *15 U.S.C. § 7003(b)(2)(B)*.

(n69)Footnote 69. On the other hand, the statutory language could be read to completely exclude those aspects of contracts that are covered by Article 9 from coverage by the E-Sign. In that case, the federal statute would be inapplicable to right to cure laws because they regulate the same aspects of contracts as Article 9 does.

(n70)Footnote 70. *15 U.S.C. § 7001(a)*, *(b)*.

(n71)Footnote 71. *15 U.S.C. § 7002(a)*.

(n72)Footnote 72. *See 15 U.S.C. § 7002(a)*. *See also* National Consumer Law Center, Consumer Banking and Payments Law, § 11.4.6 (4th ed. 2009) (detailed discussion of the opt-out provisions of E-Sign). Only two states, Arkansas and Louisiana, have enacted a uniform version of UETA after passage of E-Sign with the express intent of displacing E-Sign's consumer consent requirements. *See* National Consumer Law Center, Consumer Banking and Payments Law § 9.5.5.3.4, App. H (2d ed. 2002 and Supp.).

(n73)Footnote 73. *15 U.S.C. § 7001(c)(1)(A)*. A discussion of the requirements for valid consent under E-Sign is contained at *§ 1.05[2][a] supra* .

(n74)Footnote 74. *15 U.S.C. § 7001(c)(2)(A)*.

(n75)Footnote 75. *15 U.S.C. § 7001*.

(n76)Footnote 76. Arkansas and Louisiana. *See* National Consumer Law Center, Consumer Banking and Payments Law, § 11.4.5 (4th ed. 2009).

(n77)Footnote 77. *See* National Consumer Law Center, Consumer Banking and Payments Law, § 11.4.5 (4th ed. 2009).

(n78)Footnote 78. UETA § 5(b).

(n79)Footnote 79. *See* National Consumer Law Center, Consumer Banking and Payments Law, § 11.4.5.3 (4th ed.

2009).

(n80)Footnote 80. *See* National Consumer Law Center, Consumer Banking and Payments Law, § 11.4.5.4.3 (4th ed. 2009).

(n81)Footnote 81. *See* National Consumer Law Center, Consumer Banking and Payments Law, § 11.4.5.4.5 (4th ed. 2009).

(n82)Footnote 82. *See* National Consumer Law Center, Consumer Banking and Payments Law, § 11.4.6 (4th ed. 2009).

(n83)Footnote 83. UETA § 8(b)(3).

(n84)Footnote 84. *15 U.S.C. § 7101(c)(2)(B).*

(n85)Footnote 85. UETA § 8(b)(2).

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Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 10 Repossessions

1-10 Consumer Credit Law Manual § 10.04

§ 10.04 Replevin

[1] Overview

[a] Replevin and Writ of Replevin

Upon debtor's default, the secured party can seize the collateral through self-help repossession or through judicial action. n1 These judicial procedures have different names in different states: replevin, detinue, claim and delivery, bail, sequestration, trover, or simply recovery of personal property. For convenience, this chapter refers to all of these statutory actions as "replevin."

Every state has a replevin statute and/or specific court rules on replevin proceedings. Replevin procedures will be found in the statutory or rule provisions for pre-judgment remedies, provisional remedies, or special proceedings.

Replevin is a costly and time-consuming process compared to self-help repossession. Most courts require strict compliance with the replevin statute. Creditors usually resort to a replevin action only when self-help repossession would lead to a breach of the peace, n2 or where self-help repossession is barred.

Replevin determines, between the secured party (or any other party seeking property) and the debtor (or other person possessing the property), the rightful possession of the property. If the creditor prevails, the court orders the sheriff to seize the collateral and turn it over to the creditor. In a replevin action, the court does not grant a judgment on the debt, order a judicial sale of the collateral, or award deficiency judgment. Replevin only determines possession of the disputed property, although a plaintiff may recover damages for depreciation or loss of use, and a number of state statutes permit the joinder of a replevin claim with a claim for the value of the property n3 (in these cases, a successful plaintiffmust elect between remedies to avoid double recovery). Creditors recovering the collateral through a replevin action must still dispose of the property according to UCC requirements just as if the creditor had resorted to self-help repossession.

[b] Debtor Strategies

The debtor has several responses to a replevin action. Where the proceeding is initiated via an ex parte writ of replevin, the debtor can challenge the method of issuing the writ of replevin as violative of the state replevin statute and of the

U.S. Constitution, or may challenge it on substantive or jurisdictional grounds, raising defenses and counterclaims.

The debtor can also attack the adequacy of the creditor's bond or can post a counter-bond, regaining possession of the collateral, or can seek to have the replevin action dismissed and sue for damages if the creditor, after obtaining prejudgment custody of the collateral through a writ of replevin, fails to pursue the action on the merits, or if the creditor sells the collateral before a final judgment.

[2] Constitutional Standards Controlling Writ of Replevin

[a] General

State replevin procedures existing today typically meet constitutional requirements, but constitutional standards will be critical in many cases because courts will interpret ambiguous provisions in a manner so that they meet minimum constitutional standards. The seizure of the debtor's property without strict compliance with state procedures may violate not only the statute, but also *Fourteenth Amendment* due process or *Fourth Amendment* search and seizure standards.

[b] Due Process

In *Fuentes v. Shevin*, n4 the U.S. Supreme Court ruled that the Florida and Pennsylvania writ of replevin procedures violated due process. Debtors were denied the right to notice and an opportunity to be heard before their property was seized. *Fuentes* and the lower court cases following it n5 held that the state could seize the debtor's property without a prior hearing only in extraordinary circumstances. In response, many state legislatures amended their replevin statute to require notice to the debtor and a hearing prior to the writ's issuance.

Two years later, the Court, in *Mitchell v. W.T. Grant Co.*, n6 upheld the Louisiana writ of replevin procedure (called a writ of sequestration) even though the creditor could obtain the writ on an *ex parte* application without notice to the debtor. The Court noted that the debtor was protected against loss by the creditor's bond, and then distinguished the Louisiana procedure from the Pennsylvania and Florida procedures it had earlier rejected.

The following year, the Court, in *North Georgia Finishing v. Di-Chem,*, n7 ruled that a Georgia wage garnishment procedure fell short of the *Mitchell* due process standards.

Mitchell and *Di-Chem* taken together indicate that an *ex parte* application for a writ of replevin satisfies due process only if the creditor files under oath the factual allegations upon which the claim is based; the creditor's affidavit specifically alleges grounds for the creditor's claim of possession that are readily susceptible to proof without an adversary hearing; the writ is issued under judicial supervision; the debtor has the right to an immediate post-seizure hearing; and the creditor posts a sufficient bond.

[c] Unreasonable Search and Seizure

Fuentes, *Mitchell*, and *Di-Chem* were decided only on due process grounds, but writ of replevin procedures must also comply with *Fourth Amendment* search and seizure standards. n8 The writ of replevin authorizes the sheriff to search the debtor's property, use force if necessary, and seize property in the debtor's possession. Thus, *Fourth Amendment* protections apply to replevin actions, in addition to criminal proceedings. n9

To prevent the sheriff from conducting an overbroad search, writs of replevin must specify with particularity the property to be seized and indicate where the property is to be found. The writ should be issued only if a judge has found probable cause for a search.

[d] State Constitutional Provisions

The search and seizure and due process provisions of state constitutions have been read more expansively than the U.S. Supreme Court's current interpretations of the *Fourth* and *Fourteenth Amendments*. Consumer attorneys can argue that such provisions, or state provisions for rights without federal counterparts, forbid the issuance of *ex parte* writs of replevin.

[3] Challenging Writs Issued *Ex Parte*.

[a] Introduction

Creditors prefer to apply for writs of replevin *ex parte* when this is possible. *Ex parte* hearings minimize the creditor's paperwork, expedite the process, and give the creditor significant leverage over the debtor by seizing the collateral before the debtor can raise defenses. However, *ex parte* hearings must meet strict constitutional and statutory guidelines.

Creditors can only obtain writs of replevin *ex parte* if authorized by a particular state statute or rule, and not all states authorize this procedure.

States have redrafted their writ of replevin procedures to meet standards enunciated in *Fuentes*, *Mitchell*, and *Di-Chem*. Consequently, a debtor will likely fail in a challenge of a state's current procedures as unconstitutional on their face. n10

A constitutional challenge may be successful if the creditor applies for an *ex parte* writ under the wrong statute's procedures. If the creditor utilizes the correct statute, debtor attorneys should concentrate their efforts in determining whether the creditor's application for the *ex parte* writ strictly followed those procedures in all respects.

Most state replevin statutes limit the creditor's ability to obtain a writ *ex parte* to specified situations, such as where the creditor can establish that the debtor is likely to conceal, destroy, remove from the state, or fraudulently transfer the collateral. n11

For an *ex parte* writ to meet due process standards, the creditor must file an affidavit justifying the creditor's superior right to the collateral. Someone with actual knowledge of the allegations must swear to the affidavit, and the affidavit must indicate specific facts readily susceptible to proof without an adversary proceeding. An affidavit containing only conclusory allegations by one not having personal knowledge of the facts does not satisfy due process requirements. n12

Debtor attorneys should make certain that a judge and not just a clerk reviewed the *ex parte* application and signed the writ.

[b] The Post-Seizure Hearing

Debtors have a due process right to an immediate hearing after their property has been seized pursuant to an *ex parte* writ. n13 Debtors must receive adequate and timely notice of the right to a hearing. The failure to hold the hearing at the location specified in the notice is sufficient grounds to open a default judgment and overturn the writ of replevin.

[c] Debtor's Consent to the Seizure

Creditors may defend against a debtor's due process challenge by pointing to a provision in the credit agreement whereby the debtor consents to the creditor's repossession of the collateral. But courts should reject this defense for several reasons: it is unlikely the debtor knowingly consented to the sheriff seizing the collateral and courts should not enforce adhesive consumer credit agreements that waive consumers' constitutional due process rights. The mere inclusion in the credit agreement of a waiver of the consumer's right to a hearing on a replevin action violates the FTC's

Credit Practices Rule. n14

[d] Debtor Remedies

Where the debtor has been deprived of property through an unconstitutional process, the debtor has an action under *42 U.S.C. section 1983* for a civil rights violation.

The debtor may also prevail on a state law claim for violation of the writ of replevin procedure.

[4] Challenging Writ of Replevin at Hearing Prior to or Immediately After Seizure

[a] Right to a Hearing

Debtors have a constitutional and statutory right to contest the seizure of their property, either at a hearing before or immediately after the seizure. At the hearing, the debtor has an opportunity to object to the writ of replevin. The opportunity for a hearing must be meaningful and the debtor must be given a chance to present his defense. n15

[b] The Court's Jurisdiction to Issue Writ

A writ can be properly issued only if the creditor applies to a court that has both jurisdiction and proper venue to seize the debtor's property. n16

[c] Replevin Statute's Application to Mobile Home Seizures

A state replevin statute will not apply to mobile homes seizures where the state replevin statute applies only to personalty, and the state treats mobile homes as realty for purposes of secured transactions. n17

[d] Has a Complaint Been Filed?

State replevin procedures may require the creditor to file an adequate complaint in the replevin action and arrange for the debtor to receive a proper summons before the court will issue a writ of replevin. The debtor's attorney should argue that the writ should not issue if the complaint has not been filed or is not adequate.

[e] Debtor's Substantive Defenses and Counterclaims

The debtor's statutory right to a hearing before or immediately after issuance of the writ is based upon a constitutional due process requirement. Debtors should thus claim the right at that hearing to a full airing of their defenses and/or counterclaims. n18 In Wisconsin, the consumer may reinstate the contract and obtain possession of the collateral even after replevin. n19 Reinstatement requires paying the amount in default, court costs and certain other costs, and a performance deposit of three installments.

[f] Attorney's Fees

Under some state replevin statutes, attorney's fees may be available to the successful defendant.

[5] Creditor's Bond and Debtor's Counter-Bond

[a] Challenging the Creditor's Bond

Creditors must post an adequate bond with sufficient sureties to obtain temporary custody of the collateral pending the replevin trial on the merits. If the debtor prevails on the merits, the bond protects the debtor from damage to the collateral. Replevin statutes specify the amount of the bond, usually double the collateral's value. Where the writ of

replevin is issued ex parte, the failureto post an adequate bond is a due process violation that can lead to a civil rights action.

[b] Posting a Counter-Bond

An alternative debtor strategy to challenging the size of the bond or sufficiency of the sureties is for the debtor to post a counter-bond, although strict time limits for filing the counter-bond may be imposed on the debtor. Most states' replevin procedures allow the debtor to retain the collateral pending the trial on the merits by posting a counter-bond, although strict time limits for filing the counter-bond may be imposed on the debtor. A few state statutes allow the waiver or reduction of counter-bonds in cases of indigency or hardship.

[6] Debtor Resistance to Sheriff's Seizure of Collateral

Consumer attorneys should advise their clients not to resist the sheriff when the sheriff comes to seize the collateral pursuant to a writ of replevin. The debtor's remedy is limited to a damage action if the debtor can show the seizure was wrongful.

[7] The Trial on the Merits

[a] Creditor Failure to Pursue Replevin Action

The writ of replevin gives the creditor temporary custody of the collateral pending the outcome of the trial on the merits. If the creditor, satisfied with possession of the collateral, does not pursue the replevin action to final judgment, the debtor may be able to obtain a non-suit or other sanctions. The creditor will have to return the collateral to the debtor and will be liable for the debtor's damages.

[b] Consumer's Counterclaims and Substantive Defense

Consumer attorneys should not neglect defending the replevin action itself. The trial on the merits will give the debtor a chance to fully air all possible defenses. Any defenses relating to both the security interest and the underlying obligation should be raised. n20

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Sales (Article 2)RemediesBuyer's RemediesReplevin & Specific PerformanceCommercial Law (UCC)Secured Transactions (Article 9)DefaultGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultCreditor MisbehaviorRemedies for NoncomplianceCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionEnforcement

FOOTNOTES:
(n1)Footnote 1. Revised *U.C.C. § 9-609* [former *U.C.C. § 9-503*].

(n2)Footnote 2. Revised *U.C.C. § 9-609* [former *U.C.C. § 9-503*].

(n3)Footnote 3. *See, e.g., Ala. Code § 6-6-250*; *Wis. Stat. § 810.14. See also Aircraft Repair Servs. v. Stambaugh's Air Serv., Inc., 175 F.3d 314 (3d Cir. 1999)* (under Pennsylvania law, replevin is not an action for damages, although damages may be available "incidentally"); *Lozada v. Dale Baker Oldsmobile, Inc., 145 F. Supp. 2d 878 (W.D. Mich. 2001)* (replevin procedure can only be used to recover specific personal property and does not provide general remedy for recovery of damages); *Ivey v. Verbeck, 461 So. 2d 813 (Ala. Civ. App. 1984)* ; *Innovative Material Sys. v. Santa Rosa Utils., Inc., 721 So. 2d 1233 (Fla. Dist. Ct. App. 1998)* (claim for replevin may be joined with claim for value of

property; plaintiff must then elect between inconsistent remedies before the entry of judgment); *Demetree v. Stramondo, 621 So. 2d 740 (Fla. Dist. Ct. App. 1993)* ; *Roush v. Mahaska State Bank, 605 N.W.2d 6 (Iowa 2000)* (although damages are available in a replevin action, replevin is not an action for damages; as truck owner improperly filed replevin complaint against bank which had already returned wrongfully repossessed truck, Iowa's notice pleading rules allowed him to maintain an action for conversion, *i.e.*, for depreciation and loss of use of truck); Security Pac. Fin. Servs. v. Signfilled Corp., 125*N.M. 38, 956 P.2d 837 (Ct. App. 1998)* (where creditor who brought replevin and conversion actions had already repossessed mobile home, it had elected replevin and could obtain damages only for wrongful detention, *i.e.*, for depreciation during time while home was wrongfully held); *First Fed. Sav. & Loan Ass'n v. A & M Towing & Rd. Serv., 127 Ohio App. 3d 46, 711 N.E.2d 755 (1998)* (in replevin action, plaintiff may seek, in the alternative, return of property or money damages); *Global Steel Prods. Corp. v. Ecklund Carriers, Inc., 253 Wis. 2d 588, 644 N.W.2d 269 (2002)* (replevin remedy is return of property plus damages for its decrease in value while wrongfully held; alternative is value of property).

(n4)Footnote 4. *407 U.S. 67, 92 S. Ct. 1983, 32 L. Ed. 2d 556 (1972)* .

(n5)Footnote 5. *See Turner v. Colonial Fin. Corp., 467 F.2d 202 (5th Cir. 1972)* (interpreting Mississippi law); *Stuckers v. Thomas, 374 F. Supp. 178 (D.S.D. 1974)* ; *Thompson v. Keesee, 375 F. Supp. 195 (E.D. Ky. 1974)* . *See also Leslie v. Lacy, 91 F. Supp. 2d 1182 (S.D. Ohio 2000)* (on appeal) (Ohio statute permitting transfer of title to lienholders of motor vehicles, including mobile homes, was unconstitutional both on its face and as applied, because it provided for no notice to consumer before or after transfer, did not require proof of exigent circumstances, and provided no opportunity for a hearing).

(n6)Footnote 6. *416 U.S. 600, 94 S. Ct. 1895, 40 L. Ed. 2d 406 (1974)* .

(n7)Footnote 7. *419 U.S. 601, 95 S. Ct. 719, 42 L. Ed. 2d 751 (1975)* .

(n8)Footnote 8. *See, e.g., In re Foust, 310 F.3d 849 (5th Cir. 2002)* (genuine issue of fact whether locking up store for period of hours to inventory contents and remove fixtures was an unreasonable search); *Audio Odyssey, Ltd. v. Brenton First Nat'l Bank, 245 F.3d 721 (8th Cir. 2001)* (overlong seizure of real property in course of replevin of inventory and turning over keys to creditor violated *Fourth Amendment*), *aff'd on reh'g, 286 F.3d 498 (8th Cir. 2002)* (en banc). *See also Bernstein v. Roberts, 405 F. Supp. 2d 34 (D.D.C. 2005)* (*Fourth Amendment* applies equally to civil or criminal matters; wife of judgment debtor stated claim when federal marshals searched home pursuant to expired writ).

(n9)Footnote 9. *See, e.g., Waters v. Graham, 1999 U.S. Dist. LEXIS 8688* (D. Or. May 18, 1999) (extensive discussion of cases concerning application of *Fourth Amendment* to civil searches; although probable cause and specificity are guiding standards in civil as well as criminal cases, a "less strict or particularized showing" is sufficient for a civil seizure); *Owens v. Swan, 962 F. Supp. 1436 (D. Utah 1997)* ; *see also Abbott v. Latshaw, 164 F.3d 141 (3d Cir. 1998)* , *cert. denied, 527 U.S. 1035, 119 S. Ct. 2393, 144 L. Ed. 2d 794 (1999)* (where ex-husband alleged that constable, police and ex-wife wrongfully seized van without due process, he should have been given leave to amend complaint to add count alleging *Fourth Amendment* violation).

(n10)Footnote 10. *See Audio Odyssey, Ltd. v. Brenton First Nat'l Bank, 245 F.3d 721 (8th Cir. 2001)* (Iowa replevin statute that allows *ex parte* application for writ of replevin not unconstitutional on its face), *aff'd on reh'g, 286 F.3d 498 (8th Cir. 2002)* (en banc); *In re Foust, 310 F.3d 849 (5th Cir. 2002)* (denial of due process when court failed to make finding that pre-seizure hearing was not feasible; constitutionality of Mississippi statute "an open question" when courts have construed it to require a hearing whenever feasible but not articulated criteria for granting *ex parte* writ).

(n11)Footnote 11. *See Quality Ford of Mt. Vernon v. Metro Auto Leasing, Inc., 172 Misc. 2d 635, 660 N.Y.S.2d 341 (Sup. Ct. 1997)* (merely quoting statutory language is insufficient; creditor must allege some basis for belief that

property may be concealed or removed). *See also Audio Odyssey, Ltd. v. Brenton First Nat'l Bank, 245 F.3d 721 (8th Cir. 2001)* (in upholding constitutionality of Iowa replevin statute, court interpreted statute to require plaintiff to substantiate legal basis for obtaining *ex parte* writ of replevin, even though statute did not contain express requirement, holding that statute as written could be construed to require such a showing, and that statute grants court the authority to provide advance notice and hearing when circumstances are not exigent); *Weil v. Macri, 2002 Conn. Super. LEXIS 743* (Conn. Super. Ct. Mar. 6, 2002) (affidavit was sufficient); *Lennox Retail, Inc. v. McMillan, 786 So. 2d 1252 (Fla. Dist. Ct. App. 2001)* (allegations in unverified counterclaim insufficient); *In re Foust, 310 F.3d 849 (5th Cir. 2002)* (complaint "too skeletal" for due process, because it failed to clearly identify things to be seized). Georgia prohibits the issuance of an immediate writ of possession for interests in property arising out of consumer transactions. *Ga. Code Ann. §§ 44-14-260 to 44-14-261*; *see also Wash. State Employees Credit Union v. Robinson, 427 S.E.2d 15 (Ga. Ct. App. 1992)* (no writ of immediate possession may issue on a security interest arising from a consumer transaction); *Tempur-pedic Int'l, Inc. v. Waste to Charity, Inc., 2007 U.S. Dist. LEXIS 11435* (W.D. Ark. Feb. 16, 2007) (describing Arkansas short-form replevin procedure; *ex parte* writ requires showing of danger of concealment, destruction, or removal from jurisdiction); *Ford Motor Credit Co. v. N. Associates, Inc., 2007 U.S. Dist. LEXIS 6819* (M.D. Pa. Jan. 31, 2007) (*ex parte* writ requires showing of likelihood of success on merits and either that defendant will conceal, dispose of, waste, encumber, or remove the property, or that its value will be adversely affected; neither shown here); *In re Bursztyn, 366 B.R. 353, 2007 Bankr. LEXIS 1207* (Bankr. D.N.J. Apr. 10, 2007) (approving *ex parte* writ of replevin by bankruptcy trustee to obtain jewelry concealed by debtor when evidence showed that debtor possessed the jewelry and was likely to conceal or remove it).

(n12)Footnote 12. *See McMurrain v. Fason, 573 So. 2d 915 (Fla. Dist. Ct. App. 1991)* .

(n13)Footnote 13. *North Georgia Finishing, Inc. v. Di-Chem, Inc., 419 U.S. 601, 95 S. Ct. 719, 42 L. Ed. 2d 751 (1975)* ; *Mitchell v. W. T. Grant Co., 416 U.S. 600, 94 S. Ct. 1895, 40 L. Ed. 2d 406 (1974)* ; *Associates Commercial Corp. v. Wood, 22 F. Supp. 2d 502 (D. Md. 1998)* (Md. Transp. Code article dealing with abandoned vehicles was unconstitutional, when it provided no opportunity for a hearing before the deprivation became final, *i.e.,* before the new possessor obtained salvage title and could dismantle the vehicle); *Crown Builders v. Stowe Eng'g Corp., 8 F. Supp. 2d 483 (D.V.I. 1998)* (Virgin Islands prejudgment attachment statute, construed so as to save its constitutionality, requires pre-seizure hearing to give defendant opportunity to post security as permitted by other section of statute); *Thornton v. Carson, 111 Ariz. 490, 533 P.2d 657 (1975)* ; *Collection Prof'ls, Inc. v. Logan, 695 N.E.2d 1344 (Ill. App. Ct. 1998)* (Illinois's amended non-wage garnishment statute satisfied due process requirements; notice must be provided within two days of the garnishment, but hearing might be twenty-one to thirty days afterwards).

(n14)Footnote 14. *16 C.F.R. § 444.2(a)(1)*. 16 C.F.R. pt. 444 is reprinted in Vol. 1A *infra*.

(n15)Footnote 15. *Kingswood S., Inc. v. J.I. Case Credit Corp., 623 So. 2d 584 (Fla. Dist. Ct. App. 1993)* ; *Baldwin v. First Nat'l Bank, 362 N.W.2d 85 (S.D. 1985)* . *See Soltesz v. Miller, 56 Conn. App. 114, 741 A.2d 335 (1999)* (hearing on application for prejudgment attachment must provide opportunity for each party to present evidence; hearing was inadequate because plaintiff was not given opportunity to present evidence); *Matza v. West, 2000 Conn. Super. LEXIS 516* (Conn. Super. Ct. Feb. 25, 2000) (if affidavit seeking a pre-judgment remedy is properly executed but factually insufficient, it may be supplemented by evidence presented at the hearing; plaintiff was entitled to a hearing and the opportunity to present such evidence).

(n16)Footnote 16. *See, e.g., Leasing Techs. Int'l, Inc. v. Uniscribe Prof'l Servs., Inc., 2002 Conn. Super. LEXIS 2638* (Conn. Super. Ct. Aug. 1, 2002) (Connecticut court had no power to order replevin of goods located outside Connecticut); *Pondella Hall for Hire, Inc. v. City of St. Cloud, 837 So. 2d 510 (Fla. Dist. Ct. App. 2003)* (replevin action seeking return of property seized as part of criminal investigation, which did not result in conviction or forfeiture, must be brought in the court that issued the warrant). *But see Atlantic Bank of N.Y. v. Metropolitan Food Group, LLC, 2003 U.S. Dist. LEXIS 4164* (S.D.N.Y. Mar. 20, 2003) (New York replevin action may be brought in any county where venue otherwise lies, *N.Y. C.P.L.R. 7102(d)(1)*); *Atl. Bank v. Metro. Food Group, LLC, 2003 U.S. Dist. LEXIS 4164* (S.D.N.Y. Mar. 19, 2003) (under New York law, replevin may be brought in any county in which venue is otherwise

proper, here, county of plaintiff's residence).

(n17)Footnote 17. *See, e.g., Altegra Credit Co. v. Banks (In re Timothy Banks), 259 B.R. 848 (Bankr. E.D. Va. 2001)* (whether mobile home placed upon real property subject to foreclosure has become part of the realty must be decided on case-by-case basis based on common law doctrine of fixtures, including intent of owner in annexing mobile home to realty); *BankAmerica Hous. Servs. v. P.D.N. & Assocs., 159 Or. App. 264, 977 P.2d 396, 37 U.C.C. Rep. Serv. 2d 1158 (1999)* (under Oregon law, manufactured homes become fixtures only if they are exempt from certificate of title requirements, which can occur when new manufactured structure is located on land owned by the purchaser; real estate law controls only after an exemption acquired). *See* National Consumer Law Center, Repossessions § 5.2 (6th ed. 2005 and Supp).

(n18)Footnote 18. *See Chrysler Fin. Co. v. Flynn, 88 S.W.3d 142 (Mo. Ct. App. 2002)* (validity of breach of warranty claim must be determined before creditor's replevin claim can be resolved).

(n19)Footnote 19. *Wis. Stat. § 425.208.*

(n20)Footnote 20. *See, e.g., Chrysler Fin. Co. v. Flynn, 88 S.W.3d 142 (Mo. Ct. App. 2002)* (replevin of truck; counterclaims for breach of warranty, and various state torts; remanded to determine whether truck used for amateur farming was a consumer good, the key issue on the warranty claim; if warranty breached, consumer not in default and lender not entitled to replevin).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 10 Repossessions

1-10 Consumer Credit Law Manual § 10.05

§ 10.05 Self-Help Repossession

[1] Introduction n1

Self-help repossession is just what the name describes: the secured creditor's employee or agent takes the pledged property from the debtor's possession. The most widespread restriction on such action is that the creditor cannot breach the peace. A creditor's use of force or threats, taking property over the debtor's objection, impersonating government officials, or trespassing into the debtor's home are all possible breaches of the peace and, therefore, wrongful forms of repossession -- a tort. Creditors could claim consent, waiver, or that they are not responsible for misconduct by an independent contractor performing the repossession as defenses to such a tort claim.

[2] Representing the Client Before Repossession

[a] Voluntary Surrender

Debtors in default and unable to meet payments can surrender the collateral voluntarily to the secured party, rather than wait for the creditor to repossess. Voluntary surrender may save the consumer the creditor's repossession costs because these expenses are deducted from the collateral's sale proceeds before the remaining balance is credited to the consumer's outstanding debt. n2 Voluntary surrender also insures that the repossessor does not seize other debtor property in addition to the collateral (tools left in a car's trunk or cash left in the glove compartment), and does not damage the collateral or other property during repossession and can speed up the collateral's sale date, increasing the sale price for goods that depreciate.

The debtor's offer of voluntary surrender should be made only in return for concessions from the creditor, such as waiving its right to seek a deficiency and promising not to include the default in any credit report. This should constitute an accord and satisfaction. n3 Creditors may agree, if the debtor resumes making payments, not to sell the collateral and to return the property after a certain number of payments are made or to allow the debtor to sell the collateral in return for immediately turning over all or some of the sale proceeds to the creditor.

But voluntary surrender's financial advantages are sharply limited where state law prohibits the creditor from seeking a deficiency after disposing of the collateral.

[i] Other Pre-Repossession Options

Bankruptcy is another option that consumers should consider. The automatic stay will prevent repossession. Filing bankruptcy before repossession may be important in jurisdictions that mistakenly conclude that the bankruptcy court can not order the creditor to turn the property back over to the debtor after repossession.

[b] False Threats to Repossess

A debtor's attorney first should determine if a debt collector's threat to repossess collateral is lawful. False threats of legal action to collect a debt repeatedly have been held to be a deceptive practice.

A false threat to repossess collateral (as well as an unlawful repossession of collateral generally) violates *15 U.S.C. section 1692f(6)*, the core section of the Federal FDCPA to which repossession agents are subject. n4 Other misconduct by a repossessor may violate the FDCPA, so long as the repossessor qualifies as a "debt collector." Even though creditors are not generally covered by the FDCPA, if a creditor's employee falsely poses as a third party to threaten repossession, the creditor is covered. n5

[c] Resisting Repossession Attempts

[i] When Clients Should Object

A debtor's attorney should take several steps to assist a client threatened with repossession. The attorney can notify the creditor that the creditor is not allowed on the debtor's property, that the debtor objects to any repossession attempts, and that the creditor should not use force, threats or intimidation to obtain the collateral. The client and their family should be advised not to consent to the creditor entering the debtor's home or to the creditor repossessing the collateral. The creditor cannot use force, threats or intimidation to repossess the collateral, and the debtor should clearly object to any taking. The creditor has no right to enter the debtor's property and cannot repossess the collateral on a public street if the debtor is there and objects. The client should try to have witnesses to any attempted repossession, so that they can testify about the debtor's objections or the creditor's trespass, use of force, or threats. If the repossessor ignores the debtor's objections, the police can be called, but the debtor always is limited to verbal and passive resistance and should be emphatically advised not to resort to violence.

Clients should be advised not to resist seizure by a sheriff or other government official. Interference with a sheriff's carrying out a writ of replevin may subject the debtor to contempt of court or criminal sanctions.

The debtor should also ask the official for identification to determine if the individual is a government official or an employee of the creditor simulating official status.

In some states, there may be a risk in advising a client to resist repossession because of possible prosecution under federal or state laws for concealing collateral with intent either to defraud a creditor or hinder enforcement of a security interest. n6 An attorney also may run afoul of state ethical rules by advising or suggesting that a client conceal collateral. n7

[3] Bars to Repossession

[a] General

The UCC authorizes the secured party on default to take possession of the collateral without judicial process if this can be done without breach of the peace. n8

Another limitation to the right to repossess is that a creditor cannot repossess additional items of collateral where

seizure of an earlier item satisfies the obligation.

[b] Statutes Prohibiting Repossession

Louisiana and Wisconsin prohibit self-help repossession outright, limiting the creditor to obtaining the collateral through judicial process or the debtor's voluntary surrender. The Wisconsin Consumer Act limits the creditor to judicial action to recover the collateral, unless the debtor voluntarily surrenders the property. These restrictions apply to motor vehicle consumer leases as well, as long as the total lease obligation does not exceed $25,000. n9 In 2005, however, Wisconsin amended its laws, effective April 13, 2006, to create an exception that allows self-help repossession of motor vehicles that are collateral for debts. The exception also covers any goods that are subject to a motor vehicle lease. The secured party must not enter the consumer's home or breach the peace, and must mail the consumer a pre-repossession notice. If the consumer responds by demanding that the creditor proceed in court, the creditor must do so. n10

Other statutes forbid repossession absent the debtor's express consent. n11 Massachusetts allows self-help repossession only if the default is material and consists of failure to make one or more payments, or the occurrence of an event which substantially impairs the value of the collateral. The creditor is not allowed to enter upon property owned by or rented to the debtor unless the debtor consents to an entry, at the time of such entry. n12

[c] Limits on Self-Help Seizure of Mobile Homes

Mobile homes are exempt from repossession in several states. As a practical matter, the non-voluntary repossession of an occupied mobile home is virtually certain to violate provisions of law prohibiting the taking of unsecured property and may constitute a trespass (and therefore a breach of peace). n13 Colorado allows self-help repossession of mobile homes without the debtor's consent only if there is clear and convincing evidence that the debtor has vacated or abandoned the mobile home or the debtor voluntarily surrenders it. n14

[d] Limits on Seizure of Other Specific Types of Goods

Other secured property may also be exempt from self-help repossession under state laws.

[e] Specially Protected Debtors

[i] Military Personnel and Dependents

The Servicemembers Civil Relief Act [formerly the Soldiers' and Sailors' Civil Relief Act], n15 and some state laws, provide military personnel *and their dependents* with significant protection against self-help repossession. The federal Act prohibits creditors from repossessing collateral where the debt arises before the debtor entered military service. n16 This prohibition applies not only to transactions governed by UCC Article 9, but also to any "lease or bailment of such property." n17 The prohibition against self-help repossession applies regardless of whether there are co-obligors or co-owners. The creditor is limited to a judicial action to recover the collateral, and the court, even on its own motion, can stay the proceedings if the debtor's entry into the military service affects the debtor's ability to repay the debt, or make other disposition as is equitable to preserve the interests of all parties. n18 Debtors may have similar protection if they have difficulty paying creditors because of injury or illness resulting from military service. n19 The Act's protections against repossession are particularly potent in combination with its requirement that creditors reduce the interest rate on obligations to six percent if the debtor enters military service. n20 The only exception is if, upon application of the creditor, a court determines that the debtor's ability to pay the original interest rate is not materially affected by military service. n21 This reduction in the interest rate may mean that a debtor who has been able to make at least reduced payments may not be in default.

The Servicemembers Civil Relief Act provides misdemeanor penalties of $1000 and one year imprisonment for violations, including a creditor's self-help repossession of protected property. The legislation does not provide a private

right of action per se, but at least one court has interpreted the Servicemembers Civil Relief Act as providing such a right. n22 Moreover, a conversion action should be available for wrongful repossessions. n23

Unless the repossession occurs without the knowledge of the debtor, any repossession on a military base will necessarily be wrongful, either as a violation of constitutional due process or, if the repossessor fails to seek the assistance of the military police, as a violation of law and regulations applicable to conduct on the base. n24

[ii] Native Americans

Native Americans living on a reservation are also specially protected if tribal law restricts or prohibits self-help repossession, as many tribal codes do. n25 The Supreme Court has suggested that courts should defer to the repossession statutes of Native American tribes because tribes have the power to regulate the activities of nonmembers who enter into consensual relationships with tribe members through contracts and other commercial dealings. n26 Punitive damages may also be recoverable, even against non-Indian defendants. n27

Native American laws may even protect against repossessions that occur off tribal land. The North Dakota Supreme Court upheld a tribal court judgment finding self-help repossession wrongful under tribal law applicable to the Three Affiliated Tribes on the Fort Berthold Reservation. n28 The court held that the tribal court judgment was entitled to comity even though both the repossession and the initial contract formation occurred off tribal land.

[f] Due Process Considerations

[i] When Is There Sufficient State Action?

Since self-help repossession offers debtors only minimal due process, the critical issue is whether there is sufficient state action to trigger the constitutional due process protections.

At least seven of the twelve U.S. Circuit Courts of Appeal have considered the extent of state action in self-help repossession and unanimously have ruled that there is insufficient state action to trigger due process requirements. n29 Similarly, state courts consistently find that self-help repossession does not violate state constitutional requirements. n30

Nevertheless, there are several contexts where a debtor can claim that constitutional standards prohibit self-help repossession. Due process rights arise where the government itself is the creditor. n31 In addition, where a sheriff or other official accompanies the creditor when the goods are repossessed, virtually all cases hold that there is sufficient state action to convert a permissible self-help remedy into a constitutional tort. n32

One must distinguish the sheriff seizing collateral pursuant to a valid writ of replevin (which meets due process requirements if certain guidelines are followed) from the sheriff, with no prior legal process, informally accompanying the creditor during a self-help repossession (which constitutes sufficient state action to trigger a due process violation).

In addition to constitutional due process, police involvement in self-help repossession may also trigger rights under the *Fourth Amendment*, which prohibits unreasonable searches and seizures. n33

[ii] Private Remedies Where Due Process Violated

Debtors showing state action in a repossession still face questions of whom to sue. In brief, individual police officers who participate in the repossession are immune from liability under *42 U.S.C. § 1983* if they act in good faith, based upon an objectively reasonable understanding of the law at the time of their actions. n34 The municipality may not be liable either unless its "official policy" was to allow such police assistance in repossessions. Of course, the debtor may still have an action against the repossessor who, as a private party subject to section 1983 liability, is not entitled to

claim qualified good faith immunity, n35 but courts have not yet resolved whether a private party can raise good faith as an affirmative defense. n36

If a party is liable under section 1983, the consumer can recover damages, including recovery for mental anguish. n37 Punitive damages are available where the creditor's conduct is wanton or egregious. A *42 U.S.C. section 1983* action also authorizes recovery of attorney fees and injunctive relief.

[4] Repossession Must Not Breach the Peace

[a] Introduction

The most important restriction on the creditor's use of self-help is that the repossession must not breach the peace. n38 Breach of the peace may involve bodily force, threats, trespass, or, in some cases, even deception or trickery. The general rule is that the creditor cannot utilize force or threats, cannot enter the debtor's residence without consent, and cannot seize any property over the debtor's objections.

The 1999 revisions to Article 9 provide that the debtor cannot waive the prohibition against breach of the peace. n39 Indeed, the parties cannot even incorporate into the agreement a standard for determining whether the creditor has breached the peace. n40 The 1999 revisions also make it clear that courts should hold the secured party responsible for the actions of others taken on the secured party's behalf, including independent contractors engaged by the secured party to take possession of the collateral. n41

[B] Bodily Force and Threats

A repossessor's use of physical force on the person (not necessarily the debtor) is a breach of the peace.

A breach of the peace can occur if the secured party damages the debtor's property during the repossession. Threats can also breach the peace, such as a creditor's violent and abusive language reasonably calculated to intimidate or lead to a breach of the peace. n42 The federal Fair Debt Collection Practices Act also prohibits the use or threat of use of violence in debt collection, n43 although its coverage of repossessions has significant limitations.

[c] Repossession Despite Consumer's Objection Breaches the Peace

Repossession over the debtor's objection also breaches the peace because the dispute may lead to violent confrontation, but the debtor must object.

The objection of a third party, particularly one related to the debtor, is as effective as the debtor's own objection. The taking does not breach the peace if the confrontation occurs after the repossessor has validly gained possession of the property for the secured party.

[d] Trespass

[i] General

In considering whether a creditor's trespass on debtor's property is a breach of the peace, courts have looked at two factors: the potential for immediate violence and the nature of the property. Thus, trespass into a residence will almost certainly constitute breach of the peace, while entry on an open driveway will depend on other circumstances. Entry on the property of a non-debtor to take possession of collateral is likely to be a trespass unless the property owner consents. n43.1

[ii] Public Street or Private Driveway

One of the most frequent self-help methods is seizing a vehicle while it is parked on a public street or private driveway. Courts find no breach of the peace where the repossessor surreptitiously seizes a vehicle from a public street, the parking lot of the debtor's apartment building late at night, a public parking lot with the keys left in the car's ignition, the debtor's place of employment with the use of a duplicate key, the dealer's lot, a private driveway adjacent to debtor's home, the debtor's open garage, or an unenclosed carport.

Entry into a closed garage, even without a physical breaking, is usually treated as being analogous to entering the debtor's home and, thus, breaches the peace.

[iii] Residence

The courts discourage any unauthorized entry by the creditor into the debtor's residence. Virtually any entry into a residential structure without the consent of the debtor is a breach. Mobile homes are no exception.

The same rule as to any entry of a private residence may also apply to entry into debtor's place of business.

[e] Use of a Police Officer

If the seizure is not pursuant to a writ of replevin or other court order, the government official's participation is probably based on the creditor's informal request. If so, this official participation almost always constitutes sufficient state action to require the repossession to meet due process standards. The creditor's seizure would then constitute a civil rights violation. If the creditor's agent misrepresented himself as a government official in an attempt to forestall debtor objections to the seizure, courts are likely to find a wrongful repossession, even if the debtor mistakenly consents to the taking. n44 Misrepresentation of arepossessor's government affiliation may also violate the FDCPA, and the state deceptive practices act.

[f] Deception, Trickery, Stealth

As long as the creditor does not misrepresent the involvement of the law in the repossession, courts generally permit the creditor to repossess collateral with the use of stealth, trickery, or fraud.

But a minority of courts hold otherwise. A repossession agent's deceptive statements to a police officer called to the scene may be an element in finding a breach of the peace. n45 There is also an argument that the UCC's incorporation of an obligation of good faith into every contract and duty within the UCC imposes a duty on the creditor to avoid intentional misrepresentation during the repossession. n46

[5] Other Repossession Restrictions

[a] Method of Seizure

Creditor repossession practices are further restricted by other state and federal legislation. Small loan legislation, installment sales acts, state credit codes, and other statutes may limit the creditor's entry into the debtor's dwelling, n47 use of force, n48 or even entry into a locked motor vehicle. State law may also specify what entities are authorized to engage in self-help repossession, such as licensed personnel, employees of the creditor, or automobile dealers. The FDCPA includes a number of restrictions on independent debt collectors.

[b] Notice of Repossession

A number of states have right to cure laws that require a notice to consumers, and a right to cure, before the creditor repossesses the collateral. In addition, other states provide notice to the consumer before collateral can be seized, even

though not providing a statutory right to cure. But in virtually all other states, no notice is required before the repossession.

In every state, after collateral is seized, the creditor must eventually notify the consumer concerning the sale or other disposition of that collateral.

[c] Limitations on Professional Repossessors

A few states require that those in the business of repossessing property be licensed, or at least follow certain guidelines.

[d] Creditor's Agreement Not to Repossess

Former *UCC section 9-503* provided a right to self-help repossession "unless otherwise agreed." While this language does not appear in the 1999 revision of the provision regarding self-help repossession, Revised *U.C.C. section 9-609*, the same principle is established for all parts of the UCC by former section 1-102(3) and (4). Where a creditor has agreed after default not to repossess for a certain time period or until conditions are met, repossession in violation of the agreement is wrongful and subject to a claim for conversion.

[6] Electronic Repossessions

A few used car dealers, primarily subprime, buy-here, pay-here dealerships, have begun using a controversial new method of "repossession," which electronically disables a vehicle if the monthly loan payment is not made. Dealers using this system install a device, also known as "electronic on-time payment system," or "collateral disabling device," in the vehicle which is serving as collateral for a purchase-money loan. n49 The device includes a timing mechanism which is set by the dealer to allow the car to start for a set period of time, usually thirty days. If a payment is not made by the end of the thirty day period, the car will not start. Some systems use a code, which the borrower is given each month when payment is made, which allows the borrower to start the car for another thirty-day period. Another system uses a special key fob which the dealer programs each month when the borrower comes in to make a payment. The key fob is passed over a reader in the vehicle which allows it to start. The device is not intended to disable the vehicle while moving, but only to prevent it from being started if the borrower falls behind in payments.

Devices also exist that use global positioning technology to track the location of a car. These devices can be connected to the vehicle's ignition so that the starter can be disabled remotely. Some of the companies selling these devices advertise them as a means of repossession.

The use of these devices to repossess or enforce a security interest raises a number of issues under Article 9. A threshold issue is whether disabling a vehicle is even a repossession under the UCC. Although the creditor does not take physical possession of the vehicle, it does render it unusable for the borrower, as much as if the creditor had taken possession.

If disabling the vehicle electronically is in fact a repossession, it would seem that in states where the consumer has a right to cure a default in payments, n50 that notice (in accordance with the state right to cure statute) would have to precede the disabling of the vehicle. In addition, if the dealer or creditor uses electronic repossession when it is not legally entitled to repossession, because, for example, the consumer has revoked acceptance or is rightfully withholding payments, then the UCC penalties for wrongful repossession would apply. n51

The use of these devices may give rise to other claims as well. n52

Electronic self-help may also be practiced by computer software companies to restrict the use of software by a licensee. Typically the electronic self-help used by the software industry will be some sort of built-in deactivation, rather than remote disabling. The Uniform Computer Information Transactions Act ("UCITA"), adopted in two states, n53

contained a provision limiting the use of electronic self-help for licensed software. In 2002, however, in response to significant controversy and opposition generated by UCITA, the National Conference of Commissioners on Uniform State Laws adopted amendments to the model law that prohibit electronic self-help. n54 This prohibition can not be waived or varied by a pre-default agreement. n55 Instead, UCITA allows the licensor to seek a prejudgment injunction against further use, and authorizes the court to award attorney fees to the party who prevails in the injunction proceeding. n56

[7] Debtor's Consent as Defense to Wrongful Repossession

The debtor's valid consent at the time of seizure forecloses the debtor's right to challenge an otherwise wrongful repossession. Valid consent requires the debtor's free and knowing relinquishment. Consent obtained by fraud, force, or intimidation is neither knowing nor voluntary.

[8] Debtor's Contractual Waiver of Action for Wrongful Repossession

Creditors may attempt to insulate themselves by inserting a provision in the credit agreement whereby the debtor waives the right to bring an action for wrongful repossession. Courts typically refuse to enforce the waiver. In addition, some state legislation specifically prohibits such waivers.

[9] Creditor's Liability for the Acts of Repossession Companies

Creditors that use the services of repossession companies will claim they are not liable for the unauthorized acts of the repossessor. If the repossessor is an agent operating under the control of the secured party, then the common law doctrine of *respondeat superior* makes the secured party liable for torts committed by its agent. n57 The general rule that a master is not liable for the unauthorized, intentional torts of his servant does not apply to repossessions. Where the nature of the employment contemplates such tortious acts, the master is liable, n58 and the work of a repossessor is precisely such a job.

Secured parties often claim that the repossessor is an independent contractor and that *respondeat superior* does not apply. One exception to the doctrine that an employer is not liable for the acts of an independent contractor is where the employer fails to exercise care in selecting a competent contractor.

More broadly, the responsibility to repossess collateral without breach of the peace is a nondelegable duty for which the secured party is always responsible even if it hires independent contractors to do the work. n59 The 1999 revisions to Article 9 adopt this position. n60

[10] Consumer Remedies for Wrongful Repossession

[a] UCC Remedies

The UCC provides debtor remedies for the creditor's failure to comply with UCC Article 9. n61 If the collateral is consumer goods, statutory damages are available for any violation of Revised UCC sections 9-601 to 9-628, including when repossessors breach the peace, since UCC Article 9 authorizes repossession only if it is accomplished without breach of the peace. Remedies for breach thus include restraining the sale of the collateral or damages if the collateral has already been sold.

The remedies section of the Revised *UCC, section 9-625*, for the most part mirrors the provisions in former section 9-507. One difference, however, is thatthe provision for actual damages now applies to non-compliance with any provision of the Article, not just Part 6. n62

Revised *UCC section 9-625(a)* allows the court to grant injunctive relief "on appropriate terms and conditions." This

language probably allows the court to impose a bond requirement if that is the jurisdiction's usual rule for injunctive relief. The bond should not be based on the value of the collateral, but rather the depreciation in its value, if any, that is likely to occur due to delaying the sale. The court might also grant the injunction on the condition that the debtor maintain insurance on the collateral or take other steps to protect it.

[b] Common Law Tort Remedies

[i] Potential Tort Causes of Action

Creditors making a wrongful repossession may commit one or more common law torts, including trespass, assault, battery, conversion, invasion of privacy, and intentional infliction of emotional distress or mental anguish.

[ii] Tort Damages

If the torts are proved, courts will consider in calculating the debtor's damages the market value of the collateral at the seizure (not the eventual sale price) and/or damages for loss of use of the collateral.

The creditor is liable under a negligence theory for personal injuries resulting from an unlawful repossession.

[iii] Punitive Damages

Punitive damages are particularly appropriate in wrongful repossession cases and many courts have sustained large jury verdicts.

[c] Debtor's Replevin of Wrongfully Seized Property

In many situations, a debtor may desire the return of wrongfully seized or detained property, rather than the receipt of the property's value. Here, a consumer's attorney should consider the common law remedy of replevin, which often gives the successful party the choice of the property or its value. n63

[d] Federal Fair Debt Collection Practices Act

Repossession practices by "debt collectors" violating the FDCPA n64 can result in awards to the debtor of actual damages, n65 statutory damages up to $1000, and attorney's fees.

[e] Other Statutory Remedies

Even if the repossession clearly violates the UCC, debtor attorneys should consider alternative state statutory grounds for challenging the seizure. Installment sales acts, state credit codes, and other legislation may provide more generous debtor remedies, or may be able to provide relief cumulative to that obtained through Code remedies.

[f] Contract Claims

Often the parties' contract will echo some UCC or tort law requirements. For example, the contract may provide that the creditor may "peacefully take" the collateral if the consumer defaults. A repossession that breaches the peace will violate this contract clause as well as violating the UCC. n66

In some circumstances, a contract claim will have advantages that will make it worth pleading. Some jurisdictions allow attorney fees for breach of contract.By contrast, attorney fees are not generally available under the UCC or tort law. While attorney fees are available under the FDCPA and many state UDAP statutes, contract claims avoid those statutes' scope problems.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Secured Transactions (Article 9)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionGeneral Overview

FOOTNOTES:

(n1)Footnote 1. For a complete review of statutes and cases on this subject, as well as sample pleadings on disk, see National Consumer Law Center, Repossessions (6th ed. 2005 and Supp.).

(n2)Footnote 2. Revised *U.C.C. § 9-615(a)* [former *U.C.C. § 9-504(1)(a)*].

(n3)Footnote 3. *Cobb v. General Motors Acceptance Corp., 589 So. 2d 728, 16 U.C.C. Rep. Serv. 2d 1253 (Ala. Ct. App. 1991)* (returning collateral is new consideration when the security agreement does not require the debtor to return and surrender collateral). *See Jackson v. Slidell Nissan, 693 So. 2d 1257 (La. Ct. App. 1997)* (reversing summary judgment for creditor when buyer claimed she voluntarily surrendered vehicle as part of agreement under which creditor waived right to seek deficiency).

(n4)Footnote 4. *See* Ch. 8 *supra*. The FDCPA is reprinted Vol. 1A *infra*. *See also* National Consumer Law Center, Fair Debt Collection, § 5.5.2 (6th ed. and supp.). *See* National Consumer Law Center, Collection Actions § 11.2 (2008).

(n5)Footnote 5. *15 U.S.C. § 1692a(6)*.

(n6)Footnote 6. *See, e.g., 18 U.S.C. § 658. See also People v. Butler, 2002 Cal. App. Unpub. LEXIS 7978* (Cal. Ct. App. Aug. 23, 2002) (unpublished) (upholding criminal conviction of consumer for armed assault and threats for pointing a gun at repossessors; whether repossession was wrongful was irrelevant to criminal charge).

(n7)Footnote 7. *Cuyahoga County Bar Ass'n v. Freedman, 836 N.E.2d 559 (Ohio 2005)* .

(n8)Footnote 8. Revised *U.C.C. § 9-609* [former *U.C.C. § 9-503*].

(n9)Footnote 9. *Raneda v. Bank of Am., 668 N.W.2d 563 (Wis. Ct. App. 2003)* (table) (relying on *Wis. Stat. § 421.202(6)*).

(n10)Footnote 10. *Wis. Stat. § 425.205*. Wisconsin's administrative regulations further protect the debtor by strictly limiting "voluntary surrender" to situations in which the creditor provides the debtor with a notice of the debtor's right to a pre-repossession hearing, when the creditor does not make any misrepresentations to the debtor, and when the lender has not violated any provision of chapter 427 of the Wisconsin Statutes.Wis. Admin. Code DFI-Bkg § 80.68; *see also Homa v. E. Towne Ford, Inc., 370 N.W.2d 592 (Wis. Ct. App. 1985)* .

(n11)Footnote 11. *See* National Consumer Law Center, Repossessions, § 6.3.2 (6th ed. 2005 and Supp.)

(n12)Footnote 12. *Mass. Gen. Laws ch. 255, § 13J(a)* (mortgages and personal property); *Mass. Gen. Laws ch. 255B, § 20b(a)* (motor vehicle sales); *Mass. Gen. Laws ch. 255D, § 22(a)* (retail installment sales).

(n13)Footnote 13. *See Dixie Sav. & Loan Ass'n v. Pitre, 751 So. 2d 911 (La. Ct. App. 1999)* (damages for wrongful seizure awarded when sheriff seized mobile home and contents without providing adequate notice to occupant to allow removal of unsecured property).

(n14)Footnote 14. *Colo. Rev. Stat. § 4-9-609*.

(n15)Footnote 15. *50 U.S.C. app. § 501*. Federal and state courts have construed the Act liberally. *See* James P.

Pottoff, *Contemporary Applications of the Soldiers' and Sailors' Civil Relief Act, 132 Mil. L. Rev. 115 (1991). See also* Legal Assistance Note, *Using the Soldiers' and Sailors' Civil Relief Act to Your Clients' Advantage*, Army Law., Dec. 1993, at 34. *See, e.g., Marin v. Armstrong, 1998 U.S. Dist. LEXIS 22792,* at *6 (N.D. Tex. Sept. 1, 1998) (stating "[a]ny doubt regarding the application of the [Act] should be resolved in favor of the service member"), *motion to dismiss denied, 1998 U.S. Dist. LEXIS 22791* (N.D. Tex. Sept. 21, 1998) ; *Murdock v. Murdock, 338 S.C. 322, 526 S.E.2d 241 (Ct. App. 1999)* . The Act makes no distinction between service members who enlist and those who are called to federal active duty from National Guard or reserve units. Helpful materials on the law may be found on the JAG Corps website, www.jagcnet.army.mil (click on "Legal Assistance"). *See also* National Consumer Law Center, Repossessions, § 6.3.5.1 (6th ed. 2005 and Supp.), and National Consumer Law Center, Collection Actions, Ch. 5 (1st ed. 2008 and supp.).

(n16)Footnote 16. *50 U.S.C. app. §§ 531(1), 532.*

(n17)Footnote 17. *50 U.S.C. app. § 531(1).*

(n18)Footnote 18. *50 U.S.C. app. § 532(c). See also In re Burrell, 230 B.R. 309 (Bankr. E.D. Tex. 1999)* (in dispute regarding repossession court may, on its own initiative, apply protections of Soldiers and Sailors Act, but declined to do so because of lack of petitioner's request).

(n19)Footnote 19. *See Marin v. Armstrong, 1998 U.S. Dist. LEXIS 22792* (N.D. Tex. Sept. 1, 1998) (denying creditor's motion for summary judgment in case involving debtor's claims that creditor harassed him despite his allegation of difficulty paying debt due to illness suffered during military service), *motion to dismiss denied, 1998 U.S. Dist. LEXIS 22791* (N.D. Tex. Sept. 21, 1998) .

(n20)Footnote 20. *50 U.S.C. app. § 527*; *see Moll v. Ford Consumer Fin. Co., 1998 U.S. Dist. LEXIS 3638* (N.D. Ill. Mar. 16, 1998) (recognizing private cause of action for failure to reduce interest rate).

(n21)Footnote 21. *50 U.S.C. app. § 527(c).*

(n22)Footnote 22. *Moll v. Ford Consumer Fin. Co., 1998 U.S. Dist. LEXIS 3638* (N.D. Ill. Mar. 16, 1998) (concluding that service members have a private right of action in a case involving excessive interest).

(n23)Footnote 23. *McMurtry v. City of Largo, 837 F. Supp. 1155 (M.D. Fla. 1993)* (except for the stay during military service, the act was not intended to give service people any additional rights not possessed by civilians; because a civilian's claim would be defeated by the missed deadline, so was plaintiff's).

(n24)Footnote 24. *See Waisner v. Jones, 107 N.M. 260, 755 P.2d 598, 6 U.C.C. Rep. Serv. 2d 1374 (1988) .*

(n25)Footnote 25. *Babbitt Ford, Inc. v. Navaho Indian Tribe, 710 F.2d 587 (9th Cir. 1983) , cert. denied, 466 U.S. 926, 104 S. Ct. 1707, 80 L. Ed. 2d 180 (1984)* ; *Chischilly v. GMAC, 96 N.M. 264, 629 P.2d 340 (Ct. App. 1980) . But see Brown v. Babbitt Ford, Inc., 117 Ariz. 192, 571 P.2d 689, 23 U.C.C. Rep. 266 (Ct. App. 1977) .*

(n26)Footnote 26. *See Montana v. United States, 450 U.S. 544, 101 S. Ct. 1245, 67 L. Ed. 2d 493 (1981) . See also In re Dalton, 336 B.R. 600, 58 U.C.C. Rep. Serv. 2d 213 (B.A.P. 10th Cir. 2005)* (perfection of security interest according to tribal law is proper when debtor was tribal member, even though he did not live on the formal reservation); *In re Snell, 329 B.R. 753, 58 U.C.C. Rep. Serv. 2d 159 (Bankr. N.D. Okla. 2005)* (tribal law rules for perfection of security interests on motor vehicle titles apply to contracts with tribe members who live in tribal jurisdiction area but not on reservation, on allotted land, or in a dependent Indian community).

(n27)Footnote 27. *Halwood v. Cowboy Auto Sales, Inc., 124 N.M. 77, 946 P.2d 1088 (Ct. App. 1997)* ; *Risse v. Meeks, 585 N.W.2d 875, 1998 SD 112 (1998) .*

(n28)Footnote 28. *See Fredericks v. Eide-Kirschmann Ford, Mercury, Lincoln, Inc., 462 N.W.2d 164 (N.D. 1990)* . Note, however, that the *Fredericks* case may have been decided more on the basis of comity than on the applicability of tribal law to events occurring off tribal land. The automobile dealer initiated proceedings in tribal court but neglected to pursue an appeal in such court. The concurring opinion noted: "Perhaps the greatest test of the principle of comity is to affirm a judgment which we believe to be in error. In this instance it appears clear to me that the tribal statute did not apply to repossessions which took place off the Reservation and that the tribal court's authority to require the return of the pickup and impose the other relief contained in the judgment is questionable."

(n29)Footnote 29. *See, e.g., Gibson v. Dixon, 579 F.2d 1071 (7th Cir. 1978)* .

(n30)Footnote 30. *See Chrysler Credit Corp. v. Tremer, 48 Ala. App. 675, 267 So. 2d 467 (Civ. App. 1972)* ; *Price v. U-Haul Co., 745 So. 2d 593, 39 U.C.C. Rep. Serv. 2d 579 (La. 1999)* (self-help provision of storage facility act, allowing lessor to seize and sell lessee's property if lessee defaults, did not violate due process requirements; however, court cautioned that self-help may not be appropriate in every debtor-creditor situation, and must be evaluated on case by case basis); *Giles v. First Va. Credit Servs., 560 S.E.2d 557 (N.C. Ct. App. 2002)* (no state action in North Carolina self-help repossession: state officials not involved; statute codifies right that existed at common law, thus does not delegate "authority previously held by the state;" no state action involved in contract clause waiving right to notice of default).

(n31)Footnote 31. *See, e.g., Love v. United States, 915 F.2d 1242 (9th Cir. 1989)* (Farmers Home Administration). *Jones v. Flowers, 547 U.S. 220, 126 S. Ct. 1708, 164 L. Ed. 2d 415 (2006)* (due process standards for giving notice of tax sale if notice to address of subject property is returned unclaimed).

(n32)Footnote 32. *Yeomans v. Wallace, 291 F. Supp. 2d 70 (D. Conn. 2003)* (action under color of state law sufficiently alleged; police escorted former licensee, who claimed falsely to be retrieving only her own property, into locked store in plaintiff-storekeeper's absence, over objections of landlord). *See Booker v. City of Atlanta, 776 F.2d 272 (11th Cir. 1985)* , *reh'g, en banc, denied, 782 F.2d 180 (11th Cir. 1986)* ; *Dixon v. Lowery, 302 F.3d 857 (8th Cir. 2002)* (actions of police went well beyond "standing by" when they participated in raid and closure of restaurant, and thereafter guarded it, on behalf of alleged purchaser); *Brees v. Courtesy Ford, Inc., 45 Fed. Appx. 711 (9th Cir. 2002)* (unpublished) (police ordered consumer to move car that was blocking private road, so repossessors could remove car). *But see Barrett v. Harwood, 189 F.3d 297 (2d Cir. 1999)* (holding no state action when police officer is present at repossession in order to prevent violence), *cert. denied, 530 U.S. 1262, 120 S. Ct. 2719, 147 L. Ed. 2d 984 (2000)* ; *Vakkas v. Tyson Assocs., 2000 U.S. Dist. LEXIS 3827* (E.D. Pa. Mar. 28, 2000) (finding no state action when debtor was not present at repossession and officers did not assist repossessor); *Sherry v. Associates Commercial Corp., 60 F. Supp. 2d 470 (W.D. Pa. 1998)* (determining, oddly, that state action does not exist when officer approaches parties "when tempers flare" and responds to debtor by erroneously stating that creditor has a "repo order"), *aff'd without opinion, 191 F.3d 445 (3d Cir. 1999)* . *But cf. Van Ort v. Estate of Stanewich, 92 F.3d 831 (9th Cir. 1996)* (no county liability under § 1983 for police officer who committed robbery of home involved in police investigation, because officer did not operate under color of law in robbery; rather, his goals were private), *cert. denied. 519 U.S. 1111, 117 S. Ct. 950, 136 L. Ed. 2d 837 (1997)* .

(n33)Footnote 33. *See, e.g., Soldal v. Cook County Illinois, 506 U.S. 56, 113 S. Ct. 538, 121 L. Ed. 2d 450 (1992)* . But see, *Barber v. Galindo, 2006 U.S. Dist. LEXIS 3356* (E.D. Wis. Jan. 18, 2006) (no constitutional claims when police involvement minimal, repossession peaceable, and creditor had right to immediate possession; consumer had unknowingly bought vehicle with bad title); *Bevan v. Scott, 2005 U.S. Dist. LEXIS 20387* (M.D. Fla. Sept. 13, 2005) (extensive discussion of officers' role in private repossessions; key question is whether presence is designed to keep the peace or to facilitate the repossession); *Revis v. Meldrum, 2005 WL 1420888* (E.D. Tenn. June 16, 2005) (standing by to keep the peace while judgment creditor removes property not sufficient to make action attributable to state).

(n34)Footnote 34. *See Booker v. City of Atlanta, 776 F.2d 272 (11th Cir. 1985)* , *reh'g, en banc, denied, 782 F.2d 180 (11th Cir. 1986)* ; *Hesik v. Krug, 1993 U.S. Dist. LEXIS 3223* (N.D. Ill. Mar. 11, 1993) .

(n35)Footnote 35. *Wyatt v. Cole, 504 U.S. 158, 112 S. Ct. 1827, 118 L. Ed. 2d 504 (1992)* .

(n36)Footnote 36. *See Jordan v. Fox, Rothschild, O'Brien & Frankel, 20 F.3d 1250 (3d Cir. 1994)* .

(n37)Footnote 37. *See Guzman v. Western State Bank, 540 F.2d 948 (8th Cir. 1976)* (unconstitutional replevin procedure).*See also Fleming-Dudley v. Legal Investigations, Inc., 2007 U.S. Dist. LEXIS 21653* (N.D. Ill. Mar. 22, 2007) (breach of peace is conduct that is likely to incite immediate public turbulence; probability of violence at time of repossession is element).

(n38)Footnote 38. Revised *U.C.C. § 9-609* [former *U.C.C. § 9-503*].

(n39)Footnote 39. Revised *U.C.C. § 9-602(6)*.

(n40)Footnote 40. Revised *U.C.C. § 9-603(b)*.

(n41)Footnote 41. Revised *U.C.C. § 9-609*, Official Comment 3.

(n42)Footnote 42. *In re Daniel, 137 B.R. 884 (Bankr. D.S.C. 1992) . Cf. Saice v. MidAmerica Bank, 1999 U.S. Dist. LEXIS 20845* (D. Minn. Sept. 20, 1999) (issue of fact existed as to whether defendant breached the peace where child and personal belongings were left in car while debtor was near car; the court focused on the likelihood that the circumstances surrounding the repossession could have provoked a violent response); *Lingross v. Heilig-Meyers Furniture, 1999 U.S. Dist. LEXIS 3986* (N.D. Miss. Mar. 17, 1999) (sufficient evidence to raise genuine issue of fact as to whether breach of peace occurred when repossessor dressed in black "SWAT" uniform with face covered by a black ski mask, and with badge, handcuffs, pepper spray, mace, knife and gun in a holster on his hip attempted to repossess furniture, using threats and intimidation); *Branson v. Nissan Motor Acceptance Corp., 963 F. Supp. 595 (S.D. Miss. 1996)* (remanding claim to state court in which debtor feared, based on their tone of voice and actions, that repossessors would harm him if he tried to stop the repossession). *But cf. Cornelius v. Nuvell Fin. Servs. Corp., 256 Ga. App. 171, 568 S.E.2d 82 (2002)* (threat of arrest and rude language not breach of peace).

(n43)Footnote 43. *15 U.S.C. § 1692d(1)*.

(n44)Footnote 43.1. *JCB, Inc. v. Union Planters Bank, N.A., 2007 U.S. Dist. LEXIS 58253* (E.D. Mo. Aug. 9, 2007) .

(n45)Footnote 44. *See State v. Gandy, 2002 Ohio App. LEXIS 6482* (Ohio Ct. App. Dec. 9, 2002) (fact that defendant was attempting to repossess collateral is no defense to prosecution for impersonating peace officer); *Fleming-Dudley v. Legal Investigations, Inc., 2007 U.S. Dist. LEXIS 21653* (N.D. Ill. Mar. 22, 2007) (impersonating police officer may be breach of peace although it is not actionable under section 1983).

(n46)Footnote 45. *In re TWS Enters., Inc., 2002 Bankr. LEXIS 958* (Bankr. M.D.N.C. Aug. 23, 2002) . *But see Strong v. Torres, 2004 U.S. Dist. LEXIS 5003* (N.D. Ill. Mar. 24, 2004) (demand that repossessors leave premises insufficient to make them trespassers; no trespass unless repossessor overcomes obstacle such as gate, barricade, chain, and so forth); *Callaway v. Whittenton, 52 U.C.C. Rep. Serv. 2d 525 (Ala. 2003)* (no trespass even though there was evidence that debtor told repossessor to leave).

(n47)Footnote 46. Former *U.C.C. § 1-203* provides: "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."

(n48)Footnote 47. U.C.C.C. § 5.112 (1974).

(n49)Footnote 48. U.C.C.C. § 5.112 (1974).

(n50)Footnote 49. One example of these products can be seen at www.passtecsecurity.com, the web site of the

retailer of one device.

(n51)Footnote 50. See *§ 10.03[8] supra*, for discussion of right to cure provisions.

(n52)Footnote 51. See *§ 10.05[10] infra*, for a discussion of remedies available for wrongful repossession.

(n53)Footnote 52. *See* National Consumer Law Center, Repossessions, § 6.6 (6th ed. 2005). *See also Pelican Point Operations v. Carroll Childers Co., 807 So. 2d 1171 (La. Ct. App. 2002)* (awarding damages, plus UDAP attorney fees, against creditor who disabled computer system that controlled equipment, when user was not in default). *In re Dawson, 2006 Bankr. LEXIS 4396* (Bankr. N.D. Ohio July 28, 2006) (discussing the pernicious nature of an electronic disabling system and comparing it to the "doomsday machine" in the 1964 film *Dr. Strangelove*).

(n54)Footnote 53. *Md. Code Ann., Com. Law §§ 22-101 to 22-816*; *Va. Code Ann. §§ 59.1-501.1 to 59.1-509.2*.

(n55)Footnote 54. Unif. Computer Info. Transactions Act § 816(b) (2002).

(n56)Footnote 55. Unif. Computer Info. Transactions Act § 816(d) (2002).

(n57)Footnote 56. Unif. Computer Info. Transactions Act § 816(c) (2002); *see also* Official Comment 4 to Unif. Computer Info. Transactions Act § 816 (2002).

(n58)Footnote 57. *Mitchell v. Ford Motor Credit Co., 688 P.2d 42, 38 U.C.C. Rep. Serv. 1812 (Okla. 1984)* (where creditor directed repossessor to pick up tractor, agency was established).

(n59)Footnote 58. Restatement (Second) of Agency § 245.

(n60)Footnote 59. *Nixon v. Halpin, 620 So. 2d 796 (Fla. Dist. Ct. App. 1993)* ; *MBank El Paso, N.A. v. Sanchez, 836 S.W.2d 151 (Tex. 1992)* .

(n61)Footnote 60. Revised *U.C.C. § 9-609*, Official Comment 3.

(n62)Footnote 61. Revised *U.C.C. § 9-625* [former *U.C.C. § 9-507(1)*]. Selected U.C.C. Article 9 sections are reprinted in Vol. 1B *infra*.

(n63)Footnote 62. Revised *U.C.C. § 9-625(b)*.

(n64)Footnote 63. *Ansley v. Conseco Fin. Servicing Group, 49 U.C.C. Rep. Serv. 2d 955 (Mich. Ct. App. 2002)* (affirming award of damages for items that creditor did not return; replevin and conversion pleaded in alternative); *Berg v. Gohlike, 2002 Minn. App. LEXIS 696* (Minn. Ct. App. June 18, 2002) (unpublished) (if only part of wrongfully detained property can be returned, plaintiff may choose either the value of the property, or the return of the available parts plus the value of the missing parts).

(n65)Footnote 64. *15 U.S.C. § 1692*; see Ch. 8 *supra*, for analysis of this statute.

(n66)Footnote 65. *15 U.S.C. § 1692k(a)(1)*.

(n67)Footnote 66. *See Pantoja-Cahue v. Ford Motor Credit Co., 375 Ill. App. 3d 49* (Ill. App. Ct. July 18, 2007) (allegations would have stated contract claim if consumer had alleged existence of valid contract).

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PART I Consumer Credit
CHAPTER 10 Repossessions

1-10 Consumer Credit Law Manual § 10.06

§ 10.06 Unsecured Personal Property Taken With Repossession

[1] Description of the Problem

Creditors repossessing motor vehicles may seize items in the car for which the creditor retains no security interest, such as the consumer's cash, documents, tools, or other personal belongings.

[2] Steps to Take Prior to Bringing Legal Action

[a] Demanding Return of the Property

Even if it seems futile, the consumer's attorney should always make a written demand for the personalty as soon as is practicable, itemizing the nature and, if possible, the value of each item. n1 Failure to do so may preclude any claim for the wrongful detention of the property.

If, at the time of the seizure, the creditor provides the debtor with the time and opportunity to remove personal property from the foreclosed collateral, the debtor should do so. Failure to do so may constitute implied consent to the creditor's disposition of the unsecured property.

[b] Documenting What Property Was Seized or Damaged and by Whom

Consumer attorneys should develop supporting evidence concerning what property is missing and when and where it was last seen. A written list should be obtained from the client and witnesses who have independent knowledge of what property was with the repossessed collateral should be located. If the creditor returns unsecured property to the consumer, the consumer should inspect it immediately to determine if any items are still missing or damaged.

[c] Creditor Conditions as to Return of Unsecured Property

The debtor should not be required to pay a fee to obtain the release of unsecured property. n2 Even so, when unsecured personal property has been seized during a repossession, creditors will often ask the debtor to sign a release form in order to obtain the return of their property.

Some creditors may insert other provisions in the release form, such as a waiver of the debtor's right to receive notice of the sale of the secured collateral, n3 or a general release from tort liability. n4 The debtor should not sign a release containing these or other waivers.

[3] Legal Claims Against Creditor for Seizing Unsecured Property

[a] Common Law Tort Claims

When the secured party or its agent fails to return unsecured property taken with the repossessed collateral, the debtor has an action against the secured party for conversion for the value of unsecured personal property not returned. n5

Even if the secured party returns all the unsecured personalty it seized, the consumer still has a cause of action for trespass or conversion for the temporary loss of the use of the consumer's property. Any damage caused by the temporary loss of the personalty may be recovered. If the collateral has been damaged after being taken, the debtor has an action for negligence.

Creditors may also be liable for acts of their repossessors by virtue of agency law.

In addition, if the secured party's actions are particularly egregious, the consumer's attorney should consider seeking punitive damages in addition to actual damages. n6

[b] UCC Remedies

Under *UCC section 9-507(1)* [Revised *UCC section 9-625*], a creditor who fails to dispose of repossessed collateral in a commercially reasonable manner is liable to the debtor for "any loss" caused by this failure.

[c] FDCPA, Other Statutory Sources of Damages

Where a repossession agency, and not the creditor, repossesses unsecured personal property, the agency may also be violating the Federal FDCPA. Such a violation would lead to an FDCPA award of actual damages, statutory damages up to $1000, and attorney's fees.

Many states have enacted state debt collection legislation, and this legislation may also prohibit the seizure of unsecured property, but may have a broader scope than the FDCPA, and apply to illegal actions by creditors, and not just by repossession agencies. Similarly, state deceptive practices statutes generally apply to both repossessors and collectors, and it should generally be a violation of the deceptive practices statute to seize property in which the creditor has no security interest. n7 If the property includes a medical device or equipment necessary for health and welfare, and the consumer has no practicable means to retrieve it, the debt collector must arrange for its prompt return, and may add the reasonable cost of doing so to the consumer's indebtedness. n8

[4] Contractual Limitations to Creditor's Liability for Seizure of Unsecured Property

Creditors attempt to avoid liability for the temporary taking of unsecured property by inserting a clause into the security or credit agreement. This clause grants the secured party the right to take unsecured personalty in the course of a repossession and hold it for the debtor without liability.

Unless this clause conflicts with a specific state law, which it may, the clause will probably withstand a legal challenge. n9

Creditors may attempt, through provisions in their credit agreements, to avoid liability for their seizure of unsecured personalty, even if the creditor never returns the property to the consumer. Often these clauses can be challenged as

unconscionable.

Any type of liability disclaimer provisions may violate state law designed to protect debtors whose property is repossessed. A number of state motor vehicle financing acts and retail installment sales acts prohibit contract provisions waiving the debtor's right of action against the creditor for various illegal actions in repossession.

Debtors' attorneys should also argue that such clauses are unconscionable, unfair, or deceptive in violation of state deceptive practices statutes. The clauses may also be unconscionable under *UCC section 2-302* and thus unenforceable. n10

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureGeneral OverviewCivil ProcedureRemediesGeneral OverviewCommercial Law (UCC)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)General Overview

FOOTNOTES:
(n1)Footnote 1. *But see Montgomery Ward & Co. v. Andrews, 736 P.2d 40 (Colo. Ct. App. 1987)* (demand only necessary if defendant had lawful possession of the goods in the first place). *See generally* National Consumer Law Center, Repossessions, § 7.2.1 (6th ed. 2005 and Supp.). *See Baker v. J. Hall Services, Inc., 2004 U.S. Dist. LEXIS 25386* (N.D. Tex. Dec. 14, 2004) (debtor's failure to demand return of personal property or to claim the property when it was offered to him defeated any conversion claim debtor had). *Mayo v. Allen, 973 So. 2d 1257 (Fla. Dist. Ct. App. 2008)* (no conversion claim for property inside repossessed recreational vehicle because consumers neither demanded its return, nor showed that demand would be futile).

(n2)Footnote 2. *Carrasco v. Auto Lock Unlimited, Inc., 2005 Conn. Super. LEXIS 3304* (Conn. Super. Ct. Nov. 29, 2005) (allowing consumer to go forward with claims that charging $20 fee for return of property from repossessed car was conversion, unjust enrichment, and deceptive practices statute violation).

(n3)Footnote 3. *See, e.g., Underwood v. First Alabama Bank of Huntsville, 453 So. 2d 742, 39 U.C.C. Rep. Serv. 738 (Ala. Civ. App. 1983)* (waiver held effective).

(n4)Footnote 4. *Cf. People v. James, 122 Cal. App. 3d 25, 177 Cal. Rptr. 110 (1981)* (towing company enjoined from requiring damage waiver before vehicles released).

(n5)Footnote 5. *McGrady v. Nissan Motor Acceptance Corp., 40 F. Supp. 2d 1323 (M.D. Ala. 1998)* .

(n6)Footnote 6. *Darcars Motors of Silver Spring, Inc. v. Borzym, 818 A.2d 1159 (Md. Ct. Spec. App. 2003)* (affirming award of $25,000 punitive damages and $4,300 actual damages on conversion claim when creditor failed to return personal property after repossession), *rev. granted, 827 A.2d 112 (Md. 2003)* .

(n7)Footnote 7. *See, e.g., Gaskill v. Doss, 2000 Ohio App. LEXIS 6185* (Ohio Ct. App. Dec. 26, 2000) (affirming award of attorney fees in successful UDAP suit against creditor who lost and damaged buyer's personal property while repossessing mobile home). *See also Akins v. Enterprise Rent-A-Car, Co., 79 Cal. App. 4th 1127, 94 Cal. Rptr. 2d 448 (2000)* (affirming award of attorney fees after plaintiff prevailed on FDCPA claim for creditor's wrongful retention of personal property contained in repossessed vehicle in attempt to obtain rental payments due on vehicle).

(n8)Footnote 8. *Me. Rev. Stat. Ann. tit. 32, § 11017(3).*

(n9)Footnote 9. *See Dub Shaw Ford, Inc. v. Jackson, 622 S.W.2d 664 (Tex. App. 1981)* (provision in contract providing that unsecured property contained in repossessed collateral may be temporarily held by creditor did not violate Texas Consumer Credit Code; provision merely restated law of bailor-bailee relationship).

(n10)Footnote 10. *See* National Consumer Law Center, Repossessions, § 7.4 (6th ed. 2005 and supp.).

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PART I Consumer Credit
CHAPTER 10 Repossessions

1-10 Consumer Credit Law Manual § 10.07

§ 10.07 Disposition of Repossessed Collateral Other Than by Creditor's Sale: Reinstatement, Redemption, Strict Foreclosure, Sheriff's Sale, and Consumer's Sale

[1] Introduction

After the creditor obtains possession of the collateral, it has a choice as to how to deal with the collateral. One is to sell it. This section discusses the other options.

[2] Right to Reinstate Contract

In some states, creditors are required to permit a consumer to reinstate the contract after default and repossession. Sometimes this is called a right to redeem or a right to cure, but it is not the same as either the right to redeem customarily available under UCC Article 9 or the right to cure sometimes provided by state law.

A right to reinstate differs from the Article 9 right of redemption also in that it is usually limited to a specific time period, *e.g.*, 15 days, following repossession and may also not be available if the buyer has acted in bad faith.

The right to reinstate also differs from the right to cure, which arises prior to acceleration and repossession. The two are similar in that both generally restore the contract to its original terms.

State law usually prescribes specific notice requirements for the right to reinstate. The duty to give notice may be triggered by the creditor's exercise of control over the collateral even if the creditor does not take physical possession.

[3] Redemption of Collateral

[a] Absolute Right Until Disposition

The Code provides that the debtor may redeem repossessed collateral by tendering an amount sufficient to satisfy all obligations secured by the collateral as well as the cost of repossession. n1 If the amount due under the contract has been accelerated, the debtor must tender the total remaining amount due, not just the delinquent installments. n2 In such cases, the debtor is better off reinstating the contract or "curing" the default where state law allows. Debtors may redeem the collateral at any time before the secured party has disposed of the collateral. Failure to return the collateral

after the debtor tenders the redemption amount is conversion. n3

Because of the right to redeem, the debtor loses ownership of the collateral only when the creditor sells it or exercises the option of retaining it in satisfaction of the debt. n4 The debtor retains ownership even if the creditor has obtained a repossession title in anticipation of the repossession sale. n5 In fact, even a debtor who has waived the right to redeem still retains ownership of the collateral (but not the right to regain possession). Under Article 9, transfer of ownership occurs and the debtor's rights in the collateral are terminated only when the creditor either sells the property or goes through the notice procedure required to accept it in satisfaction of the debt. n6 The view that repossession results in a transfer of ownership is not only contrary to the language of the UCC, but completely breaks down in the case of possessory security interests, in which the creditor has possession of the collateral throughout the term of the security agreement. n7 As the Georgia Supreme Court has noted, *U.C.C. § 9-610(c)* specifically provides that the secured party may purchase the collateral at the repossession sale, and the secured party would not need to purchase the collateral if it already owned it. n8 Further, the notion that ownership vests in the secured party upon repossession is inconsistent with *UCC § 9-620*, which sets forth specific procedures for the secured party to follow if it wants to accept the collateral in satisfaction of the debt. These procedures would be meaningless if the creditor already owned the collateral. n9 In addition, *UCC § 9-617* states that the secured party's disposition of the collateral transfers to the buyer "all of the debtor's rights in the collateral," a statement that would be surplusage if repossession alone terminated the debtor's ownership. n10 The leading case to the contrary, n11 whichwas decided under the former version of Article 9, should be of little continuing precedential value as revised Article 9 is so clear about the debtor's continued ownership of the collateral after repossession.

After repossession the buyer also has the right to demand that the creditor act with due care to preserve the collateral; the right to be notified before the creditor disposes of the collateral; the right to any surplus from the sale; and the right to damages for the creditor's failure to comply with the UCC's provisions. n12 These rights further reveal the UCC's treatment of the debtor as the owner of the repossessed collateral until the creditor complies with the statutory procedures for disposition or retention of the collateral.

Debtors may be better off not to redeem collateral, but to purchase it at the repossession sale. The sale price is usually significantly less than the amount required to redeem the collateral. In states where the transaction or deficiency balance is covered by an anti-deficiency law, this may mean the debtor can recover the collateral at a bargain price and then have no further obligation to the creditor for the deficiency.

[b] Who Can Redeem

Although the former version of Article 9 allowed only "the debtor" to redeem collateral, n13 the UCC defined "debtor" broadly and, in the case of redemption, the term "debtor" most likely refers both to the collateral's owner and the debt's primary obligor.

A guarantor or cosigner or other accommodation party may also be a debtor for purposes of redemption. As sureties, they are persons who may owe payment and are thus within the Code's definition of debtor.

Revised *UCC section 9-623* explicitly includes secondary obligors in the list of parties who may redeem collateral. The section makes a distinction, however, between the "debtor," who has the right to redeem, and the primary obligor, who is not listed as having the right to redeem. "Debtor" is defined as the person who owns the collateral. n14

[c] Notice of Right

Former Article 9 did not require a notice to the debtor of the debtor's right to redeem the collateral, but other state law may impose this requirement. Such a notice is defective if it says anything other than that the debtor has the right to redeem the collateral at any time before the sale is consummated.

Improper notice of the time to redeem may make the notice of sale defective under Article 9, even if that notice is proper in all other respects. Improper notice of the amount needed to redeem has also been held to make the notice improper. Bad notices constitute a likely violation of state UDAP statutes. n15

Where state law does require notice of the right to redeem, each debtor in the transaction may be entitled to the redemption notice. The failure to provide a timely notice of the right to redeem may bar a deficiency judgment.

The 1999 revisions to Article 9 correct the failure to require notice of the right to redeem. In consumer-goods transactions, the notice of sale that the secured party must send to the debtor must include a telephone number from which the debtor may obtain the amount necessary to redeem the collateral. n16 The safe-harbor form includes not only the telephone number but also a brief description of the right of redemption. n17

[d] Determination of Redemption Amount

Redemption requires the payment of the original obligation plus expenses of repossession and possibly attorney's fees. n18 Critical to the calculation of the amount that must be tendered is the treatment of unearned finance charges and insurance premiums. Where the total amount of the debt has been accelerated, creditors are entitled to receive the outstanding principal, but are not entitled to receive as tender unearned interest or insurance payments.

Revised Article 9 requires the notice of sale in consumer-goods transactions n19 to state that the consumer can learn the amount necessary to redeem by calling a telephone number listed in the notice. n20 The consumer should call this number and ask for both the current redemption amount and how to determine whether it will increase during the redemption period (for example, due to interest). While Article 9 explicitly requires the creditor to respond only to a signed or otherwise authenticated request for the balance due, n21 the clear implication of the section 9-614 reference to a telephone number is that the creditor must provide the redemption amount in response to a telephone request. If the telephone number is inoperable or there is no one at the number who can provide the redemptionamount, the consumer has a good argument that the notice of sale was deficient. n22

If the consumer calls the number and reaches someone who provides a redemption figure, the consumer should confirm this amount in writing if time allows, so that the creditor can not later claim that the amount tendered was not the correct amount due. Article 9 provides a specific procedure that can be used to obtain written confirmation of the redemption amount. Under *UCC § 9-210(a)(4)* and (b), the debtor can request that the creditor approve or correct a statement indicating what the debtor believes to be the aggregate amount of unpaid obligations secured by collateral as of a specified date. The debtor's request should ask the creditor to confirm that the amount stated in the telephone conversation is correct as of the date of the call, and to confirm the amount that will be due on the date the debtor plans to redeem. The debtor's request must be signed or otherwise authenticated and must reasonably identify the transaction. n23

The creditor has fourteen days to respond to such a request, which Article 9 refers to as a "request regarding a statement of account." n24 The debtor is entitled to one response without charge in any six-month period. n25 After that, the creditor can charge up to $25 to respond to such a request.

If the creditor fails to respond properly to such a request without reasonable cause, the consumer is entitled to actual damages plus statutory damages of $500. n26 In addition, failure to respond, thereby making it impossible for the debtor to redeem the vehicle, may excuse the debtor's duty to tender the redemption amount, so the creditor's sale of the collateral would be conversion. n27

Section 9-210 also requires the creditor to reply, without charge, to a signed or otherwise authenticated request by the debtor for the balance due on a secured obligation. n28 This is termed a "request for an accounting" rather than a

"request regarding a statement of account." When the debtor requests an accounting, the creditor can respond by providing the balance due up to thirty-five days earlier or thirty-five days later than the date of the request. n29 As a result, this type of request is of little use in the redemption context.

If fewer than fourteen days remain before the repossession sale, there is not enough time to invoke the Article 9 procedure for confirming a statement of account. The debtor should still send a letter confirming the amount required to redeem. The letter will corroborate the consumer's understanding of the amount that the creditor stated orally. The creditor's refusal to accept that amount may violate the debtor's right to redeem or the creditor's duty of good faith. n30

The debtor should not assume that the creditor has accelerated the debt and that the entire unpaid balance must be paid to redeem the collateral. Even though the timing of acceleration is within the discretion of the creditor once a default has occurred, some creditors may hold off on acceleration because they perceive an advantage in delaying the calculation of rebates. If the debt has not been accelerated, then a consumer wishing to redeem need only pay the delinquent payments plus the creditor's expenses. n31 As there is usually a very significant difference between the amount of the overdue payments and the full accelerated balance, use of the model form's language when the debt has not been accelerated would be clearly misleading in violation of Revised Article 9. It is unlikely to be apparent to the debtor whether the creditor has accelerated the debt, but this issue can be explored through discovery. Sending a misleading notice triggers the remedies of Revised Article 9, n32 and a creditor's sale of the collateral after having impeded redemption by sending such a notice may be conversion. n33

Where the collateral is security for more than one obligation, the debtor may have to tender the amount due on all obligations in default in order to redeem the item.

[e] Tender

The mechanics of making tender under the UCC are controlled by common law tender notions. The debtor must actually have the money present and produce and offer it to the creditor. The tender must be unconditional and in the correct amount. n34

[f] Secured Party's Refusal

Actual production of the cash is not necessary if the secured party says that he or she will not accept it. If the creditor refuses to accept a properly made tender and, thus, violates Article 9, the debtor has two avenues for a remedy -- conversion and damages under section 9-507(1) [Revised *UCC section 9-625*].

[g] Waiver

The uniform version of Article 9 prohibits waiver of the right to redeem in consumer-goods transactions. n35 In other transactions waiver is allowed, but only by an agreement entered into and signed or otherwise authenticated after default. n36 Debtors' attorneys faced with a waiver should determine whether it was knowing and voluntary. n37

[4] Strict Foreclosure: Creditor's Retention of Collateral

[a] Deficiency Precluded

Except where the debtor has already paid off a substantial portion of the loan or where prohibited by state law, the creditor may propose to retain repossessed collateral in full satisfaction of the obligation. n38 Retention of the collateral, also known as strict foreclosure, being "in satisfaction of the obligation," precludes the creditor from any further claim to a deficiency, though the creditor is entitled to keep all prior amounts paid by the debtor.

On the other hand, Article 9 does not require a strictly foreclosing creditor to pay out any surplus to the debtor. n39

However, if the strictly foreclosing creditor later sells the collateral in the regular course of its business, it may be liable to the debtor for any surplus.

A secured party intending to elect strict foreclosure must notify the debtor in writing of that election. n40 If the notice is not proper, the retention is not proper either. n41 If the creditor accepts the collateral in satisfaction of the debt, there is no Article 9 sale, either public or private, and the consumer does not have the right to redeem the collateral. n42

[b] Debtor's Right to Object

The debtor has the right to object to the strict foreclosure. n43 The debtor's objection must also be in writing. n44 The debtor must send notice of any objection to the creditor's retention so that the creditor receives the objection within 21 days of the date on which the creditor sent its notice of retention.

Debtors should object to strict foreclosure if they believe that the collateral can be sold for more than the sum of the amount remaining on the obligation and the creditor's expenses of repossessing, reconditioning, and selling the collateral; that is, when a surplus would result.

[c] Constructive Strict Foreclosure

A creditor may also be held to have involuntarily retained the collateral in lieu of other remedies. Destruction of the collateral, transfer of title to the secured party, or use of the collateral while in the creditor's possession may also constitute a constructive strict foreclosure. This constructive strict foreclosure on the collateral would completely satisfy the debt just as if it were a voluntary strict foreclosure, allowing the creditor no right to seek a deficiency or to sue on the underlying debt.

A constructive strict foreclosure can also happen when the secured party "sells" the collateral to a dealer or other party pursuant to a repurchase or recourse agreement.

[d] The 60% Rule: No Strict Foreclosure

Strict foreclosure is not allowed if the debtor has paid 60% of the cash price in the case of a purchase money security interest in consumer goods or 60% of the loan in the case of another security interest in consumer goods. Unless the debtor renounces this right by signing a written statement *after* default, the creditor must sell the collateral within 90 days of taking possession, and may not retain the collateral. n45 If the creditor violates this requirement by not disposing of the goods by sale within 90 days, the debtor may choose either to recover in conversion or to seek Code remedies under section 9-507.

[e] Strict Foreclosure Provisions in Revised Article 9

The strict foreclosure provisions of Revised Article 9 contain some significant changes. The new sections eliminate "the fiction that the secured party always will present a 'proposal' for retention of collateral and the debtor will have a fixed period to respond." n46 Section 9-620(a) sets forth the conditions necessary to an effective acceptance (formerly, retention) of collateral in full or partial satisfaction of the secured obligation. The first condition is that the debtor must consent to the acceptance. The new section, therefore, is similar to old section 9-505 in that it allows the debtor to object to the strict foreclosure. n47 The revised procedure requires that the debtor send an authenticated objection within twenty days after the proposal is sent. Failure to object to a proposal sent by the secured party may constitute consent. n48

Acceptance is normally automatic once the secured party becomes bound and the time for objection passes.

The secured party must notify others (such as junior lienholders) who would be affected by acceptance of the collateral

in satisfaction of the debt. n49 If any of them object within the prescribed time (twenty days in most cases), the creditor cannot accept the collateral in satisfaction of the debt. n50

Finally, Revised Article 9 appears to foreclose arguments that an extensive delay by a secured party in disposing of collateral constitutes a constructive strict foreclosure, because it requires that the secured party consent to the acceptance of the collateral. n51

[5] Judicial Sale of Collateral

Although not frequently encountered in consumer transactions, there are circumstances in which repossessed goods may be disposed of by judicial sale. Judicial sales are conclusively presumed to be commercially reasonable under Revised *UCC section 9-627(c)* [former section 9-507(2)].

However, where the court orders or permits a sale but does not itself conduct, supervise, or approve the sale, the sale is subject to the requirement of commercial reasonableness.

[6] Sale of Collateral by Debtor

[a] Introduction

Prior to or immediately after repossession, it will often be to the advantage of the debtor to arrange a buyer for the collateral. A private buyer is likely to pay more than can be obtained through an auction or other wholesale disposition, such as the creditor is most likely to use. Whether sold before or after repossession, the permission of the creditor will be necessary.

[b] Automobiles

The client should at least try to obtain some reasonable offers for the car. These could be offered into evidence to support a value in excess of the ultimate resale value which the creditor will likely realize. If the creditor rejects such an offer, later deficiency judgment claims may breach their duty of good faith.

[c] Mobile Homes

[i] Introduction

Consumer debtors who want to sell their mobile homes while they are still subject to a long-term installment sales agreement or by consigning them to a dealer may encounter unique difficulties because of liability clauses in the transfer agreements or because of the UCC law on consignments.

[ii] Using Transfer Agreements

Many creditors will permit consumers still paying on their mobile homes to sell the homes and have the new purchaser assume the obligation of the installment sales contract. These transfer agreements, however, typically contain clauses which hold the original purchaser to continuing liability under the agreement. After one or more transfers, if there is a default, the original purchasers may find themselves liable for a deficiency judgment. In these circumstances, the original purchasers should at least be considered "debtors" under section 9-105(1)(d), with rights to notice of the disposition. Failure to give notice should render the disposition commercially unreasonable.

Under the 1999 revisions to Article 9, only the "debtor" and any secondary obligor (but not the primary obligor) are entitled to notice of the creditor's disposition of the collateral. n52 The original purchasers will be considered debtors, and be entitled to notice of the disposition, only if they still have an interest other than a security interest or other lien on

the mobile home.

[iii] Selling on Consignment

Another method by which consumers can sell mobile homes is through a consignment agreement with a dealer. Under these arrangements, the consumer retains title to the home and permits the dealer to sell the home, usually from the dealer's lot. The dealer agrees to sell the mobile home for a percentage of the sale price or for the right to keep the sale proceeds above a certain amount.

Unbeknownst to the consumer selling the mobile home, the dealer may have granted or may later grant a security interest in its inventory, which would include the consumer's mobile home, to a bank or other lender. If the dealer then defaults on its loan, the bank may repossess and sell the inventory, including the consumer's mobile home.

The consumer's attorney may be surprised to discover that the bank has a strong UCC argument that the bank is entitled to the trailer. Under section 2-326(a), goods delivered to another to be sold, but which may be returned, are considered to be for "sale or return." Goods for "sale or return" are subject to the claims of the seller's creditors even if considered "on consignment" and even if the party delivering the goods reserves title. n53

While this provision may make sense in the commercial context, it is clearly inequitable for the individual owner of a mobile home. There are a number of legal approaches to the consumer's problem.

First, the consumer should have a claim against the dealer individually for conversion. Or, the consumer could try to convince the court that section 2-326 was never intended to apply to consumer sellers. n54

Another defense specifically sanctioned by section 2-326 is to show that the dealer was generally known by its creditors to be substantially engaged in selling the goods of others. n55

The 1999 revisions to Article 9 include a repeal of the portion of section 2-326 that covered consignment sales. n56 Coverage of true consignments will be transferred to Article 9. n57 The consignor's interest in the consigned goods is considered a security interest, n58 and, if that security interest is perfected it will have priority over any security interest the merchant gives. n59 If the owner's name appears on the title to the mobile home, the owner's interest in the home will amount to a perfected security interest and will have priority. n60 If the mobile home is not subject to a title registration law, the owner's security interest may still be considered perfected and thus entitled to priority since a financing statement is not required to perfect a security interest in consumer goods. n61

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Sales (Article 2)Breach, Repudiation & ExcuseInstallment ContractsCommercial Law (UCC)Secured Transactions (Article 9)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionRedemption

FOOTNOTES:
(n1)Footnote 1. Revised *U.C.C. § 9-623* [former *U.C.C. § 9-506*].

(n2)Footnote 2. *Medallion Funding Corp. v. Helen Laundromat, Inc. 34 U.C.C. Rep. Serv. 2d 250 (N.Y. Sup. Ct. 1997)* ; *but see Sibley v. Regency Toyota, Inc., 1999 U.S. Dist. LEXIS 19636* (N.D. Miss. Dec. 9, 1999) (court finds merit in debtor's argument that Mississippi U.C.C. may prevent creditor from demanding full contract price in order to redeem car).

(n3)Footnote 3. *Telemark Dev. Group, Inc. v. Mengelt, 313 F.3d 972 (7th Cir. 2002)* .

(n4)Footnote 4. *See In re Moffett, 49 U.C.C. Rep. Serv. 2d 1341 (E.D. Va. 2003)* ; *Rozier v. Motors Acceptance Corp., 290 B.R. 910 (M.D. Ga. 2003)* ; *In re Robinson, 285 B.R. 732, 49 U.C.C. Rep. Serv. 2d 327 (Bankr. W.D. Okla. 2002)* ; *In re Pluta, 200 B.R. 740 (Bankr. D. Mass. 1996)* (debtor remains title holder and owner after repossession). *But see Bell-Tel Fed. Credit Union v. Kalter (In re Kalter), 292 F.3d 1350 (11th Cir. 2002)* (Florida law) (construing former version of Article 9 and Florida's repossession title statute).

(n5)Footnote 5. Revised *U.C.C. § 9-619(c)* (transfer of record or legal title to secured party is not a disposition and does not relieve secured party of Article 9 duties); Official Comment 2 to Revised *U.C.C. § 9-619*; *In re Robinson, 285 B.R. 732, 49 U.C.C. Rep. Serv. 2d 327 (Bankr. W.D. Okla. 2002)* .

(n6)Footnote 6. Revised *U.C.C. §§ 9-617(a)(1)*, *9-619(c)*, *9-622(a)(2)*; *see also* Official Comment 4 to Revised *U.C.C. § 9-207* (secured party's duty to preserve collateral in its possession applies whether it has possession before or after default); *Jenkins v. G2S Constructors, Inc., 665 A.2d 354 (N.H. 1995)* (title to collateral does not pass to secured party upon default, but only after disposition or strict foreclosure).

(n7)Footnote 7. *U.C.C. § 9-313*.

(n8)Footnote 8. *Motors Acceptance Corp. v. Rozier, 278 Ga. 52, 597 S.E.2d 367 (2004)* .

(n9)Footnote 9. *Id.*; *see also In re Sanders, 291 B.R. 97 (Bankr. E.D. Mich. 2003)* (setting forth this and many other inconsistencies that the *Kalter* view would create with revised Art. 9).

(n10)Footnote 10. *In re Sanders, 291 B.R. 97 (Bankr. E.D. Mich. 2003)* .

(n11)Footnote 11. *Bell-Tel Fed. Credit Union v. Kalter (In re Kalter), 292 F.3d 1350 (11th Cir. 2002)* (Fla. law).

(n12)Footnote 12. *In re Caple, 2005 Bankr. LEXIS 1094* (Bankr. M.D.N.C. Apr. 4, 2005) (debtor's right to redeem, right to surplus, and ability to agree that creditor can accept collateral in satisfaction of debt all suggest that ownership is not terminated by repossession); *Motors Acceptance Corp. v. Rozier, 597 S.E.2d 367 (Ga. 2004)* .

(n13)Footnote 13. Revised *U.C.C. § 9-623* [former *U.C.C. § 9-506*].

(n14)Footnote 14. Revised *U.C.C. § 9-102(a)(28)*.

(n15)Footnote 15. *E.g., Coones v. FDIC, 848 P.2d 783 (Wyo. 1993)* (statement in notice that debtor could redeem by bidding on the collateral at the repossession sale was misstatement).

(n16)Footnote 16. Revised *U.C.C. § 9-614(1)(C)*.

(n17)Footnote 17. Revised *U.C.C. § 9-614(3)*.

(n18)Footnote 18. Revised *U.C.C. § 9-623* [former *U.C.C. § 9-506*].

(n19)Footnote 19. *See U.C.C. § 9-102(a)(24)* (defining "consumer-goods transaction" as one in which the obligation is incurred for consumer purposes and the collateral is consumer goods); § 2.4.2.1, *supra*.

(n20)Footnote 20. *U.C.C. § 9-614(1)(C)*.

(n21)Footnote 21. *U.C.C. § 9-210*; *see Rainey v. Ford Motor Credit Co., 313 So. 2d 179, 16 U.C.C. Rep. Serv. 1436 (Ala. 1975)* (decided under former Article 9, before section 9-614 required the notice of sale to include a telephone number for the debtor to learn the redemption amount).

(n22)Footnote 22. *See* National Consumer Law Center, Repossessions, § 10.4.9.8 (6th ed. 2005).

(n23)Footnote 23. *U.C.C. § 9-210(a)(4)*.

(n24)Footnote 24. *U.C.C. § 9-210(b)*.

(n25)Footnote 25. *U.C.C. § 9-210(f)*.

(n26)Footnote 26. *U.C.C. § 9-625(f)*.

(n27)Footnote 27. *Emmons v. LeMaster, Inc., 27 Kan. App. 2d 940, 10 P.3d 33, 42 U.C.C. Rep. Serv. 2d 861 (2000) . But cf. Rainey v. Ford Motor Credit Co., 313 So. 2d 179, 16 U.C.C. Rep. Serv. 1436 (Ala. 1975)* (creditor's failure to respond to oral request for balance due does not excuse debtor from tender obligation, so creditor's sale of vehicle was not conversion).

(n28)Footnote 28. *U.C.C. § 9-610(a)(2)*, (b); *see also U.C.C. § 9-102(a)(4)* (definition of "accounting").

(n29)Footnote 29. *U.C.C. § 9-102(a)(4)*.

(n30)Footnote 30. *Draughon v. Gen. Fin. Credit Corp., 362 So. 2d 880, 25 U.C.C. Rep. Serv. 349 (Ala. 1978)* (creditor violated right to redeem when it refused to accept debtor's tender of check for amount it had orally indicated was due; a formal written request for a statement of the balance is unnecessary); *Emmons v. LeMaster, Inc., 27 Kan. App. 2d 940, 10 P.3d 33, 42 U.C.C. Rep. Serv. 2d 861 (2000)* (debtor's tender was sufficient when it included entire balance known to debtor, and creditor failed to respond to debtor's written request for the amount of certain incidental expenses; sale of collateral after refusing this tender was conversion). *But cf. Rainey v. Ford Motor Credit Co., 313 So. 2d 179, 16 U.C.C. Rep. Serv. 1436 (Ala. 1975)* (creditor's failure to respond to oral request for balance due does not excuse debtor from tender obligation, so creditor's sale of vehicle was not conversion).

(n31)Footnote 31. *See* Official Comment 2 to *U.C.C. § 9-623*, which indicates that payment of the entire balance is necessary only if the creditor has accelerated the debt, and that the security interest continues to secure unmatured obligations as if there had been no default. Official Comment to former *U.C.C. § 9-506* used this same language.

(n32)Footnote 32. Revised *U.C.C. § 9-625*; *see also* National Consumer Law Center, Repossessions, § 9.3.6.2 (6th ed. 2005).

(n33)Footnote 33. *See* National Consumer Law Center, Repossessions, § 9.3.6.2 (6th ed. 2005).

(n34)Footnote 34. *Telemark Dev. Group, Inc. v. Mengelt, 313 F.3d 972 (7th Cir. 2002) .*

(n35)Footnote 35. Revised *U.C.C. §§ 9-602(11)*, *9-624(c)*. Note that Illinois, by virtue of a non-uniform amendment to Revised *U.C.C. § 9-624(c)*, allows post-default waiver of the right to redeem even in consumer-goods transactions. *810 Ill. Comp. Stat. § 5/9-624(c)*.

(n36)Footnote 36. Revised *U.C.C. § 9-624(c)*; *see Data Sec. Inc. v. Plessman, 510 N.W.2d 361 (Neb. Ct. App. 1993) .*

(n37)Footnote 37. The Official Comments to Revised Article 9 stress that a post-default waiver must be "the bargain of the parties in fact," and that courts should carefully scrutinize waivers that appear in documents that address many additional or unrelated matters. Official Comment 5 to Revised *U.C.C. § 9-602*. The waiver must also be clear and unambiguous. *National Operating, Ltd. P'ship v. Mutual Life Ins. Co., 244 Wis. 2d 839, 630 N.W.2d 116 (2001)* (decided under former Article 9, but court states in note 19 that conclusions would be the same under Revised Article 9).

(n38)Footnote 38. Revised *U.C.C. § 9-620* [former *U.C.C. § 9-505(2)*].

(n39)Footnote 39. *See Harris v. Key Bank, 193 F. Supp. 2d 707* (W.D.N.Y.) (decided under former *U.C.C. § 9-505*), *aff'd, 51 Fed. Appx. 346 (2d Cir. 2002)* (unpublished).

(n40)Footnote 40. Revised *U.C.C. § 9-620* [former *U.C.C. § 9-505(2)*]. *See Emmons v. LeMaster, Inc., 27 Kan. App. 2d 940, 10 P.3d 33* , 42 U.C.C. Rep. 2d 861 (2000) (creditor's failure to send proper notice of strict foreclosure meant that debtor did not lose redemption right).

(n41)Footnote 41. Revised *U.C.C. § 9-620* [former *U.C.C. § 9-505(2)*]. *See Hansford v. Burns, 241 Ga. App. 407, 526 S.E.2d 896, 40 U.C.C. Rep. Serv. 2d 592 (1999)* (notice of retaking of collateral and intent to sell did not constitute notice that collateral would be retained in satisfaction of the debt, so creditor was required to dispose of collateral in a commercially reasonable manner).

(n42)Footnote 42. *Fodale v. Waste Mgmt. of Mich., Inc., 271 Mich. App. 11 (2006)* .

(n43)Footnote 43. Revised *U.C.C. § 9-620* [former *U.C.C. § 9-505(2)*].

(n44)Footnote 44. Revised *U.C.C. § 9-620* [former *U.C.C. § 9-505(2)*].

(n45)Footnote 45. Revised *U.C.C. § 9-620(e)* [former *U.C.C. § 9-505(1)*].

(n46)Footnote 46. Revised *U.C.C. § 9-620*, Official Comment 2.

(n47)Footnote 47. Revised *U.C.C. § 9-620*.

(n48)Footnote 48. Revised *U.C.C. § 9-620(c)(2)*; *see Harris v. Key Bank, 193 F. Supp. 2d 707* (W.D.N.Y.) (failure to respond to proposal was consent under former *U.C.C. § 9-505(2)*), *aff'd, 51 Fed. Appx. 346 (2d Cir. 2002)* (unpublished).

(n49)Footnote 49. Revised *U.C.C. § 9-621*.

(n50)Footnote 50. Revised *U.C.C. § 9-620(a)(2)(B)*.

(n51)Footnote 51. Revised *U.C.C. § 9-620(b)*; *see* Revised *U.C.C. § 9-620*, Official Comment 5. Strict foreclosure under Revised Article 9 is discussed more fully in National Consumer Law Center, Repossessions, § 9.4.5 (6th ed. 2005).

(n52)Footnote 52. Revised *U.C.C. § 9-611(c)(1)*, (2).

(n53)Footnote 53. *U.C.C. § 2-326(3)*. For a more detailed discussion of § 2-326, see Clark, The Law of *Secured Transactions Under the Uniform Commercial Code P 1.06*[1] (1993). *But cf. Budsberg v. Premier Credit Co. (In re Kincaid), 218 B.R. 965, 37 U.C.C. Rep. Serv. 2d 434 (Bankr. W.D. Wash. 1998)* (consumers transferred and consigned motor vehicles to auto store; auto store subsequently filed bankruptcy; because consumers' creditors noted interest on the certificates of title, their security interests survived and had priority over security interest claims of auto store's creditors). *See also In re Corvette Collection of Boston, Inc., 294 B.R. 409 (Bankr. S.D. Fla. 2003)* .

(n54)Footnote 54. *Founders Investment Corp. v. Fegett, 23 U.C.C. Rep. Serv. 903 (Ky. Ct. App. 1978)* .

(n55)Footnote 55. *U.C.C. § 2-326(3)(b)*.

(n56)Footnote 56. Revised *U.C.C. § 9-326*, Official Comment 4.

(n57)Footnote 57. Revised *U.C.C. § 9-109(a)(4)*.

(n58)Footnote 58. Revised *U.C.C. § 1-201(37)*.

(n59)Footnote 59. Revised *U.C.C. § 9-319*.

(n60)Footnote 60. Revised *U.C.C. § 9-311(a)(2)*.

(n61)Footnote 61. Revised *U.C.C. § 9-309*.

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Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 10 Repossessions

1-10 Consumer Credit Law Manual § 10.08

§ 10.08 Creditor's Sale of the Collateral

[1] Creditor Must Sell, Lease, or Otherwise Dispose of Collateral

Unless the debtor has reinstated the contract or redeemed the collateral, or the creditor properly elects to retain the collateral, the creditor must sell, lease, or otherwise dispose of the collateral. n1

The commercial reasonableness standard applies equally to leases and other dispositions as it does to sales. Violations of lease and other disposition procedures also give rise to actual damages and statutory damages under the Code. n2

[2] Commercial Reasonableness Standard

[a] General

Every aspect of the sale must be commercially reasonable: n3 the initial preparation of the collateral for resale, the notice, method, manner, time, place, and terms of the sale, and accounting to the debtor for any surplus proceeds after the sale. n4 The commercial reasonableness standard applies whether the creditor repossesses the collateral or the debtor voluntarily surrenders the collateral. n5 Commercial unreasonableness may be found based solely on one aspect of a sale that was particularly egregious or based on the cumulative effect of several less serious but commercially unreasonable practices. Although one particular aspect of the sale may not on its own cause the sale to be commercially unreasonable, the cumulative effect of a number of suspect practices may lead a court to such a finding.

Notwithstanding the importance of commercial reasonableness, the Code does not define commercial reasonableness.

Section 9-627 sets forth some circumstances in which a sale is commercially reasonable:

- When the collateral is sold in the usual manner on, or at the current price in, any "recognized market," a term that refers to markets like stock exchanges where there are standardized price quotations for essentially fungible property; n6

- When the collateral is sold in conformity with reasonable commercial practices among dealers in that type of property;

- When the sale has been approved by a judicial committee, by a bona fide creditors' committee, by a representative of creditors, or by an assignee for the benefit of creditors.

Section 9-627 also provides that the fact that a greater price could have been obtained by a disposition at a different time or in a different method does not of itself preclude the secured party from establishing commercial reasonableness.

Outside of these principles, the definition of commercial reasonableness is left to a case by case analysis.

The debtor cannot waive the requirement of commercial reasonableness prior to default. n7 In some states, the debtor cannot waive the commercial reasonableness requirement even after default.

For consumer goods, any failure to comply with the Code's sale requirements gives rise to Revised *UCC section 9-625* [former section 9-507(1)] statutory damages of the finance charge plus 10% of the cash price or principal of the loan.

[b] Burden of Proof

Creditors seeking a deficiency judgment generally have the burden of proving they acted in a commercially reasonable fashion in each aspect of the repossession and disposition of the collateral. In some jurisdictions, however, this is true only if the debtor raises the issue, n8 while, in others, the creditor has the burden regardless of the debtor's pleadings. n9 While generally considered a question of fact, and thus appropriate for jury determination, commercial reasonableness has been found by some courts to be a mixed question of fact and law. n10

[3] Creditor's Duties Toward Collateral

[a] Duty to Safeguard

A secured party is under a duty to use reasonable care in the custody and preservation of collateral in its possession. n11 Deterioration or destruction of the collateral that occurs through the creditor's reckless actions likewise should render the sale commercially unreasonable. n12 If the collateral is destroyed while in the possession of the creditor, this may be considered a constructive strict foreclosure, in which case the creditor would not be permitted to seek a deficiency.

[b] Use of Collateral

The duty to use reasonable care in the custody and preservation of the collateral means that the creditor may not drive the debtor's car for personal reasons or let someone use the debtor's mobile home pending sale. However, the creditor may always use or operate the collateral in order to preserve it or its value.

If the creditor puts the goods to an improper use, any subsequent sale of the collateral should, at the very least, be commercially unreasonable. n13 Under the former and possibly the current UCC, the debtor could argue, even further, that there has been a constructive strict foreclosure, that the obligation is thus satisfied, and that the creditor's retention of the collateral precludes any deficiency action. n14

The debtor can argue alternatively that the creditor is liable for any depreciation in value caused by the improper use of the collateral.

A third remedial approach is for the debtor to seek the fair market rental value of the property for the period the creditor improperly uses it.

In addition to the above approaches, since the creditor has not complied with the default provisions of Article 9, the creditor is liable for any resulting actual damages or the minimum statutory damages of the finance charge plus 10% of

the cash price or principal amount, whichever is larger. n15

[c] Duty to Recondition

Although Revised section 9-610(a) specifically states that the creditor may sell the collateral "in its present condition," n16 the secured party is under a duty to undertake necessary preparation of the collateral. n17 This may require simply washing and cleaning the collateral so as to make it more presentable or may involve more extensive repairs.

Any reconditioning work and any charge for such work must always be commercially reasonable. If the amount of the creditor's reconditioning work is disproportionate to the value of the collateral or does not result in a significant increase in the amount obtained for the collateral at the sale, it is very likely not commercially reasonable.

[d] Preservation of Warranties

Preservation of warranties on the collateral may also be critical to maximizing the resale price. In a departure from the previous approach of the UCC, Revised Article 9 provides that a repossession sale includes "the warranties relating to title, possession, quiet enjoyment, and the like" which arise by operation of law in similar voluntary sales. n18

Implied warranties of merchantability or fitness for a particular purpose may also arise in a repossession sale. Whether implied warranties have arisen, and whether the seller has successfully disclaimed them, will be governed by the implied warranty provisions of Article 2. n19 Again, if a disclaimer of implied warranties is likely to reduce the resale price significantly and is contrary to the usual method of sale, it may be commercially unreasonable.

Preserving manufacturers' warranties on collateral, such as new vehicles, may also be critical to securing a fair repossession sale price. The seller may have to incur some expenses to ensure that the vehicle meets the manufacturer's standards, but failure to do so is likely to have such a grave impact on the resale price that it should be commercially unreasonable except in very unusual circumstances. n20

[4] Notice of Sale

[a] Importance of Notice

Revised *UCC Section 9-611(b)* requires reasonable notice of the sale or other disposition of repossessed collateral. The notice of sale is of the utmost importance to the consumer. Notice of sale is also important because of the substantial remedies available if the creditor fails in any of a number of ways to provide proper notice. Creditors must comply with all notice requirements, even if the debtor has voluntarily surrendered the collateral to the creditor. Notice is required regardless of whether the creditor acquires possession of the collateral before or after default. n21

[b] Who Must Send Notice

The "secured party," that is, the party actually responsible for selling the collateral, must send the notice. n22

Where a secured party reassigns the collateral to the dealer pursuant to a repurchase agreement, section 9-504(5) [Revised *UCC section 9-618*] specifically provides that such a transfer confers on the transferee all the rights and duties of the secured party.

[c] Manner of Sending Notice

Former section 9-504(3) required that the notice of the sale be "sent" to the debtor. "Send" is defined in former *UCC § 1-201(38)* as "to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed."

Revised Article 9 also requires the secured party to "send" notification of the sale, n23 but includes its own definition of "send" instead of incorporating the Article 1 definition. The core of the Revised Article 9 definition is "to deposit in the mail, deliver for transmission, or transmit by any other usual means, with postage or cost of transmission provided for, addressed to any address reasonable under the circumstances." n24 This definition contemplates not just notice by mail but also by electronic means of transmission.

Revised Article 9 does not allow secured parties to transmit the notice of sale electronically as a way to avoid giving actual notice to the consumer. Section 9-611(b) requires "reasonable" notification of the sale, and Official Comment 2 specifically says that the manner in which the notice is sent must be reasonable.Further, Article 9 expands the definition of "good faith," which is required in performance and enforcement of a transaction, to include both honesty in fact and the observance of reasonable commercial standards of fair dealing. n25 Notice by electronic means would be arguably unreasonable and a violation of the duty of good faith unless the creditor had engaged in a pattern of electronic communication with the debtor, to which the debtor had consistently responded.

[d] Who Must Receive Notice

The former version of Article 9 provided, in the case of consumer goods, that the "debtor" must receive notice of the sale. n26 Except in Louisiana, former Article 9 defined "debtor" broadly as the person who owes payment or other performance of the obligation and included both the owner of the collateral and the obligor, if different. n27 The 1999 revisions to Article 9 clarify that notice must be sent to both the debtor and to any secondary obligor. n28

[e] Waiver of Notice

[i] Debtor's

The debtor may not waive the right to receive notice except by an agreement entered into and signed or otherwise authenticated after default. n29 Article 9 should be strictly construed to allow only a specific, knowing waiver. n30

[ii] Guarantor's

Courts split as to whether, under the former version of Article 9, guarantors can waive their right to notice prior to default, but have recognized that the nonwaivability of guarantors' rights under former section 9-504(3) is the majority view in the country. The 1999 revisions clarify that neither the debtor nor any secondary obligor may waive the right to receive notice of the sale unless the waiver is entered into and authenticated after default. n31

[f] Timing

The secured party must give "reasonable notification of the sale." n32 Thus, the test is whether the debtor has adequate time to react to notice of the sale and protect their interest.

State statutes may prescribe a minimum time period between the giving of notice and the sale, such as ten days. Otherwise, a court must decide what is reasonable. A period of ten days between the time of notice and the time of sale appears to be the standard minimum acceptable period. The 1999 revisions to Article 9 set ten days before sale as a "safe harbor" for non-consumer transactions, but do not specify a notice period for consumer transactions. n33

[g] Notice Sent But Not Received

Although the secured party need not prove the debtor actually received the notice, the secured party bears the burden of proving that the notice was sent or that a reasonable attempt to notify the debtor was made.

[h] Written Requirement

Under the former version of Article 9, courts were split on whether oral notice was proper or whether only written notice of the sale would suffice. The 1999 revisions to Article 9 make it clear that written notice is required. n34 The notice may, however, be electronic, although the secured party's choice of an electronic means of sending notice must be reasonable and will have to measure up to the good faith standard. n35

[i] Content

The Code specifies the required content of the notice. n36 The notice must contain the time and place of a public sale. n37 If a private sale or other disposition is contemplated instead, the notice must contain the time after which the sale or other disposition is to be made. Courts also find that the notice must state whether the sale will be public or private. n38 Describing the method of sale as an auction, without indicating whether it will be a private or public sale, is insufficient. n38.1 If either the creditor notifies the debtor that a private sale will be held and, in fact, holds a public sale, or the notice is for a public sale and a private sale is held, then the notice is defective.

The content of the notice must be accurate in all respects, such as identity of collateral to be sold, redemption price, responsibility of guarantors, etc.

The 1999 revisions to Article 9 significantly expand the information that must be included in the notice of sale in consumer goods transactions. In addition to the time and place of a public sale, or the date after which a private sale will be held, the notice will have to include: a description of the debtor and the secured party; a description of the collateral; a statement that the debtor is entitled to an accounting of the unpaid indebtedness and the charge, if any, for an accounting; a description of any liability for a deficiency of the person to which the notification is sent; a telephone number to call to learn the amount necessary to redeem the collateral; and a telephone number or mailing address to contact to get additional information. n39 While the notice need not be in any particular form, the drafters have provided a "safe harbor" form of notice that includes language to meet these requirements. All information required by the notice provision must be included in the notice and must be accurate. n40 The revised notice requirements will govern transactions entered into prior to the effective date of the 1999 revisions, as long as the notice is sent after the effective date. n41

[j] When Notice Not Required

Article 9 provides that notice is not required if the collateral is perishable, threatens to decline speedily in value, or is customarily sold on "recognized markets." n42 Only items such as stocks, bonds, securities, and commodities are sold on a "recognized market." With rare exception, courts have held that used vehicles and used appliances or other consumer goods are not perishable, do not threaten to decline speedily, and are not customarily sold on recognized markets, so that the requirement of notice prior to sale is not excepted in these cases.

The Commentary to the 1999 revision of Article 9 makes it crystal clear that automobile auctions are not "recognized markets": "A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions." n43

[k] Remedies for Notice Violations

Revised *UCC section 9-625* [former *UCC section 9-507*] provides for debtor remedies where a secured party fails to give proper notice. n44 Under Revised *UCC section 9-625*, the debtor has a right to actual damages, such as diminished sale price, and other foreseeable damages.

At minimum, in the case of consumer goods, failure to give notice should result in liability for Revised *UCC section*

9-625(c)(1) [former section 9-507(1)]'s minimum statutory damages of the finance charge plus ten percent of the cash price or loan principal. n45 The purpose of this statutory damage provision is to impose a flat penalty for noncompliance with Article 9 regardless of a plaintiff's ability to demonstrate any actual loss resulting from a given violation. In addition, it is arguably compensatory in that it ensures that a plaintiff will receive some level of compensation for a violation. It provides an incentive to pursue Article 9 claims even when the amount of actual loss that can be demonstrated is minimal. n45.1 In addition, the court may decide that, where notice is insufficient, the secured party is not entitled to a deficiency.

[5] Timing of Sale

[a] Unreasonable Delay

Under Article 9, creditors must sell repossessed consumer goods within 90 days if the debtor has already paid 60% of the cash price or 60% of the loan principal in the case of a purchase money security interest. n46 A court held that sale of a repossessed car within a year after repossession was commercially reasonable when extensive repairs were necessary and parts were difficult to get. n46.1 In addition to this specific requirement, the timing of the sale of any goods must meet a commercially reasonable standard.

An important factor in determining the commercial reasonableness of the delay is the extent to which the collateral's value is depreciating while it sits at the dealer's lot or warehouse. Unjustified delay is also commercially unreasonable where the result is the debtor having to pay substantial storage charges. The creditor's failure to comply with its own standard procedures for disposing of collateral may show unreasonable delay.

However, there is a line of cases -- primarily in the commercial, nonconsumer setting -- holding that, in certain circumstances, a delay of several months to a year is not commercially unreasonable; for example, where the collateral was expected to rise in price.

[b] Excessive Delay

If the creditor retains the collateral too long before disposing of it, a court may find that an involuntary or constructive strict foreclosure has occurred and force the creditor to retain the collateral in full satisfaction of the obligation, with no right to seek a deficiency.

However, courts do not always find a constructive strict foreclosure where the sale has been delayed if there has been good reason, and the official commentary to Revised Article 9 opines that "mere delays" in collection or disposition of collateral do not constitute a constructive strict foreclosure. n47

The revised version of Article 9 also preserves common law remedies such as conversion and estoppel when a secured party holds repossessed collateralfor an unreasonably long time. n48 These causes of action may provide a remedy similar to constructive strict foreclosure.

The creditor's delay may lull the consumer into believing that the collateral has been sold for an amount sufficient to pay the indebtedness, or the consumer may conclude that the creditor is acting in accord with a previous oral representation that returning the vehicle will resolve the debt. In either case, if the consumer changes position in reliance on the creditor's inaction, the creditor may be estopped from pursuing a deficiency.

[c] Rushed Sale

A sale that is too hastily conducted may not be commercially reasonable for a number of reasons, including the failure to advertise the sale adequately and the creditor's failure to locate potential purchasers. Creditors may also be required to wait until the proper selling season, as in the case of seasonal goods, such as heaters and air conditioners.

[6] Public vs. Private Sale

[a] Determining Public or Private

The creditor can sell the collateral at either a public or a private sale, but the choice of public or private sale must be commercially reasonable.

The most important indicator of whether a sale is public or private is the nature of the sale itself. Public sales take place at a given time, at a given place, with competitive bids. More typical of a private sale is for the collateral to remain at the dealer's place of business until an interested buyer is willing to pay a reasonable price for the collateral.

However, since public sales rarely attract more than a few bidders, it is often difficult to distinguish between the two. Discovery as to advertising, whether an auctioneer was used, how many bidders there were, and related questions usually suffice to determine the type of sale conducted. Courts have held that a public sale must be accessible to all members of the public. n49

If the creditor notifies the debtor that the sale is public, but, in fact, holds a private sale, the notice is defective and the creditor is liable for damages or other remedies under Revised *UCC section 9-625* [former section 9-507]. In fact, the creditor has the burden of proof in a deficiency action to demonstrate whether a sale is public or private, so as to show whether the type of sale held corresponds to the type of sale specified in the notice.

[b] Commercial Reasonableness of Choice

Under Article 9, the creditor may hold either a public or a private sale, but this choice must be commercially reasonable and must maximize the sale proceeds. n50 Other state statutes, however, may require public sales in some circumstances.

Article 9 seems to permit wholesale sales in most cases, even though a retail sale may result in a higher price. Thus, banks, finance companies, and other nondealer lenders are probably well within their rights to sell repossessed consumer goods at wholesale public sales.

[7] Public Sale

[a] Requirements of Auctions

Public sales must be by public auction with competitive bidding. The sale may take place either at a regular, known auction for that kind of goods or at one specifically arranged to dispose of the repossessed collateral. n51

Whenever possible, the debtor or a representative of the debtor's attorney should be present at the auction to observe the nature of the sale. To assure the highest price, the auction should be conducted by someone familiar with the type of goods being sold and with the conduct of auctions. Without a professional auctioneer, this standard may not be met.

The sale location must be such as to allow access to the collateral on the part of the buying public.

[b] Adequate Advertisement

The secured party is under a duty to give notice of the intended sale to members of the public who might be expected to buy at the sale. The secured party has the burden of proving that it exposed the potential sale to at least a substantial number of potential buyers.

It is clear that failure to advertise consumer goods at all is commercially unreasonable. The requisites for advertising or

eliciting bids vary, depending on the sale period and the type of collateral.

The advertising and notice of the sale must give prospective buyers enough time to make arrangements necessary to attend the sale and purchase the collateraland must also adequately describe the goods to be sold and the conditions of sale. The distribution of the advertising must be adequate to reach prospective bidders, such as through the use of trade journals, if appropriate, or at least in the manner of advertising like products on the open market.

It is the question of overall commercial reasonableness that is critical; the cumulative impact of minor infractions may very well convince a court that the sale as a whole does not meet Article 9 standards.

[c] Availability of Collateral for Inspection

The collateral offered for sale at public auction must be available for reasonable inspection before the auction. The need for advance inspection increases as the price of the goods increases. The sale must be to the highest responsible cash bidder. n52

A creditor may purchase the collateral at a public sale. However, if the creditor or a related party purchases the collateral at public auction, special attention must be paid to all aspects of the auction. Of particular importance is whether an auction was actually held and, if so, whether the creditor turned away or discouraged other bidders.

The 1999 revisions to Article 9 create a new remedy for some debtors where the collateral is sold to an insider at a low price. Revised section 9-615 requires the debtor to be credited with the price that would have been realized at an arm's length sale if the collateral is sold to the secured party, a person related to the secured party, or a secondary obligor, and the proceeds are significantly below the range that a commercially reasonable sale to a non-insider would have brought. As a result, sales to the following are governed by the new rule:

- A person or organization that directly or indirectly controls, is controlled by, or is under common control with the secured party--for example, parent companies, subsidiaries and other companies under common ownership. Officers and directors of these related companies are also considered insiders.

- An officer or director of the secured party or someone performing similar functions.

- An ancestor or lineal descendant of any individual described above or the individual's spouse; the spouse, brother, brother-in-law, sister or sister-in-law of any individual described above, or any relative by blood or marriage who shares a home with an individual described above. n53

- The original seller, if it has a recourse agreement with the secured party, *i.e.,* is obligated to buy back the debt if the buyer defaults. n54

The new rule applies to both public and private sales. The duty to credit the consumer with an arms-length sale price could be enforced in an individual suit, as a defense to a deficiency judgment, or in a class action. In addition, the creditor is liable for actual damages -- plus, in some cases, statutory damages -- if it also violates other provisions of Revised Article 9, such as the duty to resell the collateral in a commercially reasonable manner.

[d] Injunctions Available

Debtors' attorneys should note that Revised section 9-625(a) [former section 9-507] authorizes not only damages for commercially unreasonable sales, but also injunctions against such sales. An injunction may be appropriate if the creditor's preparation for the sale is clearly inadequate, or the creditor appears to be attempting to sell the collateral to itself at a low price. However, obtaining an injunction may not help the debtor in the end. Under many circumstances, a

debtor is better off relying on a damage remedy for an unreasonable sale.

[8] Private Sale

[a] Requirements

A creditor may elect to hold a private sale whenever it appears that this form of sale will result in a higher sale price unless other state law requires a public sale. Private sales to retail buyers, where facilities for such sales are available, are likely to produce substantially higher prices than wholesale auctions, so this form of sale, if reasonably conducted, should always be permissible. On the other hand, a private *wholesale* non-auction sale should be scrutinized more carefully to ascertain whether a higher net price could have been obtained at auction, after deducting auction expenses, or at a private retail sale.

[b] Creditor's Purchase at Private Sale

Although secured parties may buy the collateral at a public sale, they may not do so at a private sale unless the collateral is of the type customarily sold in a recognized market or is the subject of widely distributed standard price quotations. n55

If the secured party buys the collateral at an allegedly public sale, it runs the risk of a court looking at all the aspects of the sale and determining that the sale was actually private and that the secured party's purchase was thus wrongful.

[c] Good Faith Bargaining Requirement

If the creditor elects to dispose of the collateral at a private sale, the creditor must be careful to engage in good-faith bargaining and make sure that there is no self-dealing.

[d] Repurchase Agreements

A significant portion of consumer credit contracts are assigned by a dealer to a finance company. Former section 9-504(5) specifically stated that a transfer of collateral pursuant to a repurchase agreement or the like was not a sale or disposition of the collateral under Article 9. n56 Instead, the dealer or other transferee had the same rights and duties after the transfer as the secured party had prior to the transfer, and must now conduct a commercially reasonable sale of the collateral, meeting notice and all other requirements.

Debtors' attorneys faced with alleged sales between finance companies and their dealers -- particularly involving General Motors, Ford, and Chrysler -- should be familiar with the FTC activity in this area. The Commission has obtained lengthy consent agreements from the three major American automobile companies whereby they agree to discontinue improper conduct. n57

Where the collateral has been assigned back to the dealer under a repurchase agreement, it has been held that only the dealer, and not the repossessing creditor, is liable for failure to dispose of the collateral properly. n58

The 1999 revisions to Article 9 eliminate the flat rule that a transfer back to a dealer under a repurchase or recourse agreement is never an Article 9 disposition. n59 If the secured obligation, *i.e.*, the paper, rather than the collateral itself is re-assigned to the dealer under a repurchase agreement, it is not an Article 9 disposition. n60 But if the collateral itself is transferred to the secondary obligor, then it may be an Article 9 disposition. n61 Only if the secondary obligor (the dealer) agrees to accept the rights and assume the duties of the secured party, as well as take the transfer of the collateral, will it be clear that the transfer is not an Article 9 disposition. If the price at which the dealer repurchases the collateral is significantly below the usual range of prices, however, the consumer is entitled to be credited with the price that an arm's length sale to an unrelated party would have produced. n62 This revision to Article 9 will open the door to

a new wave of self-dealing, which will be difficult for consumers to police.

[9] Other Challenges to Commercial Reasonableness

[a] Sale Price

[i] Is a Low Sale Price a Sufficient Basis for a Finding of Commercial Unreasonableness?

A low sale price does not always, in and of itself, support a finding of commercial unreasonableness, especially if the sale itself is conducted in a commercially reasonable manner. n63 Allegations of a commercially unreasonable resale price alone, however, may be sufficient to place the burden on the creditor of proving that the value of the goods was less than the amount of the debt. n64 Further, if the collateral was sold at a low price to a secured party, or secondary obligor, the 1999 revisions to Article 9 provide a special remedy to the debtor. n65

In any case, the secured party is still under an affirmative duty to obtain the best possible price for the collateral. A particularly low price will subject the disposition itself to close scrutiny. n66 Courts applying the 2001 revision of Article 9 have agreed that a low sale price is relevant to the question of commercial reasonableness. n66.1

A showing that the creditor was acting solely in its own best interest, n67 and not fulfilling what is essentially its fiduciary duty n68 to the debtor, may convince the trier of facts that the price obtained was not commercially reasonable.

The District of Columbia and Guam have court rules that require a creditor seeking a deficiency judgment to show that the collateral was resold for a fair and reasonable price. n69

[b] Wholesale Disposition

[i] UCC Language

One of the most persistent problems faced by consumer debtors is the sale by the dealer of repossessed collateral at wholesale where the dealer could, with little additional effort or cost, sell the same collateral at retail at a higher price, thus reducing the size of the deficiency claim. n70 Dealers often defend their wholesale dispositions by pointing to the first sentence of Revised *UCC section 9-627* [former section 9-507(2)].

However, Revised *UCC section 9-627* [former section 9-507(2)] contains additional language indicating that dealers should sell repossessed collateral in the same way they sell similar, *non-repossessed* property. Revised section 9-627(b) states that a sale is commercially reasonable if sold pursuant to a recognized market or sold "in conformity with reasonable commercial practices among dealers in the type of property." While it is clear that there is no recognized market for the sale of used cars, they can be sold at retail in conformity with the practices of dealers of used cars. The Commentary to the 1999 revision of Article 9 makes this same point, but in somewhat stronger language. n71

[ii] Case Law

Several courts take the sensible position that wholesale disposition is not *per se* unreasonable; instead, the reasonableness of wholesale disposition depends on whether, under the circumstances, the sale will be likely to yield a net recovery as large as a retail sale. Although wholesale prices are lower, so are selling expenses, including storage, advertising, and sales commissions. Where a dealer can sell collateral at retail at a significantly higher price than wholesale, with only slightly higher sales expenses, a wholesale disposition may be commercially unreasonable.

[iii] FTC Precedent

In actions brought by the FTC against them, the three major automobile creditors signed consent agreements agreeing to sell repossessed cars in the same manner that they sell other similar used cars. While the FTC has since modified these consent orders so that this requirement and other aspects of the consent orders are no longer mandatory for dealers, the consent orders are still a useful source of authority on commercial reasonableness.

Car dealers typically sell the majority of their used cars to consumers at retail. Consequently, debtors' attorneys must look at the pattern of a dealer's sale of used cars, comparing the percentage of repossessed cars versus the percentage of other used cars that are sold at wholesale auction.

[iv] "Dealers Only" Auto Auctions

Dealers and creditors frequently dispose of repossessed automobiles at auctions that are open only to auto dealers and not to the public or the consumer debtor. Because the auctions are designed to bring in a wholesale price, repossessed cars will often sell for less than one half of their fair market value. The few courts to consider the issue have generally upheld the commercial reasonableness of a dealers-only sale. n72 These decisions are often based on the court's acceptance of the creditor's evidence either that such sales are the customary practice among creditors or that such sales usually bring the highest prices. However, if consumers can show that a certain aspect of the dealers-only auction violated Revised *UCC section 9-610* [former section 9-504], such as using an improper notice, the creditor may be barred from obtaining a deficiency and in some cases be required to pay statutory damages or fines. n73

These decisions have failed to subject the creditors' arguments to close scrutiny and those arguments may be vulnerable to attack in the appropriate factual situation.

Another issue is what type of notice must be provided concerning a dealers-only auto auction, a public or private sale notice. Most courts take the highly questionable position that dealers-only auctions are private sales for which a private sale notice is proper despite the fact that they are auctions. Yet an auction is the very essence of a public sale. If a dealers-only auction is a private sale,then purchase of the collateral by the secured party at the sale is a violation of the UCC. n74

[v] Private, Non-Auction Wholesale Disposition

Another highly suspect practice involves a dealer that sells repossessed cars privately at wholesale. That is, instead of auctioning the car, the dealer solicits bids from a limited number of other dealers. This method has a high potential for abuse, and, arguably, will not produce as good a result as either a private retail sale or a public or dealers only auction.

[vi] Dealer Justifications for Wholesale Disposition

There are a number of other reasons why dealers sell collateral at wholesale. The first involves self-dealing. If the dealer wants to sell the collateral to itself or a business associate, the dealer's incentive is to arrange a low-priced wholesale auction. Dealers may also resist selling repossessed cars at retail because the repossessed cars compete with other cars on the lot that the dealer owns outright.

[c] "Churning": Revolving Repossession Schemes

Creditors and closely-connected dealers may engage in various types of revolving repossession or "churning" schemes. These schemes generally involve the dealer selling a used car on credit terms the debtor cannot afford, often at an inflated price. The debtor almost immediately defaults, and the creditor quickly repossesses the car. The creditor sells it back to the dealer for a fraction of its worth, using this sale price to calculate the deficiency owed, and then brings a large deficiency action against the debtor. The dealer resells the repossessed car for much more than the dealer just "bought" it for, and starts the cycle over again with a new debtor. In a churning scheme, the dealer can use the same car over and over again, each time creating a sizeable deficiency action at little cost to the dealer. n75 This scheme works

particularly well if the car has an attractive appearance but is defective. When it breaks down and the buyer stops paying, the dealer repossesses it, keeping the downpayment, and sells it again.

Where practitioners believe their client and others are victims of a churning scheme, one option is to obtain class-wide relief for the many victims of the scheme. n76 A title search will reveal how often a dealership has resold a particular vehicle. In addition, some dealerships assign each car a stock number, and then add a digit to indicate how many times the dealership has sold the vehicle.

Churning violates the commercially reasonable resale requirement of Article 9, as a sale to an alter ego at a reduced price is not a commercially reasonable way to maximize the sale price. In addition, Revised Article 9, effective July 1, 2001, in most states, has a new provision that addresses churning. This new provision applies whenever a secured party sells the collateral back to a dealer who is obligated under a recourse agreement, *i.e.,* a dealer who is obligated to buy the collateral back if the buyer defaults. In such a case, if the proceeds of the sale are significantly below the range of proceeds that an arms-length sale would have produced, the creditor is required to credit the consumer with the amount that would have been realized by an arms-length sale. n77 Illinois has a special provision of its UDAP statute that forbids churning n78 but, even without such a specific prohibition, courts are likely to find that churning is a UDAP violation.

[10] Rights of Purchasers at Repossession Sales

The rights of a purchaser at a disposition after repossession, a foreclosure sale, are determined by Article 2 of the UCC covering the sale of goods. In addition to the rights provided in Article 2, Article 9 controls some aspects of the purchaser's rights. The purchaser takes all the rights of the debtor n79 and all subordinate security interests are extinguished. n80 The only two situations that will cloud the title of a foreclosure purchaser are where there is a security interest superior to that of the creditor selling the collateral n81 or where the debtor never had good title in the collateral in the first place. n82

Under the former version of Article 9, the secured party's failure to comply with the provisions of the UCC or with the requirements of any judicial proceedings will not vitiate the sale or affect the interest taken by the purchaser except:

- In the case of a public sale, if the purchaser actually has knowledge of defects in the sale or buys in collusion with the secured party, other bidders, or any other person conducting the sale; n83 or

- In the case of a private sale, if the purchaser fails to act in good faith. n84

The 1999 revisions to Article 9 protect any buyer who acts in good faith and eliminate the distinction between buyers at public and private sales. n85 Revised Article 9, in a departure from the previous approach of the UCC, provides that a repossession sale includes "the warranties relating to title, possession, quiet enjoyment, and the like" which arise by operation of law in similar voluntary sales. n86 These warranties can be disclaimed, however. n87 The Official Comments note that implied warranties of merchantability or fitness for a particular purpose may also arise in a repossession sale, a question which would be governed by Article 2. n88 Disclaimer of these warranties may so reduce the repossession sale price as to be commercially unreasonable.

A successor liability claim can proceed against an entity that purchases assets in a commercially reasonable Article 9 repossession sale if the other requirements for successor liability are met. n89 In other words, when a successor corporation buys its predecessor's assets at a repossession sale, the fact that the sale extinguishes the creditor's security interest does not insulate the successor corporation from liability under the general law of successor liability. n90

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Secured Transactions (Article 9)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionDisposition of Collateral

FOOTNOTES:
(n1)Footnote 1. Revised *U.C.C. § 9-610(a)* [former *U.C.C. § 9-504(1)*]. *See Williams v. Regency Fin. Corp., 309 F.3d 1045 (8th Cir. 2002)* (Missouri law) (listing gift, assignment, abandonment, barter, exchange, and destruction as examples of "other disposition[s]" of collateral).

(n2)Footnote 2. Revised *U.C.C. § 9-625* [former *U.C.C. § 9-507(1)*].

(n3)Footnote 3. Clark, The Law of Secured Transactions Under the Uniform Commercial Code § 4.08 (1993). However, the commercially reasonable standard does not apply to a creditor's pre-repossession forbearance arrangements with the debtor. *McDonald v. Rockland Trust Co., 798 N.E.2d 323, 52 U.C.C. Rep. Serv. 2d 516 (Mass. App. Ct. 2003)* .

(n4)Footnote 4. Revised *U.C.C. § 9-610(b)* [former *U.C.C. § 9-504(3)*].

(n5)Footnote 5. All *Valley Acceptance Co. v. Durfey, 800 S.W.2d 672, 13 U.C.C. Rep. Serv. 2d 1376 (Tex. Ct. App. 1990) . But cf. Williams v. Thomas Pontiac-GMC-Nissan-Hyundai, 1999 U.S. Dist. LEXIS 15045* (N.D. Ill. Sept. 22, 1999) (court found that the duty to be commercially reasonable only attached after a debtor's default; thus, consumer could not seek relief under *U.C.C. § 9-504* because consumer claimed no default existed).

(n6)Footnote 6. Official Comment 4 to *U.C.C. § 9-627*; *see Layne v. Bank One, 395 F.3d 271, 55 U.C.C. Rep. Serv. 2d 704 (6th Cir. 2005)* (sale on a recognized market, here NASDAQ, is commercially reasonable).

(n7)Footnote 7. Revised *U.C.C. § 9-602(7)* [former *U.C.C. § 9-501(3)*]. *See Solfanelli v. CoreStates Bank N.A., 203 F.3d 197, 40 U.C.C. Rep. Serv. 2d 914 (3d Cir. 2000)* ; *Beninati v. FDIC, 55 F. Supp. 2d 141 (E.D.N.Y. 1999) . See also Fodale v. Waste Mgmt. of Mich., Inc., 271 Mich. App. 11 (2006)* (decided under former version of Article 9).

(n8)Footnote 8. *See, e.g., City Nat'l Bank v. Unique Structures, Inc., 49 F.3d 1330 (8th Cir. 1995)* (Arkansas law).

(n9)Footnote 9. *United Mo. Bank of Kansas City, N.A. v. Gagel, 815 F. Supp. 387 (D. Kan. 1993)* (even if debtor does not plead issue affirmatively). *See also Solfanelli v. CoreStates Bank N.A., 203 F.3d 197, 200, 40 U.C.C. Rep. Serv. 2d 914 (3d Cir. 2000)* (creditor's burden to show that under the "totality of the circumstances" sale was reasonable).

(n10)Footnote 10. *See City Nat'l Bank v. Unique Structures, Inc., 49 F.3d 1330 (8th Cir. 1995)* (Arkansas law).

(n11)Footnote 11. *U.C.C. § 9-601(b)* [former *U.C.C. § 9-501(1)*, (2)] (referring to Revised *U.C.C. § 9-207(a)*). *See Harris v. Key Bank Nat'l Ass'n, 89 F. Supp. 2d 408 (W.D.N.Y. 2000)* (duty is equivalent to common law fiduciary duty), *summ. judg. granted*, *193 F. Supp. 2d 707 (W.D.N.Y. 2002)* (plaintiffs' injuries caused not by actions of defendant, but by their own inaction when notified of creditor's intent to keep collateral), *aff'd, 51 Fed. Appx. 346 (2d Cir. 2002)* (unpublished).

(n12)Footnote 12. *Marks v. Powell, 162 B.R. 820, 24 U.C.C. Rep. Serv. 2d 371 (Bankr. E.D. Ark. 1993)* (creditor's repossession agents killed many fish, kept some fish, and destroyed equipment in attempting repossession of fish farm, reducing value of the collateral).

(n13)Footnote 13. *See R & J of Tenn., Inc. v. Blankenship-Melton Real Estate, Inc., 166 S.W.3d 195, 55 U.C.C.*

Rep. Serv. 2d 278 (Tenn. Ct. App. 2004) (allowing others to use the collateral after repossession breached duty of good faith and is one factor in finding of commercial unreasonableness).

(n14)Footnote 14. See *§ 10.09[2][d] infra*.

(n15)Footnote 15. Revised *U.C.C. § 9-625* [former *U.C.C. § 9-507(1)*].

(n16)Footnote 16. Former *U.C.C. § 9-504(1)* used the same standard but refers to the collateral's "then condition."

(n17)Footnote 17. Revised *U.C.C. § 9-610*, Official Comment 4.

(n18)Footnote 18. Revised *U.C.C. § 9-610(d)*. See Revised *U.C.C. § 9-610*, Official Comment 11 and the proposed 1999 revision to *U.C.C. § 2-312*, Official Comment 5.

(n19)Footnote 19. Revised *U.C.C. § 9-610*, Official Comment 11.

(n20)Footnote 20. *See* Donald J. Rapson, *Symposium: Default and Enforcement of Security Interests Under Revised Article 9, 74 Chi.-Kent. L. Rev. 893, 917 (1999)*.

(n21)Footnote 21. *Brockbank v. Best Capital Corp., 341 S.C. 372, 534 S.E.2d 688, 42 U.C.C. Rep. Serv. 2d 310 (2000)* .

(n22)Footnote 22. Revised *U.C.C. § 9-611(b)* [former *U.C.C. § 9-504(3)*]. *But cf. Green Tree Fin. Corp. v. Stone, 2000 Del. Super. LEXIS 345* (Del. Super. Ct. Sept. 29, 2000) (acceptable for creditor to delegate to servicer the duty to send notice).

(n23)Footnote 23. Revised *U.C.C. § 9-611(c)*.

(n24)Footnote 24. Revised *U.C.C. § 9-102(a)(74)*.

(n25)Footnote 25. Revised *U.C.C. § 9-102(a)(43)*.

(n26)Footnote 26. Former *U.C.C. § 9-504(3)*.

(n27)Footnote 27. Former *U.C.C. § 9-105(d)*.

(n28)Footnote 28. Revised *U.C.C. § 9-611(c)*.

(n29)Footnote 29. Revised *U.C.C. § 9-624(a)* [former *U.C.C. §§ 9-501(3)(b)*, 504(3)].

(n30)Footnote 30. *Brockbank v. Best Capital Corp., 341 S.C. 372, 534 S.E.2d 688, 42 U.C.C. Rep. Serv. 2d 310 (2000)* .

(n31)Footnote 31. Revised *U.C.C. §§ 9-602, 9-624*. *But cf. Jett v. Peoples Bank & Trust of Hazard, 2005 WL 2173947* (Ky. Ct. App. Sept. 9, 2005) (notice of sale not required after borrower revoked acceptance of the collateral and gave no indication he had any continuing interest in the property).

(n32)Footnote 32. Revised *U.C.C. § 9-611(b)* [former *U.C.C. § 9-504(3)*].

(n33)Footnote 33. Revised *U.C.C. § 9-612*.

(n34)Footnote 34. Revised *U.C.C. § 9-611(b)*. *See Cerritos Valley Bank v. Stirling, 81 Cal. App. 4th 1108, 97 Cal. Rptr. 2d 432 (2000)* (to be consistent with *U.C.C. § 9-504(3)*, any estoppel claim can only be based on a signed writing); *Brockbank v. Best Capital Corp., 341 S.C. 372, 534 S.E.2d 688, 42 U.C.C. Rep. Serv. 2d 310 (2000)*

(abandonment of mobile home is not waiver, which can only be made by signed writing).

(n35)Footnote 35. *See § 10.08[4][c] supra*.

(n36)Footnote 36. Revised *U.C.C. §§ 9-613*, *9-614* [former *U.C.C. § 9-504(3)*].

(n37)Footnote 37. *Society Bank N.A. v. Cazeault, 83 Ohio App. 3d 84, 613 N.E.2d 1103, 21 U.C.C. Rep. Serv. 2d 398 (1993)* (notice deficient where *state* not specified: Kansas City, Kansas or Kansas City, Missouri).

(n38)Footnote 38. *Davis v. Huntsville Prod. Credit Ass'n, 481 So. 2d 1103, 42 U.C.C. Rep. Serv. 1863 (Ala. 1985)* ; *Union Safe Dep. Bank v. Floyd, 76 Cal. App. 4th 25, 31 (3d Dist. 1999)* (California *U.C.C. § 9-504* requires strict compliance and "does not permit the creditor to leave the debtor guessing regarding the type of sale contemplated"). *See In re Downing, 286 B.R. 900, 49 U.C.C. Rep. Serv. 2d 697 (Bankr. W.D. Mo. 2002)* (deficiency barred when notice governed by Revised Article 9 did not specify method of sale).

(n39)Footnote 38.1. *Garcia v. United Auto Credit Corp., 2008 U.S. Dist. LEXIS 2210 (S.D. Fla. 2008)* .

(n40)Footnote 39. Revised *U.C.C. § 9-614* (some provisions incorporated by reference from Revised *U.C.C. § 9-613*). *See In re Moffett, 356 F.3d 518, 522 (4th Cir. 2004)* (Va. law) (noting that creditor must give debtor notice of right to redeem).

(n41)Footnote 40. Revised *U.C.C. § 9-614*, Official Comment 2.

(n42)Footnote 41. Revised *U.C.C. § 9-702*.

(n43)Footnote 42. Revised *U.C.C. § 9-611(d)* [former *U.C.C. § 9-504(3)*].

(n44)Footnote 43. Revised *U.C.C. § 9-610*, Official Comment 9.

(n45)Footnote 44. Revised *U.C.C. § 9-625* [former *U.C.C. § 9-507(1)*]; *Security Sav. Bank, SLA v. Tranchitella, 249 N.J. Super. 234, 592 A.2d 284, 15 U.C.C. Rep. Serv. 2d 349 (App. Div. 1991)* .

(n46)Footnote 45. *Zions First Nat'l Bank v. Hurst, 570 P.2d 1031, 22 U.C.C. Rep. Serv. 1071 (Utah 1977)* .

(n47)Footnote 45.1. Cavil v. Globe Acceptance, Inc., Case No. CL 103257 (Iowa Dist. Ct., Polk County Dec. 5, 2007), *available at* www.consumerlaw.org/unreported.

(n48)Footnote 46. Revised *U.C.C. § 9-620(e)* [former *U.C.C. § 9-505(1)*].

(n49)Footnote 46.1. *Triple J Saipan, Inc. v. Sanchez, 64 U.C.C. Rep. Serv. 2d 574 (N. Mar. I. 2007)* .

(n50)Footnote 47. Revised *U.C.C. § 9-620*, Official Comment 5.

(n51)Footnote 48. Revised *U.C.C. § 9-620*, Official Comment 12 (explicitly mentioning conversion and cross-referencing *U.C.C. § 1-103*, which mentions estoppel).

(n52)Footnote 49. *See also* Revised *U.C.C. § 9-610*, Official Comment 7.

(n53)Footnote 50. *Vornado PS, Ltd. Liab. Co. v. Primestone Inv. Partners, 821 A.2d 296, 49 U.C.C. Rep. Serv. 2d 1348 (Del. Ch. 2002)* (New York law) (choice of public sale was commercially reasonable as the secured creditor, who was one of the most interested potential buyers of the collateral, would have been excluded from the bidding at a private sale), *aff'd*, *822 A.2d 397 (Del. 2003)* (table).

(n54)Footnote 51. *See Estate of Gammell v. Modern Fin. Co., 1998 Ohio App. LEXIS 4307* (Ohio Ct. App. Sept. 3,

1998) (sale not commercially reasonable where auction rarely sold motor vehicles), *appeal disallowed*, *84 Ohio St. 3d 1474, 704 N.E.2d 581 (1999)* .

(n55)Footnote 52. Clark, The Law of Secured Transactions Under the Uniform Commercial Code P 4.09*[2] (1993).

(n56)Footnote 53. *U.C.C. § 9-102(a)(62)*, (63).

(n57)Footnote 54. Revised *U.C.C. §§ 9-615(f)*, *9-102(a)(71)* (definition of "secondary obligor").

(n58)Footnote 55. Revised *U.C.C. § 9-610(c)* [former *U.C.C. § 9-504(3)*].

(n59)Footnote 56. Revised *U.C.C. § 9-618* [former *U.C.C. § 9-504(5)*]. *See Williams v. Regency Fin. Corp., 309 F.3d 1045 (8th Cir. 2002)* (Missouri law) (transfer from finance company to related dealer was disposition; no discussion of whether recourse agreement existed).

(n60)Footnote 57. *Chrysler Motor Co., 97 F.T.C. 139 (1981)* (consent order), *modified*, *99 F.T.C. 343 (1982); Ford Motor Co., 93 F.T.C. 402 (1980)* (consent order), *modified*, *95 F.T.C. 343 (1980)* , *modified*, *52 Fed. Reg. 16,234* (May 4, 1987) ; *General Motors Corp., 95 F.T.C. 825 (1980)* (consent order), *modified*, *53 Fed. Reg. 9,105* (Mar. 21, 1988) .

(n61)Footnote 58. *Brooks v. Wachovia Bank & Trust Co., 96 N.C. App. 89, 384 S.E.2d 288 (1989)* .

(n62)Footnote 59. Revised *U.C.C. § 9-618*.

(n63)Footnote 60. Revised *U.C.C. § 9-618(a)(1)*, (b).

(n64)Footnote 61. Revised *U.C.C. § 9-618(a)(2)*.

(n65)Footnote 62. Revised *U.C.C. § 9-615(f)*. *See* Revised *U.C.C. § 9-618*, Official Comment 3.

(n66)Footnote 63. Revised *U.C.C. § 9-627* [former *U.C.C. § 9-507(2)*]. The Official Comments to the 1999 revisions to Article 9 explicitly adopt the conclusion reached by many courts that "a low price suggests that a court should scrutinize carefully all aspects of a disposition to ensure that each aspect was commercially reasonable." Revised *U.C.C. § 9-610*, Official Comment 10. *See, e.g., McGrady v. Nissan Motor Acceptance Corp., 40 F. Supp. 2d 1323 (M.D. Ala. 1998)* ; *McReynolds v. Barnett Recovery Corp., 42 U.C.C. Rep. Serv. 2d 327 (Fla. Cir. Ct. 2000)* ; *Ford Motor Credit Co. v. Sagmiller (In re Estate of Sagmiller), 615 N.W.2d 567 (N.D. 2000)* (price is an important but not dispositive factor); *Southeast Recovery Servs. v. Northen, 565 S.E.2d 861, 47 U.C.C. Rep. Serv. 2d 1510 (Ga. Ct. App. 2002)* (fact that different price may have been paid at different time does not establish commercial unreasonableness; non-consumer case).

(n67)Footnote 64. *Brewer v. Trust Co. Bank, 205 Ga. App. 891, 424 S.E.2d 74, 21 U.C.C. Rep. Serv. 2d 189 (1992)* (even where notice valid and properly conducted resale, debtor's challenge of commercial reasonableness of price puts burden on creditor to prove value of goods not equal to debts by proof independent of reciting price obtained on resale).

(n68)Footnote 65. Revised *U.C.C. § 9-615(f)*.

(n69)Footnote 66. *State Nat'l Bank v. Academia, Inc., 802 S.W.2d 282, 14 U.C.C. Rep. Serv. 2d 662 (Tex. Ct. App. 1991)* (Illinois law) (sale price "is a key component in assessing the commercial reasonableness"). *See also* Revised *U.C.C. § 9-610*, Official Comment 10. *Wright v. Wells Fargo Auto Fin., Inc., 59 U.C.C. Rep. Serv. 2d 8 (Iowa Dist. Ct. 2005)* (low sale price not a violation when creditor established that sale was commercially reasonable); *McDonald Mobile Home Sales, Inc. v. BankAmerica Hous. Services, 218 S.W.3d 376 (Ala. Civ. App. 2005)* (large price discrepancy

signals need for close scrutiny of sale procedures).

(n70)Footnote 66.1. *Coxall v. Clover Commercial Corp., 4 Misc. 3d 654, 781 N.Y.S.2d 567, 54 U.C.C. Rep. Serv. 2d 5 (Civ. Ct. 2004)* ; *CIT Group Equip. Fin., Inc. v. FRS Farms, Inc., 64 U.C.C. Rep. Serv. 2d 948, 951 (Wis. Ct. App. 2007)* .

(n71)Footnote 67. *Bezanson v. Fleet Bank-N.H., 29 F.3d 16 (1st Cir. 1994)* (sale of business commercially unreasonable where creditor bank rejected higher bid for one at lower price that included equity interest in business for bank).

(n72)Footnote 68. The secured party's responsibility to the debtor may be phrased in terms of the fiduciary duty.

(n73)Footnote 69. *See* D.C. Super. Ct. Civ. R. 55-II-b; *Town House Dep't Stores, Inc. v. Ahn, 2003 Guam LEXIS 30* (Guam Mar. 7, 2003) (applying Civil Procedure Rule 70(a); price here was fair and reasonable).

(n74)Footnote 70. *Citizens State Bank v. Krewson, 822 S.W.2d 580, 17 U.C.C. Rep. Serv. 2d 665 (Mo. Ct. App. 1992)* (fact that farm equipment was re-sold by retail dealer a factor making sale commercially reasonable).

(n75)Footnote 71. Revised *U.C.C. § 9-610*, Official Comment 2 ("This section encourages private dispositions on the assumption that they frequently will result in higher realization on collateral for the benefit of all concerned"); *see also* Revised *U.C.C. § 9-610*, Official Comment 3 (flexibility in timing of sale is "consistent with this Article's policy to encourage private disposition through regular commercial channels").

(n76)Footnote 72. *See, e.g., Daniel v. Ford Motor Credit Co., 612 So. 2d 483, 20 U.C.C. Rep. Serv. 2d 696 (Ala. Civ. App. 1992)* (upholds dealers-only auction because it is "usual manner of sale"); *Beard v. Ford Motor Credit Co., 41 Ark. App. 174, 850 S.W.2d 23, 20 U.C.C. Rep. Serv. 2d 1158 (1993)* (dealers-only sale upheld on basis of expert testimony that such sales bring highest prices); *Ford Motor Credit v. Russell, 519 N.W.2d 460, 24 U.C.C. Rep. Serv. 2d 687 (Minn. Ct. App. 1994)* (dealers-only auction is well recognized market for hundreds of auto dealers in the area). *See also Ford Motor Credit Co. v. Sagmiller (In re Estate of Sagmiller), 615 N.W.2d 567 (N.D. 2000)* (dealers-only auction is neither per se commercially reasonable nor per se unreasonable; unrebutted facts here support finding of commercial reasonableness).

(n77)Footnote 73. *See, e.g., Bank of Am. v. Lallana, 55 Cal. App. 4th 543, 64 Cal. Rptr. 2d 168 (1997)* , *aff'd on other grounds, superseded, 19 Cal. 4th 203, 77 Cal. Rptr. 2d 910, 960 P.2d 1133 (1998)* . While the California Supreme Court affirmed the decision of the Court of Appeals, it did so on different grounds, relying on improper notice, not on the commercial unreasonableness of the dealers-only sale as the Court of Appeals had.

(n78)Footnote 74. *See § 10.08[8][b] supra.*

(n79)Footnote 75. *See, e.g.,* R. Sutton, Don't Get Taken Every Time 182-83 (Penguin Books 1994); *Williams v. Regency Fin. Corp., 309 F.3d 1045 (8th Cir. 2002)* (Missouri law) (remanding for trial on question whether finance company's disposition of vehicle to dealer was commercially reasonable). *See also Chisolm v. TranSouth Fin. Corp., 95 F.3d 331 (4th Cir. 1996)* , *appeal after remand, 164 F.3d 623 (4th Cir. 1998)* (unpublished), *reported in full at 1998 U.S. App. LEXIS 24632* (4th Cir. Oct. 5, 1998) , *class certified, 184 F.R.D. 556 (E.D. Va. 1999)* , *class decertification denied, subclasses certified, 194 F.R.D. 538 (E.D. Va. 2000)* .

(n80)Footnote 76. *See Chisolm v. TranSouth Fin. Corp. 95 F.3d 331 (1996)* , *appeal after remand, 164 F.3d 623 (4th Cir. 1998)* (unpublished), *reported in full at 1998 U.S. App. LEXIS 24632* (4th Cir. Oct. 5, 1998) , *class certified, 184 F.R.D. 556 (E.D. Va. 1999)* , *class decertification denied, subclasses certified, 194 F.R.D. 538 (E.D. Va. 2000)* (recent example of a class action against a finance company involved in a churning scheme). *See also* National Consumer Law Center, Repossessions, § 10.11.2 (6th ed. 2005 and Supp.)

(n81)Footnote 77. Revised *U.C.C. § 9-615(f)*; *see* Revised *U.C.C. § 9-102(a)(71)* (defining "secondary obligor" to include recourse parties).

(n82)Footnote 78. *815 Ill. Comp. Stat. § 505/2G.*

(n83)Footnote 79. Revised *U.C.C. § 9-617(a)(1)* [former *U.C.C. § 9-504(4)*].

(n84)Footnote 80. Revised *U.C.C. § 9-617(a)(3)* [former *U.C.C. § 9-504(4)*].

(n85)Footnote 81. Revised *U.C.C. § 9-617(a)(2)*, (3) [former *U.C.C. § 9-504(4)*].

(n86)Footnote 82. Clark, The Law of Secured Transactions Under the Uniform Commercial Code P 4.09*[1] (1993).

(n87)Footnote 83. Former *U.C.C. § 9-504(4)*.

(n88)Footnote 84. Former *U.C.C. § 9-504(4)*.

(n89)Footnote 85. Revised *U.C.C. § 9-617(b)*. *See* Revised *U.C.C. § 9-617(b)*, Official Comment 3.

(n90)Footnote 86. Revised *U.C.C. § 9-610(d)*. See Revised *U.C.C. § 9-610*, Official Comment 11 and the proposed 1999 revision to *U.C.C. § 2-312*, Official Comment 5.

(n91)Footnote 87. Revised *U.C.C. § 9-610(e)*.

(n92)Footnote 88. Revised *U.C.C. § 9-610*, Official Comment 11.

(n93)Footnote 89. *Cont'l Ins. Co. v. Schneider, Inc., 873 A.2d 1286, 57 U.C.C. Rep. Serv. 2d 583 (Pa. 2005)* .

(n94)Footnote 90. *Id.*

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Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 10 Repossessions

1-10 Consumer Credit Law Manual § 10.09

§ 10.09 Determining the Deficiency or Surplus

[1] Consumer's Right to Any Surplus

[a] Right to Surplus After Sale of Collateral

After the creditor's disposition of repossessed collateral, the creditor owes the consumer for any resulting surplus. The sale proceeds must be applied, in order, to the reasonable expenses of retaking and of the sale, satisfaction of the indebtedness, and satisfaction of any indebtedness secured by any subordinate security interest. n1 After these deductions, any amount of the sale proceeds remaining is called the surplus. The secured party is required to turn any surplus over to the debtor. n2

A significant problem in determining whether the consumer is entitled to a surplus or is liable for a deficiency has been the absence of a requirement in the UCC for the creditor to provide its calculations to the consumer. The 1999 revisions to Article 9 take on this problem by requiring the secured party in a consumer goods transaction to provide a written explanation of the surplus or deficiency. n3 A creditor who fails to respond properly to a consumer's request for an explanation is liable for statutory damages even if there is no pattern or practice of noncompliance. n4 A significant gap in the coverage of Revised section 9-616 occurs in the situation where the secured party has bid the amount of the debt and expenses, so there is neither a deficiency nor a surplus. The statute does not appear to require an explanation of the creditor's calculations in this circumstance. The debtor may be able to request an accounting under Revised section 9-210, but that section implies that the creditor need only provide an accounting of an unpaid balance. n5 The consumer is entitled to one free statement in any six-month period; additional statements cost twenty-five dollars each. Creditors must send an explanation within fourteen days after receiving a request, or at the time of paying over any surplus or demanding payment of any deficiency.

If there are joint debtors, each is entitled to a pro rata share of any surplus. The right to surplus proceeds cannot be waived by agreement. n6

While most repossessions result in a claim for a deficiency, in a surprising number of cases, a surplus is owed.

[b] Right to Surplus Where Creditor Retains Collateral

The creditor in some situations can opt to retain the collateral in full satisfaction of the debt. n7 This is known as strict foreclosure. If the creditor keeps the collateral, no deficiency is owed, but also no surplus will generally be paid. n8

If the consumer believes that sale of the collateral would lead to a surplus, the consumer has several strategies. First, the consumer can object to the strict foreclosure. The UCC requires the creditor to notify the consumer in writing of the intended strict foreclosure, and sell the collateral if the consumer objects in writing within 21 days to the strict foreclosure. n9 (The 1999 revisions to Article 9 shorten this period to twenty days.) n10

Second, even without the consumer's objection, the creditor generally cannot choose strict foreclosure if the consumer has paid more than 60% of the loan amount. n11 Instead, the creditor must sell the collateral and pay the consumer any surplus. This 60% rule is particularly significant because loans that are mostly paid off are those most likely to result in a surplus.

The UCC allows creditors to use strict foreclosure where a loan is more than 60% paid only if they obtain the consumer's permission in writing *after* default. Creditors thus have an incentive to utilize this exception to deprive the consumer of the potential surplus by obtaining the consumer's written permission that the creditor can retain the collateral in satisfaction of the debt, instead of selling it for the consumer's benefit. n12

Moreover, state law may entitle the consumer to a surplus even if the creditor has properly exercised its right of strict foreclosure.

[c] Consumer Remedies for Creditor's Failure to Pay Surplus

A creditor's failure to pay over a surplus is a violation of UCC Article 9, Part 5, so that the consumer is entitled to actual or statutory minimum damages under Revised *UCC section 9-625* [former section 9-507(1)], whichever is greater. In addition, a creditor's failure to account for the surplus is an unfair or deceptive practice, remedied by a state deceptive practices statute, and may also violate state consumer credit legislation.

[2] Creditor's Right to a Deficiency

[a] General

The creditor has a right to repayment in full of a loan, and can bring a court action to recover the full amount of the debt. But, once the creditor seizes collateral securing that loan, the creditor's right to repayment in full is limited by the UCC, other state law, and by case law. That is, after disposing of collateral, the creditor's right to seek repayment of the balance due on the note (the deficiency) is restricted in certain respects.

Once the repossession sale has been conducted, the sale proceeds must be applied, in order, to the reasonable expenses of retaking and of the sale, satisfaction of the indebtedness, and satisfaction of any indebtedness secured by any subordinate security interest. n13 If these deductions are greater than the sale proceeds, a deficiency remains on the obligation and, depending on state law, the debtor may be liable to the secured party for that amount. n14

[b] Creditor Can Both Seize Collateral and Sue on Debt

The UCC generally does not require the creditor to elect between suing on the debt and seizing the collateral. (Certain state laws do require creditors to make this election for certain credit transactions.)

Nevertheless, under the former version of Article 9, courts often required that, once a creditor had chosen one of the remedies available under the UCC (repossession or a suit on the debt), it must pursue that remedy to its fruition before pursuing other UCC remedies.

The 1999 revisions to Article 9, however, state not only that the creditor's rights are cumulative, but also that they may be exercised simultaneously. n15 Nonetheless, the Official Comments note some significant limits. First, the creditor must act in good faith and is liable under the UCC for failure to do so. Second, the provision permitting the simultaneous exercise of remedies does not override any non-UCC law, including the law of tort and statutes regulating collection of debts under which the simultaneous exercise of remedies in a particular case constitutes abusive behavior or harassment, giving rise to liability. n16

[c] No Deficiency After Strict Foreclosure

Where the creditor elects strict foreclosure, it loses its right to seek a deficiency.

[d] Creditor's Unintentional Strict Foreclosure May Preclude a Deficiency

[i] Introduction

Under a strict foreclosure, the creditor chooses to keep the collateral in lieu of selling it and seeking a deficiency. There are also a number of situations where the creditor intends to seek a deficiency, but where its actions effectively create a strict foreclosure, thus barring a deficiency.

[ii] Creditor's Sale of Collateral to Itself

A creditor cannot avoid the consequences of retaining collateral by calling a strict foreclosure a private sale of the repossessed collateral, with the creditor as the buyer at its own sale. The UCC specifically prohibits the secured party from buying repossessed consumer goods at its own private sale. The creditor's private sale to itself not only violates Article 9, but should be treated as a strict foreclosure, barring the deficiency. n17

Through a public sale, however, creditors can retain collateral and still seek a deficiency.

[iii] Creditor's Transfer of Collateral to Dealer Pursuant to Repurchase Agreement

A strict foreclosure can also happen when the secured party "sells" the collateral to a dealer or other party pursuant to a repurchase or recourse agreement. The UCC provides that such a transfer is not a sale; a transfer pursuant to a repurchase agreement leaves the "buyer" with all the duties of the original secured party. For example, if the secured party transfers the collateral to the dealer pursuant to a repurchase agreement, and the dealer retains the collateral, then this should be treated as a strict foreclosure by the secured party. Neither the creditor nor the dealer may seek a deficiency. The 1999 revisions to Article 9, however, eliminate the flat rule that a transfer back to a dealer under a repurchase or recourse agreement is never an Article 9 disposition. n18

[iv] Delay in Sale of Collateral

If the creditor holds on to the collateral too long before selling it, under the former version of Article 9, a court may find that the creditor's slow disposition amounts to a strict foreclosure and treat the collateral as if it has been retained by the creditor, even though the property was subsequently sold. An official comment to the 1999 revisions to Article 9 rejects the application of the doctrine of strict foreclosure to cases of "mere delay in collection or disposition of the collateral," n19 but other remedies may be available to the consumer.

[v] Abandoning Collateral as Worthless

Destruction of the collateral while in the possession or constructive possession of the creditor may also result in strict foreclosure. Where the creditor scraps the collateral as worthless with no notice to the debtor, the creditor cannot seek a deficiency.

[e] Commercially Reasonable Disposition as Precondition to Deficiency

An important limitation on the creditor's right to seek a deficiency can occur where the creditor did not engage in a commercially reasonable disposition of the collateral or properly notify the consumer of the sale. State law or case law may absolutely bar a deficiency where the sale or notice is improper. In other states, the creditor will have the burden of proving the collateral was worth less than the balance due by evidence other than the repossession sale.

[f] No Deficiency After Revocation of Acceptance

If the consumer properly revokes acceptance of the collateral before a repossession, the consumer may no longer be obligated on the debt. A valid revocation extinguishes the consumer's obligation to pay the seller or the seller's assignee for the property whose purchase is revoked.

If the revocation extinguishes the debt, the creditor is entitled to return of the collateral (which the repossession has already effectuated), but the creditor is not entitled to anything more and must even return payments already made, including return of the down payment or trade-in and payments already made on the loan, as well as recovery of certain expenses. n20 The consumer is not liable for any deficiency and is not liable for any expenses in the retaking and sale of the collateral, since seizure after the consumer's revocation is not a repossession.

There seems no legal impediment to revoking acceptance even after a repossession or a repossession sale.

[g] Special Notice Requirements as Precondition to a Deficiency

A number of state consumer credit statutes place certain notice requirements on a creditor and condition its right to a deficiency on compliance with these requirements. (These requirements are in addition to UCC restrictions on a deficiency where the notice of sale is defective.)

Federal legislation effective October 1, 2000, n21 and the UETA, n22 which over forty states had passed by mid-2001, allow notices to be sent electronically in some circumstances if the consumer consents. n23

[3] State Anti-Deficiency Statutes

[a] Overview

Generally, the UCC permits a creditor to seek a deficiency after sale of repossessed collateral. But about half the states have enacted legislation that limits deficiencies for at least certain consumer transactions. n24

State statutes disallowing deficiency actions are often called election-of-remedy or anti-deficiency statutes. They require creditors to elect either to pursue the full amount due on a debt in a legal action or to repossess the collateral. If the creditor repossesses the property, it cannot then bring an action for a deficiency, either against the debtor or against a surety. If the creditor sues the consumer on the debt, the creditor cannot then repossess the collateral.

Many anti-deficiency statutes are modeled after section 5.103 of either the 1968 or 1974 version of the UCCC. Consequently, the Official Comment to the UCCC and case law interpreting UCCC-type provisions should have precedential value for other election-of-remedy statutes.

Generally, under an anti-deficiency statute, the creditor has the choice of either suing on the debt or taking the goods.

[b] Dollar Limitations on Anti-Deficiency Statutes

The most common reason state anti-deficiency statutes will not apply in a particular case is the low dollar maximum on

the consumer transactions covered by the legislation, allowing creditors to seek deficiencies when the consumer transaction exceeds the statutory amount. Only two states place no monetary limits on their anti-deficiency statutes; n25 other statutes have varying dollar maximums, usually $1000 or $2000. n26

A few anti-deficiency statutes, including the UCCC, specify that the dollar maximum described in the statute increases from year to year with the Consumer Price Index or some other factor. n27

The statute may specify that the dollar maximum applies to the original cash price of the goods purchased, the original amount financed, or to the unpaid balance at the time of default. The 1974 version of the UCCC makes clear that the dollar maximum applies to each separate item purchased, and not to the total value of all the collateral. n28 The 1968 UCCC is not clear on this point.

[c] Are Consumer Loans or Only Credit Sales Covered?

Certain state anti-deficiency statutes apply only to credit sales; that is, installment sales or other credit offered by the seller at the time of sale, not to loans made directly by a bank, finance company, or other lender.

Despite the seemingly narrow scope of certain state anti-deficiency statutes, the FTC's Holder Rule n29 may subject certain lenders to anti-deficiency statutes that do not otherwise apply to lenders. Where a seller refers consumers to a lender or where there is some other business relationship between seller and lender, the loan agreement will usually contain a notice that the note holder is subject to all claims and defenses the consumer has against the seller. Where the anti-deficiency statute provides the debtor with a defense against the seller, this contractual language may provide a method to extend the anti-deficiency statute to lenders.

[d] Type of Goods Covered

Anti-deficiency statutes usually apply only to consumer transactions and not to commercial transactions. Several statutes are limited to "consumer goods," defined as goods for personal and not business use, with the intent of the buyer at the time of purchase being determinative.

[e] Excessive Damage to the Collateral May Give Rise to a Creditor Cause of Action

Anti-deficiency statutes prevent a creditor from repossessing collateral and then seeking a deficiency, but they often allow the creditor to bring an action against the consumer after repossession for excessive damage to collateral occurring before repossession. This should not apply to normal depreciation or typical wear and tear.

[f] Effect of Anti-Deficiency Statute on Foreclosure of Property Pursuant to a Judgment Lien

Anti-deficiency statutes require creditors to elect between repossessing the collateral or bringing an action on the debt. If they bring an action on the debt, the UCC allows the secured party to reduce its claim to judgment or to foreclose its interest by any available procedure provided by state law, including a judicial sale of the collateral following judgment, execution, and levy. n30 Such judicial sales are governed by other state law, not by the UCC. n31

A creditor can thus partly avoid the effect of an anti-deficiency statute by electing to bring an action on the debt, then enforcing that debt by seeking a judicial sale of the collateral, and then utilizing other remedies to collect the remaining balance due after the sale of the collateral. To prevent this outcome, a number of state anti-deficiency statutes specify that if the creditor elects to bring an action on the debt, the collateral is not subject to levy or sale on execution.

[g] Has the Creditor Made an Election?

What if, after repossession, the creditor changes its mind, and decides not to retain the collateral? The creditor can still

be held to have retained the collateral, even if it has not so notified the debtor, where it has held onto the collateral too long without returning it. This is the case even if the creditor asks the debtor later to re-take possession of the collateral.

[4] Calculating the Deficiency or Surplus

[a] Introduction

Under the UCC, it is the creditor that determines the deficiency (or surplus). Few consumers ever challenge this calculation and federal or state law enforcement officials or regulators rarely monitor these calculations. As a result, creditors may become sloppy, apply suspect procedures, or even intentionally overstate deficiencies or "forget" surpluses.

Creditors or collectors may also inflate the amount of a claim by adding charges such as collection fees. n31.1 The 1999 revisions to Article 9, which will require the creditor to send the consumer an arithmetical explanation of the surplus or deficiency, may prompt greater scrutiny of these calculations. n32

This section provides a step-by-step approach to check the creditor's calculations.

[b] The Balance Due on the Debt

[i] The Remainder Due on the Loan Before Adjustments

The major debtor liability is for the outstanding credit balance, the amount due on the note whose acceleration led to the repossession. Even if the original contract accurately computes the amount due, the creditor may not have properly credited all of the installment payments that the debtor has made.

Over the course of the loan, the creditor may have also charged the debtor for a number of late charges if the loan is calculated with precomputed interest. The consumer should obtain from the creditor documentation of the amounts of and reasons for all late or added charges over the life of the loan. While the amount due is an element of the creditor's affirmative case on which it should bear the burden of proof in most jurisdictions, one court allowed a creditor to meet this burden through a conclusory affidavit when the consumer did not provide any specific rebuttal. n33

[ii] Unearned Interest Rebates

[A] Acceleration Treated as Prepayment in Computing Rebates

The total of payments of a precomputed loan includes interest payments over the full loan term. Where the loan payments are accelerated, the creditor seeks payment earlier than scheduled, and the amount of interest owed decreases. This unearned interest should be rebated to the consumer.

[B] Computing Rebates

The actual rebate should be computed based on applicable law or the formula specified in the credit agreement, whichever is more favorable to the consumer. Federal law requires use of a method at least as favorable as an actuarial rebate (the rebate method most favorable to consumers) in all precomputed consumer credit transactions with terms longer than 61 months consummated after September 30, 1993. n34 This federal standard prohibits use of the Rule of 78 in applicable loans and preempts contrary state law specifying use of the Rule of 78. n35

Even for loans consummated before October 1, 1993, federal law still requires an actuarial rebate if certain conditions are met. In determining the proper rebate, make sure the rebate is applied to the total finance charge.

[C] The Effect of the Consumer's Waiver of the Right to a Rebate

Creditors may place a provision in the credit agreement waiving the consumer's right to a rebate of unearned interest. The federal law requiring a prompt rebate should override such a waiver because the statute states that the creditor "shall promptly refund." n36

[D] Consumer Remedies for Failure to Rebate Unearned Interest

The failure to credit a rebate of unearned interest can cause a consumer significant actual damage because the amount to be rebated can be substantial. In fact, almost the entire deficiency a creditor may seek after selling the collateral may consist of the creditor's claim for unearned interest.

In addition, creditors may incur substantial liabilities if they seek excess interest charges that should have been rebated. Retaining unearned interest is a form of usury, and credit legislation often specifies that such action will make the total finance charge or even the total amount due unenforceable.

[iii] Interest and Penalties After Acceleration

After unearned interest is rebated as of the date of acceleration, the consumer will have a balance due as of the date of acceleration. The question then becomes what additional interest and penalties a creditor can assess from that date until the amount is paid in full. The answer to this question will usually depend on state law and the contract.

Also be alert to any form of creditor "double-dipping."

[iv] Forced-Placed Insurance Premiums

In many automobile repossessions, consumers may be startled by the amount the creditor claims is due on the loan -- far in excess of the balance due on the original loan agreement. The explanation is often significant charges for automobile physical damage insurance that the creditor, some time after the original loan agreement, has purchased for, but charged to, the consumer. The total cost of this insurance over the term of a loan, with related financing costs, can add more than $5,000 to the total of payments on a loan.

This insurance is often called forced-placed insurance because the creditor has purchased the insurance for the consumer without the consumer's permission.

If insurance has been force-placed, the consumer's attorney should make sure the unearned portion of the premium is rebated upon repossession. Also make sure the consumer's own physical damage policy had lapsed, and the consumer is not being charged for the same insurance twice. State law may require a notice giving details about the force placed insurance and its effect on the payment schedule. If the creditor fails to send this notice, at least one court has held that the consumer is not liable for the cost of the insurance or related costs. n36.1

[v] Credits to the Consumer for Insurance Claim Payments

When a creditor force places physical damage insurance, the creditor will purchase vendor single interest insurance. This insurance pays off after the collateral is repossessed for damage to the vehicle during the policy term. The claim payment is made directly to the creditor and reduces the amount owed on the debt.

These insurance payments can be sizeable and the consumer attorney should take several steps to insure that payments are made and properly credited.

[c] Insurance Rebates

[i] Introduction

The typical secured consumer loan will involve various types of insurance. Credit life, credit accident and health, and credit unemployment insurance protect the consumer's ability to repay the loan against risks of the debtor's death, disability, or lost employment. n37 When the loan is accelerated and the collateral is repossessed, the consumer no longer needs this insurance because the insurance relates to the consumer's ownership of the collateral or obligation to make installment payments. The policies should thus be canceled, and the unearned portion of the insurance should then be either rebated to the secured party and credited to the consumer's account or rebated directly to the consumer.

[ii] Determining What Insurance the Consumer Has Purchased

The first step in insuring that all rebates are properly applied is determining the different types of insurance that the client has purchased. A good starting point is the Truth in Lending disclosure form, which will indicate whether credit insurance has been purchased, its cost, and the policy term. The sales agreement will usually specify any extended warranty or service contract.

[iii] Cancelling the Insurance and Calculating the Rebate

Once all forms of insurance relating to the collateral purchased from all sources have been identified, the consumer's attorney should make sure that all of the policies are cancelled following a repossession. The one exception is that a policy should probably not be canceled when the consumer has a claim under that policy that is still to be presented to the insurer.

[d] Credit to Consumer for Collateral's Value

[i] Method of Determining Value

When a creditor seeks a deficiency after seizing the collateral, the amount of the deficiency is reduced by the collateral's value. A number of motor vehicle installment sales statutes and other state legislation specify the exact manner of determining the collateral's value. These more specific statutes override the UCC's provisions in this area. n38

If a state has not enacted such legislation, the UCC specifies that the proceeds of any disposition be credited to the consumer in calculating any deficiency. n39

[ii] Determining the Collateral's Sale Price

[A] General

Where the credit is based on the sale price, and the collateral is sold at auction, determining the sale price is generally straightforward.

Where the collateral is not sold at a bona fide auction, a number of issues may arise as to determining the actual sale price. The first question is whether the collateral was in fact sold. The secured party cannot credit the consumer with an estimated "actual cash value." The secured party must use an actual sale price resulting from a commercially reasonable sale.

A second set of issues concern the creditor's sale of the collateral at a private sale to itself or to the original credit-seller pursuant to a repurchase agreement. Neither of these sales are UCC dispositions under the former version of the UCC, and the resulting "sale prices" are not adequate credits for the consumer. The actual sale price is the price at which the creditor or dealer subsequently sells the collateral, which is often a much higher price paid by a retail buyer off a dealer's lot.

Whether the sale is public or private, the 1999 revisions to Article 9 have added a new protection where the collateral is sold to the secured party, a person related to the secured party, or a secondary obligor. If the collateral is sold for a price significantly less than the range of proceeds a commercially reasonable sale would have brought, the consumer is to be credited with the price that a commercially reasonable sale would have produced. n40

When the creditor disposes of the collateral through a private retail sale to a consumer, special problems arise in determining the true sale price. Dealers properly may exclude from the sale price any finance charges, insurance, service contract, and other items, as long as these items are separately priced in the sales documents given to the consumer purchasing the repossessed car, and are not excessive. If such items are excessively priced, the argument should be made that these are part of the hidden price of the collateral's sale.

[B] Adjusting the Sale Price to Reflect a Subsequent Purchaser's Trade-In

Dealers must include in the sale price any trade-in allowance the dealer gives when selling the repossessed collateral. Consumer attorneys should not let dealers credit the debtor with only the net sales price; that is, the price of the repossessed collateral less the trade-in allowance.

[iii] Determining the Collateral's Value Where Disposition Not Commercially Reasonable

Where the creditor fails to dispose of the collateral in a commercially reasonable manner, the creditor cannot use that sale price in computing the deficiency owed. The sale price may not be a reasonable estimate of the value of the collateral because the sale was tainted.

Courts take varying approaches to computing a deficiency where the sale was not commercially reasonable. Some courts adopt the absolute bar approach which prohibits the creditor from seeking a deficiency, some courts allow the creditor to seek a deficiency, but require the creditor to prove the amount of the deficiency determining the collateral's value by some method other than the sale price, and a few use other approaches.

[e] Consumer's Liability for Repossession-Related Expenses

[i] Expenses in Seizing and Storing the Collateral

The UCC allows the creditor to be reimbursed for its reasonable expenses of retaking and holding the collateral. n41 Therefore, whether or not provided for in the credit agreement, the creditor can charge the debtor for fees paid to repossession agents, other repossession expenses, towing or transporting charges for the repossessed property, and storage fees.

The creditor must prove its entitlement to repossession expenses in order to have these amounts included in a judgment. n42 These fees must be reasonable, n43 so a secured party may not charge the debtor more for the services of a third party than the secured party paid that third party.

[ii] Expenses of Reconditioning or Repairing Collateral

[A] When Such Expenses Are Valid

Secured parties may sell "collateral in its then condition or following any commercially reasonable preparation or processing." n44 If the sale price of the repossessed collateral will be significantly enhanced, then the secured party may have an affirmative obligation to prepare or restore the collateral. The UCC specifically authorizes creditors to charge the debtor for "preparing the collateral for sale," but the charge must be reasonable. n45 Further, if the need for repairs arises because of the creditor's improper use of the collateral while in the creditor's possession, the repairs should not be

charged to the debtor.

Reconditioning charges whereby the creditor is paid twice for the same expense are clearly unreasonable.

If the contract violates the state consumer credit law, for example, by including prohibited terms or failing to state required terms, the creditor may be prohibited from charging or collecting any delinquency or finance charges. Charges relating to the repossession and sale of the vehicle may be included in the definition of the delinquency charges the creditor can not collect. n46

[B] Computing Creditor Expenses

If the secured party contracts with an independent, unrelated party for repairs or preparation of the collateral, the secured party should not charge the debtor more than the amount the third party charges the secured party. But, if the secured party performs the repairs itself, it is not clear how it should compute its charge.

There is a respectable amount of precedent indicating that only out-of-pocket expenses and not overhead or profit charges are permitted under the UCC.

[iii] Selling Expenses

Debtors are liable for secured parties' reasonable expenses for selling the collateral. n47 Consumers are liable for actual payments the secured party makes to an auctioneer for fees and expenses. Advertising expenses are also chargeable to the debtor, but only for advertising that specifically mentions the consumer's property. Where the advertising mentions several goods for sale, the consumer should only pay a reasonable share of the advertising costs.

If the secured party sells the collateral at retail, a sales commission or similar selling expense may be reasonable.

[iv] Attorney Fees

The secured party's attorney fees are often a major consumer liability in a deficiency action. The UCC allows for reasonable attorney fees and legal expenses only to the extent provided for in the credit agreement and only to the extent that they are not prohibited by state law. n48 State laws and the exact wording of all contracts should be checked to avoid overcharges here.

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureRemediesGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionDisposition of Collateral

FOOTNOTES:
(n1)Footnote 1. Revised *U.C.C. § 9-615(a)* [former *U.C.C. § 9-504(1)*]. Selected U.C.C. Article 9 sections are reprinted in Vol. 1A *infra*.

(n2)Footnote 2. Revised *U.C.C. § 9-615(d)* [former *U.C.C. § 9-504(2)*]. *See Bill Fitts Auto Sales, Inc. v Daniels, 325 Ark. 51, 30 U.C.C. Rep. Serv. 2d 382 (1996)* .

(n3)Footnote 3. Revised *U.C.C. § 9-616*. As of mid-2001, all of the states that had enacted Revised Article 9, except Illinois and North Dakota, had enacted this new requirement without significant change. In Illinois, creditors

need not include the calculations in the notice, but must supply them if the obligor requests. North Dakota simply eliminated the requirement that creditors send the explanation. *See* National Consumer Law Center, Repossessions and Foreclosures, App. A.4.3 (summary of non-uniform amendments to Revised Article 9).

(n4)Footnote 4. Revised *U.C.C. § 9-625(e)(6)*.

(n5)Footnote 5. Revised *U.C.C. § 9-210(a)(2)*; *see also* Revised *U.C.C. § 9-102(a)(4)* (definition of "accounting").

(n6)Footnote 6. Revised *U.C.C. § 9-602(5)*.

(n7)Footnote 7. Revised *U.C.C. § 9-620* [former *U.C.C. § 9-505(2)*].

(n8)Footnote 8. *Harris v. Key Bank, 193 F. Supp. 2d 707* (W.D.N.Y.) , *aff'd*, *51 Fed. Appx. 346 (2d Cir. 2002)* (unpublished).

(n9)Footnote 9. Revised *U.C.C. § 9-620* [former *U.C.C. § 9-505(2)*].

(n10)Footnote 10. Revised *U.C.C. § 9-620(d)*.

(n11)Footnote 11. Revised *U.C.C. § 9-620* [former *U.C.C. § 9-505(1)*].

(n12)Footnote 12. The FTC has challenged this practice. *See Chrysler Motor Co., 97 F.T.C. 139 (1981)* (consent order); *Gen. Motors Corp., 95 F.T.C. 825* (consent order) (1980); *Ford Motor Co., 93 F.T.C. 402* (consent order) (1979). The FTC cases are cited in *Reeves v. Foutz & Tanner, Inc., 94 N.M. 760, 617 P.2d 149, 29 U.C.C. Rep. Serv. 1450 (1980)* .

(n13)Footnote 13. Revised *U.C.C. § 9-615(a)* [former *U.C.C. § 9-504(1)*]. However, a debtor may agree, prior to default in the security agreement itself, that the order of application of the proceeds will be a different order from that provided by the Code. Note that the 1999 revisions to Article 9 add rules for payment of proceeds to consignors.

(n14)Footnote 14. Revised *U.C.C. § 9-615(d)* [former *U.C.C. § 9-504(2)*].

(n15)Footnote 15. Revised *U.C.C. § 9-601(c)*.

(n16)Footnote 16. Revised *U.C.C. § 9-601*, Official Comment 5.

(n17)Footnote 17. Revised *U.C.C. § 9-624*, Official Comment 2.

(n18)Footnote 18. For a full discussion of such agreements and their impact on repossession and deficiency judgments, see National Consumer Law Center, Repossessions (6th ed. 2005).

(n19)Footnote 19. Revised *U.C.C. § 9-620*, Official Comment 5.

(n20)Footnote 20. *U.C.C. § 2-608*; *see* National Consumer Law Center, Consumer Warranty Law Ch. 8 (3d ed. 2006).

(n21)Footnote 21. E-Sign, Pub. L. 106-229, *114 Stat. 464 (2000)*.

(n22)Footnote 22. UETA, 7A U.L.A. 20 (Supp. 2000). The text of UETA is also available on the website of the National Conference of Commissioners on Uniform State Laws, as is a list of those states which have adopted the uniform act. *See* www.nccusl.org.

(n23)Footnote 23. *See § 1.05[2][a] supra*. Note that, while § 103(b)(2)(B) of the federal statute makes an exception for state right-to-cure notices, it does not make a similar exception for state notices that are a precondition of

a deficiency judgment.

(n24)Footnote 24. *See, e.g., Kan. Stat. Ann. § 16a-5-103(2).*

(n25)Footnote 25. California and Illinois.

(n26)Footnote 26. *See, e.g., Ariz. Rev. Stat. Ann. § 44-5501(B)* ($1000).

(n27)Footnote 27. U.C.C.C. § 1.106; *Ind. Code Ann. § 24-4.5-5-103(2)*; *Minn. Stat. § 325G.22*; *Okla. Stat. Ann. tit. 14A, § 5-103(7)*; *S.C. Code Ann. §§ 37-1-103*, *37-5-109*.

(n28)Footnote 28. U.C.C.C. § 5.103(2) (1974); U.C.C.C. § 5.103, Official Comment 3.

(n29)Footnote 29. Federal Trade Commission Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses, 16 C.F.R. pt. 433, *reprinted in* Vol. 1A *infra*.

(n30)Footnote 30. Revised *U.C.C. § 9-601* [former *U.C.C. § 9-501(1)*; *U.C.C. § 9-501*, Official Comment 6].

(n31)Footnote 31. Revised *U.C.C. § 9-601*, Official Comment 8 [former *U.C.C. § 9-501*, Official Comment 6].

(n32)Footnote 31.1. *See, e.g., Fields v. W. Mass. Credit Corp., 479 F. Supp. 2d 287 (D. Conn. 2007)* (collection agency violated Fair Debt Collection Practices Act by adding illegal fifteen percent fee to deficiency it was attempting to collect).

(n33)Footnote 32. Revised *U.C.C. § 9-616*.

(n34)Footnote 33. *Gen. Motors Acceptance Corp. v. Ferguson, 56 U.C.C. Rep. Serv. 2d 543 (Ohio Ct. App. 2005)* (affirming grant of summary judgment to creditor).

(n35)Footnote 34. *15 U.S.C. § 1615(b).*

(n36)Footnote 35. *See* Ch. 6, "The Cost of Credit," *§ 6.03[4][b][i] supra* .

(n37)Footnote 36. *15 U.S.C. § 1615(a).*

(n38)Footnote 36.1. *Bank of Okla. v. Portis, 942 P.2d 249 (Okla. Civ. App. 1997)* (adding balloon payment at end of regular payments was a change in the payment schedule, and creditor was required to send a notice describing it).

(n39)Footnote 37. See Ch. 6, "The Cost of Credit," *§ 6.06 supra* , for a further discussion of credit insurance.

(n40)Footnote 38. *See* Revised *U.C.C. § 9-109(c)* [former *U.C.C. § 9-201(b)*].

(n41)Footnote 39. Revised *U.C.C. § 9-615* [former *U.C.C. § 9-504*].

(n42)Footnote 40. Revised *U.C.C. § 9-615(f).*

(n43)Footnote 41. Revised *U.C.C. § 9-615(a)(1)* [former *U.C.C. § 9-504(1)(a)*].

(n44)Footnote 42. *Coxall v. Clover Commercial Corp., 4 Misc. 3d 654, 54 U.C.C. Rep. Serv. 2d 5 (Civ. Ct. 2004)* ; *see also Boles v. Texas Nat'l Bank, 750 S.W.2d 879 (Tex. App. 1988)* (creditor has burden of proving expense of repairs to collateral was reasonable); *Hall v. Crocker Equip. Leasing, Inc., 737 S.W.2d 1, 4 U.C.C. Rep. Serv. 2d 1646 (Tex. App. 1987)* (trial court erred in finding disposition commercially reasonable when secured party failed to present evidence of reasonableness of expenses for repairs to collateral).

(n45)Footnote 43. Revised *U.C.C. § 9-615(a)(1)* [former *U.C.C. § 9-504(1)(a)*].

(n46)Footnote 44. Revised *U.C.C. § 9-610(a)* [former *U.C.C. § 9-504(1)*].

(n47)Footnote 45. Revised *U.C.C. § 9-615(a)(1)* [former *U.C.C. § 9-504(1)(a)*].

(n48)Footnote 46. *See Route 50 Auto Sales v. Muncy, 331 Ill. App. 3d 515, 264 Ill. Dec. 931, 771 N.E.2d 635 (2002)* .

(n49)Footnote 47. Revised *U.C.C. § 9-615(a)(1)* [former *U.C.C. § 9-504(1)*].

(n50)Footnote 48. Revised *U.C.C. § 9-615(a)(1)* [former *U.C.C. § 9-504(1)(a)*]. *See Route 50 Auto Sales v. Muncy, 331 Ill. App. 3d 515, 264 Ill. Dec. 931, 771 N.E.2d 635 (2002)* (relying on 815 Ill. Comp. Stat. § 375.11) (even if the state consumer credit legislation allows attorney fees, it may bar them if the contract does not comply with the statute). *See also Goucher v. Cold Springs RV Corp., 142 N.H. 299, 700 A.2d 299 (1997)* (no fees awarded in deficiency action in absence of fee provision in the agreement, and no independent authorization for fee under *U.C.C. § 9-504(1)(a)*, since "[t]hat provision addresses attorney's fees incurred prior to, and in connection with, the disposition of the collateral, not in the collection of the deficiency").

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 10 Repossessions

1-10 Consumer Credit Law Manual § 10.10

§ 10.10 Defending a Deficiency Action

[1] Introduction

[a] Importance of Defending a Deficiency Action

A creditor's deficiency claim arises when the creditor sells repossessed collateral for an amount insufficient to pay off both the loan and creditor's repossession and disposition expenses. The deficiency is the difference between what is owed the creditor (the amount due on the loan plus creditor's expenses) and what is realized in the sale of the collateral. Although the sale may result in a surplus that must be paid to the debtor, the usual sale of repossessed consumer collateral results in a deficiency.

From the client's and attorney's point of view, the deficiency claim is also an ideal forum to explore all aspects of the transaction to see if the dealer and creditor complied with the law. The creditor has already paid the filing fees and initiated the deficiency action. It is a straightforward matter for the consumer's attorney to raise counterclaims relating to the initial sale, subsequent warranty performance, the credit terms, insurance related to the transaction, debt collection harassment, the acceleration of the note, the repossession, notice of sale, and sale of the collateral.

[2] UCC § 9-625(c) Statutory Damages.

[a] Violations Leading to Statutory Damages

One of the most overlooked and misunderstood consumer remedy in response to a deficiency action is statutory damages pursuant to Revised *UCC section 9-625(c)* [former *UCC section 9-507(1)*]. n1 Under former *UCC section 9-507(1)* statutory damages were available if "the secured party is not proceeding in accordance with this Part [Article 9, Part 5]." Note that, unlike former *UCC section 9-507*, certain remedies provisions in Revised Article 9, *UCC section 9-625*, apply to noncompliance with any provision of the Article, although the minimum damages recovery still applies only to noncompliance with provisions of this Part (now Part 6 of Article 9).

UCC section 9-625(c) statutory damages are triggered by even technical Part 6 violations, such as failing to provide proper notice of a sale, or obtaining a waiver prohibited by Revised *UCC section 9-602* [former section 9-501]. The consumer need not prove reliance in order to recover under section 9-625(c). n2

[b] Section 9-625(c) Statutory Damages Limited to Consumer Goods Collateral

Revised *UCC section 9-625* [former section 9-507(1)]'s statutory damages are awarded only when the collateral is a consumer good, defined as one used or bought primarily for personal, family, or household purposes. n3 Consumer attorneys must always be careful to allege and to prove that the collateral is a consumer good.

[c] Calculation and Significance of Minimum Damages

When the creditor violates Article 9, Part 6, the consumer is entitled to the greater of the consumer's actual damages and the minimum damages set out in Revised *UCC section 9-625(c)*, namely the "credit service charge" or "time price differential" (*i.e.*, finance charge) and 10% of the "principal amount of the debt" (*i.e.*, amount financed) or "cash price." These statutory damages are based on the finance charge and amount financed at the beginning of the transaction, not the interest and principal remaining due at the time of the Code violation.

Consequently, in any deficiency action, the consumer attorney's first step is to see if there is a violation of Article 9, Part 6. If the consumer can prove a violation, the statutory damages can go a long way toward off-setting the deficiency, and may even result in a positive recovery for the consumer.

[d] Statute of Limitations for Consumer's Claim Under UCC § 9-625(c).

UCC Article 9 does not have an explicit statute of limitations, although *UCC section 2-725* does have a four-year limitation period for Article 2 actions. Most courts will turn to other state legislation specifying limitation periods for various types of legal actions -- *i.e.*, for contract, tort, statutory or other actions.

[3] Where a Deficiency Claim Is Prohibited

[a] Introduction

In a number of situations, consumers have a complete defense to a deficiency action because the creditor has no right under state law to seek a deficiency.

[b] Where Underlying Debt Is Extinguished

The creditor has no right to seek a deficiency if the consumer at the time of the deficiency claim had completely satisfied the underlying obligation, by full payment or otherwise.

[c] State Anti-Deficiency Laws

Creditors have no right to seek a deficiency where prohibited by state law.

[d] Failure to Sell Collateral or Sale to the Wrong Person

There may be no right to a deficiency where the creditor sold the collateral to the wrong person or fails to sell the collateral. In these situations, the transaction may be characterized as a strict foreclosure.

[e] Creditor's Promise to Accept Collateral in Satisfaction of Debt

To induce consumers to voluntarily surrender collateral, creditors frequently state that turning over the collateral will end the consumer's obligation. The creditor's promise has been held to be a waiver of the right to a deficiency.

[f] Procedural Defenses

Several procedural bases can stop a deficiency action, such as the party seeking the deficiency is not the party that has a present right to enforce the balance of the note.

State law may also impose special procedural requirements as prerequisites to seeking a deficiency action.

The 1999 revisions to Article 9 also require the creditor in a consumer-goods transaction to send the obligor an explanation of the amount claimed as a deficiency. n4 They also create a special $500 statutory damages provision for persistent violations of this requirement. n5 While the 1999 revisions are explicit that the $500 statutory damage provision supplants the standard statutory damages of the finance charge plus 10% of the principal, n6 there is no indication of any intent to deny the remedy of defeat of a deficiency judgment where the creditor fails to send the explanation. If the loan agreement contains an arbitration provision, the consumer may want to force the collector to bring the action via arbitration instead. n7

[4] Defective Disposition as Defense to Deficiency Action

[a] Creditor's Burden and Overview of Consumer's Remedies Where Burden Not Met

[i] Burden on Creditor to Prove All Aspects of Sale Commercially Reasonable

A creditor's failure to comply with UCC disposition or notice requirements offers the consumer an important defense to a deficiency action. n8

The first court to address the question of who has the burden of proving compliance with Article 9 under Revised Article 9 had no difficulty concluding that the creditor bears the burden of showing strict compliance. n9

When the creditor has the burden of proof, it must produce more than evidence of the resale price to meet that burden. n10 The creditor's conclusory affidavit that it sold the collateral for the best possible price is insufficient. n11 Testimony by a witness who does not have personal knowledge of the activities surrounding the sale or disposition of the property is insufficient. n12 Unauthenticated documents can not meet the creditor's burden of proof. n13 Testimony about the vehicle's market value from employees of the creditor may be insufficient unless corroborated by other objective, credible evidence. n14 If the creditor isseeking the cost of repairs to the collateral as part of the deficiency judgment, it must prove not only that they were necessary but also that their cost was reasonable. n15 In some states, if the creditor makes a *prima facie* case, the burden of persuasion shifts to the debtor. n16

[ii] Impact of Defective Disposition on Right to Deficiency

Jurisdictions take a number of different approaches in deciding the impact of the creditor's failure to prove a sale commercially reasonable. All agree that a consumer who proves a code violation is entitled by way of a counterclaim to the greater of Revised *UCC section 9-625* [former section 9-507(1)] statutory damages or actual damages. Some jurisdictions will absolutely bar any deficiency, others adopt the rebuttable presumption (or "shift") theory, and a few use a set-off approach.

For non-consumer transactions only, the 1999 revisions to Article 9 adopt the rebuttable presumption rule and reject the absolute bar rule for the failure of a secured party to proceed in accordance with Article 9 disposition or notice requirements. n17 A number of states, however, have adopted non-uniform amendments to Revised Article 9 that codify either the absolute bar or rebuttable presumption rule. Idaho, Illinois, Indiana, Louisiana, Maryland, Mississippi, Nebraska, New Jersey, North Dakota, Ohio, South Dakota, Tennessee, Virginia, and Washington have codified the rebuttable presumption rule. Kansas adopted a non-uniform amendment to Revised Article 9 that makes the rebuttable presumption rule generally applicable, but also retained its UCCC provision that applies the absolute bar rule to certain consumer credit sales and loans. Maine and California have codified the absolute bar rule, although California also eliminated the provision allowing statutory damages in the amount of the finance charge plus ten percent of the

principal. n18

For consumer transactions, the rule to be applied is specifically left up to the courts. n19 Courts are thereby allowed, but not required, to apply the absolute bar rule. The revisions also specify that courts are not to infer from the adoption of the rebuttable presumption rule for non-consumer transactions that this is the proper rule to apply for consumer transactions.

There is even more confusion as to the interrelation of Revised *UCC section 9-625(c)* statutory damages and the absolute bar and shift theories.

[b] The Absolute Bar Approach

[i] States Adopting the Absolute Bar Rule

The absolute bar rule holds that the creditor's compliance with Code disposition provisions is a condition precedent to the right to bring a deficiency action. A commercially unreasonable sale or defective notice of sale absolutely bars a deficiency. About half the states have adopted the absolute bar theory for consumer credit transactions, either by court decision or by legislation. n20

[ii] Violations Triggering the Absolute Bar

The absolute bar applies whenever the creditor fails to meet its burden of proving that every aspect of the sale is commercially reasonable. A defective notice alone will defeat a deficiency claim in most of these states.

[iii] Operation of the Absolute Bar Rule

When the creditor's conduct triggers the absolute bar rule, the deficiency being sought is precluded in its entirety, no matter what evidence the creditor later presents to prove its right to the balance due. If the amount of the debtor's counterclaims exceeds the creditor's deficiency claim, the debtor recovers at least the difference.

[iv] Justification for the Absolute Bar Rule

"The rule and requirement are simple. If the secured creditor wishes a deficiency judgment he must obey the law. If he does not obey the law, he may not have his deficiency judgment." n21

[c] The Rebuttable Presumption Theory

[i] General

Most states that do not adhere to the absolute bar approach adopt the rebuttable presumption or shift theory. n22 Creditors that violate the Code have the burden of proving by evidence independent of the collateral's sale price that the collateral's value is less than the outstanding debt, and that a deficiency is thus owed. Because the Code's disposition requirements have not been followed, the sale price cannot be accepted as an accurate indicator of value, and it would be unfair to place the burden on the debtor to determine the collateral's true value.

[ii] Distinguishing Rebuttable Presumption Precedent in Arguing for an Absolute Bar Approach

Most cases adopting the rebuttable presumption theory are not consumer cases, but are commercial cases between two merchants. These states thus have the potential of joining a growing trend toward adopting the rebuttable presumption approach in commercial cases, but the absolute bar rule in consumer cases.

[iii] Operation of the Rebuttable Presumption Approach

At least one state supreme court has ruled that the creditor must overcome its burden of showing the sale price did not equal the deficiency by clear and convincing evidence. n23 The North Dakota Supreme Court held that a creditor's evidence of the original purchase price, a tax valuation from two years before the sale, the debtor's internal valuation of the collateral from two years before the sale, the insurance proceeds from the loss of a portion of the collateral, and the amount of bids that were submitted but not accepted, along with testimony about poor market conditions, did not suffice to establish that the collateral was worth less than the sale price. n24

[d] The Set-Off Theory

Only a few states follow a third theory, which takes the questionable approach of limiting the debtor's remedies to raising counterclaims that are set-off against the creditor's deficiency recovery. Even where the creditor's sale of the collateral is commercially unreasonable, the creditor recovers the full amount of its claimed deficiency, reduced by the debtor's actual damages or by the Revised *UCC section 9-625* [former *UCC section 9-507(1)*] statutory damages.

The 1999 revisions to Article 9 adopt the rebuttable presumption theory for non-consumer transactions. n25 While Revised *UCC section 9-626(b)* cautions the court not to draw inferences applicable to consumer cases from this adoption of the rebuttable presumption rule in non-consumer cases, it would be odd for a state's courts to apply a less protective standard to consumer cases. An intermediate appellate court has held that Alabama follows the set-off approach even after the adoption of revised Article 9. n25.1

[5] Barring a Deficiency and Recovering UCC Statutory Damages

A court may refuse to grant a deficiency for various reasons. The issue then becomes, what about statutory damages. A number of courts have dismissed the deficiency claim and still awarded the full statutory damages.

If the UCC's policy of deterring creditor misconduct in consumer transactions is to be upheld, courts must award Revised *UCC section 9-625(c)* statutory damages, while at the same time applying the rebuttable presumption rule of evidence to determine the size of the deficiency.

UCC statutory damages are also appropriate when state law prohibits the creditor's deficiency. If the creditor has no right to a deficiency, then it has no right to set-off a deficiency claim against the consumer's right to statutory damages.

Consumer attorneys must be careful to structure their pleadings and request for relief so that the court can both dismiss the deficiency claim and award Revised *UCC section 9-625(c)* [former *UCC section 9-507(1)*] statutory damages.

[6] Effect on Right to Deficiency of Failure to Send Explanation of Calculations

An innovation in Revised Article 9 is that the creditor is required to send the consumer an explanation of the calculation of any surplus or deficiency after the disposition of the collateral. n26 Revised Article 9 allows statutory damages of $500 for some violations of this requirement. n27 Whether failure to send this explanation can also bar a deficiency judgment is a more complicated question. n28

[7] Timing Limitations on Creditor's Ability to File Deficiency Claims

[a] No Action on Debt Where Collateral Seized, But Not Yet Sold

A number of courts have ruled that, under the former version of the UCC, the creditor could proceed either against the collateral or through an action on the debt, but could not pursue both remedies simultaneously. The 1999 revisions to Article 9 undercut this principle, but there may still be remedies available under UCC law and non-UCC law when the creditor seeks to pursue conflicting remedies simultaneously.

[b] UCC Four-Year Limitations Period on Creditor's Deficiency Claim

A creditor's deficiency action must be filed within the applicable state statute of limitations. Creditors may be surprised to discover that for actions relating to the sale of goods, the Uniform Commercial Code imposes its own four-year statute of limitations. n29

Whenever the contract being sued upon was originally for the sale of goods, the UCC's four-year limitations period applies even to the creditor's deficiency action.

Moreover, the four-year limitations period arguably even applies to a direct loan where the FTC Holder Notice is found in the loan agreement, since it makes the holder of the note subject to all defenses the consumer could raise against the seller, n30 and the four-year UCC limitations period is a defense that the consumer could raise against the seller.

A breach of the obligation to pay occurs when the buyer fails to pay and defaults on the payment obligation.

[c] Additional Timing Requirements for Deficiency Actions

In some states, the creditor must comply with additional timing requirements in addition to the statute of limitations. A 2007 Rhode Island law requires an "action for default" under a lease or loan agreement (defined to include credit sales) for a motor vehicle bought for personal, family, or household use to be brought within two years after the cause of action accrues. n30.1

[8] Consumer's Counterclaims Relating to Repossession

[a] Counterclaims Relating to Collateral Disposition

The consumer can obtain actual damages instead of Revised *UCC section 9-625* [former *UCC section 9-507(1)*] statutory damages, if these are greater. n31 According to the UCC, if the collateral has already been sold, the debtor can recover "any loss" caused by a creditor's UCC violation. This recovery should include not just direct damages caused by the lower resale price of the vehicle, but consequential damages as well.

One type of consequential damages t hat consumers might seek is their attorney fees in defending a deficiency action if it turns out that no deficiency is owed. Another approach to obtain attorney fees is a UDAP claim for the disposition violations.

A creditor's unlawful disposition may also satisfy the elements of common law conversion, which could entitle the debtor to punitive damages.

The defense of a deficiency action is also the time to raise counterclaims relating to other aspects of the repossession.

[9] Counterclaims Not Related to the Repossession

[a] Types of Counterclaims to Raise

Consumers should always raise all their sales-related claims in a deficiency action, as long as the creditor is the seller or the seller's assignee, the FTC Holder Notice is in the loan document, or the lender is otherwise subject to the consumer's claims against the seller. This includes claims for breach of warranty, deception and fraud, and odometer rollbacks. These claims may result in recoveries of significant statutory damages, treble damages, attorney's fees, and punitive damages.

All counterclaims relating to the credit terms should also be raised, including claims for Truth in Lending disclosure

violations, violations of state credit disclosure laws, and state laws regulating the cost or terms of credit.

A third area of potential counterclaims and cross-claims relates to debt collection abuse either before the repossession or later, where the creditor seeks to collect the deficiency. These might arise under the Federal Fair Debt Collection Practices Act (FDCPA) if committed by independent collection agencies or under a state debt collection statute, a statute UDAP statute, or as a common law tort claim. Many of these potential counterclaims are based on laws that have relatively short statutes of limitations. Nonetheless, claims arising out of the same transaction can be raised by way of recoupment even if they would otherwise be time-barred. n32

[b] Raising Seller-Related Claims Against the Creditor

In general, seller-related claims can be raised as counterclaims to a deficiency action. But the consumer cannot raise seller-related claims where the creditor has a non-purchase money security interest in the collateral or where the consumer obtains a purchase money loan independent of the seller's referral or recommendation.

Where a creditor is subject to seller-related claims, there are limitations to the creditor's liability. In general, the creditor's liability for the seller's misconduct is limited to the amount outstanding on the note, the amount already paid, and any statutory attorney fees. This means that the consumer can cancel the remainder of the debt (*i.e.*, the deficiency) and recover everything already paid in, which should include all installment payments. If the loan was a credit sale with the original dealer, the amount paid also includes any down payment and trade-in. The creditor seeking a deficiency is also liable for all amounts related to the creditor's own misconduct.

[10] Cosigners and Other Sureties' Defenses to Deficiency Action

[a] Introduction

Consumers frequently find themselves facing liability for debts for which they have signed along with another person, expecting the other person to make payment. Typically, a friend or relative is asked to "cosign" a note or installment contract because a creditor has required another signature as a condition of extending credit. When the principal obligor defaults, the creditor may sell the collateral and come after both the principal obligor and the surety for the deficiency. The creditor may also sue the surety alone and not the principal obligor. The creditor may even just sue the surety on the note without first seizing the collateral.

In general, the cosigner, guarantor, or other surety has the same defenses and counterclaims to the deficiency action available to the principal obligor, including the right to seek Revised *UCC section 9-625(c)* statutory damages. n33

In addition to the other defenses and counterclaims to a deficiency set out earlier, the surety has several special defenses and counterclaims to the deficiency action or suit on the note. In addition, the surety has certain rights concerning the collateral *before* it is sold, and also as against the principal obligor.

[b] Distinguishing Cosigner or Other Surety From the Principal Obligor

Fundamental to whether a consumer can raise the special defenses and counterclaims available to sureties is whether the consumer is a surety, or, instead, is a principal obligor. The terms cosigner, guarantor, and accommodation party are often used synonymously. "Cosigner," often used generically, has no precise UCC definition. The UCC uses one catch-all term -- "accommodation party."

Under the 1990 amendments to Article 3, an accommodation party is defined as one who "signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument." n34 A guarantor is a particular kind of accommodation party -- one who adds specific words of guaranty to the signature, such as "payment guaranteed," or "collection guaranteed." n35 In most cases, a creditor may proceed directly

against an accommodation party without prior resort to the debtor. However, if an accommodation party pays the debt, the primary debtor is then liable to the accommodation party. n36

[c] Cosigner Defenses Under the Current Version of UCC Article 3

Forty-eight states and the District of Columbia have adopted the 1990 amendments to UCC Article 3.

In 2002, the National Conference of Commissioners on Uniform State Laws approved yet another revision of Article 3 for adoption by the states. n37 As of mid-2003, one state -- Minnesota -- had adopted the 2002 revision, and a few other states were considering it. n38

[i] Extension of Due Date

If the creditor extends the due date for an instrument, the current version of Article 3 provides that an accommodation party is discharged to the extent that the extension caused loss to the accommodation party. n39 The accommodation party bears the burden of proving the extension caused a loss.

[ii] Modification of Terms of Obligation

Article 3 in its current version provides that a material modification discharges the accommodation party unless the creditor proves that no loss was caused by the modification. n40

[iii] Creditor's Impairment of Collateral

Article 3 also provides a defense for an accommodation party where the creditor impairs the value of its security interest in the collateral. n41 The accommodation party has the burden of proof. A prime example is the creditor's failure to perfect the security interest in the collateral, which is then seized by some other creditor.

[iv] Waiver

Waiver of these defenses is allowed, but the accommodation party must actually agree to the waiver, either at the outset of the transaction or at the time the extension or deferral is granted. n42

[v] Defenses Where Accommodation Party's Status Is Unknown to Creditor

An accommodation party is not discharged by extension, modification, or impairment of collateral unless the creditor knows of the accommodation party's status or the note was signed in a way that makes the accommodation status clear. n43

[d] Cosigner Defenses Under the Previous Version of Article 3

The pre-1990 version of UCC section 3-606(1), still in effect in New York and South Carolina, provides for a discharge of the debt against the accommodation party if the creditor either suspends or discharges the debt against the primary debtor. Proof of loss is not required. However, if the creditor makes "an expressreservation of rights" against the accommodation party, then the extension of time does not affect the creditor's claim against the accommodation party. n44

If, after repossession, the creditor damages the collateral or otherwise fails to take reasonable care of it, the accommodation party is discharged to the extent of the damage. n45

[e] Defenses Under 2002 Revisions to Article 3

The 2002 revisions to Article 3, so far enacted only by Minnesota, make some changes in accommodation parties' defenses. First, instead of setting forth the burden of proof separately for each type of defense, Revised section 3-605 establishes a general rule that a secondary obligor has the burden of persuasion with respect to both the occurrence of the acts that allegedly harmed the secondary obligor and the loss or prejudice caused by those acts. However, if the secondary obligor demonstrates prejudice caused by an impairment of its recourse, but the damage is difficult to quantify, there is a presumption that the damage is equal to the amount of the secondary obligor's liability, thereby eliminating that liability. The obligee then has the burden of persuasion that the damage is less than the secondary obligor's liability. n46

The second major change is that, under the 2002 revisions, the obligee's release of the principal obligor discharges the secondary obligor to the same extent as the principal obligor is discharged. There is an exception to this general rule, however, if the release preserves the rights of the obligee against the secondary obligor. But even then, the secondary obligor is discharged to the extent that the release of the primary obligor causes loss. n47

[f] Creditor's Failure to Reveal Risks of Guarantee as Defense to Deficiency

At common law, a surety is released when the creditor fails to disclose facts unknown to the surety which increase the risk to the surety.

[g] Surety's Right to Notice of Sale and a Commercially Reasonable Disposition of the Collateral

Failure to give notice to the surety or proceed in a commercially reasonable manner may bar or limit a deficiency judgment, and, in the case of consumer goods, entitle the debtor to minimum damages under *UCC section 9-507(1)*. n48 Thus, the accommodation party may raise as a defense the failure to receive notice and may contest the commercial reasonableness of the sale, including seeking statutory damages. The UCC prohibits waiver of notice prior to default or waiver of the commercial reasonableness requirement. In addition, a post-default waiver of notice is effective only if it is in writing and signed by the obligor. n49

[h] Creditor's Duty of Good Faith to Surety

As part of the recent move to expand the liability of lenders, sureties have begun to argue that creditors owe them a duty of good faith beyond the literal terms of the surety agreement, which, if not followed, releases the guarantors.

[i] Creditor's Duty to Disclose Risks to Cosigner

[i] Federal Trade Commission Cosigner Requirements

The FTC Credit Practices Rule n50 requires all "cosigners" in consumer credit transactions to be given a notice prior to adding their signature to any debt. n51

[ii] State Cosigner Statutes

Some state statutes provide special consumer credit cosigner protections. The state requirements are similar to the FTC Credit Practices Rule. Failure to give the notice releases the cosigner from liability and may subject the creditor to statutory damages.

[j] Surety's Right to Redeem Collateral

If collateral is repossessed, an accommodation party, as a "debtor," has a right under *UCC section 9-506* [Revised *UCC section 9-623*] to redeem the goods.

[k] Surety's Claims Against the Principal Debtor

When the secured party seeks collection from an accommodation party, it is usually because the debtor is bankrupt, judgment proof, or unavailable. Nevertheless, the accommodation party, if forced to pay some or all of the debt, has a right of recourse against the principal debtor. n52

[11] Raising Defenses to FDIC or RTC's Deficiency Actions

The growth of bank insolvencies has meant that consumers are increasingly being sued for deficiencies by the Federal Deposit Insurance Corporation ("FDIC"), the Resolution Trust Corporation ("RTC"), or by entities who received the consumer obligation from the FDIC or RTC. Consumer attorneys in this situation will have to become familiar with the "*D'Oench, Duhme* doctrine" n53 and related provisions in the United States Code. n54 Under this rapidly evolving area of federal law, the FDIC, RTC, and successor creditors are insulated from borrowers' claims and defenses based on side agreements between the borrowers and the now insolvent predecessor banks.

Nevertheless, such creditor arguments should not succeed where the consumer's defense alleges that the original bank held a commercially unreasonable sale of the collateral or improperly seized the collateral. The RTC, FDIC, and successor creditors are certainly subject to the written terms of the loan, including these legal requirements.

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureRemediesGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)General OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionGeneral OverviewCommercial Law (UCC)Secured Transactions (Article 9)DefaultForeclosure & RepossessionDisposition of Collateral

FOOTNOTES:
(n1)Footnote 1. Louisiana and California are the only states whose versions of *U.C.C. § 9-625(c)* does not provide special damages in the case of consumer goods.

(n2)Footnote 2. *Chisolm v. TranSouth Fin. Corp., 194 F.R.D. 538 (E.D. Va. 2000)* .

(n3)Footnote 3. Revised *U.C.C. § 9-102(a)(26)* [former *U.C.C. § 9-109*].

(n4)Footnote 4. Revised *U.C.C. § 9-616(b)*.

(n5)Footnote 5. Revised *U.C.C. § 9-625(e)(5)*.

(n6)Footnote 6. Revised *U.C.C. § 9-628(d)*.

(n7)Footnote 7. *See* National Consumer Law Center, Arbitration Agreements (4th ed. 2004).

(n8)Footnote 8. *In re Ott, 278 B.R. 154, 48 U.C.C. Rep. Serv. 2d 1234 (Bankr. N.D. Ohio 2002)* (creditor failed to satisfy burden of proof when it could not explain absence of documentary evidence that it had given notice).

(n9)Footnote 9. *In re Downing, 286 B.R. 900, 49 U.C.C. Rep. Serv. 2d 697 (Bankr. W.D. Mo. 2002)* (question of sufficiency of notice of sale; note, however, that Missouri adopted Revised *U.C.C. §§ 9-625* and *9-626* with a delayed effective date so they were not in effect at the time of this decision).

(n10)Footnote 10. *Brewer v. Trust Co. Bank, 205 Ga. App. 891, 424 S.E.2d 74 (1992)* (proof of commercially reasonable procedures and sale price insufficient; creditor must also prove reasonable value of collateral); *Hall v. Owen*

County State Bank, 370 N.E.2d 918 (Ind. Ct. App. 1977) ; *Citizens Nat'l Bank v. Robertson, 101 S.W.3d 302 (Mo. Ct. App. 2003)* ; *Parks Chevrolet, Inc. v. Watkins, 329 S.E.2d 728 (N.C. Ct. App. 1985)* (reversing summary judgment for creditor when evidence showed only that it sold the collateral for a certain price to a wholesaler).

(n11)Footnote 11. *Boles v. Texas Nat'l Bank, 750 S.W.2d 879 (Tex. App. 1988)* .

(n12)Footnote 12. *McDonald Mobile Home Sales, Inc. v. BankAmerica Hous. Services, 218 S.W.3d 376 (Ala. Civ. App. 2005)* ; *see also Greenlee v. Mazda Am. Credit, 59 U.C.C. Rep. Serv. 2d 532 (Ark. Ct. App. 2005)* (testimony by creditor employee who has no personal knowledge of sale, and can only verify sale price, balance due, and that sale was a private auction, is insufficient).

(n13)Footnote 13. *DaimlerChrysler Services v. Lennington, 2006 Ohio 1546 (2006)* (unpublished).

(n14)Footnote 14. *Hall v. Owen County State Bank, 370 N.E.2d 918 (Ind. Ct. App. 1977)* .

(n15)Footnote 15. *Hall v. Crocker Equip. Leasing, Inc., 737 S.W.2d 1 (Tex. App. 1987)* .

(n16)Footnote 16. *Karlstad State Bank v. Fritsche, 374 N.W.2d 177 (Minn. Ct. App. 1985)* ; *American State Bank v. Hewson, 411 N.W.2d 57 (N.D. 1987)* (burden of persuasion, but not burden of proof, shifts to debtor); *see First Nat'l Bank v. Ruttle, 778 P.2d 434 (N.M. Ct. App. 1989)* (burden of going forward shifts to debtor).

(n17)Footnote 17. *See* Revised *U.C.C. § 9-620*. Note that Part 6 of the revisions corresponds with Part 5 of the former U.C.C. Article 9.

(n18)Footnote 18. *See* National Consumer Law Center, Repossessions, § 12.6.1.2 (6th ed. 2005 and supp.).

(n19)Footnote 19. *See* National Consumer Law Center, Repossessions, § 12.6.1.2 (6th ed. 2005 and supp.).

(n20)Footnote 20. See National Consumer Law Center, Repossessions, § 12.6.2 (6th ed. 2005 and supp.), for citations to state statutes and court decisions adopting this approach.

(n21)Footnote 21. *Atlas Thrift Co. v. Horan, 27 Cal. App. 3d 999, 104 Cal. Rptr. 315, 11 U.C.C. Rep. Serv. 417 (1972)* .

(n22)Footnote 22. See National Consumer Law Center, Repossessions, § 12.6.3 (6th ed. 2005 and supp.) for citations to state statutes and court decisions adopting this approach.

(n23)Footnote 23. *Hoch v. Ellis, 627 P.2d 1060, 31 U.C.C. Rep. Serv. 760 (Alaska 1981)* .

(n24)Footnote 24. *Oliver-Mercer Elec. Co-op., Inc. v. Davis, 696 N.W.2d 924, 57 U.C.C. Rep. Serv. 2d 724 (N.D. 2005)* .

(n25)Footnote 25. Revised *U.C.C. § 9-626(a)(3)*.

(n26)Footnote 25.1. *Folks v. Tuscaloosa County Credit Union, 64 U.C.C. Rep. Serv. 2d 957 (Ala. Civ. App. 2007)* (setting off only actual value of collateral, which was less than the debt, resulting in a deficiency).

(n27)Footnote 26. Revised *U.C.C. § 9-616*.

(n28)Footnote 27. *U.C.C. § 9-625(e)(5)*, (6); *see* National Consumer Law Center, Repossessions, § 13.2.5 (6th ed. 2005 and Supp.).

(n29)Footnote 28. *See* National Consumer Law Center, Repossessions, § 12.6.5 (6th ed. 2005 and Supp.).

(n30)Footnote 29. *U.C.C. § 2-725(1).*

(n31)Footnote 30. *See* 16 C.F.R. pt. 433; *see* Ch. 4, "Unfair and Deceptive Credit Practices," *supra.*

(n32)Footnote 30.1. *R.I. Gen. Laws § 6-51-5.*

(n33)Footnote 31. *See* Revised *U.C.C. § 9-625* [former *U.C.C. § 9-507(1)*].

(n34)Footnote 32. *Associates Home Equity Servs., Inc., v. Troup, 778 A.2d 529 (N.J. Super. Ct. App. Div. 2001)* ; *see* National Consumer Law Center, Truth in Lending § 7.2.5 (6th ed. 2007 and supp.).

(n35)Footnote 33. *See Crane v. Citicorp Nat'l Servs., Inc., 437 S.E.2d 50 (S.C. 1993)* . This principle is made explicit bythe 1999 revisions to Article 9, which will revise the statutory damage provision to state that either the debtor or a secondary obligor can recover statutory damages. Revised *U.C.C. § 9-625(c)(2). See also* Revised *U.C.C. § 9-628(e)* (secured party cannot be held liable for statutory damages more than once with respect to any secured obligation).

(n36)Footnote 34. *U.C.C. § 3-419(a).*

(n37)Footnote 35. *U.C.C. § 3-419(c).*

(n38)Footnote 36. *U.C.C. § 3-415(5).* For a more detailed discussion of guarantors, accommodation parties, and the concept of suretyship under the U.C.C., see White & Summers, Uniform Commercial Code §§ 13-13 to 13-19 (3d ed. 1988).

(n39)Footnote 37. *See* Mark Budnitz, The Law of Lender Liability Ch. 5A (2003 Supp.) (discussion of this latest revision).

(n40)Footnote 38. *Minn. Stat. §§ 336.3-101 to 336.3-605, as amended by* 2003 Minn. Sess. Law Serv. 81.

(n41)Footnote 39. *U.C.C. § 3-605(c).*

(n42)Footnote 40. *U.C.C. § 3-605(d).*

(n43)Footnote 41. *U.C.C. § 3-605(e).*

(n44)Footnote 42. *U.C.C. § 3-605(i). See Decatur County Bank v. Smith, 1999 Tenn. App. LEXIS 864, 40 U.C.C. Rep. Serv. 2d 1236* (Tenn. Ct. App. Dec. 27, 1999) (enforcing waiver clause).

(n45)Footnote 43. *U.C.C. § 3-605(h).*

(n46)Footnote 44. U.C.C. § 3-606(1) [pre-1990 version].

(n47)Footnote 45. U.C.C. § 3-606 [pre-1990 version].

(n48)Footnote 46. Revised *U.C.C. § 3-605(h)*, (i) (2002).

(n49)Footnote 47. Revised *U.C.C. § 3-605(a)(2)*, (3) (2002).

(n50)Footnote 48. *See Crane v. Citicorp Nat'l Servs., Inc., 437 S.E.2d 50 (S.C. 1993)* .

(n51)Footnote 49. *Cerritos Valley Bank v. Stirling, 81 Cal. App. 4th 1108, 97 Cal. Rptr. 2d 432 (Ct. App. 2000)* .

(n52)Footnote 50. 16 C.F.R. pt. 444, *reprinted in* Vol. 1A *infra.*

(n53)Footnote 51. FTC Credit Practices Rule, *16 C.F.R. § 444.3*.

(n54)Footnote 52. *U.C.C. § 3-419(e)* [pre-1990 *U.C.C. § 3-415(5)*].

(n55)Footnote 53. *See D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447, 62 S. Ct. 676, 86 L. Ed. 956 (1942)* .

(n56)Footnote 54. *12 U.S.C. § 1823(e)*. For further discussion of these issues, see National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 10.7 (6th ed. 2005).

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§ 11.01 Introduction

The termination of utility service can have devastating and immediate effects on a family. Loss of heat or lights can be difficult and inconvenient at any time of the year and potentially dangerous at certain times of the winter or summer when temperatures are extreme. Keeping the lights and heat on is important. This chapter discusses different strategies to use to fight utility terminations, including preventing the shutoff in the first place, restoring service if a termination has occurred, and seeking redress for improper shutoffs. n1

A "public utility" is a business whose services are sufficiently important so as to warrant government regulation n2 because the commodity which the company provides--whether electric, gas, water or telephone service--is viewed as being of great economic consequence. Local and state authorities, often called public service commissions or public utility commissions, as well as various federal agencies, have all imposed varying degrees of control upon these enterprises for the purpose of achieving what the free market cannot: the provision of adequate service at reasonable prices for anyone who demands it.

Legal Topics:

For related research and practice materials, see the following legal topics:
Energy & Utilities LawUtility CompaniesService Terminations

FOOTNOTES:
(n1)Footnote 1. For a thorough discussion of many issues concerning utility service, including termination, payment and payment assistance, weatherization, utility affordability programs, etc., see National Consumer Law Center, Access to Utility Service (3rd ed. 2004 and Supp.).

(n2)Footnote 2. 64 Am. Jur. 2d *Public Utilities* § 1 (1972). *See also* Charles F. Phillips, Jr., The Regulation of Public Utilities 3 (1993).

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§ 11.02 Legal Characteristics of Public Utilities: Duties and Obligations

First and foremost, public utilities have a duty to serve. They are obligated to provide service on reasonable terms to all who request it, provided that the prospective customer lives within the service area, is willing to comply with the utility's rules and regulations, and that the technical capacity exists to provide the service.

The second obligation which utilities must observe is the requirement that they provide safe and adequate service to all of their customers.

Public utility firms must also serve all members of the public on equal terms. They must serve all customers impartially and without undue discrimination.

The fourth duty under which utilities must operate is the requirement that they charge "just and reasonable" prices for their services.

Utility companies may also be held to an implied covenant of good faith and fair dealing implicit in all contracts under the common law of many states. Such a covenant is not a revision of company tariffs, but is a duty of all contracting parties, and is especially applicable given the higher duty of care often imposed on utility companies toward their customers.

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawContract InterpretationGood Faith & Fair DealingEnergy & Utilities LawImplied CovenantsGeneral OverviewEnergy & Utilities LawUtility CompaniesContracts for ServiceEnergy & Utilities LawUtility CompaniesRatesGeneral Overview

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§ 11.03 Regulated Utilities

Regulated utilities generally include retail electric, gas, and telephone service providers, which are investor-owned utility companies and under the jurisdiction of a state utilities commission. They are granted the right to a monopoly subject to regulation. n1

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawIndustry RegulationEnergy & UtilitiesState RegulationAntitrust & Trade LawIndustry RegulationEnergy & UtilitiesUtility CompaniesEnergy & Utilities LawAdministrative ProceedingsPublic Utility CommissionsGeneral Overview

FOOTNOTES:
(n1)Footnote 1. For current information on regulated utilities, see the following internet sites: for regulators' perspective: National Association of Regulatory Utility Commissioners (NARUC) (www.erols.com/naruc/nccei.htm); for utility company perspectives: Edison Electric Institute (www.eei.org).

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§ 11.04 Deregulation of the Public Utility

Many utility companies and their industries are currently undergoing rapid, fundamental changes of organizational and regulatory structures. Once typified by regulatory protection of monopoly investment, utility investment and pricing decision-making are increasingly guided by market forces and competition. Utility industry restructuring or deregulation changes the ways in which these companies are organized and operated, as well as changes the ways in which customers receive utility service.

At the wholesale level, restructuring involves implementation of what has come to be referred to as "open access," where natural gas pipeline owners and electricity transmission line owners are required by statute and Federal Energy Regulatory Commission Orders to provide access to these transportation facilities at a fair price.

"Electricity industry" restructuring generally describes any one of a number of ways of introducing competition between independent power producers and existing monopoly utilities to sell power to retail customers. The key is the concept of retail competition. n1

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawIndustry RegulationEnergy & UtilitiesUtility CompaniesEnergy & Utilities LawElectric Power IndustryDeregulation & RestructuringEnergy & Utilities LawUtility CompaniesOwnership & RestructuringEnergy & Utilities LawUtility CompaniesRatesGeneral Overview

FOOTNOTES:
(n1)Footnote 1. For further discussion of deregulation and restructuring, see National Consumer Law Center, Access to Utility Service, Ch. 1 (3rd ed. 2004 and Supp.).

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§ 11.05 Unregulated Utilities

[1] Municipal Utilities

One form of public utility which is typically not subject to the same array of statutory controls are publicly-owned municipal utilities ("MUNIs"). Most common in the electric power and water industries, MUNIs are government-run enterprises, not privately-run. The rationale supporting non-regulation by a utilities commission is that local control over utility service is more responsive to user needs than is commission oversight. MUNIs must still follow the common-law duties of public utilities in their dealings with their customers.

[2] Rural Electric Cooperatives

Over 1000 rural electric cooperatives ("RECs") exist and provide power to nearly 50% of all inhabitants of rural areas in the United States. Although RECs have not always been classified as public utilities, the general feeling is that they are. Thus, although they are not regulated by Public Utilities Commissions ("PUCs") in the traditional sense, they occasionally have been deemed bound by the common law duties and obligations unique to utilities. They present an odd combination of public and regulated utility provider.

[3] Unregulated Deliverable Fuels

In addition to regulated electric and natural gas utilities, MUNIs, and RECs, millions of people across the country depend upon a wide variety of unregulated "deliverable" fuels, such as propane, oil, kerosene, and wood. Thus, vendors of these alternative fuels are able to set prices and provide service much like any other provider of a non-utility good or service. Disputes with such companies are governed by the Uniform Commercial Code ("UCC") and other applicable merchant-consumer statutes and regulations.

In practical terms, customers who have disputes with such businesses cannot, therefore, seek refuge in the comprehensive protections and special rights which electric and natural gas consumers enjoy in the area of service terminations, reconnections, and deferred payment plans.

Legal Topics:

For related research and practice materials, see the following legal topics:
Energy & Utilities LawElectric Power IndustryElectricity Distribution & TransmissionState & Municipal OwnershipEnergy & Utilities LawGas IndustryLiquefied Natural GasEnergy & Utilities LawPurchase ContractsUniform Commercial CodeEnergy & Utilities LawUtility CompaniesOwnership & Restructuring

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§ 11.06 Sources of Law in Termination Cases

When a consumer's utility service is at risk of being disconnected, the law that governs depends on the type of utility. If the utility is a privately owned regulated utility, then the state's public utility commission statutes, regulations, and rules apply. If the utility is municipally owned, constitutional restrictions limit what that utility may do. If the utility is a REC, in addition to the REC's specific rules, constitutional principles may apply. Common law principles apply to all types of utilities. Federal consumer protection statutes, state unfair or deceptive trade practices acts, and/or federal civil rights statutes may also provide protection.

[1] PUC Dispute Resolution Procedures

Public utilities commissions typically are afforded power to decide individual customer disputes with regulated utilities. State statutes often provide for the initiation of complaints against a utility before the commission.

The doctrine of primary jurisdiction may be invoked to bar judicial relief absent first resorting to such remedies as the public utility commission may afford. A trial court will typically lack jurisdiction to review claims involving the rate setting process, quality of service, or other matters under the commission's express supervision.

[2] Sources of Law Particular to RECs n1

[a] The Relevance of State Commission Regulation to "Unregulated" Utilities

Rural electric cooperatives typically are not subject to the direct regulatory supervision of state utility regulatory commissions. State public utility commission regulations can be imported as implied terms of the contract between a REC and its customers under the UCC "usage of trade" provisions. n2

Deferral of service disconnections in the event of medical emergencies, prohibition of disconnections "after hours," on weekends or on holidays, and winter shutoff protections are good examples of trade practices that may be implied in the contract between an REC and its customers based on usage of trade within the public utility industry.

[b] PUC Regulations and "Unfairness."

A majority of states have unfair or deceptive act or practices ("UDAP") statutes prohibiting "unfair practices." n3 Under this standard, existing PUC regulations could well serve as an "established concept of unfairness" even though the REC is not directly subject to PUC regulation.

[3] Protections Offered From REC Membership

Members n4 of RECs may be entitled to protections against unfair termination practices as an incident of membership in the REC as a nonprofit association. Such protections arise out of the contract of the member with the REC pursuant to its articles of incorporation, corporate bylaws, and any other agreements contracted with the REC's membership. State cooperative laws may also prescribe specific standards and procedures that an REC must incorporate into its contracts with its members as to service termination.

Legal Topics:

For related research and practice materials, see the following legal topics:
Energy & Utilities LawAdministrative ProceedingsPublic Utility CommissionsAuthorityEnergy & Utilities LawElectric Power IndustryElectricity Distribution & TransmissionState & Municipal OwnershipEnergy & Utilities LawUtility CompaniesService Terminations

FOOTNOTES:
(n1)Footnote 1. For a more extensive discussion, see National Consumer Law Center, The Regulation of Rural Electric Cooperatives: The Common Law, Consumer Law and a Cornucopia of Consumer Protections (1993). *See also* National Consumer Law Center, Access to Utility Service, § 1.5 (3rd ed. 2004 and Supp.).

(n2)Footnote 2. *U.C.C. § 1-205(2).*

(n3)Footnote 3. National Consumer Law Center, Unfair and Deceptive Acts and Practices, App. A (7th ed. 2008), presents a state-by-state, statute-by-statute analysis of state unfair and deceptive acts and practices [hereinafter UDAP] laws.

(n4)Footnote 4. The recipient of an REC's services is ordinarily, but not universally, a member of the cooperative.

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§ 11.07 Constitutional Law

The conditions under which a utility may terminate or deny service to a customer may be limited by constitutional restrictions, n1 the central constitutional restriction being the *Due Process Clause of the Fourteenth Amendment*. These restrictions establish mere minimum procedures.

[1] State Action Requirement

In *Memphis Light, Gas and Water Division v. Craft*, n2 the United States Supreme Court held that where state action is present, constitutional restrictions will apply. The determination of whether a utility's action constitutes state action depends on the type of utility.

[a] Applicability to Municipal Utilities

Municipal utilities are cities and towns, or their agencies or departments, which sell utility services to retail customers. Municipalities are limited by the constitutional due process controls on government action. State action is present in all of the activities of municipal utilities. n3 The *Due Process Clause of the Fourteenth Amendment* requires that certain elements of fairness be present in the termination of utility service. In particular, in most cases, customers are at least entitled to notice prior to having their service disconnected. n4

[b] Applicability to Private (Investor-Owned) Regulated Utilities

In *Jackson v. Metropolitan Edison Co.*, n5 the Supreme Court held that state action is not present where a utility is privately owned, despite both the regulation of the utilities and the grant of a monopoly by the state. The general rule, however, is that the actions of private utilities do not constitute state action, unless the state regulator actually ordered the utility's action.

[c] Applicability to RECs

There is no court decision directly on point as to whether service terminations by RECs constitute "state action" and are, thus, subject to the constraints of constitutional due process. The right of an REC to terminate the service of a member derives solely from any inherent powers it holds pursuant to its articles of incorporation, corporate bylaws, and any

other agreements contracted with the REC's membership. State cooperative laws may also prescribe specific standards and procedures that an REC must incorporate into its contracts with its members as to service termination.

Legal Topics:

For related research and practice materials, see the following legal topics:
Constitutional LawBill of RightsFundamental RightsProcedural Due ProcessScope of ProtectionEnergy & Utilities LawElectric Power IndustryElectricity Distribution & TransmissionState & Municipal OwnershipEnergy & Utilities LawUtility CompaniesService Terminations

FOOTNOTES:
(n1)Footnote 1. *Memphis Light, Gas & Water Div. v. Craft, 436 U.S. 1, 98 S. Ct. 1554, 56 L. Ed. 2d 30 (1978)* ; *Davis v. Weir, 497 F.2d 139 (5th Cir. 1974)* ; *Smith v. Tri-County Elec. Membership Corp., 689 S.W.2d 181 (Tenn. Ct. App. 1985)* . *See generally* National Consumer Law Center, Access to Utility Service (2d ed. 2001).

(n2)Footnote 2. *436 U.S. 1, 98 S. Ct. 1554, 56 L. Ed. 2d 30 (1978)* .

(n3)Footnote 3. *DiMassimo v. City of Clearwater, 805 F.2d 1536 (11th Cir. 1986)* .

(n4)Footnote 4. *Memphis Light, Gas & Water Div. v. Craft, 436 U.S. 1, 98 S. Ct. 1554, 56 L. Ed. 2d 30 (1978)* ; *Davis v. Weir, 497 F.2d 139 (5th Cir. 1974)* ; *Smith v. Tri-County Elec. Membership Corp., 689 S.W.2d 181 (Tenn. Ct. App. 1985)* .

(n5)Footnote 5. *419 U.S. 345, 95 S. Ct. 449, 42 L. Ed. 2d 477 (1974)* .

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§ 11.08 Federal Statutes

[1] Civil Rights Statutes

Civil rights statutes apply only to recipients of federal funding. This includes, for example, receipt of Rural Electrification Agency ("REA") loans or guarantees, n1 which applies to nearly all RECs.

[2] Public Utilities Regulatory Policy Act (PURPA)

The Public Utilities Regulatory Policy Act ("PURPA"), n2 enacted in 1978, regulates electric utilities with total annual sales of electricity in excess of 500 million kilowatt-hours. PURPA requires that commissions regulating electric utility providers (or the providers themselves in the case of unregulated providers), undertake a formal hearing process to consider whether to establish regulations, rules, and standards governing terminations of customer service. n3 Most commissions and many unregulated utilities established some termination procedures in response to this statute.

[3] Bankruptcy Law as a Source of Protection

The U.S. Bankruptcy Code n4 presents one of the strongest sources of consumer rights to deal with utility shut-offs and utilities' unwillingness to restructure utility arrearages. Under the Bankruptcy Code, a consumer may prevent a disconnection and seek to discharge unpayable debts through a variety of mechanisms. n5

Legal Topics:

For related research and practice materials, see the following legal topics:
Bankruptcy LawCase AdministrationAdministrative PowersUtility ServicesEnergy & Utilities LawCogeneration & Independent Power CompaniesPublic Utility Regulatory Policies ActGeneral OverviewEnergy & Utilities LawFinancingRural Electrification LoansEnergy & Utilities LawUtility CompaniesService Terminations

FOOTNOTES:
(n1)Footnote 1. *See 7 U.S.C. §§ 901-916*; *7 U.S.C. §§ 931-940. Zepp v. Mayor & Council of Athens, 180 Ga. App. 72, 348 S.E.2d 673* , 2 U.C.C. Rep. 2d 1179 (1986); *Mulberry-Fairplains Water Ass'n v. Town of N. Wilkesboro, 105 N.C. App. 258, 412 S.E.2d 910* , 17 U.C.C. Rep. 2d 48 (1992). *But see Mattoon v. City of Pittsfield, 56 Mass. App. Ct. 124,*

775 N.E.2d 770 (2002) (the provision of water was predominantly a service because, although the city charged for the water, the rate covered storage, treatment, and distribution); *Coast Laundry v. Lincoln City, 9 Or. App. 521, 497 P.2d 1224, 10 U.C.C. Rep. 1379, 54 A.L.R.3d 930 (1972)* .

(n2)Footnote 2. *16 U.S.C. §§ 2601 et seq. (1989).*

(n3)Footnote 3. *16 U.S.C. §§ 2612(c), 2623(a) (1984). See also Dotson v. PG&E, 1995 WL 216862 (Cal. PUC 1995)* (PURPA does not mandate permanent free utility service to low-income or handicapped customers; extended payment plan ordered).

(n4)Footnote 4. *See generally* Annot., *Bankruptcy, Debtor's Protection Under 11 U.S.C. Section 316 Against Utility Service Cutoff 11 U.S.C. Section 316, 83 A.L.R. Fed. 207 (1987).*

(n5)Footnote 5. A more complete discussion of consumers' rights as bankruptcy debtors is contained in the Collier Consumer Bankruptcy Practice Guide (Matthew Bender) (see Ch. 12 regarding utility service issues).

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PART I Consumer Credit
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§ 11.09 Consumer Protection Statutes

[1] The Uniform Commercial Code (UCC)

[a] Applicability to Different Types of Utilities

Article 2 of the UCC can provide considerable protection for a consumer facing the disconnection of service provided by a utility company. In this analysis, the threshold determination to be made is whether utility service can be classified as "goods" for the purposes of rendering the UCC applicable. The majority view is that the UCC does apply to consumer purchases of utilities. n1 Specifically, the courts have found that a utility's provision of water, sewer, electricity, and gas, in metered amounts, to customers involves the sale of "goods" covered by Article 2.

[2] Unfair and Deceptive Acts and Practices (UDAP)

All states have enacted statutes, commonly called UDAP statutes, generally prohibiting unfair or unconscionable or deceptive practices. n2 UDAP statutes typically apply to the sale of goods or services or practices "in trade or commerce." Generally, utility services will fall within these coverages. Certain UDAP statutes, however, exempt regulated practices or regulated utilities, and certain state regulatory schemes are found to preempt UDAP coverage. None of these exemptions apply to RECs, as they are unregulated.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawIndustry RegulationEnergy & UtilitiesUtility CompaniesAntitrust & Trade LawTrade Practices & Unfair CompetitionState RegulationCoverageCommercial Law (UCC)Sales (Article 2)Subject MatterGoodsDefinitionEnergy & Utilities LawAntitrustGeneral OverviewEnergy & Utilities LawPurchase ContractsUniform Commercial CodeEnergy & Utilities LawUtility CompaniesService Terminations

FOOTNOTES:
(n1)Footnote 1. *See Zepp v. Mayor & Council of Athens, 180 Ga. App. 72, 348 S.E.2d 673* , 2 U.C.C. Rep. 2d 1179 (1986); *Mulberry-Fairplains Water Ass'n v. Town of N. Wilkesboro, 105 N.C. App. 258, 412 S.E.2d 910* , 17 U.C.C. Rep. 2d 48 (1992). *But see Mattoon v. City of Pittsfield, 56 Mass. App. Ct. 124, 775 N.E.2d 770 (2002)* (the provision of

water was predominantly a service because, although the city charged for the water, the rate covered storage, treatment, and distribution); *Coast Laundry v. Lincoln City, 9 Or. App. 521, 497 P.2d 1224, 10 U.C.C. Rep. 1379, 54 A.L.R.3d 930 (1972)* . *See generally* Annot., *Electricity, Gas or Water Furnished by Public Utility as "Goods" Within Provisions of Uniform Commercial Code, Article 2 on Sales* Uniform Commercial Code, Article 2, *48 A.L.R.3d 1060 (1973). Archer Daniels Midland Co. v. Brunswick County, N.C., 129 Fed. Appx. 16, 56 U.C.C. Rep. Serv. 2d 665, at 674 (4th Cir. 2005)* (applies *U.C.C. § 2-208* to sale of water; notes in footnote 10 that water is a good within meaning of *U.C.C. § 2-105*); *Adel v. Greensprings of Vt., Inc., 363 F. Supp. 2d 692 (D. Vt. 2005)* (water is a good within meaning of § 2-105; covered by implied warranty of merchantability; extensive collection and analysis of cases for and against); *Darling v. Central Vt. Pub. Serv. Co., 762 A.2d 826 (Vt. 2000)* (notes that most jurisdictions treat electricity as a good; issue not reached here because sale not shown; electricity escaped from fallen powerline and caused fire). *See also Enron Power Mktg., Inc. v. Nevada Power Co., 55 U.C.C. Rep. Serv. 2d 31 (S.D.N.Y. 2004)* (notes that Utah courts have not decided this issue; other jurisdictions treat electricity as a good). *Kotz v. Hawaii Elec. Light Co., 52 U.C.C. Rep. Serv. 2d 857 (Haw. 2004)* (unpublished, not citable) ("under the circumstances of this case," over-voltage of electricity from fallen power line not a good governed by UCC).

(n2)Footnote 2. *See generally* Ch. 4 *supra*.

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1-11 Consumer Credit Law Manual § 11.10

§ 11.10 Grounds for Termination of Service

[1] Introduction

Public utilities have a duty to provide service. n1 However, this duty is not absolute, and if customers do not abide by the utility's rules, the utility has the right to terminate service.

[2] Nonpayment

The most frequent ground for the termination of utility service is nonpayment of the bill. Utility service is not free; public utilities have the right to collect a reasonable price for their services and have the right to terminate service if a customer has not paid the utility bill. This rule has roots in the common law, n2 and has been followed by courts at both the federal and state level, n3 as well as by state commissions, in their decisions, rules, and regulations. n4

The rationale behind allowing utilities to terminate service is ostensibly to provide them with a quick and inexpensive method of enforcing payment, as opposed to bringing individual customers to court. However, rooted in the common law is the principle that the purpose of disconnection is to prevent *future* loss, and that disconnection should not primarily serve as a collection tool, but, rather, as a means to avoid future economic losses. The importance of this principle is heightened by the fact that utilities have monopoly status, and that the service they provide is an essential of everyday life.

One commission has, however, refused to allow disconnection of service for nonpayment of a deposit.

[3] Meter Tampering and Other Fraud

A utility may also terminate service if it has discovered that the customer has engaged in fraud of any kind, for example tampering with the meter or misrepresenting one's identity for the purpose of obtaining or evading payment of utility service.

Legal Topics:

For related research and practice materials, see the following legal topics:

Energy & Utilities LawUtility CompaniesService Terminations

FOOTNOTES:

(n1)Footnote 1. *See* National Consumer Law Center, Access to Utility Service (4th ed. 2008).

(n2)Footnote 2. Annot., *Right to Cut Off Water Supply Because of Nonpayment of Water Bill or Charges for Connection*, 28 A.L.R. 472 (1924) ; Annot., *Right of Telephone Company to Refuse, or Discontinue, Service Because of Failure to Pay Bills or Other Violation of Conditions of Use*, 70 A.L.R 894 (1931) ; Annot., *Right to Cut Off Supply of Electricity or Gas Because of Nonpayment of Service Bill or Charges*, 112 A.L.R. 237 (1938) .

(n3)Footnote 3. *See*, *e.g.*, *Lucas v. Wisconsin Elec. Power Co., 466 F.2d 638, 647 (7th Cir. 1972)* ("It is undisputed that at common law a utility could cut off service for nonpayment of bills."); *Huff v. Electric Plant Bd. of Monticello, 299 S.W.2d 817 (Ky. 1957)* (generally accepted rule is that public service companies may adopt regulations providing for the discontinuance of service to a customer who fails to pay the bill).

(n4)Footnote 4. *See*, *e.g.*, *LeBeau v. Green Mountain Power Corp., 100 P.U.R.3d 337 (Vt. 1973)* (public utility may disconnect a customer's service for nonpayment of proper bills and charges even in the absence of statutory authority). *See also* 25 *Fla. Admin. Code Ann. r. 25-4.113(f)* (telephone companies) (utility may discontinue telephone service for nonpayment of bills for telephone service); *Mich. Admin. Code r. 460.2161(a)* (subject to the requirements of these rules, an electric or gas utility may shut off or terminate service to a residential customer because the customer has not paid a delinquent account that accrued within the last six years).

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1-11 Consumer Credit Law Manual § 11.11

§ 11.11 Protection From Disconnection

[1] Protection From Disconnection for Low-Income and Elderly Customers

The shut-off of utility service can have serious consequences for many customers, particularly in the winter months. Some utilities have built in protections for either elderly customers, low-income customers, or both, whereby the utilities cannot terminate service, particularly in the winter months.

[a] Winter Moratoria

A utility may also have a prohibition on shutting off service during certain winter months or when the temperature drops below a certain level, regardless of who the customer is--a restriction known as a winter moratorium on terminations. Most often the moratorium is limited to certain eligible customers, who may be either low-income, elderly, disabled, or a combination. The authority for such moratoria may be state statute, commission orders, or a utility's own rules.

Sometimes the moratorium is contingent on the customer's agreement to pay a certain portion of the delinquent bill each month, for example 7% of the bill in Michigan's Winter Protection Plan, and/or agree to apply for state or federal heating assistance. n1 If the customer then fails to abide by the payment agreement, the utility may disconnect service. n2 Recently, there appears to be a growing movement among utility regulators to adopt formal rules or informal policies to protect customers from termination during periods of extreme hot or cold weather. On October 27, 2005, the California Public Utilities Commission, anticipating "exceptionally high gas prices" in the coming winter, adopted new policies under which "utilities are prohibited from shutting off service this winter [of 2005-2006] to residential customers that make regular payments of at least 50% of their bills." n3

On November 21, 2005, the Arkansas Public Service Commission revised its General Service Rule 6.15 (the "Cold Weather rule"), which previously barred electric and gas terminations on days when temperatures are forecast to be 32 degrees or lower. The Commission added a new Rule 6.15.B that additionally prohibits gas utilities from terminating service, between November 1 and March 31, to low-income and elderly households who receive Food Stamps; Women, Infants and children Assistance ("WIC"); Transitional Employment Assistance; Medicaid; or LIHEAP (fuel assistance). n4

On December 15, 2005, the Missouri Public Service Commission adopted emergency amendments to its winter moratorium rule that reduced the amount of the minimum monthly payments necessary for low-income customers to avoid termination and waived late penalty fees and interest during the moratorium period. n5

On April 5, 2006, the Ohio Public Utilities Commission extended the coverage period of its 2005/-/2006 Winter Reconnect Order from April 14, 2006, to April 28, 2006, noting, *inter alia*, the sharp increase in energy prices. n6

[b] Special Protections for the Sick

In some cases, the protection against disconnection of utility service is targeted to customers who are seriously ill or disabled, and where the "discontinuance of service will result in some person residing at that residence becoming seriously ill or more seriously ill. ..." n7 In these cases, the customer will likely have to provide medical proof of the condition, and the protection may be for a limited period of time only (such as 30 or 60 days).

[c] Payment Plans

Recognizing the difficulty many low-income customers have in keeping up with full payments of their utility bills, some utilities offer plans which provide low-income customers the opportunity to enter into different payment schedules or arrearage forgiveness plans, compliance with which will eliminate the possibility of disconnection. n8 In addition, the rules of many commissions require a utility to offer some sort of payment schedule or budget billing (equal monthly payment) plan to low-income customers, n9 and generally prohibit termination of utility service as long as the customer is abiding by the terms of the payment plan. n10

[2] Utilities May Not Disconnect for a Disputed Bill Pending Resolution of Dispute

Just as a customer's right to utility service is not absolute and a customer's service may be terminated for nonpayment of the bill, a utility's right to disconnect service is not absolute. One limitation is the general prohibition against disconnecting utility service or threatening disconnection for a *disputed* bill pending the resolution of this dispute. This rule is found within the common law, n11 state statutes, and in commission decisions n12 and rules. n13 The rationale, in part, is that the disputed portion of the bill is a matter separate from the current bill which the customer owes, and that the utility cannot disconnect current service for this separate matter.

The courts generally agree that a utility may not terminate for a disputed bill, and further state that a wrongful termination of a bill in dispute subjects the utility to damages. n14

If a utility attempts to violate its legal duty to maintain service pending resolution of a billing dispute, a court may issue an injunction preventing it from carrying out a threat to terminate service or a writ of mandamus, or award damages, including compensatory, nominal, and punitive awards.

These rights to equitable remedies should be available in the courts *regardless* of whether the affected utility is also regulated by the public utility commission.

[3] Public Utility May Not Disconnect Service Based on a "Collateral" Matter

[a] What Constitutes "Collateral" Matter

Court decisions, as well as state utility regulations, generally hold that a public utility cannot terminate the service which it is authorized by its charter to furnish because of some collateral matter unrelated to that service. n15

The definition of precisely what is "collateral" to any particular utility service, however, has been indefinite at best, but includes debt from another service address, debt for a different type of service, or a third party's debt.

[b] Separate Business Run by Utility: Disconnection of Water for Nonpayment of Sewer Charges; Local and Long-Distance Telephone Charges

In this area, the general rule about collateral matters has been subject to several significant exceptions. Most commonly, commissions and courts have allowed disconnection of local service for nonpayment of long distance telephone charges owed to the same company (as well as nonpayment of local charges), n16 and have allowed disconnection of water for failure to pay a sewer (or garbage) bill. n17

[c] Third Party's Debt

[i] General Rule

Sometimes, a utility seeks to obtain payment from a customer for a debt with which the customer has no connection, or requires as a condition of continued service that the customer pay the debt owed by a person who lives with the customer. As a general rule, commissions have not allowed utilities to disconnect service of one party because of nonpayment by another party, sometimes even where the third party was a *guarantor*. n18 There are three common scenarios in which third party debt might cause problems for the current recipient of utility service.

[ii] Prior Occupant in Arrears

First is the situation where a customer moves into a new home, and the utility cuts off service at some point because of an arrears accrued by a prior occupant or owner. Many courts and commissions have not allowed the utility to cut-off service in such a situation. n19

[iii] Landlord-Tenant Situations

Generally, utilities are not allowed to disconnect a tenant's service for a landlord's indebtedness. n20

[iv] Roommate/Family Member/Spouse in Arrears

In general, again, the rule agreed upon by most commissions is that the utility may not disconnect service to one person based on the delinquency of another (roommate, partner, etc.), and that the utility may not prevent a customer from living with an individual who has a delinquent utility bill. n21

The courts and commissions have struggled more with the issue of whether a utility should be allowed to terminate service to a customer based on a third party's debt to the utility company, when the third party is the customer's spouse, because of the possible application of the "family purpose" or "family expense" doctrine to the payment of utility bills.

Most states have such a doctrine, either as a part of the common law or as a statutory enactment, which makes both husband and wife legally liable for the payment of expenses of the family, which would generally include utility service. Thus, if one spouse fails to pay, the other may be held liable. n22

The applicability of this doctrine varies from state-to-state. Many states do not apply the doctrine to parties who are separated in anticipation of divorce. The doctrine does not apply to unmarried "couples." Its application to common law marriages, in states which recognize these, may be more difficult to ascertain depending on relevant time periods, whether or not there has been judicial recognition of the marriage, etc. More specific utility statutes could also be relied upon to defeat a family expense argument under customary rules of statutory construction.

[4] A Utility May Not Disconnect to Collect a Mistaken Undercharge

[a] Mistaken Undercharges

This situation arises when, after months or years of undercharges (often due to simple billing errors), a mistake is discovered and the household is presented with a large lump sum bill, nonpayment of which will result in termination of service. The mistake often occurs due to simple billing errors.

Unfortunately, in the public utility context, most courts refuse to follow contract law on mistake and estoppel in the underbilling context because to do so would violate the strong public policy, as established by statute, against discriminatory rates. n23

Public utilities have a statutory and common law duty to provide service at non-discriminatory rates. This duty prohibits a utility from providing service at a rate less than the one published in its tariffs. Because of this obligation, the utility has not only the right, but also the duty, to collect the undercharge in cases arising from a mistake on the part of the utility. n24 In these instances, the mandatory duties of the public utility to adhere to its tariffs, to avoid discrimination, and to prevent the grant of rebates or other preferences, outweigh the doctrines of mistake and estoppel. n25 However, despite these obligations, a utility may still be estopped from using the disconnection of service as a collection device. n26

[b] The Doctrine of Estoppel

Notwithstanding the general estoppel doctrine, the principles of utility law prevent the use of an estoppel defense to avoid the *payment* of utility undercharges. However, at the least, the estoppel doctrine should be sufficient to force the utility to collect the undercharge through a court action, rather than by threatening to terminate service. The equitable principles incorporated in the doctrines of estoppel and mistake may be applied without violating the utility's obligation to collect its rates as filed. This strategy would allow the utility to collect the under-billing but prohibit the utility from using disconnection of service for non-payment of the under-billing as a collection device. Advocates should argue that the utility is permitted to use any legitimate collection device, except for the extraordinary and highly coercive use of monopoly power to withhold a necessity. The utility and the customer would thus share the burdens of the utility's mistake.

[c] Ban on Disconnection as Collection Mechanism

Allowing the utility to collect the underbilling using any other legitimate collection device, but prohibiting the utility from using disconnection of service for nonpayment of the underbilling as a collection device, is consistent with recent trends in the doctrine regulating the collection of undercharges by freight carriers. As in those cases, while recognizing the *right* to collect the undercharge, restrictions would be placed on the *manner of collection* under this theory. The courts in a recent series of carrier cases have softened the historically absolute rule on undercharge collections, and created judicial limits instead of *ipso facto* permitting the collection of an undercharge. n27

[d] Mandatory vs. Discretionary Practices

Advocates can also argue that disconnections in cases of underbilling is *discretionary* rather than *mandatory*, and, as such, courts are free to apply the doctrine of estoppel.

[e] Protection From Disconnection in Rules

In some states, commissions have promulgated rules that prohibit altogether the "backbilling" of customers when a meter registers lower usage. More frequently, rules prohibit utilities from backbilling customers for undercharges that are older than a specified time frame. n28 As an additional protection, some rules require utilities to offer payment plans if the customer does indeed have to pay the undercharge.

[f] Past Undercharges as Collateral Matters

Another approach is to argue that the undercharge is a collateral matter, and, thus, disconnection to collect this amount is barred by the traditional rule.

[5] Protection From Disconnection by Filing for Bankruptcy Protection

Filing a petition under the Bankruptcy Code will prevent a shut-off so long as the automatic stay is in effect.

[6] No Disconnection Based on Bills From Non-Approved Tariff

Another little-used defense arises when a utility company provides service and bills for that service, but has never had the tariff upon which the bill is based properly approved by the appropriate regulatory commission. In that situation, termination for nonpayment of the bill has been denied. n29

Legal Topics:

For related research and practice materials, see the following legal topics:
Energy & Utilities LawUtility CompaniesService Terminations

FOOTNOTES:
(n1)Footnote 1. Under Kansas' Cold Weather Rule, "customers are protected against disconnection from November 1 through March 31, if they make a good faith attempt to pay their bill--defined in this case as paying one-twelfth of the total owed the company to maintain service, and agreeing to pay all past bills in equal amounts over the next 11 months" (discussed in Phillips, The Regulation of Public Utilities, at 561).

(n2)Footnote 2. The same principle applies to elderly or ill customers. *See, e.g., Conn. Gen. Stat. § 16-262d (b)* (1988) (Telegraph, Telephone, Etc., Cos./Public Service Companies) (no company or utility shall terminate service for nonpayment when resident is seriously ill, provided customer agrees to amortize unpaid balance of account over reasonable period of time, and keeps current account).

(n3)Footnote 3. Interim Opinion Approving Various Emergency Program Changes in Light of Anticipated High Natural Gas Prices 2/-/3, D. 05-10-044 (Oct. 27, 2005), *available at* www.cpuc.ca.gov/WORD_PDF/FINAL_DECISION/50946.PDF.

(n4)Footnote 4. *In re* A Residential Utility Customer Cold Weather Disconnection Rule, Ark. Pub. Serv. Comm'n No. 05-121-R (Nov. 21, 2005), *available at* www.apscservices.info/PDF/05/05-121-r_28_1.pdf. The Commission's General Service Rules are available at www.apscservices.info/Rules/general_service_rules.pdf.

(n5)Footnote 5. *Mo. Code Regs. Ann. tit. 4, § 240-13.055*. Subsequently, several utilities challenged the legality of the emergency regulation, but the Court of Appeals upheld that regulation. State *ex rel. Missouri Gas Energy v. Public Serv. Comm'n, 210 SW 3d 330 (Mo. Ct. App. 2006)* .

(n6)Footnote 6. *In re* Investigation into Long-Term Solutions Concerning Disconnection of Gas and Electric Service in Winter Emergencies, Ohio Pub. Utils. Comm'n 05-1068-*GE-UNC, 2006 WL 870234* (Apr. 5, 2006).

(n7)Footnote 7. *See, e.g.,* 52 Pa. Code §§ 56.111 (Pennsylvania Emergency Provisions) (no utility shall terminate, or refuse to restore, service to any premises when any occupant therein is certified by a physician to be seriously ill or affected with a medical condition which will be aggravated by a cessation of service or failure to restore service); 16 Tex. Admin. *Code § 25.*29(g) (disconnection of electricity service for ill and disabled). *See also Mich. Admin. Code r. 460.2153* (medical emergency) (notwithstanding any other provision of these rules, a utility shall postpone the shutoff of service for a reasonable time, but not for more than twenty-one days, if the customer produces a physician's certificate or notice from a public health or social services official stating that the shutoff of service will aggravate an

existing medical emergency of the customer, a member of family, or permanent resident of premises).

(n8)Footnote 8. For a full discussion of payment plans, budget billing plans, energy assurance plans and the like, see National Consumer Law Center, Access to Utility Service (4th ed. 2008).

(n9)Footnote 9. *See, e.g.,* Nevada Rule 704.342 (utility shall provide a program for the payment of bills for customers who have difficulty paying their bills because of financial hardship).

(n10)Footnote 10. *See, e.g., Re Rules Regulating Services of Electric Utilities, 35 P.U.R.4th 365 (Colo. 1980)* .

(n11)Footnote 11. *See Tucker v. Hinds County, 558 So. 2d 869, 873 (Miss. 1990)* .

(n12)Footnote 12. *See, e.g., Artesian Water Co. v. Cynwyd Club Apts., 297 A.2d 387 (Del. 1972)* .

(n13)Footnote 13. *See, e.g.,* Michigan Rule 460.2151(3) (Time of Shutoff) (utility shall not shut off service while a customer is awaiting the resolution of a complaint with the commission or the utility in accordance with these rules). *See, e.g.,* Wash. Admin. Code § 480-120-081(5)(g) (telephone) (service may not be totally disconnected while a subscriber is pursuing any remedy or appeal provided for by these rules, provided any amounts not in dispute are paid when due; the phone company must inform the customer of this right).

(n14)Footnote 14. *Sims v. Alabama Water Co., 87 So. 688 (Ala. 1920)* (if public utility discontinues service for nonpayment of disputed amount, it does so at its peril, and if public utility was wrong, and customer overcharged, utility is liable for damages).

(n15)Footnote 15. Annot., *Right of Public Utility Corporation to Refuse Its Service Because of Collateral Matter Not Related to that Service,* 55 A.L.R. 771 (1928) ; Annot., *Right of Municipality to Refuse Services Provided by It to a Resident for Failure of Resident to Pay for Other Unrelated Services, 60 A.L.R.3d 714 (1974). See generally* National Consumer Law Center, Access to Utility Service, 11.4.1 (4th ed. 2008).

(n16)Footnote 16. *Re Calculation of Intrastate Access Charges, 109 P.U.R.4th 143 (Ill. 1990)* (dial tone denial allows local exchange telephone carriers to discontinue service to customers who refuse to enter into reasonable arrangements to pay undisputed local services or long distance charges). Note, however, that disconnection of local service for nonpayment of long distance charges owed to another carrier, and added to a local telephone bill, is not allowed. *Re Local Competition, Universal Service, and the Non-traffic Sensitive Access Rate, 181 P.U.R.4th 600 (Ky. PSC 1997)* (no denial of local telephone service for non-payment of toll service); *Re US West Communication Inc., 153 P.U.R.4th 350 (Utah PSC 1994)* (PSC denies telephone company request to disconnect local service for failure to pay long distance charges billed by local company; decision based on public policy of not allowing regulated utility to use its status to detriment of its customers to support an unregulated business-collection of debts for third parties); *Re Interstate Access Charges for Wyoming Telephone Utilities, 84 P.U.R.4th 524 (Wyoming PSC 1987)* (no disconnection of local service for nonpayment of long distance charges; partial payments to be applied in following sequence: per direction of customer or, if no direction, first to local basic exchange charges, then to intrastate LATA charges, then pro rata among long distance providers). *But see Allstates Transworld Vanlines v. Southwestern Bell Tel. Co., 937 S.W.2d 314 (Mo. Ct. App. 1996)* (company tariffs have force of law; tariff allowing disconnection of local telephone service (in 1982) for nonpayment of Yellow Pages bill upheld).

(n17)Footnote 17. *Edris v. Sebring Utils. Comm'n, 237 So. 2d 585 (Fla. Dist. Ct. App. 1970)* , *cert. denied, 240 So. 2d 643 (1970)* (discussing definition of "collateral service").

(n18)Footnote 18. *See, e.g., Re Service Deposit & Termination Practice of Communication Utilities, 34 P.U.R.4th 512 (Idaho 1980)* (telephone companies were not authorized to terminate service for the failure of a guarantor to pay a guaranteed utility bill).

(n19)Footnote 19. *See, e.g., Price v. South Central Bell, 313 So. 2d 184 (Ala. 1975)* (public utility company has no right to refuse service to a customer in order to compel that customer to pay the bill of a former subscriber, which it is not the duty of the customer to pay); *Cascade Motor Hotel, Inc. v. City of Duluth, 348 N.W.2d 84 (Minn. 1984)* (municipal ordinance allowing a municipal utility to terminate service to a current property owner because of arrearages incurred for service provided to a former owner was held arbitrary and unreasonable). *But see* Annot., *Liability of Premises, or Their Owner or Occupant, for Electricity, Gas, or Water Charges, Irrespective of Who Is the User, 19 A.L.R.3d 1227 (1968)*. Utility rules and regulations sometimes have this same protection built in.

(n20)Footnote 20. *Davis v. Weir, 497 F.2d 139 (5th Cir. 1974)* ; *Koger v. Guarino, 412 F. Supp. 1375 (E.D. Pa. 1976)* , *aff'd without op., 549 F.2d 795 (3d Cir. 1977)* (city practice of requiring tenants to pay landlord's delinquent water bills in order to avoid terminations of water service violated due process clause). At least one court has held that a utility *could* terminate service when the tables are turned, and it is the *landlord* whose service is terminated for delinquent *tenant* bills. *District of Columbia v. Mensh, 637 A.2d 514 (Md. Ct. Spec. App. 1994)* (under D.C. law, owners of multi-unit apartment building may be held personally liable for unpaid water and sewer service charges to their properties). *Cf. California Apartment Ass'n v. City of Stockton, 80 Cal. App. 4th 699* , *rev. denied, 2000 Cal. LEXIS 6750* (Cal. Aug. 23, 2000) (court finds invalid a city ordinance that attempts to impose liability on landlord or subsequent tenant for the unpaid water, sewer, and refuse bills of a tenant).

(n21)Footnote 21. *O'Neal v. City of Seattle, 66 F.3d 1064 (9th Cir. 1995)* (city policy of denying water service to tenant based on past tenant's unpaid bill violated equal protection; follows *Davis v. Weir, 497 F.2d 139 (5th Cir. 1974)* ; rejects *Ransom v. Marrazzo, 848 F.2d 398 (3d Cir. 1988))* ; *Donovan v. General Tel. Co., 19 P.U.R.3d 49 (Cal. 1957)* (telephone company cannot deny service because another member of the household is delinquent); *In re Tampa Elec. Co., 49 P.U.R.4th 547 (Fla. 1982)* (electric company can only hold the customer of record responsible for the customer's bill and cannot force another person, not legally responsible for the debt, to pay that debt to obtain or continue service); *Walton Elec. Membership Corp. v. Snyder, 270 Ga. 62, 508 S.E.2d 167 (1998)* , *aff'g 487 S.E.2d 613 (Ga. Ct. App. 1997)* (co-op acted tortiously and punitive damages could be awarded when co-op threatened to terminate service to member who married another member who was delinquent.); *Wright v. Southern Bell Tel. & Tel. Co., 169 Ga. App. 454, 313 S.E.2d 150 (1984)* (termination of service to parents home was wrongful when it was used to coerce them into paying son-in-law's debt); *Smith v. Tri-County Elec. Membership Corp., 689 S.W.2d 181 (Tenn. Ct. App. 1985)* (electric company policy of denying service to a customer when anyone owing on an old bill planned to live in the residence was held unreasonable, arbitrary, and violation of due process).

(n22)Footnote 22. *DiBello v. Illinois Commerce Comm'n, 610 N.E.2d 730 (Ill. App. Ct. 1993)* (spouse of customer of record liable for outstanding bill; service denial until spouse's bill paid/approved; decision based on Illinois family expense statute and prior Illinois case, *Peoples Gas Light & Coke v. Illinois Comm'n, 584 N.E.2d 341 (Ill. App. Ct. 1991))* . *But see Central Ill. Light Co. v. Illinois Commerce Comm'n, 562 N.E.2d 4 (Ill. App. Ct. 1990)* (gas and electric debts incurred by former and estranged husbands after separation were not a "family expense" for which wives were liable under "Family Expense Act"). *See generally* National Consumer Law Center, Collection Actions, § 5.3.4.3 (1st ed. 2008).

(n23)Footnote 23. *Shoemaker v. Mountain States Tel. & Tel. Co., 559 P.2d 721, 723-24 (Colo. Ct. App. 1976)* (to permit an undercharge would be to disrupt the uniform application of rates).

(n24)Footnote 24. *Memphis Light, Gas & Water Div. v. Auburndale Sch. Sys., Div. of Memphis, 705 S.W.2d 652 (Tenn. 1986)* .

(n25)Footnote 25. The equitable policy of estoppel may not outweigh these statutory directives. The application of these principles in the freight industry has often been discussed. *See, e.g.,* Annot., *Carrier's Understatement of Charges Where Discrimination Is Forbidden* (1963); Annot., *Carrier's Right or Liability in Respect of Excess of Lawful Charge Over Charge Understated Where Discrimination Is Forbidden*, 83 A.L.R. 245 (1933) . The courts rely on freight cases in deciding public utility cases. Annot., *Carriers Understatement of Charges Where Discrimination Is Forbidden, 88*

A.L.R.2d 1375 (1963). See also National Consumer Law Center, Access to Utility Service, 11.6 (3rd ed. 2004 and Supp.).

(n26)Footnote 26. *See* Colton, *Protecting Against the Harms of the Mistaken Utility Undercharge*, 39 J. Urb. Aff. 99 (1991).

(n27)Footnote 27. *See, e.g., Interstate Motor Freight Sys., Inc. v. Wright Brokerage Co., 539 S.W.2d 764, 766-67 (Mo. Ct. App. 1976)* .

(n28)Footnote 28. Florida, for example, has included this rule in its regulatory scheme: 25 *Fla. Admin. Code Ann. R. 25-7.0851* (gas utility may not backbill customers for any period greater than 12 months for any undercharge in billing which is the result of the utility's mistake).

(n29)Footnote 29. *Popowsky v. Pennsylvania Public Util. Comm'n, 647 A.2d 302 (Pa. Commw. Ct. 1994)* (where utility company failed to get approval of its tariff before billing customer, Commission order requiring the customer to pay the bill or face termination was reversed; no bill owed because charges not lawful).

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1-11 Consumer Credit Law Manual § 11.12

§ 11.12 Public Utility May Not Disconnect Service Without Providing Prior Adequate Notice

[1] Right to Notice

[a] Common Law and Regulatory Restrictions

The common law routinely has conditioned the exercise of a disconnection of service upon the proper issuance of a pre-disconnection notice. n1 Some cases have held that damages were recoverable for terminating services without notice. n2 A contract by a public utility with its customer is an agreement to furnish service for an indefinite period of time. n3 An implied term of such a contract is that service will not suddenly be terminated without reasonable notice. n4 This duty has been codified in tariffs approved by public utility commissions and rules issued by commissions governing billing and collection of residential accounts.

[b] Constitution: Due Process

In some situations, there may be constitutional requirements as well, if state action is present. This would generally be true if the utility company was a municipality or if the shutoff were made pursuant to some sort of specific state agency order. In run of the mill private regulated utility shutoffs, no state action is present.

[2] What Constitutes Sufficient Notice

[a] Due Process Requirements

In *Memphis Light, Gas and Water Division v. Craft*, n5 the Supreme Court held that Due Process requires a utility to provide its customers with at least notice n6 of the proposed disconnection, the reason for this action, and information about how to protest the shutoff at a hearing n7 prior to the termination of utility service. Other courts have followed this lead. n8

[b] Regulatory Requirements

Under state statutes and commission regulations, regulated utilities, as well as some municipal utilities, have very specific guidelines about what to include in a notice to a customer regarding a proposed disconnection. These

requirements overlap substantially with what courts have held due process standards to require. Below are examples of the detailed information required in a shut-off notice:

> (a) The name and address of the customer and, if available, the address at which service is provided, if different.
>
> (b) A clear and concise reason for the proposed shut-off of service.
>
> (c) The date on or after which the utility may shut-off service, unless the customer takes appropriate action.
>
> (d) That the customer has the right to enter into a settlement agreement with the utility if the claim is for an amount that is not in dispute and the customer is presently unable to pay in full.
>
> (e) That the customer has the right to file a complaint disputing the claim of the utility before the proposed date of the shut-off of service.
>
> (f) That the customer has the right to request a hearing before a utility hearing officer if the complaint cannot be otherwise resolved and that the customer must pay to the utility that portion of the bill that is not in dispute within three days of the date that the customer requested a hearing.
>
> (g) That the customer has the right to represent himself or herself, to be represented by counsel, or to be assisted by other persons of his or her choice in the complaint process.
>
> (h) That the utility will not shut-off service pending the resolution of a complaint that is filed with the utility in accordance with these rules.
>
> (i) The telephone number and address of the utility where the customer may make inquiry, enter into a settlement agreement, or file a complaint.
>
> (j) That the customer should contact a social services agency immediately if the customer believes he or she might be eligible for emergency economic assistance.
>
> (k) That the utility will postpone the shut-off of service if a medical emergency exists at the customer's residence.
>
> (l) That the utility may require a deposit and restoration charge if the utility shuts off service for nonpayment of a delinquent account.
>
> (m) That the customer should contact the utility for information about a winter protection plan if the date on or after which shut-off of service may occur is between November 15 and March 31. Regulations sometimes require utilities to include with the notice of termination information on programs available to help pay the bill.

[c] Timing of Notice

In general, to comply with due process, a municipal utility must provide notice sufficiently in advance to permit the customer adequate time to prepare for and be present at the hearing.

State statutes governing utilities, as well as utility regulations and rules, often provide specific requirements on what

constitutes sufficient notice, usually 10-15 days. n9

[d] Receipt Requirements

In addition to the time restraints discussed above, many commissions have specific requirements on the method of providing the notice. Commissions generally require utilities to provide notice by first class mail, or sometimes by certified mail.

In addition, utilities sometimes require personal receipt of the notice, or personal contact by telephone, if possible, before disconnecting utility service. Some states require that notice be provided to a third party when the customer is either elderly or disabled. n10

In the move to recognize electronic signatures and writings, advocates should be aware that notices of utility disconnections must still be provided in hard copy under federal law. The federal Electronic Signatures in Global and National Commerce Act (E-Sign) n11 has a specific exemption for utility notices of disconnections. n12 Many states' electronic transaction laws also exempt utility disconnections, n13 and those states without the specific exemption for disconnection notices may be preempted by the more protective federal E-Sign. n14

[3] Is Notice to Actual User Required?

[a] Tenants and Master-Meter Situations

Many utility regulations have built-in protections for the utility customer whose landlord is responsible for the bill, such as requiring notices to be mailed to each individual tenant of a single-metered, multi-unit dwelling, or requiring the utility to post notice of the disconnection in a common area as well.

The utilities are often required to provide the tenant the opportunity to start service in his or her own name, *without* having to pay the back delinquency of the landlord, and, if so, the notice should inform the customer of this right. In addition, the tenant may be exempt from the normal requirement of having to pay a security deposit to receive continued service. Furthermore, if utility service is included in the rent, a tenant may be able to deduct the payments for utilities from the rent.

Legal Topics:

For related research and practice materials, see the following legal topics:
Constitutional LawBill of RightsFundamental RightsProcedural Due ProcessScope of ProtectionEnergy & Utilities LawElectric Power IndustryState RegulationGeneral OverviewEnergy & Utilities LawUtility CompaniesContracts for ServiceEnergy & Utilities LawUtility CompaniesService Terminations

FOOTNOTES:
(n1)Footnote 1. *See generally* 64 Am. Jur. 2d *Public Utilities* § 62 (1972).

(n2)Footnote 2. *See, e.g., Mississippi Power Co. v. Byrd, 133 So. 193, 194 (Miss. 1931)* , *overruled in part by First Nat'l Bank v. Langley, 314 So. 2d 324 (Miss. 1975)* . The defendant power company negligently cut off the electric current to the plaintiff's home for two days. As a result, plaintiff claimed he suffered "mental pain." However, because there was no mention of any accompanying or subsequent *physical* injury, the court held that damages for *mental suffering* cannot be recovered where caused by simple negligence, and where there is no bodily injury, malice or fraud. The court focused on the lack of evidence that the plaintiff suffered any physical injury on account of being deprived of electric light for two days.

(n3)Footnote 3. *Cates v. Electric Power Bd., 655 S.W.2d 166, 170 (Tenn. Ct. App. 1983)* .

(n4)Footnote 4. *Cates v. Electric Power Bd., 655 S.W.2d 166, 170 (Tenn. Ct. App. 1983)* (citing *First Flight Assocs., Inc. v. Professional Golf Co., 527 F.2d 931 (6th Cir. 1975)* ; *Chattanooga R. & C.R. Co. v. Cincinnati, N.O. & T. P. Ry. Co., 44 F. 456 (C.C.D. Tenn. 1890))* .

(n5)Footnote 5. *436 U.S. 1, 98 S. Ct. 1554, 56 L. Ed. 2d 30 (1978)* .

(n6)Footnote 6. *See also Davis v. Weir, 497 F.2d 139, 143 (5th Cir. 1974)* (Fifth Circuit did not have to consider whether property interest existed because the municipality conceded on appeal that it had a duty to provide the actual user with notice prior to termination).

(n7)Footnote 7. *But see Rupp v. Grantsville City, 610 P.2d 338, 341 (Utah 1980)* (where there was no dispute of fact, plaintiff residents had refused to pay connection fee, city officials discontinued water service pursuant to city ordinance allowing such actions for enforcement of mandatory sewer connection ordinance, and plaintiffs afforded adequate notice of action (several letters notifying them of the consequences of their continuing failure to comply), protections do not require right to pre-termination hearing).

(n8)Footnote 8. *Turpen v. City of Corvallis, 26 F.3d 978 (9th Cir. 1994)* (tenant had due process right to notification before disconnection for landlord's failure to pay; followed *DiMassimo v. City of Clearwater, 805 F.2d 1536 (11th Cir. 1986)* ; entitlement to notice based on property interest under Oregon Landlord and Tenant Act, *Or. Rev. Stat. § 90.320(1)(c)*).

(n9)Footnote 9. SeeAlaska Admin. Code tit. 3, § 52.450(c)(1) & (2)(15 days); *Fla. Admin. Code Ann. r. 25-4.113(1)(e)* (5 working days); *Mich. Admin. Code r.460.2163(1)* (10 days); *16 Tex. Admin. Code § 25.29(k)(3)*(10 days); *Conn. Gen. Stat. § 16-262d(a)* (13 days).

(n10)Footnote 10. *Cal. Pub. Util. Code § 10010.1 (c)* (Municipally Owned Utilities) (Public utility shall make available third-party notification service to elderly (65+) or dependent adults).

(n11)Footnote 11. Pub. L. No. 106-229, *114 Stat. 464 (2000)* (codified at *15 U.S.C. §§ 7001 et seq.*).

(n12)Footnote 12. *15 U.S.C. § 7003(b)(2)(A).*

(n13)Footnote 13. *See, e.g., Cal. Civ. Code § 1633.3(c). See also* National Consumer Law Center's Consumer Banking and Payments Law (3rd ed. 2005 and Supp.).

(n14)Footnote 14. *See* Gail Hillebrand & Margot Saunders, E-Sign and UETA: What Should States Do Now?, *available at* www.consumerlaw.org/e_sign.html (Sept. 2000).

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§ 11.13 Meter Tampering Issuesn1

[1] No Notice Required

Generally, a utility may terminate service without notice if it is discovered that the customer has engaged in fraud of any kind, for example, tampering with the meter or misrepresenting one's identity for the purpose of obtaining or evading payment of utility service. This is an exception to the general rule requiring notice prior to termination.

[2] Presumptions

In general, a utility may engage in the presumption that the possession of a meter with a tampering device was installed by the person in possession. However, the presumption is not irrebuttable and, in any event, there must be *exclusive* possession for the presumption to arise. In situations where others have an equal right and facility of access to the property, use of the presumption is inappropriate.

Legal Topics:

For related research and practice materials, see the following legal topics:
Energy & Utilities LawUtility CompaniesService Terminations

FOOTNOTES:
(n1)Footnote 1. *See* National Consumer Law Center, Access to Utility Service, § 5.3 and 11.2.2 (4th ed. 2008).

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1-11 Consumer Credit Law Manual § 11.14

§ 11.14 Recourse for Wrongful Disconnection

[1] Available Remedies

Consumers whose utility service has been unlawfully disconnected by a utility company have different remedies available:

- They may apply to a court for a mandamus to compel the restoration of service; n1 or
- They may seek an injunction in a court to prevent the utility from carrying out a threat to terminate service; n2 or
- They may sue for damages; or n3
- They may seek damages in a court action and simultaneously proceed before the commission, seeking a penalty, to be paid to the state, pursuant to commission rules or statutes. Sometimes these penalties can be very substantial; or n4
- They may seek protection from the utility commission under its dispute resolution procedures, including reconnection or a ban on disconnection until the matter is resolved. In these situations, a lawsuit can be brought under either or both breach of contract or tort theories. n5

[2] Disconnections as Torts

[a] Duty

A public utility holding a franchise has a duty to serve all members of the public "who apply for and have made the necessary arrangements to receive service, and who pay or offer to pay the price and abide by the reasonable rules and regulations of the company" n6 and to exercise reasonable care to fulfill its obligation to provide continuing service. This degree of care is heightened by the recognition that electric, gas, and water services are essentials of life and the deprivation of such services is likely to be detrimental to life, health, and property. n7

A utility's duty to provide continuous service extends to persons beyond its "customers." As a result, a variety of persons have standing to sue a utility for disconnection-related torts if they have suffered *injury in fact* to a legally protected interest.

[b] Breach

[i] The Standard

Utility companies breach their duty of care to customers and third parties when they fail to act "reasonably" with regard to utility disconnections. Whether the utility has acted reasonably is analyzed on a case-by-case basis.

[ii] Disconnection of Service as Negligence *Per Se*

It is reasonable to argue that the disconnection of service in violation of a state statute or administrative regulation requiring either uninterrupted service or specific interruption notice procedures rises to the level of negligence *per se*, although this is not universally accepted by the courts.

Under this reasoning, a utility company's statutory duty to provide uninterrupted service generally and to adhere to specific notice procedures in cases of lawful service termination can be argued to constitute "safety standards." The indispensable nature of utility service in basic life functions bolsters this argument. Without unencumbered access to utilities, the health and safety of effected persons are gravely compromised.

The advantage of arguing that violation of shut-off regulations constitutes negligence *per se* is that it eliminates the issue of "negligence" as an issue in fact.

[c] Causation

[i] Actual Cause

Advocates must carefully determine what shut-off requirements have allegedly been violated. A clear causal relationship between the violation and the ensuing harm must be established.

[ii] Legal (Proximate) Cause

To hold the utility company liable for negligence, the disconnection must also constitute the proximate cause of the harm. Whether a disconnection was the proximate cause of the harm to the utility consumer is strictly a question of foreseeability. At the time of its actions, if the utility could reasonably foresee that the shut-off would result in the damages incurred by the consumer, then the proximate cause requirement has been satisfied. This is not an overly demanding standard, as most damages that flow from a wrongful utility shut-off are foreseeable, due to the nature and importance of uninterrupted utility service. n8

[d] Damages

Damages can include compensatory, nominal, and punitive awards where appropriate. In addition, if it is built into the state's statutory scheme, on occasion, consumers may be entitled to additional damages. A customer to whom a public utility has wrongfully terminated service is entitled to recover actual damages proximately caused by the wrongful action. n9 These recoverable damages may include the customer's:

- Discomfort, annoyance, and inconvenience;
- Embarrassment and humiliation;

- Temporary loss of use or rental value of property;
- Value of appliances, furniture and other personal property destroyed or damaged;
- Value of foodstuffs destroyed;
- Incidental expenses (such as motel expenses) directly caused by the shut-off; and
- The cost of obtaining power from another source. n10

Advocates can also argue that reconnection should be provided free of charge.

In addition, if the utility acted in "reckless disregard of the rights" of the customer, the utility may also be liable for punitive or exemplary damages.

[e] Limiting Liability Through Tariff: Legitimate Practice or Contrary to Public Policy?

A utility may seek to limit its liability by placing such a limitation in its tariff. n11 Some courts have disapproved such attempts as contrary to public policy; others have upheld them. n12

A court in South Dakota, in the case *Mobile Electronic Serv., Inc. v. Firstel, Inc.,* n13 held that a local telephone company's attempt to limit its liability for negligent acts by tariff was an unenforceable contract of adhesion. In that case, a business sued the local phone company for breach of contract and negligence for failing to change the business's listing from unlisted to listed. The court refused to allow the phone company's attempt to limit its liability by unilaterally drafting and filing a tariff with the PUC and incorporating it by reference in its preprinted contract. The court cited a prior decision:

> '[T]he PUC cannot become a body to regulate claims for damages wrought in private contract. To regulate tariffs, schedules, directories, and listings is one thing, but to adjudicate on monetary rights arising thereunder is conceptually different.' [citations omitted] n14

The recent detariffing of long-distance service by the Federal Communications Commission has resulted in a lower court ruling in California that found AT&T's legal remedies provisions "that eliminate class actions, sharply curtail damages in cases of misrepresentation, fraud, and other intentional torts, cloak the arbitration process with secrecy and place significant financial hurdles in the path of a potential litigant," unlawful under the state's Consumer Legal Remedies Act and Unfair Competition Law. n15

[f] Mitigation of Damages: A Condition Precedent to Recovery

Customers seeking judgments for unlawful disconnections must attempt to mitigate their damages unless the cost of mitigating damages, such as procuring an alternate energy supply, is out-of-proportion to the damages or is otherwise unreasonable.

Legal Topics:

For related research and practice materials, see the following legal topics:
Energy & Utilities LawImplied CovenantsReasonable Care & DiligenceEnergy & Utilities LawPurchase ContractsRemedies for BreachEnergy & Utilities LawUtility CompaniesContracts for ServiceEnergy & Utilities LawUtility CompaniesLiabilityEnergy & Utilities LawUtility CompaniesService TerminationsTortsNegligenceProofElementsTortsNegligenceProofViolations of LawStatutes

FOOTNOTES:

(n1)Footnote 1. At common law, this was generally true where the situation was the wrongful termination of a bill in dispute. *See* Annot., *Mandamus as Proper Remedy to Compel Service by Public Utility*, 83 A.L.R. 917 (1933) .

(n2)Footnote 2. *See Hall v. Village of Swanton, 35 A.2d 381 (Vt. 1944)* (injunction will ordinarily be granted to prevent a public service corporation from wrongfully shutting off light, which such corporation is under contract to furnish, on the theory that the remedy at law is inadequate and that the shutting off of the supply would cause irreparable injury).

(n3)Footnote 3. *Trigg v. Middle Tenn. Elec. Membership Corp., 533 S.W.2d 730 (Tenn. Ct. App. 1975)* (electric company has the right to cut off service to a customer for nonpayment of a just service bill, but if the customer has a bona fide dispute concerning the correctness of the bill, the electric company discontinues services for nonpayment of the disputed amount at its peril, and, if the company is wrong, it is liable for damages).

(n4)Footnote 4. *See, e.g., Utah Code § 54-7-25* (utility violation of any statute or commission rule subject to penalty of $500-$2000 for each offense; for continuing offenses, each day is a separate offense).

(n5)Footnote 5. *See generally* Colton, *Unlawful Utility Disconnections as a Tort: Gaining Compensation for the Harms of Unlawful Shutoffs*, 22 Clearinghouse Review 609 (1989); *Lynn v. Houston Lighting & Power, 820 S.W.2d 57 (Tex. App. 1991)* (court, not Public Utility Commission, has exclusive jurisdiction over tort damage claims for wrongful disconnection after meter tampering dispute).

(n6)Footnote 6. Annot., *Liability of gas, electric or water company for delay in commencing service,* 97 A.L.R. (1935).

(n7)Footnote 7. *See, e.g., Consolidated Edison Co. v. Jones, 444 N.Y.S.2d 1018 (1981)* . Indeed, a number of utility tort cases indicate that, because of the consequence of the action, a utility owes the "highest standard of care" when seeking to terminate service. *Kohler v. Kansas Power & Light Co., 387 P.2d 149, 151 (Kan. 1963) . Accord Washington Gas Light Co. v. Aetna Cas. & Sur. Co., 242 A.2d 802, 804 (Md. Ct. Spec. App. 1968)* .

(n8)Footnote 8. *See Kuns v. City of Ukiah, 79 Cal. App. 4th 899, 94 Cal. Rptr. 2d 359 (2000)* , *op. withdrawn by order of ct. 2000 Cal. LEXIS 5603* (Cal. July 19, 2000) (jury question as to proximate cause was presented by these facts: A utility company shut off a delinquent customer without the required, final forty-eight-hour notice. The customer presented evidence that she might have been able to raise the money from friends or social service organizations within forty-eight hours, as she had done before several times. A candle, left unattended in a potted plant hung over the couch, started a fire which killed four children.), *modified, reh'g denied, 80 Cal. App. 4th 602b (2000), op. withdrawn by order of ct., review denied, 2000 Cal. LEXIS 5603 (Cal. 2000)* .

(n9)Footnote 9. Annot., *Measure and Amount of Damages For Breach of Duty to Furnish Water, Gas, Light or Power Service,* 108 A.L.R. 1174 (1937) .

(n10)Footnote 10. *See Wrongful Termination of Electric Service*, 15 Am. Jur. 2d *Proof of Facts* 125, 147 (1978).

(n11)Footnote 11. *See, e.g., Veals v. Consolidated Edison Corp., 452 N.Y.S. 2d 153, 155 (1982)* (with citations); *see also Landrum v. Florida Power & Light Co., 505 So. 2d 552, 553-54 (Fla. Dist. Ct. App. 1987)* (with citations).

(n12)Footnote 12. *See also Re Illinois Bell Switching Station Litig., 641 N.E.2d 440 (Ill. 1994)* (after fire at telephone company interrupted service for one month, customers sued in tort for economic losses under state public utilities act making utilities liable for all losses resulting from violation of act; tariff had "service interruption clause" which was enforceable, thus, damages limited to rebate of costs for missed service).

(n13)Footnote 13. *649 N.W.2d 603, 2002 S.D. 87 (2002)* .

(n14)Footnote 14. *649 N.W.2d 603, 2002 S.D. 87 (2002)* .

(n15)Footnote 15. *Ting v. AT&T, 182 F. Supp. 2d 902, 938-39 (N.D. Cal. 2002)* . For more information on tariff, detariffing, and telecommunications services falling outside of tariffs, see National Consumer Law Center, Access to Utility Service, § 2.8 (3rd ed. 2004 and Supp.).

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§ 11.15 Tenants' Rights Where Landlord Fails to Pay Utility

[1] Common Law

Generally, tenants are not subject to termination or deprivation of utility service where their landlord fails to pay the utility bills. This conclusion comes from a number of different sources.

It is fairly clear in the common law that a utility cannot make one customer liable for the debts of another in the absence of a statutory or contractual basis. n1 Many utility commissions have relied on the same concepts to arrive at similar conclusions.

There is also ample law from various jurisdictions holding that a utility may not deny service to a tenant for the tenant's failure to pay the landlord's past due utility bill. Notice of the intended termination of service to a tenant because of a landlord's overdue bill is generally also required.

[2] Implied Warranty of Habitability

[a] Overview

The implied warranty of habitability, which has been adopted in at least 44 states, is the modern linchpin of remedies for the tenant deprived of utility service for which the landlord is responsible. In addition, about two-thirds of the states have adopted specific statutes protecting tenants from utility terminations by landlords. About one-half of the states have special statutes and regulations limiting utility company terminations of service to tenants.

The protection of the warranty of habitability is not confined to conditions that are so gross that the premises are literally uninhabitable; rather, the warranty mandates a standard for the conditions of the leased premises, and generally incorporates the conditions promised in the lease agreement. The requirements of the local housing code are also generally included.

[b] Application of the Warranty of Habitability

The warranty of habitability is grounded in the twin principles that 1) a landlord is obligated to provide livable and

useable residential space in return for the rent, and 2) the landlord's material breach of this obligation diminishes the value of the premises, and, thus, the rent owed by the tenant.

Tenant self-help remedies for code violations, such as rent withholding, are in addition to criminal proceedings against the landlord and enforcement proceedings by local officials. All such action may occur concurrently, and the tenant generally can proceed for relief for code violations without any action being taken by local officials.

The landlord's liability for a material breach affecting habitability generally runs from the time that notice of the defect is provided to the landlord. n2 When utilities are shut off or threatened to be shut off because of nonpayment by the landlord, the landlord has actual knowledge since the landlord both knows he or she did not pay, and he or she should have received notice from the utility company of the threatened shut off for nonpayment.

[c] Jurisdictions Adopting the Warranty of Habitability

The warranty of habitability is almost universally accepted, either by case law or statute, often the Uniform Residential Landlord and Tenant Act. n3 Only four states have not formally recognized the warranty. Alabama, Arkansas, Colorado, and Wyoming do not recognize an implied warranty for housing. n4 Arkansas and Mississippi may also hold that the covenant of quiet enjoyment implied in residential leaseholds comprehends a remedy for a deprivation of landlord-supplied utility service. n5 Wyoming has no recent case law addressing this issue.

In most jurisdictions, there is no doubt that a termination or threatened termination of utility service due to the landlord's failure to pay his or her utility service constitutes a sufficient threat to the health, safety, or welfare of inhabitants to constitute a breach of the warranty. n6

[d] Waiver

The warranty, in most jurisdictions which have adopted it, may not be waived by any provision in the lease or rental agreement. n7

[e] Remedies for Breach of Warranty of Habitability

Punitive damages may be awarded when the breach is willful, wanton, or fraudulent. Most important, injunctive relief is generally available to force the landlord to bring the unit in compliance with codes in order to prevent a threat to the health, safety, or well-being of the occupants of the unit.

In jurisdictions which subject landlord-tenant relations to UDAP statutes, additional UDAP remedies may be obtained for the landlord's breach of the implied warranty of habitability, and the landlord's violation of state or local housing codes may constitute a *per se* UDAP violation. n8 In many instances, punitive damages for intentional infliction of emotional distress may also be available. n9

The failure to provide basic utilities, such as heat or hot water, has been held to be a substantial violation of the warranty of habitability resulting in substantial rent abatements. n10

[f] Serious Code Violations Violate Warranty of Habitability

A landlord's failure to substantially comply with applicable building and housing code standards which materially affect health and safety constitutes a breach of the warranty of habitability. n11

[3] Specific Statutory Protection Against Utility Termination

Many jurisdictions, including those which have adopted the Uniform Residential Landlord Tenant Act ("URLTA"),

have specific provisions which provide a tenant with a specific remedy against a utility shut-off. Wrongful termination of utility service will entitle a tenant to actual damages, as well as reasonable attorney's fees.

Similarly, many other states have laws which impose civil or criminal liability upon a landlord's failure to provide utility service to the rental units where the landlord is billed for the service. Other laws provide for self-help remedies against the landlord in the form of rent withholding, or the right to pay the utility directly and deduct the amount of the payment from the rent.

For example, Massachusetts law n12 prohibits the termination of gas or electric service in any unit where the tenant is not the customer of record unless the utility first provides notice as required in the law and complies with the implementing regulations of the Department of Telecommunications and Energy. n13 The same law requires notice to each affected tenant (1) stating the amount due on the account; (2) specifying the date on or after which service will be terminated, which must be no less than 15 and no more than 30 days after the date of the notice; and (3) advising the tenants of their right to pay the amount due, or such portion prescribed by the Department as due under its regulations, to avoid termination and the right to recover any amount so paid from the person to whom rent is paid. Service may not be terminated if the tenant pays the full amount due or such amount as is acceptable to the utility company or deemed sufficient by the Department.

The Department's implementing regulations specify the procedures companies must follow to identify accounts with "landlord customers paying for service to a residential building" and to identify the apartment numbers and addresses of any tenants who may be affected by a planned termination of a landlord-paid account. n14 The regulations also contain more detailed requirements than the statute for providing notice to landlords and, separately, to tenants prior to any termination of a landlord-paid account. n15 The utility must also provide separate notice to the Department's consumer division prior to proceeding with any termination. The Department has often ordered service to remain on, based on payment by tenants of something less than the full amount due from the landlord.

In Maine, utility terminations of service to tenants for the landlord's non-payment are only permitted after the tenant has been provided notice and an opportunity to assume responsibility for future service; the tenant is not liable for the landlord's old bill; payments by the tenant to the utility can be deducted from the rent. n16 Another statute requires the Utility Commission to have rules regarding when residential customers are subject to utility termination, including prior notice, the right to an installment payment plan and no terminations during a medical emergency. n17

[4] Special Public Utility Statutes

Many states have special statutes or utility regulations concerning a landlord's termination of service, either directly or as a result of nonpayment.

[5] Protection Against Reprisal

To protect all of these rights adopted for the benefit of tenants, most states have prohibited retaliation by the landlord against the tenant.

[6] Repair and Deduct

In some states, specific statutes have been adopted which allow tenants to pay overdue utility bills on the landlord's account, and deduct the amount of the payment from rent obligations in order to prevent service termination. n18 Many states allow by statute, or as a common law adjunct to the warranty of habitability, n19 the tenant to repair defective conditions and to deduct the cost of repairs from the rent. This remedy is generally broad enough to allow tenants to pay such portion of the landlord's *utility* arrearage as is necessary to maintain service and to deduct the payment from rent.

[7] Application of Constitutional Principles

When the terminating utility company is a state actor, constitutional due process requires that notice and an opportunity to be heard to contest the termination be provided. Indeed, a number of cases have held that it is unconstitutional for a city utility to terminate service to a tenant for the landlord's failure to pay the utility bill. n20

[8] Public Utility Commission Rules and Orders

Many public utility commissions have issued rules or orders specifically regarding the termination of utility service supplied by the landlord. n21

Legal Topics:

For related research and practice materials, see the following legal topics:
Energy & Utilities LawAdministrative ProceedingsPublic Utility CommissionsGeneral OverviewEnergy & Utilities LawElectric Power IndustryState RegulationGeneral OverviewEnergy & Utilities LawUtility CompaniesService TerminationsReal Property LawLandlord & TenantTenant's Remedies & RightsWarranty of Habitability

FOOTNOTES:
(n1)Footnote 1. *Cascade Motor Hotel, Inc. v. City of Duluth, 348 N.W.2d 84 (Minn. 1984)* (municipal ordinance allowing a municipal utility to terminate service to a current property owner because of arrearages incurred for service provided to a former owner was held arbitrary and unreasonable).

(n2)Footnote 2. *Detling v. Edelbrook, 671 S.W.2d 265 (Mo. 1984)* .

(n3)Footnote 3. At least forty-seven jurisdictions have adopted or otherwise given effect to an implied warranty of habitability by common law or by statute. Smith, *Tenant Remedies for Breach of Habitability, 35 U. Kan. L. Rev. 505 (1987). See, e.g., Johnson v. Grand Cru Prop. One Ltd. P'ship, 49 Pa. D. & C.4th 531 (Pa. Com. Pl. 2000)* (tenants whose electricity had been terminated for nonpayment were certified as a class in a lawsuit alleging breach of warranty of habitability, breach of covenant of quiet enjoyment, fraud, and negligent misrepresentation among other causes of action). In those states which do not recognize the implied warranty as such, relief may be available based on a theory of express warranty. *See Mendenhall-Moore Realtors v. Sedoris, 89 N.C. App. 486, 366 S.E.2d 534 (1988)* , on a narrower theory that recognizes a landlord's duty to maintain those items which are his exclusive control, including utility service; *Marsh v. Riley, 118 W. Va 52, 188 S.E. 748 (1936)* . On a breach of the covenant of quiet enjoyment, see *Bedell v. Los Zapatistas, 805 P.2d 1198 (Colo. Ct. App. 1991)* and *Morrison v. Smith, 757 S.W.2d 678 (Tenn. Ct. App. 1988)* . For codification of an implied warranty of habitability for provision of utility service on public health grounds, see Mass. Regs. Code tit. 105, § 410.750.

(n4)Footnote 4. *See Kitchens v. U.S., 604 F. Supp. 531, 535 (M.D. Ala. 1985)* ; *Murphy v. Hendrix, 500 So. 2d 8 (Ala. 1986)* ; *Martin v. Springdale Stores, 354 So. 2d 1144* , *cert. denied*, *354 So. 2d 1146 (Ala. Civ. App. 1978)* ; *Sanders v. Walker, 767 S.W.2d 526 (Ark. 1989)* ; *Bedell v. Los Zapatistas, Inc., 805 P.2d 1198, 1200 (Colo. 1991)* ("implied warranty of habitability does not exist" in Colorado); *Duncan v. Schuster-Graham Homes Inc., 578 P.2d 637 (Colo. Ct. App. 1978)* (limiting class of purchasers entitled to protection of the implied warranty to purchasers of new housing); *Ortega v. Flaim, 902 P.2d 199, 203 (Wyo. 1995)* ("Wyoming ... has not judicially recognized an implied warranty of habitability for rental premises"); Thomley, The Implied Warranty of Habitability in Residential Leases: Alabama's Unwarranted Position, *22 Cumberland L. Rev. 73, 79 n.30 (1991).*

(n5)Footnote 5. *See* 300 Spring Building v. Matthews, No.CA-89-211 1990, Ark. App. LEXIS 112 (Ark. App. Feb. 21, 1990) (landlord breached covenant of quiet enjoyment in commercial lease by failing to provide heat, drinking water and janitorial service); *Seymour v. Evans, 608 So. 2d 1141 (1992) . See also Blagg v. Fred Hunt, Inc., 272 Ark. 185, 612 S.W.2d 321 (1981)* .

(n6)Footnote 6. *Parker 72d Assocs. v. Isaacs, 436 N.Y.S.2d 542 (1982) . See also Davidow v. Inwood N. Prof. Group, 747 S.W.2d 373 (Tex. 1988)* (loss of electricity due to landlord's failure to pay bill); *Adams v. Gaylock, 378 S.E.2d 297 (W. Va. 1989)* (lack of electric service). A three month rent abatement was awarded for 18 days of no heat and hot water, no light in common hallway, and defective intercom system, in addition to garbage in common hallway for a year and roach-infested kitchen. *Estate of Romanow v. Heller, 469 N.Y.S.2d 876 (1983) . See also Leeris Realty Corp v. Robbin, 408 N.Y.2d 166 (1981)* (court held that the most serious breach was the failure to provide heat and hot water for a month; damages were measured by the difference in value of apartment with and without the services; the court awarded a 61% rent reduction for the period the services were out in September-October).

(n7)Footnote 7. *See, e.g., George Washington Univ. v. Weintraub, 458 A.2d 43 (D.C. 1983) .*

(n8)Footnote 8. *See generally* National Consumer Law Center Unfair and Deceptive Acts and Practices, § 3.2 (6th ed. 2004 and Supp.).

(n9)Footnote 9. *See* Annot., *Tenant Recovery for Emotional Distress Under URLTA, 6 A.L.R. 4th 528 (1981).*

(n10)Footnote 10. *See Davidow v. Inwood N. Prof. Group, 747 S.W.2d 373 (Tex. 1988)* (loss of electricity due to landlord's failure to pay bill); *Adams v. Gaylock, 378 S.E.2d 297 (W.Va. 1989)* (lack of electric service).

(n11)Footnote 11. *Smith v. David, 120 Cal. App. 3d 101, 176 Cal. Rptr. 112 (1981)* ; *Hilder v. St. Peter, 144 Vt. 150, 478 A.2d 202 (1984)* . The Massachusetts Sanitary Code has detailed provisions addressing when the owner must pay for gas, electricity, and heating oil. *See* Mass. Regs. Code tit. 105, § 410.354 (owner must pay utilities unless separately metered solely for the tenant's individual use); Mass. Regs. Code tit. 105, §§ 410.180 and 410.190 (owner required to supply and pay for water and hot water; except tenant can be required to pay for fuel for hot water if in a written lease agreement.

(n12)Footnote 12. *Mass. Gen. Laws ch. 164, § 124D.*

(n13)Footnote 13. Mass. Regs. Code tit. 220, § 25.04 (termination of service to accounts affecting tenants).

(n14)Footnote 14. Mass. Regs. Code tit. 220, § 25.04(1), (2).

(n15)Footnote 15. Mass. Regs. Code tit. 220, § 25.04(4), (6).

(n16)Footnote 16. *Me. Rev. Stat. tit. 35-A, § 706.*

(n17)Footnote 17. *Me. Rev. Stat. tit. 35-A, § 704.*

(n18)Footnote 18. For more discussion on this topic, see National Consumer Law Center, Access to Utility Service, § 4.4.1 (4th ed. 2008).

(n19)Footnote 19. *See* Restatement (Second) of Property §§ 5.4(2)(c), 11.2.

(n20)Footnote 20. *James v. St. Petersburg, 6 F.3d 1457, 1463 (11th Cir. 1993)* (actual user of a utility has a protected property interest in water service); *DiMassimo v. City of Clearwater, 805 F.2d 1536 (11th Cir. 1986)* (pre-termination notice required to actual user of utility service); *Koger v. Guarino, 412 F. Supp. 1375 (E.D. Pa. 1976)* (city practice of requiring tenants to pay landlord's delinquent water bills to avoid terminations violated due process clause); *Davis v. Weir, 328 F. Supp. 317 (N.D. Ga. 1971) , aff'd in part, modified in part, 497 F.2d 139 (5th Cir. 1974)* (city violated *equal protection clause* by refusing to provide service to tenant until tenant paid landlord's delinquent bill).

(n21)Footnote 21. *See* National Consumer Law Center, Access to Utility Service, App. A (4th ed. 2008).

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PART I Consumer Credit
CHAPTER 11 Utility Terminations

1-11 Consumer Credit Law Manual § 11.16

§ 11.16 Challenging Utility Service Terminations Effected at the Behest of Landlords: Tenants' Remedies Against Landlords and Utility Providers

[1] Public Utility Regulation

The first resort for the advocate of a tenant facing utility termination should be to the specific regulatory scheme governing service terminations in his or her state. In some states, the public service commission requires notice to tenants of impending shut-offs where service is in the landlord's name. Those electric utilities falling within the purview of the PURPA n1 likely will be governed by regulations that prescribe a requirement of notice and a hearing for the tenants prior to the time that service, even if it is in the landlord's name, is terminated. n2

It is clear from the language of PURPA, n3 from its legislative history, and from Department of Energy Guidelines that the Act contemplated notice to tenants who receive service that is billed to their landlords.

[2] Other State and Local Laws

In several states, specific statutes or local ordinances also require the utility company to give notice to tenants prior to termination of utility service which is billed to the landlord.

In about two-thirds of the states, specific statutes forbid the landlord from terminating utility service to tenants and provide civil or criminal penalties and/or injunctive relief to restore service or to avert a threatened service termination.

[3] Quiet Enjoyment

The termination of utility service works a constructive eviction, rendering the premises uninhabitable. Indeed, in most cases in which landlords order termination of service for an existing tenant, the landlord's actions are intended to force tenants from their units. Where the landlord willfully causes utility termination during the course of an ongoing tenancy, the landlord breaches the covenant of quiet enjoyment which is implied in all leases of residential premises in most jurisdictions. n4

A breach of the covenant of quiet enjoyment is remediable by an action for damages after the fact or for injunctive relief to prevent the breach.

[4] Self-Help Eviction

Most states, including the fifteen states that have adopted the URLTA, statutorily prohibit self-help eviction. Other states have reached this same result through court decisions. Several specifically forbid interference with the tenancy by the direct or indirect termination of a tenant's utility service. Thus, in most jurisdictions, self-help eviction by ordering a shut-off of utility service to the tenant is illegal and may be enjoined.

[5] Warranties of Habitability, Statutes and Regulations Ensuring a Minimum Quality of Housing and Statutes Ensuring Continuing Provision of Utility Services

As an alternative to viewing the disconnection of utility services as a crude attempt to dispossess the tenant, a landlord's ordering of a utility shut-off may be viewed as a failure to provide contracted services over the term of the tenancy. In the great majority of states, by statute or court decision, a landlord will be held to a non-waiveable duty not to interfere with a tenant's receipt of utility services. A tenant may seek injunctive relief to enjoin violations by a landlord of that duty. n5

Nearly every state which recognizes a landlord's duty to maintain the premises includes within that duty a responsibility to ensure the uninterrupted flow of vital utility services, at least to the extent the provision of those services is part of the lease. n6 Even a state, which may not recognize the failure to provide some utility service as a *per se* violation of the landlord's implied warranty, may nevertheless find that a landlord's interruption of that service breaches his or her express and implied warranties which become enforceable when the tenant rented the unit on the explicit or implicit understanding that the landlord would supply that service. n7

Several states have laws imposing civil or criminal liability upon landlords who wilfully cause the interruption of utility service to their tenants. n8 Such practices may also constitute an unfair or deceptive commercial practice under many states' UDAP provisions. n9

[6] The Aggrieved Tenants as a Third Party Beneficiary of the Contract Between the Vindictive Landlord and the Complicit Utility

A landlord enters into a contract with a utility company to supply services to his or her tenants in order to satisfy his or her contractual and legal obligations to his or her tenants. The tenants, for their part, rely upon the landlord's provision of utility service by moving into the unit, by not seeking service in their own name, and by not obtaining alternative service. Under these circumstances, the tenant may be a third-party beneficiary of the contract between the utility and the landlord, unless that contract explicitly states to the contrary, and the tenant may have a right to sue on the contract, n10 as well as a property interest sufficient to trigger Constitutional Due Process safeguards. If the tenant is a third-party beneficiary of the landlord-utility company contract, neither the landlord nor the utility is free to modify or terminate the contract without the consent of the tenant.

An intended, as opposed to an incidental, beneficiary of a contract acquires rights under that contract to enforce it. Thus, the tenant as a third-party beneficiary acquires rights under the contract and may sue the contracting parties for equitable relief or damages. n11 Further, neither the landlord nor the utility company is free to modify or rescind the contract without the tenant's consent once the tenant has relied upon the contract and both may be liable for disconnection of service without the tenant's consent. n12

[7] Using State UDAP Statutes as a Remedy Against Landlords (and Complicit Utilities)

State UDAP statutes may be useful in challenging some actions of landlords. n13 UDAP provisions and regulations may specifically identify and forbid such actions as retaliatory evictions, self-help evictions, or utility terminations. n14 In the common situation in which the landlord orders a utility termination in response to a tenant's nonpayment of rent,

unfair debt collection statutes may provide one avenue of relief available to a tenant. n15

[8] The Fair Housing Act and Other Federal Nondiscrimination Guarantees

[a] Landlord's Obligations

The Fair Housing Act (FHA) n16 proscribes both intentional discrimination and actions which are discriminatory in effect. n17 A landlord who terminates utility service to tenants in protected groups may be committing purposeful discrimination outlawed by the Act, for instance, if the landlord has not taken similar action against members of non-protected groups under like circumstances. n18

[b] Utility Companies May Be Subject to Fair Housing Act Ban on Unintentional Discrimination

A utility policy giving landlords the discretion to terminate landlord's service may be viewed as an instrument for discrimination, and, thus, the utility policy itself may violate the FHA. The FHA, by its terms, prohibits discrimination by providers of *services* to housing, as well as to those who provide housing itself. n19

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil Rights LawContractual Relations & HousingFair Housing RightsFair Housing ActEnergy & Utilities LawCogeneration & Independent Power CompaniesPublic Utility Regulatory Policies ActCompliance EnforcementEnergy & Utilities LawElectric Power IndustryState RegulationGeneral OverviewEnergy & Utilities LawUtility CompaniesService TerminationsReal Property LawLandlord & TenantLandlord's Remedies & RightsEviction ActionsSelf-Help RemediesReal Property LawLandlord & TenantTenant's Remedies & RightsWarranty of Habitability

FOOTNOTES:
(n1)Footnote 1. *16 U.S.C. §§ 2601 et seq. (1989).*

(n2)Footnote 2. *16 U.S.C. § 2625(g).*

(n3)Footnote 3. *16 U.S.C. § 2602(5).*

(n4)Footnote 4. *Bedell v. Los Zapatistas, 805 P.2d 1198 (Colo. 1991)* (Colorado, which does not recognize an implied warranty of habitability, does recognize an implied covenant of quiet enjoyment in residential leases which may be breached by an interruption of vital utility services).

(n5)Footnote 5. *Javins v. First Nat'l Realty, 428 F.2d 1071 (D.C. Cir. 1981)* ; *In re TM Carlton House Partners, Ltd., 93 B.R. 859 (Bankr. E.D. Pa. 1988)* ; *Clore v. Fredman, 319 N.E.2d 18 (Ill. 1974)* ; *Pugh v. Holmes, 384 A.2d 1234 , aff'd, 405 A.2d 897 (Pa. 1978)* ; *Conn. Gen. Stat. Ann. § 47a-14h(e)(1)*; Comment, URLTA § 4.107 (1981). *See Steele v. Latimer, 521 P.2d 304 (Kan. 1974)* ; *Jones v. Parker, 163 Mass. 564 (1895)* .

(n6)Footnote 6. *See Javins v. First Nat'l Realty, 428 F.2d 1071, 1074 (D.C. Cir. 1981)* (provision of heat and light at the heart of warranty of habitability); *In re Clark, 96 B.R. 569, 572 (E.D. Pa. 1989)* (full utility service); *Lifter v. Cohen, 480 So. 2d 1336 (Fla. Dist. Ct. App. 1985)* (hot water); *Gennings v. Newton, 567 So. 2d 637, 641 (La. Ct. App. 1990)* (water); 49 *Prospect St. Tenants' Ass'n v. Sheva Gardens, 547 A.2d 1134 (N.J. 1988)* (heat, water, security); *Academy Spires v. Brown, 268 A.2d 556 (N.J. Dist. 1970)* (garbage disposal, elevator, hot water); *Whitehouse Estates v. Thomson, 386 N.Y.S.2d 733 (1976)* .

(n7)Footnote 7. *Mendenhall-Moore Realtors v. Sedoris, 366 S.E.2d 534, 536-37 (N.C. Ct. App. 1988)* .

(n8)Footnote 8. *See, e.g., Alaska Stat. § 34.03.210*; *Ariz. Rev. Stat. Ann. § 33-1367*; *Cal. Civ. Code § 789.3*; *Conn. Gen. Stat. 47a-13* (1977); Ill. Rev. Stat. ch. 23, § 11-23.1; Kan. Rev. Stat. 58-2563; *Mass. Gen. Laws. Ann. ch. 186, § 14*; Mich. Stat. Ann. § 27A.2918; Minn. Stat. Ann. § 504-26; *Neb. Rev. Stat. 76-1427*; N.M. Stat. Ann. 70-7-36; New York Real Prop. Acts §§ 756, 235-a; *Or. Rev. Stat. §§ 91.865, 91.815*; Tex. Stat Ann. art. 5236C (Vernon); *Va. Code §§ 55-248.36, 55-248.40*; Wash. Rev. Code Ann. § 59-18-300. *See Ky. Rev. Stat. Ann. §§ 383.630, 383.655. See also Lifter v. Cohen 480 So. 2d 1336 (Fla. Dist. Ct. App. 1982) , rev. denied, 484 So. 2d 7 (1986) .*

(n9)Footnote 9. *Aponte v. Aungst, 82 B.R. 738, 746-47 (E.D. Pa. 1988) . See Kingston Sq. Tenants' Ass'n v. Tuskegee Gardens, Ltd., 792 F. Supp. 1566, 1575 (S.D. Fla. 1992)* ; *In re Clark, 96 B.R. 569 (E.D. Pa. 1989)* ; *Gargano v. Heyman, 525 A.2d 1343 (Conn. 1987)* (landlord shutting off electricity to premises of tenant who was holding over after lease terminated constituted unfair practice under Unfair Trade Practice Act); *Wolfberg v. Hunter, 432 N.E.2d 467, 472 (Mass. 1982) . See also* 940 Code of Mass. Regulations 3.08, 3.17. *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 5.5.2 (6th ed. 2004 and Supp.).

(n10)Footnote 10. *See* Restatement (Second) Contracts § 302.

(n11)Footnote 11. 4 Corbin on Contracts § 779K. *Bush v. Upper Valley Telecable, 524 P.2d 1055, 1058 (Idaho 1974) .*

(n12)Footnote 12. Restatement (Second) Contracts § 311. *See Price v. Pierce, 823 F.2d 1114, 1122 (7th Cir. 1987)* .

(n13)Footnote 13. *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 2.2.6 (7th ed. 2008). However, some states hold that landlord-tenant relations are beyond the reach of the states UDAP scheme. *Id.* at § 2.2.6; *see also* Annot., *Scope and Exemptions of State Deceptive Trade Practice and Consumer Protection Acts, 89 A.L.R. 3d 399* (1992 Supp.).

(n14)Footnote 14. *See* note 12 *supra. See also Hernandez v. Stabach, 193 Cal. Rptr. 350 (Ct. App. 1983)* ; *Mosley & Mosley Builders v. Landin Ltd., 389 S.E.2d 576 (N.C. Ct. App. 1990)* ; *Love v. Pressley, 239 S.E.2d 574 (N.C. Ct. App. 1977)* ; 49 *Prospect St. Tenants Ass'n v. Sheva Gardens, 547 A.2d 1134 (N.J. App. Div. 1988) .*

(n15)Footnote 15. *See Aponte v. Aungst, 82 B.R. 738 (E.D. Pa. 1988)* ; *Gargano v. Heyman, 525 A.2d 1343 (Conn. 1987)* . This is assuming the scope of the state's provisions contemplates landlords as creditors. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 5.5.2 (6th ed. 2004 and Supp.).

(n16)Footnote 16. *42 U.S.C. §§ 3601 et seq. (1983).* The Fair Housing Act is reprinted in Vol. 1B *infra.*

(n17)Footnote 17. *See generally Trafficante v. Metropolitan Life Ins. Co., 409 U.S. 205, 211-12, 93 S. Ct. 364, 34 L. Ed. 2d 415 (1972)* ; *Resident Advisory Board v. Rizzo, 564 F.2d 126 (3d Cir. 1977)* ; Annot., *FHA: Discriminatory Effects, 100 A.L.R. Fed. 97* ; *see also 24 C.F.R. §§ 100.90-100.135 (1992)* (HUD implementing regulations); *Newman v. Voinovich, 789 F. Supp 1410 (D. Ohio 1992)* ; *Oxford House-Evergreen v. City of Plainfield, 769 F. Supp. 1329, 1343 (D.N.J. 1991)* ; *Casa Marie Inc. v. Superior Ct. of Puerto Rico for Dist. of Arecibo, 752 F. Supp. 1152, 1168 (D.P.R. 1990) .*

(n18)Footnote 18. For example, the tenants could make out a *prima facie* case under the Act by showing that they were subjected to utility termination in response to a failure to pay rent timely, and, under similar circumstances, a member of a non-protected group did not suffer a utility termination. The landlord would then have the burden of offering a legitimate, business-related justification for the apparent differential treatment. The tenants then would prove their case by showing the landlord's explanation to be pretextual--a smoke screen to cover illegal discrimination.

(n19)Footnote 19. *42 U.S.C. § 3604(b)*; *see United States v. Parma Ohio, 494 F. Supp. 1049, 1053 (D. Ohio 1980) , aff'd, 661 F.2d 562 (6th Cir. 1981) , cert. denied, 456 U.S. 1012, 102 S. Ct. 2308 (1982)* (this broadly drafted section

(§ 3604(b)) reaches every practice which has the effect of making housing more difficult to obtain on prohibited grounds); *Concerned Tenant's Ass'n v. Indian Trails Apts., 496 F. Supp. 522, 525-26 (N.D. Ill. 1980)* ; *United States v. American Inst. of Real Estate Appraisers, 442 F. Supp. 1072 (N.D. Ill. 1977) . See also 24 C.F.R. § 100.70(d)(4) (1992)*; *Fair Hous. Council v. Ayes, 855 F. Supp. 315 (C.D. Cal. 1994) .*

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PART I Consumer Credit
CHAPTER 12 Student Loans and Trade School Abuses

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§ 12.syn Synopsis to Chapter 12: Student Loans and Trade School Abuses

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§ 12.01 Introduction

One of the most common forms of consumer loans are student loans, and student loan collections raise numerous special issues. Federal law provides collectors and student loan debtors with many special rights and responsibilities. Major sources of information in this area are the Higher Education Act ("HEA"), Department of Education ("DOE" or "Department") regulations under that Act, Department "Dear Colleague letters," and other informal interpretations. n1 In 2002, more than 45,000 students lost their federal financial aid because of the "drug conviction" provision. n2 The provision has been controversial, primarily because it is so broad that it denies aid, not only those who were convicted while in school, but also to those who were convicted of drug offenses prior to enrolling in higher education. n3 The law denies aid to students who have been convicted in a federal or state court of possessing or selling illicit drugs. Eligibility may be suspended for one year from the date of a first conviction on a drug possession charge, two years from the date of a second conviction and indefinitely for a third. n4 Students convicted of selling drugs lose eligibility for two years from the date of a first conviction, and indefinitely for a second. n5 Eligibility can be restored if the student satisfactorily completes a drug rehabilitation program or if the conviction is reversed or set aside. n6 Legislation introduced in 2005 would repeal the provisions prohibiting persons convicted of drug offenses from receiving financial assistance. n7 Other legislation restricts the scope of the drug-related ban, providing that borrowers are ineligible for aid only if the drug-related offenses were committed while they were attending college. n8

Legal Topics:

For related research and practice materials, see the following legal topics:
Education LawAdministration & OperationStudent Financial AidGeneral OverviewEducation LawAdministration & OperationStudent Financial AidEligibilityEducation LawAdministration & OperationStudent Financial AidRenewal & Revocation

FOOTNOTES:
(n1)Footnote 1. *See* Ch. 4 *supra*.

(n2)Footnote 2. Stephen Burd, *Seeking Redemption for a Drug Law*, The Chron. of Higher Educ., April 5, 2002, at A17.

(n3)Footnote 3. *Id*.

(n4)Footnote 4. *34 C.F.R. § 668.40(b)(1)*.

(n5)Footnote 5. *34 C.F.R. § 668.40(b)(2)*.

(n6)Footnote 6. *34 C.F.R. § 668.40(c)* (rehabilitation programs), *34 C.F.R. § 668.40(a)(2)* (definition of "conviction").

(n7)Footnote 7. *See* H.R. 1184, 109th Cong. (introduced 1st Sess., Mar. 9, 2005).

(n8)Footnote 8. *See* H.R. 609, 109th Cong. (introduced Feb. 8, 2005).

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§ 12.02 Overview of Major Educational Assistance Programs

[1] Federal Family Education Loans (FFELs)

The Higher Education Amendments of 1992 n1 created a new generic name for the major forms of federal student loans. Federal Family Education Loans ("FFELs") include Guaranteed Student (Stafford) Loans ("GSLs"), Unsubsidized Stafford Loans, Supplemental Loans for Students ("SLSs"), and PLUS loans. Throughout this chapter, the term FFEL is generally used instead of GSL because many of the student protections apply to all types of FFELs. n2

Significant amendments to the HEA were signed into law on October 7, 1998. n3 Although not as extensive as the 1992 Amendments, there are still a number of critical provisions for student borrowers. The most important of these provisions are reported in this chapter.

[2] Stafford Loans (GSLs)

Most student loan questions involve the most common form of FFEL, the GSLs. n4 GSLs have been renamed "Stafford" Loans and there are now subsidized and unsubsidized Stafford Loans. A Stafford Loan is a loan made to the student by an eligible lender, such as a bank, credit union or savings and loan. For a subsidized Stafford loan, while the student is in school, the United States pays the interest, and when the student leaves school and begins to repay the loan, the United States continues to pay a portion of the interest, thus accounting for the relatively low interest rate paid by the student. For an unsubsidized Stafford loan, interest accumulates while the student is in school or receiving a deferment. The SLS Program has been replaced by the Unsubsidized Stafford Loan Program.

Students repay Subsidized Stafford Loans (GSLs) six months (or in certain cases nine to twelve months) after they graduate, drop out, or the school closes; typically no interest accumulates until the first payment is due.

This "grace period" does not include any period, not to exceed three years, during which a borrower who is a member of an Armed Forces reserve component is called or ordered to active duty for a period of more than thirty days. n5 Any single excluded period may not exceed three years and must include the time necessary for the borrower to resume enrollment at the next available regular enrollment period. Borrowers are entitled to another full six- or nine-month grace period, as applicable, upon completion of the excluded period of service. n6 These same provisions apply to any individual who is an "affected individual," defined to include those serving on active duty during a war or other military

operation or national emergency, performing qualifying National Guard duty during a war or other military operation or national emergency, residing or employed in an area that is declared a disaster area by any federal, state, or local official in connection with a national emergency, or suffering direct economic hardship as a direct result of a war or other military operation or national emergency, as determined by the Secretary. n7

[3] PLUS and SLS Loans

PLUS loans are for parent borrowers and SLSs were for students. n8 These loans have a higher interest rate than Subsidized Staffords (those after July 1, 1987 are variable interest rate loans) and financial need is not a prerequisite. Unlike Subsidized Stafford Loans, interest on PLUS and SLS loans begins to accrue sixty days after the loan is *disbursed*, although the lender may defer payments until after the student graduates or stops attending school. In other respects, PLUS and SLS loans are much the same as and may supplement Subsidized Stafford Loans (GSLs), with guaranty agencies acting as insurers and the United States as reinsurer.

Effective July 1, 1994, SLS loans were no longer issued. The SLS program was merged into the unsubsidized component of the Stafford Loan Program. But many students obtained SLS loans before that date, and the conditions and benefits of those earlier loans remain unchanged. Much of the discussion concerning Stafford Loans in this chapter also applies to PLUS and SLS loans. Parent borrowers with adverse credit histories may still get loans if they enlist an endorser who has been determined not to have an adverse credit history. n9 However, the absence of any credit history cannot be considered an indication of an adverse credit history and is not to be used as a reason for denial. n10 The lender may waive these requirements if extenuating circumstances exist. n11

The PLUS program was the fastest growing student aid program from 1995 through 2006. PLUS loan borrowing grew at an average annual rate of 12.5% during this time period, in inflation-adjusted dollars. n12 The program is expected to expand even more now that graduate and professional students are eligible to get PLUS loans. It will be especially important to track how financial aid offices describe PLUS loans in their financial aid packages, particularly in relation to private loans. This is because private lenders have generated much of their business from graduate and professional students and may try to steer borrowers away from PLUS loans. PLUS loans offer more affordable interest rates than students would typically receive from private loans. Furthermore, the interest rates are fixed, compared to the variable rates of most private loans. n13

[4] Federally Insured Student Loans (FISLs)

Many older loans are insured directly by the federal government, with no guaranty agency acting as intermediary. These loans are called Federally Insured Student Loans ("FISLs"). Unless specified otherwise, the term FFEL in this section includes FISLs.

[5] Direct Loans

Federal Direct Loans ("Direct Loans") are loans directly from the federal government to the student, with the assistance of the school or other entity that originates the loan. n14 Lenders and guaranty agencies are cut out of the process.

The schools or other originators receive fees for originating the loans, but the Department selects which schools participate in the Direct Loan program. Other schools continue to participate in the FFEL program. Direct Loans have terms similar to those of FFELs, but the loans, when they become due, are immediately owed to the United States. Students can choose various repayment plans, including graduated repayment plans where the amount of the payment increases over time, and income contingent repayment where payment size varies with the student's income.

As with Stafford Loans, there are Subsidized and Unsubsidized Direct Loans. A subsidized loan is awarded on the basis of financial need. The key difference between the two types of loans is that for unsubsidized loans, borrowers are not

charged any interest before the repayment period begins or during authorized periods of deferment. In essence, the government "subsidizes" the interest during these periods. Unsubsidized loans are not awarded on the basis of financial need. Interest is charged from the time the loan is disbursed until it is paid in full. Annual and aggregate loan limits are set out in the Department regulations. n15 There are also Direct Loans for parents similar to the FFEL PLUS loans, and there are Consolidation Loans under both the FFEL and the Direct Loan programs.

Congressional changes were enacted in 2005, which aimed at limiting the scope of the "school as lender" program. Effective April 1, 2006, to be a school lender, a school must have met the "school as lender" requirements as they existed on February 7, 2006, and must have made FFEL loans as a lender on or before April 1, 2006. n16 Under new regulations, the school must not

- be a home study school;
- make a loan to any undergraduate student;
- make a loan other than Federal Stafford loans to a graduate or professional student; or
- make a loan to a borrower who is not enrolled at the school. n17

There are also new regulations that, among other provisions, require the schools participating in this program to maintain a cohort default rate that is not greater than 10% and offer loans with an origination fee and/or interest rate that is less than the applicable statutory fee or rate for any loan first disbursed on or after July 1, 2006. n18 In addition, schools must use payments they receive (exclusive of return of principal and certain costs) for need-based grants. n19 They may also use some funds for reasonable administrative expenses. The funds for need-based grants must supplement, not supplant, non-federal funds the school would otherwise use for need-based grants.

[6] Perkins Loans

Perkins Loans (formerly called National Direct Student Loans, and before that National Defense Student Loans) n20 are not FFELs. Perkins Loans are made by a school to the student and the United States takes assignment when the school cannot collect. n21

Perkins Loans are administered by the school itself, at interest rates below Staffords, and repayment is postponed nine (or sometimes six) months after the student graduates or stops attending school.

The 1998 HEA contains a number of provisions that make the Perkins regulations much more like the FFEL and Direct Loan regulations. In particular, the closed school discharge for loans made on or after January 1, 1986 will not apply to Perkins Loans as well. n22 Perkins Loan borrowers who make 12 consecutive timely monthly payments will also be able to rehabilitate defaulted loans. n23

In 2007, the Department proposed rules that would allow the Department to require assignment of a Perkins loan if the outstanding principal balance of the loan is $100 or more, the loan has been in default for seven or more years, and a payment has not been received on the loan in the preceding twelve months. There is an exception if payments were not due on the loan in the preceding twelve months because the loan was in an authorized deferment or forbearance period. n24 The Department adopted this proposal. n25 However, the 2008 HEA reauthorization law overrides the regulations. n26 The 2008 law provides that the Secretary of Education is not permitted to require the assignment of loans to the Department other than as currently allowed in cases in which the school has failed to maintain an acceptable collection record or if the school chooses not to service and collect loans. n27

[7] Pell (BEOG) and SEOG Grants; Work Study

Basic Educational Opportunity Grants ("BEOGs"), also called Pell grants, n28 and Supplemental Educational Opportunity Grants ("SEOGs") n29 are not loans, and require no repayment (unless there is an overpayment). n30 The College Work Study Program ("CWS") provides salaries for students in exchange for work. n31 All of these assistance programs are administered by the school. Students can have more than one form of student assistance, so that, for example, a student may participate in work-study, have a Pell grant, a Stafford, and a PLUS loan signed by his or her parents.

Grants do not usually have to be repaid. There are two main exceptions to this general rule for grantees who: (1) received more than they were eligible to receive, or (2) withdrew early from the program for which the grant was given. n32

The requirement to repay is waived for students who withdraw from a school because of their status as an "affected individual," defined to include those serving on active duty during a war or other military operation or national emergency, performing qualifying National Guard duty during a war or other military operation or national emergency, residing or employed in an area that is declared a disaster area by any federal, state, or local official in connection with a national emergency, or suffering direct economic hardship as a result of a war or other military operation or national emergency, as determined by the Secretary. n33 The Secretary is also permitted to waive a student's Title IV grant repayment if the student withdrew from an institution because of a major disaster. n34 In 2006, Congress created two new student grant programs: the *Academic Competitiveness (AC) Grants* and *National Science and Mathematics Access to Retain Talent (SMART) Grants*. n35 In addition to the Pell Grant amount, up to $750 will be awarded to eligible first-year AC Grant students and up to $1300 to second-year AC Grant students. Up to $4000 will be awarded to eligible National SMART Grant students for each year in addition to the Pell Grant funds. In the College Cost Reduction and Access Act of 2007, Congress created the Teacher Education Assistance for College and Higher Education (TEACH) Grant Program that provides grants of up to $4,000 per year to students who intend to teach in a public or private elementary or secondary school that serves students from low-income families. Final TEACH grant regulations were issued in June 2008 and became effective July 1, 2008. n36 The final regulations clarify that participation in the TEACH grant program is voluntary.

The TEACH grant program is not tied to financial need and provides up to $4000 annually to students who are enrolled in an eligible program and who agree to teach full-time in a high-need field at a public or private elementary or secondary school that serves low-income students. n37 Recipients of these grants must teach for at least four years within a period of eight years after completing the program for which the TEACH Grant was awarded. Although it is not tied to financial need, applicants must file FAFSAs. Students who wish to participate must complete and submit an application, including an agreement to serve and promise to repay. Students must also maintain a 3.25 grade point average while in school. n38

The Academic Competitiveness Grant was made available for the first time for the 2006-2007 school year to first-year college students who graduated from high school after January 1, 2006 and to second-year college students who graduated from high school after January 1, 2005. The Academic Competitiveness Grant award is in addition to the student's Pell Grant award. An Academic Competitiveness Grant will provide up to $750 for the first year of undergraduate study and up to $1300 for the second year of undergraduate study to full-time students who are eligible for a Federal Pell Grant and who had successfully completed a rigorous high school program, as determined by the state or local education agency and recognized by the Secretary of Education. Second year students must maintain a cumulative grade point average (GPA) of at least 3.0.

The National Science and Mathematics Access to Retain Talent Grant, also known as the National Smart Grant, is available during the third and fourth years of undergraduate study to full-time students who are eligible for the Federal Pell Grant and who are majoring in physical, life, or computer sciences; mathematics; technology; engineering; or a foreign language determined critical to national security. The student must also be enrolled in the courses necessary to

complete the degree program and to fulfill the requirements of the intended eligible major in addition to maintaining a cumulative grade point average (GPA) of at least 3.0 in coursework required for the major. The National SMART Grant award is in addition to the student's Pell Grant award.

The final regulations for the AC and SMART grants were published in October 2007. n39 In 2007, Congress passed legislation that authorizes and appropriates new mandatory funding to increase the maximum Pell grant award by $490 in 2008-2009 and 2009-2010, $690 in 2010-2011 and 2011-2012, and $1090 in 2012 and 2013. n40 The 2008 Higher Education reauthorization law includes additional Pell grant increases. n41 The law also allows students to receive two Pell grants in a single academic year as long as they are enrolled at least half-time. The Department issued proposed regulations in August 2009 to implement the new Pell Grant program provisions. n41.1 Under current law, the Secretary announces in the Federal Register whether an institution may award up to a second Pell grant scheduled award to a student in a particular award year. The proposed regulations amend this process so that students will be eligible for a second scheduled award if the student has earned in an award year at least the credit or clock hours of the first academic year of the student's eligible program and if he or she is enrolled as at least a half-time student in a program leading to a bachelor's or associate degree or other recognized educational credential. n41.2 The Department explained that it proposed these regulations to encourage a student to accelerate the completion of a program of study within a shorter time period than the regularly scheduled completion time. There are separate provisions to determine the credit or clock hours for transfer students. The proposed regulations also allow a financial aid administrator to waive payments of the student's scheduled award disbursed at a prior institution under certain circumstances. n41.3 A new statutory provision also provides that a student whose parent or guardian died as a result of performing military service in Iraq or Afghanistan after September 11, 2001, is deemed to have a zero expected family contribution (EFC) for purposes of the Pell Grant program. n41.4

In 2006-2007, 31% of Pell grants went to undergraduates enrolled in public two-year colleges. These students comprise one-third of the total undergrad enroll- ment. Thirty-four percent went to public four-year college students (42% of undergraduate enroll ment); 16% to private nonprofit college students (19% of undergraduate enrollment), and 19% to students at for-profit institutions (7% of undergraduate enrollment). n41.5 After holding steady at 5.2 million for two years, the number of Pell grant recipients rose by 5%, to 5.4 million in 2007/-/2008, resulting in a 45% increase over the decade. n41.6

[8] Determining What Type of Loan a Client Has/National Student Loan Data System

The National Student Loan Data System ("NSLDS"), is the DOE's central database for student aid. It receives data from schools, agencies that guaranty loans, the Direct Loan program, the Pell Grant program, and other U.S. DOE programs. This information is available on the Internet at http://www.nslds.ed.gov.

Borrowers can use NSLDS to make inquiries about loans and grants using a personal identification number ("PIN"). The site displays information on loan and/or grant amounts, outstanding balances, loan statuses, and disbursements.

Borrowers can also call the Federal Student Aid Information Center, 1-800-4-FED-AID, TDD 1-800-730-8913. The Center's counselors can help borrowers figure out what types of loans they have over the phone. n42 There is a Direct Loan service center specifically for Direct Loan borrowers. Borrowers should call 1-800-848-0979 (1-800-557-7392 for Direct Consolidation Loans).

In June 2007, the Department issued proposed regulations that would set deadlines for reporting of NSLDS information. The changes require guaranty agencies to report enrollment and loan status information on an FFEL borrower or student to the current holder of the loan within thirty days of any changes to the student's enrollment status. This is a decrease from the current sixty-day period. n43

Legal Topics:

For related research and practice materials, see the following legal topics:
Education LawAdministration & OperationStudent Financial AidGeneral Overview

FOOTNOTES:
(n1)Footnote 1. Pub. L. No. 102-325, *106 Stat. 448 (1992).*

(n2)Footnote 2. It is usually important to keep track of whether a Federal Family Education Loan [hereinafter FFEL] was disbursed before or after July 1, 1993. Many of the changes to the student loan programs instituted by the Higher Education Amendments of 1992 concerning deferments, repayment plans, and other topics apply only to FFELs disbursed after July 1, 1993.

(n3)Footnote 3. Higher Education Programs Authorization Extension Act, Pub. L. No. 105-244 (Oct. 7, 1998). For a summary of these provisions, see United States Department of Education [hereinafter DOE or Department], Dear Colleague Letter GEN-98-28, Clearinghouse No. 52,136 (Nov. 1998).

(n4)Footnote 4. *20 U.S.C. §§ 1071 to 1087-2*; 34 C.F.R. § 682.

(n5)Footnote 5. *68 Fed. Reg. 69312* (Dec. 12, 2003) .

(n6)Footnote 6. *Id.*

(n7)Footnote 7. *Id.*

(n8)Footnote 8. *20 U.S.C. §§ 1078, 1078-2*; *34 C.F.R. § 682.500.*

(n9)Footnote 9. *34 C.F.R. § 682.201(b)(1)(vii)* (FFEL); *34 C.F.R. § 685.200(b)(1)(vii)(A).* Technical corrections to the FFEL regulations, mainly to correspond to the Direct Loan provisions, were published in December 2003. *See 68 Fed. Reg. 75427* (Dec. 31, 2003) . An adverse credit history exists based on a credit report if the applicant is considered ninety or more days delinquent on the repayment of a debt, or the applicant has been the subject of a default determination, bankruptcy discharge, foreclosure, repossession, tax lien, wage garnishment, or write-off of a student loan debt, during the five years preceding the date of the credit report. *34 C.F.R. § 682.201(b)(2)(iii).* FFEL regulations allow a creditor to establish more restrictive standards. *34 C.F.R. § 682.201(b)(2)(iv)* (FFEL); *34 C.F.R. § 685.200(b)(1)(vii)(C)* (Direct). In final rules issued in November 2006, the Department clarified that, just as in the FFEL program, a student Direct PLUS applicant who is determined to have an adverse credit history may receive a Direct PLUS loan if he or she obtains an endorser who does not have an adverse credit history or documents to the Secretary that there are extenuating circumstances. *71 Fed. Reg. 64378* (Nov. 1, 2006) .

(n10)Footnote 10. *34 C.F.R. § 682.201(b)(2)(ii)(A), (B)* (FFEL); *34 C.F.R. § 685.200(b)(1)(vii)(B)* (Direct).

(n11)Footnote 11. *34 C.F.R. § 682.201(b)(2)(ii), (v)* (FFEL); *34 C.F.R. § 685.200(b)(1)(vii)(A)* (Direct).

(n12)Footnote 12. *See generally* College Bd., *Trends in Student Aid 2006*, at 5 (2006), *available at* www.collegeboard.com/prod_downloads/press/cost06/trends_aid_06.pdf.

(n13)Footnote 13. *See generally* Inst. for Higher Educ. Policy, *The Future of Private Loans: Who is Borrowing, and Why?* (Dec. 2006), *available at* www.ihep.org/Pubs/PDF/FutureofPrivateLoans.pdf.

(n14)Footnote 14. Student Loan Reform Act of 1993, *107 Stat. 340, enacted as* § 4021 of the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, *107 Stat. 312* (Aug. 10, 1993).

(n15)Footnote 15. *34 C.F.R. § 682.204(a)* (FFEL); *34 C.F.R. § 685.203* (Direct Loan).

(n16)Footnote 16. Pub. L. No. 109-171, *120 Stat. 4* (Feb. 8, 2006), *amending 20 U.S.C. § 1085.*

(n17)Footnote 17. *34 C.F.R. § 682.601(a)*.

(n18)Footnote 18. *34 C.F.R. § 682.601(a)(5),(6)*.

(n19)Footnote 19. *34 C.F.R. § 682.601(a)(8)*.

(n20)Footnote 20. They are referred to in this chapter only as Perkins Loans. When this chapter refers to Direct Loans, the reference is to the new Federal Direct Loan Program.

(n21)Footnote 21. *20 U.S.C. §§ 1087aa to 1087vv*; 34 C.F.R. § 674.

(n22)Footnote 22. Pub. L. No. 105-244 (Oct. 7, 1998), § 464. For information on closed school discharges, see *§ 12.06[2] infra*. The regulations for Perkins closed school discharges, when final, will likely be similar to those for other student loans.

(n23)Footnote 23. *See § 12.07[3] infra*.

(n24)Footnote 24. *72 Fed. Reg. 32410* (June 12, 2007) (proposing to amend *34 C.F.R. § 674.8(d)*).

(n25)Footnote 25. *72 Fed. Reg. 61960* (Nov. 1, 2007) .

(n26)Footnote 26. Pub. L. No. 110-315, § 463, *122 Stat. 3078* (Aug. 14, 2008).

(n27)Footnote 27. *Id. See also* U.S.C. § 1087cc(a).

(n28)Footnote 28. *20 U.S.C. § 1070a*; 34 C.F.R. § 692.

(n29)Footnote 29. *20 U.S.C. § 1070b*; 34 C.F.R. § 676.

(n30)Footnote 30. *20 U.S.C. § 1070b*; 34 C.F.R. § 676.

(n31)Footnote 31. *42 U.S.C. §§ 2751 to 2756b*; 34 C.F.R. § 675. The Department issued proposed rules in August 2009 to implement numerous changes to the federal work-study regulations. *See 74 Fed. Reg. 42380* (Aug. 21, 2009) .

(n32)Footnote 32. *34 C.F.R. § 690.79(a)(1)*.

(n33)Footnote 33. *68 Fed. Reg. 69312* (Dec. 12, 2003) .

(n34)Footnote 34. *See* Pub. L. No. 109-66, *119 Stat. 1999* (Sept. 21, 2005) (The Pell Grant Hurricane and Disaster Relief Act); Pub. L. No. 109-67, *119 Stat. 2001* (Sept. 21, 2005) (The Student Grant Hurricane and Disaster Relief Act). *See also 34 C.F.R. § 668.22(h)(5)*.

(n35)Footnote 35. Pub. L. 109-171, enacted on Feb. 8, 2006, *20 U.S.C. § 1070a-1*.

(n36)Footnote 36. *73 Fed. Reg. 35472* (June 23, 2008) . *See also 73 Fed. Reg. 36792* (June 30, 2008) (technical corrections to final regulations).

(n37)Footnote 37. High-need fields include bilingual education and English language acquisition, foreign language, math, reading specialist, science and special education, and any other field documented as high-need by the federal government or a state government and approved by the Secretary. *34 C.F.R. § 686.2*.

(n38)Footnote 38. *34 C.F.R. § 686.11*

(n39)Footnote 39. *72 Fed. Reg. 62148* (Oct. 29, 2007) .

(n40)Footnote 40. Congress passed the College Cost Reduction and Access Act on September 7, 2007. At the time this manual was written, the President had not yet signed the legislation but had indicated that he would do so.

(n41)Footnote 41. Pub. L. No. 110-315, § 401, *122 Stat. 3078* (Aug. 14, 2008). A summary of the 2008 HEA law is included at the beginning of this supplement.

(n42)Footnote 41.1. *74 Fed. Reg. 42380* (Aug. 21, 2009) .

(n43)Footnote 41.2. *Id.* (amending *34 C.F.R. § 690.67*).

(n44)Footnote 41.3. *Id.* (amending *34 C.F.R. § 690.67(c)*).

(n45)Footnote 41.4. *Id.* (proposing *34 C.F.R. § 690.75(e)*).

(n46)Footnote 41.5. The College Bd., Trends in Student Aid (2008), *available at* http://professionals.collegeboard.com/profdownload/trends-in-student-aid-2008.pdf.

(n47)Footnote 41.6. *Id.*

(n48)Footnote 42. The collection process, including the major collection players, is discussed in more detail in *§ 12.04 infra*.

(n49)Footnote 43. *72 Fed. Reg. 32410* (June 12, 2007) .

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1-12 Consumer Credit Law Manual § 12.02A

§ 12.02A The College Cost Reduction and Access Act of 2007

A very significant student assistance bill, the College Cost Reduction and Access Act of 2007 (H.R. 2669), was recently passed by Congress, and became effective, with a few exceptions, on October 1, 2007. n1

Here are a few of the key changes.

[1] Pell Grant Increases n2

The maximum Pell grant awards were increased by $490 in 2008-09 and 2009-10, $690 in 2010-11 and 2011-12, and $1090 in 2012 and 2013.

[2] Interest Rate Reductions n3

Interest rates will be gradually reduced for Stafford subsidized loan borrowers only. The cuts will apply to loans disbursed after the effective date of the legislation. The new rates will be:

- 6.8% for loans first disbursed from July 1, 2006, to July 1, 2008
- 6% for loans first disbursed from July 1, 2008, to July 1, 2009
- 5.6% for loans first disbursed from July 1, 2009, to July 1, 2010
- 4.5% for loans first disbursed from July 1, 2010, to July 1, 2011
- 3.4% for loans first disbursed from July 1, 2011, to July 1, 2012.

[3] Deferment for Certain Members of the Armed Forces n4

Congress eliminated the three-year limit on the existing military deferment and expanded eligibility to include the six-month period following the demobilization dates of qualified service members.

[4] Income-Based Repayment n5

[a] General

The Act contains a new income-based repayment program (IBR) that represents is a very positive development for borrowers. Currently, an Income Contingent Repayment Plan (ICRP) is available only in the Direct Loan program. FFEL also has an income-based repayment plan, called "income-sensitive repayment," which is less affordable because it requires borrowers to at least pay monthly accrued interest. The new IBR program, in contrast, will be directly available to both FFEL and Direct Loan borrowers.

The IBR repayment formula is more favorable to borrowers than the ICRP formula. This means that some borrowers currently in ICRPs will want to switch to the new IBR. The IBR program will not begin until July 1, 2009, and by that time, regulations should clarify whether the payments that borrowers have already made through ICRP will count toward the IBR forgiveness provision. n6

Currently, borrowers who have made twenty-five years of ICRP payments are eligible for loan cancellation or forgiveness. There is a twenty-five-year cancellation period in the new IBR as well.

[b] Eligibility

[i] Partial Financial Hardship

Borrowers must have a partial financial hardship as defined under the law in order to qualify for the income-based repayment plan (IBR). Partial financial hardship (PFH) means that a borrower's annual student loan payments under a ten-year standard repayment plan are greater than 15% of the amount by which the borrower's adjusted gross income (and that of a spouse, if applicable), as defined by the Internal Revenue Service, exceeds 150% of poverty.

This formula is more favorable than ICRP, which caps payments at no more than 20% of the amount above 100% of poverty.

[ii] Cap on Payments

If the borrower has a partial financial hardship (PFH), the monthly student loan payment is capped at 15% of adjusted gross income above 150% of poverty divided by 12.

[iii] Eligible Loans and Eligible Borrowers

Borrowers with FFEL or Direct loans may select the income-based repayment plan (IBR). The only government loans that are not eligible for IBR are Parent PLUS loans and Perkins loans. However, Perkins loans borrowers may still access the program if they have other loans and can consolidate with FFEL or Direct Loan.

[iv] Borrowers in Default

There is nothing in the new law that prevents a borrower in default from accessing the IBR. The regulations, when issued, may impose additional requirements.

[c] Forgiveness

Borrowers must repay for a period not to exceed twenty-five years. The twenty-five-year period does not have to be consecutive.

[5] Loan Forgiveness for Public Service Employees n7

The Act also contains a new loan forgiveness program for public service employees who work in public service jobs for ten years and repay their loans through an eligible repayment plan. The remaining balance is then forgiven after the ten years of service is completed.

[a] Eligibility

The program applies only to Direct Loan borrowers, but it covers all types of Direct loans, including Stafford, PLUS, and consolidation loans. Borrowers with other government loans can consolidate with Direct Loan in order to obtain this benefit, assuming they are eligible to consolidate.

Borrowers in default on FFEL consolidation loans will be able to reconsolidate with Direct Loan in order to choose public service forgiveness.

[b] Forgiveness

In order to qualify, borrowers must not be in default and must have made 120 monthly payments on their loans AFTER October 1, 2007. Payments can be made through any one or combination of eligible repayment plans, including the new income-based repayment system, income contingent repayment, ten-year standard plan payments, graduated or extended payments of not less than the monthly amount that would be due under a ten-year standard plan. n8

The borrower must be employed full-time in a public service job at the time of the forgiveness and must have been employed in a public service job during the period in which he or she made each of the 120 payments. The repayment period does not include time spent in deferment or forbearance.

[c] Definition of "Public Service Job"

The term "public service job" is defined as "a full-time job in emergency management, government, military service, public safety, law enforcement, public health, public education (including early childhood education), social work in a public child or family service agency, public interest law services (including prosecution or public defense or legal advocacy in low-income communities at a nonprofit organization), public child care, public service for individuals with disabilities, public service for the elderly, public library sciences, school-based library sciences and other school-based services, or at an organization that is described in section 501(c)(3) of the IRS Code and exempt from taxation, or teaching as a full-time faculty member at a Tribal College or University and other faculty teaching in high-needs areas, as determined by the Secretary."

[6] Definitions for Economic Hardship Deferment n9

The definition of "economic hardship" for purposes of economic hardship deferment is amended to conform to the definition of "partial financial hardship" that is necessary to qualify for an income-based repayment plan (IBR).

Legal Topics:

For related research and practice materials, see the following legal topics:
Education LawAdministration & OperationStudent Financial AidGeneral Overview

FOOTNOTES:
(n1)Footnote 1. Pub. L. No. 110-84, *121 Stat. 784* (Sept. 27, 2007). *See also* National Consumer Law Center, Student Loans (2007 Supp.).

(n2)Footnote 2. Pub. L. No. 110-84, § 102, *121 Stat. 784* (Sept. 27, 2007).

(n3)Footnote 3. *Id.* § 201.

(n4)Footnote 4. *Id.* § 202.

(n5)Footnote 5. *Id.* § 203.

(n6)Footnote 6. In contrast, the new public service program states explicitly that only payments after October 1, 2007, will count toward the ten years of repayment required prior to cancellation.

(n7)Footnote 7. Pub. L. No. 110-84, § 401, *121 Stat. 784* (Sept. 27, 2007).

(n8)Footnote 8. The last provision would apply if, for example, a borrower has a graduated plan in which payments start out at less than the amount due under a ten-year standard plan but eventually grow to that, or a higher, amount.

(n9)Footnote 9. Pub. L. No. 110-84, § 304, *121 Stat. 784* (Sept. 27, 2007).

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PART I Consumer Credit
CHAPTER 12 Student Loans and Trade School Abuses

1-12 Consumer Credit Law Manual § 12.03

§ 12.03 Repayment Options Prior to Default

[1] FFEL Repayment

Standard repayment plans are the "typical" repayment plans that borrowers will get if they fail to choose another option. n1 Standard plans carry the highest monthly payments and borrowers generally pay the same amount for each installment period. The monthly amount may vary if there is a variable loan rate. Borrowers have at least five years, but not more than ten years to repay an FFEL loan with a standard plan. n2

Graduated repayment plans are also available. Under these plans, payments start out low and increase every two years. The repayment period will vary from twelve to thirty years, depending on the total amount borrowed. n3

Extended repayment plans are another option. These plans allow loan repayment to be extended over a period from generally twelve to thirty years, depending on the total amount borrowed. Borrowers still pay a fixed amount each month of at least $50, but monthly payments usually will be less than under the Standard repayment plan. Borrowers will also usually pay more interest because the repayment period is longer. n4

Most relevant to low-income client are the income-sensitive repayment plans ("ISRP"). n5 With these plans, the amount of the borrower's installment payment is adjusted annually based on the borrower's expected total monthly gross income.

Borrowers are required to submit income information to the lender in order to establish an income-sensitive repayment plan. If the documentation shows that the borrower will be unable to repay the loan within the maximum ten year repayment period, the lender is required to grant forbearance to the borrower for up to five years. n6

The ISRP plans with FFELs are generally much less affordable than the income contingent repayment plan ("ICRP") available for Direct Loans and discussed below. This is because monthly payments under an ISRP, unlike an ICRP, must cover at least accruing interest. n7

[2] Federal Direct Loan Repayment

As of July 1, 2006, the rules for Direct Loan repayment plans are the same as for FFEL, except for the Direct Loan

Income Contingent Repayment Plan (ICR). n8 Borrowers are required to pay loans back on these plans within ten years. As with FFELS, the ten-year period is tolled during the time of any deferments or forbearances. The Direct Loan regulations require that a borrower pay a minimum of $50 per month under the standard repayment plan. n9

For Direct Loan graduated and extended plans, the regulations set out specific repayment periods based on the amount of the loans. The Direct Loan program also allows for alternative payment plans to accommodate a borrower's "exceptional circumstances." n10

The more generous provisions of the Direct Loan ICRP are particularly useful for low-income borrowers. n11 As with an FFEL income sensitive plan, the ICRP allows borrowers to submit income documentation that is used to derive an affordable monthly payment. Unlike an ISRP, monthly payments under an ICRP do not need to cover monthly accruing interest. Monthly payments can be very low, even zero for borrowers with households incomes below the poverty level. n12

Under the ICRP, borrowers make minimal payments if they are below poverty income, taking family size into account. Payments increase incrementally as income increases. The required payments are capped at 20% of any earnings above the poverty level. n13 If borrowers continue making payments for twenty-five years, any debt that remains is forgiven. n14 However, this forgiven amount may be taxable income. n15

[3] Perkins Loan Repayment

Perkins repayment plans vary from FFELs and Direct Loans in several significant ways. The regulations set out minimum monthly repayment rates. Schools are allowed to extend the repayment period due to a borrower's prolonged illness or unemployment. n16 Interest continues to accrue during any extension of a repayment period.

[4] Interest Rates

The interest rates for FFELs, Direct Loans, and Perkins Loans are limited by federal regulations. n17 In 2007, Congress passed legislation that provides for gradual reductions in interest rates for subsidized Stafford loans. n18 The rates remain fixed at 6.8% through July 1, 2008. For loans first disbursed on or after July 1, 2008, and before July 1, 2009, the interest rate is 6%. The rates are then reduced to 5.6% for loans first disbursed on or after July 1, 2009, and before July 1, 4.5% for loans first disbursed on or after July 1, 2010, and before July 1, 2011, and 3.4% for loans first disbursed on or after July 1, 2011, and before July 1, 2012. PLUS loan interest rates are also variable and currently capped at 9 percent. n19 The interest rates on these variable loans adjust annually based on statutorily established market-indexed rate-setting formulas. n20 Perkins loan interest rates are fixed, currently at 5 percent. n21 Under current law the interest rate charged to all non-consolidation loan borrowers, except PLUS borrowers, is due to change on July 1, 2006, from a variable rate with an 8.25 percent cap to a 6.8 percent fixed rate. n22

With the exception of Perkins, interest rates for these loan programs are variable. Interest rates for consolidation loans, in contrast, are currently fixed. The fixed rate is based on the weighted average of the interest rates on the loans at the time of consolidation, rounded up to the nearest one eighth of one percent. The interest rate does not exceed 8.25 percent. n23 Each program has various repayment incentives that allow lenders to reduce interest rates for borrowers who make payments electronically and in other circumstances. n24

[5] Private Loans

[a] Growth in Private Student Lending

The private student loan business has experienced tremendous growth in recent years. Despite the boom in private lending, the vast majority of students still borrow primarily federal loan products. According to 1999-2000 data from the Department, less than 4% of all students received private loans during that year. n25 However, private loan

programs are coming on strong. Private borrowing by students rose to about $5 billion in 2001-2002, up from about $1 billion in 1995-1996. n26

Private student loans continue to grow relative to the federal loans provided through the student aid system. As of 2006, private student loans totaled $17.3 billion, having grown at an average annual rate of about 27% between 2000-2001 and 2005-2006 after adjusting for inflation. n27

[b] Comparing Private Loans and Federal Loans

Private loan terms and conditions, including interest rates and fees, are generally determined by an individual's or a co-signer's credit history. Thus, low-income students and/or those with negative credit histories are more likely to receive loans on less favorable terms. Federal student loan borrowers, in contrast, must meet eligibility requirements but do not have to prove creditworthiness. n28 All eligible federal loan borrowers are subject to the same rules regarding interest rates and other terms.

Another critical difference is the lack of certain protections for private loan borrowers. For example, students with private loans are not eligible for the same types of discharge options discussed later in the Chapter. n29 The same is true for deferment and forbearance rights, all of which depend on the lender's policies and the terms of the loan contracts rather than on federal regulations.

On the other hand, there are certain advantages for private loan borrowers. Under current law, student loans made entirely by private entities should be dischargeable in bankruptcy. n30 In addition, unlike federal loan collections, there should be a statute of limitations for collection of private loans. n31 Private lenders have fewer collection tools. However, there is also no federal regulatory scheme, as discussed above, to ensure that borrowers have flexible repayment options, deferment rights, and rights to affordable payment plans. Whether these rights exist for private loan borrowers depends on the terms of the loan contract and lender policies. n32

The 2008 HEA reauthorization law includes a number of amendments to the Truth in Lending Act with respect to private student loan disclosures. The Federal Reserve Board is required to issue regulations to implement these changes no later than one year after the date of enactment of the law (August 14, 2008), and the regulations must become effective not later than six months after the date of issuance. n33 Some of these new disclosures will be required in private education loan applications and solicitations. Lenders will have to clearly and conspicuously provide information, including the potential range of interest rates; whether the rate is fixed or variable; payment deferral options; an example of the total cost of the loan over the life of the loan; information that the borrower may qualify for federal student assistance and the interest rates available with respect to these programs; information that the borrower has the right to accept the terms and consummate the transaction at any time within thirty calendar days following the date on which the application is approved; and that, except for changes based on adjustments to the index used for a loan, the rates and terms may not be changed during this time. n34 Other disclosures must be given contemporaneously at the time of approval and still others before loan consummation.

This should lead to changes in the timing of TILA disclosures for private loans. The current Truth in Lending regulations contain special rules for interim student credit extensions. n35 These are defined as credit plans that involve extensions of credit for education purposes in which the repayment amount and schedule are not known at the time the credit is advanced. n36 For interim credit extensions under a student credit program, the creditor is not required to disclose the finance charge, payment schedule, the total of payments, or the total sale price.

[6] Student Loan and Income Tax Issues

Beginning in 1998, taxpayers with qualified loans to pay certain costs of attending higher education have been allowed to take tax deductions from gross income for the interest they pay on these loans. n37 Qualified loans are loans taken

out solely to pay qualified education expenses for an individual, his or her spouse, or a dependent. The loans must also be for education provided during an academic period for an eligible student. Loans from related persons and qualified employer plans do not qualify. The maximum deductible interest on a qualified student loan is $2500 per return. Married taxpayers filing jointly are allowed to deduct the full amount only when their modified adjusted gross income is $100,000 or less. For those with incomes between $100,000 and $130,000, the deduction is gradually reduced. Taxpayers filing as single, head of household, or qualifying widow(ers) may take the full $2500 deduction as long as their adjusted gross income is $50,000 or below. The amount of the student loan interest deduction increased in 2008. The deduction in 2008 is phased out if a borrower's modified adjusted gross income is between $115,000 and $145,000. This is an increase from the 2007 limits of $110,000 and $140,000. Parents may also deduct interest for loans taken out to pay children's' education as long as the child was a dependent when the parent received the loan.

There are additional tax benefits for education, including (1) certain tax-free scholarships and fellowships; (2) non-refundable Hope and Lifetime Learning Credits of up to $1500 for qualified education expenses paid for each eligible student; n38 (3) limited deductions for tuition and related expenses; and (4) deductions for work-related education. It is unclear how effective these programs have been in increasing access to higher education, particularly for the neediest students. n39

There should not be tax consequences when a borrower's loan is cancelled. The I.R.S. has stated that it may issue guidance on this issue in the future but, in the meantime, lenders and guaranty agencies are not subject to penalties for failure to report amounts forgiven pursuant to the terms of a debt obligation. This specifically includes forgiveness upon a stated event such as death, disability, or service as a teacher. n40 In addition, the Internal Revenue Code specifically allows tax-free treatment for loans that are cancelled through programs tied to work for certain amounts of time in certain professions, such as teaching. n41 There are, however, potential tax consequences when a borrower's loan is written off after paying for twenty-five years using an income-contingent repayment plan. n42

Legal Topics:

For related research and practice materials, see the following legal topics:
Education LawAdministration & OperationStudent Financial AidGeneral OverviewEducation LawAdministration & OperationStudent Financial AidPrivate ScholarshipsTax LawFederal Income Tax ComputationDeductions for Nonbusiness ExpensesEducational Expenses (IRC secs. 127, 221)

FOOTNOTES:

(n1)Footnote 1. *34 C.F.R. § 682.209(a)(7)(vi).*

(n2)Footnote 2. *34 C.F.R. § 682.209(a)(8)(i).*

(n3)Footnote 3. *34 C.F.R. § 682.209(a)(8)(i).*

(n4)Footnote 4. *34 C.F.R. § 682.209(a)(8)(i).*

(n5)Footnote 5. *34 C.F.R. § 682.209(a)(7)(viii).*

(n6)Footnote 6. *34 C.F.R. § 682.209(a)(7)(viii)(D).*

(n7)Footnote 7. *34 C.F.R. § 682.209(a)(7)(iv).*

(n8)Footnote 8. *34 C.F.R. § 685.208.*

(n9)Footnote 9. *34 C.F.R. § 685.208(b)(3).*

(n10)Footnote 10. *34 C.F.R. § 685.208(g).*

(n11)Footnote 11. *34 C.F.R. § 685.208(f).*

(n12)Footnote 12. *See* National Consumer Law Center, Student Loan law, § 8.2.2.5 (3d ed. 2006 and Supp.).

(n13)Footnote 13. *34 C.F.R. § 685.209(a)(2).*

(n14)Footnote 14. *34 C.F.R. § 685.209(c)(4)(iv).*

(n15)Footnote 15. *See generally* National Consumer Law Center, Student Loan Law, § 8.2.2.6 (3d ed. 2006 and Supp.).

(n16)Footnote 16. *34 C.F.R. § 674.33(c).*

(n17)Footnote 17. *34 C.F.R. § 682.202(a)* (FFEL); *34 C.F.R. § 685.202(a)* (Direct Loans); *34 C.F.R. § 674.31* (Perkins). Effective July 1, 2003, federal student loan interest rates dropped even lower. The new rate for borrowers repaying Stafford loans issued beginning July 1998, is 3.42%, down from 4.06%.

(n18)Footnote 18. Pub. L. No. 110-84, *121 Stat. 784* (Sept. 27, 2007) (amending *20 U.S.C. § 1077a(l)*).

(n19)Footnote 19. *34 C.F.R. § 682.202(a)(2)(v)* (FFEL); *34 C.F.R. § 685.202(a)(2)* (Direct).

(n20)Footnote 20. For FFEL Stafford loans, for example, the market-based formula is the bond equivalent rate of the ninety-one-day Treasury bills auctioned at the final auction prior to the June 1 immediately preceding the July 1-June 30 period plus 1.7 percent during the in-school, grace, and deferment periods and 2.3 percent during repayment. *34 C.F.R. § 682.202(a)(1)(viii)(A).*

(n21)Footnote 21. *34 C.F.R. § 674.31(b)(1).*

(n22)Footnote 22. *20 U.S.C. § 1077a(l)(1).* The PLUS loan program is also scheduled to move to a fixed rate, but at the higher rate of 7.9 percent. *20 U.S.C. § 1077a(l)(2).*

(n23)Footnote 23. *34 C.F.R. § 682.202(a)(4)(iv)* (FFEL); *34 C.F.R. § 685.202(a)(3)(i)(E)* (Direct).

(n24)Footnote 24. *See, e.g., 34 C.F.R. § 685.211(b)*; *34 C.F.R. § 674.33(f)* (Perkins program allows reduction of interest rates for borrowers who make 48 consecutive monthly repayments and reductions on balances for loans paid before end of repayment period).

(n25)Footnote 25. Kate Rube, State PIRGs' Higher Education Project, *Private Loans: Who's Borrowing and Why?* (April 2003). The report may be downloaded at www.uspirg.org..

(n26)Footnote 26. Kate Rube, State PIRGs' Higher Education Project, *Private Loans: Who's Borrowing and Why?* (April 2003). The report may be downloaded at www.uspirg.org.. The study also found that private borrowing at for-profit institutions was higher than at public institutions. At less-than-two-year institutions, the average private loan was $6,095.

(n27)Footnote 27. *See generally* College Bd., *Trends in Student Aid 2006* (2006), *available at* www.collegeboard.com/prod_downloads/press/cost06/trends_aid_06.pdf.

(n28)Footnote 28. Parent PLUS loan borrowers, in contrast, are required to meet certain creditworthiness standards.

(n29)Footnote 29. *See § 12.06 infra.*

(n30)Footnote 30. *See generally § 12.06[4] infra.*

(n31)Footnote 31. *See § 12.04[6] infra*. The elimination of the statute of limitations in the Higher Education Act applies only to federal loans. *20 U.S.C. § 1091a*.

(n32)Footnote 32. For further discussion of the differences between private and government student loans, see National Consumer Law Center, Student Loan law, § 1.5.2 (3d ed. 2006 and Supp.).

(n33)Footnote 33. *Id*. § 1021 (amending the Truth in Lending Act, *15 U.S.C. § 1638*).

(n34)Footnote 34. Pub. L. 110-315, § 1021(e), *120 Stat. 3078* (Aug. 14, 2008).

(n35)Footnote 35. Reg. Z, *12 C.F.R. § 226.17(i)*.

(n36)Footnote 36. Reg. Z, 12 C.F.R. Pt. 226, Supp. I, § 226.17(i) (Official Staff Commentary).

(n37)Footnote 37. For more information, see Internal Revenue Serv., Publication 970, "Tax Benefits for Education" (2004); Internal Revenue Serv., Tax Topic 456, "Student Loan Interest Deduction." *See also 69 Fed. Reg. 25489* (May 7, 2004) (Deduction for Interest on Qualified Education Loans).

(n38)Footnote 38. The Hope Credit is a non-refundable credit per student per year equal to 100% of the first $1000 of qualified tuition and related expenses and 50% of the next $1000 paid for a student's education for the first two years of post-secondary education. The Lifetime Learning Credit is a non-refundable credit but is calculated per taxpayer per year for an unlimited number of years and equals 20% of qualified tuition and related expenses not exceeding $10,000. Both are phased out for higher income taxpayers. *See* Internal Revenue Serv., Publication 970, "Tax Benefits for Education" (2004).

(n39)Footnote 39. *See, e.g.*, Michael Arnone, *Education Tax Credits Fall Short, Study Finds*, The Chron. of Higher Educ. A27 (Oct. 24, 2003).

(n40)Footnote 40. *69 Fed. Reg. 62181* (Oct. 25, 2004) .

(n41)Footnote 41. *See* Internal Revenue Serv., Publication 970, "Tax Benefits for Education" (2004); *26 U.S.C. 108(f)*.

(n42)Footnote 42. *See* National Consumer Law Center, Student Loan Law § 8.2.2.6 (3d ed. 2006 and Supp.).

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PART I Consumer Credit
CHAPTER 12 Student Loans and Trade School Abuses

1-12 Consumer Credit Law Manual § 12.04

§ 12.04 Student Loan-Related Collections

[1] Introduction

Many of the legal issues involving student loans are related to the collection of delinquent and defaulted loans. Student complaints of deception and abuse by both private collectors and guarantors are leading to more and more litigation in this area, n1 including class action litigation. n2

The Higher Education Amendments of 1998 require the new Chief Operating Officer ("COO") of the student loan program to appoint a student loan ombudsman to assist borrowers in resolving student loan complaints. n3 The COO is also required to publicize the availability and function of the ombudsman and report on his/her activities and effectiveness to Congress. The report must also include an analysis of borrower complaints.

The key issue in any challenge to student loan collection activity is determining the appropriate legal claim to use against the entity doing the collection. Claims may vary significantly depending on whether the entity is a private collector, a nonprofit guarantor, a state agency, or the DOE.

The first problem many borrowers face is figuring out which agency is collecting their loans. This information is critical to resolving student loan problems efficiently.

Defaulted loans may be held by the DOE, by a state guaranty agency, or by the school. The Department and state guaranty agencies also contract with private collection agencies to administer many of their collection responsibilities. n4

A good place for borrowers to start is the federal student aid information center, 1-800-4-FED-AID (800-433-3243). The information center staff should be able to give borrowers the address and telephone number of the agency holding a defaulted loan. Borrowers with Direct Loans should contact the Direct Loan Servicing Center at (800) 848-0979. The number for information about Department-held loans is (800) 621-3115. More information is also available on the Department's website at *www.ed.gov*. n5

It is best to contact the student loan ombudsman for help only after these other avenues have been exhausted. For more

information about the student loan ombudsman, go to www.ombudsman.ed.gov.

[2] Common Student Loan Debt Collection Abuses

[a] Violations Unique to Student Loans

Student loan borrowers routinely receive dunning letters threatening that the Department will garnish their wages without "legal action." These letters imply that the former student will receive no notice before the wage garnishment and that there will be no opportunity either to contest the validity of the student loan or to present defenses. In truth, the statute and regulations require both notice and an opportunity for an administrative hearing before an employer may be ordered to withhold any wages. n6

Collectors may misrepresent a student's ability to obtain a closed school, unpaid refund, or false certification discharge. Collection agencies make no commissions from those obtaining the discharge, while they recover a set percentage on any payments made. These collectors thus have an incentive to discourage discharge applications. For this reason, the Department instructs them not to make any kind of determination concerning a student's eligibility, but instead to refer queries related to closed school, false certification, or unpaid refund discharges. n7

There is likely to be even more confusion and misinformation as the Department gears up to implement federal benefit offsets to collect student loans. For example, borrowers have reported numerous instances of collectors threatening to offset benefits even if the borrower receives SSI payments only. In fact, SSI benefits are completely exempt from offset.

Borrowers have also reported that the Department routinely continues collection even after borrowers have submitted disability discharge applications. This practice also clearly violates Department regulations. n8

In addition, collection agencies frequently mislead borrowers with respect to repayment options. In particular, agencies are often very aggressive in steering borrowers into loan consolidation or loan rehabilitation programs. These repayment strategies, benefit many, but not all, borrowers. Consolidation is equivalent to full payment of the existing obligation and collectors are compensated accordingly.

[b] Illegal Debt Collection Activity Not Unique to Student Loans

Student loan collectors may also engage in a number of other basic forms of illegal debt collection practices that apply to the collection of any type of consumer debt.

This subsection briefly lists a number of practices that are prohibited under the federal Fair Debt Collection Practices Act ("FDCPA"), and that can lead to actions for actual damages, up to $1000 in statutory damages, plus attorney fees. n9

Examples of fair debt collection standards include:

- The collection agency must stop contacting the student if the student so requests in writing. n10

- The collection agency, in its initial communication or within five days of that communication, must send the student a written notice identifying the debt and the creditor and giving the student the right to dispute the debt or to request the name and address of the original creditor, if different from the current one. If the student raises a dispute, the collector must suspend collection efforts on the disputed portion of the debt until the collector responds to the request. n11

The following collection agency conduct also violates the FDCPA:

- Communicating with third parties, such as relatives, employers, friends, or neighbors, about a debt unless the student or a court has given the collector permission to do so. Several narrow exceptions to this prohibition apply. Collectors may contact creditors, attorneys, credit reporting agencies, cosigners, spouses, and parents if the student is a minor. Third-party contacts are also permitted if the contacts are solely for the purpose of locating the student and do not reveal in any way the contact's underlying purpose. n12

- Communicating with the student at unusual or inconvenient times or places. The times 8:00 A.M. to 9:00 P.M. are generally considered convenient, but daytime contacts with a consumer known to work a night shift may be inconvenient. n13

- Contacting a student at work if the collector should know that the employer prohibits personal calls, or contacting the student at other inconvenient places, such as a friend's house or the hospital. n14

- Contacting a student represented by a lawyer, unless the lawyer gives permission for the communication or fails to respond to the collector's communications. n15

- Using obscene, profane, or abusive language. n16

- False representation of the amount of any debt should also violate state and/or federal fair debt collection practices statutes. These claims may arise in a number of ways, including improper calculation of collection fees and improper crediting of payments. n17

One key issue is whether an entity may evade liability by arguing that a violation occurred due to a bona fide error. n18 Debt collectors are not liable under the FDCPA if they can show by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error. n19

[3] Applicability of FDCPA to Student Loan Collections

The Federal FDCPA n20 is the key statute offering students protection from debt collection harassment. The statute specifies numerous prohibited collection techniques, provides debtors with certain rights, and provides students with statutory and actual damages and attorney fees for violations. n21 The key FDCPA issue for students is whether the Act applies to student loan collection activities.

The FDCPA specifically excludes any officer or employee of the United States or any state to the extent that their activities are in the performance of their official duties. n22 While the DOE is thus excluded if it collects its own debts, the FDCPA applies to private collection agencies hired by the Department. n23

For Department-held loans, the law is very clear. The Department's own actions are not covered, and those by private collectors are. The problem in many cases though is determining who in fact engaged in the deceptive conduct--the private collector or the Department.

Even if the Department is partially responsible for deceptive collection practices, the debt collection agency doing the actual collection may still be liable under the FDCPA. For example, even if deceptive dunning notices that instruct payment to go to a debt collector are found to emanate from the Department, the letter may be viewed as an "indirect" attempt by the collection agency to collect a debt, which is within the literal scope of the FDCPA. n24 Student loan debt collectors have also claimed that they are not subject to the FDCPA in cases where the FDCPA prohibits behavior that is required pursuant to HEA due diligence collection rules. n25 At least one court concluded that it may be appropriate

for specific provisions of the HEA to qualify specific provisions of the FDCPA. However, where the HEA is silent, the court gave full effect to the FDCPA. n26

If a lender has not yet turned a FFEL over to the guarantor or where a school is collecting on a Perkins Loan, the FDCPA does not apply if the lender or school is doing the collection activity by its in-house staff. The FDCPA does not apply to creditors, but only to collection agencies. n27 On the other hand, if the lender or school turns the loan over to a third party for collection, that third party is liable under the FDCPA. n28

In most cases, collection on FFELs is conducted by guaranty agencies or collection agencies hired by the guarantor. If a guaranty agency hires a private collector, that collector is covered by the FDCPA in the same way that a collector hired by the Department is covered. Guaranty agencies engaging in collection activity, in contrast, may be exempt under the Act's exclusion of state employees, n29 depending upon the structure and authority given the agency by the state legislature. The Ninth Circuit addressed the issue of guarantee agencies in a 2009 case. n29.1 In this case, the guaranty agency Educational Credit Management Corp. (ECMC) presented three possible grounds for FDCPA exemption, including that its collection activities were incidental to a bona fide fiduciary obligation, that its collection activity concerned a debt which it originated, and that it was a "creditor" rather than a "debt collector." The Ninth Circuit addressed the first ground only, finding that ECMC was not exempt under this category and remanding to the lower court to consider the other grounds. The court agreed that the agency had a fiduciary obligation to the Department of Education but that the collection activity was not incidental to this obligation. Although the court noted that the collection of defaulted loans is generally incidental to a guaranty agency's primary function, in this case the court accepted the borrower's evidence that the loan was assigned to ECMC by a different guarantor and acted as a collection agent. n29.2 The court found that such collection activity was not incidental to the guaranty agency's fiduciary duty to the Department of Education. The court also acknowledged that ECMC may turn out to have had a broader role than merely acting as a collector.

Guaranty agencies should not be exempt from liability under this "government actor" exemption to the Fair Debt Collection Practices Act. n30 The key issue in bringing an FDCPA action against a guarantor is determining initially whether the guarantor is a state or a private nonprofit entity.

[4] Applicability of State Debt Collection Law to Student Loans

Whether state debt collection law applies to student loan collection is an important issue. While the FDCPA exempts creditors and government agencies from its scope, state law often does not. In addition, state law may specifically prohibit certain collection activity not explicitly restricted by the FDCPA. State laws that may apply include state debt collection statutes, state unfair and deceptive acts and practices ("UDAP") statutes, and common law tort theories. n31

[5] Collection Fees and Penalties

[a] Amount of Fees

A particular area of concern for students is the collection of fees and penalties that are assessed by the entity attempting to collect on the loan. Most of these fees are associated with collection agency costs which arise due to the Department's routine practice of turning over defaulted loans to one of several major collection agencies with whom it has contracted.

There is no easy way to take an account away from a collection agency and avoid the collection fees. Even if a student attempts to pay the Department directly, the fees will be assessed. One exception is that no collection fees are assessed on amounts seized from tax refunds.

There are three strategies a student can use to avoid paying collection costs once a loan has been turned over to a collection agency. One solution is to consolidate the defaulted loan into a new Direct or FFEL loan. The consolidation

loan will include an 18.5% collection fee from the old loan, but no further amounts will go to collection fees (unless the consolidated loan goes into default). n32 A second approach is to try to cancel the student's obligation on the loan. n33 Making payments through a chapter 13 bankruptcy plan may also avoid collection fees. n34 Third, the student can complain about the collection agency's illegal or improper conduct to the Department. Sometimes the Department will then take the loan away from the collector.

A particular area of concern is the legally allowable amount of fees. Because of confusion in this area, the Department recently agreed to temporarily limit fees to 25%. This agreement arose from a lawsuit in New York in which students sued the Department for assessing 43% collection fees on certain student loan borrowers whose loan notes specified 25% collection fees. n35 The Department admits that it was in error to systematically charge 43% collection costs to those with the 25% provision in their notes. n36 It also admits that it has no method for easily distinguishing those with the 25% collection provision from other students.

Through early 2001, the Department abided by the *Gibbons* settlement and did not publicly announce or implement an alternative system. For most of this time, the Department stated on its website that collection costs would be no more than 25%.

In spring 2001, however, the Department began sending out notices to borrowers with loans that the Department had reviewed and determined that the collection fees charged the borrower did not exceed the promissory note, explaining this to them and advising the students of what to do if they felt they had been overcharged. n37

As of 2002, the Department was still sending out these notices with plans to complete the process by the end of the year.

Although this agreement does not directly bind state guaranty agencies in their assessment of collection fees, the same principles should apply to the larger universe of student loans held by state guaranty agencies. In addition, guaranty agencies cannot charge more in collection fees than the Department can charge. n38 Collection costs for rehabilitated loans may not exceed 18.5% of the unpaid principal and accrued interest at the time of sale. n39 Collection costs should be added to the unpaid principal at the time of sale. The implication is that collection costs should not be added prior to the sale while the borrower is making the required twelve consecutive monthly payments.

In an effort to minimize the pressure many collection agencies were placing on borrowers to consolidate loans, Congress in 2005 set new standards to ensure that consolidation loans are not an excessive proportion of a guaranty agency's recoveries on defaulted loans. n40

Under the new rules, if a borrower repays a defaulted loan through a FFEL consolidation loan on or after October 1, 2006, collection fees are still capped at 18.5%. However, when returning proceeds to the Department after consolidation, a guaranty agency that charged the borrower collection costs after October 1, 2006, must remit an amount that equals the lesser of the actual collection costs charged or 8.5% of the outstanding principal and interest. n41 By Oct. 1, 2009, guaranty agencies will have to remit the entire collection cost charged when returning proceeds from the consolidation of a defaulted loan that is paid off with excess consolidation proceeds. Excess proceeds means the amount of proceeds from the consolidation of defaulted loans under FFEL that exceed 45% of the agency's total collections on defaulted loans in that fiscal year. n42

In June 2007, the Department issued rules proposing to set limits on Perkins collection fees. The limits would apply to loans placed with a collection firm on or after July 1, 2008. The limits on collection costs will be:

-- For first collection efforts, 30% of the amount of principal, interest, and late charges collected;

-- For second and subsequent collection efforts, 40% of the amount of principal, interest, and late charges collected; and

-- For collection efforts resulting from litigation, 40% of the amount of principal, interest, and late charges collected plus court costs. n43

These proposals were adopted. The new collection fee limits are effective for loans placed with a collection agency on or after July 1, 2008. n44 In making this change, the Department specifically chose not to set the collection cost caps at the same level as in the FFEL program.

[b] Guaranty Agency Collection Fees

The Department's regulations require guaranty agencies to charge collection fees, whether or not provided in the borrower's promissory note. The method of allocating students' payments to the fees, effective January 1, 1998, must be the same as for Department-held loans. n45 The guaranty agency cannot assess an amount in advance for collection fees, but must, instead, apportion a percentage of each payment toward collection fees. n46 The guarantor has authority to compromise the amount of collection fees if it receives all principal and interest in full. n47 Guaranty agencies cannot charge more than what the Department would charge for collection fees. n48 The Department currently does not charge more than 25% in collection fees. n49 The same limit should therefore apply to guaranty agencies. In addition, a guaranty agency has authority to compromise the amount of collection fees charged if it receives all principal and interest in full. n50

[c] Collection Fees Sought by Lenders

The FFEL regulations set out what collection costs the lender can seek (that is, before the loan is turned over to the guarantor). n51 The lender can seek no collection costs unless such charges are authorized in the promissory note and such costs are actually incurred by the lender or its agent. n52

[d] Perkins Collection Fees

There are distinct collection fee provisions for schools collecting Perkins loans. These schools must charge all reasonable costs with regard to a loan obligation. n53 The amount of collection costs charged must be based on either the actual costs incurred for collection actions with regard to the individual borrower's loan or average costs incurred for similar actions taken to collect loans in similar stages of delinquency. n54

Before filing suit on a loan, the school may waive collection costs as follows: (1) The school may waive the percentage of collection costs applicable to the amount then past-due on a loan equal to the percentage of that past-due balance that the borrower pays within thirty days after the date on which the borrower and the school enter into a written repayment agreement or (2) The school may waive all collection costs in return for a lump-sum payment of the full amount of principal and interest outstanding. n55 Schools are required to apply payments on loans in the following order: (i) collection costs; (ii) late charges; (iii) accrued interest; and (iv) principal. n56

[6] Statute of Limitations as Defense to Collection Action

The Higher Education Technical Amendments of 1991 eliminated all statutes of limitations for any collection action by a school, guaranty agency, or the United States under a federal loan program. n57 This also eliminated all limitation periods for tax intercepts, wage garnishments, and other collection efforts.

The provision eliminating the statute of limitations applies retroactively, n58 so that loans whose limitations period had expired even before 1991 are revived. In a 2002 decision, a North Carolina district court noted the "obvious difficulty" that the retroactive application of the statutory change causes for students. n59 The borrower in this case was sued in 1998 for a student loan she had incurred between 1970 and 1972 and that she claimed to have repaid in 1973. The court initially granted summary judgment for the borrower but reversed itself in response to the government's motion to alter

or amend the judgment. The problem, as discussed by the court, is that "people do not keep records indefinitely, especially when there is no apparent purpose to do so." n60

[7] Tax Refund Interceptions

[a] Introduction

Tax refund interception is the major technique used to collect student loans. The tax refund intercept program involves a blanket seizure of almost all tax refunds due to debtors who are in default on their student loans, including the seizure of owed Earned Income Tax Credits. n61 Only federal government agencies have the authority to actually attach a debtor's tax refund. n62 There is no statute of limitations for such an offset. n63

The only sure-fire method of avoiding a tax refund intercept is to lower federal income tax withholding from earnings and any estimated tax payments. If at the end of the year, the taxpayer is not owed a refund, there can be no interception.

Another approach to stopping an intercept or recovering intercepted amounts is to file for personal bankruptcy. Filing a bankruptcy petition before the intercept activates the U.S. Bankruptcy Code automatic stay provision. n64 The stay prohibits virtually all actions against the debtor's property, including intercepts of owed tax refunds.

[b] Right to a Pre-Intercept Hearing

The Secretary can refer a debt for offset only after complying with certain procedures set out in *34 C.F.R. section 30.33(a)*.

First, the Secretary, or guarantor acting on behalf of the Secretary, must send the student a written notice of intent to seek the tax intercept. n65 Courts have held that actual notice is not required, so long as reasonable means are used to provide notice. n66 The student then has a right to inspect his/her file and must make a request to do so within twenty days of the notice. n67 To obtain a review, the student must file a request for review at the address specified in the notice by the *later* of 65 days after the date of the notice or fifteen days after the student's loan file is provided, if requested. n68 (A student can request a later hearing, but only a timely hearing request will stop the intercept pending the hearing.)

The timely request for a hearing stops the intercept until the hearing and any further request for review have been exhausted. The statute specifies that no intercept can occur until there is a determination that a debt is owed. n69

The student can also request a written agreement to repay the debt if the student does so within twenty days of receiving the notice. n70 The Secretary or guarantor provides a repayment schedule, and, to avoid the intercept, the student must make the first payment within 65 days of receipt of the original notice. n71

[c] Grounds to Contest a Tax Intercept

While many borrowers report frustration in raising even the most meritorious defenses to a tax intercept, the Department's stated policy is to consider the following types of defenses:

- The borrower has repaid the loan or the social security number is incorrect and the borrower does not owe the loan;

- The borrower has entered into a repayment agreement with the guaranty agency or the Department and the borrower is making payments as required;

- The borrower has filed for bankruptcy and the case is still open or the loan was discharged in bankruptcy; n72

- The school failed to pay the borrower an owed refund;

- The borrower is dead or totally and permanently disabled; n73

- The loan is not enforceable. The Department will apparently recognize forgery or alteration of the loan documents as a defense. It should also recognize school-related defenses on Perkins, Direct, and many FFEL Loans issued after January 1, 1994. n74 It is less clear whether the Department will consider school-related defenses (other than the failure to pay an owed refund) for FFELs issued before that date;

- The borrower is eligible for a closed-school discharge; n75

- The borrower is eligible for a false certification discharge. n76

[d] Post-Intercept Challenges

The Internal Revenue Service ("IRS") notifies the student after the fact of the tax refund intercept. n77 The IRS takes the position that there is no right to an administrative review of the intercept within the IRS and courts do not have jurisdiction to hear challenges against the IRS n78 based on the intercept. n79 As a consequence, any post-intercept challenge should be directed to the DOE, not the IRS.

[8] Wage Garnishment

[a] Introduction

The Secretary and guaranty agencies are authorized the extraordinary remedy to garnish students' wages without first obtaining a court order. n80 The 1998 HEA clarifies that federal student loans and grants themselves are not subject to garnishment or attachment except for debts owed to the Department. n81

According to the Department's regulations, the guarantor shall initiate administrative wage garnishment proceedings by the 225th day after the guarantor takes over a loan. If the debtor has insufficient income to satisfy the debt through wage garnishment, but has assets from which the debt can be satisfied, the agency shall assign the loan to the Department. n82

The guarantor must offer the student an opportunity to enter into a repayment agreement, in lieu of the garnishment, on terms agreeable to the guarantor. n83 Prior to July 1, 2006, borrowers subject to wage garnishment were still able to consolidate their loans with the Direct Loan Program. However, Congress changed these rules effective July 1, 2006, and imposed most of the same limits on Direct loan consolidation that already existed on FFEL consolidations. Under these rules, borrowers facing wage garnishment may consolidate their loans only if the garnishment order is lifted.

Garnishment is also prohibited if the borrower has been involuntarily separated from employment until the borrower has been re-employed continuously for twelve months. The regulations depart from the statute in authorizing garnishment unless the guarantor has *knowledge* that this exception applies to a particular borrower. n84 This places the burden on the borrower to notify the guarantor of the lack of continuous employment. The regulations also do not provide notice to the employer in the withholding order of the twelve months continuous employment requirement. n85

Borrowers must inform loan holders that they qualify for the unemployment exception either by checking the appropriate box on the hearing form or by providing other written notice. However, borrowers should not also have to

provide documentation or other proof that they qualify for the exception. Thus, collection letters requiring borrowers to submit affirmative proof of eligibility may violate the FDCPA. n86

However, the hearing request form issued by the Department requires that borrowers attach proof of unemployment. In a 2005 Seventh Circuit case, the court granted summary judgment for the defendant collection agency on plaintiff's claim that the agency's use of this form violated the FDCPA. n87 The court found that the Department's interpretation of the law as presented on the hearing form might be wrong but that the collection agency was not liable for using the Department's prescribed form. n88 Although the court did not approve the Department's use of the forms, it did observe that the Department's handling of the unemployment exemption in the form was reasonable and proper. n89 Under the HEA, up to 10% of "disposable pay" may be garnished, which means gross pay less withholding taxes and other amounts required by law to be deducted (such as the total amount garnished by other creditors). n90 The maximum amount that can be garnished under HEA is the *lesser of* 10% disposable income and the amount permitted by *15 U.S.C. section 1673* (which protects income equal to 30 times the prevailing minimum wage). *15 U.S.C. section 1673* also limits total garnishments to 25% of disposable income, so that a student loan garnishment and other garnishments should not exceed 25% of income. Guarantors *cannot* elect to garnish wages under state law procedures (i.e., pursuant to a post-judgment court order). n91

The Debt Collection Improvement Act of 1996 ("DCIA") extended additional authority to federal agencies collecting agency debts. n92 In 2002, the Department proposed rules to operate wage garnishment procedures under the authority of the DCIA. n93 The final rules were published in February 2003 and became effective on March 21, 2003. n94 These rules, which are discussed below, should apply only when the Department initiates garnishment. The previous rules under the HEA should continue to apply to guaranty agency garnishment actions. n95 It is unclear how this will operate in practice, since the Department will be authorized to garnish a higher amount than guaranty agencies. On its web site, the Department simply explains that "under the Higher Education Act, the Department and guaranty agencies may require employers who employ individuals who have defaulted on the repayment of a student loan to deduct 10% of the borrower's disposable pay per pay period toward repayment of the debt. Also, the Debt Collection Improvement Act of 1996 permits the Department to garnish up to 15% of disposable pay." n96 With respect to garnishment authority under the DCIA, the Department has agreed that the aggregate amount to be withheld cannot exceed the 15% limit. n97

Many states place even greater restrictions on wage garnishment or prohibit the practice outright. These state law limitations on garnishment do not apply to garnishments to satisfy student loan obligations. n98 Similarly, state procedural requirements prior to garnishment are not likely to apply either. n99 On the other hand, certain tribal law restrictions on garnishment do apply. n100 Accounts should not be submitted to garnishment while a borrower is still negotiating repayment. A 2006 bankruptcy case cites a statement in the Department's publication, *Options for Financially-Challenged Borrowers in Default*, that the Department is generally willing to accept an installment payment plan under which the borrower pays 15% of disposable pay. n100.1 The rehabilitation regulations require that borrowers make *voluntary* reasonable and affordable payments. It is therefore clear that garnishment or other involuntary payments will not count toward the required nine rehabilitation payments. However, many guaranty agencies will work with borrowers, when pressed, to resolve this impasse. For example, in 2009 meetings with the guaranty agency trade association (National Council of Higher Education Loan Programs), the association reported that the majority of its guaranty agency members were willing to release garnishments for borrowers who showed a willingness to make voluntary reasonable and affordable payments. All others agreed to accept a token voluntary payment and subtract that amount from the garnishment amount so that the gross monthly payment does not change for the borrower. Although this latter scenario means that the garnishment will continue, the borrower will also be on the way to getting out of default through rehabilitation. This scenario can only work if the borrower can make it through nine months of garnishment. There also may be a delay, as discussed in Chapter 8, in completing the rehabilitation even after the required payments are made.

Borrowers are often confused about these options because of misleading collection letters. For example, a commonly used student loan debt collection letter first informs borrowers that they may face wage garnishment to collect the loan.

The letter then states: "However, if your financial situation warrants such consideration, we have been authorized to substantially reduce the amount on the above-referenced account and cease any further collection efforts if your account is paid in full or assist you in establishing a possible repayment program on your loan." This is misleading because, prior to garnishment, most borrowers are eligible for either consolidation or rehabilitation to get out of default. Both of these options require borrowers to make only reasonable, affordable, or income-based repayments. They do not have to prove that their financial situations "warrant consideration" nor should they pay more than what is reasonable and affordable. It is unclear why the borrower would agree to voluntary payments in the same amount as would be garnished.

[b] The Right to a Hearing

The Secretary or guaranty agency must notify the student before the garnishment. The student is entitled to a hearing with an independent official within the agency, but, according to the regulations, only at a location agreeable to the guarantor or by a telephone conference. n101 There is no requirement that the guarantor tape the hearing. n102 The borrower must be given the opportunity for a hearing to contest the existence or amount of the debt and the terms of the repayment schedule. n103

If the student's written request for a hearing is received within fifteen days of the student's receipt of the garnishment notice (receipt is presumed within five days of mailing of the notice), no garnishment can issue until the hearing is provided. n104 The Department regulations require guaranty agencies to issue the hearing decision within sixty days. n105

Possible grounds for contesting the loan obligation at the hearing include that the loan has already been repaid, that the social security numbers are wrong and the individual does not owe the loan, that the borrower is making repayments pursuant to a repayment agreement, that a bankruptcy proceeding is still pending or the loan was discharged in bankruptcy, that the borrower is totally and permanently disabled, that the school closed while the student was still enrolled, that the school falsely certified the student as eligible, that the school failed to refund money owed the student, that the loan is not enforceable, or that garnishment would result in extreme financial hardship. n106

At the hearing, the agency must provide evidence establishing the existence and amount of the debt and the agency's right to administratively garnish the borrower's wages. The case should not be allowed to proceed if, for example, the agency does not have a copy of the loan application and/or promissory note. After the agency has presented this information, the burden shifts to the borrower to provide the facts necessary to support the objection raised.

In a training manual for private collection agencies, the Department set out more specifically the type of information borrowers should submit at the hearing to support the various defenses. For the discharge-related defenses, borrowers should submit the required discharge forms and relevant supporting information. For borrowers claiming that they were entitled to a full or partial refund of their loans, the Department requests that borrowers answer the following questions and provide documentation to support these answers:

- What procedures did you follow to enroll in the school?
- How long after you enrolled did you first attend the school?
- What course did you enroll in?
- What was the cost of the course?
- What did the school charge for tuition, board, and fees?

- Did you receive any other loans or grants to pay for this training?
- What was the refund policy of the school?
- Did the school give you any money from loan(s), or were all loan proceeds used for tuition, board, and fee charges?
- Did you receive any mail-order lessons?
- If so, how many of these lessons did you complete?
- How many days did you attend the school?
- Why did you leave the school?
- What procedures did you follow when you withdrew from the school?
- What was your last day of attendance?
- What steps if any did you take to see if the school issued a refund to the lender?
- Did you notify your lender that you had withdrawn from the school? If so, how did you notify them? n107

Borrowers may also raise as a defense that the debt is not enforceable. Any viable state, federal, and common law claims should be available.

The Department's AWG Hearing Guidelines handbook elaborates on the procedures that hearing officers should follow when a borrower raises one of the discharges as a defense to garnishment. According to the handbook, the case law is unanimous that borrowers can not seek these kinds of discharge relief directly from a court but must present their claim to, and obtain a determination from, the Secretary or the guarantor, who is initially responsible for determining whether the student loan should be discharged. n108

Guaranty agencies have the authority to adjudicate disputes and make binding decisions. n109 However, unlike federal agency hearings, borrowers have no explicit right to judicial review of guaranty agency actions. This lack of review has been challenged, unsuccessfully to date, on constitutional due process grounds. n110 In 2003 court pleadings, the Department acknowledged the problem and supported implying a private right of action under the HEA for judicial review of guaranty agency administrative wage garnishment hearing decisions. n111

If the student does not request a hearing, or if the student's objection is denied, then the student's employer is notified to deduct the garnishment amount from the student's paycheck. If the student is late in requesting a hearing on the garnishment, the garnishment order will proceed, but the student should still receive a hearing and a decision within sixty days. n112 If the student prevails, the garnishment should be ordered to cease and, if appropriate, amounts garnished should be returned to him/her.

Guaranty agencies have the authority to sue employers that refuse to comply with garnishment orders to recover amounts the employer has refused to withhold plus attorney fees, costs, and punitive damages in the court's discretion. n113 Employers in some cases have tried to litigate on behalf of their employees. However, the statute allows borrowers, not employers, to raise defenses to garnishment. n114

[c] Debt Collection Improvement Act of 1996 Expands Government Power to Collect Student Loan Debts

In 1996, Congress further strengthened the debt collection powers of federal agencies. n115 Federal government

agencies are now allowed to offset formerly exempt Social Security and Veterans benefits to collect debts, such as student loans, n116 although an exemption does exist for $9,000 of such benefits annually. However, if the head of the benefit-granting program objects, the Treasury must deny offset against a means-tested program, and may deny offset against other programs if persuaded that offset would "substantially interfere with or defeat" the purposes of the program. n117

The most significant difference between garnishment under the DCIA and garnishment under the HEA (the Higher Education Act under which all garnishments were previously conducted) is that the DCIA authorizes garnishment up to 15% and the HEA only up to 10%. n118

The DCIA, like the HEA, prohibits garnishment if the borrower has been involuntarily separated from employment until the borrower has been re-employed continuously for twelve months. n119 Under either garnishment scheme, borrowers have some burden to notify the loan holder of their unemployment status and to prove that they qualify for the unemployment exception.

Like the HEA, the DCIA requires notice to the borrower before garnishment. n120 The notice provisions are similar. Notice must be sent by mail to the last known address a minimum of thirty days before the initiation of garnishment procedures. n121 The notice must inform the borrower of the nature and amount of the debt, the agency's intention to initiate garnishment, and an explanation of the borrower's rights. n122

The Department's regulations under DCIA specify the borrower rights that must be disclosed in the notice. These are: (1) right to inspect and copy records; (2) right to enter into a repayment agreement; and (3) right to request a hearing about the existence, amount, or current enforceability of the debt and the rate of withholding. n123 The Department has developed a new "Request for Hearing" form for the DCIA-authorized garnishment program. The new "Request for Hearing" form allows a borrower to choose between a written record, in-person hearing or telephone hearing. It does not state that only borrowers requesting hearings within fifteen days are entitled to in-person hearings. The form does, however, state that borrowers requesting in-person hearings are required to pay their own expenses. As of 2004, the Department had posted the new Request for Hearing form on-line at: www.ed.gov/offices/OSFAP/DCS/forms/Request.For.Hearing.pdf.

[d] Servicemember Civil Relief Act Protections

The Servicemember Civil Relief Act (SCRA) limits collection tactics and enforcement of claims against active duty military personnel. n124 In general, everyone on active duty is entitled to the benefit of the Act, whether or not they are stationed in a war zone and whether they enlisted or were called up. Active duty includes full-time training duty, annual training duty, and attendance at a military school while in active military service. n125

The 2008 reauthorization amended the SCRA so that, as of August 2008, the interest rate protections will apply to federal student loans as well. n126 However, the protections in civil judicial and administrative proceedings should apply to student loan collection proceedings. These are relatively new protections arising under 2003 amendments to the Act that extended coverage to administrative as well as judicial proceedings. n127 The Act also restricts execution upon assets of the servicemember.

The protections in judicial and administrative procedures are divided into two main categories: cases in which the servicemember has not been notified of the proceeding and cases in which the servicemember has been notified. In cases in which the servicemember has not been notified, courts are prohibited from entering default judgments in cases in which the defendant has not appeared, unless the plaintiff files an affidavit stating whether or not the defendant is in military service and showing facts in support of the statement. If it appears that the defendant is in military service, the court may not enter a judgment until it appoints an attorney to represent the defendant, and there are special provisions for stays. n128 The Act also gives a servicemember who has been notified of an action or proceeding other than an

eviction the right to an automatic, non-discretionary ninety-day stay upon request. n129 The servicemember may seek an additional stay, but this extension is not automatic. In addition, the Act allows the court to stay execution of any judgment against a servicemember and to vacate or stay any pre- or post-judgment attachment or garnishment of property. n130 There are also provisions tolling statutes of limitations during the period of active duty. n131

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Debt CollectionGeneral OverviewBankruptcy LawDischarge & DischargeabilityNondischarge of Individual DebtsStudent LoansCivil ProcedureRemediesProvisional RemediesGarnishmentsEducation LawAdministration & OperationStudent Financial AidDebt CollectionMilitary & Veterans LawServicemembersSoldiers & Sailors Civil Relief Act

FOOTNOTES:
(n1)Footnote 1. *See, e.g., Miele v. Sid Bailey, Inc., 192 B.R. 611 (Bankr. S.D.N.Y. 1996)* .

(n2)Footnote 2. *See* Sibley v. Diversified Collection Servs., Clearinghouse No. 51,930 (N.D. Tex. Apr. 26, 1996) (first amended complaint-class action); Cliff v. Payco Gen. Am. Credits, Inc., Clearinghouse No. 52,132 (M.D. Fla. 1998) (class action complaint) (suit alleges violation of due process rights in collection agencies' administration of wage garnishment procedures); Mitchell v. Educational Credit Mgmt. Corp., Clearinghouse No. 52,038 (N.D. Ill. Oct. 14, 1997) (complaint-class action).

(n3)Footnote 3. Pub. L. No. 105-244 (Oct. 7, 1998), § 141(f). The ombudsman has a website and borrowers can submit problems on-line at www.sfahelp.ed.gov. The toll-free phone number is 877-557-2575.

The ombudsman's stated goal is to facilitate and provide creative options for borrowers needing assistance with federal loans, Direct, FFEL, SLS and Perkins Loans. The ombudsman will research problems and determine if borrowers have been treated fairly. They will also contact other offices within the DOE, private lenders, and guaranty agencies to assist borrowers. However, the ombudsman office strongly admonishes that they serve as a last resource, to be consulted only after a borrower has tried to resolve a problem on her own.

(n4)Footnote 4. The DOE website (www.ed.gov) lists the collection agencies with Department contracts. As of 2004, the following agencies were listed on this site: Account Control Technology, Allied Interstate Credit Corp., Inc., Aman Collection Service, Education Credit Services, Diversified Collection Services, Financial Asset Management Systems, Maximus, National Asset Management Enterprises, Nationwide Credit, NCO Group, Pioneer Credit Recovery, Progressive Financial Services, and Van Ru Credit Corp.

(n5)Footnote 5. For information about using the national student loan data base to find out how many loans and what types of loans a borrower has, see National Consumer Law Center, Student Loan Law § 1.6 (3d ed. 2006 and Supp.). Borrowers may also use a Loan Locator service managed by the non-profit National Student Clearinghouse. Only loans from participating schools are listed. *See* www.studentclearinghouse.org.

(n6)Footnote 6. *See Sanders v. OSI Educ. Servs., Inc., 2001 U.S. Dist. LEXIS 12578* (N.D. Ill. Aug. 3, 2001) (granting class certification based on borrowers' allegations that student loan debt collector violated the Fair Debt Collection Practices Act [hereinafter FDCPA]. *See also Kort v. Diversified Collection Servs., 2001 U.S. Dist. LEXIS 11701* (N.D. Ill. Aug. 2, 2001) , *class cert. granted in part, 2001 U.S. Dist. LEXIS 20988* (N.D. Ill. Dec. 17, 2001) (denying class certification on plaintiffs' FDCPA claim regarding alleged insufficient time to respond to garnishment notice, but granting class certification on claim that defendants violated the FDCPA by falsely representing that borrowers have an affirmative duty to supply "written proof" of employment history to take advantage of garnishment exception). The Court granted summary judgment on plaintiff's claim that the collection letter in this case would cause an unsophisticated consumer to believe that a wage garnishment could occur before expiration of the thirty-day notice

period required by the *HEA. Kort v. Diversified Collection Servs., Inc., 270 F. Supp. 2d 1017 (N.D. Ill. 2003)* (District Court granted summary judgment on plaintiff's claim that the collection letter in this case would cause an unsophisticated consumer to believe that a wage garnishment could occur before expiration of the thirty-day notice period required by the HEA.). Both cases raised FDCPA violations related to defendants' requiring borrowers to affirmatively prove the exception to garnishment for borrowers who have been involuntarily separated from employment. *See also Cliff v. Payco Gen. Am. Credits, Inc., 363 F. 3d 1113 (11th Cir. 2004)* (student loan borrowers allowed to bring claims under state and federal fair debt laws that, among other violations, collection agency falsely represented the claim, amount, or status of the debt, falsely represented or implied that non-payment would result in garnishment, and failed to provide pre-garnishment hearing).

(n7)Footnote 7. *Guidelines for Contract Collection Agencies Regarding Treatment of Borrowers Who Claim Relief Against Repayment Due to Closed School or False Certification*, Clearinghouse No. 51,942. *See generally* National Consumer Law Center, Student Loan Law, Chapter 6 (3d ed. 2006 and Supp.)

(n8)Footnote 8. *34 C.F.R. § 682.402(c)(1)(iii)(C)(2). See* National Consumer Law Center, Student Loan Law, § 6.6.5 (3d ed. 2006 and Supp.).

(n9)Footnote 9. For more detail, the best resource is National Consumer Law Center, Fair Debt Collection (5th ed. 2004 and Supp.), detailing what general collection practices are prohibited and available consumer remedies for such violations.

(n10)Footnote 10. *15 U.S.C. § 1692c(c)*. This provision, in particular, has been cited by collection agencies lobbying Congress to exempt student loan collectors from FDCPA coverage. They point out the conflict between federal student assistance due diligence provisions that require minimum contacts and the FDCPA prohibition against contacting borrowers in certain circumstances. Consumer advocates have responded with alternatives, including exempting collectors from the due diligence contact requirements in these cases, in lieu of the wholesale exemption from the FDCPA. This issue is likely to arise again in future legislative sessions.

(n11)Footnote 11. *15 U.S.C. § 1692g. See Avila v. Rubin, 84 F.3d 222 (7th Cir. 1996)* (student loan collector liable where other language overshadowed validation notice).

(n12)Footnote 12. *15 U.S.C. §§ 1692b, 1692c(b).*

(n13)Footnote 13. *15 U.S.C. § 1692c(a)(1).*

(n14)Footnote 14. *15 U.S.C. § 1692c(a)(3).*

(n15)Footnote 15. *15 U.S.C. § 1692c(a)(2)*; *see Alger v. Ganick, O'Brien & Sarin, 35 F. Supp. 2d 148 (D. Mass. 1999)* (contact with represented student loan debtor would be FDCPA violation).

(n16)Footnote 16. *15 U.S.C. § 1692d(2).*

(n17)Footnote 17. *Asch v. Teller, Levit & Silvertrust, P.C., 2003 U.S. Dist. LEXIS 16747* (N.D. Ill. Sept. 26, 2003) (borrowers granted summary judgment under federal and state fair debt collection practices laws; borrowers argued that, among other violations, the collector's notices contained false statements because the amount listed as due contained improper interest charges attributable to improper crediting practices).

(n18)Footnote 18. *Kort v. Diversified Collection Servs., Inc., 394 F.3d 530 (7th Cir. 2005)* .

(n19)Footnote 19. *15 U.S.C. § 1692k(c). See* National Consumer Law Center, Fair Debt Collection § 7.5 (5th ed. 2004 and Supp.).

(n20)Footnote 20. *15 U.S.C. § 1692-1692, reprinted in* Vol. 1A *infra*.

(n21)Footnote 21. *See generally* Ch. 8 *supra*.

(n22)Footnote 22. *15 U.S.C. § 1692a(6)(C)*.

(n23)Footnote 23. *31 U.S.C. § 3718(a)(2)*; *Richardson v. Baker, 663 F. Supp. 651 (S.D.N.Y. 1987)* (Federal FDCPA applies to collector servicing a tax intercept for the DOE); Marritz, FTC Informal Staff Letter (Nov. 6, 1978).

(n24)Footnote 24. *See 15 U.S.C. § 1692a(6)* (" 'debt collector' means any person who ... attempts to collect ... *indirectly*, debts owed ... another") (emphasis added).

(n25)Footnote 25. *Kort v. Diversified Collection Servs., 270 F. Supp. 2d 1017 (N.D. Ill. 2003)* .

(n26)Footnote 26. *Kort v. Diversified Collection Servs., 270 F. Supp. 2d 1017 (N.D. Ill. 2003)* (defendant collection agency pointed to the following alleged conflicts between the FDCPA and HEA: HEA regulations require a collection agency to send the borrower several written notices while the FDCPA requires debt collectors to terminate communications at the borrower's request; the HEA requires an agency to make diligent attempts to trace a borrower while the FDCPA limits contacts that debt collectors may make with third parties; the HEA requires a contractor performing garnishment services to contact a debtor's employer, an impermissible third-party contact under the FDCPA).

(n27)Footnote 27. *15 U.S.C. § 1692a(6)(A). Cf. Fischer v. Unipac Serv. Corp., 519 N.W.2d 793 (Iowa 1994)* (FDCPA does not apply to loan servicer hired before default).

(n28)Footnote 28. *See Cliff v. Payco Gen. Am. Credits, Inc., 363 F. 3d 1113 (11th Cir. 2004)* (the Secretary of Education has expressed the belief that third-party debt collectors acting on behalf of guaranty agencies to collect federal student loans come within the FDCPA).

(n29)Footnote 29. *15 U.S.C. § 1692a(6)(C)*.

(n30)Footnote 29.1. *Rowe v. Educational Credit Mgmt. Corp., 559 F.3d 1028 (9th Cir. 2009)* .

(n31)Footnote 29.2. *Id.* ECMC acknowledged in this case that it was a guaranty agency. This may not always occur since ECMC is part of the larger ECMC Group, a private non-profit corporation and guaranty agency. *See, e.g.*, *Manalansan-Lord v. Direct Loan Servicing Center, 2008 U.S. Dist. LEXIS 85006* (E.D. Mo. Oct. 22, 2008) (in motion to dismiss, ECMC stated that it was not a guaranty agency and not a debt collector).

(n32)Footnote 30. *See Brannan v. United Student Aid Funds, 94 F.3d 1260 (9th Cir. 1996)* ; *Virgen v. Sallie Mae, 2007 U.S. Dist. LEXIS 37509* (E.D. Cal. May 23, 2007) (guaranty agency was not exempt from FDCPA under "government actor" exemption, but was exempt under "fiduciary exemption"); *Rowe v. Educational Credit Mgmt. Corp., 465 F. Supp. 2d 1101 (D. Or. 2006)* .

(n33)Footnote 31. For a discussion of whether the Higher Education Act preempts state debt collection laws, see National Consumer Law Center, Student Loan Law, § 4.5.4 (3d ed. 2006 and Supp.)

(n34)Footnote 32. *See § 12.05[3] infra*.

(n35)Footnote 33. *See § 12.06 infra*.

(n36)Footnote 34. *See § 12.06[4] infra*.

(n37)Footnote 35. Gibbons v. Riley, Clearinghouse No. 50,432C (E.D.N.Y. Nov. 9, 1994) (complaint filed).

(n38)Footnote 36. Gibbons v. Riley, Clearinghouse No. 50,432 (E.D.N.Y. 1995) (stipulated extension of time for

defendants to respond to complaint); *see also* Letter of Fred J. Marinucci, Deputy Assistant General Counsel, to Andrew J. Cohen, Legal Assistance Foundation of Chicago, Clearinghouse No. 50,423 (Oct. 18, 1994) (Department does not intend to collect any amount in excess of what is allowed by the loan agreement).

(n39)Footnote 37. The notice states that if the student believes they were overcharged, they can obtain a copy of their loan agreement and repayment history. Requests for these records should be sent to:

U.S. Department of Education
P.O. Box 4222
Iowa City, IA 52244-4222,
or call 1-800-621-3115 (refer to code CCL).

(n40)Footnote 38. *See § 12.04[5][b] infra*. Regardless of the settlement agreement, the information posted on the Department's website and testimony of Department officials indicate that the Department sets a collection fee ceiling at 25 percent. *See In re Schlehr, 290 B.R. 387 (Bankr. D. Mont. 2003)* (guaranty agency official testified that the DOE has set the market for contracting out collection to private collection agencies at a rate of 25 percent; according to the official, this 25-percent rate is the ceiling under the regulations at *34 C.F.R. § 30.60* against which all other guaranty agencies are capped; each guaranty agency has to come up with its own percentage-based collection costs based on its actual expenses, which cannot exceed the Department's own 25-percent ceiling).

(n41)Footnote 39. *34 C.F.R. § 682.405(b)(3)(iv)*.

(n42)Footnote 40. Pub. L. No. 109-171, *120 Stat. 4* (Feb. 8, 2006), *amending 20 U.S.C. § 1078*.

(n43)Footnote 41. *34 C.F.R. § 682.401(b)(27)*.

(n44)Footnote 42. *Id*.

(n45)Footnote 43. *72 Fed. Reg. 32410* (June 12, 2007) .

(n46)Footnote 44. *72 Fed. Reg. 61960* (Nov. 1, 2007) . In the November 1, 2007, notice of final regulations, the Department granted schools the authority to implement these provisions before July 1, 2008.

(n47)Footnote 45. Authority for how guaranty agency payments are allocated is found at *34 C.F.R. § 682.404(f)* (effective Jan. 1, 1998), *reprinted at 61 Fed. Reg. 60,486* (Nov. 27, 1996) .

(n48)Footnote 46. The Department has taken the position that a borrower is not legally obligated to pay costs that have not been incurred. Hutchins v. United States Dep't of Educ., CV-F-02-6256-OWW-DLB, at 31 (E.D. Cal. filed Apr. 25, 2003) (Department of Education Memorandum of Points and Authorities Supporting Motion to Dismiss), *citing* H.R. Rep. No. 99-300, at 396 (1986), *reprinted in* 1986 U.S.C.C.A.N. 977. The agencies can charge the borrower only those costs that have been incurred as allocated to the particular payment.

(n49)Footnote 47. *See also 61 Fed. Reg. 60,481* (last full paragraph on the page).

(n50)Footnote 48. *34 C.F.R. § 682.410(b)(2)*.

(n51)Footnote 49. *See § 12.04[5][a] supra*.

(n52)Footnote 50. *See* National Consumer Law Center, Student Loan Law § 8.5 (3d ed. 2006 and Supp.), for discussion of the Department's authority to compromise loans or suspend or terminate collection.

(n53)Footnote 51. *34 C.F.R. § 682.202(f)*.

(n54)Footnote 52. *34 C.F.R. § 682.202(f)(1).*

(n55)Footnote 53. *34 C.F.R. § 674.45(e)(1).*

(n56)Footnote 54. *34 C.F.R. § 674.45(e)(2).*

(n57)Footnote 55. *34 C.F.R. § 674.47(d).*

(n58)Footnote 56. *34 C.F.R. § 674.33(a)(4).*

(n59)Footnote 57. Pub. L. No. 102-26 eliminated the statute of limitations set out in *20 U.S.C. § 1091a(a)*. While the elimination of the limitations period was to have sunset on November 15, 1992, the Higher Education Amendments of 1992 § 1551, *codified at 20 U.S.C. § 1091a*, extended indefinitely the abolition of the statute of limitations for student loan collections.

(n60)Footnote 58. *See e.g., United States v. Distefano, 279 F.3d 1241 (10th Cir. 2002)* ; *United States v. Phillips, 20 F.3d 1005 (9th Cir. 1994)* ; *United States v. Hodges, 999 F.2d 341 (8th Cir. 1993)* ; *United States v. Singer, 943 F. Supp. 9 (D.D.C. 1996)* , *aff'd in part, rev'd in part, 132 F.3d 1482 (D.C. Cir. 1997)* (Department confessed error and the district court's ordering of 10% surcharge to Department as fees was reversed on appeal); *United States v. Smith, 862 F. Supp. 257 (D. Haw. 1994)* .

(n61)Footnote 59. *U.S. v. Charles, 240 F. Supp. 2d 488 (M.D.N.C. 2002)* .

(n62)Footnote 60. *Id. at 490* .

(n63)Footnote 61. *See Sorenson v. Secretary of Treasury, 475 U.S. 851, 106 S. Ct. 1600, 89 L. Ed. 2d 855 (1986)* (United States has authority to seize earned income tax refunds); *Bosarge v. United States DOE, 5 F.3d 1414 (11th Cir. 1993)* , *cert. denied, 512 U.S. 1226, 114 S. Ct. 2720, 129 L. Ed. 2d 845 (1994)* (same).

(n64)Footnote 62. *McAfee v. Unger & Assocs., Inc., 730 So. 2d 623 (Ala. Civ. App. 1998)* (student's attempt to sue collection agency employed by the DOE for improperly causing an offset of her income tax refund failed; in the court's view, the collection agency could not have been involved in the offset process), *cert. denied, 730 So. 2d 626 (Ala. 1999)* .

(n65)Footnote 63. *20 U.S.C. § 1091a(a)*. This statutory provision supersedes more general Internal Revenue Code regulation 26 C.F.R. § 301.6402-6T(b)(2)m, which indicates that the debt, with the exception of a judgment debt, cannot be delinquent more than ten years. How to count the delinquency was once an issue of some concern (*compare Grider v. Cavazos, 911 F.2d 1158 (5th Cir. 1990) and Thomas v. Bennett, 856 F.2d 1165, 1169 n.4 (8th Cir. 1988)* , *with Jones v. Cavazos, 889 F.2d 1043 (11th Cir. 1989) and Roberts v. Bennett, 709 F. Supp. 222 (N.D. Ga. 1989))* , but is now irrelevant.

(n66)Footnote 64. *11 U.S.C. § 362. See generally* Collier Consumer Bankruptcy Practice Guide Ch. 8 (Matthew Bender), and Collier Consumer Bankruptcy Forms Pt. CS6 (Matthew Bender). *See also* National Consumer Law Center, Consumer Bankruptcy Law and Practice § 2.5.5, Ch. 9, §§ 10.4.2.6.4 (bankruptcy preferences), 10.4.2.6.6 (post-petition transfers), 10.4.2.6.7 (set-off provisions) (8th ed. 2006).

(n67)Footnote 65. *34 C.F.R. § 30.22(a).*

(n68)Footnote 66. *See, e.g., Savage v. Scales, 310 F. Supp. 2d 122 (D.D.C. 2004)* ; *Shabtai v. U.S. Dept. of Educ., 2003 U.S. Dist. LEXIS 14398* (S.D.N.Y. Aug. 20, 2003) ; *Setlech v. U.S., 816 F. Supp. 161, 167 (E.D.N.Y. 1992)* (using an address most recently in the agency's database or an address obtained from plaintiff's most recent tax return has been held to be "reasonably calculated to notify the vast majority of debtors of the intended referral and proposed offset"); *Nelson v. Diversified Collection Servs., Inc., 961 F. Supp. 863 (D. Md. 1997)* .

(n69)Footnote 67. *34 C.F.R. § 30.33(c)*.

(n70)Footnote 68. *34 C.F.R. § 30.33(d)*.

(n71)Footnote 69. *31 U.S.C. § 3720A(b)(3)*. There are widespread allegations that the Department ignores student requests for hearings and, even when a hearing is offered, it is not clear that the hearing comports with due process. There have been at least four challenges to the procedures used in the tax refund intercept program. *See Jones v. Cavazos, 889 F. 2d 1043 (11th Cir. 1989)* ; Richardson v. Baker, Clearinghouse No. 40,719 (S.D.N.Y. Feb. 9, 1990) (order of settlement); *Games v. Cavazos, 737 F. Supp. 1368 (D. Del. 1990)* ; Downs v. McPherson, Clearinghouse No. 51, 940 (D. Md. July 17, 1989).

(n72)Footnote 70. *34 C.F.R. § 30.27(a)(1)*.

(n73)Footnote 71. *34 C.F.R. § 30.33(f)*.

(n74)Footnote 72. *See § 12.06[4] infra*.

(n75)Footnote 73. *See § 12.06[5] infra*.

(n76)Footnote 74. *See* National Consumer Law Center, Student Loan Law, § 9.5.3 (3d ed. 2006 and Supp.) Since schools are the lender for Perkins loans, they should be subject to school-related defenses.

(n77)Footnote 75. *See § 12.06[2] infra*.

(n78)Footnote 76. *See* 12.06[3].

(n79)Footnote 77. 26 C.F.R. § 301.6402-6T(f).

(n80)Footnote 78. 26 C.F.R. § 301.6402-6T(j). *See Johnson v. IRS, 2001 U.S. Dist. LEXIS 15931* (E.D. Pa. Aug. 20, 2001) .

(n81)Footnote 79. *26 U.S.C. § 6402(e)*; *see Setlech v. United States, 816 F. Supp. 161 (E.D.N.Y. 1993) , aff'd, 17 F.3d 390 , cert. denied, 511 U.S. 1085, 114 S. Ct. 1837 (1994)* ; *Richardson v. Baker, 663 F. Supp. 651 (S.D.N.Y. 1987)* ; *Sartorious v. United States Dep't of Treasury, 671 F. Supp. 592 (E.D. Wis. 1987) . See also Albert v. OSI Educ. Serv., Inc., 2004 U.S. Dist. LEXIS 3821* (D. Minn. Mar. 11, 2004) (In denying borrower's attempt to appeal an offset, court stated that, although the plaintiff could not seek review of his tax offset against the Department of Treasury, he is "free to pursue any and all remedies he may have against 'the Federal agency ... to which the amount of such [income tax refund] reduction was paid.' *26 U.S.C. § 6402(f)*. 'He may not, however, point the guns of this lawsuit against the Treasury.'); *Greenland v. Van Ru Corp., 98 A.F.T.R.2d (RIA) 7272* (W.D. Mich. Oct. 10, 2006) (noting that *26 U.S.C. § 6402(f)* prohibits suits against the Department of Treasury to review offsets but allows recovery from the federal agency to which the offset was paid). The *Greenland* court also found that the Administrative Procedure Act (APA) does not provide for suits against the Department of Treasury in this instance. The court specifically declined to follow a contrary unpublished decision in *Omegbu v. U.S. Dep't of Treasury, 118 Fed. Appx. 989* (7th Cir. Dec. 16, 2004) . *See also Thomas v. Bennett, 856 F.2d 1165 (8th Cir. 1988)* .

(n82)Footnote 80. *20 U.S.C. § 1095a*. There has been only one court decision to date concerning the constitutionality of the procedure of authorizing private entities to garnish wages to repay student loan debts prior to a judicial determination of the enforceability of the debt. *Nelson v. Diversified Collection Servs., Inc., 961 F. Supp. 863 (D. Md. 1997)* (court found the notice adequate and the hearing procedure sufficient to meet procedural due process concerns).

(n83)Footnote 81. Pub. L. No. 105-244 (Oct. 7, 1998), § 490A.

(n84)Footnote 82. *34 C.F.R. § 682.410(b)(6)(vii)(A), reprinted at 61 Fed. Reg. 60,486* (Nov. 27, 1996) .

(n85)Footnote 83. *34 C.F.R. § 682.410(b)(10)(i)(D)*. Active servicemembers have certain rights to stay collection proceedings. In addition, the Merchant Seaman Protection and Relief Act prohibits attachment of wages of "masters" or "seamen." *46 U.S.C. § 11109*. Definitions of these terms can be found at *46 U.S.C. § 10101*. The Department of Education acknowledges the "seamen" exception in its wage garnishment guide for private collection agencies. *See* U.S. Dep't of Educ., Administrative Wage Garnishment Compliance Branch, Private Collection Agencies (PCA) Procedures Guide 64 (July 25, 2007). The guide is available at www.fsacollections.ed.gov/contractors/pca2004/awg/index.htm.

(n86)Footnote 84. *20 U.S.C. § 1095a(a)(d)(7)*; *34 C.F.R. § 682.410(b)(9)(i)(G)*.

(n87)Footnote 85. *See 59 Fed. Reg. 22,474* , Comments 72, 73 (Apr. 29, 1994); *34 C.F.R. § 682.410(b)(10)(i)(I)* (notice to employer must contain only the information necessary for the employer to comply with the withholding order).

(n88)Footnote 86. However, at least one court found that a collection agency was not liable under the FDCPA even if the information in the notice about the unemployment exception was incorrect. The court agreed with the collection agency's argument that the error was inadvertent because it used the notice form required by the Department of Education and any errors in the form were the responsibility of the Department. *Kort v. Diversified Collection Servs., Inc., 2001 U.S. Dist. LEXIS 11701* (N.D. Ill. Aug. 2, 2001), *class cert. granted in part, 2001 U.S. Dist. LEXIS 20988* (N.D. Ill. Dec. 17, 2001) (alleging that collector violated FDCPA by giving borrowers insufficient time to respond to garnishment notices and by requiring affirmative proof of unemployment exception), *plaintiff's motion for summary judgment granted in part, denied in part, 270 F. Supp. 2d. 1017 (N.D. Ill. 2003)* , *aff'd, 394 F.3d 530 (7th Cir. 2005)* ; *Sanders v. OSI Educ. Serv., Inc., 2001 U.S. Dist. LEXIS 12578* (N.D. Ill. Aug. 3, 2001) .

(n89)Footnote 87. *Kort v. Diversified Collection Serv., Inc., 394 F.3d 530 (7th Cir. 2005)* .

(n90)Footnote 88. *Id.*

(n91)Footnote 89. *Id.*

(n92)Footnote 90. *See 59 Fed. Reg. 22,473* cmt. 65 (Apr. 29, 1994).

(n93)Footnote 91. *See 59 Fed. Reg. 22,473* cmt. 62 (Apr. 29, 1994). See Vol. 1A *infra* for chart of earning exemptions reflecting the October 1, 1996 and September 1, 1997 minimum wage increases. The Department of Education refers its contractors to the Department of Treasury's website for a calculator to assist in determining disposable pay and allowable garnishment amounts. *See* http://fms.treas.gov/debt/awg.html#forms.

(n94)Footnote 92. Pub. L. No. 104-134, § 31001(o)(1) (Apr. 1996) (codified at *31 U.S.C. § 3720D*).

(n95)Footnote 93. *67 Fed. Reg. 18,072* (Apr. 12, 2002) .

(n96)Footnote 94. *68 Fed. Reg. 8,142* (Feb. 19, 2003) .

(n97)Footnote 95. *Id. at 8,148* ("The statements made by the Department regarding its intention to use DCIA garnishment authority make no suggestion that the role and authority of student loan guarantors has changed.").

(n98)Footnote 96. *See* www.ed.gov/offices/OSFAP/DCS/awg.html (2003).

(n99)Footnote 97. *68 Fed. Reg. 8,142, 8,152* (Feb. 19, 2003) .

(n100)Footnote 98. *See 59 Fed. Reg. 22,473* cmt. 63 (Apr. 29, 1994); *20 U.S.C. § 1095a(a)* (garnishment requirements are allowed notwithstanding any provisions of state law). *See, e.g., Clear v. Missouri Coordinating Bd.*

Higher Educ., 23 S.W.3d 896 (Mo. Ct. App. 2000) , *transfer denied*; *Nelson v. Diversified Collection Servs. Inc., 961 F. Supp. 863 (D. Md. 1997)* .

(n101)Footnote 99. *See Nelson v. Diversified Collection Servs., Inc., 961 F. Supp. 863 (D. Md. 1997)* .

(n102)Footnote 100. *See 59 Fed. Reg. 22,473* cmt. 63 (Apr. 29, 1994).

(n103)Footnote 100.1. *Bender v. Van Ru Corp., 338 B.R. 62 (Bankr. W.D. Mo. 2006)* . The publication is available on-line at www.ed.gov/offices/OSFAP/DCS/forms/2004.Borrower.Options.pdf (Oct. 2004).

(n104)Footnote 101. *34 C.F.R. § 682.410(b)(10)(i)(J).*

(n105)Footnote 102. *See 59 Fed. Reg. 22,474, 22,475* cmt. 74 (Apr. 29, 1994).

(n106)Footnote 103. *34 C.F.R. § 682.410(b)(9)(i)(E).*

(n107)Footnote 104. 34 C.F.R. § 684.410(b)(10)(i)(K).

(n108)Footnote 105. 34 C.F.R. § 684.410(b)(10)(i)(K).

(n109)Footnote 106. In 1998, the Department issued new "Notice Prior to Wage Withholding" and "Request for Hearing or Exemption" notices listing these defenses. These notices are attached to the Department's March 17, 1998 Dear Guaranty Agency Director Letter, Clearinghouse No. 52,042.

(n110)Footnote 107. U.S. Dept. of Educ., Administrative Wage Garnishment Hearings Branch, Atlanta Serv. Ctr., *Administrative Wage Garnishment (AWG) Hearings Training Manual for Private Collection Agencies (PCA)*, adopted Jan., 19, 2000. These questions and requirements should apply to the DCIA-authorized garnishment process as well.

(n111)Footnote 108. Dep't of Educ., "AWG Hearing Guidelines" (rev. Mar. 1, 2004) (citing *In re Scholl, 259 B.R. 345 (Bankr. N.D. Iowa 2001)* (closed school claim)); *United States v. Wright, 87 F. Supp. 2d 464 (D. Md. 2000)* ; *United States v. Bertucci, 2000 U.S. Dist. LEXIS 12877* (E.D. La. Aug. 29, 2000) ; *In re Bega, 180 B.R. 642 (Bankr. D. Kan. 1995)* .

(n112)Footnote 109. *20 U.S.C. § 1095a.*

(n113)Footnote 110. *See* National Consumer Law Center, Student Loan Law § 5.3.4 (2d ed. and Supp.).

(n114)Footnote 111. *See* Hutchins v. United States DOE, CV-F-02-6256-OWW-DLB (E.D. Cal. filed Apr. 25, 2003) (Department of Education Memorandum of Points and Authorities Supporting Motion to Dismiss).

(n115)Footnote 112. 34 C.F.R. § 684.410(b)(10)(i)(L).

(n116)Footnote 113. *20 U.S.C. § 1095a(a)(6)*; *Educational Credit Mgmt. Corp. v. Central Equip. Co., 477 F. Supp. 2d 788 (E.D. Ky. 2007)* (employer ordered to pay actual attorney fees of guaranty agency even though those fees amounted to more than the amount of the employee's defaulted loan). *See Educational Credit Mgmt. Corp. v. Wilson, 2006 U.S. Dist. LEXIS 96458* (E.D. Tenn. Oct. 3, 2006) (denying compensatory damages, but awarding attorney fees for collector in a case in which borrower's employer challenged wage garnishment order and borrower was eventually able to obtain a closed-school discharge of her loans; court awarded attorney fees for efforts expended by collector to pursue garnishment while borrower "inexplicably" delayed applying for discharge; collector had requested higher fees, but court rejected collector's argument that it must automatically award the full amount of fees claimed); *Education Credit Mgmt. Corp. v. Cherish Prods., Inc., 312 F. Supp. 2d 1183 (D. Minn. 2004)* .

(n117)Footnote 114. *20 U.S.C. § 1095a(a)(5).*

(n118)Footnote 115. *Debt Collection Improvement Act of 1996, Pub. L. No. 104-134 Ch. 10* (Apr. 26, 1996).

(n119)Footnote 116. *31 U.S.C. § 3716(c)(3)(A)(i).*

(n120)Footnote 117. *31 U.S.C. § 3716(c)(3)(A)(i).* For more information about the 1996 Act, see National Consumer Law Center, Fair Debt Collection, Ch. 10 (5th ed. and Supp.). *See also* National Consumer Law Center, Student Loan Law, § 5.3.3 (3d ed. 2006 and Supp.).

(n121)Footnote 118. *31 U.S.C. § 3720D(b)(1)* (DCIA); *20 U.S.C. § 1095a(1) (HEA).* The final DOE rules for garnishment under the DCIA are at *68 Fed. Reg. 8,142* (Feb. 19, 2003) .

(n122)Footnote 119. *31 U.S.C. § 3720D(b)(6).* For further discussion of the differences between garnishment under the HEA, and garnishment under the DCIA, see National Consumer Law Center, Student Loan Law § 5.3.3 (3d ed. 2006 and Supp.).

(n123)Footnote 120. *31 U.S.C. § 3720D(b)(2).*

(n124)Footnote 121. *31 U.S.C. § 3720D(b)(2).*

(n125)Footnote 122. *31 U.S.C. § 3720D(b)(2).*

(n126)Footnote 123. *68 Fed. Reg. 8,142* (Feb. 19, 2003) .

(n127)Footnote 124. *50 U.S.C. app. §§ 501-596. See generally* National Consumer Law Center, Student Loan Law, § 9.5.4 (3d ed. 2006 and supp.); *see also* National Consumer Law Center, Collection Actions, Ch. 7 (1st ed. 2008 and supp.).

(n128)Footnote 125. For a discussion of servicemembers protected by the Act, see National Consumer Law Center, Student Loan Law, § 9.5.4 (3d ed. 2006 and supp.); *see also* National Consumer Law Center, Collection Actions, Ch. 7 (1st ed. 2008 and supp.).

(n129)Footnote 126. Pub. L. No. 110-315 § 422 (2008).

(n130)Footnote 127. § 101(5) (defining "court" to include state and federal administrative agencies); § 2(2) (referring to administrative proceedings in purpose clause); § 102(b) (Act applies to any judicial or administrative proceeding commenced in any court or agency).

(n131)Footnote 128. *See* National Consumer Law Center, Student Loan Law, § 9.5.4.1 (3d ed. 2006 and supp.); National Consumer Law Center, Collection Actions, § 7.5 (1st ed. 2008 and supp.).

(n132)Footnote 129. National Consumer Law Center, Student Loan Law, § 9.5.4.1 (3d ed. 2006 and supp.); National Consumer Law Center, Collection Actions, § 7.5 (1st ed. 2008 and supp.).

(n133)Footnote 130. *50 U.S.C. App. § 524.*

(n134)Footnote 131. *50 U.S.C. App. § 526(a).*

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 12 Student Loans and Trade School Abuses

1-12 Consumer Credit Law Manual § 12.05

§ 12.05 Rescheduling Student Loan Payments

One common way of dealing with student loan collection problems is for the student to reschedule the payments. This section examines each of the seven different ways to do this: deferments, forbearance, loan consolidation, repayment plans, guaranty agencies compromising the debt, the Department compromising the debt, and a chapter 13 bankruptcy.

[1] Deferments

[a] Introduction

Student loan borrowers are legally entitled in certain situations to defer payments. The HEA sets out different rights for different types of loans.

For "subsidized" student loans (where the United States pays the interest while the student is enrolled in school), a deferment not only postpones when a student must make payments, but interest obligations do not accrue during the deferment period. n1 Instead, the federal government pays the interest portion of the loan and the student's payments on the principal are postponed until after the deferment expires.

An important limitation to the usefulness of the student's deferment right is that it exists only when the student is "delinquent" on the loan obligation, not when the student is in "default." n2 If the student is in default, he or she can only obtain a deferral by making repayment arrangements acceptable to the holder of the loan. n3

If a student cannot qualify for a deferment because the loan is in default, the student can re-establish eligibility for a deferment by consolidating the loan into a new loan, n4 or by rehabilitating the defaulted loan after twelve monthly payments. Then the student could apply for a deferment under the new loan. n5 In June 2007, the Department proposed rules to simplify the deferment granting process. Under the proposed rules, FFEL lenders will be permitted to grant graduate fellowship deferments, rehabilitation training program deferments, and unemployment, military service, and economic hardship deferments if another FFEL lender or the Department has granted the borrower deferments for the same reason and the same time frame. n6 The Department may also grant Direct loan deferments based on information received from an FFEL lender, and Perkins schools may do so based on information received from another Perkins loan holder, an FFEL lender, or the Department. n7 Under this proposal, loan holders may rely in good faith on the determinations of others. However, loan holders may not grant a deferment based on another's determination if they

have evidence indicating that the borrower does not qualify for the deferment.

[b] Grounds for Seeking a Deferment

Different student loans have different rules about when the borrower qualifies for a deferment. Rules differ not only by the type of loan (e.g., Perkins or FFEL), but when the loan was extended (e.g., before or after July 1, 1993).

No matter the type of deferment being sought, several items are worthy of note. Most deferments carry maximum time limits and each deferment has recertification requirements, generally every six months, for the student to remain eligible. In addition, even though the Higher Education Act requires all loans to be treated as one for deferment purposes, n8 the borrower is advised to file deferment applications for each loan in order to ensure proper and complete attribution.

One set of grounds for deferment applies to Direct Loans, FFELs extended after July 1, 1993, and to most consolidation loans extended after July 1, 1993. n9 The available deferments are:

a) Student deferments for at least half-time study, n10

b) Graduate fellowship deferments, n11

c) A rehabilitation training program deferment, n12

d) An unemployment deferment not to exceed three years, n13

e) An economic hardship deferment, granted one year at a time for a maximum of three years, n14 and

f) Deferment for Peace Corps service. n15

The economic hardship deferment is the most complicated and usually the most important for low-income borrowers. The first three qualification categories are "automatic" as long as the borrower can provide supporting documentation. These are the three categories:

1. Previous qualification for economic hardship deferment under another federal loan program. n16

2. Receipt of federal or state public assistance benefits. This includes anyone receiving payments under a federal or state public assistance program, such as TANF, SSI, Food Stamps, or state general public assistance. n17

3. Peace Corps. The borrower qualifies if he or she is serving as a Peace Corps volunteer. n18

There is also an income and employment-based category. Prior to July 1, 2009, there were three ways to qualify under this category. All three continue to apply to borrowers that applied for economic hardship deferments prior to July 1, 2009 or for those who apply after July 1, 2009 for a deferment period that began prior to that date. n19 The three tests are described below. As of July 1, 2009, only test number 1 will still be used.

1. *Full-time workers making less than a stated income level*. As of July 1, 2009, this is the only qualifying income/employment-based test.

An individual qualifies for an economic hardship deferment if he or she is working full-time and the earnings from this full-time job do not exceed the greater of the minimum wage or 150% of the federal poverty level applicable to the

borrower's family size and state. n20

The College Cost Reduction and Access Act eliminated these grounds for economic hardship deferment. n21 However, the Department delayed issuing the corresponding regulations so that borrowers could continue to qualify using all of the tests until the new income-based repayment program (IBR) becomes available in July 2009. n22

In addition, the new income criteria under economic hardship deferment test #1 are more generous to borrowers. Previously a borrower qualified under this test if his income did not exceed the greater of the minimum wage or the federal poverty level for a family of two, regardless of family size. The test is now the greater of the minimum wage or 150% of the federal poverty level for the borrower's actual family size and state. The test was changed to mirror the standard that will be used to determine partial financial hardships under the new income-based repayment program.

A borrower in default may have some difficulties accessing IBR. However, if in default, the borrower would not be eligible for the deferment regardless of the formula used.

In addition, in fall 2001, the Department issued guidance regarding deferments for borrowers called to active duty as a result of the September 11 terrorist attacks. These new requirements include:

- If a borrower's loans are in an in-school status, in-school deferment status, or in a grace period when the borrower is ordered to active duty or reassigned, the lender is required to maintain the loans in that status during the period of the borrower's active duty service or reassignment. n23 The status must also be maintained during the time necessary for the borrower to resume enrollment in the next available regular enrollment period if the borrower wishes to return to school. n24 This maintenance of loan status may not exceed a total of three years. n25 The regulations for most of the discharges explicitly provide that both past and current loan obligations may be cancelled. n26 Thus, a borrower should be allowed to seek a discharge even if her loans are already paid off, possibly through involuntary payments such as tax offsets. Although the current obligation is already extinguished, the borrower should still be able to get a refund and other appropriate relief such as elimination of negative notations on credit reports.

Revocation of a closed school discharge is contemplated in the regulations only if the borrower provides testimony, sworn statements, or documentation that does not support the material representations made to obtain the discharge. n27 It is unclear how the Department interprets this provision.

The 1998 Higher Education Act amendments require the Secretary of Education to consult with the Secretary of Veterans Affairs to establish a deferment for disabled veterans. n28

The 2005 Deficit Reduction Act created a new military deferment for all three loan programs, FFEL, Direct Loans, and Perkins Loans. n29 The deferment applies to loans for which the first disbursement is made on or after July 1, 2001.

Previously the military deferment applied for only three years and was available only during periods in which borrowers are serving on active duty, or performing qualifying National Guard duty, during a war or other military operation.

Congress eliminated the three-year limit on the military deferment and expanded eligibility to include the six-month period following the demobilization dates of qualified service members when it enacted the College Cost Reduction and Access Act of 2007. n30

The College Cost Reduction and Access Act of 2007 added a new deferment for members of the National Guard or other reserve component of the Armed Forces or members of such forces in retired status. n31 This deferment is available for FFEL, Direct and Perkins loan borrowers. n32

The deferment is available for thirteen months following the conclusion of the borrower's active duty military service if the borrower was enrolled in a program of instruction at an eligible institution at the time, or within six months prior to the time, the borrower was called to active duty. n33 If the borrower returns to enrolled student status during the thirteen-month period, the deferment expires at the time of that return. n34

In addition to any other deferments, members of the National Guard or other reserve component of the Armed Forces or retired members of the Armed Forces, called to active duty within six months of when they are enrolled or were enrolled in school, are eligible for a deferment during the thirteen months following the conclusion of service. This right expires upon return to enrolled status in school.

There may be some cases in which a borrower is eligible for a military deferment on loans first disbursed on or after July 1, 2001, but ineligible for the deferment on older loans. A borrower consolidating loans first disbursed on or after July 1, 2001, is eligible for the new deferment on the entire consolidation loan, but only if all of the borrower's government loans included in the consolidation loan were first disbursed on or after July 1, 2001. n35

A different set of rules applies to those with FFELs extended before July 1, 1993. The grounds for deferment under these loans include: unemployment for up to two years; full-time student at a participating school; n36 active duty status in the U.S. Armed Forces; receiving or being scheduled to receive service under a program designed to rehabilitate disabled individuals; temporarily totally disabled for up to three years; providing nursing or similar services to a spouse who is temporarily totally disabled; parental leave; and mothers of pre-school children starting work at no more than one dollar above the minimum wage. n37 The regulations set out detailed standards as to when a student is eligible for a deferral based on these grounds, particularly for unemployment, rehabilitation, temporary total disability, and spouse's temporary total disability. n38 Maximum deferment periods vary for each type of deferment. n39 The in-school, rehabilitation, and armed services deferments do not have time limits.

Another set of rules applies for Perkins Loans. n40 Perkins Loans may also be completely cancelled in certain circumstances, including the debtor's service in Head Start or in the military service in an area "of hostilities." n41 The 1998 HEA contains a number of provisions that make the Perkins regulations much more like the FFEL and Direct Loan regulations. In particular, the closed school discharge for loans made on or after January 1, 1986 will now apply to Perkins Loans. n42

For Perkins loans made after July 1, 1993, deferments are available based on a number of grounds, including qualifying in-school status; n43 full-time teaching in certain schools and in Head Start; n44 full-time service in law enforcement or as correction officers under certain circumstances; n45 certain military service; n46 certain volunteer service such as the Peace Corps; n47 inability to find, despite seeking, full-time employment for a period not to exceed three years; n48 and qualifying economic hardship conditions for a period not to exceed three years. n49 The Perkins economic hardship requirements are similar to those for FFEL and Direct loans. n50

There are different criteria for Perkins Loans made before July 1, 1993. n51 Borrowers with these older loans are not eligible for economic hardship or unemployment deferments but are eligible for temporary disability deferments, among others. Perkins Loan borrowers who make 12 consecutive timely monthly payments will also be able to rehabilitate defaulted loans. n52

[c] Parent PLUS Deferment

Repayment for PLUS loans generally begins on the date the loan is fully disbursed. n53 There is no grace period. However, graduate PLUS borrowers may defer repayment while they are enrolled in school at least half-time and for loans first disbursed on or after July 1, 2008, for six months after they cease to be enrolled. In addition, in the 2008

Higher Education Opportunity Act, Congress created new in-school deferment provisions for parent PLUS borrowers. n54 The law provides that a parent PLUS borrower may defer repayment of a PLUS loan first disbursed on or after July 1, 2008, during the period while the student on whose behalf the loan was obtained is enrolled on at least a half-time basis and during the six-month period that begins on the later of the day the student ceases to be enrolled or, if the parent borrower is also a student, the day after the parent ceases to be enrolled on at least a half-time basis. The parent PLUS borrower must request this deferment. In July 2009, the Department issued a new parent PLUS borrower deferment request form. n55 The Department also published proposed regulations in July 2009 regarding the parent PLUS deferment and related interest capitalization rules. n56

[2] Forbearance

Forbearance means a loan holder agreeing to a temporary stoppage of payments, an extension of time for making payments, or acceptance of smaller payments. n57 Forbearance is not as helpful for a student as a deferment because interest will continue to accrue while the loan payments are reduced or postponed. Consequently, the size of the outstanding obligation may actually increase during a forbearance period.

On the other hand, forbearance is available even if the student is in default. n58 Obtaining a forbearance agreement will not take the student out of default. But a student in default will obtain a temporary halt to collection actions--such as tax refund intercepts, collection contacts and garnishments--during the forbearance period.

A student not yet in default can use a forbearance agreement to delay going into default. The 180- (now 270-) day period before a delinquency is transformed to a default does not include periods of time when payments are subject to forbearance.

Both FFEL and Direct Loan regulations provide for administrative forbearances under various circumstances, such as while the lender is resolving a change in the loan's status or pending the resolution of a discharge application. n59 With a few limited exceptions such as local or national emergencies, the FFEL administrative forbearances are discretionary. n60

Both programs provide for forbearances during:

- A properly granted period of deferment for which the lender learns the borrower did not qualify. n61
- At the beginning of an authorized deferment period or an administrative forbearance period for FFEL loans. n62
- For Direct Loans, the period in which payments are overdue at the beginning of an authorized deferment period. n63
- The period beginning when the borrower entered repayment until the first payment due date was established. n64
- The period prior to the borrower's filing of a bankruptcy petition. n65
- For FFEL loans, a period not to exceed an additional sixty days after the lender has suspended collection for the initial sixty-day period and receives reliable information that the borrower (or student in the case of a PLUS loan) has died. n66
- For FFEL loans, the periods described in the disability discharge regulations in regard to the borrower's total and permanent disability. n67

- For Direct Loans, a period after the Secretary receives reliable information indicating that the borrower (or the student, in the case of a Direct PLUS Loan) has died or the borrower has become totally and permanently disabled, until the Secretary receives documentation of death or total and permanent disability. n68

- Periods necessary for the Secretary or the guaranty agency to determine the borrower's eligibility for discharge of the loan because of an unpaid refund, attendance at a closed school, or false certification of loan eligibility or the borrower's or, if applicable, endorser's bankruptcy. n69 The Direct Loan regulations specifically include teacher loan forgiveness programs. n70 The FFEL regulations also allow for forbearances for borrowers who are performing the type of service that would qualify the borrower for loan forgiveness and associated forbearance under the requirements of the teacher loan forgiveness program. However, these forbearances are mandatory rather than discretionary. n71

- Periods not to exceed sixty days while the lender collects and processes documentation supporting the borrower's request for a deferment, forbearance, change in repayment plan, or consolidation loan. n72

Administrative forbearances are particularly important to request when a borrower has applied for a consolidation loan or loan discharge and it is likely that considerable time will pass before the application is resolved. In some cases, the loan holder may agree to cease collection while applications are pending but may prefer to call this cessation something other than a forbearance. It is important to advocate aggressively in these cases since the Department clearly has the discretion to grant forbearances in these circumstances.

The Department also issued special forbearance guidance to assist borrowers called to active duty in response to the September 11 terrorist attacks (and aftermath) or those who lived in or worked in the New York City declared disaster area. This guidance required lenders to grant forbearances to borrowers whose loans are in repayment (other than those with in-school deferments) for the expected period of the borrower's active duty service, beginning on the first day of active duty, not to exceed one year. Borrowers must request these forbearances, but lenders must grant them if requested. Forbearances beyond the initial period require supporting documentation and a written agreement with the borrower.

The Department also required mandatory forbearances for borrowers who lived or worked in the New York City designated disaster area. This period of mandatory forbearance was effective from September 11, 2001 through January 31, 2002. To get relief beyond that period, borrowers are required to submit supporting documentation for forbearance, deferment, or other relief. n73

With respect to Perkins loans, for qualified borrowers in the military, the Department has also waived the requirement that a borrower must send a written request and supporting documentation to apply for a Perkins forbearance. Instead, the school must grant a forbearance based on the borrower's status as an "affected individual" for a one-year period, including a three-month "transition period" that immediately follows that period. These forbearances may be granted without supporting documentation or a written agreement, based on the written or oral request of the borrower, a member of the borrower's family, or another reliable source. The purpose of the three-month transition period is to assist borrowers so that they will not be required to reenter repayment immediately after they are no longer "affected individuals." In order to grant the borrower forbearance beyond the initial period, supporting documentation from the borrower, a member of the borrower's family, or another reliable source is required. In addition, affected individuals do not have to provide the loan holder with documentation showing that they are subject to a military mobilization. The borrower, a member of his/her family, or another reliable source may request the forbearance for one year including a three-month transition period without providing the loan holder with documentation. Documentation must be submitted to support a forbearance beyond this period. n74

"Affected individuals" are those who are serving on active duty during a war or other military operation or national emergency, are performing qualifying National Guard duty during a war or other military operation or national emergency, reside or are employed in an area that is declared a disaster area by any federal, state, or local official in connection with a national emergency, or suffered direct economic hardship as a direct result of a war or other military operation or national emergency, as determined by the Secretary. n75 In July 2008, the Department proposed a mandatory forbearance for borrowers who are called to active military duty for more than a thirty day period and who do not qualify for a military service deferment during the active duty period, but do qualify for the post-active duty deferment. n76 These proposals were adopted. The forbearance is available to members of the National Guard who qualify for a post-active-duty deferment but do not qualify for a military or other deferment. The National Guard member must be engaged in active state duty for a period of more than thirty consecutive days beginning on the day after the grace period ends for loans that have not entered repayment or on the day after the borrower ceases at least half-time enrollment for a loan in repayment. n77

[a] Grounds for Seeking a Forbearance

Both the FFEL and Direct Loan regulations provide for forbearances if borrowers are in poor health or have other personal problems that affect the ability of the borrower to make the scheduled payments. n78 Forbearance for these reasons is discretionary under FFEL regulations. n79 The forbearance is granted up to a year at a time, but there are no limits to the number of years this type of forbearance may be granted. n80

Both FFEL and Direct Loan regulations provide for administrative forbearances for various reasons such as while the lender is resolving a change in the loan's status or pending the resolution of a closed school or false certification discharge application. n81 With a few limited exceptions such as local or national emergencies, the FFEL administrative forbearances are discretionary.

The FFEL program also provides for mandatory forbearances, based on a statutory right. n82 This right to forbearance is available even if a student is in default. n83 To obtain mandatory forbearance, the borrower must request a forbearance from the holder of the loan and provide sufficient supporting documentation. n84

Most relevant for low-income borrowers are mandatory administrative forbearances for up to five years in cases where the borrower will not be able to repay the loan within the maximum repayment term. n85

In addition, FFEL and Direct Loan forbearances are mandatory in increments up to one year for periods that collectively do not exceed three years if the amount of the borrower's monthly student loan payments collectively are equal to or greater than 20% of the borrower's total monthly income. n86 Borrowers are required to submit documentation of income and other relevant information.

The 1998 HEA authorizes forbearance for a period not to exceed 60 days after a borrower's request for deferment, forbearance, change in repayment plan or consolidation of loans. This period is meant to give the borrower time to submit supplementary documents or other information. The interest that accrues during the 60-day period cannot be capitalized. n87

The 1998 HEA also establishes an Incentive Repayment Program for Perkins Loan holders, allowing an institution, with the approval of the Secretary, to reduce the interest rate on a loan by no more than 1% if the borrower makes 48 consecutive monthly repayments, or to discount by no more than 5% the balance owed on a loan that the borrower pays in full prior to the end of the repayment period. n88

[b] Private Loan Deferments and Forbearances

Unlike federal loans, there is no federal law requiring private student loan creditors or servicers to offer deferments or forbearances. In a 2008 study, the National Consumer Law Center surveyed private loan notes and found that most lenders provided an in-school deferment option. n89 However, interest generally accrued during this period, and borrowers were given the choice of paying the interest while in school or approving capitalization once they entered repayment.

No forbearance rights were specified in nearly half of the loans in the survey. n90 Creditors may offer these plans, but they do not inform borrowers about available choices ahead of time in the loan notes. A number of lenders in the survey disclosed that they would charge fees to process forbearance and deferment requests. The fees were generally up to $50 for forbearances.

Sallie Mae and other lenders have changed their forbearance policies. Previously, according to allegations in shareholder lawsuits, they heavily encouraged forbearance as a way of keeping delinquency rates lower. n91 The company now says that they are applying far more analysis to forbearance requests to make sure that borrowers are both committed to repaying their debt and have the actual ability to benefit from forbearance. n92 Since the economic crisis of 2008/2009, many lenders that are still offering private student loans are now requiring borrowers to pay interest while in school.

[3] Consolidation Loans

[a] Introduction

Borrowers can consolidate their defaulted student loans into a new Federal Direct Consolidation Loan with an ICRP (Income Contingent Repayment Plan)or obtain an FFEL consolidation loan with an ISRP (Income Sensitive Repayment Plan). As of July 1, 2009, an even better alternative, income-based repayment (IBR) will be available for both FFEL and Direct Loan borrowers. Borrowers in default will first have to get out of default in order to use the new IBR program. They may accomplish this by either rehabilitating or consolidating their loans, as discussed in this chapter. n93

Consolidation loans with ICRP or ISRP are designed for those who cannot afford to repay their existing student loans. Borrowers with family incomes not exceeding the poverty line for their family size need make no payments on Direct Consolidation Loans with ICRP. Payments for others are contingent on family income level and the size of the student loan. n94

After obtaining a Consolidation Loan, the borrower also obtains a fresh start--becoming eligible for new loans, grants, and even deferments. Borrowers will no longer be listed as currently in default on their credit records, and no longer subject to tax intercepts, garnishments, or other collection efforts.

[b] Which Loans Can Be Consolidated

Students can consolidate Subsidized and Unsubsidized Stafford Loans, SLSs, FISLs, PLUS Loans, Direct Loans, Perkins Loans, Health Education Assistance Loans ("HEALs"), n95 and just about any other type of federal student loan. n96 But to consolidate these types of loans, the student must have at least one outstanding FFEL or Direct Loan. n97 Borrowers may also consolidate a FFEL consolidation loan into a Direct consolidation loan if the FFEL consolidation loan is held by a guaranty agency as a result of a bankruptcy claim. The Department clarified in final regulations that even though borrowers with defaulted Direct consolidation loans are no longer eligible to "re-consolidate" except in the circumstances described above, they may enter into rehabilitation agreements that provide for reasonable and affordable payments. n98

Borrowers may also add loans received prior to the date of a consolidation loan during the 180-day period following the

making of the consolidation loan. Any new loans received during this period may also be added to the consolidation loan. n99 After the 180-day period is over, the borrower may no longer add loans to the existing consolidation loan.

The Department has internal guidelines for deciding whether to consolidate a defaulted Direct Consolidation Loan. Specifically, the Department will not "re- consolidate" a consolidation loan if the underlying loans in the defaulted consolidation loan had been in default. In practice, this means that a borrower can consolidate defaulted loans with the Direct Loan program only once.

Borrowers have the option to consolidate all, just some, or even just one of their existing student loans. Married borrowers can also choose to consolidate loans from both spouses. n100 There is no minimum or maximum size for a Direct Consolidation Loan.

It is important for borrowers to understand that FFEL consolidation rules limit borrowers to one consolidation loan, locking borrowers in at the current rate for the life of the loan. n101 According to the Department, Direct Consolidation Loan borrowers could conceivably consolidate more than once but, given the restrictive formula for calculating interest rates, this may not be an advantage for many borrowers. In general, depending on how much a borrower owes and the length of the consolidated loan, a borrower who chooses to consolidate could end up spending more in interest over the longer time period. The Department warns that, in some situations, consolidation can double a borrower's total interest expense. Consolidation can also add additional fees to the borrower's balance, including collection fees, as noted above.

Another problem to consider is that many borrowers who consolidate a defaulted student loan will default again within twelve months. This is particularly true among borrowers who consolidate defaulted loans. According to a 2000 General Accounting Office study, over 20,000 borrowers repaying consolidation loans under the ICRP had already defaulted on one or more of their underlying loans. This group of previous defaulters had default rates on their consolidation loans over 40%. n102 In addition, consolidation results in a borrower losing some ability to raise school-related defenses. n103

Borrowers have many choices with respect to loan consolidation lenders and brokers. The maximum interest rates are set by federal law, although lenders are free to offer lower rates. n104 The differences between programs can be seen mainly in discounts the lenders can offer. Many lenders offer discounts to borrowers who enroll in the lender's automatic bill payment program. Another discount is often given as a reward for making a series of on-time payments, usually after a few years. Sallie Mae, for example, has offered a 0.25 percent immediate interest rate reduction to borrowers who enroll in automatic payment and an additional 1 percent reduction to those who make regular, on-time payments for three years on loan balances of more than $10,000. Some lenders will provide cash rebates to borrowers who make regular on-time payments rather than lowering interest rates. n105

[4] Reasonable and Affordable and Other Repayment Plans; Loan Rehabilitation

For those in default to guarantors or the Department on FFELs, one of the best options to reschedule payments is to seek a reasonable and affordable payment plan based on the total financial circumstances. The defaulted borrower has a statutory right to such a plan, and payments can be as low as $5 a month or less. n106

A student can renew eligibility for new loans and grants and cure the loan default by "rehabilitating" the defaulted loan. Loan rehabilitation for FFELs and Direct Loans may be requested after the borrower has made nine payments within 20 days of the due date during a consecutive period of 10 months. n107 The payment amount is determined by the guaranty agency (or the United States if it is holding the loan) in the same way as a reasonable and affordable payment plan to renew eligibility. n108

[5] Guaranty Agency Compromise and Write-Off Authority

The Department has approved Standardized Compromise and Write-Off Procedures for use by all guaranty agencies for FFELs. n109 The compromise standards relate to a negotiated agreement between the student loan borrower and the guaranty agency to accept less than full payment as full liquidation of the entire debt.

This compromise will often, but not always, be binding on the United States. It is important for borrowers to secure written verification of this point to assure that the United States will not demand the student's balance at a later date.

Write-off is different from compromise. The write-off procedures for FFEL loans are intended only to stop guaranty agency collection activity. In general, write-off does not relieve the debtor of the debt. This is in contrast to Perkins write-offs, through which the borrower can be relieved of all repayment obligations. n110 Once a guaranty agency has written-off an FFEL loan, it must permanently assign the loan to the Depart- ment. n111 The exception to this policy is that guaranty agencies have the authority to write-off loans with principal balances of less than $100 and a total balance of less than $1,000, and any loans in which the remaining balance represents only interest, attorney fees, court costs, or collection costs without requiring the permanent assignment of the loan to the Department. n112 Write-off and assignment may in some cases be less desirable for the borrower, particularly if the United States seeks larger collection fees than the guaranty agency.

The Department sets out guidelines for guaranty agencies to consider in deciding whether to write off loans and cease collection activity. Agencies are required to consider the debtor's and, if applicable, an endorser's current inability to repay the debt. Examples of borrowers who might qualify include: borrowers who are repeatedly unemployed and have no prospects for future employment; borrowers who repeatedly are public assistance recipients; borrowers who are chronically ill, partially disabled, or of an age that results in their inability to work; borrowers whose potential for future earnings is limited or non-existent; and borrowers who have no other funds available to them from other sources, such as inheritance. Borrowers who receive a compromise or write-off must reaffirm the amount compromised or written-off if they later want to receive an FFEL loan. n113 Perkins lenders have discretion to write-off a loan balance less than $25 or less than $50 if, for a period of at least two years, the borrower has been billed (and has not paid) the balance. n114 When a school writes-off an account, the borrower is relieved of all repayment obligations. n115

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawConsiderationEnforcement of PromisesForbearanceEducation LawAdministration & OperationStudent Financial AidDebt CollectionEducation LawAdministration & OperationStudent Financial AidEligibilityEducation LawAdministration & OperationStudent Financial AidRenewal & Revocation

FOOTNOTES:

(n1)Footnote 1. For unsubsidized loans, where the borrower is responsible for interest accrued while the student is in school, the student remains obligated for accrued interest during the deferment period. In this situation, lenders are encouraged to forbear and capitalize interest payments until after the deferral period. *See 34 C.F.R. § 682.211.*

(n2)Footnote 2. *34 C.F.R. § 682.210(a)(7).* Note that the 1998 Higher Education Act changes the definition of "default." Formerly, a loan payable in monthly installments was considered in default if payment was more than 180 days past due; under the new amendments, this period is extended to 270 days and applies where the first day of delinquency occurs on or after October 7, 1998. Pub. L. No. 105-244 (Oct. 7, 1998), § 429(c).

(n3)Footnote 3. *34 C.F.R. § 682.210(a)(8).*

(n4)Footnote 4. *See § 12.05[3][a] infra.*

(n5)Footnote 5. *See § 12.07[3] infra.*

(n6)Footnote 6. *72 Fed. Reg. 32410* (June 12, 2007) .

(n7)Footnote 7. *Id.*

(n8)Footnote 8. *20 U.S.C. § 1092c(a).*

(n9)Footnote 9. *34 C.F.R. § 682.210(a)(1)(ii).*

(n10)Footnote 10. *34 C.F.R. §§ 682.210(s)(2)* (FFELs), 685.204(b)(1)(i)(A) (Direct Loans).

(n11)Footnote 11. *34 C.F.R. §§ 682.210(s)(3)* (FFELs), 685.204(b)(1)(i)(B) (Direct Loans).

(n12)Footnote 12. *34 C.F.R. §§ 682.210(s)(4)* (FFELs), 685.204(b)(1)(i)(C) (Direct Loans).

(n13)Footnote 13. *34 C.F.R. §§ 682.210(s)(5)* (FFELs), 685.204(b)(2) (Direct Loans). The borrower must be conscientiously searching for full-time employment (defined as at least 30 hours per week and expected to last at least three months), must document the search, and must verify the search every six months.

As of July 1, 2003, there are new, less onerous, requirements for borrowers applying for the unemployment deferment based on a conscientious employment search. *See 67 Fed. Reg. 67,048* (Nov. 1, 2002) ; United States DOE, Dear Colleague Letter GEN-03-04, Approval of Revised Unemployment Deferment and Economic Hardship Deferment Forms for the Federal Family Education Loan Program (Mar. 2003). To get the initial deferment, the borrower is required to certify that she is diligently seeking but unable to find full-time employment and that she is registered with a public or private employment agency. *34 C.F.R. § 682.210(h)(2)(i).* The initial period of deferment can be granted for a period of unemployment that begins up to six months before the lender receives the borrower's request and can be granted for up to six months after that date. *34 C.F.R. § 682.210(h)(2)(i).*

(n14)Footnote 14. *34 C.F.R. §§ 682.210(s)(6)* (FFELs), 685.204(b)(3) (Direct Loans). The definition of "economic hardship" for purposes of economic hardship deferment was amended by the College Cost Reduction and Access Act of 2007, Pub. L. No. 110-84, *121 Stat. 784* (Sept. 27, 2007), to conform to the definition of "partial financial hardship" that is necessary to qualify for an income-based repayment plan (IBR). Currently, a borrower working full-time is considered to have an economic hardship if his or her income does not exceed the greater of the minimum wage or the amount equal to 100% of the poverty line for a family of two. Under the new definition, the "100% of the poverty line for a family of two" is replaced by 150% of the poverty line applicable to the borrower's family size.

The criteria for borrowers not working full-time should remain the same, including receipt of federal or state public assistance benefits.

(n15)Footnote 15. *34 C.F.R. § 682.210(s)(vi)* (FFELs); *34 C.F.R. § 685.204(b)(3)* (Direct Loans).

(n16)Footnote 16. *34 C.F.R. §§ 682.210(s)(6)(i)* (FFEL), 685.204(b)(3)(i) (Direct Loan). The Direct Loan program economic hardship deferment regulations specifically refer to the requirements in the FFEL regulations. The standards are the same for both loan programs. This deferment is also available for Perkins loan borrowers. *34 C.F.R. § 674.34(e).*

(n17)Footnote 17. *34 C.F.R. § 682.210(s)(6)(ii).*

(n18)Footnote 18. *34 C.F.R. §§ 682.210(s)(6)(ii)* (FFELs), 685.204(b)(3)(ii) (Direct Loans).

(n19)Footnote 19. *73 Fed. Reg. 63232, 63235* (Oct. 23, 2008) .

(n20)Footnote 20. *34 C.F.R. § 682.210(s)(6)(iii).*

(n21)Footnote 21. *34 C.F.R. § 682.210(s)(v).*

(n22)Footnote 22. *73 Fed. Reg. 37694* (July 1, 2008) .

(n23)Footnote 23. United States DOE, Dear Colleague Letter GEN-01-13, Recent Terrorist Attacks: Persons Affected by Military Mobilization (Sept. 2001). A later Dear Colleague Letter, GEN-03-06 (Mar. 2003), provides additional guidance and extends most of the time limits for borrowers actively serving in the military. The current military deferment applies for only three years and is available only during periods in which borrowers are serving on active duty, or performing qualifying National Guard duty, during a war or other military operation.

Congress eliminated the three-year limit on the military deferment and expanded eligibility to include the six-month period following the demobilization dates of qualified service members when it enacted the College Cost Reduction and Access Act of 2007. Pub. L. No. 110-84, *121 Stat. 784* (Sept. 27, 2007). However, the time limits for all non-military deferments remain unchanged.

In addition to any other deferments, members of the National Guard or other reserve component of the Armed Forces or retired members of the Armed Forces, called to active duty within six months of when they are enrolled or were enrolled in school, are eligible for a deferment during the thirteen months following the conclusion of service. This right expires upon return to enrolled status in school.

(n24)Footnote 24. *Id.*

(n25)Footnote 25. This same September 2001 guidance also required lenders to grant forbearances to loans that are in repayment (other than those in an in-school deferment status) for the expected period of the borrower's active duty service. The borrower is required to request this forbearance, but it must be granted upon request. *See* United States DOE, Dear Colleague Letter GEN-01-13 (Sept. 2001). Lenders are also required to cease collection activities against borrowers in default for the expected period of the borrower's military service through September 14, 2002. The Department may extend this period. It is best to consult the Department web site, www.ed.gov, for updated information.

(n26)Footnote 26. *34 C.F.R. § 682.402(d)(2)(i)* (closed school discharge); *34 C.F.R. § 682.402(e)(2)(i)* (false certification discharge).

(n27)Footnote 27. *34 C.F.R. § 682.402(d)(4)(ii).*

(n28)Footnote 28. Pub. L. No. 105-244 (Oct. 7, 1998), § 490F.

(n29)Footnote 29. Pub. L. No. 109-171 § 8007, *120 Stat. 4* (Feb. 8, 2006), *amending 20 U.S.C. § 1078(b)(1)(M).*

(n30)Footnote 30. Pub. L. No. 110-84, *121 Stat. 784* (Sept. 27, 2007).

(n31)Footnote 31. Pub. L. No. 110-84 (2008); *34 C.F.R. § 682.210(u)* (FFEL).

(n32)Footnote 32. *34 C.F.R. § 682.210(u)* (FFEL); *34 C.F.R. § 674.34(i)* (Perkins); *34 C.F.R. § 685.204(f)* (Direct).

(n33)Footnote 33. *34 C.F.R. § 682.210(u)(1).*

(n34)Footnote 34. *34 C.F.R. § 682.210(u)(3).* Proposed rules issued in July 2008 state that the deferment terminates if the borrower returns to school on at least a half-time basis. *73 Fed. Reg. 37694, 37697* (July 1, 2008) .

(n35)Footnote 35. *Id.*

(n36)Footnote 36. Borrowers whose loan was obtained on or after July 1, 1987, and who have no outstanding FFEL balance on that date, may obtain an in-school deferment for half-time study if the borrower also received or will receive a Stafford or SLS loan for the period during which deferment is sought. *34 C.F.R. 682.210(c)(iii).*

(n37)Footnote 37. *20 U.S.C. § 1077(a)(2)(c)*; *34 C.F.R. § 682.210(b)*, *(c)*, *(e)*, *(f)*, *(g)*, *(h)*, *(i)*, (o), (r).

(n38)Footnote 38. *See 34 C.F.R. § 682.210(e)*, *(f)*, *(g)*, *(h)*.

(n39)Footnote 39. *34 C.F.R. § 682.210(b)*.

(n40)Footnote 40. *34 C.F.R. §§ 674.34*, *674.35* and *674.36*.

(n41)Footnote 41. *34 C.F.R. §§ 674.54 to 674.58*. The Department has modified the requirements that limit military deferments to a three-year cumulative period so that the time during which affected individuals are serving on active duty is excluded from this time limit. The Department will pay interest that accrues on subsidized Stafford Loans during an extended period of deferment under this modification. *68 Fed. Reg. 69312* (Dec. 12, 2003) . The Department has also modified certain documentation requirements for this deferment. "Affected individuals" are those who are serving on active duty during a war or other military operation or national emergency, are performing qualifying National Guard duty during a war or other military operation or national emergency, reside or are employed in an area that is declared a disaster area by any federal, state, or local official in connection with a national emergency, or suffered direct economic hardship as a direct result of a war or other military operation or national emergency, as determined by the Secretary.

(n42)Footnote 42. Pub. L. No. 105-244 (Oct. 7, 1998), § 464. For information on closed school discharges, see *§ 12.06[2] infra*. The regulations for Perkins closed school discharges, when published, will likely be similar to those for other loans.

(n43)Footnote 43. *34 C.F.R. § 674.34(b)(1)(i)*.

(n44)Footnote 44. *34 C.F.R. § 674.34(c)*.

(n45)Footnote 45. *Id*.

(n46)Footnote 46. *Id*.

(n47)Footnote 47. *34 C.F.R. § 674.34(e)*.

(n48)Footnote 48. *34 C.F.R. § 674.34(d)*. The Perkins unemployment deferment does not have the same documentation requirements as FFEL and Direct Loans. However, Perkins holders will require borrowers to provide certification supporting their applications.

(n49)Footnote 49. *34 C.F.R. § 674.34(e)*.

(n50)Footnote 50. See § *34 C.F.R. § § 682.210(s)(6)(i)*.

(n51)Footnote 51. *34 C.F.R. § 674.35*.

(n52)Footnote 52. Pub. L. No. 105-244 (Oct. 7, 1998), § 464. *See § 12.05[4] infra*.

(n53)Footnote 53. *See § 12.02[3]*, *supra*.

(n54)Footnote 54. Pub. L. No. 110-315 § 424 (amending *20 U.S.C. § 1078-2*).

(n55)Footnote 55. U.S. Dep't of Educ., Dear Colleague Letter FP-09-06, Approval of FFEL Program Deferment Request Forms (July 30, 2009).

(n56)Footnote 56. *74 Fed. Reg. 36555* (July 23, 2009) (amending *34 C.F.R. § 682.210*).

(n57)Footnote 57. *34 C.F.R. § 682.211(a)(1)*.

(n58)Footnote 58. *34 C.F.R. § 682.211(a)(1)*.

(n59)Footnote 59. *34 C.F.R. § § 682.211(f)* (FFEL), 685.205(b) (Direct Loans).

(n60)Footnote 60. The regulations for mandatory administrative forbearances are set out at *34 C.F.R. § 682.211(i)*.

(n61)Footnote 61. *34 C.F.R. § § 682.211(f)(1)*, *685.205(b)(1)*.

(n62)Footnote 62. *34 C.F.R. § 682.211(f)(2)*.

(n63)Footnote 63. *34 C.F.R. § 685.205(b)(2)*.

(n64)Footnote 64. *34 C.F.R. § § 682.211(f)(3)* (FFELs), 685.205(b)(3) (Direct Loans).

(n65)Footnote 65. *34 C.F.R. § § 682.211(f)(4)* (FFELs), 685.205(b)(4) (Direct Loans).

(n66)Footnote 66. *34 C.F.R. § 682.211(f)(6)*.

(n67)Footnote 67. *34 C.F.R. § 682.211(f)(5)*. A similar provision for Direct Loans can be found at *34 C.F.R. § 685.205(b)(5)*.

(n68)Footnote 68. *34 C.F.R. § 685.205(b)(5)* (Direct Loans).

(n69)Footnote 69. *34 C.F.R. § § 682.211(f)(7)* (FFELs), 685.205(b)(6).

(n70)Footnote 70. *34 C.F.R. § 685.205(b)(6)(iv)*.

(n71)Footnote 71. *34 C.F.R. § 682.211(h)(2)(ii)(C)*.

(n72)Footnote 72. *34 C.F.R. § § 682.211(f)(10)* (FFELs), 685.205(b)(9) (Direct Loans).

(n73)Footnote 73. United States DOE, Dear Colleague Letter GEN-01-13, Recent Terrorist Attacks-Persons Affected by Military Mobilization (Sept. 2001). Note that the Department may issue additional guidance to extend these periods or otherwise supplement this guidance. Additional guidance will be available on the Department's web site, www.ed.gov. *See also* Dep't of Educ., *General Guidance for Helping Title IV Participants Affected by a Disaster*, Dear Colleague Letter #GEN-04-04 (Feb. 2004).

(n74)Footnote 74. *68 Fed. Reg. 69312* (Dec. 12, 2003) .

(n75)Footnote 75. *Id.*

(n76)Footnote 76. *73 Fed. Reg. 37694* (July 1, 2008) .

(n77)Footnote 77. *34 C.F.R. § 682.211(h)(2)(iii)*.

(n78)Footnote 78. *34 C.F.R. § 682.211(a)(2)(i)* (FFEL); *34 C.F.R. § 685.205(a)(1)* (Direct Loans).

(n79)Footnote 79. *34 C.F.R. § 682.211(a)(2)(i)*.

(n80)Footnote 80. *34 C.F.R. § 682.211(c)* (FFEL); *34 C.F.R. § 685.205(c)* (Direct Loans).

(n81)Footnote 81. *34 C.F.R. § 682.211(f)* (FFEL); *34 C.F.R. § 685.205(b)* (Direct Loans).

(n82)Footnote 82. *20 U.S.C. § 1078(b)(1)(V).*

(n83)Footnote 83. *20 U.S.C. § 1078(c)(3).*

(n84)Footnote 84. *34 C.F.R. § 682.211(i)(3).*

(n85)Footnote 85. *34 C.F.R. § 682.211(i)(5)(ii).*

(n86)Footnote 86. *34 C.F.R. § 682.211(h)(2)(i)* (FFEL); *34 C.F.R. § 685.205(a)(5)* (Direct Loans).

(n87)Footnote 87. Pub. L. No. 105-244 (Oct. 7, 1998), § 417(c)(4).

(n88)Footnote 88. Pub. L. No. 105-244 (Oct. 7, 1998), § 464.

(n89)Footnote 89. National Consumer Law Center, Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers (Mar. 2008), *available at* www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf.

(n90)Footnote 90. *Id.*

(n91)Footnote 91. *See, e.g., In re* SLM Corp. Secs. Litig., No. 08 Civ. 1029 (S.D.N.Y. filed Dec. 8, 2008) (amended class action complaint).

(n92)Footnote 92. Paul Basken, *Sallie Mae Reports $159-Million Loss and More Delinquencies by Borrowers*, The Chron. of Higher Educ. (Oct. 23, 2008).

(n93)Footnote 93. The 2008 Higher Education reauthorization law clarifies that those borrowers who had been in default qualify for IBR, not only those "in default." Pub. L. No. 110-315 § 494F, *122 Stat. 3078* (Aug. 14, 2008). This change was incorporated in the regulations at *34 C.F.R. § 682.215(a)(2)* and *34 C.F.R. § 685.221(a)(2). See 73 Fed. Reg. 63232* (Oct. 23, 2008) .

(n94)Footnote 94. For a discussion of the costs of Income Contingent Repayment Plan [hereinafter ICRP] vs. Income Sensitive Repayment Plan [hereinafter ISRP] and other advantages and disadvantages of the Direct Consolidation Loan and the FFEL Consolidation Loan programs, see National Consumer Law Center, Student Loan Law, § 8.2 (3d ed. 2006 and Supp.). There is no charge to obtain a Direct Consolidation loan. The first step is to request an application by calling the current toll-free number: (800) 557-7392 or for TDD: (800) 557-7395. Borrowers can also apply for Direct Consolidation loans using the Internet. The website is www.ed.gov/DirectLoan. The Direct Loan website has information about interest rates and payment plans for consolidation loans. It also provides a number of calculators to help borrowers estimate their monthly repayments under the various plans. On its web site, the Department states that borrowers are generally advised not to jointly consolidate loans. The Department cites the joint and severability provision as the main concern for borrowers. *See* http://studentaid.ed.gov.

(n95)Footnote 95. Note that the Health Education Assistance Loan [hereinafter HEAL] program has been phased out. *See* United States DOE, Dear Colleague Letter GEN-96-14, Clearinghouse No. 52,133 (August 1996); United States DOE, Dear Colleague Letter GEN-98-18, Clearinghouse No. 52,137 (August 1998).

(n96)Footnote 96. *34 C.F.R. § 685.215(b).*

(n97)Footnote 97. *34 C.F.R. § 685.215(d).*

(n98)Footnote 98. *71 Fed. Reg. 64378* (Nov. 1, 2006) ; U.S. Dep't of Educ., Dear Colleague Letter GEN-06-20, Update on Consolidation Loan Issues (Dec. 1, 2006).

(n99)Footnote 99. *Id*.

(n100)Footnote 100. On its web site, the Department states that borrowers are generally advised not to jointly consolidate loans. The Department cites the joint and severability provision as the main concern for borrowers. *See* http://studentaid.ed.gov.

(n101)Footnote 101. *20 U.S.C. § 1078-3(a)(3)(B)(i)*.

(n102)Footnote 102. *See* General Accounting Office, Direct Loan Default Rates, GAO-01-68 (Oct. 2000), *available at* www.gao.gov.

(n103)Footnote 103. *See* National Consumer Law Center, Student Loan Law, § 8.2.4 (3d ed. 2006 and Supp.).

(n104)Footnote 104. *20 U.S.C. § 1077a(m)*.

(n105)Footnote 105. *See* Kaja Whitehouse, *Getting Personal: How to Pick a Student Loan Consolidator*, Dow Jones Newswire, June 1, 2004, at D2.

(n106)Footnote 106. *34 C.F.R. § 682.401*. For the definition of a satisfactory repayment plan, see *34 C.F.R. § 682.200*.

(n107)Footnote 107. See *34 C.F.R. § 682.405(a)(2)* (FFEL); *34 C.F.R. § 682.211(f)* (Direct).

(n108)Footnote 108. *20 U.S.C. § 1078-6(a)(1)*; *34 C.F.R. § 682.405(b)(1)(i)(B)* (no minimum requirement for reasonable and affordable payment plan). *See generally* National Consumer Law Center, Student Loan Law, § 8.3.3 (3d ed. 2006 and Supp.).

(n109)Footnote 109. See Letter from Jean Frohlicher, President of the National Council of Higher Education Loan Programs, Inc. re: Compromise and Write-Off Procedures (Nov. 7, 1993), with attached approval by Robert W. Evans, Director, Division of Policy Development (Nov. 24, 1993), and attached Standardized Compromise and Write-Off Procedures, all found at Clearinghouse No. 49,168.

(n110)Footnote 110. *34 C.F.R. § 674.47(h)(3)*.

(n111)Footnote 111. *See* Letter from Jean Frolicher re: Compromise and Write-off Procedures (Nov. 7, 1993), Clearinghouse No. 49,168.

(n112)Footnote 112. *See* Letter from Jean Frolicher re: Compromise and Write-off Procedures (Nov. 7, 1993), Clearinghouse No. 49,168.

(n113)Footnote 113. *See* Letter from Jean Frolicher re: Compromise and Write-off Procedures (Nov. 7, 1993), Clearinghouse No. 49,168.

(n114)Footnote 114. *67 Fed. Reg. 67,048* , *amending 34 C.F.R. § 674.47(h)*, effective July 1, 2003. The write-off amount was increased from $5.

(n115)Footnote 115. *67 Fed. Reg. 67,048* , *amending 34 C.F.R. § 674.47(h)(3)*.

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 12 Student Loans and Trade School Abuses

1-12 Consumer Credit Law Manual § 12.06

§ 12.06 Cancelling Student Loan Obligations

[1] Introduction

The statutory forms of discharge discussed below and the common law defenses offer the borrower complete relief relative to a student loan, as opposed to simply delaying the repayment obligation. Thus, the student no longer owes anything on the loan, and the student becomes eligible again for new student loans and grants.

[2] The Closed School Discharge

[a] The Closed School Discharge Applies to Specified Types of Loans

The closed school discharge is applicable to the student's obligation and that of all endorsers of Direct Loans n1 and FFELs received at least in part on or after January 1, 1986. n2 The closed school discharge thus applies to Staffords and SLSs and the parents' obligation under PLUS Loans. n3

If a student consolidates a loan eligible for discharge, the consolidation loan is not discharged, but the student receives a credit in the amount of the original loan relating to the closed school. n4 In addition, the closed school discharge does not apply to FFEL loans where all of the loan was received before January 1, 1986, or to Perkins Loans or FISLs.

[b] Determining if a Student Qualifies for a Discharge

The HEA states that the Secretary shall discharge one of the specified loans if the borrower was unable to complete the program due to the school's closure. n5 The regulations provide this discharge if the branch of the school at which the student attended closed. n6 The closed school discharge applies to any school at which the student obtained an FFEL or Direct Loan, whether or not the school or branch was in fact an eligible institution under the program. n7

The regulations provide a discharge if the student was still enrolled at the time of the school's closure n8 or if the student withdrew from the school within ninety days before the school's closure. n9 The ninety-day period may be extended if the Secretary determines that exceptional circumstances related to the school's closing would justify an extension. n10

The Secretary determines the closure date, and, for most situations, the student should rely on the Secretary's Cumulative List Of Closed Schools to determine the official closure date. n11

Students can obtain closed school discharges if the school closed before they completed a program, even if the school issued the student a diploma or other certificate. On the other hand, if a student completes a program, there is no discharge even if the student never received a diploma or certificate. n12

Students are also barred from receiving a discharge if they completed the program through a "teach-out" at another school, or through transfer of credits or hours earned at the closed school to another school. n13

[c] Relief Available for Those Obtaining a Closed School Discharge

When a student receives a closed school discharge, the student (and any other obligor on the note) is no longer obligated to repay the loan or any charges or costs associated with the loan. n14 That is, the loan principal, interest charges, collection costs, and all other charges are forgiven.

In addition, the student is reimbursed all amounts paid to date on the loan, whether those payments were voluntary or involuntary, such as through tax intercepts or garnishments. n15 The borrower is no longer regarded in default, and is immediately eligible for new loans and grants. n16

The discharge of an FFEL must also be reported to all credit reporting agencies to which the holder previously reported the loan's status "so as to delete all adverse credit history assigned to the loan." n17

[d] How to Obtain a Closed School Discharge

The Department and guaranty agencies will not automatically provide discharges to those who appear eligible. Students must apply for the discharge. Guarantors are required to inform those appearing eligible of their right to apply, with an application form, and the guarantors must forbear collecting from these individuals. n18

To apply for a discharge, students will typically fill-out forms created by the loan holder, and submit the application to the loan holder. The regulations specify the minimum information required, and it is this information that the student should make sure is included on the application. n19

There is no time limit on a student's eligibility for a discharge. n20 As discharge decisions often take many years to process, advocates should be prepared to request administrative forebearances for students so that collection activities will cease until the discharge has been granted or denied. n21 The regulations do not set out a review right for denial of a closed school discharge application. The Department expects guaranty agencies to respond to discharge requests within ninety days, although the Department has not set any time limits for its own response to discharge requests. The Department has published a new form for closed school discharge applications. n22 In addition, the 1998 HEA authorizes the Department and guaranty agencies to grant closed school discharges without a written application if there is enough information to establish discharge. n23 Specifically, a discharge may be granted without an application if 1) the borrower received a discharge for a Perkins or direct loan for the same program of study or 2) the Department or guaranty agency determines that the borrower qualifies for a discharge based on information in the Secretary or agency's possession. This may facilitate advocacy that a group of students be given a closed school discharge in settlement of an action, instead of requiring each student to submit an application.

[e] Effect of School Closure on Perkins, FISLs, and Older FFELs

The 1998 HEA expands the closed school discharge to Perkins Loans made on or after January 1, 1986. n24 As a consequence, students with Perkins Loans should not apply for closed school discharges because the Department is

certain to deny the application as not within the scope of the statute.

The closed school discharge applies only to loans disbursed after January 1, 1986. As a consequence, students whose loans were disbursed *in full* before that date should not seek a closed school discharge. Instead, these students will have to pursue other approaches.

[3] False Certification Discharge

[a] In General

Students are entitled to a loan discharge if they received at least part of an FFEL after January 1, 1986, n25 or received a Direct Loan, and if their eligibility to borrow was falsely certified by the school. n26

The Department recognizes only three bases for a false certification discharge:

a) The school falsifies a non-high school graduate's ability to benefit from the program.

b) The school enrolls a student unable to meet minimum state employment requirements for the job for which the student is being trained.

c) The school forges or alters the student loan note or check endorsements.

[b] Discharge Based on Ability-to-Benefit (ATB) Fraud

Department regulations authorize a false certification discharge if, as a non-high school graduate, n27 the student was nonetheless admitted to a school and the school falsified the student's ability to benefit from the program. n28 For a school not to have falsified the ability of a student enrolled after July 1, 1987 n29 to benefit from the school, the student must have done at least one of the following:

a) Passed an ability-to-benefit ("ATB") test, the test being approved by the accrediting agency (or for enrollments after July 1, 1991, by the Secretary) and administered substantially in accordance with the test publisher's or accreditor's requirements for use of the test; n30

b) Successfully completed a program of developmental or remedial education provided by the school; n31 or

c) Enrolled before July 1, 1991 and received a general education diploma before completing the program of instruction. n32 The Higher Education Opportunity Act added a new "ability to benefit" qualification category. Students may be shown to have the ability to benefit from the education or training upon satisfactory completion of six credit hours or the equivalent coursework that are applicable toward a degree or certificate offered by the institution of higher education. n33 It is unclear how this will work in practice. For example, a student may enroll in a course and presumably not be eligible for federal aid but then qualify later if she completes the six credit hours.

For periods of enrollment after July 1, 1996 and before June 30, 2000, the student must have done at least one of the following:

- Obtained a passing score on an independently administered test; n34 or

- Enrolled in an eligible institution that participates in an alternative admissions process. n35 Alternative processes can be implemented by the states for some or all schools in that state. These processes must be approved by the Secretary of Education. In order to gain approval, the state must present certain information including proof of a

minimum success rate. n36

For periods of enrollment beginning on or after July 1, 2000, the student must meet one of the two conditions discussed above for July 1, 1996 through June 30, 2000, or meet the requirements for valid home schooling. n37

For example, a school not administering a valid test where one is required is a clear example of ATB fraud. Even if an approved ATB test is used, a false certification discharge may still be granted if the student was not given the appropriate portion of the test. n38 The Department also considers various testing errors, even if unintentional, proof of ATB falsification. n39

A further precondition is placed on students that completed the program. The student must show that a reasonable attempt was made to obtain employment in the field for which the student received training. n40 The requirement that students show failure to find employment was successfully challenged in the D.C. Circuit. n41 This precondition to a false certification discharge was found to be inconsistent with the governing statute and therefore invalid. After this decision, the DOE agreed to extend the benefits of the ruling to borrowers nationwide. The Department's action was initially confirmed in a July 2000 Dear Colleague Letter and later formalized in new regulations effective July 1, 2001. n42

[c] Discharge Based on Student's Inability to Meet Minimum State Job Requirements

Even students with a high school diploma can receive a false certification discharge if, *at the time of the student's enrollment*, "the student would not meet the requirements for employment (in the student's state of residence) in the occupation for which the training program supported by the loan was intended because of physical or mental condition, or age, or criminal record or other reason accepted by the Secretary." n43

The discharge should also apply where the school's program, instead of the student, does not meet minimum state requirements. For example, a discharge should be available where a program was not certified by the state, and graduation from a certified program is a precondition under state law for employment.

Borrowers should submit detailed documentation of the status or condition that prevents them from working in the particular field. In addition, the Department will generally require a copy of the state statute or regulation showing the requirements for employment in the particular field and that the condition or status would prevent the student from meeting those requirements.

[d] Forgery

A third important basis for a false certification discharge is if the student's signature was forged on the loan application, promissory note, loan check endorsement, or authorization for an electronic funds transfer. n44 If the borrower's signature appears forged, the student must submit five specimens of the student's own signature, two of which had to have been within one year of the forgery. n45

A false certification discharge for a forged check is only available if the proceeds of the forged check went toward tuition payments the student was not obligated to pay, such as that portion of tuition not owed under the applicable refund formula after the student had dropped out. n46 The regulations and a Dear Colleague Letter appear to place the burden not on the student, but on the guaranty agency to determine whether the forged check proceeds went toward a legitimate student obligation or not. n47

The Department will not grant a discharge based on forgery if the borrower benefited from the loan. n48 This cancellation only applies if the school forged the borrower's signature or endorsed the borrower's loan without authorization. n49 A borrower may still qualify for a cancellation if someone else committed the forgery by either

applying for a discharge based on identity theft or by challenging the enforceability of the loan due to forgery. n50

The relief available for those obtaining a false certification discharge is identical to that for a closed school discharge. n51

[e] How to Apply for a False Certification Discharge

There is no time limit on a student's eligibility for a false certification discharge. n52 Whether a student seeks a discharge based on a disqualifying condition, ATB falsification, or a forged check, the application should be directed to the entity holding the loan, almost always either a guaranty agency or the DOE.

According to the regulations, the student must submit a written request for a discharge and a sworn statement (not notarized, but sworn under the penalty of perjury) attesting:

> (1) Whether the student has made a claim against another party on the loan (such as from a state tuition recovery fund);
>
> (2) That at least part of the loan was disbursed after January 1, 1986;
>
> (3) That the student agrees, at the Secretary's request, to provide additional information concerning the student's eligibility for a discharge; and
>
> (4) That the student will cooperate with the Secretary in enumerated enforcement actions and to assign to the Secretary certain rights the student has to recover from third parties. n53

Since discharge applications often take many years to process, advocates should be prepared to request administrative forbearances for students so that collection activities will cease until the discharge has been granted or denied. n54 The Department's delays in making decisions on false certification discharges are among the issues raised in a 1998 class action complaint. The complaint alleges that the Secretary has not assigned adequate staff to administer the program, resulting in a backlog of over 10,000 undecided applications that have been pending, in some cases, for years. n55

[f] Identity Theft

The Higher Education Reconciliation Act of 2005 provides for discharges of FFEL or Direct loans if the borrower's eligibility to borrow was falsely certified due to identity theft. n56 This basis for a discharge became effective on July 1, 2006.

The regulations published in August 2006 require a borrower seeking this discharge to

- certify that the borrower did not sign the promissory note or that any other means of identification used to obtain the loan was used without the borrower's authorization;
- certify that the borrower did not receive or benefit from the proceeds of the loan with knowledge that the loan had been made without the borrower's authorization; and
- provide a copy of a local, state, or federal court verdict or judgment that conclusively determines that the borrower was a victim of the crime of identity theft and that the loan in question was made as a result of that theft. n57

If the judicial determination of the crime does not expressly state that the loan was obtained as a result of the crime, the

borrower must provide authentic samples of his or her signature or other means of identification and a statement of facts that demonstrate that the borrower's eligibility for the loan in question was falsely certified as a result of identity theft.

The Department clarifies in the interim regulations that it is not suggesting in any way that borrowers are liable for loans they did not execute or authorize when there is no crime of identity theft. n58 The Department reiterated this point in final regulations, stating that an individual who claims that a signature was forged is not required to delay asserting that claim until a criminal prosecution occurs and nothing in the regulations requires such a delay. n59 Borrowers may also be eligible for false-certification discharges due to forgery. n60 In addition, they may have common law contract defenses or other defenses derived from HEA regulations. For example, FFEL program regulations provide that benefits are payable to loan holders only when the lender obtained a legally enforceable promissory note to evidence the loan. n61 Lender rights are also subject to the obligation of the lender to exercise due diligence in making the loan. n62

[4] Discharging Student Loans in Bankruptcy

[a] When Can a Student Loan Be Discharged in Bankruptcy?

A chapter 7 or 13 discharge eliminates all of a debtor's unsecured debts, with certain statutory exceptions. While student loans are unsecured debts subject to discharge, the Bankruptcy Code restricts when most types of student loans can be discharged in either a chapter 7 or chapter 13 bankruptcy.

Student loan debtors suffered a major setback in 1998 to their ability to discharge student loans. For all bankruptcy cases filed on or after October 7, 1998, the discharge of student loans which first became due more than seven years prior to the bankruptcy filing will no longer be allowed. n63 Cases pending on October 7, 1998 are not affected by the change in the law.

Most educational loans can only be discharged if the consumer can show that payment of the debt "will impose an undue hardship on the debtor and the debtor's dependents." n64

This special restriction on dischargeability applies to educational loans "made, insured or guaranteed by any governmental unit, or made under any program funded in whole or in part by a government unit or a nonprofit institution." n65 Consequently, the dischargeability of Stafford, SLS, Federal Direct, and Perkins Loans are all restricted. Most courts find these limitations apply not only to student borrowers, but also to parents who co-sign a student loan or take out a PLUS or other loan for their child's education. n66

In addition, the limits apply to loans by state agencies and nonprofit organizations. n67 Loans made by for-profit institutions may be discharged. n68 The limits on dischargeability also apply to educational benefit overpayments (such as Pell grant overpayments) and obligations to repay funds received as educational benefits, scholarships or stipends. n69 They do not apply to a student's nonpayment of tuition, which does not involve an extension of credit. n70 The limits on dischargeability on HEALs are more severe than for other student loans. n71

[b] Discharging Student Loans Over Seven Years Old No Longer Allowed for Cases Filed After October 7, 1998

For all bankruptcy cases filed after October 7, 1998, the discharge of student loans which first became due more than seven years prior to the bankruptcy filing will no longer be allowed. n72 For cases filed before October 7, 1998, or still pending on that date, if the first student loan installment meets the seven-year test, then the entire loan and not just the first installment can be discharged. n73

The most important issue in counting the seven year period is that the seven years are "exclusive of any applicable suspension of the repayment period." n74 This means that a deferment or forbearance may lengthen the seven year

period if repayments were suspended during that period. n75 Students also have to be aware of the bankruptcy implications of consolidating one or more student loans into a new consolidated loan. This may start the seven year period running all over again with the consolidated loan. n76

[c] Substantial Hardship as Basis for Discharging Student Loan

A student loan may be discharged if payment of the debt "will impose an undue hardship on the debtor and the debtor's dependents." n77 There is no statutory definition of "undue hardship." Generally, it means the consumer's present income is inadequate to pay the loan and future earning potential will not change this situation. n78 The consumer may also have to show that the attempt to discharge the debt is in good faith. n79 The student's undue hardship argument may be stronger where the student loan arose from a private vocational school that closed down or defrauded the student.

Whether a student loan is discharged based on hardship is not automatically determined in the bankruptcy proceeding. The debtor must affirmatively seek such a determination. If the debtor fails to do so, and a loan holder subsequently attempts to collect on the loan, the loan's dischargeability can be resolved at that later date either by the bankruptcy court or by a state court in a proceeding relating to the note's collection. In general, it is best to resolve the loan's dischargeability in the bankruptcy court while the case is pending. The student may do this by bringing an adversary proceeding in the bankruptcy court seeking a declaratory judgment that a particular debt is dischargeable. n80 An "adversary proceeding" is a lawsuit within the bankruptcy case initiated by the filing of an adversary complaint. It is subject to rules almost identical to the Federal Rules of Civil Procedure, including those relating to discovery procedure. n81 As an alternative to or in conjunction with pursuing an undue hardship action, a debtor may wish to raise issues of fraud or lack of educational benefit from a program by challenging the creditor's proof of claim or through nonbankruptcy administrative remedies. n82

[d] Student's Rights After Bankruptcy Discharge

If there has been a judicial determination that a student loan is discharged in bankruptcy, the consumer is no longer liable for the obligation and is protected from any attempt to collect the debt. n83 Similarly, a school cannot withhold a former student's transcripts just because the debt has been discharged in bankruptcy. n84

In addition, the Bankruptcy Reform Act of 1994 specifies that those discharging student loans in bankruptcy remain eligible for new loans and grants. The United States, guarantors, and lenders cannot discriminate against those who have not paid their student loans where those loans were discharged in bankruptcy. n85

Nevertheless, the Department will look to a prior bankruptcy in considering an applicant's future creditworthiness in applying for PLUS loans.

[e] Discharge of Student Loans Owed to State Agencies

Following the Supreme Court decision in *Seminole Tribe v. Florida*, state agencies collecting student loan debts aggressively asserted *Eleventh Amendment* immunity (sovereign immunity) as a way of barring debtors from discharging student loans in bankruptcy. n86 The issue of sovereign immunity arises because debtors must affirmatively seek student loan discharges through an adversary proceeding. State agencies had argued that this proceeding, which they characterized as a private suit in federal court against the state, was barred by the *Eleventh Amendment*. n87

Fortunately for student loan debtors, the sovereign immunity issue in undue hardship cases has now been resolved favorably by the Supreme Court. In *Tennessee Student Assistance Corp. v. Hood*, n88 the Court relied upon an exception previously carved out for admiralty proceedings and held that a bankruptcy dischargeability suit brought against the state does not implicate a state's *Eleventh Amendment* immunity from suit.

Another issue that may arise in these cases is the threshold question of whether the state actor collecting the loan is truly an "arm of the state." n89 If not, the state actor should not be entitled to assert sovereign immunity.

Most circuit courts have established a multi-prong test to determine whether an agency is an "arm of the state." n90 The foremost factor under these tests is whether the state will be financially burdened by the action in question. n91 This should be a strong argument in the student loan context within which states are usually not responsible for guaranty agencies' financial obligations n92 because such entities typically have a legal existence distinct from the state. n93 Moreover, based on their contractual arrangement with the Department of Education, guaranty agencies are reimbursed by the federal government for most of the indebtedness on discharged loans. n94 One court has applied the various factors of the "arm of the state" test to a student loan authority and found that it was not entitled to claim sovereign immunity. n95

[5] Discharge Based on Death, Disability

The borrower's death is a defense to collection actions on Stafford, SLS, Perkins, and Federal Direct Loans, and both parents' or the student's death discharges PLUS loans. n96 The borrower's permanent and total disability also excuses payment, although for a PLUS loan the disability of only one of two obligated parents does not discharge the debt. n97 There are also separate regulations allowing disability discharges for Health Education Assistance Loan Program (HEAL) loan borrowers. The Secretary of Health and Human Services (HHS) has the authority to discharge HEAL loans based on a finding of total and permanent disability. n98 Borrowers must provide HHS with medical evidence no more than four months old to substantiate disability claims. n99 The definition of total and permanent disability for HEAL loans is similar, but not precisely the same, as the definition for most other federal loans. HEAL loans may be discharged if the borrower is "unable to engage in any substantial gainful activity because of a medically determinable impairment, which the Secretary expects to continue for a long and indefinite period of time or to result in death." n100 The definition of total and permanent disability for FFEL loans is: "The condition of an individual who is unable to work and earn money because of an injury or illness that is expected to continue indefinitely or result in death." n101 The disability defense may rely on a preexisting condition only if that condition has deteriorated. n102

Prior to 1999, a disabled borrower simply had a licensed physician certify that the borrower was permanently disabled with an onset date after the date of the loan. This had to be done on the proper form and the discharge was almost always granted.

In 1999, the Department's Inspector General ("IG") conducted a study that led to a Department crackdown on alleged fraud. The IG found that 23% of borrowers who received disability discharges in a specified time period worked and earned money after the disability determination was made or the loan was discharged. n103

The Department initially set out a more restrictive approach to evaluating disability discharges in a November 1999 Dear Colleague letter. n104 A subsequent May 2002 Dear Colleague letter reiterated these standards and clarified the disability process under the new disability discharge regulations. n105

The disability procedures under the new program are as follows:

- The borrower applies to the loan holder for a discharge. The lender may continue collection until it receives the certification of disability. n106 After receiving the certification, the lender must cease collection efforts. n107 The Department interprets the regulations to apply only to lenders. According to the Department, a guaranty agency or the Department may continue at least certain collection efforts even after receipt of a disability discharge application. However, the Department claims that, if it is the loan holder, action on a completed application should occur within a few days. The loan holder makes a preliminary determination as to whether the borrower meets the criteria for a disability discharge. For

Perkins Loans, the school makes this determination. In the FFEL program, the current holder makes the determination. For Direct Loans, the Department's direct loan staff makes the decision. n108

The Department intends for this preliminary determination to be a rigorous process. The Department's expectations were initially set out in the November 1999 Dear Colleague letter and affirmed in the May 2002 letter.

The Department requires guaranty agencies and others making preliminary disability determinations at a minimum to:

- Require additional information to support the borrower's application where the information provided is not definitive, is illegible, or incomplete.

- Reaffirm the physician's certification if the diagnosis and prognosis do not appear to reach the standard of total and permanent disability.

- Assist borrowers to obtain deferments or forbearances in cases when it does not appear that the borrower is totally and permanently disabled. n109

The Department also suggests that agencies may want to seek the assistance of a qualified physician to evaluate discharge requests. n110

The Department will review all preliminarily approved loans to affirm that the borrower meets the disability discharge criteria. If the Department agrees with the preliminary determination, the borrower is placed in a conditional discharge status for three years *beginning on the date the borrower became totally and permanently disabled*. n111

The 2008 HEA reauthorization law amends the definition of total and permanent disability in a number of important ways. The effective date of these amendments is July 1, 2010. n112 The new definition is more favorable for borrowers on one hand because it allows discharges to be granted to borrowers not only with conditions that are expected to result in death, but also if the conditions have lasted for a continuous period of not less than sixty months or can be expected to last for this sixty month period. However, the law specifically allows the Department to develop safeguards as necessary to prevent fraud and abuse, including regulations to reinstate the obligation and resume collection for any borrower who receives a new loan or earns income in excess of the poverty line after receiving a discharge. Depending on how the regulations are crafted, it may be easier to get a discharge, but more difficult to retain the benefits over time.

The new definition also states that a borrower who has been determined by the Secretary of Veterans Affairs to be unemployable due to a service-connected condition and who provides documentation of such determination shall be considered permanently and totally disabled and shall not be required to present additional documentation.

The Department describes the review process as a three-step system. Before getting to this point, as discussed earlier, both the lender and guaranty agency (or solely the guaranty agency if the lender had assigned the loan to the agency before the borrower applied for discharge) must have made a preliminary determination of disability. The loan is then assigned to the Department. At this point, the Department will review the previous determinations. This review will generally include further contact with the borrower's physician. The Department will have a medical professional take a look at the applications to ensure that the medical information is sufficient. To help overcome this hurdle, it is critical that borrowers submit as much medical documentation as possible along with their application. The Department claims that it will try to set a time limit of about thirty days for this medical review process.

Assuming the borrower passes the Department's additional medical review, the next step is to confirm that the borrower did not receive any disqualifying federal loans. If the conditional period has already passed, the Department will check back to review whether the borrower took out any Perkins, FFEL, or Direct Loans during the conditional period. The only exception is that the borrower is permitted to receive a FFEL or Direct Consolidation Loan during the conditional

period as long as it does not include any loans that are in a conditional discharge status. n113 Presumably, this means that the borrower could have received loans prior to his disability that he later chose to consolidate. If the conditional period has not yet passed, the Department will continue to monitor borrowers to determine whether they receive any disqualifying federal loans.

If the borrower overcomes both of these hurdles, the Department will then confirm that the borrower has no disqualifying earnings during the conditional period, as described above. The Department's process can be time-consuming. However, during this review period, all collection activity should cease and interest should not be accruing on the borrower's loans. n114

If the borrower satisfies the criteria for a disability discharge during and at the end of the conditional discharge period, the balance of the loan will be discharged. n115 Any payments received after the date the borrower became disabled are to be returned. n116

The Department has developed a new disability request form incorporating these changes. n117 Unfortunately, borrowers will often find that a discharge is denied even after they have submitted a properly completed physician's certification of total and permanent disability. Such denials may be appealed under the judicial review provision of the Administrative Procedures Act. n118

Sometimes a student who receives a discharge because of a permanent disability is able at a later date to go back to school--either to pursue job training which medical or technological changes have now made feasible or to obtain a more general education. The Department has issued regulations concerning students who have received disability discharges for FFELs or Federal Direct Loans and want to regain eligibility for new FFELs or Federal Direct Loans. To regain eligibility, the student must obtain a doctor's certificate that the student can engage in substantial gainful activity, and must sign a statement acknowledging that the new loan cannot be cancelled in the future on the basis of any impairment present when the new loan is made, unless that impairment substantially deteriorates. n119

A lender is required to cease collecting on a loan after receiving a physician's certificate or letter supporting a disability claim. n120 In addition, once the lender is notified that the guaranty agency has discharged a loan, the lender is required to return to the borrower any payment received after the date that the borrower became permanently disabled as certified by the physician. n121 The lender is also required at that time to notify the borrower that there is no obligation to repay a loan discharged on the basis of disability. n122

The 1998 HEA requires the Secretary of Education to consult with the Secretary of Veterans Affairs to establish a procedure to permit Department of Veterans Affairs physicians to provide the information necessary to enable disabled veterans to document eligibility for deferments or cancellations of student loans. n123

[6] Other Loan Cancellations

Perkins Loans may be completely cancelled in certain circumstances, including the debtor's service in Head Start or in the military service in an area "of hostilities." n124 The Department has issued rules describing in detail the "affected individuals" eligible for these waivers. The category includes borrowers serving on active duty during a war or other military operation or national emergency, performing qualifying National Guard duty during a war or other military operation or national emergency, residing or employed in an area that is declared a disaster area by any federal, state, or local official in connection with a national emergency, or suffering direct economic hardship as a direct result of a war or other military operation or national emergency, as determined by the Secretary. n125 The reason for the interruption in service must be related to the borrower's status as an "affected individual."

The Perkins program was also the first to provide for cancellations of loans for teachers in low-income school districts and for other service, including military and volunteer service. n126 Perkins cancellations are available even for

borrowers in default in certain circumstances. n127 Despite the language in the statute and regulations, there is still some ambiguity regarding eligibility for some of the Perkins loan cancellations. For example, a class of public interest attorneys sued the Department after the Department terminated them from the Perkins "Children's and Family Service" cancellation program. n128 The District Court held that the Perkins Loan public service employment cancellation did not apply to public service attorneys working for New York City's Administration for Children's Services. n129 The Second Circuit reversed. n130 The Second Circuit refused to defer to the Department's informal interpretations of qualifications for the Perkins "Full-time Employment in a Public or Private Nonprofit Child or Family Service Agency" cancellation. In reaching this decision, the court found that, based on the criteria listed in the statute, the plaintiffs qualified for cancellation of their Perkins loans.

The Second Circuit noted that the Department's regulations setting out the qualifications for this cancellation simply repeat the statutory language verbatim. n131 Further, the Department's restrictive interpretation of the eligibility criteria was derived not from the regulations but from the Federal Student Aid Office's *Financial Aid Handbook* and informal e-mails from Department of Education staff. The Second Circuit found that the *Chevron* deference to the Department in this case was clearly inapplicable. n132 Although denying plaintiffs' claims, the court acknowledged that the statute and regulations do not define the meaning of "providing services" for purposes of determining eligibility. However, the court found that the Department has consistently applied the term to require "exclusive" and "direct" service to at-risk populations.

Since the Second Circuit decision, the Department has clarified its position in a Dear Colleague letter and in proposed regulations. n133 Regulations proposed in June 2007 expand on the current regulations and specify that, to qualify for a child or family service cancellation, a borrower who is a full-time, non-supervisory employee of a child or family service agency must be providing services directly and exclusively to high-risk children from low-income communities. n134 In addition, the proposed regulations specify that any services provided to the children's families must be secondary to the services provided to the high-risk children. n135

The proposed rules became final in November 2007. n136 At that time, the Department clarified that an attorney who is an employee of a child or family service agency must meet the same eligibility requirements as any other non-supervisory employee of a child or family service agency. The attorney must provide services directly and exclusively to high-risk children from low-income communities. Discharge determinations are made on a case-by-case basis and require consideration of the attorney's specific responsibilities. However, according to the Department, in general if the attorney represents the agency in court, the attorney is not providing services directly to the child. If the attorney represents children in court such as in the role of a guardian *ad litem*, the attorney would be considered to be providing services directly to the child. n137

The FFEL and Direct Loan programs recently added similar loan forgiveness regulations for teachers, effective July 1, 2001. n138

The FFEL and Direct Loan programs apply only to borrowers with no outstanding loan balances as of October 1, 1998 or later. Unlike the Perkins programs, FFEL and Direct Loan borrowers are not eligible for teacher loan forgiveness for defaulted loans unless they first make satisfactory repayment arrangements and reestablish loan eligibility. n139 Proposed rules issued in August 2002 for the Direct Loan program include new language stating that a joint Direct Consolidation loan may be partially discharged if one of the borrowers qualifies for teacher loan forgiveness. n140 These proposed rules were finalized in November 2002 and are effective as of July 1, 2003. n141 In 2006, Congress passed a new program to provide loan forgiveness for spouses and parents of certain individuals who died or who became permanently disabled due to the September 11 attacks. n142

[7] Forgery, Mistake, Infancy, and Other Defenses to Loan Enforceability

A student's obligation to pay a student loan is conditioned upon the loan agreement being enforceable under basic

contract principles that affect a borrower's obligation on any note, such as forgery, mistake, and fraud. The only common law contract defense not available to student loan borrowers is infancy; that is, that the student was under age when signing the loan document. The HEA specifies that the U.S. and guaranty agencies, irrespective of state law on the issue, shall not be subject to a claim of infancy. n143

The HEA does not limit other contract defenses, and these should thus apply to student loans as they do to any other type of loan. The Department on numerous occasions has stated that the student does not owe on a loan, and guaranty agencies should not seek payment, to the extent to which the loan obligation is not enforceable under state law. n144

[8] Discharge for Unpaid Refunds

In November 1999, the DOE finalized regulations that provide an important new basis to discharge a student loan: that the school failed to make an owed refund to the student. n145

Failure to provide refunds was one of the most common complaints during the heyday of trade school fraud in the 1980s and early 1990s. Many borrowers signed up for schools, never attended classes, but were still charged the full amount of the loan. This new discharge should fill in some of the gaps left by the closed school and false certification discharges, which provide relief for many, but not all victims of trade school abuses.

The discharge applies to the following types of loans entered into after January 1, 1986: Guaranteed Student (Stafford) Loans, Unsubsidized Stafford Loans, Supplemental Loans for Students (SLSs), PLUS (parent borrower) loans, and Federal Direct Loans. Students already can raise an unpaid refund as a defense to the Perkins Loan collection action. n146 The unpaid refund discharge became effective as of July 1, 2000. n147

The unpaid refund discharge applies to students who signed up for a school but never attended, or withdrew, or terminated within a time frame that entitled them to a refund, but who never received the refund from the school. Students who completed 60% or more of the loan period are not entitled to refunds and therefore not entitled to the discharge. n148 A student should not have to show written proof or other formal proof of withdrawal or termination in order to qualify.

Students who never received the owed refund are eligible to reduce their current obligations by the amount that should have been refunded plus interest and related charges. The amount of the unpaid refund will be determined based on information the holder of the loan has or that the borrower can provide, or by applying the appropriate refund formula to information that the borrower provides or that is otherwise available to the agency. If the actual school refund formula is not available, the regulations set out a substitute formula to determine the amount eligible for discharge. n149

[a] Applying for the Discharge

The procedures and timing for a loan discharge are slightly different depending on whether the school is currently open or closed. If the school is still open, to qualify for the discharge, the borrower and guarantor must document that they attempted to resolve the problem within 120 days from the date that the borrower submitted a completed application for discharge. n150 This requirement does not apply if the school is closed.

Except where the guaranty agency (with the Department's approval) determines, based on information in its possession, that the borrower qualifies for a discharge, borrowers must submit written discharge applications. n151 Applications should be sent to the holder or guaranty agency. In most cases the holder will be the guaranty agency. n152

The Department has developed a uniform application form. n153 In addition, the regulations require agencies to send discharge applications to potentially eligible borrowers. n154 Once they do so, they must cease collection until the application is resolved. n155 If the borrower does not return the application within sixty days, collection actions can

resume. n156

There is no time limit for the agency to make a decision. However, once an application is granted, the holder must suspend collection within thirty days, discharge the appropriate amount, and inform the borrower of the determination. n157

If the application is denied, the holder must notify the borrower in writing of the reason for the determination and of the borrower's right to request review within thirty days of the borrower's submission of additional documentation. Collection must be suspended during the review period. n158

[b] Relief Available for Those Obtaining a Discharge

Eligible borrowers will be granted a discharge in the amount of the unpaid refund including any accrued interest and any collection of other charges relating to the amount of the unpaid refund. n159 If the borrower has already paid off part of the loan, and the amount still owing on the loan is less than the unpaid refund, part of the unpaid refund will be used to fully discharge the loan. The rest of the unpaid refund will be paid to the borrower in cash to the extent the borrower has made payments of that amount on the loan. The holder of the loan is also required to report the discharge to all credit reporting agencies to which the holder previously reported the status of the loan. n160

Legal Topics:

For related research and practice materials, see the following legal topics:
Bankruptcy LawDischarge & DischargeabilityNondischarge of Individual DebtsStudent LoansConstitutional LawState AutonomyGeneral OverviewEducation LawAdministration & OperationStudent Financial AidDebt CollectionEducation LawAdministration & OperationStudent Financial AidEligibilityEducation LawAdministration & OperationStudent Financial AidRenewal & Revocation

FOOTNOTES:
(n1)Footnote 1. *34 C.F.R. § 685.213*. The closed school discharge legislation does not explicitly apply to Direct Loans for the simple reason that Direct Loans did not exist at that time. Nevertheless, the Direct Loan legislation indicates that unless otherwise specified, Direct Loans "shall have the same terms, conditions, and benefits" as FFELs. *20 U.S.C. § 1087e(1)*.

(n2)Footnote 2. *34 C.F.R. § 682.402(d)(1)(i). See also 59 Fed. Reg. 22,466, 22,469* cmts. 19, 43 (Apr. 29, 1994) (a loan is dischargeable even if part of it was disbursed in 1985, as long as part was disbursed in 1986).

(n3)Footnote 3. *34 C.F.R. §§ 682.402(d)(1)(i), 682.402(d)(1)(ii)(B)*.

(n4)Footnote 4. United States DOE, Dear Colleague Letter 94-G-256, Clearinghouse No. 50,422 (Sept. 1994).

(n5)Footnote 5. *20 U.S.C. § 1087(c)(1)*.

(n6)Footnote 6. *See 34 C.F.R. §§ 682.402(d)(1)(ii)(C)* (FFELs), 685.213(a)(2)(ii) (Direct Loans).

(n7)Footnote 7. *See 34 C.F.R. § 682.402(d)(1)(ii)(C)* (FFELs).

(n8)Footnote 8. A student on an approved leave of absence is treated as still enrolled. The definition of an approved leave of absence is found at *34 C.F.R. § 668.22(j)(2)*; *see also 34 C.F.R. § 682.605(c)*.

(n9)Footnote 9. *See 34 C.F.R. §§ 682.402(d)(1)(i)* (FFELs), 685.213(c)(1)(ii) (Direct Loans).

(n10)Footnote 10. *See 34 C.F.R. §§ 682.402(d)(1)(i)* (FFELs), 685.213(c)(1)(ii) (Direct Loans). In July 1997, the

Department issued a Dear Colleague Letter extending the 90-day period for students who attended and withdrew from specified correspondence schools. The Letter provides that guaranty agencies and lenders must review records to identify borrowers who would qualify for discharge under this extension. Agencies must reevaluate previously denied applications from borrowers identified in this process and mail out applications to all others. Previously denied applicants who meet all the other closed school discharge requirements should be granted discharges without the submission of new applications. *See* United States DOE, Dear Colleague Letter 97-G-300 (July 1997), Clearinghouse No. 52,043. DOE Dear Colleague Letters can be obtained by accessing the Department's website, http://www.ed.gov, or directly at http://ifap.ed.gov.

(n11)Footnote 11. The Department continually updates this list. The easiest way to access the list is through the DOE's website. The site allows advocates to search for a specific school's closure date. The general Department website is www.ed.gov. The specific site for the list is www.ed.gov/offices/OSFAP/Students/closedschool/search.html.

(n12)Footnote 12. United States DOE, Dear Colleague Letter 94-G-256, Clearinghouse No. 50,422 (Sept. 1994).

(n13)Footnote 13. *34 C.F.R. § 682.402(d)(3)(ii)*. *See* McComas v. Riley, Clearinghouse No. 52,039 (S.D. W.Va. Feb. 27, 1998) (opinion and order granting defendants' renewed motion for summary judgment).

(n14)Footnote 14. *See 34 C.F.R. §§ 682.402(d)(2)(i)* (FFELs), 685.213(b)(1) (FDSLs).

(n15)Footnote 15. *See 34 C.F.R. §§ 682.402(d)(2)(ii)* (FFELs), 685.213(b)(2) (FDSLs).

(n16)Footnote 16. *See 34 C.F.R. §§ 682.402(d)(2)(iii)* (FFELs), 685.213(b)(3) (FDSLs).

(n17)Footnote 17. *See 34 C.F.R. § 682.402(d)(2)(iv)* (FFELs). The language in *34 C.F.R. § 685.213(b)(3)* (FDSLs) is not so extensive, solely requiring the Secretary to report the loan discharge to credit bureaus.

(n18)Footnote 18. *34 C.F.R. § 682.402(d)(6)*.

(n19)Footnote 19. *34 C.F.R. § 682.402(d)(3)*. The 1998 HEA authorized the Department and guaranty agencies to grant closed school discharges without a written application in limited circumstances. *34 C.F.R. §§ 682.402(d)(8)* (FFEL), 674.33(g)(3) (Perkins). Specifically, a discharge may be granted without an application if (1) the borrower received a discharge of a different type of loan for the same program of study or (2) the Department or guaranty agency determines that the borrower qualifies for a discharge based on information in the Secretary or guaranty agency's possession. This may facilitate advocacy that a group of students be given a closed school discharge in settlement of an action, instead of requiring each student to submit an application.

(n20)Footnote 20. *34 C.F.R. §§ 682.402(d)(6)(J)*, *682.402(e)(6)(v)*.

(n21)Footnote 21. *See 34 C.F.R. § 682.211(f)(7)*.

(n22)Footnote 22. The form is available on the DOE website: www.ed.gov. The Department issued new forms in June 2002. *See* United States DOE, Dear Partner Letter GEN-02-05, Approval of Loan Discharge Application Forms (June 2002) (school closure discharge forms, false certification discharge forms). If the address to which the borrower is requested to send payments is the National Payment Center in Greenville, TX, borrowers should submit completed forms to U.S. Dept. of Ed., P.O. Box 4222, Iowa City, IA 52244-4222.

(n23)Footnote 23. *64 Fed. Reg. 42,176* (Aug. 3, 1999) (proposed rules) (amending *34 C.F.R. § 682.402(d)(8)*).

(n24)Footnote 24. Pub. L. No. 105-244 (Oct. 7, 1998), § 464. The regulations for Perkins closed school discharges will likely be similar to those for other loans.

(n25)Footnote 25. *See 59 Fed. Reg. 22,466, 22,469* cmts. 19, 43 (Apr. 29, 1994). A loan is dischargeable even if

part of it was disbursed in 1985, as long as part was disbursed in 1986.

(n26)Footnote 26. *20 U.S.C. § 1087(c)(1)*. The discharge does not apply to Perkins Loans, but students should be able to raise the school's misconduct as a defense to loan repayment because the school is the original lender.

(n27)Footnote 27. The Department takes the position that a graduate of a foreign high school is deemed to be a high school graduate. *34 C.F.R. 668.32(e)(1)* merely states that ability to benefit need not be shown if the student has a "high school diploma or its recognized equivalent."

(n28)Footnote 28. *34 C.F.R. § 682.402(e)(1)(i)(A)*.

(n29)Footnote 29. For students enrolled before that date, the school had to have developed and consistently applied criteria for determining whether students had the ability to benefit, and the school had to have been able to demonstrate that to the Secretary. *See 34 C.F.R. § 682.402(e)(13)(ii)(A). See also 34 C.F.R. § 686.6* (July 1, 1986).

(n30)Footnote 30. *34 C.F.R. § 682.402(e)(13)(ii)(B)*. For example, the current standards set out by the Department are found at *61 Fed. Reg. 55,542* (Oct. 25, 1996) .

(n31)Footnote 31. *34 C.F.R. § 682.402(e)(13)(ii)(C)*.

(n32)Footnote 32. *34 C.F.R. § 682.402(e)(13)(i)*.

(n33)Footnote 33. *20 U.S.C. § 1091(d)(4)*.

(n34)Footnote 34. *34 C.F.R. § 682.402(e)(13)(ii)(D)(1)*, *34 C.F.R. § 668.32(e)(2)*. The regulations effective July 1, 2003 also clarify that an institution must obtain the results of an approved ATB test directly from either the test publisher or the assessment center that administered the test. There are a number of requirements for independently administered tests, including that the test be given at an assessment center by a test administrator who has no financial or ownership interest in the school. The regulations for independently administered tests are set out in 34 C.F.R. § 668, sub-pt. J. *34 C.F.R. § 668.151* relates to the administration of tests.

(n35)Footnote 35. *34 C.F.R. § 682.402(e)(13)(D)(2), citing regulations for approved state processes at 34 C.F.R. § 668.156*.

(n36)Footnote 36. *34 C.F.R. § 668.156(b)*.

(n37)Footnote 37. *34 C.F.R. § 682.402(e)(13)(ii)(E)(1), (2)*. The home schooling regulations can be found at *34 C.F.R. § 668.32(e)(4)*.

(n38)Footnote 38. Pellot v. Riley, Order, Clearinghouse No. 52,116A (E.D. Pa. 1998); Pellot v. Riley, Memorandum of Law in Support of Plaintiff's Motion for Summary Judgment, Clearinghouse No. 52,116B (E.D. Pa. 1998) (nursing assistant student given only clerical portion of an approved test found eligible on appeal for a false certification discharge).

(n39)Footnote 39. United States DOE, Dear Colleague Letter Gen-95-42 from Elizabeth M. Hicks, Deputy Assistant Secretary for Student Financial Assistance, Clearinghouse No. 51,675, at 5, 6 (Sept. 1995).

(n40)Footnote 40. *34 C.F.R. § 682.402(e)(3)(ii)(C)*. The student must also certify to this effect in the discharge application.

(n41)Footnote 41. *Jordan v. Secretary of Educ. of the United States, 194 F.3d 169 (D.C. Cir. 1999) , rev'g 26 F. Supp. 2d 173 (D.D.C. 1998) .*

(n42)Footnote 42. United States DOE, Dear Colleague Letter #G-00-01 (July 2000), *reprinted at* National Consumer Law Center, Student Loan Law, App. C. (2001). The relevant regulation is *34 C.F.R. § 682.402(e)(3)(ii)(C), as amended, 65 Fed. Reg. 65,616, 65,620* (Nov. 1, 2000) .

(n43)Footnote 43. *34 C.F.R. § 682.402(e)(13)(iii)(B).*

(n44)Footnote 44. *34 C.F.R. § 682.402(e)(1)(i)(B), (e)(1)(ii).*

(n45)Footnote 45. *34 C.F.R. § 682.402(e)(3)(iii), (iv).*

(n46)Footnote 46. *34 C.F.R. § 682.402(e)(1)(ii).*

(n47)Footnote 47. United States DOE, Dear Colleague Letter 94-G-256 item 11, from Leo Kornfeld, Deputy Assistant Secretary for Student Financial Assistance Programs, Clearinghouse No. 51,670 (Sept. 1994).

(n48)Footnote 48. *34 C.F.R. § 682.402(e)(1)(i).*

(n49)Footnote 49. *34 C.F.R. § 682.402(e)(1)(i)(B).*

(n50)Footnote 50. *See* § [f], *infra*, (Identity Theft cancellation).

(n51)Footnote 51. *See § 12.06[2] supra.*

(n52)Footnote 52. *34 C.F.R. §§ 682.402(d)(6)(J), 682.402(e)(6)(v).*

(n53)Footnote 53. *34 C.F.R. § 682.402(d)(3), (e)(3), (e)(4).*

(n54)Footnote 54. *34 C.F.R. § 682.211(f)(7).*

(n55)Footnote 55. White v. Riley, Clearinghouse No. 52,121 (E.D. Pa. 1998) (class action complaint).

(n56)Footnote 56. Pub. L. No. 109-171, *120 Stat. 4* (Feb. 8, 2006).

(n57)Footnote 57. *34 C.F.R. § 682.402(e)(3)(v)* (interim final rule). *See 71 Fed. Reg. 45666* (Aug. 9, 2006) .

(n58)Footnote 58. *71 Fed. Reg. 45666* (Aug. 9, 2006) .

(n59)Footnote 59. *71 Fed. Reg. 64378, 64388, 64389* (Nov. 1, 2006) .

(n60)Footnote 60. *See supra.*

(n61)Footnote 61. *71 Fed. Reg. 45666* (Aug. 9, 2006) (citing *34 C.F.R. § 682.402(e)(1)(i)(B), 682.406(a)(1)*).

(n62)Footnote 62. *Id.* (citing *34 C.F.R. § 682.206(a)(2)*).

(n63)Footnote 63. Higher Education Programs Authorization Extension Act, Pub. L. No. 105-244 (Oct. 7, 1998), § 971.

(n64)Footnote 64. *11 U.S.C. § 523(a)(8).*

(n65)Footnote 65. *11 U.S.C. §§ 523(a)(8), 1328(a)(2).* See Collier Consumer Bankruptcy Practice Guide Ch. 26 (Matthew Bender), Collier Consumer Bankruptcy Forms Pt. CS13, § CS13.81, Forms CS13.82-1, CS13.82-2 (Matthew Bender), for a more detailed discussion on the dischargeability of student loans.

(n66)Footnote 66. *See Uterhark v. Great Lakes Higher Educ. Corp. (In re Uterhark), 185 B.R. 39 (Bankr. N.D.*

Ohio 1995) ; *Owens v. Nebraska Higher Educ. Loan Program, Inc. (Matter of Owens), 161 B.R. 829 (Bankr. D. Neb. 1993)* .

(n67)Footnote 67. *See Seminole Tribe v. Florida, 517 U.S. 44 (1996)* (loans from state agencies); *TI Fed. Credit Union v. DelBonis, 72 F.3d 921 (1st Cir. 1995)* (federally chartered credit union is a governmental unit for purposes of exception to discharge); *In re Merchant, 958 F.2d 738 (6th Cir. 1992)* (loan guaranteed by nonprofit institution was nondischargeable); *In re Roberts, 149 B.R. 547 (C.D. Ill. 1993)* (loan from nonprofit credit union nondischargeable). (law school loans originated and funded by for-profit entities held dischargeable); *In re Sinclair-Ganos, 133 B.R. 382 (Bankr. W.D. Mich. 1991)* (credit union not a nonprofit institution within meaning of § 523(a)(8)). *See generally* Patricia L. Barsalou & Scott A. Stengel, *Ex Parte Young: Relativity in Practice*, *72 Am. Bankr. L.J. 455 (1998);* National Consumer Law Center, Consumer Bankruptcy Law and Practice § 13.3.2.2 (6th ed. 2000 and Supp.).

(n68)Footnote 68. *In re Scott, 287 B.R. 470 (Bankr. E.D. Mo. 2002)* (loan made by for-profit truck driving school dischargeable). *But see In re Pilcher, 149 B.R. 595 (B.A.P. 9th Cir. 1993)* (private loan received from for-profit lender as part of Law Access program involving two nonprofit institutions was covered by exception to discharge); *In re Bolen, 287 B.R. 127 (D. Vt. 2002)* (same); *In re O'Brien, 299 B.R. 725 (Bankr. S.D.N.Y. 2003)* (same).

(n69)Footnote 69. *11 U.S.C. § 523(a)(8).*

(n70)Footnote 70. *In re Van Ess, 186 B.R. 375 (Bankr. D.N.J. 1995)* ; *Manning v. Chambers, 290 B.R. 328 (N.D. Ill. 2003)* (applying analysis of *Renshaw* and *Mehta*, tuition debt held dischargeable as no evidence that parties entered into loan arrangement prior to services being provided); *In re Navarro, 284 B.R. 727 (Bankr. C.D. Cal. 2002)* (agreement that student would be responsible for tuition and fees was not a promissory note for sum certain and therefore was dischargeable).

(n71)Footnote 71. *42 U.S.C. § 294f(g). See also In re Rice, 78 F.3d 1144 (6th Cir. 1996)* (denial not unconscionable).

(n72)Footnote 72. Higher Education Programs Authorization Extension Act, Pub. L. No. 105-244, § 971 (Oct. 7, 1998).

(n73)Footnote 73. *See, e.g., In re Nunn, 788 F.2d 617 (9th Cir. 1986)* .

(n74)Footnote 74. *11 U.S.C. § 523(a)(8)(A)* (as in effect Oct. 6, 1998).

(n75)Footnote 75. *In re Huber, 169 B.R. 82 (Bankr. W.D.N.Y. 1994)* (deferment period counts even where debtor eventually found not eligible for deferment where repayment requirement was suspended); *In re Barciz, 123 B.R. 771 (Bankr. N.D. Ohio 1990)* (forbearance tolls running of period). *But see In re Flynn, 190 B.R. 139 (Bankr. D.N.H. 1995)* (a reference to a period of forbearance did not refer to a suspension of payment).

(n76)Footnote 76. *See, e.g., Hiatt v. Ind. State Student Assistance Comm'n, 36 F.3d 21 (7th Cir. 1994)* ; *In re Cobb, 196 B.R. 34 (Bankr. E.D. Va. 1996)* ; *In re Hasselgrave, 177 B.R. 681 (Bankr. D. Or. 1995)* ; *In re Menendez, 151 B.R. 972 (Bankr. M.D. Fla. 1993)* ; *In re Martin, 137 B.R. 770 (Bankr. W.D. Mo. 1992)* ; *United States v. McGrath, 143 B.R. 820 (Bankr. D. Md. 1992) . But see In re McKinney, 120 B.R. 416 (Bankr. N.D. Ohio 1990)* .

(n77)Footnote 77. *11 U.S.C. § 523(a)(8).*

(n78)Footnote 78. *See, e.g., Brunner v. New York State Higher Educ. Servs., 831 F.2d 395 (2d Cir. 1987)* (court required showing of 1) current income insufficient for minimal standard of living, 2) likelihood of little change, and 3) good faith efforts to pay in the past). The debtor has the burden of proof on all elements of the hardship test. The Second Circuit's *Brunner* test has been adopted by the Third, *Fourth, Fifth, Seventh, Ninth, Tenth, and Eleventh Circuits. See Educ. Credit Mgmt. Corp. v. Polleys, 356 F.3d 1302 (10th Cir. 2004)* ; *In re Ekenasi, 325 F.3d 541 (4th*

Cir. 2003) ; *In re Gerhardt, 348 F.3d 89 (5th Cir. 2003)* ; *In re Cox, 338 F.3d 1238 (11th Cir. 2003)* ; *Goulet v. Educ. Credit Mgmt. Corp., 284 F.3d 773 (7th Cir. 2002)* ; *In re Brightful, 267 F.3d 324 (3rd Cir. 2001)* ; *In re Rifino, 245 F.3d 1083 (9th Cir. 2001)* , *cert. denied sub nom. Nowland v. U.S., 534 U.S. 927 (2001)* . The substantial amount of student loan debt many consumers now confront, in some cases exceeding $100,000, has caused several courts to find undue hardship even for debtors with incomes well above the poverty level. *E.g., In re Nys, 308 B.R. 436 (B.A.P. 9th Cir. 2004)* . *See also In re McGinnis, 289 B.R. 257 (Bankr. M.D. Ga. 2003)* (debtor's income can exceed poverty level and still satisfy *Brunner* test); *In re Innes, 284 B.R. 496 (D. Kan. 2002)* (modest holiday gifts for the debtors' children, a "single frugal" summer vacation, and the debtors' use of a tax refund to make home repairs not incompatible with a minimal standard of living); *In re Cheney, 280 B.R. 648 (N.D. Iowa 2002)* ("lifestyle choices" should not be questioned if expenses are not excessive); *In re Myers, 280 B.R. 416 (Bankr. S.D. Ohio 2002)* (expenses for cell phone, satellite T.V., and three vehicles were within minimum standards of living for family with nine children); *In re Lewis, 276 B.R. 912 (Bankr. C.D. Ill. 2002)* (debtor not required to purchase less expensive auto); *In re Murphy, 305 B.R. 780 (Bankr. E.D. Va. 2004)* ; *In re Alston, 297 B.R. 410 (Bankr. E.D. Pa. 2003)* (debtor's use of Earned Income Tax Credit refunds of approximately $3,000 to $5,000 for necessary home repairs and furniture, expenses that are normally part of a monthly budget, did not establish debtor was living beyond a minimal standard of living). *But see In re Durrani, 311 B.R. 496 (Bankr. N.D. Ill. 2004)* ($52.00 per month cable bill not inappropriate).

(n79)Footnote 79. For example, the Sixth Circuit examined three factors to determine an undue hardship. *See In re Cheesman, 25 F.3d 356 (6th Cir. 1994)* , *cert. denied, 513 U.S. 1081 (1995)* . *See also In re* Faish (Pennsylvania Higher Educ. Assistance Agency v. Faish), *72 F.3d 298 (3d Cir. 1995)* , *cert. denied, 518 U.S. 1009, 116 S. Ct. 2532, 135 L. Ed. 2d 1055 (1996)* . The test requiring a good faith effort to pay the loan does not require that repayment actually occurred, although it may require some effort to deal with the loan prior to bankruptcy. *In re* Maulin (Maulin v. Salliemae), *190 B.R. 153 (Bankr. W.D.N.Y. 1995)* . *Cf. Educ. Credit Mgmt. Corp. v. Polleys, 356 F.3d 1302 (10th Cir. 2004)* (good faith prong of *Brunner* test should consider debtor's reasons for seeking discharge and whether debtor is intentionally creating hardship); *see also In re Oyler, 300 B.R. 255 (B.A.P. 6th Cir. 2003)* (debtor's choice to work in low-paying field as minister not by itself evidence of bad faith and should not be used against debtor under undue hardship test). *But see In re Gerhardt, 348 F.3d 89 (5th Cir. 2003)* (debtor failed second prong of *Brunner* test by choosing to work only as a cellist in the low-paying field in which he was trained). *See generally* Andrew M. Campbell, *Bankruptcy Discharge of Student Loan on Ground of Undue Hardship Under § 523(a)(8)(B) of Bankruptcy Code of 1978 (11 U.S.C.A. § 523(a)(8)(B)) Discharge of Student Loans, 144 A.L.R. Fed. 1 (1998)* .

(n80)Footnote 80. *See Fed. R. Bankr. P. 7001.* The student has the burden to prove entitlement to a hardship discharge, though the student loan creditor generally has the initial burden to establish the existence of the debt. *Kopf v. United States DOE (In re Kopf), 245 B.R. 731 (Bankr. D. Me. 2000)* ; *Green v. Sallie Mae Servicing Corp. (In re Green), 238 B.R. 727 (Bankr. N.D. Ohio 1999)* .

(n81)Footnote 81. *See Fed. R. Bankr. P. 7001-7087.* Under the present fee schedule adopted by the Administrative Office of the federal courts, there is no filing fee for an adversary complaint brought by a debtor in a bankruptcy case.

For a more detailed discussion of adversary proceedings, see National Consumer Law Center, Consumer Bankruptcy Law and Practice (6th ed. 2000 and Supp.)

(n82)Footnote 82. *See In re Goldberg, 297 B.R. 465 (Bankr. W.D.N.C. 2003)* (striking student loan creditor's proof of claim for lack of consideration when school closed before student received any benefit from purported education program). *See also In re Gregory, 387 B.R. 182 (Bankr. N.D. Ohio 2008)* (refusing to consider untimely closing of debtor's educational institution as an undue hardship factor, noting availability of administrative remedies outside of bankruptcy for relief from the obligation).

(n83)Footnote 83. *11 U.S.C. § 524(a)(2).* Damages and attorney fees are available if improper collection activities occur.

(n84)Footnote 84. *11 U.S.C. § 524(a)(2).*

(n85)Footnote 85. Pub. L. No. 103-394, § 313, *amending 11 U.S.C. § 525* (Oct. 22, 1994). *See also* Cong. Rec. H107771 (Oct. 4, 1994).

While the Act applies to bankruptcies filed after Oct. 22, 1994, unless otherwise noted, the language of § 313 makes clear a Congressional intent to apply that section to any student loan discharged in bankruptcy, even to student loans discharged under the Bankruptcy Act, i.e., discharged before 1979.

(n86)Footnote 86. *Seminole Tribe v. Fla., 517 U.S. 44 (1996) . See generally* Patricia L. Barsalou & Scott A. Stengel, *Ex Parte Young: Relativity in Practice, 72 Am. Bankr. L.J. 455 (1998);* National Consumer Law Center, Consumer Bankruptcy Law and Practice § 13.3.2.2 (6th ed. 2000 and Supp.).

(n87)Footnote 87. The doctrine of sovereign immunity acts as a jurisdictional bar to suits filed by private individuals against non-consenting states. For a good summary of the doctrine in student loan cases, see *In re Greenwood, 237 B.R. 128 (N.D. Tex. 1999)* (upholding state agency's sovereign immunity claim). For other cases in which sovereign immunity was affirmed, see for example *Murphy v. Mich. Guar. Agency (In re Murphy), 271 F.3d 629 (5th Cir. 2001)* (adversary proceeding seeking student loan discharge was "suit" against the state barred by *Eleventh Amendment*); *In re Kahl, 240 B.R. 524 (Bankr. E.D. Pa. 1999)* ; *In re Stout, 231 B.R. 313 (Bankr. W.D. Mo. 1999)* ; and *In re Schmitt, 220 B.R. 68 (Bankr. W.D. Mo. 1998) .*

(n88)Footnote 88. *124 S. Ct. 1905 (2004) .*

(n89)Footnote 89. *See Lake County Estates, Inc. v. Tahoe Reg'l Planning Agency, 440 U.S. 391 (1979) .*

(n90)Footnote 90. *See, e.g., Duke v. Grady Muni. Schools, 127 F.3d 972 (10th Cir. 1997)* ; *Mancuso v. N.Y. State Thruway Auth., 86 F.3d 289 (2d Cir. 1996) , cert. denied, 519 U.S. 992 (1996)* ; *Hadley v. N. Ark. Cmty. Technical Coll., 76 F.3d 1437 (8th Cir. 1996) , cert. denied, 519 U.S. 1148 (1997)* ; *Harter v. C.D. Vernon, 101 F.3d 334 (4th Cir. 1996) , cert. denied, 521 U.S. 1120 (1997)* ; *Christy v. Pa. Turnpike Comm'n, 54 F.3d 1140 (3d Cir. 1995) , cert. denied, 516 U.S. 932 (1995)* ; *Metcalf & Eddy v. P.R. Aqueduct & Sewer Auth., 991 F.2d 935 (1st. Cir. 1993)* . For a more detailed discussion of this topic, see NCLC Reports, *Bankruptcy and Foreclosures Ed.*, 19 (Nov./Dec. 2000).

(n91)Footnote 91. *See Metcalf & Eddy v. P.R. Aqueduct & Sewer Auth., 991 F.2d 935 (1st Cir. 1993) .*

(n92)Footnote 92. The enabling statutes of guaranty agencies often provide that their bonds and loan guaranties are not an obligation of the state. *See, e.g., Iowa Code § 261.38*; *Mich. Comp. Laws § 390.1154*; *N.J. Stat. § 18A:71A-18* (same for New Jersey Higher Education Student Assistance Authority); *N.C. Gen. Stat. § 116-202*; *24 Pa. Cons. Stat. § 5105.1(b)* (bonds and notes of Pennsylvania Higher Education Assistance Authority not debt of Pennsylvania); *R.I. Gen. Laws § 16-57-12.*

(n93)Footnote 93. *See In re Muir, 239 B.R. 213 (Bankr. D. Mont. 1999)* (student loan guaranty agency failed to satisfy burden of demonstrating that it was an arm of the state and entitled to *Eleventh Amendment* immunity). *But see In re Kahl, 240 B.R. 524 (Bankr. E.D. Pa. 1999)* (finding Texas agency to be an arm of the state, but no waiver of sovereign immunity). *See generally Duke v. Grady Muni. Schs., 127 F.3d 972 (10th Cir. 1997)* (court must focus on legal liability for a judgment rather than practical or indirect impact a judgment would have on a state's treasury); *Metcalf & Eddy v. P.R. Aqueduct & Sewer Auth., 991 F.2d 935 (1st Cir. 1993)* (rejecting among other arguments the state agency's claim that it could claim immunity solely on the basis that judgments against it might absorb unrestricted funds donated by the state and in that way lead indirectly to the depletion of the state's treasury).

(n94)Footnote 94. *See 10 U.S.C. § 1087(b).*

(n95)Footnote 95. *Lees v. Tenn. Student Assist. Corp., 264 B.R. 884 (W.D. Tenn. 2001) .*

(n96)Footnote 96. *20 U.S.C. § 1087*; *34 C.F.R. §§ 674.58*, *682.402*, *685.212(a)*. The death of only one of two obligated parents does not discharge a PLUS loan.

(n97)Footnote 97. *20 U.S.C. § 1087*; *34 C.F.R. §§ 674.58*, *682.402*, *685.212(b)*.

(n98)Footnote 98. *42 C.F.R. § 60.39(b)(1)*. *See, e.g.*, *Student Loan Mktg. Ass'n v. Herdman, 2005 Cal. App. Unpub. LEXIS 2505* (Cal. App. Mar. 22, 2005) (not officially published).

(n99)Footnote 99. *42 C.F.R. § 60.39(b)(2)*.

(n100)Footnote 100. *42 C.F.R. § 60.39(b)(1)*.

(n101)Footnote 101. *34 C.F.R. § 682.200* (FFEL).

(n102)Footnote 102. *34 C.F.R. §§ 682.402(c)(11)*, *685.212(b)*.

(n103)Footnote 103. The report is cited in United States DOE, Dear Colleague Letter GEN-99-36, Clearinghouse No. 52, 492 (Nov. 1999), *reprinted at* National Consumer Law Center, Student Loan Law, App. C (3d ed. 2006 and Supp.).

(n104)Footnote 104. *Id*.

(n105)Footnote 105. United States DOE, Dear Colleague Letter GEN-02-03 (May 2002), *reprinted at* National Consumer Law Center, Student Loan Law, App. C (3d ed. 2006 and Supp.).

(n106)Footnote 106. *34 C.F.R. § 682.402(c)(3)*.

(n107)Footnote 107. *Id*.

(n108)Footnote 108. *Id*.

(n109)Footnote 109. United States DOE, Dear Colleague Letter GEN-99-36, Clearinghouse No. 52,492 (Nov. 1999); United States DOE, Dear Colleague Letter GEN-02-03 (May 2002), both *reprinted at* National Consumer Law Center, Student Loan Law, App. C (3d ed. 2006 and Supp.).

(n110)Footnote 110. United States DOE, Dear Colleague Letter GEN-02-03 (May 2002), *reprinted at* National Consumer Law Center, Student Loan Law, App. C (3d ed. 2006 and Supp.).

(n111)Footnote 111. *34 C.F.R. §§ 682.402(c)(1)* (FFEL), 674.61(b) (Perkins), 685.213(a) (Direct Loans).

(n112)Footnote 112. Pub. L. No. 110-315 § 437 (2008).

(n113)Footnote 113. *34 C.F.R. § 682.402(c)(1)(ii)(B)*.

(n114)Footnote 114. Department staff confirmed in a July 2003 conversation with the National Consumer Law Center that it would not continue to collect while still reviewing loans. They did not cite regulatory authority, but the Department should be bound by *34 C.F.R. § 682.402(c)(1)(iv)(C)(3)*, which requires that lenders cease collection activity after receiving the disability certification.

(n115)Footnote 115. *34 C.F.R. § 682.402(c)(15)*.

(n116)Footnote 116. *34 C.F.R. § 682.402(c)(1)(i)*, *(r)(2)*, *(3)*.

(n117)Footnote 117. The form is available on the Department's website at http://ifap.ed.gov. The new form is

attached to the United States DOE, Dear Partner Letter Gen-02-04 (June 2002). The most recent form was made available in December 2002, to be used for all disability discharge requests on or after March 31, 2003. *See* United States DOE, Dear Colleague Letter GEN-02-12 (Dec. 2002).

(n118)Footnote 118. For an example of a successful appeal, see *United States v. Norton, 2002 U.S. Dist. LEXIS 2691* (N.D. Iowa Feb. 5, 2002) (denial of government's motion for summary judgment on disability discharge).

(n119)Footnote 119. *34 C.F.R. §§ 682.201(a)(4), (5), 685.200(a)(iv).*

(n120)Footnote 120. 34 C.F.R. § 402(c)(2).

(n121)Footnote 121. 34 C.F.R. § 402(c)(3).

(n122)Footnote 122. 34 C.F.R. § 402(c)(3).

(n123)Footnote 123. Pub. L. No. 105-244 (Oct. 7, 1998), § 490F.

(n124)Footnote 124. *34 C.F.R. §§ 674.58* (Head Start cancellation), 674.59 (military cancellations).

(n125)Footnote 125. *68 Fed. Reg. 69312* (Dec. 12, 2003) .

(n126)Footnote 126. *34 C.F.R. §§ 674.55* (teacher cancellations), 674.56 (employment in certain professions, such as nursing or medical technicians), 674.57 (law enforcement), 674.59 (military service), 674.60 (volunteer service, including Peace Corps).

(n127)Footnote 127. *34 C.F.R. § 674.52(c).*

(n128)Footnote 128. *De La Mota v. U.S. Dept. of Educ., 2003 U.S. Dist. LEXIS 14863* (S.D.N.Y. Aug. 29, 2003) (legislative history and other evidence indicated that the cancellation was primarily intended to apply to professionals other than lawyers). The cancellation at issue was the "Full-time Employment in a Public or Private Nonprofit Child or Family Service Agency" cancellation, *34 C.F.R. § 674.56(b).*

(n129)Footnote 129. *De La Mota v. United States Dep't of Educ., 2003 U.S. Dist. LEXIS 14863* (S.D.N.Y. Aug. 29, 2003) .

(n130)Footnote 130. *De La Mota v. United States Dep't of Educ., 412 F.3d 71 (2d Cir. 2005)* .

(n131)Footnote 131. *Id.* (citing *34 C.F.R. § 674.56(b)(1); 20 U.S.C. § 1087ee(a)(2)(I)).*

(n132)Footnote 132. *De La Mota v. United States Dep't of Educ., 412 F.3d 71 (2d Cir. 2005)* (citing *Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837 (1984))* .

(n133)Footnote 133. U.S. Dep't of Educ., Dear Colleague Letter, GEN-05-15, Child or Family Service Loan Cancellation Benefit in the Federal Perkins Loan Program (Oct. 19, 2005); *72 Fed. Reg. 32410* (June 12, 2007) .

(n134)Footnote 134. *72 Fed. Reg. 32410, 32419* (June 12, 2007) .

(n135)Footnote 135. *Id.*

(n136)Footnote 136. *72 Fed. Reg. 61960* (Nov. 1, 2007) .

(n137)Footnote 137. *Id. at 61975.*

(n138)Footnote 138. *34 C.F.R. §§ 682.215* (FFEL), 685.217 (Direct Loans).

(n139)Footnote 139. *34 C.F.R. §§ 682.215(8), 685.217(8).*

(n140)Footnote 140. *67 Fed. Reg. 51,036* (Aug. 6, 2002) , *amending 34 C.F.R. § 685.220(l).* According to the Department, similar changes were not made to FFEL consolidation regulations because the construction of those regulations already provides for a partial discharge under these circumstances.

(n141)Footnote 141. *67 Fed. Reg. 67,048* (Nov. 1, 2002) , *adding 34 C.F.R. § 685.220(l)(3)(iv).*

(n142)Footnote 142. The provisions were passed as part of the Third Higher Education Extension Act of 2006, Pub. L. 109-292. *See 71 Fed. Reg. 78075* (Dec. 28, 2006) (Interim Final Regs).

(n143)Footnote 143. *20 U.S.C. § 1091a(b)(2).* This provision only applies explicitly to FFELs, and not Perkins Loans. While the provision does not mention Direct Loans, it will apply to Direct Loans because, unless otherwise specified, Direct Loans "shall have the same terms, conditions, and benefits" as FFELs. *20 U.S.C. § 1087e(a)(1).*

(n144)Footnote 144. A good enunciation of this policy is found in a letter from Acting Assistant Secretary Whitehead to Congressman Stephen Solarz, Clearinghouse No. 44,343 (May 19, 1988).

(n145)Footnote 145. *34 C.F.R. §§ 682.402(l)* (FFEL), 685.216 (Direct Loans).

(n146)Footnote 146. *See* National Consumer Law Center, Student Loan Law, § 6.4 (3d ed. 2006 and Supp.).

(n147)Footnote 147. *64 Fed. Reg. 58,937-58,970* (Nov. 1, 1999) .

(n148)Footnote 148. *34 C.F.R. § 682.402(o)(2)(iii).*

(n149)Footnote 149. *34 C.F.R. § 682.402(o)(2).*

(n150)Footnote 150. *34 C.F.R. § 682.402(l)(2)(ii).*

(n151)Footnote 151. *34 C.F.R. § 682.402(l)(5)(iv).*

(n152)Footnote 152. The regulations are slightly different if the lender holds the loan. In these circumstances, lenders are required to provide the guaranty agency with documentation related to the borrower's qualification for discharge. *34 C.F.R. § 682.402(m).*

(n153)Footnote 153. *See* United States DOE, Dear Guaranty Agency Director Letter GEN-01-15 (Nov. 2001). The form is available on the Department's website.

(n154)Footnote 154. *34 C.F.R. § 682.402(l)(5).*

(n155)Footnote 155. *34 C.F.R. § 682.402(l)(5)(ii).*

(n156)Footnote 156. *34 C.F.R. § 682.402(l)(5)(iii).*

(n157)Footnote 157. *34 C.F.R. § 682.402(l)(5)(vi).*

(n158)Footnote 158. *34 C.F.R. § 682.402(l)(5)(vii). See* National Consumer Law Center, Student Loan Law, § 6.4.4 (3d ed. 2006 and Supp.)

(n159)Footnote 159. *34 C.F.R. § 682.402(l)(3)(i).*

(n160)Footnote 160. *34 C.F.R. § 682.402(l)(3)(ii).*

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PART I Consumer Credit
CHAPTER 12 Student Loans and Trade School Abuses

1-12 Consumer Credit Law Manual § 12.07

§ 12.07 Eligibility for Additional Educational Assistance

[1] Loss of Eligibility

Another key issue for students with defaulted loans is how to renew eligibility for additional educational assistance. Student loans are now dischargeable only if their repayment would cause substantial hardship. n1

Federal law specifies a number of ways that those in default on their student loans can become eligible for new loans and grants. The remainder of this section details those options.

[2] Renewing Eligibility by Making Six Reasonable and Affordable Payments

[a] Standards for Renewing Eligibility

Federal law requires guaranty agencies to establish a program which allows students in default to renew eligibility for loans and grants upon the student's payment of six consecutive monthly payments in an amount that is "reasonable and affordable based upon the borrower's total financial circumstances." n2 The legislation's Conference Report makes clear that the Secretary must offer the same opportunity to renew eligibility where the Department is holding the loan.

Although the regulations do not speak to the issue, the Department has stated that a student is eligible to obtain a reasonable and affordable repayment schedule even if the defaulted loan has been reduced to a court judgment. n3

Whether the Department or a guaranty agency holds the loan, the student, to renew eligibility, must enter a satisfactory repayment arrangement, defined as six consecutive, full monthly payments within fifteen days of the due date. A satisfactory repayment arrangement involves an amount that is determined to be reasonable and affordable based on the borrower's total financial circumstances. n4

If the student stays current on the reasonable and affordable plan, the student apparently can keep on the plan indefinitely at that level of payment. While the student will still technically be in default, the student will not be subject to tax intercepts, wage garnishments, collection contacts, or collection lawsuits. The student's credit record will most likely still show a default.

[3] Loan Rehabilitation

A student can renew eligibility for new loans and grants and cure the loan default by "rehabilitating" the defaulted loan. Loan rehabilitation for FFELs and Direct loans may be requested after the borrower has made nine payments within twenty days of the due date during a period of ten consecutive months. n5 Prior to July 1, 2006, twelve consecutive payments were required. The longer requirement still applies to Perkins loan rehabilitations. Pursuant to the 1998 HEA, institutions are now required to report to credit bureaus when a borrower has made six consecutive monthly payments on a defaulted loan, and to disclose promptly any changes to information previously disclosed. n6

The payment amount is determined by the guaranty agency (or, the U.S., if it is holding the loan) in the same way as a payment plan to renew eligibility, described in the prior subsection, being based on the borrower's total financial circumstances. n7 After the student makes twelve timely monthly payments under the new plan, and the borrower requests rehabilitation, the guarantor or the U.S. must attempt to secure a lender to purchase the loan. n8 If the loan is sold (it may not be if no lender agrees to purchase the loan), the loan is removed from default status and the student is eligible for new loans and grants. n9 The regulation explicitly provides for rehabilitation of defaulted loans reduced to judgment, although, in that case, the borrower must sign a new promissory note prior to sale of the loan. n10

[4] Consolidation of Defaulted Loan Renews Student's Eligibility

Another way to renew eligibility for loans and grants is to consolidate the loan in default into either a new FFEL loan or a new Direct Loan. n11

Legal Topics:

For related research and practice materials, see the following legal topics:
Education LawAdministration & OperationStudent Financial AidEligibilityEducation LawAdministration & OperationStudent Financial AidRenewal & Revocation

FOOTNOTES:
(n1)Footnote 1. *See § 12.06[4][c] supra*.

(n2)Footnote 2. *20 U.S.C § 1078-6(b)*. The Conference Report for this provision states that the provision is intended to provide a second chance at educational loans and grants for low-income students previously defrauded by trade schools. *See* H.R. Conf. Rep No. 102-630, at 467 (1992).

(n3)Footnote 3. Letter from Robert W. Evans, Director, Division of Policy Development, Policy, Training, and Analysis Service, Department of Education to Cornelius Foley, President of the New York State Higher Education Services Corporation, Clearinghouse No. 47,963 (Mar. 3, 1993).

(n4)Footnote 4. *34 C.F.R. § 682.200*, satisfactory repayment arrangement.

(n5)Footnote 5. See *34 C.F.R. § 682.405(a)(2)* (FFEL); *34 C.F.R. § 685.211(f)* (Direct).

(n6)Footnote 6. Pub. L. No. 105-244 (Oct. 7, 1998), § 463(b).

(n7)Footnote 7. *20 U.S.C. § 1078-6(a)(1)*; *34 C.F.R. § 682.405(b)(1)*.

(n8)Footnote 8. *34 C.F.R. § 682.405(b)(1)*.

(n9)Footnote 9. *20 U.S.C. § 1078-6(a)(3)*; *34 C.F.R. § 682.405(a)(3), (b)(2)*.

(n10)Footnote 10. *34 C.F.R. § 682.405(a)(4)*.

(n11)Footnote 11. *See § 12.05[3][a] supra*.

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PART I Consumer Credit
CHAPTER 12 Student Loans and Trade School Abuses

1-12 Consumer Credit Law Manual § 12.08

§ 12.08 Students' Claims Against the School

[1] Introduction

Student loan issues, particularly for low-income borrowers, often involve deceptive and fraudulent vocational school practices. This section therefore sets out legal theories and strategies for bringing claims against the school and related entities.

[2] Connections Between Schools and Lenders

Improper ties between lenders and schools have generated considerable controversy in recent years. The key concern has been lenders offering inducements in exchange for schools recommending their products and services to students.

Much of the controversy has centered on school preferred-lender lists. These are lists of recommended lenders that many schools use. Schools set their own criteria for inclusion on the list. If used properly and without bias, many believe that the lists can help borrowers navigate the complex student loan marketplace. Schools often claim that the lists help them increase efficiency by limiting the number of lenders they must routinely deal with.

The Higher Education Act clearly prohibits schools from refusing to certify loans because of the borrower's choice of lender or guaranty agency. n1 However, until recently, there was little enforcement activity. The Government Accountability Office (GAO) concluded in a 2007 report that, while the Department has some processes to oversee general compliance in the guaranteed loan programs, it has no oversight tools designed to proactively detect potential instances of lenders providing improper inducements. n2

A report by the U.S. Senate Committee on Health, Education, Labor, and Pensions highlighted the following key problems:

- FFEL lenders providing compensation to schools with the expectation and, in some cases, with explicit agreements that the school will give the lenders preferential treatment, including placement on preferred lender lists.

- FFEL lenders spending large sums on travel and accommodation expenses for meetings of Advisory

Boards comprised of school officials and often expecting these benefits to yield increased loan volume or other preferential treatment.

- School officials with financial interests, including stock and options to purchase stock, in FFEL lenders that are on the preferred lender list or are otherwise recommended to students.

- School officials receiving payments for consulting and other services from FFEL lenders that are on the preferred lender list or are otherwise recommended to students. n3

Congress is considering numerous bills to crack down on these abuses. In some cases, the legislation would apply to both government and private student loans. n4 In addition, in June 2007, the Department issued proposed rules that would increase its ability to enforce improper inducement regulations. n5 The proposed regulations also set specific guidelines for preferred lender lists. These guidelines include a requirement that lenders using these lists include at least three lenders that are not affiliated with each other. Schools would also be required to disclose, as part of the list, the method and criteria the school used to select any lender that it recommends or suggests, to provide comparative information to prospective borrowers about interest rates and other benefits offered by the lenders, and to include a prominent statement, in any information related to its list of lenders, advising prospective borrowers that they are not required to use one of the school's recommended or suggested lenders. n6 The proposed "improper inducement" regulations were adopted with only a few changes. n7 For example, the final rules include loan forgiveness programs for public service and other targeted purposes approved by the Secretary as "permissible activities," as long as the benefits are not marketed to secure loan applications or loan guarantees.

Among other "improper inducement" provisions in the final regulations, lenders and guaranty agencies are prohibited from providing staffing services to schools except for services provided to participating foreign schools at the direction of the Secretary, as third-party servicers, or otherwise on more than a short-term, emergency, and non-recurring basis to assist schools with financial-aid-related functions. According to the Department, these limitations also restrict the lender and guaranty agency from providing entrance and exit counseling. n8 The regulations define "emergency basis" as a state-declared or federally declared natural disaster, a federally declared national disaster, and other localized disasters and emergencies identified by the Secretary. n9 The 2008 HEA reauthorization law has a similar provision, allowing staffing on a short-term, non-recurring basis to assist the schools during emergencies, including state-declared or federally declared natural disasters, federally declared national disasters, and other localized disasters and emergencies identified by the Secretary. n10

The proposed "preferred lender" regulations were also adopted with only a few changes. n11 The regulations require schools using preferred lender agreements to include at least three lenders on the list. A May 2008 Department of Education letter clarifies that a school which has been unable to identify at least three lenders may provide the names of lenders that have indicated that they would provide FFEL loans to the school's students and parents. n12 The school must be clear it is not endorsing a particular lender and that borrowers can choose to use any FFEL lender that will make loans to them. Schools may also provide a comprehensive list of lenders that have made loans to the school's students or parents in the past three to five years (or some other period) and have indicated that they would continue to make such loans. Schools doing this in lieu of preferred lender lists should not provide any additional information about the lender. n13

The 2008 HEA reauthorization law includes additional provisions addressing improper inducements and preferred lender lists. These provisions will apply in most cases to private loans as well. n14

[3] UDAP Theories to Challenge School Misconduct

[a] Introduction

UDAP claims are generally well-suited to challenge trade school abuses. Oral and print misrepresentations can be deceptive, the failure to disclose can be deceptive, and enrolling students unable to benefit from a program can be unfair or unconscionable. The student's proof burden is simplified with a UDAP claim because the student normally need not prove intent, scienter, or other components of a common law fraud claim. n15 A number of courts have found, however, that state UDAP and other claims against schools and lenders conflict with federal law and are therefore preempted. n16 A few sections of the HEA expressly preempt certain state law claims. These include state usury laws, n17 state statutes of limitations, n18 state infancy defenses, n19 and state disclosure requirements. n20 The fact that certain provisions are expressly preempted bolsters the argument that Congress did not intend the HEA to so "occupy the field" that it would automatically preempt all state laws. n21 Thus, the key preemption doctrine to consider in these cases is "conflict preemption." Conflict preemption may arise under two circumstances: from a direct conflict between state and federal law, such that compliance with both is impossible (called "direct conflict"), or because a state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" (called "obstacle preemption"). n22

The Fourth Circuit addressed these issues in a 2005 case, overturning the district court's ruling that the plaintiff's state claims were preempted based on "obstacle preemption." n23 According to the court, the existence of extensive regulations pursuant to the HEA does not automatically mean that non-conflicting state law is preempted. n24 Further, the fact that there is no private right of action to enforce the HEA does not lead to the conclusion that the plaintiff's pursuit of state law claims would obstruct the federal scheme. n25 To the contrary, the court emphasized that the Supreme Court has recognized that the availability of a state law claim is even more important in an area where no federal private right of action exists. n26 In this case, the plaintiff sought redress under state law for the defendant's alleged violation of the HEA provision requiring lenders that receive loan verification certificates to complete and return these certificates within ten days. n27

This section will detail existing UDAP precedent concerning trade school abuses, but other unfair or deceptive practices are equally actionable under a UDAP statute. Trade school abuses should be challenged even if the exact practice is not listed below. State UDAP laws have various exclusions that may apply in these cases. For example, community colleges or other public colleges may be excluded from various UDAP laws that have government entity exemptions. n28

[b] FTC Guides and Rule

The Federal Trade Commission ("FTC") has issued guides concerning unfair and deceptive private vocational school practices. n29 The guides specify that schools cannot misrepresent, through their name or otherwise, that they are connected with government agencies or civil service commissions n30 or that they are an employment agency or employer. n31

For example, schools must disclose if the course is offered through correspondence. n32 It is deceptive for a school to misrepresent the nature of its approval or accreditation or the extent to which former students, employers, or counselors recommend a course. n33 Other deceptive misrepresentations relate to a school's size, location, facilities, or equipment, n34 the currency of its courses and the number of educational qualifications of its personnel, n35 and statements that a school is nonprofit or connected with a charitable organization. n36

The FTC updated its vocational school guides in 1998, renaming them the "Guides for Private Vocational and Distance Education Schools." n37 The most significant change was a new provision addressing misrepresentations about a school's placement success following training. The Guides now specifically state that it is deceptive for a school, in promoting a course of training, to misrepresent the availability of employment after graduation from the course, the success that the school's graduates have realized in obtaining such employment, or the salary that the school's graduates will receive in such employment. n38 The new guide also states that it is deceptive for a school to misrepresent that the lack of a high school education or prior training is not an impediment to successful completion of a course or obtaining employment. n39

[c] Other Precedent

Courts have identified a number of other trade school practices not enumerated in the FTC Guides as unfair or deceptive. State UDAP precedent and FTC case law provide important additional principles concerning job and earnings claims, student loans, and refund policies.

Schools may not deceive students with respect to the nature, terms or conditions of contractual obligations, veterans' educational benefits, and federally insured student loans. n40 A school may not misrepresent its refund policy or deceive students into attending additional classes before dropping out with the result that their contractual obligation is significantly increased under the refund formula. n41 Schools must also pay all owed refunds. n42

It is deceptive to misrepresent the amount of personalized instruction available in a correspondence course, or the difficulty of the correspondence courses themselves. n43 Schools cannot misrepresent students' ability to benefit from a course. Schools cannot fail to meet state entrance standards. n44 Nor can schools encourage students to falsify their identity or immigration status. n45 Using a deceptive name for an educational program or making changes to a program without proper disclosures may also give rise to UDAP claims. n46

Also deceptive are misrepresentations concerning the nature of school placement services. n47 For example, in one UDAP case, consumer recovery was based on the school's "admissions officers" (who worked on commission and made as much as $56,000 a year) promising 90 to 95% job placement when in fact the school was reporting to its accrediting agency job placement rates averaging only 47%. The school's higher 90 to 95% figure was derived only from students who kept in touch with the school's placement office, not the total number of the school's graduates. n48

Another source of precedent on unfair or deceptive trade school practices may be found in a state's education statutes, such as California's Maxine Waters Student Protection Act. n49 In some cases, these statutes will provide for a private right of action. If not, a violation of these standards may be actionable under a state UDAP statute. It should be noted, however, that a number of courts have found that state UDAP and other claims against schools and lenders conflict with federal law and are therefore preempted. n50

[d] Other State Law Claims

State UDAP claims are key to school cases, but other theories should also be considered. Common law fraud, in particular, should not be overlooked because of the possibility of punitive damages. n51

In some states, a state RICO claim may provide better remedies than a UDAP claim, or the two together may provide more relief than just a UDAP claim. For example, one UDAP and state RICO case in Oregon against a school resulted in a jury verdict of $320,000 in multiple and punitive damages for nine former computer school students. n52

Courts have also, on a variety of legal theories, rescinded enrollment agreements and directed schools to reimburse students for their tuition payments or student loan debts. n53

Another possible state law theory is a state education statute explicitly providing a private right of action. Even when a state education statute does not provide a private right of action, a violation of that statute may be a state UDAP violation. It is also possible to raise contract defenses such as duress when appropriate. n54

[e] Federal Claims

There are two possible federal claims against schools which provide federal court jurisdiction--the Federal RICO statute n55 and the Federal HEA. n56 Note, however, that the consumer must have a good reason to seek federal, instead of state, court jurisdiction because there are drawbacks with RICO and particularly with HEA claims.

A RICO claim requires consumers to prove various technical elements, which will significantly complicate a case. Nevertheless, RICO claims have proved successful in a number of trade school cases. n57

The HEA claim may be dismissed outright because most courts find there is no implied private right of action under the statute. n58 The HEA also explicitly states that failure to comply with its loan disclosure requirements does *not* provide a basis for a claim for civil damages. n59 Also, the Sixth Circuit affirmed in 2009 that the TILA federal student loan exemption applies only to government student loan programs promulgated under the Higher Education Act. TILA should apply to other federal student loan programs. n60

[f] When to Raise Claims Against the School

A key question when a student is defrauded by a trade school is whether the student should sue the school affirmatively or wait to be sued on the loan and raise school-related defenses. Suing the school affirmatively presents the student in a better stance before the court. In fact, particularly for pre-1994 FFELs, some courts refuse to allow the student to raise such claims as a defense to a collection action. n61 Moreover, it is rare that the holder of a student loan will actually sue on the loan.

A consumer sued on a loan by a guaranty agency or the United States should consider not just raising school-related defenses to the collection action, but also impleading the school (if still solvent). Joining the school will also aid discovery and paint a clearer picture for the judge.

Where no collection action has been brought against the student, but where tax refund intercepts and other collection contacts are threatened, and the school is insolvent, another approach is to bring an affirmative action for declaratory relief that the loan amount is not owed to the guarantors or the Department because of school-related claims.

[g] Potential Defendants

When the school is bankrupt or judgment-proof, a number of other parties (in addition to the obvious choices of the lender, guaranty agency, and the United States) may be liable for the school's malfeasance and may have assets to satisfy a judgment.

Another possible approach to recover from a bankrupt school is to jump ahead of other creditors by means of a criminal restitution order. *United States v. Grundhoefer* n62 affirms an order of almost $1 million in criminal restitution to students victimized by a private vocational school. Brooklyn and Bronx Legal Services suggested to two different federal judges sentencing several principals of the school that all the criminal restitution go to defrauded students and not to the school's other creditors. The judges agreed, instructing the government and the legal services attorneys to work out a restitution plan. The school's bankruptcy trustee, representing the school's other creditors, appealed. The Second Circuit found no abuse of discretion in the restitution plan, and no standing by the other creditors to object to the courts' orders. n63

There are also other possible avenues. First, it is possible to recover a judgment from a school in bankruptcy and a proof of claim should be submitted.

When dealing with an insolvent school, the following potential alternative defendants should also be explored:

a) *A bonding company or state tuition recovery fund*, since schools are licensed by many states, and a bond or contribution to a state tuition recovery fund is usually a pre-condition to licensure. In addition, the U.S. DOE, separately, often requires schools to provide a letter of credit if the school appears in financial difficulty and wishes to participate in the FFEL or Federal Direct Loan programs. This letter of credit, in appropriate circumstances, can be used

to reduce the student's obligation on a loan, but is unlikely to provide a source of cash recovery for the student.

b) *The parent company or franchisor* is often a deep pocket and may aid or abet the school's misrepresentations.

c) *Owners, officers,* n64 *and employees are responsible* for their own actions, even if they are acting as a corporate agent. Individuals dealing directly with a student, and those supervising those individuals, are potential defendants, as is a school's owner to the extent the owner supervises the school or to the extent the corporate veil can be pierced.

d) *Advertising agencies, accountants, lawyers, or others aiding and abetting a fraudulent scheme* are individually liable for their own misconduct.

Other possibilities include the accrediting agency or the DOE. n65

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawPrivate ActionsRacketeer Influenced & Corrupt OrganizationsCoverageAntitrust & Trade LawTrade Practices & Unfair CompetitionFederal Trade Commission ActEducation LawAdministration & OperationCareer & Vocational SchoolsEducation LawAdministration & OperationStudent Financial AidGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *20 U.S.C. § 1082* (sanction authority); *34 C.F.R. § 682.603(e). See also* U.S. Dep't of Educ., Borrower Choice of FFEL Lender, Dear Colleague Letter GEN-07-01 (Mar. 29, 2007).

(n2)Footnote 2. U.S. Gov't Accountability Office, Federal Family Education Loan Program: Increased Department of Education Oversight of Lender and School Activities Needed to Help Ensure Program Compliance, GAO-07-750 (July 2007).

(n3)Footnote 3. U.S. Senate Health, Educ., Labor, and Pensions Comm., Report on Marketing Practices in the Federal Family Education Loan Program (June 14, 2007), *available at* http://kennedy.senate.gov/imo/media/doc/Student%20Loan%20Report.pdf.

(n4)Footnote 4. *See, e.g.*, H.R. 890, 110th Cong. (2007) (Student Loan Sunshine Act).

(n5)Footnote 5. *72 Fed. Reg. 32410* (June 12, 2007) . Among other enhanced enforcement provisions, the proposed rules expand borrower rights to raise school-related claims against lenders.

(n6)Footnote 6. *Id.*

(n7)Footnote 7. *72 Fed. Reg. 61960* (Nov. 1, 2007) .

(n8)Footnote 8. *Id.*

(n9)Footnote 9. *Id.*

(n10)Footnote 10. Pub. L. No. 110-315 § 493, *122 Stat. 3078* (Aug. 14, 2008).

(n11)Footnote 11. *72 Fed. Reg. 61960* (Nov. 1, 2007) .

(n12)Footnote 12. U.S. Dep't of Educ., *School Use of a Preferred Lender List in the FFEL Program*, Dear Colleague Letter, GEN-08-06 (May 9, 2008).

(n13)Footnote 13. *Id.*

(n14)Footnote 14. Pub. L. No. 110-315 §§ 151, 152, 436, *122 Stat. 3078* (Aug. 14, 2008).

(n15)Footnote 15. For a general discussion of unfair and deceptive acts and practices [hereinafter UDAP] claims, see Ch. 4 *supra*.

(n16)Footnote 16. *See, e.g., Armstrong v. Accrediting Council for Continuing Educ. and Training, Inc. 168 F.3d 1362 (D.C. Cir. 1999)* (federal student loan policy preempted student loan recipient's state law mistake and illegality claims as well as assertion of vocational school misconduct as a defense to collection); *Washkoviak v. Student Loan Mktg. Assoc., 849 A.2d 37 (D.C. 2004)* (UDAP claims based on lenders failure to disclose information about late fees and for improper charging of late fees preempted by HEA); *Morgan v. Markerdowne Corp., 976 F. Supp. 301 (D.N.J. 1997)* (although HEA does not preempt all state law, it does preempt any state law which conflicts with it; HEA impliedly preempted borrower's state law claims to the extent they would hold the lender and guaranty agency liable for the alleged school misrepresentations).

(n17)Footnote 17. *20 U.S.C. § 1078(d).*

(n18)Footnote 18. *20 U.S.C. § 1091a(a).*

(n19)Footnote 19. *20 U.S.C. § 1091a(b)(2).*

(n20)Footnote 20. *20 U.S.C. § 1099. See, e.g., Washkoviak v. Student Loan Mktg. Assoc., 849 A.2d 37* (D.C. May 6, 2004) .

(n21)Footnote 21. *See, e.g., College Loan Corp. v. SLM Corp., 396 F.3d 588 (4th Cir. 2005)* .

(n22)Footnote 22. See discussion in *College Loan Corp. v. SLM Corp., 396 F.3d 588 (4th Cir. 2005)* .

(n23)Footnote 23. *College Loan Corp. v. SLM Corp., 396 F.3d 588 (4th Cir. 2005)* .

(n24)Footnote 24. *Id.* (*citing Abbot v. Am. Cyanamid Co., 844 F.2d 1108 (4th Cir. 1988))* . See *supra* for a discussion of possible conflicts with the FDCPA.

(n25)Footnote 25. *College Loan Corp. v. SLM Corp., 396 F.3d 588 (4th Cir. 2005)* .

(n26)Footnote 26. *College Loan Corp. v. SLM Corp., 396 F.3d 588 (4th Cir. 2005)* (citing *Silkwood v. Kerr-McGee Corp., 464 U.S. 238, 104 S. Ct. 615 (1984)* , *as cited in Worm v. Am. Cyanamid Co., 970 F.2d 1301 (4th Cir. 1992))* , *on appeal after remand, 5 F.3d 744 (4th Cir. 1993)* .

(n27)Footnote 27. *34 C.F.R. § 682.209(j).*

(n28)Footnote 28. *See, e.g., Meyer v. Community Coll. of Beaver County, 965 A.2d 406 (Pa. Commw. Ct. 2009)* (community college that had its certification revoked was immune from UDAP statutory and treble damages); *Barr v. Community Coll. of Beaver County, 968 A.2d 235 (Pa. Commw. Ct. 2009)* .

(n29)Footnote 29. Guides for Private Vocational and Home Study Schools, 16 C.F.R. pt. 254. As part of a review of all Federal Trade Commission [hereinafter FTC] guides to determine which are now obsolete and should be rescinded or whether certain guides should be amended, the FTC requested, in April 1996, public comment on this guide. *See 61 Fed. Reg. 14,685* (Apr. 3, 1996) . Although some industry members supported repeal of the guides, the FTC decided to retain them and then sought supplemental comments on some proposed modifications. *See 62 Fed. Reg. 19,703* (Apr. 23, 1997) . In August 1998, the FTC voted to update the vocational school guides, renaming them the "Guides for Private Vocational and Distance Education Schools." *See 63 Fed. Reg. 42,570* (Aug. 10, 1998) .

(n30)Footnote 30. *See also Grady L. Rushing, 59 F.T.C. 1182 (1961)* , *aff'd, 320 F.2d 280,* (5th Cir. 1963) , *cert. denied, 375 U.S. 986, 84 S. Ct. 519, 11 L. Ed. 2d 473 (1964)* ; *Herbert Gundlach, 53 F.T.C. 355 (1956)* ; *James McCorrey, 53 F.T.C. 1 (1956)* .

(n31)Footnote 31. *See also FTC v. Couture Sch. of Modeling, 1990 U.S. Dist. LEXIS 4129 (D. Md. 1990)* (injunction); United States v. Eyler, 5 *Trade Reg. Rep. (CCH) P 22,891 (M.D. Fla. 1990)* (consent decree); *World Wide Sys., 86 F.T.C. 182 (1975)* (consent order).

(n32)Footnote 32. *See also* Florida Rules of the Dep't of Legal Affairs Ch. 2-18, Contracts for Future Consumer Services.

(n33)Footnote 33. *See also Ohio Christian Coll., 80 F.T.C. 815 (1972)* ; *Chicago Tech. Coll., 35 F.T.C. 569 (1942)* ; *Nat'l Sys. Corp., 93 F.T.C. 58 (1979)* (consent order); *Fuqua Indus., 85 F.T.C. 93 (1975)* (consent order). *But see Lidecker v. Kendall Coll., 550 N.E.2d 1121 (Ill. App. Ct. 1990)* (failure to inform prospective students of nursing school's lack of accreditation not a UDAP violation where school did not intend that students rely on the omission, and the lack of accreditation did not cause the student harm).

(n34)Footnote 34. *See also Eastern Detective Acad., Inc., 78 F.T.C. 1428 (1971)* ; *New England Tractor Trailer Training of Mass., 88 F.T.C. 55 (1976)* (consent order); *World Wide Sys., 86 F.T.C. 182 (1975)* (consent order); *Midwest Automation Training, 71 F.T.C. 721 (1967)* (consent order); People *ex rel.* Abrams v. New York Vocational Sch., Inc., Clearinghouse No. 43,088 (N.Y. Sup. Ct. 1987); *American Commercial Colls., Inc. v. Davis, 821 S.W.2d 450 (Tex. Ct. App. 1991)* .

(n35)Footnote 35. *See also Markus-Campbell Co., 44 F.T.C. 305 (1947)* ; *Lafayette United Corp., 88 F.T.C. 683 (1976)* (consent order); *New England Tractor Trailer Training of Mass., 88 F.T.C. 55 (1976)* (consent order).

(n36)Footnote 36. *See also* Florida Rules of the Dep't of Legal Affairs Ch. 2-18, Contracts for Future Consumer Services; Massachusetts Consumer Protection Regulations, *940 Code Mass. Reg. § 3.10*, Private Home Study, Business, Technological, Social Skills and Career Schools--Correspondence and Other.

(n37)Footnote 37. *63 Fed. Reg. 42,570* (Aug. 10, 1998) (amending 16 C.F.R. pt. 254), *corrections*, *63 Fed. Reg. 72,350* (Dec. 31, 1998) .

(n38)Footnote 38. *16 C.F.R. § 254.4*.

(n39)Footnote 39. *16 C.F.R. § 254.5*.

(n40)Footnote 40. *Bell & Howell Co., 95 F.T.C. 761 (1980)* (consent order); People v. Wilshire Computer Coll., Clearinghouse No. 46,309B (Cal. Super. Ct. 1991) (preliminary injunction pursuant to stipulation); *Manley v. Wichita Bus. Coll., 237 Kan. 427, 701 P.2d 893 (1985) . But see Finstad v. Washburn Univ. of Topeka, 845 P.2d 685 (Kan. 1993)* (overruling the holding in *Manley* that actual damages are not required in Kansas UDAP cases).

(n41)Footnote 41. People v. Wilshire Computer Coll., Clearinghouse No. 46,309B (Cal. Super. Ct. 1991) (preliminary injunction pursuant to stipulation); *Manley v. Wichita Bus. Coll., 237 Kan. 427, 701 P.2d 893 (1985)* ; *Reynolds v. Sterling Coll., Inc., 750 A.2d 1020 (Vt. 2000)* (summary judgment awarded to student on contractual claim, consumer fraud claim remanded. Change in refund policy after substantial tuition payments had been made found to be a unilateral modification of specific contractual term for which no consideration had been received). *But see Finstad v. Washburn Univ. of Topeka, 845 P.2d 685 (Kan. 1993)* (overruling the holding in *Manley* that actual damages are not required in Kansas UDAP cases).

(n42)Footnote 42. United States v. Eyler, 5 *Trade Reg. Rep. (CCH) P 22,891 (M.D. Fla. 1990)* (consent decree); People v. Wilshire Computer Coll., Clearinghouse No. 46,309B (Cal. Super. Ct. 1991) (preliminary injunction pursuant

to stipulation). In addition, there is now a federal discharge program to reimburse students for unpaid refunds.

(n43)Footnote 43. *Bell & Howell Co., 95 F.T.C. 761 (1980)* (consent order).

(n44)Footnote 44. People v. Wilshire Computer Coll., Clearinghouse No. 46,309B (Cal. Super. Ct. 1991) (preliminary injunction pursuant to stipulation).

(n45)Footnote 45. *Id.*

(n46)Footnote 46. *See, e.g., Deen v. New Sch. Univ., 2007 U.S. Dist. LEXIS 25295* (S.D.N.Y. Mar. 27, 2007) .

(n47)Footnote 47. *Control Data Corp., 97 F.T.C. 84 (1981)* (consent order); *Bell & Howell Co., 95 F.T.C. 761 (1980)* (consent order); *In re Universal Training Serv. Inc., 94 F.T.C. 167 (1979)* (consent order); *In re Bureau of Engraving Inc., 93 F.T.C. 32 (1979)* (consent order); *In re Driver Training Inst., Inc., 92 F.T.C. 235 (1978)* (consent order); *In re Commercial Programming Unlimited Inc., 88 F.T.C. 913 (1976)* (consent order); *In re Lafayette United Corp., 88 F.T.C. 683 (1976)* (consent order); *In re Lear Siegler, Inc., 86 F.T.C. 860 (1975)* (consent order); *In re Weaver Airline Personnel Sch., 85 F.T.C. 237 (1975)* (consent order); *In re Eastern Detective Academy Inc., 78 F.T.C. 1428 (1971)* ; *In re Missouri Coll. of Automation, 67 F.T.C. 258 (1965)* (consent order); People *ex rel.* Abrams v. New York Vocational Sch., Inc., Clearinghouse No. 43,088 (N.Y. Sup. Ct. 1987); Florida Rules of the Dept. of Legal Affairs, Chs. 2-18, Contracts for Future Consumer Services.

(n48)Footnote 48. *Beckett v. Computer Career Inst., Inc., 120 Or. App. 143, 852 P.2d 840 (1993)* .

(n49)Footnote 49. *Cal. Educ. Code § 94850* (formerly § 94316). Most of the provisions in the California Student Protection Act apply only to violations that occurred after January 1, 1990. For some provisions, the effective date is January 1, 1991. There are some, more limited protections in the California Code for pre-1990 violations. The California law became inoperative on July 1, 2007, and is scheduled to be repealed as of January 1, 2008, unless a later enacted statute extends that date. *Cal. Educ. Code § 94999*. However, in July 2007, California passed a law that creates a temporary process for proprietary schools to be regulated by the state. The former regulatory body, the Bureau of Private Postsecondary and Vocational Education, went out of business on June 30, 2007. The new law allows the state Department of Consumer Affairs to enter into voluntary agreements in which for-profit schools agree to comply with state rules. *See* Goldie Blumenstyk, *California Restores For-Profits' Regulation*, The Chron. of Higher Educ., July 27, 2007, at A19. Pursuant to the July 2007 legislation (A.B. 1525), any claim or cause of action that arose under the Student Protection Act on or before June 30, 2007, is preserved. At the time this manual was written, the legislature had passed another bill that the Governor had not yet signed. This bill, S.B. 45, would extend the law to July 1, 2008.

(n50)Footnote 50. *See, e.g., Armstrong v. Accrediting Council for Continuing Educ. and Training, Inc. 168 F.3d 1362 (D.C. Cir. 1999)* (federal student loan policy preempted student loan recipient's state law mistake and illegality claims as well as assertion of vocational school misconduct as a defense to collection); *Washkoviak v. Student Loan Mktg. Assoc., 849 A.2d 37 (D.C. 2004)* (UDAP claims based on lenders' failure to disclose information about late fees and for improper charging of late fees preempted by HEA); *Morgan v. Markerdowne Corp., 976 F. Supp. 301 (D.N.J. 1997)* (although HEA does not preempt all state law, it does preempt any state law which conflicts with it; HEA impliedly preempted borrower's state law claims to the extent they would hold the lender and guaranty agency liable for the alleged school misrepresentations). *See also* National Consumer Law Center, Student Loan Law, § 9.3.2.1 (3d ed. 2006 and Supp.)

(n51)Footnote 51. *See Moy v. Adelphi Inst., Inc., 866 F. Supp. 696 (E.D.N.Y. 1994)* (misrepresentation and fraud claims survived motion to dismiss, but not claim for negligent misrepresentation or breach of fiduciary duty); *Ross v. Creighton Univ., 957 F.2d 410 (7th Cir. 1992)* (basic legal relationship between student and school is contractual in nature). *See also Gally v. Columbia Univ., 22 F. Supp. 2d 199 (S.D.N.Y. 1998)* (implied contract between students and school required university to act in good faith and students to satisfy academic requirements and comply with school procedures).

(n52)Footnote 52. Beckett v. Computer Career Inst., Inc. (Or. Cir. Ct. July 2, 1990), *aff'd in part and rev'd in part, 120 Or. App. 143, 852 P.2d 840 (1993)* .

(n53)Footnote 53. *Brown v. Hambric, 168 Misc. 2d 502, 638 N.Y.S.2d 873 (City Ct. 1995)* (travel agent school found to be a deceptive pyramid scheme; rescission of contract warranted where failure to deliver the promised support and training was unconscionable and deceptive business practice); *Cavaliere v. Duff's Bus. Inst., 413 Pa. Super. 357, 605 A.2d 397 (1992)* (general claim of lack of quality education not actionable, but misrepresentation or breach of contract would be).

(n54)Footnote 54. *See, e.g., In re Mason, 300 B.R. 160 (Bankr. D. Conn. 2003)* (consolidation loan was obtained through duress and was therefore null and void under state law).

(n55)Footnote 55. *18 U.S.C. §§ 1961-1968*, *reprinted in* Vol. 1A *infra*.

(n56)Footnote 56. *20 U.S.C. §§ 1000 et seq*. See National Consumer Law Center, Student Loan Law, § 9.3.3 (3d ed. 2006 and Supp.) for a discussion of other possible federal claims.

(n57)Footnote 57. *See Rosario v. Livaditis, 963 F.2d 1013 (7th Cir. 1992)* (Illinois law); *Moy v. Adelphi Inst., Inc., 866 F. Supp. 696 (E.D.N.Y. 1994)* ; *Gonzalez v. North Am. Coll., 700 F. Supp. 362 (S.D. Tex. 1988)* (students sufficiently alleged RICO claim).

(n58)Footnote 58. *See Labickas v. Arkansas State Univ., 78 F.3d 333 (8th Cir. 1996)* , *cert. denied, 519 U.S. 968, 117 S. Ct. 395, 136 L. Ed. 2d 310 (1997)* ; *Morgan v. Markerdowne Corp., 976 F. Supp. 301 (D.N.J. 1997)* ; *Bartels v. Alabama Commercial Coll., 918 F. Supp. 1565 (S.D. Ga. 1995)* , *rev'd on other grounds, 54 F.3d 702 (11th Cir. 1995)* ; *Moy v. Adelphi Inst., Inc., 866 F. Supp. 696 (E.D.N.Y. 1994)* ; Spinner v. Chesapeake Bus. Inst. of Va., Clearinghouse No. 49,131A (E.D. Va. Feb. 5, 1993). *But see* Tipton v. N.E. Bus. Coll., Clearinghouse No. 44,339 (S.D. W. Va. Jan. 8, 1988) (private right of action); *Chavez v. LTV Aerospace Corp., 412 F. Supp. 4 (N.D. Tex. 1976)* (private cause of action where school allegedly imposed illegal charges on students).

(n59)Footnote 59. *20 U.S.C. § 1083(c)*.

(n60)Footnote 60. *See U.S. v. Petroff-Kline, 557 F.3d 285 (6th Cir. 2009)* (applying TILA to borrower's Health Education (HEAL) loans).

(n61)Footnote 61. *See §§ 12.09[1][d]*, *12.09[2] infra* .

(n62)Footnote 62. *916 F.2d 788 (2d Cir. 1990)* .

(n63)Footnote 63. *Id*.

(n64)Footnote 64. *See* Goldsmith v. Rodano, Clearinghouse No. 50,943C (Cal. Super. Ct. Aug. 21, 1995) (former president agrees to pay $100,000 to 75 students and $30,000 to student's attorney).

(n65)Footnote 65. For a specific discussion on how to develop a case in this area and for more detailed information on possible defendants, see National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 10.6 (6th ed. 2004 and Supp.). *See also* Ch. 4 *supra*.

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Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 12 Student Loans and Trade School Abuses

1-12 Consumer Credit Law Manual § 12.09

§ 12.09 Raising School-Related Defenses Against Student Loan Collection Action

[1] Introduction

In many cases, defrauded students have no other practical recourse than to raise school-related defenses on their student loans. While it is almost always preferable to obtain a closed school or false certification discharge than to raise school-related defenses, most defrauded students will not receive such discharges. Similarly, most defrauded students will not want to file for bankruptcy or may not be able to obtain a bankruptcy discharge of their student loans. The student suing the school raises many practical problems, not the least of which is that the school may now be insolvent, or insolvent by the time a judgment is entered against the school. Defrauded students often do not have the financial or legal resources to pay their loan in full and then bring an affirmative suit against the school.

Consequently, for millions of students defrauded by trade schools, raising school-related defenses on their student loans is critical.

Unfortunately for defrauded students, whether they can raise school-related defenses to their loans is a complex issue, depending initially on the type of student loan involved. Students can raise school-related defenses for Perkins Loans, Direct Loans, and usually on FISLs. They can also raise these defenses on FFELs extended on or after January 1, 1994, where a for-profit school has a referral or other business relationship with the lender.

The situation for earlier FFELs, on the other hand, is far from clear, and these earlier FFELs still comprise the majority of problem loans. In addition, special issues arise where an FFEL has lost its guaranteed status or where a student loan is consolidated into a new student loan.

This section sets out existing standards for raising school-related defenses for all of these types of loans, which differ dramatically depending on the type of loan at issue. Practitioners must properly match their client's type of loan with the appropriate discussion below. n1

[a] Perkins Loans

Schools are the lender for Perkins Loans, so the lender (i.e., the school) is obviously subject to school-related defenses. The lender may *assign* the note to the United States for collection. n2 The United States, as assignee, is subject to all

defenses that could be raised against the assignor. n3

[b] Direct Loans

The HEA specifies that, notwithstanding any other provision of state or federal law, the Secretary shall, for Direct Loans, specify in regulations when school misconduct may be asserted as a defense to loan repayment, but the student's recovery pursuant to such a defense cannot exceed the amount the borrower has repaid on the loan. n4 The Secretary has issued these regulations, n5 which state that in any proceeding to collect on a Direct Loan, the borrower may assert as a defense against repayment any act or omission of the school that would give rise to a cause of action against the school under applicable state law. In addition, the Secretary may determine that all or part of amounts already paid on the loan should be refunded to the student. n6

[c] FISLs

FISLs usually date back to the 1970s or early 1980s. Loans from a bank or even from a school were insured directly by the United States. Students can raise many school-related defenses to FISLs because, until 1986 (when it was dropped without comment), an FISL regulation explicitly stated that the United States would not collect an FISL to the extent that a school had closed or students had certain school-related defenses. n7 This regulation should apply at least to FISLs entered into before 1986. Moreover, where the school was the originating lender, students should also be able to raise all defenses against the assignee (the United States) based on the same rationale as Perkins Loans. n8

[d] FFELs Extended After January 1, 1994

Starting on January 1, 1994, all FFELs use a common promissory note that is drafted by the U.S. DOE. The note includes an adaptation of the FTC Holder Notice.

Students whose notes include this loan provision will be in a strong position to raise school-related claims because, as a matter of contract law, the student has the right to raise school-related defenses under the terms of the loan provision. Nevertheless, this loan provision, by its very terms, only allows consumers to raise school-related defenses to a FFEL if the school is for-profit and if the school refers students to the lender or is affiliated with the lender by common control, contract, or business arrangement. In raising school-related defenses, the student should thus allege that the school is for-profit and that it refers students or has a business arrangement with the lender. n9

The Department has issued a letter giving its interpretations when a referral relationship exists. n10

[2] FFELs Extended Before 1994

In large part, the Department refuses to recognize legitimate school-related defenses for FFELs entered into before 1994. For these loans, the only undisputed right to relief is through a closed school or false certification discharge. n11

The key question in determining whether students can raise school-related defenses to FFELs extended before 1994 is whether the originating lender (usually a bank) is subject to the student's claims against the school. If the bank is, then so are its assignees--a secondary market lender, a guaranty agency, and the United States. n12

An important avenue for relief for students would be if general principles of lender liability for other consumer transactions and for other student loans (including FFELs after January 1, 1994) also applied to FFELs prior to 1994. Since the lender would be liable for the school's misconduct, then the same would be true for the guaranty agency and the Department, who are merely assignees of the lender. Legal theories allowing the student to raise school-related claims and defenses against the lender, the guaranty agency, and the United States are set out immediately below.

[3] Agency and Other Common Law Theories

One ground for lender liability for school-related claims is that the lender has appointed the school its agent for certain functions, and that, under *respondeat superior*, the principal is liable for the acts of its agent within the actual or apparent scope of the agent's authority. n13 The federal regulatory scheme should not preempt application of the state or federal common law of *respondeat superior*. n14

One weakness of the agency approach is that the principal will only be liable for acts within the actual or apparent authority of the agent, which will usually relate to the student's enrollment in the school, and not to the school's quality of teaching, equipment, or placement services.

[4] State Lender Liability Statutes

Approximately one-third of the states have enacted statutes specifically requiring that lenders be liable for the acts of their related sellers, specifying in some detail the type of relationship between the seller and lender that is sufficient to allow the consumer to raise seller-related defenses on the loan. While these statutes in some states are vague, requiring court interpretation, in general, they should provide a solid basis for a student raising school-related defenses to a FFEL. n15

Beside questions of interpretation of a particular state law, the major argument why these statutes would not apply is that they are preempted by federal law. However, the HEA should not preempt these state laws where the DOE now requires that current student loans provide for the same protection specified in these state laws--that related lenders are liable for school-related claims. n16 The Department has also stated that its "regulations do not preempt state law that would affect the conduct of litigation or the enforcement of judgments, but would only preempt those state laws, if any, that would conflict with the regulatory requirement that a guarantee agency institute suit and attempt to enforce a judgment." n17

It is also Department policy that a loan which is unenforceable because of state law defenses is not re-insurable, and the guaranty agency should not honor the guaranty. n18 If the loan is not guaranteed or reinsured, the guaranty agency and the United States have no right to collect from the student.

Court precedent is consistent with this general view--that the HEA does not preempt the field of lender liability, and that these state statutes are generally effective, n19 unless they specifically conflict with a federal requirement. n20

[5] Origination Theory

The Secretary of Education recognizes that students can raise school-related defenses to FFEL collection actions when the school is in an "origination relationship" with the lender. n21

Unfortunately for students, the D.C. Circuit has ruled that the Secretary has not sufficiently communicated an intention to be bound by the origination policy so as to create a legally enforceable right grounded in federal law. n22 If a court follows the D.C. Circuit approach, then the sole application of the origination theory would be in persuading the Department to drop a loan collection.

Other courts have found the origination theory binding on the Department and guarantors, n23 based on the Department's statements that it expects guaranty agencies not to collect unenforceable loans where an origination relationship exists. n24

[6] Student Claims Against Tuition Recovery Funds

State tuition recovery funds ("STRFs") can be a valuable source of relief for defrauded students where a school is

insolvent and where the student cannot obtain a closed school or false certification discharge. STRFs contain deposits of money collected from schools approved to operate in the state. The funds are disbursed to victimized students under specified conditions.

Many states have either a STRF or a bond program to reimburse defrauded students. States with STRFs tend to have two different funds--one for degree-granting institutions, and one for schools that offer non-degree-granting vocational programs. n25

The STRF is an important student remedy because it will provide relief in situations where defrauded students cannot obtain a closed school, unpaid refund, or false certification discharge. The California STRF, for example, will pay claims where a student ceased attending a school because of a breach or anticipatory breach of the agreement for the course of instruction. n26 The California STRF also provides relief for students who have obtained judgments against schools for violations of the state student protection act provisions, but are unable to collect the judgment after diligent efforts. n27 The operation of STRFs varies significantly by state. Advocates will need to contact their own state regulatory agency concerning detailed information on their STRF.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawAgency RelationshipsDuties & LiabilitiesAuthorized Acts of AgentsLiability of PrincipalEducation LawAdministration & OperationStudent Financial AidDebt CollectionEducation LawAdministration & OperationStudent Financial AidState Assistance

FOOTNOTES:
(n1)Footnote 1. More detail on these issues is also available at National Consumer Law Center, Unfair and Deceptive Acts and Practices, Ch. 6 (6th ed. 2004 and Supp.). *See also* Ch. 4 *supra*.

(n2)Footnote 2. *See 34 C.F.R. § 674.8(e)*.

(n3)Footnote 3. The note is not a negotiable instrument so the United States cannot be a holder-in-due course. *See, e.g., 34 C.F.R. §§ 674.32(h), 674.51*.

(n4)Footnote 4. *20 U.S.C. § 1087e(h)*.

(n5)Footnote 5. *34 C.F.R. § 685.206(c)*. The Secretary also announced a negotiated rulemaking to further refine these regulations, *59 Fed. Reg. 11,004* (Feb. 28, 1995) , but that rulemaking has since been terminated with no action taken.

(n6)Footnote 6. *34 C.F.R. § 685.206(c)*.

(n7)Footnote 7. 34 C.F.R. pt. 518 (1985) (since rescinded). *See also United States v. Griffin, 707 F.2d 1477 (D.C. Cir. 1983)* .

(n8)Footnote 8. *Cf. United States v. Griffin, 707 F.2d 1477 (D.C. Cir. 1983)* (not ruling on whether the United States was an assignee or surety because Department regulations authorized students to raise defenses).

(n9)Footnote 9. Many pre-1994 FFELs should also have included the FTC holder notice. The problem is whether there is a private right of action for the failure to include the notice. *See generally §§ 14.04[4] infra, 4.04[1][g] supra* .

(n10)Footnote 10. Division of Policy Development, Office of the Assistant Secretary for Postsecondary Education, Overview of the Federal Trade Commission Holder Rule, Clearinghouse No. 49,162 (July 2, 1993).

(n11)Footnote 11. *See §§ 12.06[2][a], 12.06[3][e] supra* .

(n12)Footnote 12. There may be additional issues that arise in trying to hold secondary market purchasers liable for a school's fraud or negligence. *See Crawford v. American Inst. of Prof'l Careers, Inc., 934 F. Supp. 335 (D. Ariz. 1996)* (state law claims against secondary purchasers deemed preempted by the HEA; court agreed that purchasers could not comply with state law and the anti-discrimination provisions of the HEA, which require purchasers to purchase certain loans without any independent oversight or control over school programs; no separate fraud or wrongdoing alleged against purchaser in this case).

(n13)Footnote 13. *See* Shorter v. Riley, Clearinghouse No. 47,950B (N.D. Ga. Nov. 18, 1993); Tillis v. Bank of Am., Clearinghouse No. 49,932 (Cal. Super. Ct. Nov. 17, 1993).

(n14)Footnote 14. Shorter v. Alexander, Clearinghouse No. 47,950 (N.D. Ga. Dec. 8, 1992). *See also § 12.09[4] infra* (discussion of preemption of state statutes). *But see Bartels v. Alabama Commercial Coll., 918 F. Supp. 1565 (S.D. Ga. 1995)* (only relationship between guarantors or secondary market holders and school were functions required by the HEA; liability based on such functions would conflict with the HEA; court never considered whether there were special functions delegated by the originating lender to the school), *rev'd on other grounds, 54 F.3d 702 (11th Cir. 1995)* ; *Bogart v. Nebraska Student Loan Program, 313 Ark. 656, 858 S.W.2d 78 (1993)* (court finds that federal law preempts state law claim based on agency, the students apparently not bringing to court's attention various federal court rulings limiting preemption).

(n15)Footnote 15. *See Tipton v. Secretary of Educ., 768 F. Supp. 540 (S.D. W. Va. 1991)* .

(n16)Footnote 16. *See § 12.09[4] supra.*

(n17)Footnote 17. *55 Fed. Reg. 40,120* (Oct. 1, 1990) .

(n18)Footnote 18. *See, e.g.,* Letter from Acting Assistant Secretary Whitehead to Congressman Stephen Solarz, Clearinghouse No. 44,343 (May 19, 1988).

(n19)Footnote 19. *See, e.g., Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc., 84 F.3d 1452 (D.C. Cir. 1996)* (ruling on state law claims must first determine whether district court should exercise pendent jurisdiction and consider possibility of declaratory relief; if district court decides to proceed, it must revisit state law issues as to which state law applies, whether provision is preempted by federal law, and interpretation of state law), *on remand, 950 F. Supp. 1 (D.D.C. 1996)* (court maintained jurisdiction of pendent claims and found case to be appropriate for declaratory relief), *on further remand, 980 F. Supp. 53 (D.D.C. 1997)* (court determined that California law controls and invited plaintiff to amend complaint to assert claims and defenses under California consumer protection laws), *aff'd, 168 F.3d 1362 (D.C. Cir. 1999)* ; *Jackson v. Culinary Sch. of Washington, Ltd., 27 F.3d 573 (D.C. Cir. 1994)* , *vacated on other grounds, 115 S. Ct. 2573 (1995)* (appellate court used *de novo* instead of abuse of discretion standard to review district court's decision to decide state law issues in declaratory judgment action), *remanded to district court on state law claims, 59 F.3d 254 (D.C. Cir. 1995)* (to determine on what basis federal court decided to rule on state law issues); *Tipton v. Secretary of Educ., 768 F. Supp. 540 (S.D. W. Va. 1991)* ; Wilson v. Manufacturers Hanover Trust Co., Clearinghouse No. 45,921 (W. Va. Cir. Ct. Sept. 25, 1990).

Two cases have ruled otherwise: *Graham v. Security Sav. & Loan, 125 F.R.D. 687 (N.D. Ind. 1989)* , sub nom. *Veal v. First Am. Sav. Bank, 914 F.2d 909 (7th Cir. 1990)* ; Molina v. Crown Bus. Inst., Clearinghouse No. 45,920 (N.Y. Sup. Ct. Sept. 1990). *See also Tipton v. Secretary of Educ., 768 F. Supp. 540 (S.D. W. Va. 1991)* .

(n20)Footnote 20. *Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc., 84 F.3d 1452 (D.C. Cir. 1996)* (ruling on state law claims must first determine whether district court should exercise pendent jurisdiction and consider possibility of declaratory relief; if district court decides to proceed, it must revisit state law issues as to which state law applies, whether provision is preempted by federal law, and interpretation of state law), *on remand, 950*

F. Supp. 1 (D.D.C. 1996) (court maintained jurisdiction of pendent claims and found case to be appropriate for declaratory relief), *on further remand, 980 F. Supp. 53 (D.D.C. 1997)* (court determined that California law controls and invited plaintiff to amend complaint to assert claims and defenses under California consumer protection laws), *aff'd, 168 F.3d 1362 (D.C. Cir. 1999)* ; Hernandez v. Alexander, Clearinghouse No. 46,792 (D. Nev. May 18, 1992); *Jackson v. Culinary Sch. of Washington, 788 F. Supp. 1233 (D.D.C. 1992)* ; *Tipton v. Secretary of Educ., 768 F. Supp. 540 (S.D. W. Va. 1991)* ; *Bogart v. Nebraska Student Loan Program, 313 Ark. 656, 858 S.W.2d 78 (Ark. 1993)* .

(n21)Footnote 21. A good enunciation of this policy is found in a letter from Acting Assistant Secretary Whitehead to Congressman Stephen Solarz, Clearinghouse No. 44,343 (May 19, 1988). H.R. Conf. Rep. No. 102-630, at 508 (1992).

(n22)Footnote 22. *Jackson v. Culinary Sch. of Washington, Ltd., 27 F.3d 573 (D.C. Cir. 1994)* , *vacated on other grounds*, *115 S. Ct. 2573 (1995)* (appellate court used *de novo* instead of abuse of discretion standard to review district court's decision to decide state law issues in declaratory judgment action), *remanded to district court on state law claims, but affirming ruling on origination*, *59 F.3d 254 (D.C. Cir. 1995)* (to determine on what basis federal court decided to rule on state law issues); *see also Bartels v. Alabama Commercial Coll., 918 F. Supp. 1565 (S.D. Ga. 1995)* , *rev'd on other grounds*, *54 F.3d 702 (11th Cir. 1995)* .

(n23)Footnote 23. *Morgan v. Markerdowne Corp., 976 F. Supp. 301 (D.N.J. 1997)* ; *Tipton v. Secretary of Educ., 768 F. Supp. 540 (S.D. W.Va. 1991)* . *See also* Hernandez v. Alexander, Clearinghouse No. 46,792 (D. Nev. May 18, 1992); Alberto v. School of Bus. Machs., Clearinghouse No. 46,755 (N.J. Super. Ct. July 26, 1991); *Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc., 84 F.3d. 1452 (D.C. Cir. 1996)* (ruling on state law claims must first determine whether district court should exercise pendent jurisdiction and consider possibility of declaratory relief; if district court decides to proceed, it must revisit state law issues as to which state law applies, whether provision is preempted by federal law, and interpretation of state law), *on remand*, *950 F. Supp. 1 (D.D.C. 1996)* (court maintained jurisdiction of pendent claims and found case to be appropriate for declaratory relief), *on further remand*, *980 F. Supp. 53 (D.D.C. 1997)* (court determined that California law controls and invited plaintiff to amend complaint to assert claims and defenses under California consumer protection laws), *aff'd*, *168 F.3d 1362 (D.C. Cir. 1999)* .

(n24)Footnote 24. *See, e.g.,* Letter from Acting Assistant Secretary Whitehead to Congressman Stephen Solarz, Clearinghouse No. 44,343 (May 19, 1988).

(n25)Footnote 25. The following is a fairly current list of states which have state tuition recovery funds, including contact information:

- *Arizona*: Student Tuition Recovery Fund, 1400 W. Washington, Suite 260, Phoenix, AZ 85007. (602) 542-5709.

- *Arkansas*: State Board of Higher Education, 114 E. Capital, Little Rock, Ark. 72201. (501) 371-2000.

- *California*: Bureau for Private Postsecondary and Vocational Education, California Department of Consumer Affairs, Student Tuition Recovery Fund, 400 R Street, Suite 5000, Sacramento, CA 95814. (916) 445-3427.

- *Connecticut*: Department of Higher Education, P.O. Box 2219, Hartford, CT 06145.

- *Delaware*: Department of Education, 401 Federal St., P.O. Box 1402, Dover, DE 19903-1402. (302) 739-4601.

- *Georgia*: Tuition Guaranteed Trust Fund, 2189 N. Lake Pkwy, Bldg. 10, Suite 100, Tucker, GA

30084. (770) 414-3300.Non-Public Post Secondary Commission, 2100 E. Exchange Pl. #203, Tucker, GA 30303. (770) 414-3302.

- *Louisiana*: Student Protection Fund, P.O. Box 94064, Baton Rouge, LA 70804-4064.

- *Maryland*: Guaranteed Student Tuition Fund, 16 Francis St., Annapolis, MD 21704.

- *Massachusetts*: Board of Cosmetology, 239 Causeway Street, Boston, MA 02114. (617) 727-3067. Board of Higher Education, One Ashburton Pl, Suite 1401, Boston, MA 02108. (617) 727-7785. Private Postsecondary Schools, 350 Main St., Malden, MA 02148.

- *Nebraska*: Department of Education, 310 Centennial Mall South, Lincoln, NE 68509. (402) 471-2295.

- *Nevada*: State Board of Cosmetology, 1785 E. Sahara Ave., Suite 255, Las Vegas, NV 89104. (702) 486-6542. Student Tuition Indemnification Fund, 1820 E. Sahara, Suite 111, Las Vegas, NV 89104.

- *New Mexico*: Commission on Higher Education, 5301 Central Northeast, Suite 1500, Albuquerque, NM 87108. (505) 841-6611. State Board of Barbers and Cosmetologists, 1599 St. Francis Dr., P.O. Box 251, Santa Fe, NM 87504. (505) 827-7550.

- *New York*: Tuition Reimbursement Account, 116 W. 32d St., 14th Floor, New York, NY 10001. (212) 643-4760.

- *Ohio*: Student Tuition Recovery Authority, 35 East Gay St., Suite 403, Columbus, OH 43215. (614) 446-2752.

- *Oklahoma*: Board of Private Vocational Schools, 2200 North Classen Blvd, Oklahoma City, OK 73106. (405) 521-2225.

- *Oregon*: Tuition Protection Fund, 255 Capital Street, NE, Salem, OR 97310-0203. (503) 378-3600. www.ode.state.or.us.

- *Tennessee*: Tuition Guarantee Fund, 404 James Robertson Parkway, Suite 1900, Nashville, TN 37243. (615) 741-5293.

- *Texas*: Tuition Protection Fund, 101 East 15th St., Austin, TX 78778. (512) 936-3253.

- *Vermont*: Career and Lifelong Learning Department, 120 State St., Montpelier, VT 05620. (802) 828-5139. Vermont State Board of Cosmetology, 109 State St., Montpelier, VT 05609. (802) 828-2373.

- *Virginia*: Student Tuition Recovery Fund, P.O. Box 2120, Richmond, VA 23218. (804) 225-2848.

- *Washington*: Tuition Recovery Trust Fund, P.O. Box 43105, Olympia, WA 98504-3105. (360) 753-5673.

(n26)Footnote 26. *Cal. Educ. Code § 94944(a)(1)(A)(iv)*. The Act is scheduled to be repealed as of January 1, 2005. *See Cal. Educ. Code § 94999*.

(n27)Footnote 27. *Cal. Educ. Code § 94944(a)(2)*.

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PART I Consumer Credit
CHAPTER 12 Student Loans and Trade School Abuses

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§ 12.10 Consumer Claims Against Scholarship Finders

A newly popular form of consumer abuse occurs where companies take advance payments from consumers in order to find them scholarships and grants. These companies sometimes make their pitch by sending high school and college students postcards advertising that, for an advance fee, they can find "unclaimed" scholarship and grant funds from private sources. When a company cannot get a consumer to send money in advance, it may discover the consumer's checking account number and take money out of the account with an unauthorized demand draft or telecheck. n1

Most of these bogus scholarship-finding companies promise to refund their fee if the student does not receive a minimum amount of aid, but quite frequently provide neither the promised financial aid not the promised refunds. n2 In some situations, the companies may also claim a refund is not owing because contractual small print places onerous conditions on receiving the monies. n3

Even where the companies do provide information, it may consist solely of lists of financial aid sources to which students must apply on their own. n4 One company recently agreed to stop its practice of selling employment and financial aid directories that they misrepresented as programs guaranteeing students with free room, board, and transportation or free financial aid. n5

Legal Topics:

For related research and practice materials, see the following legal topics:
Education LawAdministration & OperationStudent Financial AidPrivate Scholarships

FOOTNOTES:
(n1)Footnote 1. FTC v. Student Aid, Inc., 5 *Trade Reg. Rep. (CCH) P 24,312 (S.D.N.Y. 1997)* (proposed consent decree).

(n2)Footnote 2. FTC v. National Scholarship Found., Inc., 5 *Trade Reg. Rep. (CCH) P 24,512 (S.D. Fla. 1998)* (order for permanent injunction); FTC v. Deco Consulting Servs., Inc., 5 *Trade Reg. Rep. (CCH) P 24,363 (S.D. Fla. 1998)* (consent decree); FTC v. National Grant Found., Inc., 5 *Trade Reg. Rep. (CCH) P 24,427 (S.D. Fla. 1998)* (proposed consent decree); FTC v. Coll. Assistance Servs., Inc., 5 *Trade Reg. Rep. (CCH) P 24, 357 (S.D. Fla. 1998)* (proposed consent decree); FTC v. Career Assistance Planning, Inc., 5 *Trade Reg. Rep. (CCH) P 24,253 (D. Md. 1997)*

(proposed consent decree).

(n3)Footnote 3. FTC v. Student Aid, Inc., 5 *Trade Reg. Rep. (CCH) P 24,312 (S.D.N.Y. 1997)* (proposed consent decree).

(n4)Footnote 4. FTC v. National Grant Found., Inc., 5 *Trade Reg. Rep. (CCH) P 24,427 (S.D. Fla. 1998)* (proposed consent decree).

(n5)Footnote 5. FTC v. Progressive Media, Inc., 5 *Trade Reg. Rep. (CCH) P 24,304 (W.D. Wash. 1997)* (proposed consent decree).

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§ 13.01 Introduction

Few events are more devastating to a family than the loss of a home to foreclosure; children may be forced to change schools and leave friends; a family may be distanced from workplaces and social support. The homeowner's equity is often lost as a result of a foreclosure sale, and it is not unusual for the foreclosed homeowner to find that he or she is personally liable for a large deficiency. Wages may be threatened to pay the deficiency judgment, further contributing to the family's financial distress. Shortly after the foreclosure, the family may be summarily evicted from the home, although some states provide a waiting period (redemption period) before an eviction can take place. Affordable replacement housing can be difficult to find, particularly for a family already in financial straits.

The strategies discussed in this chapter are designed to prevent foreclosures, whenever possible, and, alternatively, if prevention is not possible, to postpone a foreclosure long enough to allow the family to find appropriate housing.

It is important to note from the outset that none of these strategies *alone* are likely to save a home. Rarely will litigation fully resolve the family's problem. Some legal defenses may reduce the amount owed or may cause a delay in the foreclosure process. Eventually, however, the homeowner will probably be left with some debt which must be paid. At that point, the homeowner must be able to cure the default, to arrange a negotiated restructuring, to refinance, or to force a cure through the bankruptcy process.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingMortgages & Other Security InstrumentsForeclosuresGeneral Overview

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§ 13.02 The Foreclosure Process Generally

[1] Introduction

Foreclosure procedures are wholly determined by state law, the details of which vary from state to state. n1 The two most common methods of foreclosure in this country are judicial foreclosure and nonjudicial foreclosure by "power of sale." All states have a procedure for judicial foreclosure and some states require that mortgages be foreclosed only by judicial process. States which permit foreclosure by power of sale have enacted statutes regulating such foreclosures.

Most states have added varying levels of protection for the homeowner to the statutory foreclosure process. Some states permit a homeowner to "cure" a default by paying the installments due and any costs of the foreclosure to reinstate the loan. All states allow the homeowner to "redeem" the mortgage by paying off the total outstanding debt before the sale, or, in some states, by paying the purchase price, plus costs and interest, to the purchaser within a time certain after the sale. A few states have developed mortgage assistance programs in response to plant closings and high rates of foreclosures involving laid-off workers.

[2] Judicial Foreclosure

In approximately half of the states, mortgages are always foreclosed by judicial action, either because of state law requirements or local custom. In these states, the lender must file an action in court, usually in the county where the property is located, to obtain a judicial decree authorizing a foreclosure sale. Generally, to obtain a judgment, the lender must prove that there is a valid mortgage between the parties, that the borrower is in default on the mortgage, and that the proper procedure has been followed. The homeowner then has an opportunity to raise procedural and substantive defenses to the foreclosure, such as tender of the payments due, the lender's fraud, usury, invalidity of the mortgage, and Truth in Lending Act ("TILA") violations. In addition, certain technical procedural defenses may be available, such as lack of jurisdiction, lack of joinder of necessary parties, insufficiency of service of process, and improper pleading. If the court concludes, after considering any defenses, that there has in fact been a default and that the lender has the legal right to foreclose, the court will determine the total amount owed and may set a deadline for a redemption, if redemption is available. If this amount is not paid by the deadline set by the court, the foreclosure will proceed, usually according to local rules and/or statutes governing foreclosure sales.

The court's decree of foreclosure may provide that additional notice of the foreclosure sale be given according to the

decree. Typically, the sale is conducted by the sheriff or other public officer appointed by the court. In many states, after the sale, the court must review the sale procedures and confirm the sale.

[3] Nonjudicial, "Power of Sale" Foreclosure

In twenty-six states, and the District of Columbia, foreclosing lenders are permitted to sell the mortgaged property at a foreclosure sale without filing a court action. n2 In these jurisdictions, foreclosures are accomplished by the lender's exercise of the "power of sale" contained in the mortgage (or deed of trust). That is, the original mortgage contains a clause stating that in the event of a default in payments or other breach, the holder of the mortgage may conduct a sale of the property after giving notice as required by the terms of the mortgage or applicable statute. Generally, notice of the sale is followed by a sale by an auctioneer, sheriff, or a public official.

Notice requirements differ from state to state. Most states require that notice of the sale be mailed, by registered or certified mail, to the homeowner, though some do not. Nearly all states require some form of public notice either by legal advertisement in a newspaper or posting in a public place. Some states require that notice also be given to junior lienors, taxing authorities, and other persons with an interest in the property.

Because notice requirements vary so much from state to state, it is important to check the local notice requirements carefully, as well as any notice requirements contained in the mortgage. Courts have held that a lender's failure to comply strictly with notice requirements may render the sale void. n3

To contest a foreclosure by power of sale, the homeowner must file an affirmative action and request an injunction to stop the sale. n4 Otherwise, there is no judicial involvement at all in the foreclosure. Most courts require that a bond be posted prior to the issuance of any injunctive relief.

A further disadvantage faced by consumers required to file an action to stop a foreclosure, rather than defend against a lender's action, is that some claims against the lender may be beyond the applicable statute of limitations. When a foreclosure is by judicial action, even time-barred claims can arguably be raised defensively to reduce the amount of the plaintiff's claim. These arguments may not be equally available in an affirmative injunctive action to prevent a foreclosure. However, some courts have allowed borrowers to raise time-barred claims in affirmative suits in power of sale jurisdictions on the theory that these actions are actually "defensive" in nature. That is, they are brought not in response to a lender's foreclosure, but, because the foreclosure is conducted extra judicially, it is the borrowers who have to initiate court action. n5 Additionally, a number of bankruptcy courts have also allowed debtors to raise time-barred claim in response to a lender's proof of claim. n6

[4] Other Methods of Foreclosure

There are two other, less common methods of foreclosure: strict foreclosure and foreclosure by entry and possession.

Strict foreclosure is allowed in only two states, Connecticut and Vermont. The lender in these jurisdictions must go to court to get a court order declaring the borrower to be in default of the mortgage. Title to the property then shifts to the lender. The borrower can redeem by paying the balance of the loan by a date set by the court. With strict foreclosure, there is no sale. The results of a strict foreclosure are grossly unfair to borrowers where the property is worth more than the amount of the debt. The foreclosing lender gets title without regard to the amount owed. Borrowers lose all of their equity and the lender gets a windfall.

With foreclosure by entry and possession, the lender physically enters onto the property and takes constructive possession of the property. This method is used in Maine, Rhode Island, and New Hampshire, and in Massachusetts in conjunction with foreclosure by power of sale. Entry and possession is usually used as a supplemental procedure to termination of an owner's rights by exercise of a power of sale.

[5] Right to Cure a Default

At least 19 states, and the District of Columbia, provide by statute that the borrower can cure a default in payments by paying the amount due, plus any permissible costs and fees, by a time certain before the sale. n7 This amount would only include payments due up to the date of the cure (including interest), but not future payments or accelerated payments. If the borrower becomes current in his or her obligations by the cure deadline, the foreclosure is stopped and the mortgage is reinstated. Some states place limits on the number of times a homeowner can take advantage of the right to cure. Other state statutes provide that the foreclosure action shall be stayed upon payment of the installments due, but that if a new default occurs within a certain time period, the action may be reinstated. The time period during which the homeowner can cure the default varies from state to state.

Failure to give notice of a statutory right to cure, even where the homeowner has actual notice of the amount needed to cure, may render the foreclosure defective as a matter of law. n8

Many mortgages also provide a contractual right to cure a default in payments within a specified period of time. Certain mobile home loans are covered by a federal 30-day right to cure.

When a borrower cannot cure within the statutory period, but can cure in installments within a "reasonable time" while also making current payments, a chapter 13 bankruptcy may be advisable. Since bankruptcy is governed by federal law, this option is available in all states.

[6] Redemption

All states allow the homeowner to redeem the mortgage by paying the total outstanding balance, including costs, prior to the sale. The homeowner may be able to exercise this equitable right of redemption by taking a new loan to pay off the defaulted loan, selling the home and repaying the mortgage from the proceeds, or by selling the redemption right. n9 In some states, homeowners also have a "statutory right of redemption" from the sale under which the right of redemption continues for a set period of time after the sale. The borrower redeems under the statutory right of redemption by paying (or finding a buyer to pay) the total purchase price, plus interest and any allowable costs to the foreclosure sale purchaser. n10 Some statutes also permit lienors or other interested parties to redeem the mortgage. In most "power of sale" foreclosure jurisdictions, any right of redemption is foreclosed by the exercise of the power of sale.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingMortgages & Other Security InstrumentsForeclosuresJudicial ForeclosuresReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresPrivate Power-of-Sale ForeclosureReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresStrict ForeclosureReal Property LawFinancingMortgages & Other Security InstrumentsRedemptionMortgagor's RightReal Property LawFinancingMortgages & Other Security InstrumentsRedemptionStatutory Redemption

FOOTNOTES:
(n1)Footnote 1. *See Harbor Funding Corp. v. Kavanagh, 666 A.2d 498 (Me. 1995)* (law of situs of property governs foreclosure; mortgage provision choosing foreign state's law did not govern foreclosure of real property located in Maine).

(n2)Footnote 2. For a complete listing of these laws, see National Consumer Law Center, Foreclosures, App. C (2d ed. 2007 and Supp.).

(n3)Footnote 3. *See, e.g., Independence Fed. Sav. Bank v. Huntley, 573 A.2d 787 (D.C. 1990) , cert. denied, 498*

U.S. 853, 111 S. Ct. 148, 112 L. Ed. 2d 114 (1990) (borrower's actual receipt of foreclosure notice did not excuse bank's failure to strictly comply with statutory notice requirements); *Cummings v. Anderson (In re Cummings), 173 B.R. 959 (Bankr. N.D. Ga. 1994)* (advertisement of sale by assignor of note violated statutory notice requirements because assignor did not conduct sale; sale set aside), *aff'd without op., 112 F.3d 1172 (11th Cir. 1997)* ; *Abdel-Kafi v. Citicorp Mortgage, Inc., 772 A.2d 802 (D.C. 2001)* (notice of foreclosure sale invalid when mortgagee sent notice to wrong address). *In re Kitts, 274 B.R. 491 (E.D. Tenn. 2002)* (foreclosure sale void where there was a failure to comply with notice provisions in deed of trust).

(n4)Footnote 4. *See Plein v. Lackey, 67 P.3d 1061 (Wash. 2003)* (obtaining restraining order or injunction to restrain a trustee's sale is the only means by which a home owner may stop a sale once foreclosure has begun).

(n5)Footnote 5. *See* National Consumer Law Center, Foreclosures, § 4.2.3 (2d ed. 2007 and supp.).

(n6)Footnote 6. *See, e.g., In re Coxson, 43 F.3d 189 (5th Cir. 1995)* .

(n7)Footnote 7. *See* National Consumer Law Center, Foreclosures, App. C (2d ed. 2007 and supp.).

(n8)Footnote 8. *Bank-Fund Staff Fed. Credit Union v. Cuellar, 639 A.2d 561 (D.C. 1994)* (notice fatally defective, foreclosure laws are to be construed in favor of homeowners); *Marra v. Stocker, 532 Pa. 187, 615 A.2d 326 (1992)* (failure to comply with state statutory obligation to provide notice describing right to cure renders sale invalid); *Moet II Inc. v. McCarthy, 646 N.Y.S.2d 64 (N.Y. App. Div. 1996) . But see Fidelity Bank v. Krenisky, 72 Conn. App. 700, 807 A.2d 968 (Conn. App. 2002)* (notice of default was legally sufficient to permit action for foreclosure even though it did not inform the mortgagors of their right to reinstate the mortgage, where the mortgagors had actual notice of that right).

(n9)Footnote 9. *But see Flynn v. Korneffel, 451 Mich. 186, 547 N.W.2d 249 (1996)* (payment of redemption amount into escrow account was not redemption under statute), *reh'g denied, 453 Mich. 1201, 551 N.W.2d 163 (1996)* .

(n10)Footnote 10. *See Watts v. Rudulph Real Estate, 675 So. 2d 411 (Ala. 1996)* (where foreclosure sale purchaser did not act with due diligence in providing itemized statement of costs to owner of right to redeem, owner was excused from compliance with 10-day limit on surrendering property in order to redeem).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.03

§ 13.03 Prelitigation Strategies: Negotiating a Workout Agreement and Other Tactics to Avoid Foreclosure

[1] The Changing Climate for Workouts

In the past several years, the dynamic for negotiating pre-foreclosure workout agreements for low and moderate income homeowners has begun to improve. The banking industry has slowly and ponderously begun the process of liberalizing its approach to homeowner defaults.

The system is far from perfectly responsive, but especially given the recent spate of bad Supreme Court case law on bankruptcy, some homeowners will now do better with a negotiated agreement than with a straightforward cure of arrears in chapter 13.

[2] Breaking Down the Amount of the Default

An understanding of existing loan terms and the amount of the default is essential to a workout negotiation. A high interest rate, for example, might be negotiated down to market rates.

Obtaining a breakdown of the default between principal, interest, insurance escrow, tax escrow, foreclosure fees, and costs is also important. It is easier to negotiate forgiveness of interest than legitimate hard costs like escrow advances expended by the debtor. Additionally, in some cases, a breakdown of the default will reveal that some charges claimed are not proper. n1 Foreclosure fees and costs, for example, may be paid out to a lawyer on retainer, but not expended. The lender should recover unexpended fees and costs and deduct them from the arrears if a workout is achieved.

In 1990, Congress added a new section to the Real Estate Settlement Procedures Act ("RESPA"), which created a mechanism for borrowers to obtain answers from lenders or loan servicers to disputes they have about their accounts or to obtain corrections to their accounts where appropriate. The section, known as the Servicer Act, includes a private right of action to enforce its provisions. By invoking the protections of the Act, borrowers in default can challenge the amount of the claimed default and require the lender to respond promptly to the dispute. If the lender fails to meet its obligations, it will face liability for statutory damages and attorney's fees. n2 The Act applies to any servicer of a "federally related mortgage," which is broadly defined and includes most mortgages.

The loan "servicer" includes the entity responsible for servicing the loan (accepting payments, maintaining escrow

accounts, etc.) and the holder of the loan if the holder also services the loan. n3 Within sixty days of receipt of a "qualified written request" from the consumer, the servicer must conduct an investigation if an error is alleged; provide the information requested, if available; make any necessary correction to the account; and inform the consumer of its actions. n4

[3] Determining Whether Your Client Has Defenses to Repayment

In some cases, obtaining loan paperwork or talking to your client may uncover potential consumer defenses to collection, such as Truth in Lending ("TIL") violations, usury, fraud, or unfair and deceptive practices. Whenever possible, the client should not make an agreement to repay money to a lender when there is a substantial defense to repayment. When appropriate, legal claims can be used as bargaining chips for workouts either before or after legal action is commenced. A "qualified written request," under RESPA, provides an opportunity to obtain informal discovery and, if the error is correctable, to have the situation resolved without litigation.

[4] Knowing the Players

The mortgage holder is the entity which holds the borrower's mortgage. This is the party that has the right to foreclose. A high percentage of mortgages are now held by investors, including Fannie Mae or Freddie Mac. n5 When a mortgage is assigned upon sale in the secondary market, the mortgage is generally serviced by a bank or servicing company, which may or may not be the same as the originating lender. That entity is known colloquially as the " servicer ".

Unfortunately, one of the problems which has plagued the modern mortgage lending industry is unresponsive loan servicers. When a servicer is unresponsive to a workout proposal, it is appropriate to go over its head and complain directly to the mortgage holder. Fannie Mae, Freddie Mac and some institutional investors have loss-mitigation departments which will intervene, if pushed, to address a proposed workout. The applicable Fannie Mae offices are regional. n6 Freddie Mac's loss mitigation is done on a national basis. n7

The lender's attorney is also an agent with delegated authority to foreclose the mortgage. Mortgage insurance is increasingly common in residential mortgage transactions. If the borrower defaults, the mortgage insurer generally will pay the lender any monies not recouped in the foreclosure process. The mortgage insurer, therefore, has an interest in preventing foreclosure in many cases. It may, therefore, be helpful to keep the insurer informed about the work-out negotiations.

[a] Securitization

Mortgage holders package their loans as securities and sell the right to the future income stream to investors. These rights are pooled in a variety of different ways so that the income stream from a single loan may be divided up and sold as part of two or more different securities. Investments in mortgage securities are typically made by large institutions when the securities are issued, though they may be purchased after they are issued in the secondary market. n8

The majority of mortgage securities are issued and/or guaranteed by the Government National Mortgage Association (Ginnie Mae), or by government-sponsored enterprises (GSEs), the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Fannie Mae and Freddie Mac's servicing handbooks contain the workout guidelines for their loans.[nn] Almost all HUD-insured loans are securitized by Ginnie Mae. Ginnie Mae's policies and requirements may supplement HUD's policies in addressing defaults and loan workouts. Other loans are held by trusts, managed by trustees who act as fiduciaries for investors in the trust. The trust may outline the parameters of its loan workout policy in a transactional document called a pooling and servicing agreement.

Pooling and servicing agreements (PSA) broadly govern the servicing of loans in the trust, and the duties of the various parties to the trust agreement. The PSA may outline the loss mitigation or workout options available to the servicer and

the parameters of the servicer's authority to implement those options. It may be worthwhile for advocates to review this document if they are having trouble coming to an agreement with a servicer.

If the security was publicly sold, then the PSA is publicly available on the U.S. Securities and Exchange Commission's (SEC) website. n9 However, searching SEC-filed documents requires the name of the actual loan trust in which the consumer's loan is contained. n10

[b] RESPA Disclosure Requirements as to Identity of the Mortgage Holder and Servicer

Typically, a mortgage loan will be assigned or sold several times during its term, and may be held by one entity but serviced by another. To insure that borrowers know the identity of the lender or servicer, a provision of the RESPA requires that any person who makes a mortgage loan covered by RESPA n11 must disclose to each applicant at the time of application (in a format prescribed by the United States Department of Housing and Urban Development ("HUD")) n12 whether the servicing of the loan may be assigned, sold, or transferred at any time during the term of the mortgage. The notice must also include a statement of the consumer's rights when there is a dispute about the account as well as information about the consumer's right to notice in the event of a transfer of servicing. n13

If the servicing of a mortgage is actually transferred, the old (transferring) servicer must notify the consumer in writing 15 days before the effective date of the transfer. n14 Such a notice need not be given, however, if the lender provided it at closing. The new servicer must provide the identical notice to the consumer not more than 15 days after the effective date of the transfer. n15 Notices from the old and new servicer can be combined into one notice as long as it is sent to the consumer no later than 15 days before the effective date of the transfer. n16

If a consumer mistakenly sends a payment to the old servicer within a sixty-day period after the transfer, and the payment is received before the due date, no late fee can be imposed nor can the payment be treated as late for any other purposes. n17

Failure to comply with these requirements subjects a lender or servicer to actual damages, costs, and reasonable attorney fees for "each such failure." n18 If evidence also reveals a pattern or practice of noncompliance, the court may award "additional" damages for each violation up to $1,000. n19

[5] Relevance of the Homeowner's Equity Position and Ability to Make Lump Sum Payment

Mortgage holders tend to be most willing to discuss favorable workout terms for borrowers who have the least amount invested in their property. If there is substantial equity, lenders are generally eager to foreclose since they can buy the property at below market rates, resell for fair market value and keep the difference. Conversely, where there is little equity, foreclosure is likely to be a losing proposition for the lender, so that a workout is a better option.

One further incentive to build upon for a workout discussion is the availability of a lump sum toward the workout. Many mortgage holders will provide much more favorable workout terms to borrowers who have a lump sum saved toward curing the default.

[6] The Workout Agreement

[a] Knowing the Parameters of the Mortgage Holder's Policies

The most important part of a workout negotiation may be deciding what terms to request from the mortgage holder. There are a variety of workout terms available (and there is an infinite amount of inconsistent terminology used in the industry to describe those terms). A borrower should propose terms at least sufficient to address the economic problem which caused the default.

Most mortgage holders have written policies governing workouts. The scope of these policies differs from lender to lender.

Fannie Mae and Freddie Mac, as the largest investors in the mortgage marketplace, set the industry standards on workout options. The most important documents in the industry are Fannie Mae's *Selling and Servicing Guides* together with their periodic updates. The Fannie Mae *Single-Family Servicing Guide*, which includes a copy of the servicing contract between Fannie Mae and its vendors, is available on-line at www.allregs.com/efnma. n20 As Fannie Mae is the biggest purchaser of mortgages on the secondary market, their *Guides* and workout policies tend to be used generically by many servicers, as well as by some lenders acting for themselves. Fannie Mae also publishes a valuable book called *Foreclosure Prevention* that summarizes and explains Fannie Mae's workout policies. n21

Freddie Mac has its own multi-volume seller/servicer guide and publishes *Pursuing Alternatives to Foreclosure*.. The latter is not currently available directly to the general public. n22 It is not unreasonable to use the Fannie Mae publications as background for making workout proposals to Freddie Mac and its servicers. Freddie Mac's articulated policy is to consider all proposals.

In addition to the options discussed below, in certain circumstances both Fannie Mae and Freddie Mac will consider a charge-off of the loan instead of foreclosure. n23 A charge-off ceases collection efforts on a mortgage when the debt is deemed to be uncollectible. A small monetary delinquency that is deemed uncollectible accompanied by serious, uninsured damage to the property (i.e., natural disaster, presence of hazardous substance) may lead to a charge-off. All other workout options must be explored before a recommendation for a charge-off is considered. n24

[b] Requesting Delay of Foreclosure Sales

At the outset, the most important request may be for a delay of the foreclosure sale process long enough to make a workout application. A completed foreclosure sale will generally cut off all workout possibilities. In addition, as the foreclosure process moves forward, the mortgage holder continues to incur costs that will eventually have to be reimbursed by the borrower. These costs increase the amount the borrower must raise to cure the delinquency, and efforts should be made to keep costs to a minimum.

When an agreement to delay a sale is reached, it is essential to reduce it to writing. In most cases, a confirming letter should suffice unless the sale is a court-supervised process for which applicable procedural requirements must be met. n25 In addition, if the loan is transferred to a new servicer, any agreement with the former servicer should be reaffirmed in writing. n26 If an agreement to delay the sale is breached, the borrower may not have a remedy unless he or she can prove actual damages (such as reduced sale price) caused by the breach. n27 Whatever the process, it is a good idea to check and make sure that the sale is actually cancelled.

A lender may be liable for refusing a request to delay a foreclosure sale. The lender may have a duty to provide the homeowner with a reasonable delay to allow the homeowner to conduct a market sale of the property. Ideally, the homeowner should produce a buyer with a legally binding commitment to purchase the property at a price that would result in a full recovery of all money due to the lender, including costs. n28

[c] Industry-Sponsored Workout Plans

[i] HOPE NOW/ American Securitization Forum Plan

The mortgage industry, guided by Treasury Secretary Paulson, created a voluntary program to help consumers who have securitized subprime adjustable rate mortgages avoid foreclosure by temporarily freezing their interest rate at the initial level. n29 The plan sets up a streamlined procedure for processing loan modifications for borrowers who are current on their loan payments but in danger of default after the initial interest rate resets. These borrowers may be

offered a limited modification under which the interest rate will be kept at the existing rate, generally for a period of five years following the upcoming reset. Since the modification offered under the plan is a temporary rate freeze, attorneys are likely to obtain more substantial loan modifications for their clients in an individualized workout or litigation settlement.

The plan applies to securitized subprime residential ARM loans originated between January 1, 2005 and July 31, 2007 with an initial interest rate reset between January 1, 2008 and July 31, 2010. The subprime loan must be a first lien ARM with an initial fixed-rate period of thirty-six months or less. Loans referred to as "2/28s" and "3/27s" meet this description.

Only borrowers who are current with loan payments are eligible for help. In addition the borrower must currently occupy the property as a primary residence; have a mortgage payment which will go up by more than 10% at the upcoming reset; and meet credit score requirements. Finally, the loan-to-value ratio (LTV) must be greater than 97% (based on first lien only).

Some borrowers may receive this temporary rate freeze modification without signing a written agreement, by making two payments under the loan as modified, after receiving notice of the modified terms. Borrowers who unwittingly receive this limited temporary freeze modification may be precluded from later obtaining another modification.

[ii] Project Lifeline

On February 12, 2008 Treasury Secretary Paulson and six HOPE NOW alliance members announced the creation of Project Lifeline. n30 The project grants eligible borrowers a thirty-day delay in the foreclosure proceedings. The borrower must be at least ninety days delinquent, and not less than thirty days from a scheduled foreclosure sale, or in bankruptcy. Any type of loan product including subprime, Alt-A, and prime loans qualify for the program. Second liens and home equity loans are eligible. The project does not apply to properties that are vacant or bought as investment.

The stated purpose of the project is to pause in the foreclosure process so the borrower can be evaluated for a loan modification.

Project guidelines emphasize that the project is not a moratorium and borrowers will be evaluated for a delay of the proceedings or workout on an individual basis. Given that the delay is not automatic, borrowers should negotiate with the servicer for a more substantial delay of the foreclosure proceedings earlier in the process. n31

[iii] Loan Modification and Mediation

A growing number of states and localities are implementing foreclosure mediation programs to help homeowners avoid foreclosure. The mortgage industry is increasingly willing to modify loans, but, because servicers are insufficiently staffed, mediation is sometimes the only chance a homeowner has for serious negotiation over modifying a loan. State and local mediation programs vary widely in design.

Regardless of whether mediation is available, housing counselors and attorneys can help borrowers negotiate for a modification before the servicer initiates a judicial or non-judicial foreclosure action. The goal of a modification is usually to permanently reduce the monthly payment and make the loan affordable for the borrower. Common modifications are changing ARMs to fixed-rate loans, reducing interest rates, waiving late fees and other default-related charges, extending the loan term, and capitalizing any arrearage. n31.1 One of the most effective ways to reduce the monthly payment on a loan is for the mortgage holder to forgive a portion of the principal balance. This, however, is fairly rare despite evidence that mortgage lenders often sustain a greater financial loss by foreclosing than by agreeing to a sustainable loan modification. n31.2

Federal efforts to encourage the mortgage industry to modify more loans have produced the FDIC's "Mod in a Box" and "Making Home Affordable" Programs. n31.3 Both programs are voluntary and based on a net present value analysis (NPV) developed by the FDIC. n31.4 The NPV analysis takes into account the costs of foreclosure and the current property value to determine whether a proposed loan modification will be less expensive to the mortgage holder than foreclosure. Mod in a Box also includes a set of guidelines for modifying a loan to reach an affordable payment based on the borrower's income. The program, however, is entirely voluntary and may be applied at the servicer's discretion on a loan-by-loan basis.

The Making Home Affordable program is similar but requires servicers to sign a contract with the Treasury Department and offers incentive payments for each modification. Under the contract, servicers must grant qualified borrowers a modification under the program guidelines upon request. Servicers must also review all loans in their portfolio for potential eligibility then notify borrowers to submit additional documentation. It is unclear how effectively servicers will notify potentially eligible borrowers. The list of servicers that have signed contracts to participate in Making Home Affordable includes many of the largest servicers. n31.5

[d] Potential Mortgage Workout Terms

[i] Traditional Payment Agreements

A payment agreement (a/k/a forbearance agreement, reinstatement agreement, or deferral agreement) involves curing a default by making regular monthly mortgage payments as they are due, together with partial monthly payment on the arrears.

The homeowners most likely to benefit from this type of payment agreement are those who have experienced temporary financial difficulties which are now resolved. The homeowners need to have some excess income in their budget to commit to the mortgage beyond the regular monthly payment. Until recently, most mortgage holders limited payment agreements to no more than one year for reinstatement. Agreements up to 24 months are now common. Time periods of 36 and even 48 months are also possible, although the servicer must get special approval from the mortgage holder.

One pitfall to this type of arrangement is that it may fail to account for the extra initial expenses associated with recovery from temporary financial difficulties.

[ii] Temporary Interest Rate Reduction

A temporary interest rate reduction may be available to help homeowners who have ongoing financial problems which are likely to be temporary in nature, but which preclude full payment of the mortgage for a foreseeable period of time.

Typically, rates can be reduced fairly easily to the market rate of interest or, with some cause shown, below market. Fannie Mae may be willing in appropriate cases to lower rates as far as 3%.

[iii] Recasting of Missed Payments

A similar provision for temporary mortgage relief is known as recasting (a/k/a deferral). Recasting involves canceling missed payments and adding the obligation to make those payments to the end of the loan term. Because of changes in mortgage accounting practices, most large institutional lenders (including Fannie Mae and Freddie Mac) no longer consider recasting. Where this option remains available, the mortgage holder is usually unwilling to recast more than six monthly payments.

[iv] Permanent Modification of Loan Terms

In some cases, mortgage holders will agree to permanent changes in loan terms, such as permanent interest rate

reduction, extension of the loan's payment period, reamortization, cancellation of principal, or a combination of all four.

[v] Modification of Securitized Loan

The majority of mortgage securities are issued and/or guaranteed by Ginnie Mae, Fannie Mae and Freddie Mac. Modifications are permitted under Fannie Mae and Freddie Mac servicing guidelines. For the most part, many other prime and subprime mortgage-backed securities pooling and servicing agreements (PSA) permit loan modifications if the loan is in default or if the servicer determines that default is reasonably foreseeable. A few transactions limit the number of loan modifications to no more than 5% or 10% of the total pool. If the PSA contains such a restriction, and if the servicer has hit the cap, the modified loan may have to be removed from the loan pool. Other restrictions, and the parameters of the servicer's authority to implement workout proposals, will be outlined in the PSA. n32

[vi] Other Creative Workout Terms

Some mortgage holders will consider other offers of workouts involving temporary or permanent relief, even if they are highly creative, such as deferral or subordination of a portion of the principal in favor of a home equity loan for emergency home repairs, cancellation of accrued arrears, or substitution or surrender of alternative collateral in exchange for a modification. n33

[vii] Presales and Other Disposition of Property

The lending industry lumps a variety of other alternatives to foreclosure together under the rubric of "presales." Generally, this means that the property is sold or otherwise transferred, rather than foreclosed.

[viii] Sales for Fair Market Value

In many cases, it is in the homeowner's interest to sell the property rather than to have it foreclosed, since the property is likely to sell for a higher price through a realtor than in the foreclosure process. This is especially true for homeowners who have substantial equity and little likelihood of being able to afford reinstatement or modification of their loan. The homeowner then gets any other proceeds of the sale above the amount of any liens on the property.

The common form of such an agreement requires the homeowner to agree to list the property with a realtor immediately. The mortgage holder generally reserves the right to approve the sale, but will always do so if the sale price is sufficient to cover the amount due on the mortgage. Good faith efforts to market and sell the property are generally required. A time limitation is also typical, usually no more than six months. Of course, if the property can be sold for the amount due before foreclosure is complete, the homeowner can tender full payment on the claim from the sale proceeds in order to vitiate the foreclosure sale. However, if additional time to find a buyer or complete the sale is necessary, the lender must agree to postpone the sale for a period of time.

[ix] Short Sales

Some mortgage holders, particularly in a depressed real estate market, will agree to allow property to be sold through a realtor rather than foreclose, even if the proceeds of the sale will not cover the amount due on the mortgage. This is called a "short" sale.

It rarely makes sense for a consumer to complete a short sale if the lender does not agree to waive any deficiency. However, some lenders will require that a homeowner make a partial cash payment on the deficiency as a condition of the sale. All lenders will request a financial statement to make sure that the deficiency claim they are releasing would have limited economic value. A few lenders that own properties for which foreclosure makes little sense (e.g., in neighborhoods where resale would be time consuming and expensive) will provide incentives for the homeowner or a realtor to arrange a short sale. HUD's short sale program, for example, provides latitude for a servicer to make payments

to the homeowner in order to encourage short sales.

In most communities there are realtors that specialize in arranging short sales. In order to earn a sales commission, these realtors will often deal with the details necessary to obtain lender approval.

[x] Mortgage Assumptions and Other Transfers

Some mortgages can be assumed (taken over) by a third party. A mortgage is always assumable if the contract documents say it is or, in most states, if the documents are silent on this issue. Other mortgages contain a "due on sale" provision, a clause specifying that transfer of the property accelerates the full loan balance. There are a number of situations in which assumption can take place despite attempts by the mortgage holder to enforce a due on sale provision.

Some mortgage holders also refer to deeds in lieu of foreclosure and refinancings by third party lenders as presales.

[xi] Negotiating an Affordable and Sustainable Loan Modification

[A] Introduction

Over the past few years, the financial services industry and the federal government have launched several voluntary efforts to modify loans en masse. Unfortunately, these voluntary efforts did not result in homeowners being offered modifications that were realistic or sustainable over the long-term. Not surprisingly, many homeowners have re-defaulted under these unrealistic and burdensome modification terms.

There are several structural barriers in the mortgage servicing industry that discourage loan modifications. The most visible problem is the lack of adequate staff to properly respond to consumers' requests for loan modifications or other types of workouts. Homeowners have a very difficult time finding a live person who can provide reliable information about the loan account and who has authority to make modification decisions. Once the homeowner makes contact with the servicer's representative, an appropriate loan modification may remain elusive due to the terms of the pooling and servicing agreement, which govern most subprime mortgage securitizations. Some pooling and servicing agreements give servicers the ability to modify loans, while others cap loan modifications by a number or percentage of outstanding balance in the loan pool. n34.1

Despite the barriers, modifying the terms of a mortgage can be an effective way to reform an unaffordable mortgage and prevent foreclosure. For homeowners who received mortgages with abusively high interest rates or who now owe more on the mortgage than the fair market value of the property, a modification that combines interest rate and principal reductions may be the only way to restore long-term stability. Modifications that do not reduce the amount owed, and certainly those that do not even reduce monthly payments, will delay, but not prevent, foreclosures. To better assist homeowners, advocates should understand and use the tools, such as the net present value analysis, that are used by servicers to evaluate whether modifications are a good value for investors.

[B] The Net Present Value Analysis

Most securitization documents allow the servicer to modify the terms of a mortgage loan if it is in the best interest of investors. n34.2 To determine what is in the best interest of investors, servicers will perform a net present value test. Once the terms of the proposed modification are established, the net present value of the money the investor would receive under the proposed modification is compared with what would be received if no modification were made. If the servicer can expect a greater return from modifying the mortgage, then the servicer should modify and not foreclose on the mortgage. In other words, a modification will be less costly to investors than foreclosing on the property. Leading investor representatives have stated that servicers should perform loan modifications when a proposed loan modification "passes" a net present value test. n34.3

[C] Making Home Affordable Modification Program Net Present Value Test

The Making Home Affordable Modification Program n34.4 requires servicers to perform a net present value test on loans that are at least sixty days delinquent or at risk of default. If the servicer can expect a greater return from modifying the mortgage then the modification is considered to be "net present value positive" and the servicer must modify the mortgage absent fraud or a prohibition in the securitization contracts. If contractual agreements (such as pooling and servicing agreements) restrict participation in the program, servicers are required to use reasonable efforts to obtain waivers or approvals from the parties.

If the test produces a "net present value negative" because the projected return would be greater without a modification, the servicer has the option to modify the loan in its discretion. If the mortgage is serviced for a third-party investor, the servicer must obtain the investor's express permission. Details of the specific factors considered under the net present value test for the Making Home Affordable Modification Program have not yet been released. The Department of Treasury has prepared an illustrative spreadsheet, but neither that spreadsheet nor the numbers used for the re-default rate, home appreciation forecast, or REO stigma are publicly available.

The FDIC's spreadsheet is publically available on the Internet at www.fdic.gov/consumers/loans/loanmod/NPV.xls and incorporates a net present value analysis, and is a good tool to use when analyzing the benefits of a loan modification. n34.5

[e] Workout Options for HUD, VA and RHS Loans n34

The regulations and guidelines issued by HUD require that HUD-insured lenders consider alternatives to foreclosure within ninety days of the date of default. n35 However, HUD does not require that mortgagees actually accomplish workouts with homeowners; mortgagees need only consider foreclosure avoidance tools.

The Department of Veteran Affairs ("VA") has established guidelines and procedures for workouts of delinquent loans insured by the agency. n36 The VA expects the holder of the mortgage to exhaust all possible alternatives before pursuing foreclosure. The holder of the mortgage may grant forbearance, usually of not more than twelve months, to qualified borrowers.

The Rural Housing Authority's ("RHS") section 502 Single-Family Housing Program includes special servicing programs designed to assist the borrower in keeping their home in the event of financial setbacks. n37 Options under these programs include payment moratorium, delinquency work-out agreements and protective advances.

[f] Alternatives to Workouts

There are a variety of alternatives to workouts which will prevent foreclosure. These should be considered and acted on in preference to a workout where appropriate.

[i] Refinancing

If the home was financed at one of the high interest rates that prevailed during the late 1970s and 1980s, refinancing at a lower interest rate and/or with a longer payment period can greatly reduce monthly payments. Moreover, refinancing a low interest first mortgage and high interest second mortgage into a low interest first mortgage can also reduce payments.

On the other hand, some refinancing schemes are frauds. Even legitimate refinancing options that look like an improvement on closer inspection are far more costly than the existing mortgage. In order to evaluate the cost and value of refinancing, it is imperative to carefully review the proposed loan terms. n38

The major disadvantages in refinancing residential mortgage debts are the increased finance charges that result from extending the repayment period, the possibility of having to pay points, the additional closing costs, and prepayment penalties on the old mortgages. The feasibility of refinancing depends on whether the homeowner can obtain a loan at a reasonable rate, usually from a savings bank, a commercial bank, a credit union, or a legitimate mortgage company. Most finance companies and certain mortgage companies do not make residential loans at reasonable rates and terms. The availability of special mortgage programs should also be explored, such as Federal Housing Administration or "FHA"-guaranteed loans, state bonded mortgage funds, or local neighborhood development funds available through banks' community reinvestment programs. Another disadvantage which must be explored carefully is whether the borrowers will lose their right to raise defenses to the original loan if it is refinanced with a new lender.

Under the Federal Equal Credit Opportunity Act, lenders who reject a credit application must explain their reasons. n39 Rejected homeowners should obtain the reasons for their rejection and determine whether the reasons are legitimate. Consumers should try to cure any problems so that the next application will be successful.

[ii] Deeds in Lieu of Foreclosure

It may be possible to negotiate to have the lender accept voluntary return of the property as an alternative to foreclosure. This is usually called a "deed in lieu of foreclosure." Deeds in lieu will not be accepted by the mortgage holder if there are junior liens on the property because, in that case, foreclosure is necessary for the mortgage holder to obtain clear title.

Deeds in lieu should not be offered unless the lender agrees to some consideration for the agreement, such as forgiveness of deficiency claims or an extra period of time for the homeowner to remain in the property before eviction. The lender may agree to these terms in order to save the time and expense of foreclosure. Borrowers should be cautioned, however, about the tax consequences of forgiveness of any portion of the loan. Under the federal tax code, forgiveness of debt is generally treated as taxable income to the debtor, n40 unless the debtor is insolvent before the discharge or the discharge occurs in a bankruptcy case. n41

Deeds in lieu can be a poor choice for a homeowner if there is significant equity in the property. That equity can only be realized by a sale rather than a voluntary transfer, even, perhaps, a foreclosure sale.

[iii] State and Local Mortgage Assistance Programs

Some states have developed mortgage assistance programs that provide for loans to homeowners to pay part of the monthly mortgage payment for several years. Homeowners who are behind in their payments because of reasons beyond their control (e.g., lay-offs, plant closings) and who are likely to be able to resume full home loan payments in several years are eligible. Some unions and corporations also have mortgage assistance programs. Notice to the homeowner of this assistance is a prerequisite to foreclosure in Pennsylvania. Lenders in Pennsylvania must also delay foreclosure proceedings once they receive notice that a homeowner has been approved for assistance from the program. n42

The federal government has established a similar mortgage relief program for borrowers unemployed as a result of a military base closing. n43

The City of Chicago and other communities have also created loan funds for homeowners facing foreclosure. It is a good idea to check on local programs with someone familiar with foreclosure prevention strategies in your area.

[g] Credit Consequences of Workout Agreements and Foreclosure

There are no easy answers for clients who are worried about how workout agreements or foreclosure will affect their credit. Most adverse information about a consumer's credit history is reported for seven years. Bankruptcy can be reported for 10 years. n44

Unfortunately, there are no hard and fast rules about how any individual credit granting decision will be made based on a particular notation on a credit report. Each creditor evaluates credit reports differently.

The following general information may be useful to clients worried about their credit:

(1) *Concerns about future credit should rarely influence how homeowners address their current problem*. A consumer cannot control how a credit report will be evaluated by those who check credit reports. Any delinquency will usually mean "bad credit risk" to most creditors even if it is paid in full relatively quickly. There are generally more important concerns in the foreclosure avoidance process than the potential future impact on a consumer's credit rating which may result from choosing one type of foreclosure plan instead of another.

(2) *A foreclosure avoidance plan of any type is likely to look better on a credit report than a completed foreclosure*. Any effort which prevents a foreclosure from being completed will show a creditor that the homeowner has made an effort. Repayment plans and loan modifications, if they cure the arrears, will show that the homeowners have gotten back on their feet.

(3) *A completed foreclosure is usually fatal to applications for new mortgages from reputable lenders for about two years*. Bankruptcy is also usually fatal for two years. The completed foreclosure will be an important consideration for most lenders even after the two year period has expired until the notation is deleted from the credit report (after seven years).

(4) *A deed in lieu of foreclosure is not a big improvement over foreclosure*. One myth about credit reporting is that a deed in lieu of foreclosure will keep a borrower in good standing on his or her credit record. A deed in lieu of foreclosure is a strong black mark on a credit record; it is only slightly better than a completed foreclosure. A deed in lieu should be considered where appropriate, but should not be seen as a "silver bullet" for future credit.

(5) *Unsecured credit is often available even to people with a recent foreclosure on their credit records*. There is a great deal of competition in the credit card business. Companies even compete for borrowers with bad credit records. It is therefore a good idea to shop around for reasonable terms rather than simply to accept the first offer.

(6) *Avoid credit repair scams*. For-profit credit repair is almost always a scam. No one can clean a credit record entirely if there have been delinquencies on debts within the past seven years. Some credit repair companies recommend credit "fixes" which are illegal. Others charge a great deal of money to write letters to credit reporting agencies that a consumer can write just as easily for free.

(7) *Even if the consumer is in a high risk credit pool, it is still essential to shop around when applying for credit*. Many finance companies and other "hard money" lenders prey on people's beliefs that they have no other potential source of credit. When offered credit only at high rates, a consumer should shop around, using the APR (annual percentage rate) to compare one credit offer to another.

Legal Topics:

For related research and practice materials, see the following legal topics:

Banking LawConsumer ProtectionReal Estate Settlement ProceduresDisclosureBanking LawConsumer ProtectionReal Estate Settlement ProceduresLoan ServicingReal Property LawFinancingMortgages & Other Security InstrumentsDeed in Lieu of ForeclosureReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresGeneral OverviewReal Property LawFinancingWorkouts

FOOTNOTES:

(n1)Footnote 1. *See Dwyer v. J.I. Kislak Mortgage Corp., 13 P.3d 240 (Wash. Ct. App. 2000)* (lender violated the state consumer protection statute when it presented borrower with a payoff statement that included amounts that were not necessary to pay off mortgage).

(n2)Footnote 2. *See Ploog v. Home Side Lending, Inc., 209 F. Supp. 2d 863 (N.D. Ill. 2002)* . An individual consumer may recover actual damages, costs, and reasonable attorney fees for "each such failure." If the evidence also reveals a pattern or practice of noncompliance, the court may award "additional" damages for each violation up to $1000. Arguably, the "additional" damages which fall under the $1000 limitation do not include punitive damages.

(n3)Footnote 3. *12 U.S.C. § 2605(i)(2).*

(n4)Footnote 4. *See* National Consumer Law Center, Foreclosures, § 2.2.5 (2d ed. 2007 and supp.).

(n5)Footnote 5. Fannie Mae is the common name for a quasi-governmental agency known more formally as the Federal National Mortgage Association. Freddie Mac is the colloquial name for the Federal Home Loan Mortgage Corporation. The objective of both entities is to provide liquidity in the housing market by purchasing mortgages in order to put capital back into the hands of the originating lender so that new loans can be made.

(n6)Footnote 6. Midwestern Regional Office, (312) 368-6200 (Illinois, Indiana, Iowa, Michigan, Minnesota, Nebraska, North Dakota, Ohio, South Dakota, Wisconsin).

Northeastern Regional Office, (215) 575-1400 (Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Puerto Rico, Rhode Island, Vermont, Virgin Islands).

Southeastern Regional Office, (404) 398-6000 (Alabama, D.C., Florida, Georgia, Kentucky, Maryland, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, West Virginia).

Southwestern Regional Office, (972) 773-HOME (Arizona, Arkansas, Colorado, Kansas, Louisiana, Missouri, New Mexico, Oklahoma, Texas, Utah).

Western Regional Office, (626) 396-5100 (Alaska, California, Guam, Hawaii, Idaho, Montana, Nevada, Oregon, Washington, Wyoming).

It may be necessary to call the office where your client's servicer is located, rather than the office for the region where your client lives. Fannie Mae's home office can be reached at (202) 752-7000.

The Fannie Mae *Servicing Guide* and Freddie Mac's *Single Family Seller/Servicer Guides* are available on-line at www.allregs.com. Access to the Fannie Mae *Servicing Guide* is free of charge. However, only registered users may access Freddie Mac's *Seller/Servicer Guides*, and registration involves a subscription fee.

(n7)Footnote 7. To lodge a complaint about a Freddie Mac servicer, it is necessary to call 1-800-FREDDIE and access the customer service representative from the initial menu. Ask the customer service representative for the name and number of someone in the loss mitigation department who can review your workout proposal.

(n8)Footnote 8. A detailed discussion of the securitization process is included in National Consumer Law Center,

Foreclosures, § 1.2.2 (2d ed. 2007 and supp.).

(n9)Footnote 9. A securitization trust, once identified, will have web-accessible SEC forms, often with the PSA and other important transactional documents attached as exhibits. To locate documentation for a particular securitization, start with an "Edgar" search. Go to the SEC's homepage at www.sec.gov and click on "Search for company filings" under the section titled "Filings and Forms (EDGAR)." More detail about finding and analyzing documents in this database may be found at Kevin Byers, *Researching Subprime Residential Loan Securitizations*, The Consumer Advocate vol. 9, no. 1, at 15/-/20 (Jan./Feb./Mar. 2003) (newsletter of the Nat'l Ass'n of Consumer Advocates).

(n10)Footnote 10. The Truth in Lending Act requires the loan servicer to disclose this information. *15 U.S.C. § 1641(f)*.

(n11)Footnote 11. *See generally* National Consumer Law Center, Cost of Credit: Regulation, Preemption and Industry Abuses, § 12.2.1 (3rd ed. and Supp.).

(n12)Footnote 12. *12 U.S.C. § 2605(a)*; Reg. X § 3500.21(b) (the regulation calls this a "servicing disclosure statement"). Regulation X, however, allows the disclosure statement to be given within three business days after submission of the application, if the application is taken by telephone, or not at all if the loan application is denied within three business days following receipt of the application. Reg. X § 3500.21(b)(1) and (c)(1).

(n13)Footnote 13. Reg. X § 3500.21(b)(3)(iv) and § 3500.21(d) and (e).

(n14)Footnote 14. *12 U.S.C. § 2605(b)(2)(A)*. The regulation creates certain exemptions to this notice require ment. Reg. X § 3500.21(d)(1)(i)(A)-(C). The term "effective date of transfer" is defined in *12 U.S.C. § 2605(i)(1)* to mean the date on which a consumer's mortgage payment is first due to the transferee servicer pursuant to the assignment, sale, or transfer agreement.

(n15)Footnote 15. *12 U.S.C. § 2605(c)*. The timing of the notice may be altered in certain situations. *See* § 2605(c)(2)(B) & (C); Reg. X § 3500.21(d)(5). *But see Daw v. Peoples Bank & Trust Co., 2001 U.S. App. LEXIS 3229 (7th Cir. 2001)* (lender not required to give borrower advance notice of assignment because, once borrower defaulted, there were no longer any scheduled periodic payments to make or collect and, thus, there were no servicing rights to assign, sell or transfer).

(n16)Footnote 16. Reg. X § 3500.21(d)(2)(C).

(n17)Footnote 17. *12 U.S.C. § 2605(d)*; Reg. X § 3500.21(d)(5).

(n18)Footnote 18. *12 U.S.C. § 2605(f)(1)*; Reg. X § 3500.21(f)(1). In a class action, the class can recover actual damages and up to $1,000 per class member for each such violation where there has been a pattern or practice of noncompliance. Total damages awarded in a class action cannot exceed $500,000, however, or 1% of the net worth of the servicer, whichever is less.

(n19)Footnote 19. *12 U.S.C. § 2605(f)*. *See* National Consumer Law Center, Foreclosures, § 2.2.4.6 (2d ed. 2007 and supp.), and National Consumer Law Center, Fair Debt Collection, § 6.4 (2d ed. 2007 and supp.).

(n20)Footnote 20. The guide is updated periodically through Lender Announcements and Lender Letters. These are available at www.efanniemae.com/sf/guides/ssg.

(n21)Footnote 21. This book can be ordered for $25 by calling Fannie Mae at (800) 471-5554.

(n22)Footnote 22. Access to *Pursuing Alternatives to Foreclosure* is only available to servicers. *See* list of publications at www.freddiemac.com/learn/service/#pub. Freddie Mac's Single-Family Seller/Servicer Guides are

available on-line at www.allregs.com. However, access to the Freddie Mac *Guide* is not free of charge; you must be a registered user and registration involves a subscription fee.

(n23)Footnote 23. Access to *Pursuing Alternatives to Foreclosure* is only available to servicers. *See* list of publications at www.freddiemac.com/learn/service/#pub. Freddie Mac's Single-Family Seller/Servicer Guides are available on-line at www.allregs.com. However, access to the Freddie Mac *Guide* is not free of charge; you must be a registered user and registration involves a subscription fee.

(n24)Footnote 24. Freddie Mac Single-Family Seller/Servicer Guide, vol. 2, § 65.14. For further discussion of workout options with Fannie Mae and Freddie Mac loans, see, National Consumer Law Center, Repossessions, § 2.6 (1st ed. 2005).

(n25)Footnote 25. This will vary on a state-by-state basis.

(n26)Footnote 26. *See Walker v. Midland Mortgage Co., 935 So. 2d 519 (Fla. Dist. Ct. App. 2006)* (oral agreement with former servicer did not prevent new servicer from instituting foreclosure proceedings).

(n27)Footnote 27. *Pennsylvania Footwear Corp. v. Midatlantic Bank, N.A. (In re Pennsylvania Footwear Corp.), 204 B.R. 165 (Bankr. E.D. Pa. 1997)* .

(n28)Footnote 28. *See Snowden v. Chase Manhattan Mortg. Corp., 2003 Mass. Super. LEXIS 398, 17 Mass. L. Rep. 27 (Mass. Super. Ct. 2003)* . *See also Peoples Heritage Bank v. Pease, 838 A.2d 354 (Me. 2003)* (lender who breached terms of oral repayment agreement by foreclosing on borrower's property liable for damages).

(n29)Footnote 29. The plan was announced on December 6, 2007 by Treasury Secretary Paulson and the American Securitization Forum (ASF). The ASF's summary of the plan titled Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans (ASF Plan) is available at www.americansecuritization.com/ uploadedFiles/ FinalASFStatementon Streamlined Servicing Procedures.pdf. A detailed analysis of the plan is available in 26 NCLC REPORTS, *Bankruptcy & Foreclosures Ed.* 13/-/16 (Jan./Feb. 2008).

(n30)Footnote 30. The alliance members are Bank of America, Chase, Citigroup, Countrywide, Washington Mutual, and Wells Fargo. A fact sheet is available at www.fsround.org/hope_now/pdfs/February12-ProjectLifelineOverview.pdf.

(n31)Footnote 31. In Massachusetts for example, the Division of Banks will help homeowners negotiate a sixty-day delay of the foreclosure proceedings.

(n32)Footnote 31.1. Capitalizing the arrearage means adding the arrearage to the principal balance of the loan.

(n33)Footnote 31.2. Unfortunately many loan servicers have failed to modify loans sufficiently, resulting in borrowers who re-default within a matter of months. Therefore it is important to evaluate the borrower's ability to afford any modification offer.

(n34)Footnote 31.3. *See* www.fdic.gov/consumers/loans/loanmod/loanmodguide.html and http://makinghomeaffordable.gov. Making Home Affordable is also known as the Home Affordable Modification Program.

(n35)Footnote 31.4. The FDIC's Mod in a Box website, *supra*, has a downloadable Excel spreadsheet programmed to perform the NPV analysis.

(n36)Footnote 31.5. This list of servicers and copies of their contracts are available at www.financialstability.gov/impact/contracts_list.htm.

(n37)Footnote 32. *See* National Consumer Law Center, Foreclosures, § 2.3.4.7 (2d ed. 2007 and supp.).

(n38)Footnote 33. For a more detailed discussion of workout terms, *see* National Consumer Law Center, Foreclosures, § 2.3 (2d ed. 2007 and supp.).

(n39)Footnote 34.1. *See* National Consumer Law Center, Foreclosures § 2.3.4.7 (2d ed. 2007 and supp.) for a discussion of the limits of modifying securitized loans.

(n40)Footnote 34.2. *See* Credit Suisse, Fixed Income Research, The Day After Tomorrow: Payment Shock and Loan Modifications (Apr. 5, 2007).

(n41)Footnote 34.3. *See* American Securitization Forum, Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans (June 2007), *available at* www.americansecuritization.com/uploadedFiles/ASF%20Subprime%20Loan%20Modification%20Principles_060107.pdf.

(n42)Footnote 34.4. The Making Home Affordable Modification Program is discussed in National Consumer Law Center, Foreclosures § 2.3.6.2.1(2d ed. 2007 and supp.).

(n43)Footnote 34.5. For a full discussion of workout negotiation strategies and considerations, see National Consumer Law Center, Foreclosures § 2.3.4.4A (2d ed. 2007 and supp.).

(n44)Footnote 34. These programs are discussed further at § 13.06 *infra*.

(n45)Footnote 35. *See 12 U.S.C. § 1735u;* United States Department of Housing and Urban Development [hereinafter HUD], Mortgagee Letter 97-44 (Sept. 29, 1997) and United States HUD, Mortgagee Letter 00-05 (Jan. 19, 2000). The mortgagee letters, other HUD materials, and periodic updates are currently available on the internet at http://www.hud.gov/fha/sfh/slmhome.html. HUD workout options are described at National Consumer Law Center, Foreclosures, § 2.7.1 (2d ed. 2007 and supp.). *See also* United States HUD, Mortgagee Letter 2002-17 (Aug. 29, 2002) (revising special forbearance program to make it easier for home owners who are unemployed and but have a reasonable prospect of reemployment to use this option. Lenders may enter special forbearance agreements with home owners who have good payment records and a stable employment history, but have not received a commitment of employment at the time the lender reviews their financial information. The home owner may be required to make partial payments based on her ability to repay and is required to actively seek employment during the term of the reduced payments).

(n46)Footnote 36. *38 C.F.R. §§ 36.4300 et seq.* ; VA Handbook H26-94-1 § 3.06(a) (February 1994). Materials on Department of Veteran Affairs [hereinafter VA] policies including the above referenced handbook and updates to it are currently available at http://www.homeloans.va.gov/service.htm. *See also* National Consumer Law Center, Foreclosures, § 2.7.2 (1st ed. 2005 and Supp.).

(n47)Footnote 37. *42 U.S.C. 1472*, 7 C.F.R. pt. 3550, sub-pt. G. *See also* National Consumer Law Center, Foreclosures, § 2.7.3 (2d ed. 2007 and supp.).

(n48)Footnote 38. For further discussion of the refinancing process, see *supra*. *See also* National Consumer Law Center, Cost of Credit Regulation, Preemption and Industry Abuses, § 6.5 (3rd ed. and Supp.) (evaluating refinancing as a way out of real estate mortgage foreclosure).

(n49)Footnote 39. Reg. B, *12 C.F.R. § 202.9*. *See Newton v. United Cos. Fin. Corp., 24 F. Supp. 2d 444 (E.D. Pa. 1998)* .

(n50)Footnote 40. *I.R.C. § 108(d)(1)(e)(4).*

(n51)Footnote 41. *I.R.C. § 108(a)(1)(A), (B).*

(n52)Footnote 42. *See NBD Mortgage Co. v. Pennsylvania Hous. Fin. Agency Homeowner Emergency Assistance Program, 168 Pa. Commw. 645, 651 A.2d 237 (1994)* (lender which proceeded to foreclose after it learned that application had been approved was not entitled to recover costs).

(n53)Footnote 43. *12 U.S.C. § 1735g.*

(n54)Footnote 44. General information can be found in National Consumer Law Center, Fair Credit Reporting Act (5th ed. 2002 and Supp.). There is also substantial information for consumers about credit reporting and how to improve a bad credit report in National Consumer Law Center, Surviving Debt: A Guide for Consumers (4th ed. 2002).

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.04

§ 13.04 Legal Defenses to Foreclosure: Procedural Defenses

[1] Introduction

Before a legally valid foreclosure can take place, there must be a valid mortgage between the parties, a default by the borrower, proper foreclosure procedure, and no cure (where permitted) or redemption by the borrower.

The procedure by which procedural challenges can be raised will depend on the method of foreclosure used. If the foreclosure is by judicial process, the homeowner/borrower will have the opportunity to raise defenses and counterclaims to the foreclosure in his or her answer to the foreclosure complaint. A trial will then be held to resolve the claims and counterclaims.

With the more common foreclosure by power of sale, however, the foreclosure takes place entirely outside the judicial process. There is no court hearing, no opportunity to raise defenses or counterclaims, no judgement or decision by a court. Thus, to contest a power of sale foreclosure, the homeowner must file an affirmative action to raise these claims and enjoin the foreclosure. This action should be accompanied by a motion for a temporary restraining order and preliminary injunction to prevent a foreclosure sale while the homeowner's claims are being litigated. In most states, the posting of a bond is a prerequisite to a temporary restraining order or preliminary injunction. Courts in most jurisdictions may waive this requirement, however, in appropriate circumstances, including indigence. Often the foreclosure is imminent when the homeowner first seeks legal advice, so the advocate must work very quickly to prevent the foreclosure. One potential problem that must be considered is whether the statutes of limitations governing some of these claims bars their assertion where the foreclosure is taking place many years after the original transaction.

Whether the foreclosure is by judicial or non-judicial process, sometimes filing a bankruptcy petition is the easiest way to stop an imminent foreclosure and allow the homeowner time to initiate these claims. n1 Substantive and procedural defenses are not waived when a homeowner files bankruptcy.

In most jurisdictions, foreclosures are seldom contested by the homeowner. As a result, lenders are often careless about complying with procedural foreclosure requirements, such as the proper and timely service of notice, service on the proper parties, or advertisement in the appropriate place and manner. Practitioners who represent homeowners in foreclosures have found that statutory requirements are not met in many cases. By raising a lack of compliance, the

homeowner can force the lender to start the foreclosure process over again, or at least to correct the defect, providing the homeowner with additional time to arrange a workout refinancing or a private sale.

Because foreclosure is such a harsh remedy, some courts take the position that strict compliance with statutory procedure, and the terms of the mortgage, is required before the foreclosure is permitted. Failure to strictly comply with statutory requirements can be a defense to foreclosure.

[2] Default: Waiver and Estoppel

While the provisions regarding default and acceleration in the contract documents should be checked for errors or ambiguities, almost all mortgages provide that the failure to pay any installment on its due date is a default which entitles the lender to accelerate the balance of the debt without notice to the homeowner. Some states, however, require that a notice be sent to the borrower indicating the lender's intent to accelerate and providing the borrower an opportunity to cure the default. n2

Some courts have refused to enforce an acceleration provision strictly where the lender has previously accepted late payments from the homeowner and has not insisted on timely future payments. n3 These courts generally hold that the acceptance of late payments by the lender modifies or waives the strict acceleration provisions or stops the lender from strictly enforcing the acceleration provisions. Thus, where there has been an acceleration without notice and subsequent foreclosure, the homeowner may be entitled to have the foreclosure dismissed and be given the opportunity to make timely future payments on the mortgage after notice that late payments will no longer be accepted. A pattern of acceptance of late payments at least creates a factual question as to whether a new agreement had been created. Likewise with accepting partial payments.

Some mortgages contain a provision that a waiver of any breach shall not constitute a waiver of any other or subsequent breach or default. Most courts, however, have found such clauses do not bar the borrower from claiming waiver or estoppel.

Estoppel may also provide a defense where a lender has agreed to delay foreclosure while the borrower attempts to refinance or to catch up payments, and the borrowers have relied to their detriment on the lender's promise.

[a] Real Party in Interest in a Judicial Proceeding

State law and rules of civil procedure determine who is a real party in interest and therefore has standing to bring a foreclosure action. The real party in interest is generally the entity that possesses the right sought to be enforced. n4 The question of standing, and a party's right to invoke the jurisdiction of the court, typically becomes an issue when the foreclosing entity was not properly assigned the note and mortgage, or the true holder of the loan is in doubt. n5 In that instance, courts often require proof of assignment of both the note and the mortgage to verify the identity of the holder.

Challenging a lender's standing to bring a foreclosure action is a means of temporarily delaying the proceeding as the common law or rules may allow for substitution of the real party in interest. n6

[i] Proper Assignment of Mortgage

Without a valid mortgage, a holder of the note has no lien on the property and generally can only institute a collection action, not foreclose on the home. n7 Of course, a successful collection action might give rise to a judgment lien, so defeating the mortgage and not the note may only delay the inevitable if the property can not be protected by a state homestead exemption.

The statute of frauds requires that any interest in real estate be in writing. n8 Mortgages are now widely considered to

create an interest in real estate. n9 Transferring the interest created by a mortgage via assignment should also be covered by the statute of frauds. n10 Using the statute of frauds to defeat a foreclosure action may be easiest when there is no writing transferring either the note or the mortgage to the foreclosing entity. Practitioners should remember that in many jurisdictions, the statute of frauds can be waived, either by failure to plead or failure to object to parole testimony. n11

Courts, primarily in Ohio, have dismissed foreclosure cases brought by assignees when the assignees could not produce a written assignment. n12 The decisions in Ohio are based in part on a requirement in Ohio's law that assignments of mortgages be recorded. n13 Several courts in other states have barred borrowers from asserting the failure of the assignment to comply with the statute of frauds primarily because they find that the borrower is not a third party beneficiary of the assignment contract. n14 As a general rule, only the parties to the contract transferring the interest in land are able to assert a defense of the statute of frauds. n15 This of course overlooks much of the reason for the statute of frauds: to prevent fraud, to protect title to land, and to prevent multiple claims. Borrowers in today's world of securitization, where mortgages are sold often and early, with correspondingly frequent false claims n16 have reason to demand that any foreclosing entity demonstrate the validity of the documents relied on to assert the claim.

[ii] Standing of Servicers to Foreclose

Most mortgage loans are pooled and sold to investors on the secondary market. Mortgage originators retain the right to service the loans they sell to permanent investors. This includes collecting payments, maintaining all necessary accounts (including escrow accounts for taxes and insurance), making necessary disbursements, and forwarding the payments to loan investors.

Investors such as Freddie Mac and Fannie Mae enter into contracts with servicers to administer the mortgages which they hold. Under Freddie Mac and Fannie Mae guidelines the servicer does not retain an interest in the mortgage or note. The original of any note sold to the investor must be endorsed in blank and delivered to the investor's document custodian. n17 The servicer is assigned the mortgage. n18 However, the servicer is then required to assign the mortgage to the investor, but this assignment is unrecorded. n19 Thereafter the servicer will be the mortgagee of record to ensure that legal notices related to the property are sent to it.

[iii] Challenging a Servicer's Standing to Foreclose

When a foreclosure action is initiated in the servicer's name, the servicers' standing to bring a foreclosure action depends mainly on state statute and case law. In securitized transactions, it is common for the servicer to file the foreclosure action though an investor or trust is the actual holder of the note and mortgage. n20 Borrowers are most successful in challenging a servicer's standing where state law clearly defines the holder of the note and mortgage as the real party in interest.

Some courts have allowed a servicer to file a foreclosure action in its own name when the servicer's agreement with the holder gives the servicer a right to collect and foreclose on the mortgage. n21 Moreover, servicers and lenders often file affidavits from company executives asserting an ownership interest in the loan being foreclosed without providing proper documentation. The failure to produce sufficient evidence documenting the foreclosing entity's interest in the note and mortgage may necessitate a dismissal or delay in the proceedings.

[iv] Standing of Mortgage Electronic Registration System to Foreclose

The Mortgage Electronic Registration System (MERS) n22 is an electronic registry and clearinghouse established to track ownership and servicing rights in mortgages. Once a loan is assigned to MERS, all subsequent assignments will not be recorded in public records. The company will then internally track all changes of ownership, servicing rights, corporate names and mergers.

MERS can become mortgagee of record in two ways. For a newly originated loan, a mortgage or deed of trust is prepared with MERS named as the nominee for the lender. MERS as nominee for the lender has been approved by Fannie Mae, Freddie Mac, Ginnie Mae, FHA, and the VA. A lender may also execute an assignment to MERS immediately after closing.

Unlike servicers which have an economic interest in servicing the debt, sufficient to confer standing in some jurisdictions, MERS has no beneficial interest in the mortgage in its role as nominee for the holder. MERS does not become the holder of the promissory note that represents the loans. n23 In most jurisdictions, however, MERS forecloses on the loan in its own name or assigns the mortgage to a servicer. n24 MERS has asserted that as the lender's nominee it has the right to foreclose in its own name. A borrower is most successful in challenging this assertion in jurisdictions where the holder of the promissory note is an indispensable party. n25

[v] New Statutory Requirements Related to Identifying Mortgage Holders

Several states have enacted legislation that requires mortgage holders to provide identifying information about themselves and their interest in the property when they foreclose. While these provisions are typically designed to facilitate settlement negotiations, the disclosure requirements can also serve as a basis for ascertaining claims related to the standing and real-party-in-interest status of the foreclosing party. For example, Maryland has enacted a statute which requires that the notice of intent to foreclose list identifying information about the mortgage holder and servicer, including contact information for a person who has authority to modify the loan. n25.1 The statute requires that a complaint or "order to docket" for a foreclosure sale be accompanied by an original or certified copy of the mortgage or deed of trust and a copy of the debt instrument accompanied by an affidavit certifying ownership of the debt. This certification must include a certified copy of the assignment or deed of appointment of a substitute trustee authorizing the party to foreclose. n25.2

Several other recent state enactments require that foreclosure notices identify contacts with the foreclosing entity who have authority to negotiate over loan terms. n25.3 The foreclosing party's failure to comply with these notification requirements should strengthen challenges raising standing and real-party-in-interest claims. New York has amended its foreclosure statutes to add a requirement that foreclosure complaints filed after September 1, 2008 for high-cost and subprime loans must include an affirmative allegation that at the time of filing the plaintiff was the owner and holder of the note and mortgage or had been delegated authority on behalf of the owner and holder. n25.4

[b] Other Procedural Defenses

Procedural defenses to foreclosure vary from state to state, and can only be determined by reference to state statutes and case law. In general, in states which require a judicial proceeding to foreclose, service of process and other procedural requirements must be met. Foreclosure pleadings may be subject to rules set by case law or rule. Similarly, rules may require that relevant documents be attached to the complaint. Failure to comply may be grounds to object to foreclosure or to move for dismissal, resulting in temporary delays. n26

Although a lender's failure to comply with statutory notice requirements may be a defense to foreclosure, n27 actual notice is generally not required: compliance with statutory notice requirements will usually be sufficient, even where the homeowner can prove that he or she did not receive the notice. n28

[3] Deed of Trust: Trustee Obligations

In some jurisdictions, a deed of trust is used as security for a loan, instead of a mortgage. Although there is little practical difference between the two, because a deed of trust is held by a trustee who has an independent duty to protect the rights of the borrower (as well as the lender), borrowers in foreclosure under a deed of trust may be able to raise breach of the trustee's duty as a defense to a foreclosure sale or, after foreclosure, when seeking to set aside a sale.

In most jurisdictions "a trustee under a deed of trust owes fiduciary duties both to the *lender* and to the borrower." n29 Because of her fiduciary relationship, the trustee must be "scrupulously fair and impartial" in carrying out these duties, including the foreclosure sale. n30 The trustee must comply strictly with the terms of the power of sale and with the statute.

Failure to comply with statutory requirements may subject the trustee to liability for wrongful foreclosure and may constitute grounds to set aside the sale. n31 In addition, if the trustee has actual knowledge of anything which should legally prevent the foreclosure, she may have a duty to investigate. n32

If the trustee has any potential conflict of interest in acting as trustee, she must disclose this fact or will be required to prove that she was faithful to her duties. n33

Finally, selling the property at a price that is shockingly low may amount to a breach of the trustee's duty, n34 though courts usually look for some irregularity or unfairness in addition to a low price. n35

[4] Default: Enforceability of Due on Sale Contract Provisions

[a] Overview

Due on sale clauses are common contract provisions which give a lender the option to immediately call due, or accelerate, a real-estate secured loan when the borrower sells or transfers all or part of the security to a third party. n36 Almost all consumer mortgage loans contain such a provision in the loan note and/or mortgage. Many lenders seek to enforce this right (which can lead to foreclosure proceedings) even when the transfer is between family members or in the probate process upon death of the debtor.

The enforceability of such clauses now is largely a matter of federal law, since state common law or statutory limits on the enforceability of due on sale clauses have been for the most part preempted by the Garn-St. Germain Depository Institutions Act of 1982 ("DIA" or "the Act"), n37 which makes such clauses generally enforceable.

DIA applies to any lender, which is defined to include individuals, state and federal banks, state and federal credit unions, and finance companies, n38 and every loan, mortgage, advance, or credit sale secured by a lien on real property. n39

The Act provides that notwithstanding state law, the exercise of a due on sale clause by a lender is governed exclusively by the terms of the contract, subject only to the limitations contained in the Act. Most importantly, DIA prohibits the exercise of due on sale rights with respect to certain nonsubstantive or nonsale transactions, including intra-family transfers. n40 DIA also allowed states the opportunity to maintain some restrictions with respect to some loans. Michigan, New Mexico, and Utah exercised the right to continue state restrictions.

In addition, the Act makes clear that it does not prohibit mortgage assumption. In fact, it specifically encourages lenders to permit an assumption of a mortgage, either at the contract rate of interest or at a rate between the contract rate and the market rate. n41

[b] Federal Exemptions

Under DIA and Office of Thrift Supervision ("OTS") regulations issued pursuant to DIA, valid due on sale contract provisions are enforceable by lenders, but nine specific exemptions prevent the enforcement of the due on sale clause. n42 These federal regulations and their preemption of state law can be raised defensively to prevent foreclosure if one of these exemptions applies.

[c] Intra-Family Transfers

The federal law aims to protect intra-family transfers from triggering acceleration. These include transfers to the borrower's relative on the borrower's death, transfers to the borrower's children and spouse, and transfers resulting from a marriage dissolution or property settlement.

[d] Lender Waiver by Agreement

In all states other than Michigan, New Mexico, and Utah, if, before a transfer occurs, a lender and the proposed transferee enter into a written agreement for the latter to assume the loan, the lender waives its option to exercise a due on sale clause with respect to that transfer. n43

[e] Contractual Limits on Due on Sale Clauses Are Not Preempted

With respect to all loans, contractual limits on the lender's right to accelerate still apply. Both parties are bound by the contract and the statute does not change that.

[f] Prepayment Fees and Loan Acceleration

Some mortgages include provisions which require a borrower to pay a penalty if the loan is repaid before it is legally due. The federal regulations prohibit the charging of such fees when the lender seeks to enforce a due on sale clause by written demand or formal proceedings on loans secured by the borrower's home. n44

[5] Other Procedural Defenses

Other examples of successful procedural defenses may include the failure of the lender to introduce the original note in the foreclosure proceeding, the misjoinder of a claim for personal liability on the mortgage note in the foreclosure proceeding, failure to join a necessary party, the improper or ineffective assignment of the mortgage, or the failure to comply with statutory notice requirements.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingMortgages & Other Security InstrumentsForeclosuresGeneral OverviewReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresJudicial ForeclosuresReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresPrivate Power-of-Sale ForeclosureReal Property LawFinancingMortgages & Other Security InstrumentsFormalitiesReal Property LawFinancingMortgages & Other Security InstrumentsTransfersDue-on-Sale Clauses

FOOTNOTES:
(n1)Footnote 1. See Collier Consumer Bankruptcy Practice Guide Ch. 4 (Matthew Bender), for discussion of using bankruptcy to stop a foreclosure.

(n2)Footnote 2. *See Citimortgage, Inc. v. Lovelett, 2001 Conn. Super. LEXIS 581* (Conn. Super. Ct. Feb. 27, 2001) (notice of default may be required in order to accelerate and foreclose even when the mortgage note does not require such notice); *Sarasota, Inc. v. Ballew, 2001 Tex. App. LEXIS 1262* (Tex. App. Feb. 28, 2001) (note and deed of trust do not require automatic acceleration of note upon default and mortgagee who did not clearly and unequivocally express intent to accelerate the note cannot foreclose).

(n3)Footnote 3. *See, e.g., Smith v. General Fin. Corp., 243 Ga. 500, 255 S.E.2d 14 (1979)* ; *Meehan v. Cable, 135 N.C. App. 715, 523 S.E.2d 419 (1999)* (note holder who repeatedly accepted late payments waived the right to

accelerate debt without first notifying mortgagor that prompt payment would be expected in the future). *But see Ocwen Fed. Bank, FSB v. Weinberg, 1999 Conn. Super. LEXIS 2204* (Conn. Super. Ct. Aug. 11, 1999) (where mortgage expressly contains non-waiver clause, mortgagee did not waive right to accelerate mortgage by accepting late payment).

(n4)Footnote 4. *See First Union National Bank v. Hufford, 146 Ohio App. 3d 673, 767 N.E.2d 1206 (Ohio Ct. App. 2001)* (a real party in interest is one who is directly benefited or injured by the outcome of the case).

(n5)Footnote 5. *See, e.g., Harmony Homes v. United States ex rel. Small Bus. Admin., 936 F. Supp. 907 (M.D. Fla. 1996)* (lender who assigned away interest in property was not the proper party to file suit to foreclose a mortgage); *Laing v. Gainey Builders, Inc., 184 So. 2d 897 (Fla. Dist. Ct. App. 1966)* ; *Redding v. Gibbs, 280 N.W.2d 53 (Neb. 1979)* ; *First Union Nat'l Bank v. Hufford, 767 N.E.2d 1206 (Ohio 2001)* ; *Washington Mutual Bank v. Green, 156 Ohio App. 3d 461, 806 N.E.2d 604 (Ohio Ct. App. 2004)* (question of fact which existed as whether the lender was owner and holder of note and mortgage, precluding summary judgment); *Kramer v. Millott, 1994 Ohio App. LEXIS 4454* (Ohio Ct. App. Sept. 23, 1994) .

(n6)Footnote 6. *See East Coast Properties v. Galang, 308 A.D.2d 431, 765 N.Y.S.2d 46 (N.Y. App. Div. 2003)* .

(n7)Footnote 7. *But see Conn. Gen. Stat. § 49-17* (permitting foreclosure where the note is validly transferred even if the mortgage is not assigned); *U.C.C. § 9-203(g)* (right to foreclose belongs in equity to owner of the debt).

(n8)Footnote 8. The Statute of Frauds was enacted in English law in 1677 and carried over, either by statute or common law, to all of the states except Louisiana. Restatement (Second) of Contracts ch. 5, statutory n. (1981) (listing the corresponding state statutes).

(n9)Footnote 9. *See, e.g., Manir Properties v. Resolution Trust Corp., 1993 U.S. Dist. LEXIS 13582* (E.D. Pa. Sept. 27, 1993) (explaining that Pennsylvania common law treated mortgages as a "chose in action" and therefore not subject to the statute of frauds but that Pennsylvania law now clearly treats mortgages as interests in real property).

(n10)Footnote 10. *Lininger v. Sonenblick, 532 P.2d 538 (Ariz. Ct. App. 1975)* (holding, without discussion, that assignments of mortgages are covered by the statute of frauds). *But see Levy v. McGill, 137 Fed. Appx. 613 (5th Cir. 2004)* (statute of frauds may not cover assignments of mortgages); *Love v. Irwin, 228 F.2d 501 (5th Cir. 1956)* (holding in dicta that assignment of mortgages may not be covered by the statute of frauds).

(n11)Footnote 11. *Gramatan Home Investors Corp. v. Whittemore, 518 A.2d 32 (Vt. 1986)* (overturning dismissal of foreclosure action for assignee's failure to produce documentary evidence of assignment because borrowers waived statute of frauds defense when they did not object to testimony of the assignment). *But see Becker v. Dramin, 6 Conn. Supp. 33 (Conn. Super. Ct. 1938)* (mortgage follows note, so assignment of mortgage is not covered by the statute of frauds, provided there is a valid transfer of the note). *Cf. Levy v. McGill, 137 Fed. Appx. 613 (5th Cir. 2004)* (asset purchase agreement, in lieu of assignment, was definite enough and did not need to be delivered to transfer trust deed).

(n12)Footnote 12. *See In re Foreclosure Cases, 2007 U.S. Dist. LEXIS 84011* (N.D. Ohio Oct. 31, 2007) ; *KeyBank N.A. v. Estate of Wright, 2006 Ohio 4643* (Ohio Ct. App., Lucas County Sept. 1, 2006) (denying Countrywide leave to intervene and assert prior lien in mortgage foreclosure action since it had not produced or recorded an assignment of the prior mortgage). *Cf. Everhome Mortg. Co. v. Rowland, 2008 Ohio 1282* (Ohio Ct. App., Franklin County Mar. 20, 2008) (reversing summary judgment in favor of assignee in foreclosure action since assignee failed to demonstrate it had an interest in either the note or the mortgage).

(n13)Footnote 13. *See In re Foreclosure Cases, 2007 U.S. Dist. LEXIS 84011* (N.D. Ohio Oct. 31, 2007) . *Cf. In re Dimmings, 386 B.R. 199 (Bankr. N.D. Ohio 2008)* (denying motion for relief from stay in part because original creditor and subsequent assignee failed to record mortgage). *But cf. Martin v. Select Portfolio Serving Holding Corp., 2008 U.S. Dist. LEXIS 16088* (S.D. Ohio Mar. 1, 2008) (failure to record or produce assignment until requested by plaintiff in FDCPA action does not invalidate assignment).

(n14)Footnote 14. *See Countrywide Home Loans, Inc. v. Brown, 223 Fed. Appx. 13 (2d Cir. 2007)* (borrower cannot raise of frauds defense because the defense is "personal" to the assignor); *Austin v. Countrywide Homes Loans, 261 S.W.3d 68 (Tex. App. Houston 1st Dist. 2008)* (homeowner was not a party to the assignment and so has no right to invoke the statute of frauds with respect to the assignment). *Cf. Levy v. McGill, 137 Fed. Appx. 613 (5th Cir. 2004)* (statute of frauds may not cover assignments and asset purchase agreement, in lieu of assignment, was definite enough and did not need to be delivered to transfer trust deed); *Conradt v. Lepper, 81 P. 307 (Wyo. 1905)* (borrower could not assert illegal assignment of mortgage as a defense to foreclosure if the underlying mortgage was valid).

(n15)Footnote 15. Restatement (Second) of Contracts § 144 (1981).

(n16)Footnote 16. *See, e.g., Impac Warehouse Lending Group v. Credit Suisse First Boston LLC, 270 Fed. Appx. 570 (9th Cir. Cal. 2008)* (litigation by warehouse lender against securitizer and mortgage broker; mortgage broker sold same loans to both warehouse lender and securitizers, apparently creating fake documentation for the sale to the warehouse lender).

(n17)Footnote 17. *See, e.g.*, Fannie Mae Single Family Servicing Guide, Part IV, Chapter 2, § 204. Notes and other key documents are held on behalf of investors by third-party document custodians which are approved financial institutions, by mortgage servicers, or by the investors themselves.

(n18)Footnote 18. *See* Fannie Mae Single Family Servicing Guide, Part IV, Chapter 4, § 403; Freddie Mac Single-Family Seller/ Servicer Guide § 22.14.

(n19)Footnote 19. *See* Fannie Mae Single Family Servicing Guide, Part IV, Chapter 4, §§ 402, 403. Fannie Mae requires that, for any mortgage not registered with MERS, the mortgage seller prepare an assignment of the mortgage to Fannie Mae; that assignment should not be recorded. If the mortgage seller will not service the loan, Fannie Mae requires a recorded assignment from the seller to the servicer. The note is not endorsed to the servicer. See also Freddie Mac Single-Family Seller/ Servicer Guide § 22.14.

(n20)Footnote 20. If the servicer files suit in its own name instead of in the name of the holder, an argument could be made that this is a fraud on the court. On the other hand, if the creditor files suit in the name of the actual holder, it may be the unauthorized practice of law for a servicer to retain counsel to represent the holder. At least one court has come to such a conclusion. *In re Morgan, 225 B.R. 290 (Bankr. E.D.N.Y. 1998)* .

(n21)Footnote 21. Bankers Trust v. 236 Beltway Inv., 865 F. Supp. 1186 (E.D. Va. 1994) (both lender and servicer had standing to sue on mortgage in default); *First Nat'l City Bank v. Burton M. Saks Constr. Corp., 70 F.R.D. 417 (D. V.I. 1976)* (servicer the proper party under Rule 17(a) when contract with holder gave it the authority to bring a foreclosure action); *In re Tainan, 48 B.R. 250 (Bankr. E.D. Pa. 1985)* (servicer, in capacity as representative of Fannie Mae for collection purposes, was the party in interest for Rule 17(a) purposes in a relief from stay proceeding). *Green Tree Servicing L.L.C. v. Sanders, 2006 WL 2033668* (Ky. Ct. App. July 21, 2006) (under terms of pooling and servicing agreement, servicer became the real party in interest once the loan was automatically assigned to it at the commencement of a foreclosure action).

(n22)Footnote 22. MERS' website, www.mersinc.org contains useful information on the company and a state-by-state summary of its recommended foreclosure procedures.

(n23)Footnote 23. *See* Fannie Mae Single Family Servicing Guide, Part IV, Chapter 2, § 204. *See also Taylor, Bean & Whitaker Mortgage Corp. v. Brown, 276 Ga. 848, 583 S.E.2d 844 (Ga. 2003)* ; Nelson & Whitman, Real Estate Finance Law, § 5.34 (West Group 4th ed. 2002).

(n24)Footnote 24. According to Fannie Mae guidelines, when MERS is the mortgagee of record (either as an assignee or as the nominee for the original mortgage), the jurisdiction in which the property is located will determine how foreclosure proceedings are initiated or conducted. In most states the foreclosure attorney should initiate the action

in MERS' name. Fannie Mae Single Family Servicing Guide, Part VIII, Chapter 1, § 105. Freddie Mac requires foreclosure in the name of MERS or a transfer of the mortgage from MERS to servicer and foreclosure in the servicer's name. Freddie Mac Single-Family Seller/Servicer Guide, § 66.17.

(n25)Footnote 25. *Mortgage Elec. Registration Sys. v. Rees, 2003 Conn. Super. LEXIS 2437* (Conn. Super. Ct. Sept. 4, 2003) .

(n26)Footnote 25.1. *Md. Code Ann., Real Prop. § 7-105.1(c).*

(n27)Footnote 25.2. *Md. Code Ann., Real Prop. § 7-105.1(d).*

(n28)Footnote 25.3. *See Cal. Civ. Code § 2923.5*; *Colo. Rev. Stat. § 38-38-102.5*; *Ga. Code Ann. § 44-14-162.2*; *Mass. Gen. Laws Ann. ch. 244, § 35A*; *N.J. Stat. Ann § 2A:50-56*; N.C. Gen. Stat. Ann. § 53-243.11(21) (West).

(n29)Footnote 25.4. McKinney's New York Laws Real Property Actions and Proceedings § 1302.

(n30)Footnote 26. For a good listing of procedural defenses and case law, see National Consumer Law Center, Foreclosures, § 4.3 (1st ed. 2005 and Supp.). *But see Ocwen Fed. Bank v. Harris, 2000 U.S. Dist. LEXIS 16649* (N.D. Ill. Oct. 23, 2000) (assignee did not need lost promissory note to foreclose). *See, e.g., Hutchison v. Chase Manhattan Bank, 922 So. 2d 311 (Fla. Dist. Ct. App. 2006)* (mortgagor was not served with a summons or named as a party in foreclosure proceedings; he did not receive adequate notice or have an opportunity to be heard in accordance with due process under the state constitution).

(n31)Footnote 27. *Agricola Partners, Inc. v. Parker, 655 So. 2d 967 (Ala. 1995) . See Abdel-Kafi v. Citicorp Mortgage, Inc., 772 A.2d 802 (D.C. 2001)* (notice of foreclosure sale was invalid when mortgagee sent notice to the wrong address); *Ohio Sav. Bank v. Hawley, 2001 Ohio App. LEXIS 702* (Ohio Ct. App. Feb. 16, 2001) (foreclosure sale vacated when mortgagor did not receive actual notice of the sale; notice by publication was inadequate). *See also G.E. Capital Mortgage Servs. v. Baker, 1999 Conn. Super. LEXIS 1791* (Conn. Super. Ct. July 2, 1999) (letter to mortgagor which improperly provided for a thirty-day cure period instead of the sixty days required by the mortgage is a special defense to foreclosure).

(n32)Footnote 28. *See Mississippi Farm Bureau Ins. Co. v. Coleman, 876 F. Supp. 111 (S.D. Miss. 1995) .*

(n33)Footnote 29. *Perry v. Virginia Mortgage & Inv. Co., 412 A.2d 1194, 1197 (D.C. 1980)* (citing *S & G Inv. Inc. v. Home Fed. Sav. & Loan Ass'n, 505 F.2d 370, 377 n.21 (D.C. Cir. 1974))* ; *see National Life Ins. Co. v. Silverman, 454 F.2d 899 (D.C. Cir. 1971)* ; *Maynard v. Sutherland, 313 F.2d 560, 565 n.16 (D.C. Cir. 1962)* ; *Spruill v. Ballard, 58 F.2d 517 (D.C. Cir. 1932)* ; *Killion v. Bank Midwest, 987 S.W.2d 801, 813 (Mo. Ct. App. 1998)* ; *Sloop v. London, 219 S.E.2d 502, 504-05 (N.C. 1975) .*

(n34)Footnote 30. *Sheridan v. Perpetual Bldg. Ass'n, 322 F.2d 418, 421* (trustee breached duty by releasing first purchaser at foreclosure sale who had bid higher amount, then selling to second buyer for less, without consulting borrower); *Killion v. Bank Midwest, 987 S.W.2d 801, 813 (Mo. Ct. App. 1998)* (fiduciary relationship does exist between the trustee and the debtor and creditor; trustee is considered to be the agent of both debtor and creditor and should perform the duties with impartiality and integrity).

(n35)Footnote 31. *In re Worcester, 811 F.2d 1224 (9th Cir. 1987)* (trustee's failure to accurately describe property in notice of sale and in deed was grounds for setting aside sale); *Sloop v. London, 219 S.E.2d 502, 505 (N.C. 1975)* (trustee's failure to attend sale and his signing of sale "report" before sale occurred were breaches of duty).

(n36)Footnote 32. *See Killion v. Bank Midwest, 987 S.W.2d 801 (Mo. Ct. App. 1998)* (finding no breach of duty, but noting the trustee may proceed without making an investigation unless he has actual knowledge of anything which would *legally* prevent the foreclosure). *But see Lewis v. Jordan Inv., Inc., 725 A.2d 495, 500 (D.C. 1999)* ("Absent

fraud, misrepresentation, or self-dealing, we do not impose any additional duties upon the trustee."); 2 Baxter Dunaway, The Law of Distressed Real Estate § 17:25 (2003) (no duty to investigate absent unusual circumstances).

(n37)Footnote 33. *Sheridan v. Perpetual Bldg. Ass'n, 322 F.2d 418, 421 (D.C. Cir. 1963)* (because of their close connection with the lender, trustees were not qualified to act as trustees unless borrower, after full and fair disclosure, acquiesced); *Lewis v. Jordan Inv., Inc., 725 A.2d 495, 500 (D.C. 1999)* ; *Perry v. Virginia Mortgage & Inv. Co., 412 A.2d 1194, 1197 (D.C. 1980)* ; *Mills v. Mutual Bldg. & Loan Ass'n, 216 N.C. 664, 6 S.E.2d 549, 552 (1940)* (trustee who both acted as trustee and bid at sale on behalf of creditor breached duty of impartiality).

(n38)Footnote 34. *Lewis v. Jordan Inv., Inc., 725 A.2d 495, 500 (D.C. 1999)* (finding that the foreclosure sale price was not shockingly low); *see In re Krohn, 52 P.3d 774, 777, 781 (Ariz. 2002)* .

(n39)Footnote 35. *See § 13.14[4] infra*; *see also In re Worcester, 811 F.2d 1224, 1232 (9th Cir. 1987)* (inadequate price plus irregularity in sale constitute grounds to set aside sale).

(n40)Footnote 36. *See American Investors, Inc. v. King, 796 So. 2d 955 (Miss. 2001)* (lender may foreclose when mortgagor deeded interest to third party without prior written consent of lender).

(n41)Footnote 37. *12 U.S.C. § 1701j-3.*

(n42)Footnote 38. *12 C.F.R. § 591.2(g).*

(n43)Footnote 39. *12 U.S.C. § 1701j-3(a)(1).*

(n44)Footnote 40. *12 U.S.C. § 1701j-3(d).*

(n45)Footnote 41. *12 U.S.C. § 1701j-3(b)(3).*

(n46)Footnote 42. *12 U.S.C. § 1701j-3(d)*; *12 C.F.R. §§ 591.3-591.5 (1994)*:

> 1) the creation of a lien or other encumbrance subordinate to the lender's security instrument which does not relate to the transfer of rights of occupancy, provided that such encumbrance is not created pursuant to a contract for deed;
>
> 2) the creation of a purchase money security interest for household appliances;
>
> 3) a transfer by devise, descent or operation of law on the death of a joint tenant or tenant by the entirety;
>
> 4) the granting of a leasehold interest for three years or less with no option to purchase;
>
> 5) a transfer, resulting from the borrower's death, to a relative who will occupy the property;
>
> 6) a transfer to the borrower's spouse or children where they will occupy the property;
>
> 7) a transfer resulting from a decree of dissolution of marriage, legal separation agreement or incidental property settlement agreement where the transferee becomes the owner and occupier of the property;
>
> 8) a transfer into an *inter vivos* trust in which the borrower is a beneficiary and which does not affect a transfer of occupancy rights, provided that the borrower does not refuse to provide the lender with reasonable means to receive timely notice of a transfer of the beneficial interest or a change in occupancy;

9) any other transfer or disposition described in regulations proscribed by the Federal Home Loan Bank Board.

(n47)Footnote 43. *12 C.F.R. § 591.5(b)(4)*. Lenders may also waive their option to exercise the due on sale clause by accepting payments from the transferee. *See Brown v. Powell, 648 N.W.2d 329 (S.D. 2002)* (court held that because vendor was aware that purchaser had assigned his interest to attorney while accepting payments on contract from attorney, thus vendor waived non-assignment clause and forfeiture of contract was inequitable). *But see Kings Langley, Ltd. v. Federal Dep. Ins. Corp., 108 F.3d 338 (9th Cir. 1996)* (table) (text available at *1996 U.S. App. LEXIS 33199*) (no waiver by acceptance of payments after transfer when lender not aware of transfer and manner of payment designed to conceal transfer); *In re Martin, 176 B.R. 675, 676 (Bankr. D. Conn. 1995)* (lender does not waive its right to enforce a due on sale provision when it does not specify violation of due on sale provision when it accelerated the mortgage because the lender was not aware of the transfer at the time).

(n48)Footnote 44. *12 C.F.R. § 591.5(b)(2)*.

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.05

§ 13.05 State Moratoria on Foreclosure

Many states enacted moratorium laws postponing foreclosure sales of homes and farms during the economic depression of the 1930s. n1 Generally, such statutes prevent foreclosures during times of "emergency" by requiring lenders to accept smaller payments during the moratorium. A foreclosure conducted in violation of a moratorium should be invalid.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingMortgages & Other Security InstrumentsForeclosuresGeneral OverviewReal Property LawFinancingState Regulation

FOOTNOTES:
(n1)Footnote 1. *See* R. Admunson & L. Rotman, *Depression Jurisprudence Revisited: Minnesota's Moratorium on Mortgage Foreclosure*, *10 Wm. Mitchell L. Rev. 805 (1984);* T. Benston, *Iowa's Mortgage Moratorium Statute*, *33 Drake L. Rev. 303* (1983/1984). In addition, at least one federal moratorium program is in effect. *See 42 U.S.C. § 1475* (Farm Housing Loan Payment Moratorium and Foreclosure Procedures) (Secretary can grant a moratorium on payments if borrower, due to circumstances beyond her control, is unable to continue making payments without unduly impairing her standard of living; in cases of extreme hardship the Secretary can also cancel interest due and payable on such loans during the moratorium.).

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.06

§ 13.06 Foreclosure of Federally Insured, Guaranteed and Direct Loan Program Mortgages for One to Four Family Homes; Loan Servicing Requirements

[1] Foreclosure of HUD-Insured Mortgages

Families facing foreclosure of mortgages insured under sections 203, 221, or 235 of the National Housing Act n1 have significant protections not available to persons with conventional loans. Most courts which have considered the issue have held that the mortgagee's failure to follow the servicing obligations is a valid equitable defense to foreclosure. n2

[2] Termination of the HUD Assignment Program

Until recently, the HUD Home Mortgage Assignment Program was the primary vehicle for low-income homeowners with FHA-insured mortgages to prevent foreclosure during periods of temporary financial hardship. Homeowners facing foreclosure for reasons beyond their control applied directly to HUD for relief. If the homeowner qualified, HUD accepted assignment of the mortgage from the insured lender and provided temporary forbearance (for up to 36 months) and other relief to allow the homeowner an opportunity to regain firm financial footing.

On April 26, 1996, Congress terminated the HUD assignment program. After that, HUD urged lenders to utilize other existing foreclosure avoidance/loss mitigation tools to reduce FHA foreclosure costs and help address the needs of borrowers facing temporary financial hardship. HUD has issued revised regulations, and developed educational efforts aimed at lenders, a written clarification of the potential workout options, and an incentive program to encourage lenders to help HUD mitigate its losses by working with homeowners when appropriate. n3

[3] Summary of Current Workout Options

The options available for homeowners with HUD-insured mortgages now include the following: 1) *Special Forbearance*: (reduced or suspended payments for up to eighteen months); 2) *Partial Claims*: (HUD covers up to 12 months arrearage to the mortgagee, the homeowner gives HUD an interest-free mortgage in the amount of the arrears); n4 3) *Mortgage Modification*: (reamortization of the arrearage over the remaining term of the loan or a term not exceeding thirty years); 4) *Pre-Foreclosure Sale*: (mortgagees can allow sale of the property through pre-foreclosure sales); and 5) *Deed In Lieu*.

[4] FHA Secure

The FHA Secure initiative allows borrowers who are current or who became delinquent on an adjustable rate mortgage following the reset of the interest rate to refinance into an FHA-insured mortgage. n5 All non-FHA adjustable rate mortgages are eligible to be refinanced. To qualify, a delinquent borrower must have made all payments on time during the six-month period prior to the reset. There are no limits on how far behind the borrower can be to qualify though the loan amount under FHA Secure may not exceed geographical mortgage loan limits and maximum loan-to-value ratios (between 97.15% and 98.75%). The new mortgage may pay off first and second mortgages, and include closing costs, prepaid expenses, discount points, prepayment penalties, and late charges. Delinquent principal, interest, taxes, and insurance may also be added, provided that the delinquency arose after the reset. The program is temporary and loan applications must be signed no later than December 31, 2008.

[5] New Foreclosure Requirements for HUD-Insured Lenders

For defaults occurring after February 1, 1998, the mortgagee must either use a foreclosure prevention tool or begin foreclosure within six months of default (the prior requirement was nine months). n6 HUD believes this shortened time will encourage workouts rather than foreclosures. n7

In addition, all mortgagers must now review all mortgage loans that are in default for three months to determine if any of the loss mitigation tools are appropriate. n8 Mortgagees must now document that they have considered all loss mitigation options to determine which, if any, are appropriate before initiating foreclosure. n9 HUD may impose sanctions on lenders for failure to engage in loss mitigation activities in the form of a penalty in the amount of three times the amount of any HUD insurance benefit the lender is entitled to receive. n10

The foreclosure of VA-guaranteed mortgages may be subject to state or federal protections. Some courts have held that VA regulations preempt state foreclosure law protections. n11 Other courts hold that the only state law nullified are those inconsistent with VA regulations or their purposes. n12 Where original mortgagor has not been made a party to the foreclosure of an assumed mortgage, the original mortgagor is not liable for any deficiency. n13

In addition, HUD guidelines also require mortgagees to provide special relief for military personnel on active duty, including postponement of payment on the principal, and protections during foreclosure. n14

[6] Foreclosure of VA-Guaranteed Mortgages

A homeowner whose mortgage is insured by the Veteran's Administration has additional rights not available to homeowners with private conventional mortgages. The holder of the mortgage may not foreclose unless the borrower fails to make three full monthly payments; n15 may allow the borrower to reinstate prior to sale by tender of the amount of delinquency, including installment payments, late charges, and reasonable expenses incurred and paid by the lender if foreclosure has begun; n16 must provide 30 days' advance notice to the VA of its intention to foreclose; n17 must accept partial payments in many circumstances; n18 and must extend all reasonable forbearance, including consideration of temporary suspension of payments, extension of the loan, and acceptance of partial payments. n19

In addition, under the Servicemembers Civil Relief Act, a court order is required prior to a foreclosure, sale or seizure of property while the service member is on active duty or within ninety days after the end of active duty. n20

Although authority exists for the VA to refund the unpaid balance of a loan to the lender, or to take an assignment of the loan and the mortgage, n21 in reality, the VA rarely exercises this authority. Courts have found that the VA's decision not to exercise this authority is not subject to judicial review. Nonetheless, some state courts have allowed borrowers to raise improper servicing as an equitable defense to foreclosure. n22

[7] Foreclosure of Farmers Home Administration Loans and Mortgages

Rural farm and non-farm borrowers under the RHS (formerly the Farmer's Home Administration or "FmHA") have significant rights not available to borrowers with conventional loans. n23

[8] Protections from Foreclosure Available Under the Servicemembers Civil Relief Act

The Servicemembers Civil Relief Act (SCRA) n24 provides special foreclosure and other protections for military service personnel on active duty and their dependents. The SCRA was signed into law on December 19, 2003, and is a complete revision of the Soldiers' and Sailors' Civil Relief Act of 1940. n25 The new law preserves or expands many of the protections available under the original law and restates or clarifies certain key issues. A number of states have similar laws. n26

Since the rewritten law preserves the substance of the original Soldiers' and Sailors' Civil Relief Act, decisions under this former law remain relevant.

[a] Who is Protected by the Act?

The Act applies to members of the uniformed services on active duty, n27 and includes members of the National Guard who are called to active service authorized by the President or Secretary of Defense for more than thirty consecutive days for the purpose of responding to a national emergency, n28 reservists ordered to report for military service, n29 persons ordered to report for induction under the Military Selective Service Act (*50 U.S.C. App. § 451 et seq.*), n30 and United States citizens serving with allied forces, n31 are also entitled to the Act's protections, as are dependents and co-obligors of servicemembers are entitled to many of the protections of the Act, in some circumstances. n32 The act may also protect a small business owned by a servicemember. n33

[b] Protections Against Foreclosure

The relief provided by the Act applies to a servicemember who originated a mortgage, trust deed or security in the nature of a mortgage prior to beginning active duty, and for which the servicemember is still obligated. n34

A court order is required prior to a foreclosure, sale or seizure of property while the servicemember is on active duty or within ninety days after the end of active duty. n35 This is especially helpful in the states where lenders are permitted to foreclose on the mortgage without court action. A foreclosure in violation of this provision may render the sale invalid and subject the lender to criminal prosecution.

Servicemembers may waive the protections provided by a court ordered sale, but the waiver must be in writing and executed during or after the servicemember's period of active duty. n36 Assuming a sale was properly performed, a servicemember may obtain an extension of a state statutory redemption period by an amount of time equal to the servicemember's period of active duty. n37

In addition, a court may, on its own or upon application by a servicemember, impose a stay of the foreclosure proceedings or fashion such equitable relief as may be appropriate to protect the interests of all parties. n38 Military service must materially affect the servicemember's ability to pay the mortgage or meet his or her obligations under the mortgage.

A court order is also required for tax sales of certain real property. n39

Other relief available under the Act includes reopening a default foreclosure judgment issued during active duty or within sixty days after the end of active duty. n40 Upon an application by, or on behalf of a servicemember, the court

may reopen the judgment if the servicemember was materially affected by military service in making a defense to the action, and the servicemember has a meritorious or legal defense to the action. n41 The servicemember must seek to vacate the judgment no later than ninety days after release from active duty.

The Act also provides protections against the forfeiture of land installment contracts similar to those provided for mortgages. n42 Lenders are also responsible for providing written notice of the SCRA's mortgage-related provisions to borrowers who are forty-five days late on their mortgage. n43

[c] Interest Rate Reduction Under the Act

The Act requires that a lender reduce the interest rate to six percent on any loan obligation incurred prior to active duty. The loan shall not bear a rate higher than six percent during the period of active duty, unless a court decides, on application by the lender, that the servicemember's ability to pay the higher interest rate is not materially affected by military service. n44 Interest in excess of six percent must be forgiven, not simply deferred. n45 In addition, the amount of the periodic payments must be reduced by the amount of the interest forgiven. n46 This prevents lenders from requiring the same monthly payment from the servicemember but simply shifting a greater portion of that payment to pay off the principal.

To benefit from the interest rate reduction, the servicemember must provide written notice to the lender and a copy of the military orders calling the servicemember to active duty and any other orders further extending military service. n47 This notice must be given no later than 180 days after the servicemember's termination or release from active duty. n48 The interest rate reduction is effective as of the date on which the servicemember is called to active duty. n49

[d] Remedies for Violation of the Act

A private cause of action is not directly established under the Act. However, the Act expressly preserves the servicemember's right to pursue a claim for wrongful conversion. n50 In addition, courts have held that the former version of the Act creates a private cause of action for violations. n51 The debtor is not confined to raising the violation of the Act defensively, in response to a foreclosure, but can sue affirmatively. n52

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawFederal ActsFair Housing & National Housing ActsMilitary & Veterans LawServicemembersSoldiers & Sailors Civil Relief ActReal Property LawFinancingFederal ProgramsFederal Housing AdministrationReal Property LawFinancingFederal ProgramsU.S. Department of Housing & Urban Development ProgramsReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresGeneral OverviewReal Property LawFinancingWorkouts

FOOTNOTES:
(n1)Footnote 1. *12 U.S.C. §§ 1701 et seq.*

(n2)Footnote 2. *See Mellon Mortgage Co. v. Larios, 1998 U.S. Dist. LEXIS 7988* (N.D. Ill. May 19, 1998) (failure to comply with HUD servicing requirements is a defense to foreclosure); *Cross v. Federal Nat'l Mortgage Ass'n, 359 So. 2d 464 (Fla. Dist. Ct. App. 1978)* ; *Heritage Bank N.A. v. Ruh, 191 N.J. Super. 53, 465 A.2d 547 (1983) . See also Washington Mutual Bank v. Mahaffey, 154 Ohio App. 3d 44, 796 N.E.2d 39 (Ohio App. 2003)* (foreclosing mortgagee was denied summary judgment based on its failure to arrange a face-to-face interview with the borrower; even though a representative of the mortgagee visited the borrower's property, the mortgagee failed to establish that it made a reasonable effort to arrange an interview with the borrower because it did not satisfy the HUD regulations' minimum requirement of one letter sent to the borrower via certified mail). *See also 24 C.F.R. § 203.500* ("It is the intent of the Department that no mortgagee shall commence foreclosure or acquire title to a property until the requirements of this

subpart have been followed.").

(n3)Footnote 3. United States HUD, Mortgagee Letter 00-05 (Jan. 19, 2000). *See also* periodic updates to this letter contained in United States HUD, Mortgagee Letter 2001-14 (May 23, 2001); United States HUD, Mortgagee Letter 2002-13 (June 7, 2002); and United States HUD, Mortgagee Letter 2002-17 (Aug. 29, 2002) (supersedes portion of Mortgagee Letter 00-05 which discusses Special Forbearance).

(n4)Footnote 4. *24 C.F.R. § 203.371 (1996).*

(n5)Footnote 5. Dep't of Hous. & Urban Dev., Mortgagee Letter 07-11 (Sept. 5, 2007). A fact sheet is available at www.hud.gov/news/fhahandout.pdf.

(n6)Footnote 6. *24 C.F.R. § 203.355.*

(n7)Footnote 7. *61 Fed. Reg. 35,015* (July 3, 1996) .

(n8)Footnote 8. *See 12 U.S.C. § 1735u; 24 C.F.R. § 203.605*; Mortgagee Letter 97-44 (Sept. 29, 1997) and Mortgagee Letter 00-05 (Jan. 19, 2000). The mortgagee letters, other HUD materials, and periodic updates are currently available on the internet at http://www.hud.gov/fha/sfh/slmhome.html. HUD workout options are described at National Consumer Law Center, Foreclosures, § 2.7.1 (1st ed. 2005 and Supp.).

(n9)Footnote 9. *24 C.F.R. § 203.605.*

(n10)Footnote 10. Pub. L. No. 105-276, § 601 (Oct. 21, 1998).

(n11)Footnote 11. *Mortgage Associates, Inc. v. Cleland, 653 F.2d 1144 (7th Cir. 1981)* (federal law preempts on issues of VA's obligation as a guarantor and the laws of foreclosure); *United States v. Wells, 403 F.2d 596 (5th Cir. 1968)* ; *United States v. Rossi, 342 F.2d 505 (9th Cir. 1965)* .

(n12)Footnote 12. *Federal Home Loan Mortgage Corp. v. Dutch Lane Assocs., 810 F. Supp. 86 (S.D.N.Y. 1992)* (VA held bound to comply with notice requirements of state deficiency judgment statute); *United States v. Whitney, 602 F. Supp. 722 (W.D.N.Y. 1985) . Cf. Jensen v. Turnage, 782 F. Supp. 1527 (M.D. Fla. 1990) . See also Yunis v. U.S., 118 F. Supp. 2d 1024 (C.D. Cal. 2000)* (pursuant to federal rule of decision that only the VA could dispose of property that it acquired through administration of its home loan guaranty program, nonjudicial foreclosure sale of property owned by VA, under the program, was void, even though sale complied with state law).

(n13)Footnote 13. *United States v. Whitney, 602 F. Supp. 722 (W.D.N.Y. 1985)* (VA could not recover deficiency judgment against mortgagor where it chose not to make mortgagor a party to the foreclosure proceeding; state law not "inconsistent state law" displaced by VA regulations).

(n14)Footnote 14. *See, e.g., 24 C.F.R. §§ 203.345*, *203.346* and *203.610*. Mortgagees are also required to comply with the Servicemembers Civil Relief Act. Mortgagee Letter 2003-04 (Mar. 24, 2003); Mortgagee Letter 2001-22 (Sept. 24, 2001) (discussing mortgagees' responsibility under the Soldiers' and Sailors' Civil Relief Act of 1940, a predecessor of the Act). See *§ 13.06[7]*, *infra*, for a discussion of the Servicemembers Civil Relief Act.

(n15)Footnote 15. *38 C.F.R. § 36.4316(a)*; VA Handbook H26-94-1 § 3.06(a) (February 1994). Materials on VA policies including the above referenced handbook and updates to it are currently available at http://www.homeloans.va.gov/service.htm. *See also* National Consumer Law Center, Foreclosures, § 3.3 (2d ed. 2007).

(n16)Footnote 16. *38 C.F.R. § 36.4308(a).*

(n17)Footnote 17. *38 C.F.R. § 36.4317.*

(n18)Footnote 18. *38 C.F.R. § 36.4315(b)(2).*

(n19)Footnote 19. Section F.I.b., VA Lender's Handbook 26-7 (Lender's Handbook).

(n20)Footnote 20. *50 U.S.C. app. § 533(c).*

(n21)Footnote 21. *38 U.S.C. § 1816(a).*

(n22)Footnote 22. *See* National Consumer Law Center, Foreclosures, § 3.3 (2d ed. 2007). Loan servicing handbooks and other resources for information about VA-guaranteed mortgages are available on the VA web site at: www.homeloans.va.gov.

(n23)Footnote 23. *See* U.S.C.§ 1472, 7 C.F.R. pt. 3550, sub-pt. G. *See also* National Consumer Law Center, Foreclosures, § 3.4 (1st ed. 2005 and Supp.).

(n24)Footnote 24. *50 U.S.C. app. §§ 501, et seq.*

(n25)Footnote 25. *50 U.S.C. app. §§ 501-593.*

(n26)Footnote 26. *See, e.g., N.Y. Military Law § 300 et seq . See, e.g., Watkins v. Sands, 2005 Cal. App. Unpub. LEXIS 5069* (Cal. Ct. App. June 10, 2005) (unpublished) (the 2003 law, unlike the 1940 version, applies to administrative as well as judicial proceedings); *Linscott v. Victor Aerospace, 2006 U.S. Dist. LEXIS 6287* (D. Or. Jan. 31, 2006) (court cited principle of liberal construction in favor of servicemember; found private right of action under § 537 regarding chattel liens).

(n27)Footnote 27. § 101; *50 U.S.C. app. § 511.*

(n28)Footnote 28. § 101(2)(A)(ii); *50 U.S.C. app. § 511(2)(A)(ii).*

(n29)Footnote 29. § 106; *50 U.S.C. app. § 516.*

(n30)Footnote 30. *Id.*

(n31)Footnote 31. § 104; *50 U.S.C. app. § 514.*

(n32)Footnote 32. *See, e.g.*, §§ 103 (*50 U.S.C. app. § 513*) (stay, postponement, suspension, vacation of judgments, and bail bonds), 308 (*50 U.S.C. app. § 538*) (general extension to dependents).

(n33)Footnote 33. *Linscott v. Vector Aerospace, 2006 U.S. Dist. LEXIS 30023* (D. Or. May 12, 2006) (subchapter S corporation; servicemember owner had personally guaranteed his company's debts). *See also Rodriguez v. American Express, 2006 U.S. Dist. LEXIS 17727* (E.D. Cal. Apr. 7, 2006) (sole proprietor of "small construction company").

(n34)Footnote 34. § 303(a); *50 U.S.C. app. § 533(a).*

(n35)Footnote 35. § 303(c); *50 U.S.C. app. § 533(c).*

(n36)Footnote 36. §§ 303(c)(2), 107; *50 U.S.C. app. §§ 533(c)(2), 517. See also* § 16.6.6, *infra.*

(n37)Footnote 37. § 206(b); *50 U.S.C. app. § 526(b). See Peace v. Bullock, 40 So. 2d 82 (Ala. 1949)* (extending period allowed for redemption of real estate under a prior version of the Act); *Ill. Nat'l Bank of Springfield v. Gwinn, 348 Ill. App. 9, 107 N.E.2d 764 (1952)* (Soldiers' and Sailors' Civil Relief Act extended the time for borrower to redeem).

(n38)Footnote 38. § 303(b); *50 U.S.C. app. § 533(b). See Scranton Lackawanna Trust Co. v. Griffith, 51 Pa. D. &*

C. 475 (C.P. 1944) (under Soldiers' and Sailors' Civil Relief Act, court in the exercise of its sound discretion may stay foreclosure, upon condition that interest and taxes be paid promptly when due, when title to the mortgaged premises is in name of the dependent mother of servicemember, who had previously assisted in making payments on the mortgage and to whom in return his mother had promised to convey title to the property). Courts often exercise their equitable powers by ordering partial payment of the mortgage. *See, e.g., Fed. Nat'l Mortgage Ass'n, 136 F. Supp. 859 (E.D. Mich. 1956)* ; *R.R. Fed. Sav. & Loan v. Morrison, 40 N.Y.S.2d 319 (Sup. Ct. 1943)* ; *Nassau Sav. & Loan Ass'n v. Ormond, 39 N.Y.S.2d 92 (Sup. Ct. 1942)* .

(n39)Footnote 39. *Id. See Fed. Home Loan Mortgage Corp. v. Taylor, 318 So. 2d 203 (Fla. Dist. Ct. App. 1975)* (under Soldiers' and Sailors' Civil Relief Act court in mortgage foreclosure action was within discretion in determining that acceleration of entire mortgage debt would be unconscionable, on basis of a technical default of one month's installment which could have arisen from excusable misunderstanding and lack of effective and timely communications because mortgagors were in the Philippines in connection with mortgagor husband's military duty).

(n40)Footnote 40. § 201(g); *50 U.S.C. app. § 521(g). See also Kramer v. Ginger, 341 Ill. App. 368, 93 N.E.2d 437 (1950)* (when persons affected by foreclosure proceedings alleged that at time of service of summons they were both in military service, and plaintiff had not filed proper affidavit of military service and had not had attorney appointed to protect interests of defendants, petition filed within ninety days from time defendant first received knowledge of proceedings to set aside decree of sale and decree confirming sale was timely under the Soldiers' and Sailors' Civil Relief Act).

(n41)Footnote 41. § 201(g); *50 U.S.C. app. § 521 (g).*

(n42)Footnote 42. § 302; *50 U.S.C. app. § 532.*

(n43)Footnote 43. Dep't of Hous. & Urban Dev., Mortgagee Letter 06-28 (Nov. 20, 2006).

(n44)Footnote 44. § 207(c); *50 U.S.C. app. § 527(c).*

(n45)Footnote 45. § 207(a)(2); *50 U.S.C. app. § 527(a)(2). See Linscott v. Vector Aerospace, 2006 U.S. Dist. LEXIS 30023* (D. Or. May 12, 2006) (where lump-sum judgment against servicemember could not be broken down into principal, permissible interest, and excess interest, entire judgment was tainted by 18% interest rate; enforcement must be enjoined); *Rodriguez v. American Express, 2006 U.S. Dist. LEXIS 17727* (E.D. Cal. Apr. 7, 2006) (issue of fact whether excess interest properly credited to servicemember borrower's account).

(n46)Footnote 46. § 207(a)(3); *50 U.S.C. app. § 527(a)(3).*

(n47)Footnote 47. § 207(b)(1); *50 U.S.C. app. § 527(b)(1).*

(n48)Footnote 48. *Id.*

(n49)Footnote 49. § 207(b)(2); *50 U.S.C. app. § 527(b)(2). See Donahou v. Presidential Limousine & Auto Sales, Inc., 2007 U.S. Dist. LEXIS 30257* (W.D. Ark. Apr. 24, 2007) (active duty does not include 8-month "Delayed Entry" period between time servicemember enlisted and time he reported for duty; he had no military duties during this time and was able to maintain civilian employment).

(n50)Footnote 50. § 303(d)(2); *50 U.S.C. app. §§ 531(d)(2).*

(n51)Footnote 51. *Marin v. Citibank, N.A., 208 F.3d 203 (2d Cir. 2000)* (unpublished, citation limited, text available at *2000 U.S. App. LEXIS 3789*) (reversing dismissal of affirmative suit and remanding for consideration of existence of private cause of action); *Cathey v. First Republic Bank, 2001 U.S. Dist. LEXIS 13150* at *14 (W.D. La. July 6, 2001) ; *Moll v. Ford Consumer Fin. Co., 1998 U.S. Dist. LEXIS 3638* (N.D. Ill. Mar. 23, 1998) . *See also Linscott v.*

Victor Aerospace, 2006 U.S. Dist. LEXIS 6287 (D. Or. Jan. 31, 2006) (§ 537, concerning chattel liens confers a private right of action; collection and discussion of cases finding private right of action under §§ 513, 518, and 526).

(n52)Footnote 52. *Moll v. Ford Consumer Fin. Co., 1998 U.S. Dist. LEXIS 3638* (N.D. Ill. Mar. 23, 1998) .

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.07

§ 13.07 Legal Defenses to Foreclosure: Substantive Defenses

[1] Introduction

In order to be valid, a foreclosure must be based on a valid, legally enforceable mortgage (or deed of trust). n1 This section will discuss some of the possible challenges to the validity of the mortgage agreement itself, and other claims that may be raised based on lender misconduct in the making of the loan. These claims may possibly be raised post-foreclosure in an action to set aside the sale, depending on state law and on who purchased at the sale, but obviously it is preferable to raise any available claims before the foreclosure has taken place. After a foreclosure sale, the borrower may be unable to set aside the sale, although he or she would still have a claim for damages against the original lender for wrongful foreclosure, or, in some circumstances, could seek injunctive relief to reverse the foreclosure.

[2] Lender Liability for Loans Which Are Disadvantageous to the Borrower

[a] General

Many credit transactions, especially predatory home equity secured credit and home improvement schemes, may involve overreaching and lead to contracts truly disadvantageous to borrowers. Some overreaching is substantive, as in gross disparity between the price of a product or service and its value; some is procedural, as in misrepresentation about terms or benefits, or a failure to disclose material information. n2

[b] Unfair and Deceptive Acts and Practices (UDAP) Statutes

Some unfair practices can be challenged under state unfair and deceptive acts and practices ("UDAP") statutes, providing the statute governs the type of transaction (the extension of credit) and creditor involved. n3

Several widespread practices may be challenged by UDAP claims, for example, "flipping" loans, where a lender makes a series of loans to a consumer, each loan refinancing the prior loan; "overcollateralizing," where a home is taken as security for a relatively small loan; or "loan-padding"--structuring a loan to increase its size without advancing additional funds to borrowers, thereby increasing lender profit or giving a larger loan on which to foreclose. Other state UDAP claims involve failure to follow servicing guidelines. n4

In an attempt to curb the increasing number of property flipping schemes, the FHA recently implemented property flipping guidelines. These guidelines seek to hold lenders accountable for the quality of appraisals on properties secured by FHA-insured mortgages. n5 The final rule requires that:

- Only owners of record can sell properties that will be financed using FHA-insured mortgages (the transaction may not involve any sale or assignment of the sales contract);

- Any re-sale of a property may not occur 90 or fewer days from the last sale to be eligible for FHA financing;

- For re-sales that occur between 91/-/180 days where the new sales price exceeds the previous sales price by 100%, FHA will require additional documentation validating the property's value. n6

In addition, the rules provide flexibility for FHA to examine and require additional evidence of appraised value when properties are re-sold within twelve months. n7

Remedies available for UDAP violations will vary depending on the state UDAP statute, but generally include actual damages, often statutory damages, and, in some states, punitive and treble damages. Here, UDAP damage claims could be used in two ways: the borrower may assert that he or she is not in default because the lender was involved in misconduct concerning the underlying transaction; or the borrower can assert that the UDAP claims against the lender offset the amount of delinquent payments. There is little case law in this area.

Where a lender has violated a UDAP statute, or engaged in usury or fraud, arguably the lender's illegal conduct renders the underlying contract unenforceable and, therefore, the action to enforce the mortgage by foreclosure should fail.

The borrower may attempt to stop a foreclosure by claiming that his or her claims (UDAP, usury, etc.) against the lender offset the amount of delinquent payments. These claims may eliminate the delinquency or reduce it to an amount that the borrower could afford to pay to redeem the mortgage.

Where state UDAP statutes authorize equitable relief, a UDAP claimant may seek to void or rescind the contract based on illegality.

[c] Fraud/Misrepresentation, Fiduciary Duty and RICO

Creative uses of fraud or misrepresentation may result in the note being declared unenforceable.

A credit transaction may give rise to special duties to the borrower, up to and including a fiduciary duty, which gives rise to a duty of fair and honest disclosure of all facts which might be presumed to influence the consumer in regard to his or her actions. Where there is a duty to disclose, failure to do so should give rise to a tort claim for nondisclosure, or the silence may qualify as misrepresentation. Such claims can be used to invalidate the underlying mortgage transaction or to recover money damages to offset any delinquency. n8

In the foreclosure process the lender has a fiduciary duty to ensure that the homeowner obtains the highest price possible from the sale of the property. A lender's refusal to postpone a foreclosure sale, for example, to allow the homeowner to conduct a market sale to a willing and financially capable buyer is a violation of its fiduciary duty. The pre-auction sale would have satisfied the lender's lien and costs and netted the homeowner a surplus. n9

The Federal Racketeering Influenced and Corrupt Organizations Act ("RICO") n10 provides powerful civil remedies, including attorney's fees and treble damages, to victims subjected to a broadly defined range of "racketeering activity"

or to the collection of an "unlawful debt," which is defined as any usurious debt bearing interest of at least twice the "enforceable rate." n11

[3] Truth in Lending

[a] Truth in Lending Rescission Rights

In addition to being entitled to a TIL disclosure statement summarizing the credit terms prior to consummating a credit transaction, a homeowner has a TIL right to rescind most non-purchase money transactions for which the home is taken as collateral, such as most home equity or home improvement loans.

The rescission right is absolute for three days, but it may also last up to three years, n12 if the homeowner does not sell the home and if important "material" TIL disclosures were not provided correctly at the time of the original credit transaction. Once notice of rescission is given, the lien on the consumer's home becomes void, n13 taking away the creditor's foreclosure remedy, and its leverage. The homeowner is entitled to a return, or a credit against the balance of the debt, of all finance, interest, and other charges, such as closing costs and broker's fees. n14

If the transaction is subject to the rescission right, and there are valid grounds for exercising the extended right, rescission is a complete defense to foreclosure on the property.

When the consumer has rescinded a transaction, after the creditor takes the required steps, the consumer is then obligated to tender the loan proceeds, or the fair market value of any property received which may be less than the original credit obligation. n15

[b] Rescission Rights in Bankruptcy

Filing a bankruptcy, which can be done quite quickly with a bare bones petition, n16 stops any collection activity immediately, including both judicial and non-judicial foreclosures. In general, the merits of the TIL rescission and other consumer defenses can be litigated in an adversary proceeding within the debtor's bankruptcy case. Moreover, if a debtor files for bankruptcy and does not assert TILA claims, the debtor is not estopped from asserting those claims in a later bankruptcy proceeding. n17 In other words, TILA claims are not compulsory counterclaims in bankruptcy.

In a chapter 13 bankruptcy, once the bankruptcy court has determined the consumer's tender obligation after all defenses and setoffs have been accounted for, any remaining obligation can be tendered in installments through the chapter 13 plan.

Another advantage of bankruptcy court is that there is a strong argument that an arbitration clause is ineffective in bankruptcy litigation. n18

In *Beach v. Ocwen Federal Bank*, n19 the Supreme Court ruled that extended rescission rights under TILA must be exercised within the three year period provided under the statute. The court has barred the use of TILA rescission by recoupment as a defense to a collection action or to a creditor's bankruptcy proof of claim after expiration of the three year period.

[c] Truth in Lending Damages Claims

Nearly all home mortgages, where the lender is in the business of making loans to consumers, are subject to the disclosure requirements of the TILA. These requirements include the disclosure of the annual percentage rate ("APR"), n20 disclosure of the finance charge, n21 disclosure of the amount financed, n22 and disclosure of any security interest taken. n23 Failure to disclose these items as required may give rise to claims for actual damages, n24 statutory damages, n25 and attorney's fees. n26 Statutory damages are limited to twice the finance, but not less than $200.00 and not more

than $2000.00. While these claims will not defeat the mortgage, they may be used to reduce the amount of indebtedness. Claims for damages are not limited to non-purchase money mortgages. If the loan is covered by the Home Ownership and Equity Protection Act ("HOEPA"), the consumer is entitled to not only statutory damages and actual damages, but also special enhanced damages in the amount of all finance charges and fees paid by the consumer. n27 This award can make a substantial reduction in the balance.

[d] Special Truth in Lending Disclosure Requirements for High-Rate Home Equity Loans

In 1994, Congress passed HOEPA n28 to prevent some predatory lending practices targeted at vulnerable consumers, effective as to loans made after October 1, 1995.

This Act applies to high interest or high fee mortgages not obtained for the purchase of the home; that is, second mortgages or home equity loans. Violations of the Act trigger the usual TIL monetary damages, and, possibly, enhanced damages, as well as TIL rescission. n29 In addition, the law limits the right of assignees of high-cost mortgages to assert holder in due course statue to cut off consumer claims and defenses.

Covered loans are subject to additional TIL disclosure requirements and to prohibitions on certain mortgage terms, including prepayment penalties, n30 balloon payments in loans with terms of less than five years, and negative amortization. n31

After October 1, 2002, due on demand provisions or call provisions that permit the creditor to terminate the loan in advance of the original maturity date and to accelerate the entire loan balance are prohibited except in limited circumstances. n32 The new rules also prohibit a lender from refinancing a HOEPA loan into a new HOEPA loan within one year of the origination date, unless the refinancing is in the borrower's best interest. n33

[4] Usury

Federal preemption of state usury laws has limited usury as a possible defense to a foreclosure action. However, where a lender is foreclosing on a second mortgage, or where the state has "opted out" of the federal preemption provisions, usury laws may provide a viable defense. Even where state (or federal) law places no restrictions on interest rates, other than that the interest rate shall be as the contract provides, the loan may be usurious, if there is "hidden interest," such as where unauthorized charges for lender services are not included in the stated interest rate or where excessive "points" or similar charges are made. Where there is hidden interest, the actual interest rate is higher than the stated contract rate, and, therefore, the loan is usurious. n34

The remedies available where usury can be established will vary from state-to-state. Often a statute will declare a usurious loan void as to all or part of the interest while leaving the principal obligation intact. Under such statutes, the widely accepted rule is that all payments already made on the contract will be applied to the principal debt until the debt has been paid off. Thus, in a foreclosure case, a borrower may be able to raise a usury claim to reduce or eliminate the amount of a default.

Some statutes declare usurious transactions to be completely void and prohibit any creditor recovery whether or not the principal has been repaid.

[5] Credit Disability Insurance: Obtaining Benefits

Credit disability insurance guarantees payment of a loan in the event that the borrower is unable to work as a result of a disability.

One of the problems associated with credit disability insurance is post-claim denial of coverage by the insurance

company after the consumer had been led to believe that the insurance requested in the credit transaction had taken effect. This happens for one of two reasons. Either the insurance company determines that the borrower was not eligible for the insurance at the time of application and is, therefore, not covered, or, the creditor fails to submit or properly process the application so that coverage is never effective.

At least one court stopped a foreclosure based on a bank's negligent failure to obtain insurance coverage after a borrower purchased credit disability insurance. Borrowers may need to allege some misconduct on the part of the lender with respect to the credit insurance in order to enjoin foreclosure or repossession upon denial of a claim. n35

[6] Home Equity Scams and Foreclosure Fraud

There is no limit to the creative schemes that have been devised to separate homeowners, who have financial problems or who are otherwise vulnerable, from their property and their equity. A few of the more common scenarios, however, include sale/leaseback schemes, home improvement financing scams, and refinancing schemes/equity skimming. Failure to pay for these ventures if a secured loan is taken out may lead to foreclosure and the need to raise appropriate defenses. n36

[7] Raising Claims and Defenses Against the FDIC or RTC

Borrowers who find themselves in the position of defending against a foreclosure action brought by the Federal Deposit Insurance Corporation ("FDIC") or the Resolution Trust Corporation ("RTC") after it has taken over a failed lender may have difficulty raising certain claims against these agencies which arise out of the failed lender's conduct. There are special common law and statutory defenses available to the FDIC and RTC which provide broad immunity from many claims under the so-called *D'Oench, Duhme* doctrine; however, the law in this area is in a state of flux. n37

[8] Challenging the Amount of the Claimed Default: Unauthorized Fees and Overcharges

Even where the borrower concedes that some amount is due and owing on the mortgage, the lender's calculation of the balance of the debt should not automatically be accepted as accurate. Unauthorized fees should not be included in the amount needed to cure or redeem the mortgage. While some overcharges may be inadvertent, where an overcharge appears to be deliberate or where a creditor fails to correct an overcharge after notice, the borrower may have grounds for claims under the state UDAP and state debt collection laws for actual damages, as well as attorney's fees. Where overcharges involve interest, a usury claim may be available. n38

In some cases, it may be advantageous for the borrower to challenge the amount owed under the mortgage even *after* the foreclosure, so as to reduce the redemption amount or the amount of a deficiency judgment.

[9] Other Defenses

[a] Lender's Violation of the Equal Credit Opportunity Act

A number of courts, including one federal circuit court, n39 have allowed homeowners to raise a lender's violation of the Equal Credit Opportunity Act ("ECOA") n40 as a defense to foreclosure. This claim most commonly arises where a lender requires a wife's signature on a promissory note, not just the mortgage, even though she is not an applicant on the loan, and even though the husband is creditworthy in his own right. Requiring a wife to sign solely because of her status as the wife of the applicant violates the ECOA. n41

Consumer remedies available under the ECOA include actual damages, punitive damages up to $10,000, attorney's fees and costs, n42 and equitable relief, which may allow the wife to void her liability under the note and mortgage. There is a two-year statute of limitations for ECOA claims, but such a claim can be raised later as a defense or recoupment to the lender's claim to enforce the mortgage. n43

[b] Incompetence of the Borrower

Contracts entered into by incompetents are generally voidable. This may be a defense to foreclosure by voiding the underlying note and mortgage.

[c] Unconscionability of Mortgage

The common law contract defense of unconscionability may be applied to stop a foreclosure, where either the mortgage terms are unreasonably favorable to the lender, or where certain aspects of the transaction render it unconscionable.

[d] Fair Lending Statutes

A number of courts have allowed homeowners to raise a lender's violation of the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA) as a defense to foreclosure. For example, the Maine Supreme Judicial Court has used its equitable power under the ECOA to bar a lender from foreclosing on property owned by joint tenancy when the wife's signature on the mortgage was obtained in violation of that Act. n44 Claims of reverse redlining under either the ECOA or the FHA may also be raised defensively in foreclosure actions. n45 More recently, ECOA has been used affirmatively to combat the predatory practice of making loans to consumers for a larger amount than they applied for and without a formal loan denial and statement of reasons why the loan in the amount requested was not provided. n46

As a general rule, both the ECOA and the FHA have a two-year statutes of limitation for affirmative claims. n47 However claims usually can be brought by way of set-off or recoupment. n48 In addition to equitable relief discussed above, consumer remedies for violation of fair lending statutes in affirmative or defensive cases include actual damages, punitive damages, and attorney fees and costs. n49

Significantly, both the ECOA and the FHA may allow consumers to reach assignees and secondary market players. The ECOA definition of creditor explicitly includes assignees as long as they regularly participate in credit decisions, including setting the terms of the credit. n50 The FHA explicitly applied to the selling, brokering, or appraising of residential real estate and to any other entity providing financial assistance related to a loan covered by the Act. n51 The FHA also applies to the activities of secondary market players in the purchasing of loans, debts, or securities, the pooling and packaging of these instruments, and the marketing and sale of securities issues on the basis of loans or debts. n52

[e] Miscellaneous Defenses

Under a California statute, a cosigner on a consumer credit transaction is entitled to a statutory notice from the lender at the time the loan is made. n53, n54 Failure to provide this notice has been held to be a defense to foreclosure. n55

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawTrade Practices & Unfair CompetitionState RegulationCoverageBanking LawConsumer ProtectionTruth in LendingDisclosureReal Property LawFinancingMortgages & Other Security InstrumentsGeneral OverviewReal Property LawFinancingMortgages & Other Security InstrumentsMortgagee's InterestsReal Property LawFinancingState RegulationReal Property LawFinancingUsury

FOOTNOTES:
(n1)Footnote 1. *But see Provident Bank v. Francis, 2001 Conn. Super. LEXIS 1255* (Conn. Super. Ct. May 10, 2001) (a mortgage deed not properly witnessed and acknowledged is valid as between the original mortgagor and mortgagee).

(n2)Footnote 2. *See generally* National Consumer Law Center, Foreclosures, § 5.3 (2d ed. 2007 and Supp.). *See*

also National Consumer Law Center, Consumer Law Pleadings, No. 1 (2003 Cumulative CD-Rom and Index Guide), containing sample pleadings for use in abusive mortgage lending cases.

(n3)Footnote 3. *See generally § 4.02 supra. Williams v. First Gov't Mortgage & Investors Corp., 225 F.3d 738 (D.C. Cir. 2000)* ; *Duren v. First Gov't Mortgage & Investors Corp., 2000 U.S. App. LEXIS 15469* (D.C. Cir. June 7, 2000) ; *Barker v. Altegra Credit Co. (In re Barker), 249 B.R. 391 (Bankr. E.D. Pa. 2000)* (unfair and deceptive acts and practices [hereinafter UDAP] violation where lender failed to advise the debtor of the detrimental financial consequences of refinancing a 9% loan with one bearing an interest rate of 18%), *op. withdrawn by, op. replaced by 251 B.R. 250 (Bankr. E.D. Pa. 2000) . Marks v. Chicoine, 2007 U.S. Dist. LEXIS 29438* (N.D. Cal. Apr. 6, 2007) (allegation that broker misstated interest rate and failed to disclose that loan had forty-year term states UDAP claim). *See also Cohen v. JP Morgan Chase & Co., 498 F.3d 111, 126-127 (2d Cir. 2007)* (reversing dismissal of UDAP claim; charging of illegal fee may constitute deception even if it was disclosed).

(n4)Footnote 4. *Hart v. GMAC Mortg. Corp. (In re Hart), 246 B.R. 709 (Bankr. D. Mass. 2000)* (UDAP violation for lender to proceed to foreclosure after becoming aware that debtor had complied with payment obligations under forbearance agreement, and to fail to straighten out its accounting of debtor's payments); *Rodriguez v. Mellon Bank, N.A. (In re Rodriguez), 218 B.R. 764 (Bankr. E.D. Pa. 1998)* (UDAP violation for mortgage company to fail to send out the required notice of cure and also to fail to send out the required notice of the right to seek emergency mortgage assistance from a state agency).

(n5)Footnote 5. The regulations permit administrative action against a mortgagee for "[s]ubmitting, or causing to be submitted, with an application for FHA mortgage insurance an appraisal, valuation condition sheet, or any other documentation relating to an appraisal that does not satisfy FHA requirements." *24 C.F.R. § 25.9(ee). See also 24 C.F.R. § 203.5(e).*

(n6)Footnote 6. *24 C.F.R. § 203.37a.*

(n7)Footnote 7. *Id.*

(n8)Footnote 8. For examples of the effective use of fraud or misrepresentation claims in a foreclosure case, see National Consumer Law Center, Foreclosures, § 4.8.6 (1st ed. 2005 and Supp.) *See also Harrel v. Solt, 2000 Ohio 1964, 2000 Ohio App. LEXIS 6312* (Ohio Ct. App. Dec. 27, 2000) (summary judgment denied and lender cannot foreclose on a home that mortgagors were fraudulently induced to purchase); *Home Loan & Inv. Bank v. Sebjan, 2000 Conn. Super. LEXIS 1910* (Conn. Super. Ct. July 24, 2000) (summary judgment denied and mortgagee cannot foreclose when mortgagee negligently misrepresented amount of mortgage).

(n9)Footnote 9. *Snowden v. Chase Manhattan Mortg. Corp., 2003 Mass. Super. LEXIS 398, 17 Mass. L. Rep. 27 (Mass. Super. Ct. 2003) .*

(n10)Footnote 10. *18 U.S.C. §§ 1961 et seq., reprinted in* Vol. 1A *infra. See Matthews v. New Century Mortgage Corp., 2002 U.S. Dist. LEXIS 2144* (S.D. Ohio Feb. 2, 2002) (plaintiffs adequately alleged pattern in state RICO claim brought against defendants who had allegedly been part of a fraudulent home improvement loan scheme targeting elderly women); *Faircloth v. Certified Fin. Inc., 2001 U.S. Dist. LEXIS 6793* (E.D. La. May 16, 2001) (court accepted settlement in class action that alleged that defendant had lent funds to plaintiffs with pending personal injury actions and then flipped the loans to create unlawful interest; judge approved attorney fee of more than $530,000). Chapter 7 of National Consumer Law Center, Consumer Law Pleadings, No. 1 (2003 Cumulative CD-Rom and Index Guide) contains a sample complaint against a mortgage lender which includes a civil RICO count.

(n11)Footnote 11. *18 U.S.C. § 1961(6). See Cannon v. Nationwide Acceptance Corp., 1997 U.S. Dist. LEXIS 20019,* (N.D. Ill. Dec. 9, 1997) *. See also Stewart v. Associates Consumer Discount Co., 183 F.R.D. 189 (E.D. Pa. 1998)* (class certification granted where allegations involve a scheme targeting borrowers who had difficulty obtaining credit from banks, sending them "live" checks, charging excessive points, upselling the loans from consumer loans to

home-secured loans, an repeatedly refinancing loans); *Parish v. Beneficial Ill., 1996 U.S. Dist. LEXIS 4453,* (N.D. Ill. Apr. 9, 1996) (pleading a loan flipping scheme can constitute "racketeering activity;" case dismissed without prejudice on the issue of pleading a "pattern;" plaintiffs permitted to conduct limited discovery on this issue). *See also Pulphus v. Sullivan, 2003 U.S. Dist. LEXIS 7080* (N.D. Ill. Apr. 25, 2003) (RICO claim arising from home improvement loan scheme; plaintiff sufficiently alleged conduct by assignees of loans by pleading that they had reviewed loan documents of originating lenders, underwrote the loans, and approved loan applications, and sufficiently alleged conduct by loan originator by pleading that employee of title company closed the fraudulent loan on the originator's behalf).

(n12)Footnote 12. *15 U.S.C. § 1635(f).*

(n13)Footnote 13. *15 U.S.C. § 1635(b)*; Reg. Z §§ 226.15(d)(2), 226.23(d)(2); Official Staff Commentary §§ 226.15(d)(1)-1, 226.23(d)(1)-1.

(n14)Footnote 14. *15 U.S.C. § 1635.*

(n15)Footnote 15. *See generally* National Consumer Law Center, Foreclosures, § 5.5.1 (2d ed. 2007 and Supp.). *But see Yamamoto v. Bank of N.Y., 329 F.3d 1167 (9th Cir. 2003)* (court has the discretion to condition rescission on tender by the borrower of the property received from the lender, and court could require that mortgagors provide proof of their ability to repay loan proceeds if rescission is granted); *Wilson v. Homeowners Loan Corp., 263 F. Supp. 2d 1212 (E.D. Mo. 2003)* (court had discretion to condition rescission on borrower's prior return of loan proceeds); *In re Armstrong, 288 B.R. 404 (Bankr. E.D. Pa. 2003)* (court may condition the avoidance of the lender's security interest on the return of its money by the plaintiffs); *Regency Sav. Bank v. Chavis, 776 N.E.2d 876 (Ill. 2002)* (courts have the power to modify the procedure to effect the grant of rescission). *See also* National Consumer Law Center, Truth in Lending § 6.7.1 (5th ed. 2003 and Supp.). *See also Williams v. Bank One (In re Williams), 291 B.R. 636 (Bankr. E.D. Pa. 2003)* (no authority for equitable modification); *In re Myers, 175 B.R. 122 (Bankr. D. Mass. 1994)* (conditional rescission inappropriate in bankruptcy context under identical provisions in Mass. TIL statute). *Cf. In re* Lang, Clearinghouse No. 45,907 (D. Or. Aug, 1 1990) (rescission condition on repayment of tender amount is only available in limited situations and upon equitable consideration of court).

(n16)Footnote 16. *See* Collier Consumer Bankruptcy Practice Guide Ch. 6, P 6.05 (Matthew Bender), and Collier Consumer Bankruptcy Forms pt. CS10 (Matthew Bender).

(n17)Footnote 17. *See Walker v. Contimortgage (In re Walker), 232 B.R. 725 (Bankr. N.D. Ill. 1999) . But see Albano v. Norwest Fin. Haw., Inc., 244 F.3d 1061* (9th Cir.) (Truth in Lending Act [hereinafter TILA] suit barred by *res judicata* when homeowners did not bring TILA claim in state foreclosure proceeding), *cert. denied, 122 S. Ct. 505, 151 L. Ed. 2d 415 (2001) .*

(n18)Footnote 18. *See* National Consumer Law Center, Truth in Lending § 7.7.2.6 (6th ed. 2007 and Supp.); *see generally* National Consumer Law Center, Truth in Lending § 6.2.6.1 (6th ed. 2007 and Supp.).

(n19)Footnote 19. *523 U.S. 410, 118 S. Ct. 1408, 140 L. Ed. 2d 566 (1998) . See also Roberson v. Cityscape Corp. (In re Roberson), 262 B.R. 312 (Bankr. E.D. Pa. 2001)* (under Pennsylvania law, homeowner cannot assert claim for rescission defensively after three-year bar).

(n20)Footnote 20. *15 U.S.C. § 1638(a)(4)*; Reg. Z § 226.18(e).

(n21)Footnote 21. *15 U.S.C. § 1638(a)(3)*; Reg. Z § 226.18(d).

(n22)Footnote 22. *15 U.S.C. § 1638(a)(2)(A)*; Reg. Z § 226.18(b).

(n23)Footnote 23. *15 U.S.C. § 1638(a)(9)*; Reg. Z § 226.18(m).

(n24)Footnote 24. *15 U.S.C. § 1640(a)(1).*

(n25)Footnote 25. *15 U.S.C. § 1640(a)(2)(A).*

(n26)Footnote 26. *15 U.S.C. § 1640(a)(3).*

(n27)Footnote 27. *15 U.S.C. § 1640(a)(4)*; *see § 13.07[3][d] infra.*

(n28)Footnote 28. The majority of the law is codified in *15 U.S.C. § 1639*. The definition of covered mortgages is at *15 U.S.C. § 1602(aa)*. Final implementing regulations were published at *60 Fed. Reg. 15, 463* (Mar. 24, 1995) (12 C.F.R. pt. 226). *See also* National Consumer Law Center, Foreclosures, § 5.6 (2d ed. 2007 and supp.) and National Consumer Law Center, Truth in Lending Ch. 9 (6th ed. 2007 and supp.). For more detailed discussion of the Home Ownership and Equity Protection Act of 1994 [hereinafter HOEPA].

(n29)Footnote 29. HOEPA, § 152(j), *codified at 15 U.S.C. § 1639(j).*

(n30)Footnote 30. *See Williams v. Gelt Fin. Corp. (In re Williams), 232 B.R. 629 (Bankr. E.D. Pa. 1999)* , *aff'd*, *237 B.R. 590 (E.D. Pa. 1999)* . (violation of TILA where lender included prepayment penalties in a "high cost" loan), *aff'd, remanded, 1999 U.S. Dist. LEXIS 12512* (E.D. Pa. Aug. 10, 1999) .

(n31)Footnote 31. *See* National Consumer Law Center, Foreclosures § 5.6.2 (2d ed. 2007 and Supp.).

(n32)Footnote 32. Regulation Z, *12 C.F.R. § 226.32(b)(1)(iv)* (as amended).

(N33)Footnote 33. Regulation Z, *12 C.F.R. § 226.34(a)(3)* (as amended).

(n34)Footnote 34. For further discussion of hidden interest, see *supra*.

(n35)Footnote 35. *See Bank of Coushatta v. Hodges, 525 So. 2d 581 (La. Ct. App. 1988)* (where borrower alleged no negligent or wrongful act by lender, lender could not be precluded from foreclosing even where borrower disputed credit insurer's denial of coverage).

(n36)Footnote 36. *See generally* National Consumer Law Center, Foreclosures, § 5.3 (2d ed. 2007 and Supp.).

(n37)Footnote 37. *315 U.S. 447, 62 S. Ct. 676, 86 L. Ed. 956 (1942)* ; *Langley v. FDIC, 484 U.S. 86, 108 S. Ct. 396, 98 L. Ed. 2d 340 (1987)* (borrower may not raise fraud in the inducement against the FDIC. *See Resolution Trust Corp. v. Carr, 13 F.3d 425 (1st Cir. 1993)* (wrongful acceleration or unreasonable sale claims may survive *D'Oench, Duhme* defense); *FDIC v. Kagan, 871 F. Supp. 1522 (D. Mass. 1995)* ; *Resolution Trust Corp. v. Davies, 824 F. Supp. 1002 (D. Kan. 1993)* (fraud in the factum claims may survive *D'Oench, Duhme* doctrine). *See also* National Consumer Law Center, Foreclosures, § 5.12.3 (2d ed. 2007 and supp.).

(n38)Footnote 38. For discussion of common examples of overcharges, see National Consumer Law Center, Foreclosures, §§ 6.4.3, 6.4.4 (2d ed. 2007 and supp).

(n39)Footnote 39. *Silverman v. Eastrich Multiple Inv. Fund, L.P., 51 F.3d 28 (3d Cir. 1995)* .

(n40)Footnote 40. *15 U.S.C. §§ 1691-1691f*; *see generally* Ch. 5 *supra*; National Consumer Law Center, Credit Discrimination (5th ed. 2009).

(n41)Footnote 41. *15 U.S.C. § 1691*; Reg. B, *12 C.F.R. § 202.7(d)(1).*

(n42)Footnote 42. *15 U.S.C. § 1691e.*

(n43)Footnote 43. *Silverman v. Eastrich Multiple Inv. Fund, L.P., 51 F.3d 28 (3d Cir. 1995)* .

(n44)Footnote 44. *15 U.S.C. § 1691*. The ECOA also prohibits discrimination against consumers who exercise their rights under the Consumer Credit Protection Act. *See generally* National Consumer Law Center, Credit Discrimination Ch. 3 (5th ed. 2009).

(n45)Footnote 45. *42 U.S.C. §§ 3604*, *3605*. *See* National Consumer Law Center, Credit Discrimination § 8.4 (5th ed. 2009).

(n46)Footnote 46. *Calaska Partners Ltd. v. Corson, 672 A.2d 1099 (Me. 1996) . See 15 U.S.C. § 1691b(a)*; *12 C.F.R. § 202.7(d)(1)* (prohibiting creditor's from requiring spouse's signature unless spouse is a joint applicant). *See also Integra Bank v. Freeman, 839 F. Supp. 326 (E.D. Pa. 1993)* ; *Still v. Cunningham, 94 P.3d 1104 (Alaska 2004)* ; *Banco Popular N. Am. v. Estate of Smith (In re Smith), 2004 Conn. Super. LEXIS 1751* (Conn. Super. Ct. June 29, 2004) (ECOA claim may form basis of valid foreclosure defense).

(n47)Footnote 47. *See* National Consumer Law Center, Credit Discrimination § 11.8.2 (5th ed. 2009).

(n48)Footnote 48. *See Newton v. United Co. Fin. Corp., 24 F. Supp. 2d 444 (E.D. Pa. 1998)* . Counteroffers that are accepted or used are not considered to be "adverse actions" under the ECOA. There is a split amount the courts whether written notice is required if there is no adverse action. *Cf. Ricciardi v. Ameriquest Mortg. Co., 2004 U.S. Dist. LEXIS 27306* (E.D. Pa. Mar. 15, 2004) (no ECOA violation where written notice of change in terms provided at closing); *Diaz v. Va. Hous. Dev. Auth., 117 F. Supp. 2d 500 (E.D. Va. 2000)* (notice of counteroffer does not have to be in writing); *In re United Cos. Fin. Corp., 277 B.R. 596 (Bankr. D. Del. 2002)* (denying class certification in case based on ECOA counteroffer notice requirements).

(n49)Footnote 49. *See* National Consumer Law Center, Credit Discrimination § 11.7 (5th ed. 2009).

(n50)Footnote 50. Regulation B, *12 C.F.R. § 202.2*(*l*)-(1). The Commentary further clarifies that the definition of creditor includes an assignee or a potential purchaser of the obligation who influences the credit decision by indicating whether or not it will purchase the loan if the transaction is consummated. Official Staff Commentary, *12 C.F.R. § 202.2*(*l*)-(1).

(n51)Footnote 51. *42 U.S.C. § 3605*.

(n52)Footnote 52. *24 C.F.R. § 100.125*.

(n53)Footnote 53. *Cal. Civ. Code §§ 1799.90(a)(5)*, *1799.91*; *Cal. Bus. & Prof. Code §§ 10240(a)*, *(b)*, *10241*.

(n54)Footnote 54. [Reserved]

(n55)Footnote 55. *Engstrom v. Kallins, 49 Cal. App. 4th 773, 56 Cal. Rptr. 2d 842 (1996) , review denied, 1997 Cal. LEXIS 303* (Cal. Jan. 22, 1997) .

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.08

§ 13.08 Due Process Challenges to Foreclosure by Power of Sale

[1] Introduction

Due process requires deprivation of a significant property interest to be preceded by both adequate notice and a meaningful opportunity for hearing. Foreclosure by power of sale would seem to violate this standard in two ways: personal notice of a foreclosure sale is not required in all states, and no state which permits power of sale foreclosure requires a hearing prior to foreclosure. In the mid- to late- 1970s, there was a wave of assaults on the power of sale foreclosure as a violation of due process. Almost all foundered, however, at the circuit court level on the Supreme Court's state action doctrine, given the Court's insistence that there can be no constitutional deprivation without a state actor, and that most power of sale foreclosure proceedings are between two private parties. n1

Without state action, there is no due process protection. There are at least two foreclosure situations, however, where state action may be easily established: where the foreclosing mortgagee is a government agency such as the VA or FmHA, or where the state foreclosure process requires the participation of a government official.

[2] Foreclosure by HUD of Single Family Mortgages

Under the "Single Family Mortgage Foreclosure Act of 1994," n2 HUD is authorized to foreclose defaulted single family mortgages by nonjudicial power of sale. The statute appears to preempt state foreclosure law by implication, so that even in states where judicial foreclosure is otherwise required, HUD may follow the nonjudicial foreclosure procedure established by the statute.

This law raises serious due process issues, particularly for borrowers in states which otherwise require a lender to foreclose by judicial process. No provision is made for a pre-foreclosure hearing, which due process would seem to require. The law may also run afoul of the contracts clause by abrogating rights under existing mortgage contracts which call for foreclosure by judicial process. Regulations promulgated under the Act do not appear to rectify these apparent defects. n3

[3] Participation by State Official

In some states, statutory foreclosure procedures require the participation of a state official for the proper conduct of the

foreclosure. In these states, a strong argument may be made that the involvement of the state official constitutes state action for due process purposes. A number of courts have reached this conclusion.

It is probably unrealistic to argue that the mere recording of a deed would constitute state action. Indeed, at that point, the deprivation suffered under a foreclosure would already have taken place. But where it is required by state law that a clerk issue a writ, or receive documents, such as an accounting of sales results in order to finalize a foreclosure, or that a sheriff execute a foreclosure, it is consistent with constitutional law to find the presence of state action.

[4] Due Process Requirements Once State Action Is Found

Once state action has been established, due process protections must be applied. Exactly what this means for borrowers, however, is not entirely clear. Generally, due process requires notice reasonably calculated to apprise interested parties of the pendency of the action and a pre-deprivation hearing aimed at establishing the validity of the underlying claim. In light of the Supreme Court's decision in *Mennonite Board of Mission v. Adams*, n4 notice by publication or posting (constructive notice) is probably invalid.

The hearing provided must give the recipient an effective opportunity to defend by confronting witnesses and presenting arguments and evidence orally. The recipient has the right to be represented by counsel, and the impartial decision maker's conclusion must be based solely on legal rules and evidence adduced at the hearing and put in writing, stating the reasons for the decision and the evidence relied upon.

A waiver contained in the mortgage giving up these rights is unlikely to be honored by the court.

Legal Topics:

For related research and practice materials, see the following legal topics:
Constitutional LawBill of RightsFundamental RightsProcedural Due ProcessScope of ProtectionReal Property LawFinancingFederal ProgramsU.S. Department of Housing & Urban Development ProgramsReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresPrivate Power-of-Sale ForeclosureReal Property LawFinancingMortgages & Other Security InstrumentsFormalities

FOOTNOTES:
(n1)Footnote 1. *Apao v. Bank of N.Y., 324 F.3d 1091 (9th Cir. 2003)* (extensive regulation of the secondary mortgage market does not convert private foreclosure procedures into state action).

(n2)Footnote 2. Pub. L. No. 103-327, *108 Stat. 2316* (codified at *12 U.S.C. §§ 3751 to 3768*).

(n3)Footnote 3. *24 C.F.R. §§ 27.100 et seq.*

(n4)Footnote 4. *462 U.S. 791, 798, 103 S. Ct. 2706, 77 L. Ed. 2d 180 (1983)* (applying due process notice requirements to tax sale, holding that notice by publication insufficient).

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.09

§ 13.09 Using Equitable Grounds to Prevent a Foreclosure

[1] Generally

Foreclosure actions at common law were actions in equity. Many state statutes retain the equitable character of the foreclosure process, even where the foreclosure is by power of sale, through provisions granting the mortgagor the right to petition the court to enjoin the foreclosure sale.

A number of courts have relied solely on equitable considerations to prohibit foreclosure, despite the lender's legal right to foreclose. Courts have found the conduct of the lender to be unconscionable or so lacking in good faith as to warrant the court's intervention to prevent the foreclosure.

[2] Failure to Comply With HUD and VA Servicing Guidelines

Federal regulations and HUD issued handbooks set forth in detail the procedures to be followed by lenders of HUD-insured loans when a borrower defaults. These guidelines recommend several alternatives to foreclosure, including assignment of the mortgage to HUD, and require that the lender take certain steps prior to foreclosure to determine whether foreclosure can be avoided. In an appropriate case, the lender's conduct may provide grounds for the court to exercise its equitable power to prevent a foreclosure.

[3] Mortgagee's/Trustee's Duty of Good Faith

A trustee under a deed of trust, or a mortgagee under a mortgage, has a duty to exercise good faith and diligence in conducting a foreclosure sale of property. n1 Failure to meet this duty may result in damages or the enjoining of a foreclosure.

The lender is also obligated to exercise good faith and diligence to protect the interests of the homeowner before the foreclosure sale. This may include postponing the foreclosure sale to allow the homeowner to conduct a market sale of the property and retain some of the equity in the property. A Massachusetts trial court held that a lender did not exercise good faith when it refused to postpone a foreclosure sale, despite the homeowner producing a buyer that made a legally binding commitment to purchase the property and was willing to pay a price that would result in a full recovery of all money due to the lender, including costs, and net $50,000 to the homeowner. The lender's compliance with state

foreclosure statutes did not relieve it of liability for breach of its duty. n2

Another argument may be made for pre-foreclosure equitable relief when the sale is not likely to bring a fair price, as for example, when it is not widely advertised or is scheduled for a holiday or in a manner that would chill the bidding.

[4] Enjoining a Foreclosure Sale Where There Is Sufficient Equity in the Property to Satisfy the Mortgage Debt

Prior to a sale, a homeowner with substantial equity may be able to enjoin a foreclosure to allow a sale on the open market. A foreclosure sale is virtually guaranteed to bring no more than the balance due on the note. A sale on the open market, however, should allow the homeowner to retain some of his equity in the property. Such a sale presents no risk to the lender; it will be paid in full from the sale proceeds.

If it is not possible to get an injunction from the court to stop the foreclosure to allow a more orderly sale, a chapter 13 bankruptcy filing providing for liquidation of the property may provide a solution, by staying all proceedings against the property and, thus, allowing time for a sale.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingFederal ProgramsU.S. Department of Housing & Urban Development ProgramsReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresEquitable Foreclosures

FOOTNOTES:
(n1)Footnote 1. *Brown v. Freedman, 222 Ga. App. 213, 474 S.E.2d 73 (1996)* , *recons. denied*, (July 11, 1996) (mortgagee has duty to exercise the power of sale so as to protect his security--not to gain as much as possible regardless of mortgagor's rights); *Pearman v. West Point Nat'l Bank, 887 S.W.2d 366 (Ky. Ct. App. 1994)* (covenant of good faith and fair dealing implied in all mortgage contracts; duty continues after default and throughout foreclosure process).

(n2)Footnote 2. *Snowden v. Chase Manhattan Mortg. Corp., 2003 Mass. Super. LEXIS 398, 17 Mass. L. Rep. 27 (Mass. Super. Ct. 2003)* .

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§ 13.10 Special Issues Relating to Foreclosure of Mortgages Held by HUD

[1] HUD Foreclosure Statute

Congress has enacted legislation authorizing the foreclosure by nonjudicial power of sale of *HUD-held* single family mortgages. The statute, titled "Nonjudicial Foreclosure of Single Family Mortgages," n1 appears to preempt state foreclosure law by implication. Some of the other key aspects of this new foreclosure provision are:

- HUD must designate a foreclosure commissioner to carry out foreclosures in accordance with the statute.
- The borrower must be given a "Notice of Default and Foreclosure Sale" at least 21 days prior to the sale.
- The foreclosure commissioner may cancel the sale if the borrower cures the default (i.e., pays the installments which are then due) before the sale, though the Commissioner has discretion to refuse to cancel a foreclosure sale if the borrower has cured a default previously.
- The borrower has no right of redemption after foreclosure.
- If the foreclosure sale price is less than the outstanding mortgage debt, the foreclosure commissioner can ask the Attorney General to seek a deficiency judgment, unless the mortgage prohibits such an action.

[2] Challenges to the Law

The new law raises serious due process issues, as well as questions of preemption of state law. No provision is made in the statute for a pre-foreclosure hearing, which due process would seem to require. n2 The apparent abrogation of rights to judicial foreclosure under the mortgage and/or state law is also troubling.

[3] Foreclosure Defense and Counseling for Loans Sold by HUD

There may be little use now, however, for the special rules regarding foreclosure of HUD-held mortgages. In 1995, as a cost-cutting measure, HUD began divesting itself of approximately 90,000 mortgage loans which it acquired through the HUD assignment and other programs. Aggressive collection activities by the lenders who have purchased the mortgages from HUD has resulted in much foreclosure activity and substantial confusion about procedures.

[4] The Importance of the Terms of the HUD Loan Sale Agreements: Enforcement by Borrowers

The purchasers of the loans are bound by the terms of their loan sale agreements, each of which has important protective provisions for the affected homeowners. HUD inserted a provision in every loan sale agreement which confirms that homeowners have third party beneficiary status to enforce the servicing requirements. Thus, in addition to making complaints to HUD if servicers are not following these mandates, homeowners have the right to sue to enforce the loan sale agreement.

On other important points, however, the loan sale agreements for each of the four sales differ and cannot be easily summarized. n3

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingFederal ProgramsU.S. Department of Housing & Urban Development ProgramsReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresGeneral Overview

FOOTNOTES:
(n1)Footnote 1. Pub. L. No. 103-327, *108 Stat. 2316* (codified at *12 U.S.C. §§ 3751 to 3768*).

(n2)Footnote 2. *See Johnson v. United States Dep't of Agric., 734 F.2d 774 (11th Cir. 1984)* ; *United States v. Ford, 551 F. Supp. 1101 (N.D. Miss. 1982)* .

(n3)Footnote 3. *See* National Consumer Law Center, Foreclosures, § 3.2.4.2 (2d ed. 2007 and Supp.).

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§ 13.11 Elderly Homeowners: Special Considerations

[1] Overview

The foreclosure of a home is always a tragedy. Where elderly homeowners are involved, the consequences are even more dire. Limited income may make it impossible to find other housing. The emotional costs of leaving a family home of many years may be simply overwhelming. Equity rich, cash poor elderly homeowners are particularly attractive targets for unscrupulous lenders, home improvement contractors, and salesmen. Loss of a home to foreclosure can mean not only loss of shelter, but also loss of an elder's most valuable asset, the equity in their home. Elders are often targeted by unscrupulous mortgage lenders based on the amount of equity in their homes. Lack of experience in complicated financial matters or, in some cases, a lack of mental capacity may make some seniors even more vulnerable. Tragically, however, it is not only slick siding salesmen or shady finance companies who take advantage of the elderly. In some cases, older homeowners find themselves facing the loss of their home because of actions taken by their own children or a care giver whom they have trusted. In addition to the other claims described in this chapter, some additional legal issues may arise when advocating for an elderly homeowner facing foreclosure.

If a homeowner seeks assistance after a foreclosure judgment has been entered, advocates may have that judgment set aside for compelling reasons. For example, one Ohio appellate court ordered a default judgment vacated for excusable neglect where the elderly homeowner's affidavit indicated that she had such poor vision she could not read the complaint, her memory was so faulty that she forgot she received paperwork from the court, and she had difficulty understanding the documents. The court noted that the homeowner's case was particularly compelling because of possible fraudulent practices by the home improvement company that brokered the loan. n1

[2] Exploitation by Lenders, Home Improvement Contractors and Others

In addition to the remedies described above, which may also apply in cases where a senior is taken advantage of by a stranger, some additional remedies may be available.

There is a growing trend in state legislatures amending their UDAP statutes to provide for enhanced penalties where fraud is targeted at the elderly. These statutes generally provide extra private or state remedies for specified types of violations, such as if a seller willfully disregards the rights of the older person and if the older person was more vulnerable by reason of age or health than other persons. Penalties recovered by state enforcement agencies often go to

a special fund to facilitate additional enforcement against elder fraud.

In 1994, Congress passed the HOEPA, n2 which placed substantial limitations on certain home equity lenders' ability to impose some of the terms they had been freed by deregulation to use. Among the restricted terms are negative amortization balloon payments and prepayment penalties.

The legislation applies only to closed-end loans secured by the borrower's primary home with either interest rates or closing costs above certain levels set by the Act.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingFederal RegulationsHome Owners Equity Protection ActReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *Fifth Third Bank v. Perry, 2004 Ohio 1543, 2004 Ohio App. LEXIS 1378* (Ohio Ct. App., Mahoning County Mar. 17, 2004) .

(n2)Footnote 2. *Codified at 15 U.S.C. § 1639. See § 13.07[3][d] supra;* National Consumer Law Center, Foreclosures, §§ 5.6 (2d ed. 2007); National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 12.2.2.2 (3rd ed. and Supp.).

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§ 13.12 Reverse Mortgage Abuses

Reverse mortgages (sometimes called "reverse annuity mortgages" or "RAMs") are rising debt loans made to elderly homeowners which are secured by equity in the home. Repayment of the reverse mortgage loan is generally not required until certain events occur, such as the homeowner's death or the sale of the home. Typically, reverse mortgage loans are paid out to the homeowner in monthly installments. The amount of the monthly proceeds received by the homeowner is determined by the value of the home, the interest rate and other fees charged, the loan term, the amount of any initial lump sum disbursed to the homeowner, and the homeowner's age. n1

Reverse mortgages are subject to some additional disclosure requirements under the federal TILA. n2 A number of states have also enacted laws designed to protect against abuses in reverse mortgages.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingMortgages & Other Security InstrumentsNonconventional Mortgages

FOOTNOTES:
(n1)Footnote 1. For a general discussion of reverse mortgage loans, see *Reverse Mortgages: Mandatory Counseling and Other Protections for the Elderly Homeowner, 27 Clearinghouse Rev. 622 (1993); Home Equity Conversion Programs: A Housing Option for the "House-Rich, Cash-Poor" Elderly, 23 Clearinghouse Rev. 481 (1989).*

(n2)Footnote 2. *See , 15 U.S.C. § 1648.*

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§ 13.13 Bankruptcy

[1] Introduction

A consumer facing the loss of his or her home through foreclosure or execution on a judgment may be able to secure temporary or permanent relief in the bankruptcy court. Some possible avenues of relief are discussed below. n1 A complete discussion of the bankruptcy process can be found in *Consumer Bankruptcy Law and Practice* n2 and we recommend that volume for those considering using bankruptcy to assist their clients. In addition, many of the topics discussed in this chapter have been affected by amendments made to the Bankruptcy Code by the 2005 Bankruptcy Act. n3 While some of these changes are covered in this chapter, readers are encouraged to review the more detailed discussion of these amendments in the National Consumer Law Center's Consumer Bankruptcy Law and Practice. n4

[a] Automatic Stay

The filing of a petition in bankruptcy automatically prevents almost all creditor actions against the debtor and the debtor's property, including foreclosure, foreclosure sales, and the filing of liens against the property. n5 A foreclosure conducted in violation of the automatic stay is generally void. n6 Depending on the circumstances of the case, this protection may be permanent or temporary.

The 2005 Bankruptcy Act creates a number of new exceptions and limitations to the automatic stay, several of which apply if there have been prior dismissed bankruptcy cases. If the debtor has had one prior bankruptcy case dismissed within the year before the petition is filed, the automatic stay will terminate thirty days after the case is filed. n7 However, the debtor may file a motion within the thirty-day period requesting that the court extend the stay as to all or some creditors. n8 The debtor must demonstrate that the case has been filed in good faith, typically by showing that circumstances have changed. The 2005 Act does not define good faith for purposes of this stay limitation, but good faith has been given a recognized meaning by case law with respect to the filing of a case. n9 In addition, this stay limitation provision sets forth several circumstances in which a case is presumed to be filed in bad faith, and the debtor may need to rebut such a presumption if it arises with clear and convincing evidence to the contrary. n10

[b] Discharge of a Deficiency Judgment

Because a deficiency judgment is an unsecured debt, it is subject to discharge in bankruptcy. n11

[c] Truth in Lending Rescission

A debtor may bring a rescission action and other consumer claims in bankruptcy court against a creditor who holds a security interest in the debtor's home. If the action is successful, the security interest will be released, in whole or in part, and the debtor is not liable for any finance charges. In several jurisdictions, after rescission, the debt may be treated as a wholly unsecured claim. n12

[i] Setting Aside a Foreclosure Sale in Bankruptcy

It is still possible to set aside a mortgage foreclosure or tax sale in bankruptcy, although grounds to do so have been limited by a 1994 Supreme Court decision. n13

[d] Curing a Mortgage Default

The borrower may be able to file a petition under chapter 13 and propose a plan to pay off the mortgage arrearage within a reasonable time and resume making mortgage payments, even if foreclosure proceedings have already begun. n14

[e] Voiding Mortgage Liens by Strip Down in Chapter 13

Although the Supreme Court has limited the availability of this remedy, it is nevertheless possible in some cases to use bankruptcy lien avoidance principles to void mortgage liens in whole or in part. n15 Where this bankruptcy remedy remains available, it can prevent a foreclosure by making a mortgage entirely void, or by reducing the amount owed and secured by the lien to a manageable sum.

[f] Avoiding Judgment Liens

If a creditor sues a homeowner and gets a judgment, the creditor may file the judgment as a lien against the debtor's home. The creditor may later execute on that lien by asking a court to sell the home and use the proceeds to satisfy the amount of the judgment lien. If the home is exempt from execution under state or federal law, bankruptcy may be used to avoid or nullify that lien. n16

[g] Saving Equity in Chapter 13

Sometimes homeowners may not be able to prevent the loss of their home because of overwhelming financial burdens. The homeowners, however, would be better off selling their home themselves, at a higher price than would be obtained at a foreclosure sale, thereby protecting their equity. It may be possible to do this in a chapter 13 bankruptcy (and sometimes in chapter 7 also). Filing bankruptcy can give the homeowner needed time to arrange the private sale.

[2] How to Use Consumer Defenses in Response to a Motion for Relief From Stay in Chapter 13 n17

[a] Responding to the Motion

A common problem in bankruptcy cases involving disputed secured claims arises when the creditor files an early motion for relief from the automatic stay to proceed with a foreclosure.

Although it is generally true that you cannot raise counterclaims directly to a motion for relief from stay, it is clear that defenses are permitted. It is thus possible to plead that the motion should be denied because the creditor has no cognizable claim or has a claim which is substantially less than the amount asserted.

[b] The Applicable Legal Standard for Evaluating Consumer Defenses to a Motion for Relief

A number of courts have held that the existence of defenses to a creditor's claim is relevant to a determination of that creditor's motion for relief. Commonly, upon a showing of "likelihood of success on the merits," courts will continue the stay until the objection to claim can be heard and finally determined.

[3] Curing Defaults on Home Loans

[a] Generally

A chapter 13 bankruptcy plan may provide for the curing of a default on a home loan. Monthly payments are reinstated and the chapter 13 debtor has a right to pay the delinquent arrearage in installments over a reasonable period of time without having to pay the entire debt balance due within the time period of the plan.

The Code does not define what period of time is "reasonable" for purposes of section 1322(b)(5). This necessarily depends to some extent on the facts and the circumstances of each case. Since the payments on long-term obligations are often higher than on any others, the debtor should seek whenever possible to make them outside the plan to avoid adding to them the substantial cost of the trustee's percentage fees and expenses (usually 10%).

Section 506(b) of the Code provides for collection of attorney's fees and costs as part of the amount needed to cure only if provided for by the parties' agreement and not otherwise restricted by state law. The creditor and its counsel have the burden of proving that the fees requested are reasonable. n18

Some courts have held that the inclusion in a proof of claim of any attorney fee incurred in connection with the bankruptcy case is improper unless the fee has been sought and approved under *Federal Rule of Bankruptcy Procedure 2016*, because the fee would be paid from the property of the bankruptcy estate. n19 Other courts have held that a creditor may include an attorney fee demand in a proof of claim without filing an application under *Rule 2016* if the claim is sufficiently detailed and provides adequate notice to the debtor. n20

One court of appeals has concluded that creditor's attorneys fees arising after confirmation of a chapter 13 plan to cover, for example, the costs of collecting a post-confirmation default, are not subject to court approval under section 506(b) or the automatic stay. n21

In *Rake v. Wade*, n22 the Supreme Court held that homeowners seeking to cure a default by paying the arrears in installments over a reasonable period of time in chapter 13 also have to pay interest on the arrears at present value. In 1994, Congress overruled the Supreme Court's decision in *Rake*, but only for mortgages made after October 22, 1994. n23 This means that if there is a default on a mortgage made after that date, payment of interest on arrears will only be necessary to the extent required under the underlying mortgage as limited by state law. Consequently, in almost every case, interest cannot be charged on the arrears (or at least on the interest portion of the arrears) because it would be inconsistent with the contract or state law. The operative date is the date the mortgage was signed, not the date of the default.

[b] Curing a Default Under Section 1322(b)(5) *After* Foreclosure.

The Bankruptcy Code now makes clear that a mortgage default can be cured under *11 U.S.C. section 1322(b)(3)* and *(5)* until the residence is sold at a valid foreclosure sale. n24 Thus, debtors may always use the chapter 13 process to cure a default in judicial foreclosure states, after the foreclosure judgment, up to the date of sale.

Some courts have held that a debtor may cure a default or pay off the balance owed on a mortgage in bankruptcy even after a valid foreclosure sale, when there is a state law right of redemption. n25 Under those precedents, state law post-foreclosure redemption rights come into the debtors' bankruptcy estate.

Some courts have found that a debtor retains an interest in the property until the trustee (or mortgagee) executes a deed to the foreclosure sale purchaser (or similar memorandum that satisfies the statute of frauds), and the consideration (purchase price) has been paid, or the sale has not been confirmed by the court where confirmation is required. If the borrower files bankruptcy during this time period, the interest becomes property of the bankruptcy estate. A *subsequent* execution of a deed (post-filing) would be void because of the automatic stay. A debtor can then attempt to cure the default on the mortgage through the chapter 13 plan. Other courts have found that, under state law, the sale is complete when the gavel falls at the foreclosure auction. Research under the applicable state's foreclosure law may be required to pursue a cure after the auction.

A valid foreclosure may not necessarily cut off a homeowner's right to reinstate the mortgage, decelerate the loan, and cure the default under section 1322(b)(5).

[c] Paying Secured Claims in Full

There are several reasons to consider paying off a home mortgage in full during the bankruptcy process, rather than curing the default and reinstating according to the loan's original terms. Perhaps the most important is that when a secured claim is paid in full pursuant to section 1325(a)(5), the debtor may pay present value interest rather than contract rate interest, and may reamortize the loan over the full length of the plan.

If the loan is at a high interest rate or would have matured before the end of the plan, the effect of these changes is likely to be lower monthly payments for housing costs. Additionally, upon completion of the plan, the loan will be fully paid so that no relationship between the lender and the debtor remains. Foreclosure then will be permanently averted.

The right to modify and pay off the terms of a home mortgage that would have matured during the chapter 13 bankruptcy is now clear. n26 The Code, as amended in 1994, does not distinguish between older purchase-money mortgages that are coming due and new short-term mortgages such as home equity loans. Thus, perhaps the most advantageous use of this provision will be to pay off high rate home equity loans at a lower rate and over a longer term in a bankruptcy plan. In addition, balloon payments can be spread out over the entire term of the plan.

Paying off the mortgage during the plan is generally best suited to situations where there is a low balance remaining on the mortgage. Otherwise, it is unlikely that the homeowner will be able to afford the payments required to pay off the debt in full within the maximum five-year period of a chapter 13 plan.

[4] Stripping Down Residential Mortgages to the Value of the Collateral

11 U.S.C. section 506 provides that a secured claim in bankruptcy may be limited to the amount of the value of the creditor's collateral. The statute further provides that a lien may be voided to the extent it exceeds the value of the collateral to which it is attached. n27 The process of voiding liens under this provision has come to be called "strip down."

This allows the debtor to pay off the present value of the allowed secured claim as modified at present value during the pendency of the plan. The availability of strip down is limited however, where the secured creditor's sole security is a mortgage on the debtor's residence. n28

Where strip down is available, it is a valuable strategy to prevent foreclosure because it makes some or all of a mortgage go away. If the mortgage is entirely void (e.g., as it may be in the case of some junior mortgages), then obviously foreclosure is no longer a relevant concern. If the mortgage is partially void, there is a smaller balance on which the debtor is obligated, thus increasing the potential to cure the default, pay-off, achieve a workout, or refinance.

Finally, if property is not considered real property under state law, strip down should also be available. Where mobile homes are defined by state law as personalty, one of the few potential advantages of this treatment is that *11 U.S.C. section 1322(b)(2)* does not apply and strip down is available. n29

[5] Avoiding Judicial Liens--*11 U.S.C. Section 522(f)(1)*

In bankruptcy, the debtor may "avoid" (i.e., nullify) many types of prebankruptcy transfers of exempt property. n30 Exemptions may be established by the Code or by state law.

The power to exempt judicial liens extends to every type of exempt property, without limitation. The burden is on the debtor to file a lien avoidance proceeding. If none is filed, all liens on the property of the debtor, including otherwise exempt property, will normally survive the bankruptcy.

[6] Sale of Property

In some cases, homeowners may have no choice but to sell their home on which mortgage payments are no longer possible, often through a liquidation provision of a chapter 13 plan, to prevent the loss of equity and other ramifications of a foreclosure sale. Before any sale of the property, it is advisable to obtain a specific order authorizing the sale free and clear of liens to satisfy any title insurers, specifying the distribution of the proceeds, and setting the compensation of any real estate broker. This can generally be accomplished by a motion seeking such an order, with service on all lienholders and other affected parties.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral OverviewBankruptcy LawCase AdministrationAdministrative PowersStaysCoverageClaims Against DebtorsBankruptcy LawCase AdministrationAdministrative PowersStaysRelief From StaysGeneral OverviewBankruptcy LawCase AdministrationExaminers, Officers & TrusteesCompensationBankruptcy LawCase AdministrationExaminers, Officers & TrusteesStatutory LiensReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresDeficiency JudgmentsReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresJudicial Foreclosures

FOOTNOTES:
(n1)Footnote 1. *See* Collier Consumer Bankruptcy Practice Guide (Matthew Bender).

(n2)Footnote 2. National Consumer Law Center, Truth in Lending (6th ed. 2007 and supp.). Attorneys just getting started in bankruptcy should also consider reviewing National Consumer Law Center, Bankruptcy Basics (2007).

(n3)Footnote 3. Pub. L. No. 109-8 (Apr. 20, 2005).

(n4)Footnote 4. National Consumer Law Center, Consumer Bankruptcy Law and Practice, § 11.4.2 (2009 9th ed.)

(n5)Footnote 5. *11 U.S.C. § 362*.

(n6)Footnote 6. *See Kalb v. Feuerstein, 308 U.S. 433, 60 S. Ct. 343, 84 L. Ed. 370 (1940)* ; *In re Nail, 195 B.R. 922 (Bankr. N.D. Ala. 1996)* (foreclosure conducted after bankruptcy reinstated was void, even though creditor was not aware of the reinstatement, because it was on notice of the hearing on the motion to reinstate and chose not to attend or inquire as to results). *But see Jones v. Garcia (In re Jones), 63 F.3d 411 (5th Cir. 1995) , cert. denied, 517 U.S. 1167, 116 S. Ct. 1566, 134 L. Ed. 2d 666 (1996)* (sale in violation of stay is voidable rather than void and can be ratified if court annuls the automatic stay).

(n7)Footnote 7. *11 U.S.C. § 362(c)(3)*; National Consumer Law Center, Consumer Bankruptcy Law and Practice,

9.3.3 (2009 9th ed.). Since the stay terminates under this provision only "with respect to the debtor," the automatic stay provided under § 362(a) continues to apply in the later case as to property of the estate. Although § 362(c)(3) also states that the stay terminates as to property securing a debt of the debtor, it is not clear how courts will apply this section given that the statutory language also states that the stay terminates only "with respect to the debtor." If the debtor's auto remains estate property, for example, this may mean that a secured creditor cannot proceed with a home foreclosure after the 30-day period has expired without first seeking stay relief. This stay limitation also does not apply if the prior case was dismissed under § 707(b) and the new case is filed under a chapter other than chapter 7.

(n8)Footnote 8. *11 U.S.C. § 362(c)(3)(B).*

(n9)Footnote 9. *See* National Consumer Law Center, Consumer Bankruptcy Law and Practice, § 9.3.3.2.2 (2009 9th ed.).

(n10)Footnote 10. *11 U.S.C. § 362(c)(3)(C).* For a discussion of the circumstances giving rise to the presumption, see National Consumer Law Center, Consumer Bankruptcy Law and Practice, 9.3.3.2.3 (2009 9th ed.).

(n11)Footnote 11. *11 U.S.C. §§ 727, 1328.*

(n12)Footnote 12. *Myers v. Federal Home Loan Mortgage Co. (In re Myers), 175 B.R. 122 (Bankr. D. Mass. 1994)* ; *In re Celona, 90 B.R. 104 (1988)* , *aff'd, 98 B.R. 705 (Bankr. E.D. Pa. 1989)* ; *In re Tucker, 74 B.R. 923 (Bankr. E.D. Pa. 1987)* (consumers also entitled to $1,000 TIL statutory damages by recoupment, $1,000 damages for the creditor's failure to respond properly to the rescission demand, and attorney fees), *superseded by statute as stated in Michel v. Beneficial Consumer Discount Co., 140 B.R. 92 (Bankr. E.D. Pa. 1992)* ; *In re Chancy, 33 B.R. 355 (Bankr. N.D. Okla. 1983)* (creditor received 8% payout); *In re Wright, 11 B.R. 590 (Bankr. S.D. Miss. 1981)* (consumer also entitled to TIL statutory damages and attorney fees). *But see Wepsic v. Josephson (In re Wepsic), 231 B.R. 768 (Bankr. S.D. Cal. 1998)* ; *Heritage Fed. Credit Union v. Cox (In re Cox), 175 B.R. 266 (Bankr. C.D. Ill. 1994)* ; *Lynch v. GMAC Mortgage Corp. (In re Lynch), 170 B.R. 26 (Bankr. D.N.H. 1994)* .

(n13)Footnote 13. *BFP v. Resolution Trust Co., 511 U.S. 531, 114 S. Ct. 1757, 128 L. Ed. 2d 556 (1994)* .

(n14)Footnote 14. *11 U.S.C. § 1322(b)(3)(5).*

(n15)Footnote 15. For discussion of situations where strip down may still be available, see National Consumer Law Center, Foreclosures, § 9.6 (2d ed. 2007 and Supp.).

(n16)Footnote 16. *11 U.S.C. § 522(f).*

(n17)Footnote 17. For practice tips, see National Consumer Law Center, Foreclosures, § 9.2.7.8 (2d ed. 2007 and Supp.).

(n18)Footnote 18. *In re Coates, 292 B.R. 894 (Bankr. C.D. Ill. 2003)* (claim of mortgage servicer for attorney fees, foreclosure expenses, and other charges denied as servicer failed to produce evidence that would satisfy its burden of proving reasonableness); *In re Staggie, 255 B.R. 48 (Bankr. N.D. Idaho 2000)* (burden of proof not satisfied because counsel's billing summary failed to provide detailed breakdown of time entries). For agreements entered into after October 22, 1994, § 1322(e) similarly requires that the creditor's right to collect attorney fees and costs must be provided for in the underlying agreement. *See In re Plant, 288 B.R. 635 (Bankr. D. Mass. 2003)* (§ 1322(e) rather than § 506(b) determines creditor's entitlement to pre-petition fees in chapter 13 cure situation).

(n19)Footnote 19. *In re Tate, 253 B.R. 653 (Bankr. W.D.N.C. 2000)* ; *see also In re Plant, 288 B.R. 635 (Bankr. D. Mass. 2003)* (*Rule 2016* application required if creditor's claim for fees contested by debtor); *Powe v. Chrysler Fin. Corp., 281 B.R. 336 (Bankr. S.D. Ala. 2001)* (nationwide class of debtors certified to challenge creditor's failure to adequately disclose attorney fees charged to debtors); *In re Noletto, 281 B.R. 36 (Bankr. S.D. Ala. 2000)* (fees that are

not properly claimed or disclosed with specificity, or omitted from an arrearage claim to be paid under debtor's plan, are per se unreasonable); *In re Gifford, 256 B.R. 661 (Bankr. D. Conn. 2000)* (court noted that in future cases it would follow *Tate* and require oversecured creditors to seek approval of fees under *Rule 2016*).

(n20)Footnote 20. *In re Powe, 281 B.R. 336 (Bankr. S.D. Ala. 2001)* ; *see also In re Atwood, 293 B.R. 227 (B.A.P. 9th Cir. 2003)* (proof of claim lacking specific detail fails to meet creditor's evidentiary burden on reasonableness of fees).

(n21)Footnote 21. *Telfair v. First Union Mortgage Corp., 216 F.3d 1333 (11th Cir. 2000)* , *cert. denied, 531 U.S. 1073, 121 S. Ct. 765 (2001)* . *See also Tate v. NationsBanc Mortgage Corp. (In re Tate), 253 B.R. 653 (Bankr. W.D.N.C. 2000)* (attorney's fee included in proof of claim is improper unless fee has been sought and approved under *Rule 2016*); *In re Gifford, 256 B.R. 661 (Bankr. D. Conn. 2000)* . *Cf. In re Nield, 95 B.R. 259 (Bankr. D. Me. 1989)* . Note that this problem can be addressed by a carefully drafted plan provision. *See* National Consumer Law Center, Foreclosures, § 9.3.2 (2d ed. 2007). In addition, an amendment made by the 2005 Act provides a statutory remedy in the bankruptcy court if a mortgage lender has misapplied payments under a chapter 13 plan and thereby caused the debtor to incur unnecessary and improper fees. *11 U.S.C. § 524(i).*

(n22)Footnote 22. *508 U.S. 464, 113 S. Ct. 2187, 124 L. Ed. 2d 424 (1993)* .

(n23)Footnote 23. *11 U.S.C. § 1322(e).*

(n24)Footnote 24. *11 U.S.C. § 1322(c)(1).* One court has held that a default on a real estate installment sale agreement cannot be cured after a state court determination that the buyers' rights under that contract have been terminated, even when the buyers remain in possession of the property. *In re Belmonte, 240 B.R. 843 (Bankr. E.D. Pa. 1999)* , *aff'd in part, rev'd in part, 2001 U.S. Dist. LEXIS 1844* (E.D. Pa. Jan. 18, 2001) . *See also In re Grassie, 293 B.R. 829 (Bankr. D. Mass. 2003)* (debtor retains equity of redemption when bankruptcy petition filed minutes after foreclosure sale and memorandum of sale signed by purchaser but before memorandum of sale signed by auctioneer); *In re Benson, 293 B.R. 234 (Bankr. D. Ariz. 2003)* (trustee's sale is not complete until bid price is paid); *In re Pellegrino, 284 B.R. 326 (Bankr. D. Conn. 2002)* (discussing when debtor's rights in the property are exhausted under strict foreclosure process). *But see In re Brown, 249 B.R. 193 (Bankr.N.D.Ill. 2000)* (buyer under real estate installment sales agreement still had right to cure after seller declared forfeiture because buyer had right to cure and reinstate contract under state law); *Colon v. Option One Mortgage Corp., 319 F.3d 912 (7th Cir. 2003)* (chapter 13 debtor's right to cure a mortgage default expires under Illinois law upon completion of the foreclosure sale and does not continue during the period between sale and judicial confirmation by state court).

(n25)Footnote 25. *In re Ragsdale, 155 B.R. 578 (Bankr. N.D. Ala. 1993)* . The court's decision contains a comprehensive list of decisions from other jurisdictions on this issue. *See also In re Frazer, 238 B.R. 262 (Bankr. D. Vt. 1999)* (right to redemption in Vermont, a strict foreclosure state, is a property right that comes into the estate and does not expire during the case by virtue of § 108(b)). *See also In re Connors, 497 F.3d 314 (3d Cir. 2007)* (chapter 13 filed during ten-day redemption period under New Jersey law extends period sixty days from filing of petition). *But see In re McCarn, 218 B.R. 154 (B.A.P. 10th Cir. 1998)* (debtor's right to cure ends at time of foreclosure sale regardless of state law redemption periods).

(n26)Footnote 26. *11 U.S.C. § 1322(c)(2)* permits a chapter 13 debtor to modify a mortgage that will mature during the plan period. Permissible modifications would include payments over the period of the plan and payment of interest at present value under § 1325(a)(5)(B)(ii). *In re Petrella, 230 B.R. 829 (Bankr. N.D. Ohio 1999)* (mortgagee's objection to confirmation denied because evidence established that mortgage would mature during plan and could be modified); *In re Mattson, 210 B.R. 157 (Bankr. D. Minn. 1997)* (§ 1322(b)(2) protections did not apply to loans maturing before end of plan); *In re Young, 36 C.B.C.2d 1011, 199 B.R. 643 (Bankr. E.D. Tenn. 1996)* (debtor could strip down mortgage if last payment was due before final scheduled plan payment). *See* 8 Collier on Bankruptcy, P 13222.16, at 13222-51 (15th ed. rev.). *See also In re Nepil, 206 B.R. 72 (Bankr. D.N.J. 1997)* (loan on which creditor had obtained foreclosure

judgment could be treated as loan on which final payment due before end of plan). *But see Witt v. United Cos. Lending Corp. (In re Witt), 113 F.3d 508, 37 C.B.C.2d 1703 (4th Cir. 1997)* (strip down not permitted under § 1322(c)(2) because this law provides for modification of payments and not claims).

(n27)Footnote 27. *11 U.S.C. § 506(d).*

(n28)Footnote 28. *11 U.S.C. § 1322(b)(2)*; *Nobelman v. American Sav. Bank, 508 U.S. 324, 113 S. Ct. 2106, 124 L. Ed. 2d 228 (1993)* . See National Consumer Law Center, Foreclosures, § 9.6 (2d ed. 2007 and supp.), for a discussion of when this limitation is inapplicable.

(n29)Footnote 29. *In re Blevins, 152 B.R. 130 (Bankr. N.D. Tex. 1992)* ; *In re Plaster, 101 B.R. 696 (Bankr. E.D. Okla. 1989)* ; *In re Colver, 13 B.R. 521 (Bankr. D. Nev. 1981) . Cf. Rouse v. Chase Manhattan Bank, U.S.A., N.A. (In re Brown), 226 B.R. 39 (Bankr. W.D. Mo. 1998)* (mobile home lien avoidable by trustee as a preference); *In re Speights, 131 B.R. 205 (Bankr. N.D. Fla. 1991)* ; *In re Carter, 116 B.R. 156 (Bankr. W.D. Mo. 1990)* .

(n30)Footnote 30. *11 U.S.C. § 522.*

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.14

§ 13.14 Setting Aside a Completed Foreclosure

[1] Procedural Issues

The process required to undo a completed foreclosure will depend on the foreclosure method used by the lender. If the foreclosure was conducted by power of sale, the foreclosed homeowner must initiate a suit to set aside the sale. Because the power of sale foreclosure is extra-judicial, there is no existing action in which any claims to invalidate the completed foreclosure can be raised. The action to set aside the sale may be filed in state court, or the homeowner can file bankruptcy and seek to set aside the sale within the bankruptcy case.

Where a foreclosure has been conducted by judicial process, the homeowner will have to reopen the foreclosure judgment entered by the court if the homeowner intends to raise defenses to the underlying mortgage or the lender's right to foreclose. Otherwise, *res judicata* will bar litigation of the homeowner's claim. n1 To raise claims regarding the conduct of the sale or the adequacy of the sale price, it is not necessary to reopen the foreclosure judgment. If, however, the sale has been confirmed by the court, the homeowner must reopen the order of confirmation. The homeowner's motion to reopen can be litigated in the state court, or, if the homeowner files bankruptcy, can be made in the existing state court foreclosure action then removed to the bankruptcy court to be litigated. In some states, there is a time limit to raise objections to a facially valid sale. n2 If the sale is set aside as void, title is normally restored to the homeowner. Mortgage and lien interests on the property are generally restored as if no foreclosure had taken place. n3

If the lender was the purchaser at the foreclosure sale (which is usually the case), once the sale has been set aside, the homeowner should be able to raise claims against the lender based on the underlying mortgage.

Even if the sale cannot be successfully challenged, the homeowner may have claims for damages against the lender. In some cases, these damages may be substantial and may include attorney fee awards. Although these claims may not invalidate the mortgage or the foreclosure, they may create leverage which could be used by the homeowner to reacquire the property from the lender in some cases.

[2] Grounds on Which a Foreclosure May Be Set Aside

In order to successfully recover the property after a foreclosure, a homeowner must be able to assert a legal basis to invalidate the foreclosure sale after a power of sale foreclosure, or to invalidate the judgment or sale after a judicial

foreclosure. Generally, the homeowner will be required to show some irregularity in the foreclosure process, which makes the sale void under state law, or that the sale price was so inadequate that it shocks the conscience. Most claims based on the underlying transaction are lost if not raised before the sale, unless the homeowner can have the sale set aside.

In addition, some state foreclosure statutes provide that a completed sale to a good faith purchaser cuts off the foreclosed home owner's right to challenge the sale on procedural grounds. n4

[3] Irregularity in the Conduct of the Sale

Each state has its own statutory scheme prescribing required foreclosure procedures. Noncompliance with some aspects of this scheme will subject a sale to being set aside, without proof that the noncompliance affected the outcome of the sale. Failure to provide required notice to the borrower, or to other lien holders, will generally invalidate a sale, as will failure to comply with a material term of the mortgage contract. n5

[4] Inadequacy of Sale Price

[a] Generally

All courts follow the well-settled rule that mere inadequacy of price will not justify setting aside a foreclosure sale, absent additional circumstances of unfairness or irregularity, unless the sale price is so grossly inadequate as to shock the conscience of the court. A review of decisions from various jurisdictions shows that while it is possible in the rare case to shock the court, it is difficult to get a sale set aside solely on this basis. n6

[b] Inadequate Price and Irregularity in the Conduct of the Sale

When a low sale price is coupled with some irregularity in the foreclosure process, courts are more likely to set aside the sale. And, when the sale price is very low, even slight irregularities will be sufficient to justify setting it aside.

[c] Inadequate Price and Unfairness

A mortgagee or trustee conducting a foreclosure sale is bound to act in good faith and to exercise reasonable diligence to protect the rights of the debtor. Where a foreclosure sale yields a price grossly disproportionate to the property's value, it may be an indication of bad faith. In addition, inadequate price coupled with actions to frustrate the homeowner's presale redemption right may be sufficient to allow a court to set aside the sale. In *Commercial Credit Loans, Inc. v. Espinoza*, n7 the court concluded that a sale to the lender at a price of about one-fifth of value could not be confirmed. In addition to the inadequate price, the court found that the lender had unconscionably frustrated the homeowner's efforts to pay off the debt in full prior to foreclosure. The evidence showed that the lender failed to respond to a Spanish-speaking homeowner's request for information about the amount necessary to cure and the date, time and place of sale. The court ordered the lender to accept the debtor's post-sale cure of the default.

[5] Setting Aside a Foreclosure Sale in Bankruptcy

Sales that are conducted in violation of the automatic stay are generally void and can be set aside on that ground alone. n8 This means that any foreclosure sale taken after a bankruptcy filing is without legal effect. n9 This is true whether the seller had knowledge of the stay, though there are limited exceptions to this general rule.

A few courts have held that a sale in violation of the stay is voidable rather than void. n10 If the sale is merely voidable the court could ratify the sale, but will usually only do this on a showing that enforcing the stay would be unfair to the lender.

[a] Fraudulent Transfers--*11 U.S.C. Section 548*

A Supreme Court case, *BFP v. Resolution Trust Co.*, n11 has made it more difficult to set aside a foreclosure sale as a fraudulent transfer in bankruptcy. However, state law may provide alternative grounds which can be used to invalidate a sale in bankruptcy court. A sale which is invalid under state law for any reason is equally invalid in the bankruptcy process. In addition, if the sale was not regularly conducted or was collusive in some way, *BFP* may not apply at all and *11 U.S.C. section 548* may be invoked to set aside the sale. n12 If the grounds which produce state law invalidity, however, also take the sale outside of the protections of *BFP* because it was not "regularly conducted," then the requirements of a fraudulent transfer case can be pled in the alternative.

The Supreme Court expressly limited its holding in *BFP* to mortgage foreclosures of real estate, stating that "the considerations bearing on other foreclosures and forced sales (to satisfy tax liens, for example) may be different." n13 For tax foreclosures which do not involve a formal sale of the property (i.e., where the purchaser obtains a lien or a certificate rather than an actual deed), the *BFP* analysis should not be relevant. n14 Typically, the purchaser of a tax lien pays only the amount of delinquent taxes, an amount which bears no relationship to the value of the property. For this reason, there is no logical basis on which to conclude that the tax lien purchase price is a "reasonably equivalent value."

[b] Preferences--*11 U.S.C. Section 547*

If a secured creditor forecloses within the 90-day preference period and the value of the property foreclosed upon is in excess of the creditor's claim, some bankruptcy courts have held that the foreclosure may be set aside as a preference.

[c] Sales That Are Not Complete Under State Law

If a debtor retains legal title to property under state law until an event that occurs after sale, such as delivery of a deed or confirmation of the sale, and the debtor files for bankruptcy during that period, the debtor's retained ownership interest comes into the estate. n15 This principle is important because if an auction has been held, but the sale process is not considered complete under state law, a bankruptcy debtor retains an ownership interest and the right to cure the default under *11 U.S.C. section 1322(c)(1)*.

An additional argument may be made if the deed generated by the foreclosure sale has not yet been recorded. In many circumstances, the trustee may avoid unrecorded interests in property under the "strong-arm" power granted by *11 U.S.C. section 544(a)*. By doing so, property comes into the estate free of those interests. If the trustee can avoid the unrecorded interest based on state law, the debtor may claim an exemption in the recovered property. n16

Additionally, the debtor may exercise the trustee's powers under section 544(a) to avoid involuntary transfers of exempt property when the trustee fails to act. n17 Where the opportunity is available, debtors may recover their exempt interest in the property and regain rights that apply to secured claims as if the collateral had never been transferred.

Legal Topics:

For related research and practice materials, see the following legal topics:
Bankruptcy LawCase AdministrationExaminers, Officers & TrusteesFraudulent TransfersElementsBankruptcy LawCase AdministrationExaminers, Officers & TrusteesVoidable TransfersLien Creditor & PurchaserReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresJudicial ForeclosuresReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresPrivate Power-of-Sale Foreclosure

FOOTNOTES:
(n1)Footnote 1. *See Anyanwutaku v. Fleet Mortgage Group, 85 F. Supp. 2d 566 (D. Md. 2000)* (borrower barred from bringing new case alleging violations of various state laws and federal constitution; all claims concerning the propriety of sale should have been litigated in state foreclosure proceedings and were resolved with finality in those proceedings),

aff'd, 229 F.3d 1141 (4th Cir. 2000) .

(n2)Footnote 2. *See Citicorp Mortgage v. Bartolome, 94 Haw. 422, 16 P.3d 827 (Ct. App. 2000)* (motion to reconsider default judgment of foreclosure was denied because appeal was untimely); *Independence One Mortgage Corp. v. Gillespie, 289 N.J. Super. 91, 672 A.2d 1279 (App. Div. 1996)* (void sale can be challenged at any time; voidable sale can only be challenged within time limits set by court rule).

(n3)Footnote 3. *E.g., Williams v. Kimes, 996 S.W.2d 43 (Mo. 1999)* .

(n4)Footnote 4. *See Taylor v. Just, 138 Idaho 137, 59 P.3d 308 (2002)* (Idaho statute provides that any failure to comply with statutory notice requirements does not affect a sale to a good faith purchaser for value; provision does not apply to home owner's challenge on the grounds that there was no default).

(n5)Footnote 5. *See Keybank Nat'l Ass'n v. Sargent, 2000 ME 153, 758 A.2d 528 (2000)* (any irregularity in sale following foreclosure will not serve as grounds to set aside foreclosure judgment if there was no allegation of defect in judgment itself); *Ohio Sav. Bank v. Hawley, 2001 Ohio App. LEXIS 702* (Ohio Ct. App. Feb. 16, 2001) (foreclosure sale vacated because mortgagor did not receive actual notice of sale; notice by publication was inadequate). *See also Goldberg v. Frick Elec. Co., 363 Md. 683, 770 A.2d 182 (2001)* (sheriff's sale set aside as notice of sale failed to mention mortgage exceeding $100,000 on property); *J. Ashley Corp. v. Burson, 131 Md. App. 576, 750 A.2d 618 (2000)* (sale confirmed when borrower did not demonstrate any harm or prejudice resulting from forty-five minute delay in start of the sale). *See also Rea v. Fivegees Investments, 2006 Mich. App. LEXIS 1208* (Mich. Ct. App. Apr. 18, 2006) (failure to provide notice of taxes owed violated homeowner's due process rights and justified setting aside the foreclosure sale); *Sudhoff v. Federal National Mortgage Association, 2006 Fla. App. LEXIS 12498* (Fla. Dist. Ct. App. July 28, 2006) (failure to provide notice to wife, whose name was also on the mortgage, constituted improper notice and justified setting aside the foreclosure sale). *See Davenport v. HSBC Bank, USA, 739 N.W.2d. 383 (Mich. Ct. App. 2007)* (successor mortgagee who did not own interest in mortgage at time of publication of foreclosure notice was not eligible to foreclose; subsequent sheriff's sale was void); *United States Dep't of Agriculture v. Scurry, 940 A.2d 1164 (N.J. 2008)* (doctrine of laches did not bar borrower from relief from sheriff's sale when borrower did not receive required notice, had deposited substantial funds with her attorney to cure arrears, her counsel offered to cure the default and received no reply from the mortgagee, successful purchaser at the sheriff's sale was the foreclosing mortgagee, and the property remained vacant and had not been transferred to an innocent third party). *See also Meade v. JD Venture Capital, L.L.C., 832 N.Y.S.2d 665 (N.Y. App. Div. 2007)* (failed to comply with statutory notice requirements).

(n6)Footnote 6. *In re Krohn, 203 Ariz. 205, 52 P.3d 774 (2002)* (a sale of real property under power of sale in a deed of trust may be set aside solely on the basis that the bid price was *grossly* inadequate; property with value of $57,500 sold for $10,000 was grossly inadequate); *Manion v. Chase Manhattan Mortgage Corp., 2002 WY 49, 43 P.3d 576, 577 (2002)* (fact that there is some inadequacy in the sale price is not sufficient grounds for setting aside a sale when the sale was lawfully made and rightly conducted, with full opportunity for competition in the bidding, and without fraud, partiality, or oppression); *see also In re Schleier, 290 B.R. 45 (Bankr. S.D.N.Y. 2003)* (holding foreclosure sale void because of bankruptcy filing minutes before the completion of the sale; further holding that even if the sale was not void for violation of the automatic stay, it would have been set aside on the grounds that the price was grossly inadequate when property sold for $245,000 and evidence established property's value was $1 million); James Gadsen & Alfred Farha, *Under What Circumstances Can A Foreclosure Sale Be Set Aside Under New York Law?,* N.Y. St. B.J., May/June 1993, at 42. *See also Litke v. Morris, 2006 U.S. Dist. LEXIS 16956* (N.D. Miss. Apr. 4, 2006) (purchase price of 8% of the home's actual value was grossly inadequate and the foreclosure sale was set aside, but the purchaser was entitled to recovery of the purchase price and amount invested in home repairs).

(n7)Footnote 7. *293 Ill. App. 3d 923, 689 N.E.2d 282 (1997)* ; *see also Aikens v. Wagner, 231 Ga. App. 178, 498 S.E.2d 766 (1998)* .

(n8)Footnote 8. *In re Cueva, 371 F.3d 232 (5th Cir. 2004)* ; *In re Ford, 296 B.R. 537 (Bankr. N.D. Ga. 2003)* ; *In*

re Burg, 295 B.R. 698 (Bankr. W.D.N.Y. 2003) (tax foreclosure sale conducted in violation of automatic stay was void, and did not give purchaser good title to property or any right to obtain relief of the stay for the purpose of evicting the debtor). *Kalb v. Feuerstein, 308 U.S. 433, 60 S.Ct. 343, 84 L.Ed. 370 (1940) . But see In re King, 35 B.R. 530 (Bankr. N.D. Ga. 1983)* (automatic stay did not void foreclosure sale which occurred an hour after debtor's chapter 13 filing when sale of property by mortgagee was made to good faith purchasers, who were without knowledge of commencement of chapter 13 case, and who paid fair, equivalent value for property, and no copy of chapter 13 petition was filed in county recording office prior to consummation of foreclosure sale). If the stay violation was willful, the debtor may be entitled to damages. *11 U.S.C. § 362(h)*; *see In re Mauck, 287 B.R. 219 (Bankr. E.D. Mo. 2002) . In re Dawson, 346 B.R. 503 (Bankr. N.D. Cal. 2006)* (debtor awarded emotional distress damages); *In re Kaufman, 315 B.R. 858 (Bankr. N.D. Cal. 2004)* (substantial punitive and other damages awarded against a mortgage company that auctioned personal property in the debtor's residence after a foreclosure sale, in violation of stay). *But see In re Coho Resources, Inc., 345 F.3d 338 (5th Cir. 2003)* (violations are merely "voidable" and are subject to discretionary "cure" through annulment of stay).

(n9)Footnote 9. *In re Shamblin, 890 F.2d 123 (9th Cir. 1989)* (tax sale held in violation of the stay is void).

(n10)Footnote 10. *Easley v. Pettibone Mich. Corp., 990 F.2d 905 (6th Cir. 1993)* (actions in violation of stay are voidable and shall be voided absent limited equitable circumstances). *See In re Stockwell, 262 B.R. 275 (Bankr. D. Vt. 2001)* (court validated sale undertaken in violation of automatic stay but debtor's redemption period was reinstated); *In re Williams, 257 B.R. 297 (Bankr. W.D. Mo. 2001)* (court validated sale conducted in violation of the automatic stay because debtor did not act in good faith with respect to the mortgage debt or foreclosure proceedings). *See generally* National Consumer Law Center, Foreclosures, § 10.1.4.1 (1st ed. 2005 and Supp.).

(n11)Footnote 11. *511 U.S. 531, 114 S. Ct. 1757, 128 L. Ed. 2d 556 (1994)* .

(n12)Footnote 12. *See generally* National Consumer Law Center, Consumer Bankruptcy law and Practice, § 10.4.2.6.5 (8th ed. 2006 and Supp.).

(n13)Footnote 13. *BFP, 114 S. Ct. 1757 at n.3. But see In re McGrath, 170 B.R. 78 (Bankr. D.N.J. 1994)* (applying *BFP* analysis to tax sales).

(n14)Footnote 14. *E.g., In re Sherman, 223 B.R. 555 (B.A.P. 10th Cir. 1998)* (*BFP* does not apply to Wyoming tax sale when statutory procedure does not provide for competitive bidding); *In re Butler, 171 B.R. 321 (Bankr. N.D. Ill. 1994)* ; *In re McKeever, 132 B.R. 996 (Bankr. N.D. Ill. 1991)* . In Illinois, the property transfer is an administrative act based on prior sale of the tax lien and a failure to redeem; there is no property sale to which the *BFP* analysis could apply. *See also In re Grandoe Country Club Co., Ltd., 252 F.3d 1146 (10th Cir. 2001)* (*BFP* analysis applied because tax sale under state law subject to competitive bidding procedure).

(n15)Footnote 15. *See In re Dow, 250 B.R. 6 (Bankr. D. Mass. 2000)* (debtor who filed chapter 13 bankruptcy a few minutes after sale of her home, but before mortgagee signed the memorandum of sale, did not lose ownership in home as she had a right of redemption under Massachusetts law; the property became part of the estate). *See also In re Grassie, 293 B.R. 829 (Bankr. D. Mass. 2003)* (debtor retains equity of redemption when bankruptcy petition filed minutes after foreclosure sale and memorandum of sale signed by purchaser but before memorandum of sale signed by auctioneer); *In re Benson, 293 B.R. 234 (Bankr. D. Ariz. 2003)* (trustee's sale is not complete until the bid price is paid; so when debtor filed bankruptcy after fall of auctioneer's hammer, but before high bidder paid bid price, bidder's subsequent payment of bid price violated stay, as "act to obtain possession of property of the estate"); *In re Pellegrino, 284 B.R. 326, 330 (Bankr. D. Conn. 2002)* (discussing when debtor's rights in the property are exhausted under strict foreclosure process); *In re Brown, 282 B.R. 880 (Bankr. E.D. Ark. 2002)* (under Arkansas law, judicial foreclosure not complete until sale is confirmed by court, bankruptcy filed after sale but one day before sale was confirmed). *But see Colon v. Option One Mortgage Corp., 319 F.3d 912 (7th Cir. 2003)* (under Illinois law, chapter 13 debtor's right to cure a mortgage default expires upon completion of the foreclosure sale of the property and does not continue during the

period between that sale and the judicial confirmation of that sale by the state court).

(n16)Footnote 16. *11 U.S.C. § 522(g)*. The right is available only if the transfer is involuntary -- such as a transfer by foreclosure sale.

(n17)Footnote 17. Several courts have allowed trustees or debtors acting in their stead to avoid transfers by foreclosure during the period before the foreclosure deed is recorded. *See, e.g., In re Burns, 183 B.R. 670 (Bankr. D.R.I. 1995)* ; *MacDonald v. Tack (In re McDonald), 164 B.R. 325 (Bankr. C.D. Cal. 1994) . Cf. Young v. Wash. Fed. Sav. & Loan Ass'n (In re Young), 156 B.R. 282 (Bankr. D. Idaho 1993)* (state law provision protecting purchasers at foreclosure sale until recording of foreclosure deed prevents exercise of strong-arm powers).

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PART I Consumer Credit
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§ 13.15 Post-Foreclosure Issues

[1] The Right of Redemption

Most state foreclosure statutes provide homeowners with redemption rights; that is, the right to pay the balance of the debt, including foreclosure expenses, to extinguish a lender's claim. In some states, the right must be exercised prior to a foreclosure sale. In others, the right continues for a certain period after the foreclosure.

Few financially distressed homeowners are able to redeem their homes, but the redemption right gives them the chance either to sell the home privately, refinance the debt, or cure the arrearage in bankruptcy. It may keep them from losing the equity in their homes, which is virtually inevitable with a foreclosure sale.

[2] Deficiency Judgments

If the foreclosure sale price is not enough to pay off the loan balance and any allowable foreclosure expenses, in most states, the lender is free to sue the borrower for this "deficiency." A deficiency judgment can be satisfied by garnishing wages or attaching other non-exempt property. Though a lender may decide not to sue for a deficiency where it seems unlikely that the homeowner will have any assets to satisfy the judgment, foreclosed homeowners should at least be aware of the possibility of a deficiency action after a foreclosure.

Some states have enacted anti-deficiency statutes which prohibit or limit deficiency claims against the former homeowner. A few states have banned deficiency judgments outright when mortgages are foreclosed nonjudicially. More states place limits on the amount of the deficiency judgment by requiring that the borrower be given credit for the "fair value" of the property after the foreclosure.

Most anti-deficiency statutes apply only to the foreclosure of purchase money mortgages. n1

Courts have limited deficiency judgments on equitable grounds when the foreclosure sale price was found to be inadequate, as a result of sale practices that were not commercially reasonable or because of mortgagee self-dealing. n2

A mortgagee or trustee has a duty to use good faith in the conduct of a foreclosure sale. This duty includes using due diligence to obtain a fair price for the borrower's property. When a lender purchases at its own foreclosure sale, it will

be held to an even higher standard of utmost diligence for the protection of the rights of the borrower.

A breach of this duty may also be a basis upon which a court can deny a deficiency claim. Evidence of the lender's failure to use good faith in conducting the sale may be found where a foreclosing lender purchases the property at its own foreclosure sale, then immediately resells it to a third party for a substantial profit.

[3] Deficiency Claims Are Unsecured

If a borrower is obligated for a deficiency, keep in mind that this debt is not secured by any of the borrower's remaining property until a judgment lien is obtained. The foreclosed borrower at this point could file bankruptcy and discharge the deficiency as an unsecured debt. Moreover, even if the creditor obtains a court judgment for the deficiency, it still cannot seize exempt property to satisfy the deficiency. To the extent the judgment creates a lien which impairs an exemption, it can be avoided in bankruptcy pursuant to section 522(f).

[4] Claims for Damages for Wrongful Foreclosure

Many states have common law on wrongful foreclosure including a cause of action by that name. n3 In most states, however, there is little recent case law. A wrongful foreclosure may also give rise to a cause of action for UDAP, n4 common law fraud, n5 or for torts such as trespass or conversion n6 that take place during the foreclosure. Tort damages will not, however, be available for the wrongful foreclosure itself if the only duties breached arise from the contract. n7

[5] Claiming a Foreclosure Sale Surplus

If the foreclosure sale yields more than the amount owed to the foreclosing mortgagee, there is a surplus available for distribution. Though surpluses unfortunately are rare due to depressed prices at foreclosure sale auctions, it is in the former homeowner's interest to attempt to maximize the amount of the surplus as any balance that is not used to pay off liens on the property must be returned to the former owner.

State legal process differs on how and when sale proceeds (including surpluses) are distributed. In some states, distribution of sale proceeds is a subject that is addressed during the confirmation of the sale, with notice to all parties. n8 The foreclosing mortgagee and any junior lienholders n9 can file claims subject to objection by the former homeowner or others who might also have an interest in the surplus. n10 In some states, including many nonjudicial foreclosure states, distribution of excess sale proceeds is more informal. The trustee or the mortgagee's attorney distributes proceeds without any direct supervision by the court.

The former homeowner should attempt to evaluate any claims to the extent possible. Legal proceedings to reduce the amount a lienholder is claiming from the sale proceeds, if successful, will increase the share available to the homeowner (unless the total amount due on multiple liens exceeds the foreclosure sale price). A lienholder might overstate fees and costs associated with foreclosure, for example, or fail to properly rebate precalculated interest or insurance premiums.

Complex issues may arise during foreclosure when there are also judicial liens on the property. The debtor's homestead exemption, if provided under state law, should be paid ahead of any claims of judicial lienholders. In a few states, the right to a homestead exemption must be affirmatively sought by filing a claim. Whether or not an affirmative claim is required, the homeowner must be vigilant to make certain that sale proceeds are appropriately distributed. At a minimum, whenever excess sale proceeds are potentially available, the homeowner should keep the relevant court, trustee, or mortgage company informed with a current address

[6] Repurchasing the Home at the Foreclosure Sale

Like any other person or entity, a homeowner is allowed to bid on and buy her own property at a foreclosure sale. In some instances, the price at sale will be less than the amount for which the homeowner could redeem prior to sale.

Moreover, because the foreclosure sale extinguishes liens that are junior to the foreclosing mortgagee's interest, the property may be purchased at sale without junior encumbrances. n11

There are, however, various state law prerequisites to bidding on and purchasing property at a foreclosure sale. These prerequisites always include some form of deposit requirement and require the balance be paid within a relatively short time period. In some states, the time frame for paying the balance of the debt is too short for the purchaser to shop for and obtain conventional financing. If the balance is not paid, for whatever reason, most states mandate that the deposit is forfeited and that the property must be resold.

Another potential disadvantage to strategically waiting to purchase the property at foreclosure is that the homeowner may be outbid.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingMortgages & Other Security InstrumentsForeclosuresGeneral OverviewReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresDeficiency JudgmentsReal Property LawFinancingMortgages & Other Security InstrumentsRedemptionMortgagor's Right

FOOTNOTES:
(n1)Footnote 1. *Brumley v. Mallard, Ltd. Liab. Co., 154 N.C. App. 563, 575 S.E.2d 35 (2002)* (mortgage must state on its face that it is purchase money mortgage in order for anti-deficiency statute to apply).

(n2)Footnote 2. *See National Loan Investors, L.P. v. LaPointe (In re LaPointe), 253 B.R. 496 (B.A.P. 1st Cir. 2000)* (guarantor may offset the amount of the deficiency with damages she suffered as a result of lender's bad faith in conducting sale).

(n3)Footnote 3. *See, e.g., McCarter v. Bankers Trust Co., 247 Ga. App. 129, 543 S.E.2d 755 (2000)* ; *Kattar v. Demoulas, 433 Mass. 1, 739 N.E.2d 246 (2000)* ; *Price v. Bustamante, 2001 Tex. App. LEXIS 5251* (Tex. App. July 26, 2001) . *See also Murieta Car Wash, Inc. v. North Country Bank, 2005 WL 2100012* (Cal. Ct. App. Aug. 31, 2005) (unpublished) (measure of damages for wrongful foreclosure is fair market value at time of foreclosure, minus liens and encumbrances); *UMLIC VP L.L.C. v. T & M Environmental Systems, Inc., 176 S.W.3d 595 (Tex. App. 2005)* (wrongful foreclosure gives rise to cause of action for return of property or for damages; measure of damages is fair market value of property minus balance due on debt; punitive damages not available). *See also Gregorakos v. Wells Fargo Nat'l Ass'n, 647 S.E.2d 289 (Ga. Ct. App. 2007)* (to establish a claim for wrongful foreclosure, plaintiff must establish a legal duty owed to it by the foreclosing lender, a breach of that duty, a causal connection between the breach of that duty and the injury it sustained, and damages); *Dobson v. Mortg. Elec. Registration Sys., 259 S.W.3d 19 (Mo. Ct. App. 2008)* (claim of wrongful foreclosure sufficient to set aside a sale not the same as a claim to recover damages in tort; tort claim can be asserted when lender had no right to foreclose and plaintiffs must plead and prove that they was not in default).

(n4)Footnote 4. This will depend on the scope of the state's UDAP statute. *Compare Levine v. First National Bank of Commerce, 917 So. 2d 1235 (La. Ct. App. 2005)* (mortgage foreclosure not exempt transaction "specifically regulated or authorized by the Comptroller of the Currency" because Comptroller had no specific regulations governing this activity; UDAP damages, here $300,00 for mental anguish and humiliation, affirmed) *with Everson v. Mineola Community Bank, 2006 Tex. App. LEXIS 6738* (Tex. App. July 31, 2006) (no UDAP claim for wrongful foreclosure or other claims arising from mortgage; mortgage not a good or service within meaning of Texas UDAP statute).

(n5)Footnote 5. *Hamilton v. Willms, 2005 U.S. Dist. LEXIS 31629* (E.D. Cal. Nov. 22, 2005) (borrower stated claim for promissory fraud; evidence that lender never intended to keep promise to postpone sale in return for $2000 payment, did not come to pick up payment as arranged, then refused to postpone sale for ten minutes while borrower's representative went to nearby bank); *Bassett v. Jasper Banking Co., 629 S.E.2d 434 (Ga. Ct. App. 2006)* (fact issue

whether bank officer knew of borrower's blindness and misled him as to terms of documents); *Jenkins v. WM Specialty Mortgage, L.L.C., 2006 U.S. Dist. LEXIS 6308* (N.D. Tex. Feb. 17, 2006) (borrower stated common law fraud claim against lender's employee who allegedly made false statements about home equity loan that was later accelerated and posted for foreclosure).

(n6)Footnote 6. *King v. Bank of New York, 2005 U.S. Dist. LEXIS 32466* (Sept. 7, S.D. Tex. 2005) (borrower stated trespass claim against trustee who initiated eviction after allegedly wrongful foreclosure).

(n7)Footnote 7. *UMLIC VP L.L.C. v. T & M Environmental Systems, Inc., 176 S.W.3d 595 (Tex. App. 2005)* (no punitive damages in contract, even if breach is malicious; no independent duty of good faith and fair dealing; no independent cause of action for mental anguish).

(n8)Footnote 8. But separate notice to parties respecting the confirmation of the sale may not be constitutionally mandated if those parties had received notice of the foreclosure proceeding itself. *Galt Alloys, Inc. v. Keybank Nat'l Ass'n, 85 Ohio St. 3d 353, 708 N.E.2d 701 (1999)* . However, some state statutes mandate notice.

(n9)Footnote 9. Properties are sold at foreclosure subject to any senior liens. Junior liens are paid only if there are sufficient sale proceeds after the foreclosing mortgagee is paid and, in most states, only if the junior lienholder affirmatively files a claim. *See, e.g., 2793 S. 3095 W. v. Munford, 1 P.3d 1116, 2000 UT App. 116 (2000)* ; *Household Fin. Indus. Loan Co. v. Upton (In re Upton), 102 Wash. App. 220, 6 P.3d 1231 (2000)* .

(n10)Footnote 10. For example, a third lienholder might object to the amount claimed by a second lienholder in order to increase its recovery.

(n11)Footnote 11. *See BCGS, L.L.C. v. Jaster, 299 Ill. App. 3d 208, 700 N.E.2d 1075 (2d Dist. 1998)* .

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.16

§ 13.16 Tax Consequences of a Foreclosure Sale: An Introduction

Both borrowers and their counsel may be surprised to learn that loss of a home by foreclosure can result in taxable income to the foreclosed homeowner in two different ways. First, if the foreclosure sale price greatly exceeds the homeowner's tax basis in the property, the homeowner may incur a taxable capital gain. And, if in connection with the foreclosure, the lender forgives any part of the mortgage debt (for example, by waiving a deficiency in exchange for a deed in lieu of foreclosure), then the homeowner can possibly, but is not likely to, incur taxable "discharge of indebtedness (DOI) income." Further consultation with an accountant or tax attorney may be necessary to resolve any specific taxation issues that arise in a given case. n1 Borrowers can have both capital gains and discharge of indebtedness income in the same transaction, if they are personally liable for the debt. n2 This double liability happens whenever the amount realized from a foreclosure sale is (1) more than the borrower's basis but (2) less than the outstanding mortgage debt and the lender forgives the difference between the outstanding mortgage debt and the foreclosure sale price.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingMortgages & Other Security InstrumentsDeed in Lieu of ForeclosureReal Property LawFinancingMortgages & Other Security InstrumentsForeclosuresGeneral OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesLiens (IRC secs. 6320-6327)General OverviewTax LawState & Local TaxesReal Property TaxGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See also* National Consumer Law Center, Foreclosures, § 14.7 (2d ed. 2007 and Supp.).

(n2)Footnote 2. *See, e.g., Rev. Rul. 90-16, 1990-1 C.B. 12* .

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.17

§ 13.17 Forfeiture of Land Installment Sales Contracts

Land installment sales contracts are used in some states as an alternative to mortgages or deeds of trust. The method by which they are foreclosed or "forfeited" depends on state law. n1

Under an installment sales contract, the buyer takes possession of the property and makes monthly installment payments of principal and interest to the seller until the principal balance is paid off. The seller retains legal title to the property until the final payment is made, and then title is conveyed to the buyer.

Many such contracts include a "time is of the essence clause," which purports to allow the seller to forfeit the contract if any payment is missed, retake possession of the property, and keep all payments made as liquidated damages. If the contract is near completion, a forfeiture would result in a windfall to the seller.

Traditionally, these provisions were upheld by the courts as written, despite the obvious unfairness to the buyer. More recently, however, courts have begun to question this approach, and some states have enacted legislation to add protections for buyers or to eliminate forfeiture as a remedy altogether.

A few states have enacted legislation which provides a contract buyer with a grace period to cure the default and avoid forfeiture. n2 In some states, the length of the grace period is determined by the percentage of the contract price the buyer has already paid.

If the default is not cured by the expiration of the applicable grace period, then the forfeiture can proceed, either judicially or non-judicially, depending on the requirements of state law.

Other states have adopted legislation which treats some land sales contracts like mortgages. Even in states where there are no legislative restrictions on forfeiture, some courts have created limitations on the use of forfeiture using equitable grounds, or have decided that land sales contracts are de facto mortgages and must be foreclosed in the same manner.

In the bankruptcy context, a number of bankruptcy courts have ruled that a land sales contract creates a security interest, which allows the debtor to cure any arrearage through the life of the plan, in accordance with *sections 1322(b)(2)*, *(b)(5)* and *1325(a)(5) of the Bankruptcy Code*. While some of these decisions are based on state law, other courts have held

that how state law characterizes land sales contracts is not controlling in bankruptcy. These courts rely upon federal bankruptcy law and cite the policies expressed in the relevant provisions of the Bankruptcy Code, which favor the preservation of the rights which a debtor and the estate hold in property, particularly residences.

In addition, a debtor in bankruptcy may be able to set aside the forfeiture of a land installment sales contract where the remaining debt under the contract is significantly less than the value of the forfeited property.

Because the law is unsettled, both statutory and case law research is necessary to determine what protections are available to a purchaser under a land sales contact. Absent consumer protections in either source, litigation challenging forfeitures may be possible based on equitable principles and on due process grounds if state action can be shown.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingInstallment Land Sale Contracts

FOOTNOTES:
(n1)Footnote 1. *See* National Consumer Law Center, Foreclosures, § 12.3 (2d ed. 2007 and Supp.).

(n2)Footnote 2. *See Iowa Code § 656.6* (thirty-day grace period); La. Rev. Stat. Ann. § 9-2941 (can cure within forty-five days of notice of cancellation from seller); *Minn. Stat. § 559.21*; *N.D. Cent. Code §§ 32-18-01 to 32-18-06* (one-year grace period); S.D. Codified Laws §§ 21-50-01 to 21-50-07. *But see Tex. Prop. Code Ann. §§ 5.061 to 5.080*; *Flynn v. Korneffel, 451 Mich. 186, 547 N.W.2d 249 (1996)* (default amount must actually be paid to seller, deposit of funds in escrow account is not sufficient to redeem).

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.18

§ 13.18 Mobile Home Foreclosures

[1] Must Foreclosure Procedures Be Followed to Retake Mobile Home?

Much of the law concerning foreclosure of mobile homes involves the question of whether the unit is considered real property or personal property for that purpose. Depending on the jurisdiction, this determination may be made by statute for all mobile homes, or it may depend on facts such as whether the mobile home is attached to the land on which it rests. n1 Some states, such as Colorado, require that certain steps be taken to convert the unit from personal to real property. n2

If the mobile home is realty, state foreclosure procedures described in this chapter are likely to apply. If the mobile home is considered to be personalty, then repossession, replevin and other creditor remedies are available in the event of default, although several states prohibit all self-help seizures of mobile homes. n3

Even states that do not grant a general right to cure may have a special statute extending that right to mobile home buyers. n4 Furthermore, whether a mobile home is considered realty or personalty, a right to cure the default which supplements or goes beyond state law is potentially available due to regulations of the federal Office of Thrift Supervision. n5

[2] Truth in Lending Defenses in Mobile Home Foreclosures

TIL claims may be available as defenses or counterclaims in mobile home foreclosure cases. The federal TILA requires disclosures in any consumer credit transaction. n6 The disclosures are to be made by the party to whom the obligation is initially payable. n7

The TILA does not apply to transactions in which the amount financed exceeds $25,000, but there is an exception for transactions in which the creditor takes a security interest in real property or in personal property used or expected to be used as the principal dwelling of the consumer. n8 The reference to personal property covers mobile homes, so the result is that TILA covers mobile home credit regardless of whether it exceeds $25,000. TILA also applies to sales of land to consumer buyers.

If the creditor does not make the disclosures required by TILA, the consumer can sue for actual damages plus attorney

fees. n9 Moreover, certain violations lead to statutory damages of double the finance charge. n10 In many cases there is a $1000 cap on statutory damages, but the cap is $2000 in the case of a closed-end credit transaction secured by real property or a dwelling, n11 including a mobile home. n12

If the creditor files a replevin action to recover a mobile home, the consumer may be able to raise TILA claims defensively. n13 If the TILA claims equal or exceed the alleged delinquency, the court may find that the creditor does not have grounds for replevin. There is a one-year statute of limitations for TILA damage suits, but TILA claims can generally be raised as defenses to the creditor's claim regardless of the statute of limitations. n14

While TIL damages are an attractive counterclaim that can reduce the alleged delinquency on a mobile home, the statute also offers a right to rescind that can be an even more powerful tool to prevent foreclosure. Unfortunately, however, the right to rescind applies to only a small subset of credit transactions secured by mobile homes.

The TILA gives consumers the right to rescind certain home-secured transactions, but this right does not apply when the credit is extended to finance the acquisition of the home, n15 unless the consumer gives a security interest in an existing residence to secure the new extension of credit. In the mobile home context, the right to rescind would apply if the consumer already owned a mobile home on a plot of land and "traded up" for a better mobile home, giving the creditor a security interest in the land. A home equity loan, home improvement loan, or other non-purchase money transaction secured by a mobile home would also be subject to the right to rescind. n16

The HOEPA requires special disclosures and creates special substantive restrictions for certain high-rate home-secured loans. Like the TIL rescission right, it does not apply to credit used to purchase a mobile home. n17

[3] RESPA Defenses in Mobile Home Foreclosures

The federal RESPA n18 can also provide defenses and counterclaims in mobile home foreclosures, and unlike the rescission right, it applies to purchase-money credit.

In the mobile home context, RESPA applies to loans secured by land on which a mobile home sits or on which a mobile home will be placed within two years. n19 It thus applies to a loan that finances both land and a mobile home as a single transaction; to a loan to purchase a mobile home if the loan is secured not only by the home but also by the land on which the home will be placed; and to a loan to purchase just the land on which a home will be placed. It does not, however, apply to credit that is secured just by a mobile home, nor does it cover installment sales.

When RESPA applies, it requires disclosures about closing costs both before and at the time of settlement, notices about escrow accounts and servicing transfers, and the right to obtain account information through a qualified written request. RESPA also prohibits kickbacks and unearned fees for settlement services, charges for preparation of certain documents, and steering of borrowers to a particular title insurance company. Treble damages and attorney fees are available for violation of the anti-kickback provision, n20 and the statute also creates a private cause of action for violations of the anti-steering provision n21 and the servicer obligations. n22

Like TILA damage claims, it should be possible to raise RESPA claims defensively in a replevin action as a means of reducing the alleged delinquency. n23

[4] Defenses Based on State Credit Statutes

Claims and defenses under state credit statutes should also be investigated. Most mobile home sales are financed and will thus be covered by a state credit statute. If the transaction is set up as an installment sale, with the contract assigned to a financing institution, often there is a retail installment sales act ("RISA") or motor vehicle retail installment sales act ("MVRISA") that applies. If the transaction is set up as a loan, a different statute will apply. Remedies under credit

statutes are often very powerful and can include unenforceability of the obligation. Special attention should be paid to the scope of such statutes because determination of which statute covers mobile home sales is often difficult. Federal law has also preempted many state credit statutes. n24

[5] Homestead Exemption

Sometimes foreclosure upon a mobile home is threatened because of a judgment lien rather than a consensual security interest. The determination of whether a mobile home is considered realty or personalty is important in this context. A homestead exemption typically applies to land and the improvements and chattels attached to the land. n25 If a mobile home is attached to the land, it may be included in the homestead and exempt from execution of the lien. n26 If it is not attached, and therefore not part of the homestead, it may be sold to satisfy the lien unless another exemption covers it. Some state homestead exemptions specifically include mobile homes. n27

[6] Problems Relating to Mobile Home Parks

Abuses in mobile home repossessions or foreclosures may occur when mobile home parks are owned by or connected with mobile home dealers. For example, if the original buyers try to sell the home as a way of avoiding foreclosure and recouping their investment, the park owner may refuse to transfer the lot lease to the buyer. This can prevent the sale, making it possible for the park owner or the creditor to buy the home at a low price at the foreclosure sale. Then the park owner, either acting for itself or for the creditor, may sell the home to a new buyer or may rent out the home along with the lot.

If the state has a comprehensive mobile home park statute, it may outlaw restrictions on sale or transfer of mobile homes within the park. It may also prohibit unreasonable refusal by the park to rent to a new buyer.

If Article 9 governs the transaction, the creditor's sale of the home must be commercially reasonable. If the park is operated by or closely connected to the dealer that sold the home originally, the park's reacquisition of the home may not count as an Article 9 repossession sale. Under Article 9, the repossession sale will occur only when the park sells the home to a new buyer, and any surplus should go to the original buyer. Revised Article 9 retreats from this position as an inflexible rule, n28 but adds a new remedy for low-price sales to insiders. n29

[7] Additional Foreclosure-Related Issues

Self-help repossessions which involve trespass or breach of the peace are always illegal and should be challenged aggressively. n30 It is extremely difficult for a creditor to accomplish a self-help repossession of a mobile home without a breach of the peace, and the potential for damage to personal property is great. n31

Additional issues may arise as to the land on which the mobile home rests. If the land is owned by the mobile home owner, the land may be subject to a mortgage or other liens. If the mobile home is attached to the land after the land is purchased, it may become a fixture, subject to the security interest on the land. Generally, the issue will be a question of fact controlled by evidence such as whether the wheels are removed and whether the home is substantially anchored to the ground. n32

For homeowners who rent the land on which the mobile home rests, some states strictly regulate mobile home park leases and evictions, at minimum requiring that the land or park owner follow certain specific notice procedures prior to commencing eviction proceedings. n33 Because alternative mobile home park space is not always readily available, the effect of eviction for nonpayment of ground rent may be loss of the mobile home as well. Claims have been brought against park owners based on unfair trade practice laws, other consumer protection statutes and common law conversion when rent increases appear to be in bad faith for the purpose of forcing homeowners to abandon valuable mobile homes. n34

Warranty defenses may be available if the home is defective. n35 Such defenses are clearly available if the manufacturer or seller financed the sale and may be available if the financing entity and the manufacturer or seller are closely related. n36

A number of states have statutes that limit deficiency judgments in at least some circumstances. n37 Finally, workout agreements on mobile home loans are increasingly possible, because with depreciation, the home is likely to be worth less than the amount due on the loan because of depreciation giving lenders a substantial incentive to work with borrowers in order to avoid a large loss in the foreclosure process.

[8] Using Bankruptcy to Prevent Loss of a Mobile Home

A bankruptcy filing under chapter 13 will provide a right to cure in installments in the context of a confirmed plan n38 and is a good alternative if a workout cannot be negotiated. Furthermore, in states that consider mobile homes to be personalty rather than real property, the debtor has the right to "strip down" the secured claim to the value of the collateral and then to pay off the reduced secured claim. n39 Any amount of the unsecured portion of the claim that remains unpaid after the debtor completes the Chapter 13 plan will be discharged, along with the unpaid portion of other unsecured debts.

[9] Raising Seller-Related Defenses Against the Foreclosing Creditor

The creditor foreclosing on a mobile home will usually be liable for the consumer's claims against the seller, up to the amount paid by the consumer, because of the contractual language required by the Federal Trade Commission Holder Rule. n40 All assignees of consumer sales contracts have this derivative liability, and purchase-money lenders do also as long as the seller arranged the financing or is affiliated with the lender by common control, contract or business arrangement. n41

The creditor is also, of course, liable for its own wrongful acts. In addition, if the loan to purchase the home is insured under *12 U.S.C. section 1703*, the lender must investigate the manufacturer's record of warranty compliance and obtain certification that the home site meets minimum standards. n42 A lender's failure to comply with these duties may make it fully liable for problems with the home, rather than liable only up to the amount that the consumer has paid as the Holder Rule requires.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingFederal RegulationsGeneral OverviewReal Property LawFinancingFederal RegulationsHome Owners Equity Protection ActReal Property LawHomestead ExemptionsReal Property LawMobilehomes & Mobilehome ParksExemptionsReal Property LawMobilehomes & Mobilehome ParksSecurity Interests

FOOTNOTES:
(n1)Footnote 1. *See, e.g., In re Claxton, 239 B.R. 598 (Bankr. N.D. Okla. 1999)* (mortgagee had valid lien against mobile home that was permanently resting on concrete foundation; had stone skirting on three of its four sides; and was surrounded by porches, landscaping and metal fence); *Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 B.R. 348 (Bankr. E.D.N.C. 1998)* ; *In re Harris, 166 B.R. 163 (Bankr. D. Colo. 1994)* .

(n2)Footnote 2. *See Colo. Rev. Stat. §§ 38-29-101-38-29-143*; *Leader Fed. Bank for Sav. v. Saunders, 929 P.2d 1343 (Colo. 1997)* ; *see also Mo. Rev. Stat. § 700.111*; *In re White, 287 B.R. 232 (E.D. Mo. 2002)* (to convert a mobile home from personal property to real property under state law, mobile home owner must attach the home to a permanent foundation situated on real estate she owns); *Notoco Indus., Inc. v. Powell, 835 So. 2d 835 (La. Ct. App. 2002)* (citing

Louisiana law which outlines actions necessary for a mobile home to become immovable).

(n3)Footnote 3. *See* Ch. 10 *supra*.

(n4)Footnote 4. *See, e.g., Minn. Stat. §§ 327.64*, *327.66*; *Pa. Stat. Ann. tit. 69, § 623(G)* (West).

(n5)Footnote 5. *See § 10.03[8][c] supra*; National Consumer Law Center, Foreclosures, § 11.5.2 (2d ed. 2007 and supp.).

(n6)Footnote 6. *See* Ch. 1 *supra;* National Consumer Law Center, Truth in Lending (6th ed. 2007 and supp.).

(n7)Footnote 7. *15 U.S.C. § 1602(f)*.

(n8)Footnote 8. *15 U.S.C. § 1603*.

(n9)Footnote 9. *15 U.S.C. § 1640(a)*; *see* National Consumer Law Center, Truth in Lending (6th ed. 2007 and supp.) (full discussion of Truth in Lending disclosure requirements).

(n10)Footnote 10. *15 U.S.C. § 1640*.

(n11)Footnote 11. *15 U.S.C. § 1640(a)(2)(A)(iii)*.

(n12)Footnote 12. *15 U.S.C. § 1602(v)*.

(n13)Footnote 13. *See* National Consumer Law Center, Foreclosures, § 11.6 (2d ed. 2007 and supp.).

(n14)Footnote 14. *See* National Consumer Law Center, Truth in Lending, § 7.2.5 (6th ed. 2007 and supp.).

(n15)Footnote 15. *See 15 U.S.C. §§ 1635(e)(1)* (exempting "residential mortgage transactions" from right to rescind), 1602(w) (defining "residential mortgage transaction"), 1602(v) (defining dwelling to include a mobile home); *see also* Official Staff Commentary §§ 226.2(a)(24)-2,-4,-5, 226.23(f)-1 (which flesh out these definitions).

(n16)Footnote 16. For discussion of effects of rescission when available, see National Consumer Law Center, Truth in Lending, § 6.6.3 (6th ed. 2007 and supp.).

(n17)Footnote 17. *15 U.S.C. § 1602(aa)(1)* (excluding "residential mortgage transactions"). *See generally § 13.07[3] supra;* National Consumer Law Center, Truth in Lending, § 9.2.4.1 (6th ed. 2007 and supp.).

(n18)Footnote 18. *12 U.S.C. § 2602(1)*. The loan must also must be made by a federally insured lender or be federally related in one of the other ways spelled out in § 2602.

(n19)Footnote 19. *24 C.F.R. § 3500.5(B)(4)*.

(n20)Footnote 20. *12 U.S.C. § 2607(d)(2)(3)*.

(n21)Footnote 21. *12 U.S.C. § 2608(b)*.

(n22)Footnote 22. *12 U.S.C. § 2605(f)*.

(n23)Footnote 23. *See § 13.07[3] supra*. The Real Estate Settlement Procedures Act [hereinafter RESPA] is discussed in more detail in National Consumer Law Center, Cost of Credit, § 12.2.1 (2009 4th ed.).

(n24)Footnote 24. *See* National Consumer Law Center, Cost of Credit, Ch. 3 (2009 4th ed.).

(n25)Footnote 25. *Green Tree Credit Corp. v. Thompson (In re Thompson), 217 B.R. 375 (B.A.P. 2d Cir. 1998)* . *See generally* National Consumer Law Center, Collection Actions, § 12.5.2 (1st ed. 2008 and 2009 supp.) (discussion of homestead exemptions).

(n26)Footnote 26. *In re Buzzell, 110 B.R. 440 (Bankr. D. Neb. 1990)* (mobile home, which was permanently annexed to property by means of wooden addition, qualified for exemption under homestead act). *See also In re Meola, 158 B.R. 881 (Bankr. S.D. Fla. 1993)* ; *In re Mangano, 158 B.R. 532 (Bankr. S.D. Fla. 1993)* . *Gold v. Schwartz, 774 So. 2d 879 (Fla. Dist. Ct. App. 2001)* (mobile home permanently attached to land qualifies as a homestead).

(n27)Footnote 27. *See, e.g., Ariz. Rev. Stat. § 33-1101A* (homestead exemption includes the mobile home and the land on which the mobile home resides); *Fla. Stat. Ann. § 222.05*; *N.Y. C.P.L.R. § 5206(a)*; *In re Irwin, 293 B.R. 28 (D. Ariz. 2003)* (motor home, actually used as the debtor's residence, can qualify for homestead exemption under state law).

(n28)Footnote 28. Rev. *U.C.C. § 9-618*.

(n29)Footnote 29. Rev. *U.C.C. § 9-615*. The new remedies apply to a low-price resale to the original dealer if the dealer assigned the contract to the creditor with recourse. *See* Rev. *U.C.C. § 9-102(a)(71)(B)* (definition of "secondary obligor").

(n30)Footnote 30. *See § 10.05[4] supra*.

(n31)Footnote 31. *See, e.g., Gaskill v. Doss, 2000 Ohio App. LEXIS 6185* (Ohio Ct. App. Dec. 16, 2000) (affirming award of attorney fees in successful UDAP suit against creditor who lost and damaged buyer's personal property while repossessing mobile home).

(n32)Footnote 32. *See United States v. Shelby County, 385 F. Supp. 1187 (W.D. Tenn. 1974)* (trailers not permanently fixed to ground are not fixtures); *Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 B.R. 348 (Bankr. E.D.N.C. 1998)* (creditor has valid lien against real property and mobile home when mobile home was permanently affixed to the land by brick foundation and also connected to water and septic facilities); *Rochman v. Cape Mercantile Bank & Trust Co., 156 B.R. 794 (Bankr. S.D. Ill. 1993)* (property underpinned on concrete blocks and subject to assessment as real estate found to be fixture); *In re Gray, 40 B.R. 429 (Bankr. W.D. Okla. 1984)* (no permanent foundation and wheels were not removed so mobile home is not fixture).

(n33)Footnote 33. *See, e.g.,* Mobile Home Park Act, *Colo. Rev. Stat. § 38-12-202(1)(a), (c)*; Mobile Home Landlord and Tenant Rights Act, *765 Ill. Comp. Stat. § 745/1*; *N.Y. Real Prop. Law § 233* (McKinney).

(n34)Footnote 34. *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.5.1 (6th ed. 2004 and supp.) (discussion of the application of UDAP laws to residential leases and mobile home parks). In some states, special protections have been enacted for mobile home park tenants. *E.g., Cal. Civ. Code § 798* (mobile home residency law); *see Yee v. City of Escondido, 503 U.S. 519, 112 S. Ct. 1522, 118 L. Ed. 2d 153 (1992)* (city's mobile home rent control ordinance and California's mobile home residency law do not constitute a *Fifth Amendment* taking).

(n35)Footnote 35. *See generally* National Consumer Law Center, Consumer Warranty Law, Ch. 17 (3rd ed. 2006).

(n36)Footnote 36. See generally National Consumer Law Center, Unfair and Deceptive Acts and Practices § 6.6.5.4 (6th ed. 2004 and supp.) *See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 6.6 (6[th] ed. and Supp.).

(n37)Footnote 37. *See* National Consumer Law Center, Foreclosures, § 11.3.7 (2d ed. 2007); *Cal. Civ. Code § 2983.8*; *Cal. Heath & Safety Code § 18038.7* (statute prohibits deficiency judgments for mobile homes unless there is substantial damfage beyond wear and tear from normal use).

(n38)Footnote 38. *See § 13.13 infra*; National Consumer Law Center, Foreclosures, § 11.12 (2d ed. 2007).

(n39)Footnote 39. *See also In re Trible, 290 B.R. 838 (D. Kan. 2003)* (creditor's failure to note its lien on mobile home's certificate of title rendered its security interest in the mobile home unperfected under state law and subject to avoidance under § 544). *In re Stratton, 248 B.R. 177 (Bankr D. Mont. 2000)* ; *In re Blevins, 152 B.R. 130 (Bankr. N.D. Tex. 1992)* (modification available because mobile home is personal property); *In re Plaster, 101 B.R. 696 (Bankr. E.D. Okla. 1989)* ; *In re Colver, 13 B.R. 521 (Bankr. D. Nev. 1981) . Cf. In re Speights, 131 B.R. 205 (Bankr. N.D. Fla. 1991)* (modification not available because facts establish that home was permanently affixed to the real estate); *In re Carter, 116 B.R. 156 (Bankr. W.D. Mo. 1990)* . At the time of this writing, Congress was considering amendments to the bankruptcy code that would eliminate the possibility of stripping down mobile home security interests, so practitioners should check the current status of federal legislation. *But see In re Garrett, 276 B.R. 217 (E.D. Tenn. 2002)* (creditor's lien remained properly perfected following a mobile home's interstate relocation; the law of the state that issued the certificate continued to govern where the certificate was not surrendered and the home was not registered in the new state at the commencement of the case); *In re Cassady, 197 B.R. 846 (E.D. Tenn. 1996)* (creditor properly perfected its security interest in debtor's mobile home by notation of its lien on the certificate of title even though the home was subsequently attached to the land).

(n40)Footnote 40. 16 C.F.R. 433. *See BCS Fin. Corp. v. Sorbo, 213 Ga. App. 259, 444 S.E.2d 85 , cert. denied, 1994 Ga. LEXIS 928* (Ga. Sept. 8, 1994) . *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 6.6 (6th ed. and Supp.).

(n41)Footnote 41. *16 C.F.R. § 433.1(d).*

(n42)Footnote 42. *24 C.F.R. § 201.21(d)(3).*

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PART I Consumer Credit
CHAPTER 13 Foreclosure Defense

1-13 Consumer Credit Law Manual § 13.19

§ 13.19 The Rights of Tenants in Possession Following Foreclosure on Their Landlord

[1] Generally

When a landlord owning residential rental property defaults on a mortgage, tenants stand to lose their homes. Frequently, the first step taken by a foreclosure sale purchaser is to attempt to evict existing tenants. Whether or not the purchaser may legally evict tenants of the former owner will depend largely on state law.

If a lease was given prior to the mortgage, the rights of a tenant are not extinguished by the foreclosure of the mortgage. This is so because the foreclosure purchaser acquires no greater interest than the mortgagor had. The foreclosure purchaser "steps into the shoes" of the foreclosed owner, who had transferred the possessory interest to the tenant and was not entitled to possession of the rental property, by virtue of the lease. However, leases may contain a subordination clause making the lease subordinate to later mortgages, in which case the foreclosure will terminate the tenancy.

If the lease is executed after the mortgage, the majority view holds that the judicial foreclosure of the mortgage does not extinguish the tenancy if the foreclosing party is on notice, actually or constructively, of the tenancy, unless the tenant is made a party to the foreclosure. If the tenant is not made a party to the foreclosure, then the tenancy is not extinguished, provided the mortgagee had notice of the tenancy. Most courts also hold that the nonjudicial (or power of sale) foreclosure of a mortgage extinguishes a tenancy entered into after the execution of the mortgage.

Under the minority view, the foreclosure action extinguishes the tenancy, irrespective of whether the tenant is made a party to the foreclosure action.

The majority rule, which requires that tenants be made parties to the foreclosure, provides tenants with at least a limited opportunity to defend their interests in the property.

A tenant also has the right to redeem the property by paying the mortgage debt prior to the foreclosure or by paying the foreclosure sale price after the sale where state law provides a statutory right of redemption. While this right may appear at first to be of little value to most tenants, a group of tenants working together with a community group or government housing agency may be able to use the redemption right as a means to obtain mortgage financing to purchase the property.

With respect to the issue of the lender having notice of the tenancy, notice may be either actual or constructive. A recorded lease provides notice. But even if the lease is not recorded (and most residential leases are not), the mortgagor may be deemed to be on notice of the tenancy because the possession is apparent or susceptible of ascertainment on reasonable inspection. Thus, where a tenant lives at the property, the lender may be on constructive notice of the tenant's interest in the property, and may be under a duty to investigate to ascertain the tenant's claims. If the property is an occupied apartment building with multiple units, the nature of the property alone would put the lender on notice that there are tenants in possession of the property.

[2] The Post-Foreclosure Rights of Tenants in "Good Cause" Eviction Jurisdictions

A few localities, including New York City, Washington, D.C., and New Jersey, have enacted statutory provisions which limit the grounds on which tenants may be evicted, notwithstanding the expiration of the tenant's lease. These statutes are referred to as "good cause" eviction statutes. Typically, permissible reasons for eviction include failure to pay rent, breach of a lease, or the commission of an illegal act in the rental unit. The foreclosure and sale of the property does not constitute good cause for eviction. Courts in these jurisdictions have held that the eviction restrictions apply to purchasers at foreclosure sales. n1

[3] Federally Subsidized Tenancies

Tenants in federally subsidized housing may have additional protections based on the lease contract. Subsidized tenants may also have equitable claims, which can be raised in the foreclosure action, to require the new owner to continue the tenancy and to enter into an agreement with HUD to continue the rent subsidy. New laws may provide additional protection for subsidized tenancies. Recent Massachusetts legislation codifies protections for subsidized tenancies by stating explicitly that foreclosure does not affect leases subsidized under state or federal law. n2

[4] Rights of Tenants if Their Landlord Files Bankruptcy

In many cases involving foreclosure on a landlord, the landlord files bankruptcy in an effort to retain the property. Most such cases are filed under chapter 7 or 11. Residential property may be transferred away from the current landlord during or immediately after the bankruptcy process. In some situations, the transfer will be voluntary and in others required by the court.

A variety of steps may be taken to protect tenants rights in the bankruptcy process. The Bankruptcy Code includes special protections for tenants when their landlords seek to terminate leases in the bankruptcy process. n3

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawFinancingMortgages & Other Security InstrumentsForeclosuresGeneral OverviewReal Property LawLandlord & TenantTenant's Remedies & RightsGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See Chase Manhattan Bank v. Josephson, 135 N.J. 209, 638 A.2d 1301 (1994)* (New Jersey Anti-Eviction Act applies to foreclosing mortgagees, protecting tenants from eviction irrespective of whether tenancy was established before or after execution of mortgage); *United Institutional Servicing Corp. v. Santiago, 62 Misc. 2d 935, 310 N.Y.S.2d 733 (Civ. Ct. 1970)* (foreclosure sale did not strip tenants of protection under eviction statute). *But see Vermont Tenants, Inc. v. Vermont Hous. Fin. Agency, 170 Vt. 77, 742 A.2d 745 (1999)* (state statute which governed landlord-tenant issues did not apply to eviction of tenant following strict foreclosure).

(n2)Footnote 2. *See Mass. Gen. Laws ch. 186, § 13A.*

(n3)Footnote 3. For further discussion of the rights of tenants when landlords file bankruptcy, see National Consumer Law Center, Consumer Bankruptcy law and Practice, Ch. 17 (8th ed. 2006 and Supp.).

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PART I Consumer Credit
CHAPTER 14 Liability of Assignees and Related Creditors; The FTC Holder Rule

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PART I Consumer Credit
CHAPTER 14 Liability of Assignees and Related Creditors; The FTC Holder Rule

1-14 Consumer Credit Law Manual § 14.01

§ 14.01 Overview

In consumer transactions, one of the most important issues is whether a creditor is subject to the claims and defenses that the consumer has against the *seller* or original creditor. This is important to prevent the need for a second lawsuit against a possibly bankrupt or unavailable defendant while a collection suit takes place. By far the most practical action for the consumer is to defend the collection action by raising in that case the consumer's claims and defenses against the seller or original creditor.

There are three types of collection actions possible here. In the first type of action, a seller may sell goods or services on credit and assign the note to a subsequent creditor, who later seeks collection on the note. This creditor may then seek the protection of Uniform Commercial Code ("UCC") section 3-302 "holder in due course" status, claiming to be insulated from most assignor-related defenses.

However, in most consumer transactions, *UCC section 3-302* has no effect because of the Federal Trade Commission's ("FTC's") Rule Concerning the Preservation of Consumers' Claims and Defenses ("FTC Holder Rule" or "Rule"). n1 This Rule requires credit-sellers to include in consumer credit contracts a notice that any assignees are subject to the consumer's claims and defenses against the assignor. This effectively defeats the assignee's status under the UCC as a holder in due course, and also subjects the assignee, as a matter of contract law, to the consumer's claims and defenses. n2

The second type of collection action does not involve a credit sale, but a note originated by a third party lender that provides funds that are paid to the seller. Such third party lenders or their assignees may claim insulation from the consumer's claims and defenses against the seller.

The FTC Holder Rule again offers consumers in this situation their best remedy. The Rule requires sellers to arrange for the FTC Holder notice to be present in all notes where the seller refers consumers to the lender or is affiliated with the lender by common control, contract, course of dealing or by any arrangement, be it formal or informal. n3 The FTC Holder Rule language in the note states that the holder is subject to all claims and defenses the consumer has against the related seller, up to the amount of the loan.

The third type of collection action involves a loan that is not related to a sales transaction. The FTC Holder Rule does

not offer much assistance in this type of action because the Rule only provides consumers with a way to raise claims they have against the "seller."

Banks collecting on a bounced or dishonored check do not involve the FTC Holder Rule because there is no credit, the check is a negotiable instrument, and the bank is a holder in due course. A common situation is where a consumer purchases goods or services through a credit card issued by a third party. n4

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawTrade Practices & Unfair CompetitionFederal Trade Commission ActBanking LawConsumer ProtectionCredit Card AgreementsGeneral OverviewCommercial Law (UCC)Sales (Article 2)Form, Formation & ReadjustmentThird Party ContractsCommercial Law (UCC)Negotiable Instruments (Article 3)EnforcementHolders in Due CourseGeneral OverviewContracts LawDebtor & Creditor Relations

FOOTNOTES:
(n1)Footnote 1. 16 C.F.R. pt. 433, *reprinted in* Vol. 1B *infra*. The Federal Trade Commission [hereinafter FTC], in 1992, announced that the Preservation of Consumers' Claims and Defenses Rule [hereinafter FTC Rule or Rule] would not be amended or repealed after a review of the rule's cost to small business. *See 57 Fed. Reg. 28,814* (June 29, 1992) .

(n2)Footnote 2. *See Hempstead Bank v. Babcock, 115 Misc. 2d 97, 453 N.Y.S.2d 557 (Sup. Ct. 1982)* ; *De La Fuente v. Home Sav. Ass'n, 669 S.W.2d 137 (Tex. Ct. App. 1984)* .

(n3)Footnote 3. *16 C.F.R. § 433.1(d), (g).*

(n4)Footnote 4. The ability of a consumer to raise defenses on this credit card purchase against the card issuer is detailed in Ch. 15 *infra* .

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PART I Consumer Credit
CHAPTER 14 Liability of Assignees and Related Creditors; The FTC Holder Rule

1-14 Consumer Credit Law Manual § 14.02

§ 14.02 Scope of the FTC Holder Rule

The Rule operates by a notice being placed in consumer credit agreements whereby, as a matter of the contract itself, the parties agree that the consumer can raise seller-related claims and defenses against the holder of the note. As such, the *effect* of the Rule is directly felt by *any* agreement that includes the FTC Holder notice. Even if a transaction is beyond the scope of the FTC Rule, if the credit agreement contains the FTC Holder notice, the holder is subject to seller-related claims and defenses. n1

There is no requirement that the Holder notice appear at any particular place in the loan documents, so the consumer's attorney must carefully review all portions of all the documents for the notice, including monthly statements or charge slips. Creditors cannot avoid the Rule by stating in credit agreements that holders are subject to claims and defenses if the FTC Holder Rule applies to the transaction, but that holders are not subject to such claims if the Rule is found not to apply. This is a Rule violation.

[1] Sales Transactions Covered

The FTC Holder Rule, in general, requires a notice to be inserted in credit agreements whenever the seller finances a sale or a creditor is related to the seller and that creditor finances the sale. The Rule applies broadly to "any sale or lease of goods or services to consumers in or affecting commerce," n2 including home improvement contracting, vocational training, employment counseling, and health spa membership, as well as all types of goods.

"Consumer" is defined as "a natural person who seeks or acquires goods or services for personal, family, or household use." n3 As such, the Rule applies to virtually every type of *consumer* sales transaction, but not to agricultural production equipment purchases, the purchase of securities, purchases made by an organization, or sales of real estate. n4 It is unclear whether the FTC Holder Rule applies to leases. n5

An important application of the FTC Holder Rule is illustrated where shoddy or non-existent home improvement work leads to the consumer refusing to make payments, which then leads to an assignee lender trying to foreclose. In this situation, the consumer's claims against the home improvement contractor can be raised against the foreclosing assignee. n6

[2] Covered Sellers

Since the Rule only applies to sellers who sell in the ordinary course of their business, isolated sales by individuals are not covered. n7 Since the FTC only has authority to impose requirements on sellers within the scope of the FTC Act, the FTC Holder Rule does not apply where the seller (not the assignee or related lender) is outside the scope of the FTC Act.

Public entities and truly nonprofit corporations are not within the scope of the FTC Act, n8 and the FTC Holder Rule does not obligate these entities as *sellers* to arrange for the notice to be placed in consumer credit agreements. Other entities outside the scope of the FTC Act include banks, savings and loans, federal credit unions, and common carriers and air carriers subject to federal regulation. n9

[3] Covered Credit Transactions

The Rule requires the FTC Holder notice to be placed in any instrument evidencing a debt arising from a "purchase money loan" or a "financed sale" (the typical credit sale where the seller acts as the initial creditor). n10 The term "purchase money loan" covers a loan made to a consumer by a creditor related in some way to the seller, which facilitates the purchase of goods or services from the seller.

For a credit transaction to be a "purchase money loan," the transaction must meet four preconditions. First, there must be a cash advance received by the consumer in return for a finance charge within the meaning of Truth in Lending ("TIL").

Second, the cash advance must be applied in whole or *substantial* part to a purchase of goods or services from the seller. A loan is still covered even if some part is kept by the consumer or goes to pay off another debt, as long as a substantial part goes to purchase the goods or services from the seller.

Third, the seller must be related to the creditor, either by referring consumers to the creditor or by being affiliated to the creditor by common control, contract, or virtually any form of business arrangement or practice. n11 Fourth, the Rule only applies where the related creditor fits the Rule's definition of "creditor." A creditor is a person who in the ordinary course of business makes purchase money loans or finances the sale of goods or services to consumers, n12 but does not apply to a creditor who in the particular transaction at issue is acting as a credit card issuer. But sellers that have their own "house" credit card must still comply with the Rule. In addition, separate federal legislation applies to the consumer's ability to raise with the card issuer the consumer's claims against the merchant. n13

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionCredit Card AgreementsGeneral OverviewBanking LawConsumer ProtectionTruth in LendingGeneral OverviewContracts LawDebtor & Creditor RelationsContracts LawSecured TransactionsPerfection & PriorityPriorityCreditor PrioritiesPurchase-Money Security Interests

FOOTNOTES:
(n1)Footnote 1. *In re Gray, 49 B.R. 540 (Bankr. E.D. Va. 1985)* ; *Music Acceptance Corp. v. Lofing, 32 Cal. App. 4th 610, 39 Cal. Rptr. 2d 159 (1995)* . *See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 6.6 (6th ed. 2004). *But cf. Whittington v. Patriot Homes, Inc., 2006 U.S. Dist. LEXIS 61739* (W.D. La. Aug. 30, 2006) (FTC Holder Notice not enforceable as contract term where the contract stated that the notice applied if a box was checked and the lender signed next to the box. Since neither action was taken, the notice was not enforceable).

(n2)Footnote 2. *16 C.F.R. § 433.2*.

(n3)Footnote 3. *16 C.F.R. § 433.1(b)*.

(n4)Footnote 4. Staff Guidelines, *41 Fed. Reg. 20,024* , Affected Transactions (May 14, 1976).

(n5)Footnote 5. While the Rule explicitly indicates that it applies to a "sale or lease," other aspects of the Rule require the lease to involve a "consumer credit contract." *16 C.F.R. § 433.2(a), (b). See Marchionna v. Ford Motor Co., 1995 U.S. Dist. LEXIS 11408* (N.D. Ill. Aug. 9, 1995) (rule does not apply to pure lease). *Fifth Third Bank v. Roberts, 2004 Ohio 6488, 2004 Ohio App. LEXIS 5926, 55 U.C.C. Rep. Serv. 2d (CBC) 378* (Ohio Ct. App., Hardin County 2004) (does not apply to leases). If the FTC Holder Rule does not apply to a lease, another possibility is state law that may create similar rights. *See, e.g.*, 815 Ill. Comp. Laws. 636/70.

(n6)Footnote 6. *See, e.g., Antuna v. Nescor, Inc., 2002 Conn. Super. LEXIS 1003* (Conn. Super. Ct. Apr. 1, 2002) ; *Citifinancial Mortgage Co. v. Freeman, 2006 WL 1029321* (N.J. Super. Ch. Ct. Apr. 13, 2006); *Green Tree Consumer Discount Co. v. Newton, 909 A.2d 811 (Pa. Super. Ct. 2006)* .

(n7)Footnote 7. *16 C.F.R. § 433.1(j).*

(n8)Footnote 8. *15 U.S.C. § 44* (definition of "corporation").

(n9)Footnote 9. *15 U.S.C. § 45(a)(2).*

(n10)Footnote 10. *16 C.F.R. §§ 433.1(i), 433.2.*

(n11)Footnote 11. *16 C.F.R. § 433.1(d), (f), (g). See Associates Home Equity Servs., Inc. v. Troup, 343 N.J. Super. 254, 778 A.2d 529 (App. Div. 2001)* .

(n12)Footnote 12. *16 C.F.R. § 433.1(c).*

(n13)Footnote 13. This legislation is examined at Ch. 15 *infra* .

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PART I Consumer Credit
CHAPTER 14 Liability of Assignees and Related Creditors; The FTC Holder Rule

1-14 Consumer Credit Law Manual § 14.03

§ 14.03 Operation of the FTC Holder Rule

[1] Seller-Related Claims Covered by the Rule

The holder of a credit agreement containing the Holder notice is liable for all seller-related "claims or defenses connected with the transaction." n1 As a result, consumers may not only raise seller-related *defenses* against creditors, but also may bring *affirmative claims* against the creditor relating to the seller. n2 Creditors are also liable for *all* claims and defenses involving the seller, including those relating to the advertising, oral claims, sale, warranties, insurance, service contracts, financing, collection, servicing of warranty, and anything else connected with the transaction. n3 On the other hand, if the consumer's claim against a seller is based on an entirely separate transaction with the seller, a transaction not involving the creditor, the creditor will have no liability since "the holder's obligations are limited to those arising from the transaction which he finances." n4 The creditor is liable even if it would be exempt from direct liability under the statute on which the consumer's claim against the seller is based. n5 For example, even if a UDAP statute exempts banks, a bank can be derivatively liable under the Holder Notice for the consumer's UDAP claims against a car dealer, where the dealer is within the UDAP statute's scope.

[2] Consumer's Claims Can Offset Remainder Due on the Note

The FTC Holder Rule limits the consumer's recovery from the creditor for seller-related claims to the "amounts paid by the debtor hereunder." n6 This means the consumer can get back all payments made plus cancel all remaining indebtedness under the note. n7 But the consumer will not be entitled to receive from the creditor an affirmative recovery which exceeds the amounts of money the consumer had paid in. n8

[3] Recovery of Amounts Already Paid

In calculating the amounts paid in, add both the amounts the consumer paid to the note holder and any amount paid to a prior holder of the note. n9 Where a loan is a credit sale assigned to a creditor (as opposed to a direct loan with a third-party creditor), the amount paid in by the consumer includes all deposits and trade-ins given to the seller, and the price which the creditor realizes when it sells collateral after repossession. n10

[4] Are Attorney Fees Included Within the Cap?

The creditor's liability for the consumer's attorney fees should not be capped by the creditor's maximum liability for seller-related claims. n11 Ohio UDAP attorney fees are an exception to this rule, based on the fact that UDAP fees are available in Ohio only in the court's discretion, and only against sellers who intentionally violate the statute. n12 The argument for recovery of attorney fees above the cap is even stronger in those states, such as California, that treat fees as costs incidental to a judgment, not as part of damages. Since the fees are in the nature of costs, they should be awarded independent of the determination of damages.

In some states, such as California, if a credit agreement provides attorney fees for the creditor, state law requires that such fees be available to the consumer as well. n13 As such, attorney fees are not based on a statute relating to the seller's misconduct, or otherwise related to the FTC Holder Rule. Instead, the fees are squarely based on the fact that the holder has required the consumer to litigate to recover amounts owed to the consumer under the contract, and as such, the fees should be independent of any FTC Holder Rule cap.

[5] No Limit on Creditor's Liability for Own Conduct

The FTC Rule sets out a creditor's liability for the acts of the seller. The creditor is additionally liable for its own conduct. There are no limits to the creditor's liability for its own conduct, and the amount of that liability is then added above and beyond its maximum liability for the seller's conduct. The lender can even be independently liable for its own conduct in misleading the consumer as to the consumer's rights to raise seller-related claims against the lender. n14

[6] Relation of FTC Holder Rule to TIL Limitation on Assignee Liability

Another issue is the interplay of the FTC Holder Rule and the Truth in Lending Act ("TILA"). n15 The TILA explicitly limits an assignee's TIL liability to those TIL violations apparent on the face of the documents. But an assignee with no liability under the TILA arguably is liable under the FTC Holder Rule for the full amount of the *assignor's* TIL liability (subject, of course, to the maximum liability cap under the FTC Holder Rule). That is, since the contract explicitly states the assignee is liable for claims against the assignor, this contract clause must be given effect. Some courts have followed this argument and found an assignee liable under the FTC Holder Rule for assignor-related TIL claims. n16 The trend, though, is for courts to reach the opposite conclusion. n17 One court has applied the same reasoning to an Equal Credit Opportunity Act claim, holding the FTC Holder Rule overridden by federal regulations that limit an assignee's liability to situations where the assignee knew or should have known of the assignor's violation. n18 This is not the case, though, for other types of consumer claims, such as odometer violations. n19

[7] Relation of FTC Holder Rule to the Magnuson-Moss Warranty Act

The Federal Magnuson-Moss Warranty Act states that for purposes of civil liability under that Act, "only the warrantor actually making a written affirmation of fact, promise or undertaking shall be deemed to have created a written warranty, and any rights arising thereunder may be enforced under this section only against such warrantor and no other person." n20 The question arises whether a claim under the Magnuson-Moss Warranty Act can be brought against an assignee of the warrantor, based on the FTC Holder language, or whether the above-quoted language restricts the consumer's ability to bring such a claim against anyone other than the warrantor.

It is important to note what the above-quoted language does *not* say. Since by its very terms it is limited to written warranties, a consumer can certainly bring a Magnuson-Moss Warranty Act claim against an assignee, as long as that claim is not based on the enforcement of a written warranty. Examples of claims not based on a written warranty are claims for breach of an implied warranty, for breach of a service contract, for violation of various Magnuson-Moss Act disclosure requirements, or for violation of various substantive Magnuson-Moss Act restrictions, such as those dealing with tie-ins. n21

The only issue is whether a claim based on a written warranty can be brought against the warrantor's assignee, based on

the fact that the note contains the FTC Holder notice. At least one court has held that the Magnuson-Moss language trumps the FTC Holder notice, n22 but that case appears to involve an implied warranty claim, not a written warranty claim. The better view is that third parties do not have *direct* liability for breaches of the warrantor's written warranty. For example, a dealer is not liable if a manufacturer's written warranty is breached. But a third party can have derivative liability if that party is subject to claims the consumer can bring against the written warrantor.

The court that found the Magnuson-Moss Warranty Act to trump the FTC Holder Rule based its ruling on similar case law relating to the relationship of the FTC Holder Rule to TIL's limitation on assignee liability. But TIL's limitation on assignee liability specifically restricts assignee liability, while the Magnuson-Moss Warranty Act limitation applies broadly to all third party liability, and does not even mention the issue of assignee liability. It thus leaves open the issue of whether the legislative intent was to limit third parties' direct liability only, or also their derivative liability. Citing TIL case law is not helpful in making this decision.

[8] Does FTC Holder Rule Create Federal Jurisdiction?

A lender may attempt to remove a state law case to federal court (or the consumer may bring an action in federal court) based on the fact that the consumer's case relies in part on the FTC Holder language. But the consumer's claim is based on the language of the credit agreement that contains the FTC Holder Notice (or may be based on various state law theories where the FTC Holder Notice language is missing. n23 As such, the FTC Holder Notice does not create any federal jurisdiction. n24

[9] Relation of FTC Holder Rule to State Law

The FTC Holder Rule states that the consumer's "recovery hereunder" is limited. The FTC Holder Rule does not limit a larger recovery under a different state or federal law.

[10] Consumer's Waiver of Claims Against Creditor

Another issue is the effect of the FTC Holder Rule where the consumer signs a document indicating the work purchased with the loan proceeds has been completed and performed satisfactorily. It is unlikely that a court will give much credence to such a statement, particularly where it is part of boilerplate language the consumer is asked to sign. n25 Similarly, a court will not give much credence to a provision whereby the consumer waives his or her right to raise defenses against assignees where the contract also contains the FTC Holder notice. n26

[11] Holder's Refusal to Accept Liability Under Holder Rule as an Independent UDAP Violation

It is very common for holders to inform consumers that the holder is not subject to the consumer's claims and defenses against the seller, even where the FTC Holder Notice is in the loan documents. Instead, the holder tells the consumer to take up the dispute with the seller, but that the consumer must continue to pay the lender.

These representations by the holder mislead the consumer as to the status of the obligation and as to the consumer's legal rights. n27 As such, the holder's own conduct is a UDAP violation, and the holder is liable for that conduct over and above any derivative liability it has for the seller's conduct. n28 Thus, where there is any question as to the holder's liability for attorney fees or multiple damages for the seller's conduct, there should be no question as to such liability for the holder's own conduct.

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionMagnuson-Moss Warranty ActCoverageBanking LawConsumer ProtectionCredit Card AgreementsLiabilityBanking LawConsumer ProtectionTruth in LendingLiabilityContracts

LawDebtor & Creditor Relations

FOOTNOTES:

(n1)Footnote 1. *16 C.F.R. § 433.2.*

(n2)Footnote 2. *See Boggess v. Lewis Raines Motors, Inc., 20 F. Supp. 2d 979 (S.D. W. Va. 1998)* (allowing used car buyer to assert claims against assignee arising from seller's misrepresentation of car's mileage); *Maberry v. Said, 911 F. Supp. 1393 (D. Kan. 1995)* ; *Taylor v. Trans Acceptance Corp., 267 Ill. App. 3d 562, 641 N.E.2d 907 (App. Ct. 1994)* (consumer can assert fraud claims against assignee). *See also Alvizo v. Metro Ford Sales & Serv., Inc., 2001 U.S. Dist. LEXIS 21777* (N.D. Ill. Dec. 28, 2001) (holder liable for dealer's conversion of personal property in car after buyer returned it); *Javorsky v. Freedom Driving Aids, Inc., 2001 U.S. Dist. LEXIS 14078* (N.D. Ill. Aug. 29, 2001) ; *Morales v. Walker Motors Sales, Inc., 162 F. Supp. 2d 786 (S.D. Ohio 2000)* (because of Holder Rule, holder steps into shoes of seller); *Condor Capital Corp. v. Michaud, 2000 Conn. Super. LEXIS 1894* (Conn. Super. Ct. July 25, 2000) (RISA and U.C.C. claims). *But see LaBarre v. Credit Acceptance Corp., 11 F. Supp. 2d 1071 (D. Minn. 1998)* (used car buyer could not assert against note's assignee a breach of contract action arising from dealer's obligation to procure insurance), *aff'd in part, rev'd in part, 175 F.3d 640 (8th Cir. 1999) . Mitchell v. Church, 2006 Del. Super. LEXIS 295* (Del. Super. Ct. July 31, 2006) (unpublished) (creditor steps into seller's shoes); *First of Am. Bank v. Thompson, 552 N.W.2d 516, 520 (Mich. Ct. App. 1996)* (by virtue of FTC Holder Notice, assignee steps into shoes of seller, and is subject to all claims and defenses as seller would have been, including statute of limitations); *Green Tree Consumer Discount Co. v. Newton, 909 A.2d 811 (Pa. Super. Ct. 2006)* (claims of substandard home improvement work and fraud). *But cf. Primus Auto Fin. Serv. v. Brown, 840 N.E.2d 254 (Ohio Ct. App. 2005)* (claims against assignee are barred where res judicata bars assertion of that claim against seller).

(n3)Footnote 3. FTC Staff Guidelines, *41 Fed. Reg. 20,024* (May 14, 1976) . *See also Gill v. Fidelity Fin. Servs., Inc., 631 So. 2d 913 (Ala. 1993)* ; *Felde v. Chrysler Credit Corp., 219 Ill. App. 3d 530, 580 N.E.2d 191 (App. Ct. 1991)* (warranty breach); *Alvizo v. Metro Ford Sales & Serv., Inc., 2001 U.S. Dist. LEXIS 21777* (N.D. Ill. Dec. 28, 2001) (holder liable for dealer's conversion of personal property in car after buyer returned it). *See also Javorsky v. Freedom Driving Aids, Inc., 2001 U.S. Dist. LEXIS 14078* (N.D. Ill. Aug. 29, 2001) ; *Morales v. Walker Motors Sales, Inc., 162 F. Supp. 2d 786 (S.D. Ohio 2000)* (because of Holder Rule, holder steps into shoes of seller); *Condor Capital Corp. v. Michaud, 2000 Conn. Super. LEXIS 1894* (Conn. Super. Ct. July 25, 2000) (RISA and U.C.C. claims). *See generally* National Consumer Law Center, Consumer Law Pleadings with Disk, Number One §§ 3.1, 3.2, 3.8, and 3.9 (1994) (complaint, interrogatories, and briefs in a case in which the creditor's liability was based upon the contract's inclusion of the notice required by the FTC Rule). *But see LaBarre v. Credit Acceptance Corp., 11 F. Supp. 2d 1071 (D. Minn. 1998) , aff'd in part, rev'd in part, remanded, 175 F.3d 640 (8th Cir. 1999)* (used car buyer could not assert against note's assignee a breach of contract claim arising from dealer's obligation to procure insurance).

(n4)Footnote 4. FTC Staff Guidelines, *41 Fed. Reg. 20,024* (May 14, 1976) .

(n5)Footnote 5. *Reagans v. Mountainhigh Coachworks, Inc., 117 Ohio St. 3d 22* (Jan. 31, 2008) ; *Pratt v. North Dixie Manufactured Housing., Ltd., 2003 Ohio 2363 (Ohio Ct. App. 2003)* ; *Nations Credit v. Pheanis, 656 N.E.2d 998 (Ohio Ct. App. 1995)* ; *Milchen v. Bob Morris Pontiac-GMC Truck, 113 Ohio App. 3d 190, 680 N.E.2d 698 (1996)* .

(n6)Footnote 6. *16 C.F.R. § 433.2.*

(n7)Footnote 7. FTC Staff Guidelines, *41 Fed. Reg. 20,023* (May 14, 1976) .

(n8)Footnote 8. *Mount v. LaSalle Bank Lake View, 926 F. Supp. 759 (N.D. Ill. 1996)* ; *Music Acceptance Corp. v. Lofing, 32 Cal. App. 4th 610, 39 Cal. Rptr. 2d 159 (Ct. App. 1995) . See Scott v. Mayflower Home Improvement Corp., 363 N.J. Super. 145, 831 A.2d 564 (Law Div. 2001)* (treble damages barred if they would push recovery over cap).

(n9)Footnote 9. *Alduridi v. Community Trust Bank, N.A., 1999 Tenn. App. LEXIS 718* (Tenn. Ct. App. Oct. 26,

1999) (creditor, not consumer, should bear the risk of recovering payments made to the dealer); *Resolution Trust Corp. v. Cook, 840 S.W.2d 42 (Tex. App. 1992)* .

(n10)Footnote 10. *Maberry v. Said, 911 F. Supp. 1393 (D. Kan. 1995)* ; *Featherlite Credit Corp. v. Caride, 2000 Del. Super. LEXIS 206* (Del. Super. Ct. May 30, 2000) ; Credit Acceptance Corp. v. Smith, Case No. 96CVF001066, Clearinghouse No. 52,138 (Ohio Mun Ct., Vandalia, July 31, 1997); FTC Staff Guidelines, *41 Fed. Reg. 20,023* (May 14, 1976) . *But see General Motors Acceptance Corp. v. Grady, 27 Ohio App. 3d 321, 501 N.E.2d 68 (Ct. App. 1985)* .

(n11)Footnote 11. *Kish v. Van Note, 692 S.W.2d 463 (Tex. 1985) . See also § 4.06[11] supra. But see Simpson v. Anthony Auto Sales, Inc., 32 F. Supp. 2d 405 (W.D. La. 1998)* ; *Riggs v. Anthony Auto Sales, Inc., 32 F. Supp. 2d 411 (W.D. La. 1998)* ; *Patton v. McHone, 1993 Tenn. App. LEXIS 212 (Tenn. Ct. App. 1993)* ; *Scott v. Mayflower Home Improvement Corp., 363 N.J. Super. 145, 831 A.2d 564 (Law Div. 2001)* (plaintiffs may not recover attorney fees in excess of amounts they paid). *Lucia v. West Hills Auto & Truck Center, Inc., 2005 WL 3875895* (Ohio Ct. Com. Pleas Aug. 22, 2005) (unpublished). *But see Reagans v. Mountainhigh Coach Works, Inc., 2006 Ohio 423 (Ohio Ct. App. 2006)* (holder is liable for attorney fees, but they are subject to the cap), *appeal granted, 848 N.E.2d 857 (Ohio 2006)* .

(n12)Footnote 12. *Reagans v. Mountainhigh Coach Works, Inc., 881 N.E.2d 245 (Ohio 2008)* .

(n13)Footnote 13. National Consumer Law Center, Consumer Warranty Law, § 10.7 (3d ed. 2006 and supp.) lists states with such a provision.

(n14)Footnote 14. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 6.6.1 (7th ed. 2008 and supp.).

(n15)Footnote 15. The Truth in Lending Act [hereinafter TILA] is reprinted in Vol. 1B *infra*.

(n16)Footnote 16. *In re Stewart, 93 B.R. 878 (Bankr. E.D. Pa. 1988)* ; *Cox v. First Nat'l Bank of Cincinnati, 633 F. Supp. 236 (S.D. Ohio 1986) . See also Taylor v. Quality Hyundai, Inc., 150 F.3d 689, 693 (7th Cir. 1998)* (TILA assignee liability rule "limits only certain TILA claims"); *Green v. Levis Motors, Inc., 179 F.3d 286, 296 (5th Cir. 1999)* (TILA "limits assignee liability on only one set of claims (i.e., the specified TILA claims")); *Irby-Greene v. M.O.R., Inc., 79 F. Supp. 2d 630, 633 (E.D. Va. 2000)* ; *Scott v. Mayflower Home Improvement Corp., 363 N.J. Super. 145, 831 A.2d 564 (Law Div. 2001) . But see Taylor v. Quality Hyundai, Inc., 150 F.3d 689 (7th Cir. 1998)* (TIL limit on assignee liability trumps the FTC Holder notice found in the note), *reh'g denied, 1998 U.S. App. LEXIS 21348* (7th Cir. Aug. 21, 1998) , *cert. denied, 525 U.S. 1141, 119 S. Ct. 1032, 143 L. Ed. 2d 41 (1999)* ; *Walker v. Wallace Auto Sales, Inc., 155 F.3d 927 (7th Cir. 1998)* (same); Owens v. Tranex Credit Corp., Clearinghouse No. 52,129 (S.D. Ind. 1998) (same); *Young v. Ford Motor Co., 1998 U.S. Dist. LEXIS 15376 (N.D. Ill. 1998)* (same), *summ. judgment denied, 1998 U.S. Dist. LEXIS 17820* (N.D. Ill. Nov. 6, 1998) ; *Cemail v. Viking Dodge, Inc., 982 F. Supp. 1296 (N.D. Ill. 1997)* (holding that TILA's limitation of an assignee's liability to those Truth in Lending [hereinafter TIL] violations that are apparent on the face of the documents trumps the FTC Rule's imputation of an assignor's liability to an assignee), *mot. denied, claim dismissed, 1999 U.S. Dist. LEXIS 20562* (N.D. Ill. Sept. 14, 1999) ; *Lindsey v. Ed Johnson Oldsmobile, Inc., 1996 U.S. Dist. LEXIS 13570* (N.D. Ill. July 19, 1996) , *class certification granted in part and denied in part, 1997 U.S. Dist. LEXIS 7138* (N.D. Ill. May 13, 1997) .

(n17)Footnote 17. *See Green v. Levis Motors, Inc., 179 F.3d 286 (5th Cir. 1999)* , *cert. denied, 528 U.S. 1020, 120 S. Ct. 528, 145 L. Ed. 2d 409 (1999)* ; *Ellis v. GMAC, 160 F.3d 703 (11th Cir. 1998)* ; *Taylor v. Quality Hyundai, Inc., 150 F.3d 689 (7th Cir. 1998)* , *reh'g denied, 1998 U.S. App. LEXIS 21348* (7th Cir. Aug. 21, 1998) , *cert. denied, 525 U.S. 1141, 119 S. Ct. 1043, 143 L. Ed. 2d 41 (1999)* (TIL limit on assignee liability trumps the FTC Holder notice found in the note); *Walker v. Wallace Auto Sales, Inc., 155 F.3d 927 (7th Cir. 1998)* (same); *Fillinger v. Willowbrook Ford, Inc., 1999 U.S. Dist. LEXIS 3629* (N.D. Ill. Mar. 22, 1999) (discussing assignee liability for unfair and deceptive acts or practices [hereinafter UDAP] claims based on TIL violations); National Consumer Law Center, Truth in Lending § 7.3.10 (5th ed. 2003). *See also Ramadan v. Chase Manhattan Corp., 229 F.3d 194 (3d Cir. 2000)* ; *Javorsky v. Freedom*

Driving Aids, Inc., 2001 U.S. Dist. LEXIS 14078 (N.D. Ill. Aug. 29, 2001) ; *Lacasse v. All Star Dodge, 2001 U.S. Dist. LEXIS 6590* (M.D. La. Feb. 2, 2001) .

(n18)Footnote 18. *Coleman v. GMAC, 196 F.R.D. 315, 2000 U.S. Dist. LEXIS 13236 (M.D. Tenn. 2000)* .

(n19)Footnote 19. *Eromon v. Grand Auto Sales, Inc., 333 F. Supp. 2d 702 (N.D. Ill. 2004)* .

(n20)Footnote 20. *15 U.S.C. § 2310(f)*.

(n21)Footnote 21. *See* National Consumer Law Center, Consumer Warranty Law Ch. 2 (3d ed. 2006 and supp.).

(n22)Footnote 22. Owens v. Tranex Credit Corp., Clearinghouse No. 52,129 (S.D. Ind. 1998).

(n23)Footnote 23. *See § 14.04*, *infra*(raising state law theories related to UCC Articles 3 and 9, state assignment law, and UDAP law).

(n24)Footnote 24. *See Glovier v. Barton Homes, L.L.C., 452 F. Supp. 2d 657 (W.D. La. 2006)* .

(n25)Footnote 25. *See Alvarez v. Union Mortgage Co., 747 S.W.2d 484 (Tex. Ct. App. 1988)* . *See also Mahaffey v. Investor's Nat'l Sec. Co., 103 Nev. 615, 747 P.2d 890 (1987)* .

(n26)Footnote 26. *Heastie v. Community Bank, 727 F. Supp. 1133 (N.D. Ill. 1989)* ; *Hernandez v. Forbes Chevrolet Co., 680 S.W.2d 75 (Tex. Ct. App. 1984)* ; *Hinojosa v. Castellow Chevrolet Oldsmobile, 678 S.W.2d 707 (Tex. Ct. App. 1984)* .

(n27)Footnote 27. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 5.6.8 (7th ed. 2008 and supp.).

(n28)Footnote 28. *See Jaramillo v. Gonzales, 50 P.3d 554 (N.M. Ct. App. 2002)* (failure to concede liability under FTC Holder Rule is UDAP violation).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 14 Liability of Assignees and Related Creditors; The FTC Holder Rule

1-14 Consumer Credit Law Manual § 14.04

§ 14.04 Where FTC Notice Improperly Omitted

[1] Introduction

The *seller's* violation of the FTC Holder Rule (by its failure to arrange for the Holder notice to be included in the loan documents) is a state UDAP. n1 violation. In some states, this may even directly violate a state UDAP regulation. n2 But this UDAP claim against the *seller* rarely is of value to the consumer, who wishes to raise seller-related defenses to a creditor's collection action. However, there are other possible theories.

[2] Liability of Assignees of High-Rate Mortgages

[a] General

The Home Ownership and Equity Protection Act of 1994 ("HOEP") provides consumers with the right to raise claims and defenses against assignees of certain home mortgages. n3 Of special note, this federal statute provides the consumer with the right to raise both *claims* and defenses against assignees, and provides this right whether or not the assignee is a holder in due course or has inserted a waiver of defense clause in the promissory note. Unlike the FTC Holder notice, the HOEP provision applies whether or not the originating lender places a notice in the loan documents.

The HOEP provision is similar to the FTC Holder notice concerning the cap on assignee liability. The assignee's maximum liability for claims and defenses relating to the originating lender is the remainder of the mortgage indebtedness plus the total amount paid by the consumer in the transaction. n4

[b] Loans Covered by HOEP

The HOEP provision giving consumers the right to raise claims and defenses against assignees applies only to loans covered by HOEP. n5

HOEP applies to closed-end consumer credit transactions securing a consumer's principal dwelling, where the loan was entered into after October 1, 1995, n6 and applies only to non-money loans such as refinancings taking a security interest in a home, home improvement loans, or second mortgages. HOEP explicitly excludes reverse mortgages, open-end loans, and mortgages to purchase or construct a home. n7

In addition, loans meeting this definition must either: 1) have an annual percentage rate which exceeds by more than ten percentage points the yield on treasury securities having comparable maturities at the time the loan is made; n8 or 2) charge total points and fees both in excess of $400 (this number is adjusted each year for inflation) and 8% of the total loan amount. n9 Such points and fees include prepaid interest, points, origination fees, service charges and other creditor's charges for costs of doing business, all compensation paid to mortgage brokers, and certain real estate charges. n10

[c] Exemption Where Assignee Is Unaware of HOEP Coverage

Assignees are exempt from HOEP's assignee liability provision if the assignee "demonstrates, by a preponderance of the evidence, that a reasonable person exercising ordinary due diligence" could not have determined that the loan was covered by HOEP. n11

[3] Assignees Generally Subject to Assignor-Related Defenses Where FTC Holder Notice Is Omitted

Where a credit-seller fails to include the FTC Holder notice, there should be little problem raising seller-related defenses against the assignee's collection action. For an assignee of the credit-seller to claim insulation, it must claim it is a holder in due course under *UCC section 3-302*. The consumer should be able to defeat this argument because the noncompliance with the FTC Holder Rule should mean the creditor does not comply with the prerequisites of *UCC section 3-302*.

UCC section 3-302(b) gives holder status only if an assignee takes a negotiable instrument "in good faith" and without notice of any claim by the consumer against the seller. An assignee's taking an instrument that on its face violates the FTC Holder Rule should defeat any claim of good faith and should be notice of a consumer's claims against the seller, at least claims relating to this FTC Holder Rule violation.

The close connectedness doctrine, also referred to as the "party to the transaction" doctrine, contests a lender's assertion of holder-in-due-course status by disputing the "good faith" and "without notice" requirements of *UCC section 3-302* where the lender played some part in the original transaction. It has also been used to allow a consumer to assert defenses to the enforcement of a non-negotiable instrument, such as a retail installment sales contract or a lease, against a third party who would not otherwise be subject to such defenses. n12 The doctrine can be thought of as a common law alternative to the FTC Holder Rule and is particularly suited to cases where a seller arranged credit through a particular financer to finance the sale and the paper was assigned when executed. n13

[4] Holder's UDAP Liability Where Notice Is Omitted

[a] Creditor's Actions as a Deceptive Practice

Where a creditor's promissory note violates the FTC Holder Rule, the creditor is engaging in a deceptive practice. A creditor also violates the state UDAP statute by supplying other forms for the consumer to sign, such as completion certificates, that contain language sidestepping the FTC Holder Rule by absolving the creditor of responsibility for some or all of the seller's liability. n14 It is also a material non-disclosure where the creditor fails to inform the consumer that the creditor's loan documents violate federal law. See also UDAP regulations, such as those in Massachusetts, n15 Wisconsin, n16 Georgia, n17 and Idaho. n18 A federal court allowed a case to go to trial to determine if it was unconscionable or unfair to have a credit agreement without the Holder notice. n19 However, the court later found no evidence that a contract without the Holder notice was unconscionable where the consumer offered no evidence that the contract unreasonably favored the creditor. n20

[b] Are the Creditor's Actions Within the UDAP Statute's Scope?

Where a consumer is bringing a UDAP claim directly against the creditor for using a note failing to contain the Holder notice, both the creditor and the creditor's alleged violation must be within the scope of the UDAP statute. Most cases facing such a UDAP scope issue involve student loan notes where the bank and guaranty agency did not include the FTC Holder notice in the loan documents. Many courts appear to be looking for ways of avoiding these complex cases, and a number of these cases have dismissed UDAP claims because of scope issues.

[5] RICO Liability for Omitted Holder Notice

Where a creditor's participation in violating the FTC Holder Rule is deceptive, the practice may also involve mail or wire fraud, and thus lead to a RICO violation. n21

[6] Does Violation of FTC Holder Rule Make the Note Illegal and Thus Unenforceable?

Another approach is to argue that the whole note is voidable where it fails to include a provision required by law. A related argument is that the creditor is estopped from claiming insulation from seller-related claims. Consumers relied on the loan documents, including all terms required by law, and the creditor cannot now renege on that implied promise.

[7] State Statute May Create Derivative Liability Despite Omission of Holder Language

A number of states have also enacted state "holder" laws. These laws state that, as a matter of a state's substantive law, related lenders are subject to seller-related claims. The operation of these state laws are not dependent on the seller or lender's insertion of the FTC Holder notice into the note or contract.

State holder statutes are usually drafted with their own unique language that makes them broader or narrower in certain ways than the FTC Holder Rule. For example, some state statutes may only allow the consumer to recover the unpaid balance. n22 On the other hand, the Missouri UDAP statute allows claims arising from the sale. n23 Where the consumer has a claim against the manufacturer, but not the dealer, the holder may have no liability under the FTC Holder Rule, but may have such liability under the Missouri statute. n24 Where the consumer has more rights under state law than the Holder Rule, the Holder Rule does not pre-empt such rights. n25

Other state statutes apply to assignments from a seller to a lender, and specify that the consumer can bring seller-related affirmative claims against the assignee. n26 Such statutes are useful because, under the common law (assuming the FTC Holder Rule does not apply), consumers can only raise defenses against the assignee and not raise affirmative claims to recover money.

About a third of the states have laws applying to some situations where a consumer takes out a loan directly with a lender, and where the lender is connected in some fashion with the seller. n27 These laws apply when there is a special relationship between the lender and seller, which relationship is defined in the statute. Many state holder laws cover leases that would not meet the TIL definition of credit sale. n28 These laws cover leases either by broadly defining a term such as "retail installment contract" to include leases, or by explicitly mentioning consumer leases in the holder statute.

[8] Revised Article 9 Requires Notice to be Implied

Revised Article 9 of the UCC makes an omitted Holder Notice part of the contract as a matter of law, allowing the consumer to utilize the Holder Notice as if it were included. Revised Article 9 has been adopted by all fifty states, and applies to the enforcement of the consumer's rights after July 1, 2001, even if the contract was created before July 1, 2001. Under Revised Article 9, an assignee of a contract without the required notice is subject to a consumer account debtor's claims and defenses to the same extent as if the contract had contained the notice. n29 Revised Article 9 applies to any credit sales agreement assigned to a lender or other holder. It does not apply to negotiable instruments.

Even prior to the enactment of Revised Article 9, some courts were willing to imply the Holder Notice into an agreement where it is required to be placed. n30

In 2002, the National Conference of Commissioners on Uniform State Laws and the American Law Institute adopted revisions to UCC Article 3. These revisions will be introduced to state legislatures, but have not yet been adopted in any state, and may face opposition from banking interests.

Revised Article 3 complements the Article 9 provisions discussed above by stating that the FTC Holder Notice shall be implied into any promissory note whenever that notice should have been inserted into the note. n31 The consumer may assert against the holder all claims and defenses that would have been available against the "payee" if the note included the FTC Holder Notice. n32 A payee is the person who receives the funds from the loan, *i.e.*, the seller.

Revised Article 3 thus insures that any assignment not covered by Article 9 (because it involves a negotiable instrument) will be covered by the analogous Article 3 provision. Article 3 also applies to direct loans where the seller refers the consumer to the lender and the consumer then signs a note with the lender. n33

[9] Common Law Theories for Lender Liability

At common law, various theories establish a lender's liability for the conduct of closely related parties. These theories, based on the lender's participation in the deceptive scheme, include close-connectedness, conspiracy, joint enterprise, agency, and the like. n34 This liability is found irrespective of any waiver of defense clause or alleged holder-in-due-course status.

Civil conspiracy targets an unnaturally close relationship between the seller and the financer. However, unlike the close connectedness doctrine, which is simply a tool with which to assert defenses against a financer's attempt to collect on a note or contract, civil conspiracy is a tort claim that can yield affirmative damages. In *Williams v. ITT Financial Services*, n35 a court upheld a jury's award of $15,000 compensatory damages and $1.5 million in punitive damages against a lender who had financed a home improvement loan with a contractor who defaulted on the work. The court found that the lender had known that the contractor was in financial difficulty, and further knew that he was fraudulently using money from new contracts to pay for work on old ones, in a Ponzi-type scheme. n36

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawConsumer ProtectionDeceptive Acts & PracticesState RegulationCommercial Law (UCC)Negotiable Instruments (Article 3)EnforcementHolders in Due CourseRequirementsCommercial Law (UCC)Secured Transactions (Article 9)Application & ConstructionDefinitionsParties to Secured TransactionsContracts LawDebtor & Creditor RelationsReal Property LawFinancingFederal RegulationsHome Owners Equity Protection Act

FOOTNOTES:
(n1)Footnote 1. UDAP is the generic term for state laws which prohibit unfair and deceptive acts and practices. They vary in scope of coverage, name, etc., but are all generally designed to prevent such practices especially in consumer contracts. *See generally* Ch. 4 *supra*. *But cf. Morales v. Walker Motors Sales, Inc., 162 F. Supp. 2d 786 (S.D. Ohio 2000)* (failure to use type size specified by Holder Rule not material, so not a UDAP violation); *Hayner v. Old Kent Bank, 2002 Mich. App. LEXIS 190* (Feb. 12, 2002) (unpublished, limited precedent) (bank's acceptance of contract without Holder Notice was not UDAP violation).

(n2)Footnote 2. Georgia Office of Consumer Affairs Regulations, Ga. Comp. R. & Regs. r. 122 (state incorporates FTC Rule as state UDAP regulation so that any violation of FTC Rule is automatic Georgia UDAP violation).

(n3)Footnote 3. *15 U.S.C. § 1641(d)(1)*. The Home Ownership and Equity Protection Act of 1994 [hereinafter

HOEP] is reprinted in Vol. 1B *infra*.

(n4)Footnote 4. *15 U.S.C. § 1641(d)(2)*.

(n5)Footnote 5. HOEP coverage is explored in detail in another chapter of this book, Ch. 2 *supra* . Only a brief summary is presented here. *Pulphus v. Sullivan, 2003 U.S. Dist. LEXIS 7080* (N.D. Ill. Apr. 28, 2003) ; *Lewis v. Delta Funding Corp. (In re Lewis), 290 B.R. 541, 556 (Bankr. E.D. Pa. 2003) . See also Harvey v. EMC Mortg. Corp. (In re Harvey), 2003 Bankr. LEXIS 642* (Bankr. E.D. Pa. June 9, 2003) (HOEPA abrogates holder in due course defense and makes assignee liable for all claims except under laws that have conflicting assignee liability provisions).

(n6)Footnote 6. *15 U.S.C. § 1602(aa)(1)*.

(n7)Footnote 7. *15 U.S.C. § 1602(aa)(1)*.

(n8)Footnote 8. *15 U.S.C. § 1607(aa)(1)(A)*; *12 C.F.R. § 226.32(a)(i)*. The FTC adopted an amendment to its regulation, effective October 1, 2002, that lowered the trigger to 8 percentage points above comparable Treasury securities for first-lien mortgage loans. *66 Fed. Reg. 65,604* (Dec. 20, 2001) .

(n9)Footnote 9. *15 U.S.C. § 1602(aa)(1)(B)*; *12 C.F.R. § 226.32(a)(ii)*.

(n10)Footnote 10. *15 U.S.C. § 1602(aa)(4)*; *12 C.F.R. § 226.32(b)*.

(n11)Footnote 11. *15 U.S.C. § 1641(d)(1)*.

(n12)Footnote 12. *See, e.g., Mercedes-Benz Credit Corp. v. Lotito, 306 N.J. Super. 25, 703 A.2d 288 (Super. Ct. App. Div. 1997)* (allowing consumer to assert breach of warranty claims against assignee of automobile lease).

(n13)Footnote 13. *See Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967)* .

(n14)Footnote 14. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 11.6.4.4 (7th ed. 2008).

(n15)Footnote 15. Massachusetts Consumer Protection Regulations, Mass Regs. Code tit. 940, § 3.07, Advertising or Offering to Sell on an "Easy Credit" Basis.

(n16)Footnote 16. Wisconsin Department of Agriculture, Trade and Consumer Protection Rules, Wis. Ad. Code ch. Ag. 110, Home Improvement Trade Practices.

(n17)Footnote 17. Georgia Office of Consumer Affairs Regulations, Ga. Comp. R. & Regs. r. 122.

(n18)Footnote 18. Idaho Consumer Protection Regulations, Idaho Admin. Code §§ 04.02.01.020.44, 04.02.01.210.

(n19)Footnote 19. *Jackson v. Culinary Sch. of Wash., 788 F. Supp. 1233 (D.D.C. 1992) . See also* Spinner v. Chesapeake Bus. Inst. of Virginia, Clearinghouse No. 49,131A (E.D. Va. Feb. 5, 1993).

(n20)Footnote 20. *Jackson v. Culinary Sch. of Washington, 811 F. Supp. 714 (D.D.C. 1993) , aff'd in part on other grounds, vacated and remanded in part on other grounds, 27 F.3d 573 (D.C. Cir. 1994)* (finding, on *de novo* review, that district court should have refused to issue declaratory judgment on state law issues), *vacated and remanded, 515 U.S. 1139, 115 S. Ct. 2573, 132 L. Ed. 2d 824 (1995)* (circuit court should have used abuse of discretion standard, not *de novo* review, in determining whether district court should have ruled on state law issues), *on remand, remanded, 59 F.3d 254 (D.C. Cir. 1995)* (remanding for district court to exercise its discretion about whether to issue declaratory judgment on state law issues), *mot. dismissed, 1995 U.S. App. LEXIS 22304* (D.C. Cir. July 25, 1995) .

(n21)Footnote 21. *Brown v. LaSalle Northwest Nat'l Bank, 820 F. Supp. 1078 (N.D. Ill. 1993)* .

(n22)Footnote 22. *Wis. Stat. Ann. § 422.408*.

(n23)Footnote 23. *Mo. Rev. Stat. § 408.405*.

(n24)Footnote 24. *Cf. Chrysler Fin. Co. v. Flynn, 88 S.W.3d 142 (Mo. Ct. App. 2002)* (seeming to assume this interpretation of the Missouri statute).

(n25)Footnote 25. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 11.6.3.11 (7th ed. 2008 and supp.).

(n26)Footnote 26. *See Mich. Comp. Laws § 445.1207* (applies only to home improvement contracts); *Mich. Comp. Laws § 492.114a* (applies only to motor vehicle sales and leases); Wis. Admin. Code § ATCP 110.06 (home improvement contracts); *see also Cannoy v. Interstate Builders, Inc., 2003 Mich. App. LEXIS 7* (Mich. Ct. App. Jan. 3, 2003) (language of state law limits recovery to amount paid to specific holder, not to amount paid on the debt to all holders); *Jackson v. DeWitt, 592 N.W.2d 262 (Wis. Ct. App. 1999)* (finding that Wis. Admin. Code applies even where installment sales agreement is not a negotiable instrument).

(n27)Footnote 27. *See, e.g., Ariz. Rev. Stat. Ann. § 44-145*; *Cal. Civ. Code § 2982.5(d)(4)* (motor vehicle sales only); *Iowa Code Ann. § 537.3405*; *Kan. Stat. Ann. § 16a-3-405*; Me. Rev. Stat. Ann. tit. 9A, § 3-404; *Md. Code Ann., Com. Law § 12-309*; *Mass. Gen. Laws Ann. ch. 255, § 12F*; *Or. Rev. Stat. § 83.860*; *R.I. Gen. Laws § 6-27-5* (limited statute); *S.C. Code Ann. § 37-3-410. See also Bennett v. Reliable Credit Ass'n, 125 Or. App. 531, 865 P.2d 496 (Ct. App. 1993)* .

(n28)Footnote 28. State holder laws that appear to cover at least some leases beyond those defined as credit transactions by Regulation Z include *Alaska Stat. § 45.50.541(a)*; Ariz. Stat. § 44-145; *Colo. Rev. Stat. § 5-3-303*; *Del. Code tit. 6 §§ 4312, 4301(6)* (defining "retail installment contract" to include leases without a requirement that purchase option be for no or nominal additional consideration).

(n29)Footnote 29. Revised *U.C.C. § 9-403(a)*. *See* Revised *U.C.C. § 9-403*, Official Comment 5.

(n30)Footnote 30. *See, e.g., Associates Home Equity Servs., Inc. v. Troup, 343 N.J. Super. 254, 778 A.2d 529 (App. Div. 2001) . But see Crisomia v. Parkway Mortgage, Inc., 2001 Bankr. LEXIS 1469* (Bankr. E.D. Pa. Aug. 21, 2001) ; *Hayner v. Old Kent Bank, 2002 Mich. App. LEXIS 190* (Mich. Ct. App. Feb. 12, 2002) (Holder Rule places no duty upon lender who accepted contract without Holder Notice).

(n31)Footnote 31. Revised *U.C.C. § 3-305(e)*.

(n32)Footnote 32. Revised *U.C.C. § 3-305(e)(2)*.

(n33)Footnote 33. Revised *U.C.C. § 3-305(e)* applies to "instruments." There are two major types of instruments--drafts and notes. A check is a type of draft. The typical consumer loan involves a note.

(n34)Footnote 34. *Smith v. Navistar Int'l Transp. Corp., 714 F. Supp. 303 (N.D. Ill. 1989)* (buyer who obtains financing through an entity closely connected to the seller may use the seller's breach of its duties to the buyer as a defense to liability under the financing instrument); *Karmich Inv. Group v. W.M.R. Rest., 86 Ohio App. 3d 479, 621 N.E.2d 561 (Ct. App. 1993)* (court recognized the close-connectedness doctrine, but concluded that there was no close connection based on the facts). *See also* 2 White & Summers, Uniform Commercial Code § 17-7 (4th ed. 1995).

(n35)Footnote 35. *1997 Ohio App. LEXIS 2721* (Ohio Ct. App., Hamilton County June 25, 1997) , *aff'd sub nom. Williams v. Aetna Fin. Co., 83 Ohio St. 3d 464, 700 N.E.2d 859 (1998) , cert. denied, 526 U.S. 1051, 119 S. Ct. 1357, 143 L. Ed. 2d 518 (1999)* .

(n36)Footnote 36. *Williams v. Aetna Fin. Co, 1997 Ohio App. LEXIS 2721,* at *30-31 (Ohio Ct. App., Hamilton County June 25, 1997) .

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PART I Consumer Credit
CHAPTER 14 Liability of Assignees and Related Creditors; The FTC Holder Rule

1-14 Consumer Credit Law Manual § 14.05

§ 14.05 Raising Lender-Related Defenses Against the Lender's Assignee

Generally, an assignee is subject to all defenses that the consumer could raise against the assignor. n1 There are two important exceptions to this rule. First, *UCC section 3-305* generally allows an assignee to be free from those defenses if it has attained the status of a holder in due course. The second exception to the rule is if the note contains a valid waiver of the consumer's right to raise defenses against assignees. However, such waivers are rarely effective.

[1] Is There a Negotiable Instrument?

Assignees only attain the holder-in-due-course status (and, thus, avoid defenses the consumer could raise against the assignor) if they strictly comply with the requirements of *UCC section 3-302*. One critical requirement is that the note must be a negotiable instrument. *UCC section 3-104(a)* sets out complex rules as to when a note is negotiable. The note must contain an unconditional promise to pay a sum certain and contain no other promise, order, obligation or power given by the maker except as authorized by UCC Article 3. Additional language in the note as required by a small loan law, other state law, or carelessness by the creditor may defeat a note's negotiability. n2 In addition, even if the promise meets these requirements, it is not a negotiable instrument if it is marked "not transferable," "non-negotiable," or the like. n3

UCC section 3-104(a) requires the note to contain a promise to pay a fixed amount of money. A variable rate loan may not be an unconditional promise to pay a fixed amount of money. n4 Similarly, if the instrument refers to a payment scheme by which the consumer is given an allowance for referrals, the note may not be for a fixed amount of money. n5

To be negotiable, an instrument must be payable on demand at a definite time. n6 An estimated payment schedule, with the lender later notifying the consumer of the first payment due date, does not meet this requirement. n7 A payment due a certain period after completion of home improvement work might also not contain a definite time.

Another potential challenge to a note's negotiability will have special utility in cases of home equity loans. A holder of a negotiable instrument must obtain that instrument via an indorsement either written on the instrument itself or on a paper affixed to the instrument. n8 Such a separate paper for an indorsement is called an allonge. n9 Some cases have found that separate sheets stapled to, rolled in, or clipped to the instrument are not affixed. n10

[2] Creditor's Good Faith and Lack of Notice of Defenses

To attain holder-in-due-course status, the holder must also take the instrument in good faith n11 and without notice of any defense or claim. n12 The holder will have to establish good faith; the burden is on the assignee to show it has met the UCC's prerequisites for the holder-in-due-course status. n13

Defects apparent on the face of the documents, such as unfair contract terms, Truth in Lending violations, or usurious interest rates, should defeat the holder-in-due-course status. Assignees with close business ties to assignors are particularly vulnerable to challenges that they are not holders in due course, n14 particularly where they supply forms, receive assignment of substantially all the seller's contracts, and have constructive knowledge of seller's fraud. n15

[3] Defenses That Can Be Raised Against Holder in Due Course

UCC section 3-305 establishes that a holder in due course takes an instrument free from all defenses *except* incapacity, duress, or illegality that is sufficient to nullify the obligation or fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms. These defenses are thus available. n16

Another important application of *UCC section 3-305* is if a loan is usurious. n17 A similar result should be reached when a UDAP or other consumer protection statute authorizes the court to void an agreement where the statute is violated. n18 As revised, *UCC section 3-305* now provides an additional defense against certain holders: the right to enforce an instrument is subject to a "claim in recoupment" against the original payee, so long as the claim arose from the transaction that gave rise to the claim. n19 However, the rights of a holder in due course are not subject to a claim of recoupment against a person other than the holder, a significant limit on the defense's utility. n20

[4] Waivers of Consumer's Right to Raise Defenses

Assignees may attempt to rectify their failure to achieve holder-in-due-course status with a provision in the credit documents that the consumer waives his or her right to raise defenses against assignees. But this provision is disfavored, rarely enforced by the courts, n21 and often violates specific state laws prohibiting such waivers. In addition, former *UCC section 9-206(1)* permits waiver of defense clauses only where the assignee takes the contract for value, in good faith, and without notice of claims and defenses.

[5] State Legislation and Common Law Theories Limiting the Holder-in-Due-Course Status

Finally, consumers should review their own state legislation and state common law. Before the FTC Holder Rule, states often enacted laws limiting the holder-in-due-course status in consumer transactions. n22 Consider whether these laws reach real estate sales, assignments of direct loans, or other transactions not covered by the FTC Holder Rule. n23

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Negotiable Instruments (Article 3)EnforcementDefenses & ClaimsCommercial Law (UCC)Negotiable Instruments (Article 3)EnforcementHolders in Due CourseRequirementsCommercial Law (UCC)Negotiable Instruments (Article 3)General Provisions & DefinitionsDefinitionsNegotiable & Nonnegotiable InstrumentsCommercial Law (UCC)Secured Transactions (Article 9)Third Party RightsAssignmentsCommercial Law (UCC)Secured Transactions (Article 9)Third Party RightsDefenses

FOOTNOTES:
(n1)Footnote 1. Restatement (Second) of Contracts § 336 (1981); 9 Corbin, Corbin on Contracts §§ 892, 892A (Interim ed. 2002 & Supp.); Farnsworth, Farnsworth on Contracts § 11.8 (1990 & Supp.); 3 Williston, Williston on Contracts § 432 (1960 & Supp.). *See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 6.7 (6th ed.

2004).

(n2)Footnote 2. *See Ford v. Darwin, 767 S.W.2d 851 (Tex. Ct. App. 1989)* (promissory note which also contained a promise to sell stock was not a negotiable instrument); *Reid v. Pyle, 51 P.3d 1064 (Colo. Ct. App. 2002)* (language conditioning obligation upon transfer of property made note non-negotiable). *But see Jenkins v. Karlton, 329 Md. 510, 620 A.2d 894 (1993)* (negotiability of note was not destroyed by endorser's promise to pay collection fees, including attorney fees).

(n3)Footnote 3. *U.C.C. § 3-104(a)* (does not apply to checks). *See Bovarnick v. Fleet Bank, 55 U.C.C. Rep. Serv. 2d 491 (Mass. Super. Ct. 2004)* .

(n4)Footnote 4. *Resolution Trust Corp. v. Maplewood Invs., 31 F.3d 1276 (4th Cir. 1994)* (variable rate note is a non-negotiable instrument); *In re Miraj & Sons, Inc., 192 B.R. 297 (Bankr. D. Mass. 1996)* (variable rate notes are non-negotiable instruments). *But see In re AppOnline.com, Inc., 290 B.R. 1 (Bankr. E.D.N.Y. 2003)* (reference to separate mortgage agreement and inclusion of acceleration language do not impair negotiability under NY's 1990 version of Art. 3).

(n5)Footnote 5. *Cf. American Plan Corp. v. Woods, 16 Ohio App. 2d 1, 45 Ohio Op. 2d 2, 240 N.E.2d 886 (Ct. App. 1968)* .

(n6)Footnote 6. *U.C.C. § 3-104(a).*

(n7)Footnote 7. *In re Boardwalk Marketplace Sec. Litig., 668 F. Supp. 115 (D. Conn. 1987)* .

(n8)Footnote 8. *U.C.C. §§ 3-201(b)* and *3-204(a)*. Note that if it is bearer paper, only delivery of the instrument is necessary.

(n9)Footnote 9. *Cf. U.C.C. § 3-204*, Official Comment 1.

(n10)Footnote 10. *Adams v. Madison Realty & Dev. Inc., 853 F.2d 163 (3d Cir. 1988)* ; *Crossland Sav. Bank FSB v. Constant, 737 S.W.2d 19* , 4 U.C.C. Rep. 2d 1479 (Tex. Ct. App. 1987).

(n11)Footnote 11. *U.C.C. § 3-302(a)(2).*

(n12)Footnote 12. *U.C.C. § 3-302(a)(2).*

(n13)Footnote 13. *U.C.C. § 3-308(b). See also Greene v. Gibraltar Mortgage Inv. Corp., 488 F. Supp. 177 (D.D.C. 1980)* .

(n14)Footnote 14. *See generally* Annot., *36 A.L.R. 4th 212 (1985)* (good faith under *U.C.C. § 3-302*).

(n15)Footnote 15. *Vasquez v. Superior Court (Karp), 4 Cal. 3d 800, 94 Cal. Rptr. 796, 484 P.2d 964 (1977)* .

(n16)Footnote 16. *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 11.7.2.5 (7th ed. 2008).

(n17)Footnote 17. *See* National Consumer Law Center, The Cost of Credit: Regulation, Preemption and Industry Abuses, § 10.8.2 (6th ed. 2005).

(n18)Footnote 18. *See Columbus Checkcashiers Inc. v. Stiles, 56 Ohio App. 3d 159, 565 N.E.2d 883 (Ct. App. 1990)* (contractor's failure to obtain a license sufficient defense to check casher who was holder in due course). *But see Kedzie & 103rd Currency Exch., Inc. v. Hodge, 156 Ill. 2d 112, 619 N.E.2d 732 (1993)* (plumber's noncompliance with plumbing license law not sufficient to void check).

(n19)Footnote 19. *U.C.C. § 3-305(a)(3).*

(n20)Footnote 20. *U.C.C. § 3-305(b).*

(n21)Footnote 21. *See, e.g., Vasquez v. Superior Court (Karp), 4 Cal. 3d 800, 94 Cal. Rptr. 796, 484 P.2d 964 (1977)* ; *Fairfield Credit Corp. v. Donnelly, 158 Conn. 543, 264 A.2d 547 (1970)* ; *Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967)* .

(n22)Footnote 22. *State v. Scott Runyan Pontiac-Buick, Inc., 194 W. Va. 770, 461 S.E.2d 516 (1995)* (under West Virginia law, assignee takes note subject to all rights of the consumer). *See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 6.7 (6th ed. 2004 and Supp.).

(n23)Footnote 23. *See, e.g., Jerry v. Second Nat'l Bank, 208 Mich. App. 87, 527 N.W.2d 788 (Ct. App. 1994)* (finding assignee of retail installment contract liable for buyer's claims and defenses under Michigan statute similar to FTC Rule); State *ex rel. Easley v. Rich Food Servs., Inc., 535 S.E.2d 84 (N.C. Ct. App. 2000)* (attorney general can obtain cancellation of contracts and restitution from finance company based on Holder notice required by state statute).

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PART I Consumer Credit
CHAPTER 15 Credit Cards

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PART I Consumer Credit
CHAPTER 15 Credit Cards

1-15 Consumer Credit Law Manual § 15.01

§ 15.01 Introduction

This chapter reviews federal regulation of credit cards (including telephone credit cards) n1 found in the Consumer Credit Protection Act, n2 including the consumer's right to dispute credit card charges. n3

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionCredit Card AgreementsGeneral Overview

FOOTNOTES:
(n1)Footnote 1. Reg. Z § 226.3 n.4. See *15 U.S.C. § 1603(3), (4)*, for transactions otherwise exempt.

(n2)Footnote 2. The Consumer Credit Protection Act is reprinted in Vol. 1A *infra*.

(n3)Footnote 3. See Ch. 1 *supra* for required credit card disclosures and Ch. 6 *supra* for state regulation of credit charges.

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PART I Consumer Credit
CHAPTER 15 Credit Cards

1-15 Consumer Credit Law Manual § 15.02

§ 15.02 Billing Error Procedures

[1] Covered Billing Errors

The Fair Credit Billing Act ("FCBA") billing error procedures apply to open-end credit accounts as well as all consumer credit cards. n1 Billing errors include any of the following practices found on a customer's *periodic statement*: n2

- An extension of credit that was not made to the consumer, n3 or not made in the amount reflected on the statement; n4 This can include an allegation that the creditor charged the consumer for a transaction for which the consumer is not liable, because the debt was owed by another person;
- An unauthorized extension of credit; n5
- An extension of credit that is not properly identified;
- An extension of credit for property or services that was not accepted by the consumer or the consumer's designee; n6 (Whether acceptance has occurred is a matter of state law, and will, in most states, depend on application of Uniform Commercial Code principles.)
- An extension of credit for property or services not delivered to the consumer or the consumer's designee as agreed; n7
- Failure to include a payment or other credit to the account; n8
- Computational or accounting error in the credit-related portion of the statement. n9
- An extension of credit for which the consumer requests additional clarification or documentation; n10 or
- Failure to send the periodic statement to the consumer's last known address. n11

A billing error can also consist of billing someone who was issued a credit card but had not requested it, in violation of the TIL prohibition against unsolicited issuance. n12 It can also include the improper assessment of finance charges. n13

[2] Notice of Billing Error

To use billing error procedures, the consumer must send a notice of billing error to the address identified for this purpose by the creditor, which must be received by the creditor no later than 60 days after the creditor first transmitted the first periodic statement that reflects the billing error. n14 In order to state a claim for violation of the billing error procedures, a consumer may need to plead compliance with these notice requirements. n15

The billing error notice must be in writing to preserve the consumer's rights, n16 must include sufficient information to identify the cardholder's name and account number, n17 the reasons for the belief that a billing error occurred, and the type, date, and amount of the error. n18 Effective July 2010, if a creditor states in its periodic statements that it will accept notices submitted electronically and provides instructions on how to do so, a consumer who submits a notice electronically pursuant to those instructions will satisfy the requirement that the notice be in writing. n19 If a consumer reasserts a billing error that the creditor has already responded to, investigated, and resolved, the creditor need not respond again. n20 This exemption only applies, however, if the consumer's second notice claims "substantially the same" billing errors as the first. n21

A consumer who does not send a dispute letter within the 60-day period does not have a billing error claim based on the inclusion of the wrongful charge in a subsequent periodic statement because the notice must be sent after the first periodic statement in which the charge appears. n22 The consumer might have a claim under another section of TILA. For example, inaccurate disclosure of the finance charge or the balance should violate TILA's periodic statement disclosure requirements. n23 Even if the statute is interpreted to confine the dispute to the new interest and charges, the creditor's investigation would have to encompass the underlying disputed charge in order to resolve them.

A consumer who did not send a dispute letter within the sixty-day period might also still have a Truth in Lending ("TIL") claim based on the inclusion of the wrongful charges in the periodic statement. Inaccurate disclosure of the finance charge or the balance is a violation of *15 U.S.C. section 1637(b)(4)* and *(7)*. n24 Sending a billing error notice is an option the consumer can pursue if he or she wants to place the duty of investigating and responding upon the creditor. Failure to give the billing error notice does not affect the consumer's right to raise the error as a defense in a collection action. n25 Consumers are not required to have a good faith belief that they actually do not owe the disputed amount in order to invoke FCBA's billing error procedures. n26 Note that the Commentary, effective July 2010, clarifies that the consumer need not send a notice to *the merchant* in a billing error dispute involving purchases not accepted or not delivered as agreed. n27

[3] Creditor's Interim Steps Upon Notice of Billing Error

Once the creditor receives the billing error notice, in writing, at the specified address, the creditor must acknowledge receipt of the billing error notice within 30 days of receiving it, unless it has already investigated and resolved the billing error during that time period. n28

After the consumer gives notice, the consumer may withhold payment of the amount in dispute and charges related thereto, n29 or pay the amount without waiving billing error rights. n30

The creditor may not attempt to collect the amount in dispute or related charges, close the account, or report the consumer for nonpayment to a credit reporting agency prior to resolution of the alleged error. The creditor may send a periodic statement indicating the amount in dispute.

If the consumer has an automatic payment plan whereby deductions from a deposit account held by the card issuer are used to pay the open-end credit, the card issuer may not deduct the disputed amount if it has received the billing error notice any time up to three business days before the scheduled deduction date. n31 Currently, this restriction applies only to a card issuer's own automatic payment plan from funds on deposit with it. n32 Effective July 2010, this protection applies to any automatic payment plan offered by the issuer, whether or not the payments are deducted from an account held by the issuer. n33 However, it does not apply to automatic payment plans offered by another financial institution, such as a bill payment service by the institution at which the consumer's deposit account is held. n34 When the automatic deduction comes from an account held by a financial institution other than the card issuer, the consumer may have rights under the Electronic Fund Transfer Act. n35 The consumer can stop payment by written or oral notice to the depository bank up to three business days before the scheduled transfer. n36

[4] Creditor's Billing Error Investigation

The creditor must determine whether a billing error occurred (unless the creditor decides to correct the account as requested by the consumer or unless the consumer withdraws the billing error notice) by conducting a "reasonable" investigation, n37 not merely accepting the merchant's word. The creditor must investigate and resolve the billing error dispute within two complete billing cycles (or 90 days, if that is sooner). n38 The creditor must meet the timeframes for investigation even if the billing error qualifies for another type of investigation under TILA, such as an investigation for unauthorized use or pursuant to a cardholder's right to assert claims and defenses against the merchant. n39

[a] Resolution of Error

If the creditor determines that the billing error occurred, it must correct the error and credit the account with any disputed amount and related charges (including charges imposed for the error resolution process, documentation, etc.), mail or deliver a correction notice to the consumer, n40 and report the resolution of a disputed account to each credit agency notified of a delinquency. n41

If the creditor determines that there was no billing error, or a different error than that complained of, the creditor must: mail or deliver to the consumer an explanation of its reasons for concluding that the billing error asserted by the consumer was wrong in whole or in part; furnish copies of any documentary evidence if the consumer so requests; and correct any different error discovered and credit the account with any disputed amount and related charges (including charges imposed for the error resolution process, documentation, etc.). n42 An ambiguous and cursory statement that does not set forth a legitimate justification for rejecting the dispute is insufficient, nor does an explanation meet the statutory standard if it fails to mention the liability theory that the creditor argues at trial. n43

If the creditor determines that the consumer owes all or part of the disputed amount, the creditor must promptly notify the consumer in writing of the amount owed and the time for payment, allow the consumer any free ride period for payment of the amount, and not report the disputed amount as delinquent unless the consumer has not paid by the time the free ride period is over, or 10 days has passed, whichever time period is longer. n44

If the consumer notifies the creditor in writing during the above time period for payment that the consumer still disputes the charge, the creditor must report the amount as disputed if it reports it as delinquent. n45

Even if the creditor's resolution does not favor the consumer, a consumer's invocation of the billing error procedures may present a defense in a collection action. For example, many card issuers will bring collection actions using a common law theory of "account stated" or "action on an account," which requires that the parties agree that a debt is valid and due. n46 The fact that a consumer had raised a billing error claim may mean the creditor cannot meet the elements of an account stated claim, because the consumer does not agree that the debt is valid. n47 TIL's protection against unauthorized use may also prevent the creditor from bringing an account stated claim in some states, as the TILA specifically imposes on the creditor the burden of showing that the use of the card was authorized. n48

Note: Effective July 2010, the Commentary clarifies that the creditor must make a substantive final resolution within the time limits for investigation. If a creditor fails to complete the investigation and fails to provide a written explanation as to why there was no error or a different error, or otherwise fails to comply with the error resolution procedures required in such cases, the creditor generally must credit the disputed amount and related finance or other charges to the consumer's account. n49

Furthermore, the requirement for a final resolution prohibits the creditor from reversing amounts previously credited for an alleged billing error. This is true even if the creditor obtains evidence after the error resolution time period that indicates that the billing error did not occur as asserted by the consumer. n50

[b] Credit Reports and Billing Errors

Once the consumer has properly notified the card issuer of a billing error, neither the creditor nor its agent may report the disputed amount as delinquent (but may report the amount as in dispute) to any person, including a credit reporting agency or a collection agency. n51 Actual and statutory damages are available for violation of the restrictions on reporting of disputed amounts. n52 Violation of this requirement may also give rise to liability under the Fair Credit Reporting Act ("FCRA"). n53 Under the FCRA, a credit reporting agency must conduct a reinvestigation if a consumer disputes information in the consumer's credit report. n54 In addition, the creditor may be liable if it does not cooperate in the reinvestigation. n55 The FCRA may provide an additional remedy, or an alternative remedy if the Truth in Lending Act ("TILA") is not violated or the consumer has not invoked her billing error rights, for example, because she has missed the sixty-day deadline. In order to invoke her FCRA rights, however, consumers must dispute the error directly with the credit reporting agency in writing. Thus, consumers should be advised to send billing error disputes in writing to both the creditor directly (to invoke TILA rights) and to any credit reporting agency for which the consumers' credit reports are inaccurate because of the billing error or the fact the creditor did not comply with TILA. A card issuer could still pursue normal collection routines on the disputed amount, n56 including filing suit or referral to a collection agency, but must notify the attorney or collection agency, who in turn must also notify the court or any third party of the dispute. n57

[c] Charges for Error Resolution Procedure

Generally, if a billing error occurred, even if it was not the error asserted by the consumer, the creditor cannot impose any charges related to the investigation and resolution of the dispute. n58

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionCredit Card AgreementsGeneral OverviewBanking LawConsumer ProtectionCredit Card AgreementsDispute Resolution

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1666*. The Fair Credit Billing Act [hereinafter FCBA] is reprinted in Vol. 1A *infra*. *See also Jacobs v. Marine Midland Bank, NA, 124 Misc. 2d 162, 475 N.Y.S.2d 1003 (Sup. Ct. 1984)* . Some state statutes provide analogous billing error dispute rights. *See, e.g., Cal. Civ. Code §§ 1747-1747.95* (Song-Beverly Credit Card Act). *Cf. Davis v. Md. Bank, N.A., 2002 U.S. Dist. LEXIS 26468* (N.D. Cal. June 18, 2002) (noting that because FCBA provides similar protections to California's Song-Beverly Credit Card Act, it would not be contrary to California public policy to enforce Delaware choice of law provision).

(n2)Footnote 2. Not all billing errors are found on a periodic statement. A billing error has occurred when a creditor reports as delinquent an amount that has been paid in full. *Saunders v. Ameritrust of Cincinnati, 587 F. Supp. 896 (D. Ohio 1984)* .

(n3)Footnote 3. Reg. Z § 226.13(a)(1).

(n4)Footnote 4. *15 U.S.C. § 1666(b)(1).*

(n5)Footnote 5. Reg. Z § 226.13(a)(1). *See* Reg. Z § 226.12(b). Unauthorized noncredit transactions involving an automated teller machine or debit card which is also a credit card are subject to Reg. E § 205.6. If an ATM transaction activates an overdraft credit feature on a checking account, it is also subject to Regulation E.

(n6)Footnote 6. Official Staff Commentary § 226.13(a)(3)-1. *See Bell v. May Dep't Stores Co., 1999 Mo. App. LEXIS 344* (Mo. Ct. App. Mar. 23, 1999) (en banc) (whether buyer has accepted the goods or services is a question of state law, determined under the U.C.C.; summary judgment not appropriate where buyer orally rejected goods within a reasonable time after delivery and then followed up with a letter), *modified, remanded*, *6 S.W.3d 871 (Mo. 1999)* .

(n7)Footnote 7. This provision includes nondelivery, late delivery, delivery to the wrong place, delivery of the wrong quantity, delivery of property or services different from that agreed upon, and the consumer's refusal to accept delivery because the goods did not comply with the contract, but it does not include a dispute that relates to the quality of property or services that the consumer has accepted. Official Staff Commentary § 226.13(a)(3)-1; *Greisz v. Household Bank, 8 F. Supp. 2d 1031 (N.D. Ill. 1998), aff'd on other grounds*, *176 F.3d 1012 (7th Cir. 1999)* ; *Beaumont v. Citibank (S.D.) N.A., 2002 U.S. Dist. LEXIS 5276* (S.D.N.Y Mar. 28, 2002) (no billing error when consumer returned products due to dissatisfaction). In *Beaumont*, the consumer returned products and services approximately one year after purchase, thus presumably precluding him from arguing that he did not accept or he refused delivery of the goods. However, the consumer alleged that the goods and products were not the same as those he had been promised by the merchant. The court failed to consider that this return could fit within the definition of a billing error under Reg. Z § 226.12(a)(3) as a situation in which the merchant delivered goods "different from that agreed upon." Official Staff Commentary § 226.13(a)(3)-1. However, it would appear the consumer also failed to send the billing dispute within the required timeframe. *See § 15.02[2] infra.*

(n8)Footnote 8. *15 U.S.C. § 1666(b)(4)*; Reg. Z § 226.13(a)(4). This provision can be invoked when a card issuer fails to post a payment sent by the consumer even though the card issuer never received the funds. *See Purcell v. Universal Bank, N.A., 2003 U.S. Dist. LEXIS 7061* (E.D. Pa. Apr. 28, 2003) .

(n9)Footnote 9. Official Staff Commentary § 226.13(a)(5)-1.

(n10)Footnote 10. Official Staff Commentary § 226.13(a)(6)-1; *Burnstein v. Saks Fifth Ave. & Co., 208 F. Supp. 2d 765 (E.D. Mich. 2002)* (a request for clarification can constitute a billing error triggering creditor's obligations for resolution).

(n11)Footnote 11. Reg. Z § 226.13(a)(7).

(n12)Footnote 12. *Kennedy v. Victoria's Secret Stores, 2004 U.S. Dist. LEXIS 19525* (E.D. La. Sept. 29, 2004) . This might be a billing error claim that would be useful for victims of identity theft, see § 5.8.2, *supra.*

(n13)Footnote 13. *Eicken v. U.S.A.A. Fed. Sav. Bank, 2006 U.S. Dist. LEXIS 38843* (S.D. Tex. June 12, 2006) .

(n14)Footnote 14. Reg. Z § 226.13(b)(1). *See Plutchok v. European Am. Bank, 143 Misc. 2d 149, 540 N.Y.S.2d 135 (Dist. Ct. 1989)* ; *Dawkins v. Sears Roebuck & Co., 109 F.3d 241 (5th Cir. 1997)* , *corrected, 1997 U.S. App. LEXIS 12696* (5th Cir. Apr. 8, 1997) ; *Conn-Burnstein v. Saks Fifth Ave., 85 Fed. Appx. 430 (6th Cir. 2003)* (without adequate notice of a billing error, creditor's duties under FCBA were never triggered). *Greisz v. Household Bank, 8 F. Supp. 2d 1031 (N.D. Ill. 1998)* (creditor's duty to investigate and resolve an alleged billing error is triggered only when consumer sends timely written notice), *aff'd on other grounds*, *176 F.3d 1012 (7th Cir. 1999)* .

(n15)Footnote 15. *Turk v. Chase Manhattan Bank USA, 2001 U.S. Dist. LEXIS 8862* (S.D.N.Y. Feb. 20, 2001)

(insufficient for cardholders to plead that they sent "timely billing inquiries" to creditor; cardholders required to plead that they met all of notice requirements for billing error procedures).

(n16)Footnote 16. *See, e.g., Payne v. Diner's Club Int'l, 696 F. Supp. 1153 (S.D. Ohio 1988)* . *Davis v. Md. Bank, N.A., 2002 U.S. Dist. LEXIS 26468* (N.D. Cal. June 18, 2002) (plaintiff's telephone call to dispute charges insufficient to preserve billing error claim).

(n17)Footnote 17. Reg. Z § 226.13(b)(2).

(n18)Footnote 18. Reg. Z § 226.13(b)(3). *But see Williams v. Cawley, 2005 U.S. Dist. LEXIS 35576* (E.D. Mich. Apr. 26, 2005) (plaintiff's request for "verification and validation" did not amount to a proper billing error notice to adequately inform creditor that the plaintiff was disputing transactions in his account).

(n19)Footnote 19. Official Staff Commentary § 226.13(b)-2, effective July 2010.

(n20)Footnote 20. Reg. Z § 226.13(h).

(n21)Footnote 21. Reg. Z § 226.13(h); *General Elec. Capital Fin., Inc. v. Bank Leumi Trust Co., 1999 U.S. Dist. LEXIS 485* (S.D.N.Y. Jan. 19, 1999) (consumer's second notice of billing error, to which creditor did not respond, was not "substantially the same" as first notice, so consumer had FCBA claim).

(n22)Footnote 22. *Dawkins v. Sears Roebuck & Co., 109 F.3d 241 (5th Cir. 1997)* ; *Cunningham v. Bank One, 487 F. Supp. 2d 1189 (W.D. Wash. 2007)* (following *Dawkins*).

(n23)Footnote 23. *15 U.S.C. § 1637(b)(4), (7). See* § 5.6.8, *supra*.

(n24)Footnote 24. *See* Ch. 1 *supra*.

(n25)Footnote 25. *Crestar Bank, N.A. v. Cheevers, 744 A.2d 1043 (D.C. App. 2000)* (consumer could raise unauthorized use as defense to collection suit without having sent billing error notice).

(n26)Footnote 26. *Kurz v. Chase Manhattan Bank, 273 F. Supp. 2d 474 (S.D.N.Y. 2003)* , *subsequent proceeding at 324 F. Supp. 2d 444, 2004 U.S. Dist. LEXIS 12881 (S.D.N.Y. 2004)* .

(n27)Footnote 27. Official Staff Commentary § 226.13(a)(3)-3 (effective July 2010).

(n28)Footnote 28. Reg. Z § 226.13(c)(1). *See General Elec. Capital Fin., Inc. v. Bank Leumi Trust Co., 1999 U.S. Dist. LEXIS 485* (S.D.N.Y. Jan. 19, 1999) (consumer's second notice of billing error, to which creditor did not respond, was not "substantially the same" as first notice, so consumer had FCBA claim).

(n29)Footnote 29. Reg. Z § 226.13(d)(1). Consumers who guess wrong as to the related charges, and, therefore, fail to pay part of an undisputed amount, may risk delinquency reports, collection efforts, finance charges, card revocation, etc. To protect themselves, the consumers could withhold payment of the principal only. They may, in addition, notify the card issuer that they expect an appropriate refund in the event the error is confirmed. Or the consumers could include in the billing error notice a request for clarification of the related charges that they need not pay pending resolution of the dispute. See Reg. Z § 226.13(d)(1), allowing the consumers to withhold paying charges that they believe are related to the disputed amount.

(n30)Footnote 30. Official Staff Commentary § 226.13(d)(1).

(n31)Footnote 31. Reg. Z § 226.13(d)(1). This restriction applies only to a card issuer's own automatic payment plan from funds on deposit with it. The three day limit does not prevent transfer when the source of the payment is held by a third party. Official Staff Commentary § 226.13(d)(1)-4.

(n32)Footnote 32. Official Staff Commentary § 226.13(d)(1)-4.

(n33)Footnote 33. Reg. Z § 226.13(d)(1) effective July 2010.

(n34)Footnote 34. Official Staff Commentary § 226.13(d)(1)-4, effective July 2010.

(n35)Footnote 35. *15 U.S.C. §§ 1693-1693r*. For a detailed discussion of the Electronic Fund Transfer Act, see National Consumer Law Center, Consumer Banking and Payments Law, Ch. 4 (4th ed. 2009).

(n36)Footnote 36. *15 U.S.C. § 1693e*.

(n37)Footnote 37. Reg. Z § 226.13(f).

(n38)Footnote 38. Reg. Z § 226.13(c)(2).

(n39)Footnote 39. Interim Award on Liability Phase of Arbitration Hearing, Hassibi v. Bank One Trust, Clearinghouse 55,634 (Feb. 3, 2006) (arbitration award), *reported at* www.nclc.org/unreportedcases.

(n40)Footnote 40. Reg. Z § 226.13(e).

(n41)Footnote 41. *15 U.S.C. § 1666a(c)*.

(n42)Footnote 42. *15 U.S.C. § 1666(a)(3)(b)(ii)*; Reg. Z § 226.13(f); Official Staff Commentary § 226.13(f).

(n43)Footnote 43. *Dillard Dep't Stores, Inc. v. Owens, 951 S.W.2d 915 (Tex. App. 1997)* (interprets parallel provisions regarding unauthorized users).

(n44)Footnote 44. Official Staff Commentary § 226.13(g).

(n45)Footnote 45. *15 U.S.C. § 1666a(b)*.

(n46)Footnote 46. For a discussion of account stated claims, *see* National Consumer Law Center, Fair Debt Collection, § 14.5.2 (5th ed. 2004).

(n47)Footnote 47. *Cf. Discover Bank v. Walker, 3 Misc. 3d 139A, 787 N.Y.S.2d 677, 2004 N.Y. Misc. LEXIS 782 (2004)* (consumer defeated creditor's motion for summary judgment on account stated claim by notifying card issuer of unauthorized use).

(n48)Footnote 48. *Cf. Bank of New York (Del.) v. Santarelli, 128 Misc. 2d 1003, 491 N.Y.S.2d 980 (N.Y. County Ct. 1985)* (in account stated action, TILA required card issuer to prove each charge on the account was authorized by the borrower). *But see Citibank v. Morgan, 2006 Conn. Super. LEXIS 573* (Conn. Super. Feb. 27, 2006) (consumer's allegation that there was dispute over amount owed entitled him to hearing only as to damages; creditor entitled to summary judgment on account stated claim as to liability).

(n49)Footnote 49. Official Staff Commentary § 226.13(c)(2)-2, effective July 2010.

(n50)Footnote 50. *Id*.

(n51)Footnote 51. Reg. Z § 226.12(c)(2).

(n52)Footnote 52. *15 U.S.C. § 1640*; *see, e.g., Purcell v. Universal Bank, N.A., 2003 U.S. Dist. LEXIS 7061* (E.D. Pa. Apr. 28, 2003) (actual damages may include damages from denial of subsequent credit application due to negative information submitted to credit reporting agency in violation of FCBA).

(n53)Footnote 53. *5 U.S.C. §§ 1681*-1681u.

(n54)Footnote 54. *15 U.S.C. § 1681i*. *See generally* National Consumer Law Center, Fair Credit Reporting, Ch. 4 (6th ed. 2006 and supp.).

(n55)Footnote 55. *15 U.S.C. § 1681s-2(b)*. *See generally* National Consumer Law Center, Fair Credit Reporting (6th ed. 2006 and supp.).

(n56)Footnote 56. Official Staff Commentary § 226.13(d)(2)-1. Regulation Z § 226.13(d)(1), n.30.

(n57)Footnote 57. *15 U.S.C. § 1640*.

(n58)Footnote 58. Of course, it could not assess such a charge unless it had been disclosed in the initial disclosure statement or change of terms notice. Official Staff Commentary § 226.6(b)(2)-1. An erroneous charge would trigger billing error procedures.

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PART I Consumer Credit
CHAPTER 15 Credit Cards

1-15 Consumer Credit Law Manual § 15.03

§ 15.03 Cardholder's Defenses Against Card Issuer for Merchant Misconduct

[1] General

Generally, a credit card issuer is subject to all claims (except tort claims) and defenses of a consumer against a merchant when the consumer uses a credit card as a method of payment or extension of credit, if certain conditions are met. n1 For a card issuer to be subject to the consumer's claims and defenses against a merchant, the credit card must have been used to purchase goods or services in person or by mail or telephone. n2

In addition, the claims or defense must have to do with the property or services purchased from the merchant with the credit card, such as nondelivery of the goods (which could also be asserted as a billing error) or a dispute as to the quality of the merchandise. The cardholder also must have made a good faith attempt to resolve the matter with the merchant; n3 the amount of credit involved in the disputed transaction must be more than $50; n4 and the transaction must have occurred in the same state as the cardholder's current address or within 100 miles from that address, n5 though the card issuer may waive this statutory limitation. n6 The location of a transaction is a matter of state law and could be the consumer's home for mail or telephone orders. In limited situations, the cardholder can still raise claims and defenses against the card issuer if the amount in controversy is less than $50 or where the transaction occurs out-of-state. n7

Once the cardholder has met the above three conditions, where applicable, payment for the disputed transaction may be withheld, to the extent of the credit outstanding on that transaction and finance charges attributable thereto. n8

[2] Resolution Process; Adverse Credit Reports While Cardholder Asserts Claims and Defenses

The claims and defenses provisions and process operate independently of the billing error provisions, though both may be applicable to some disputes and in some circumstances. n9 The claims and errors provisions is not designed to actually resolve the underlying dispute; it is aimed at preserving the consumer's right to assert claims and defenses against the merchant. That dispute ultimately must be determined under state or other applicable law. n10 As a practical matter, when the consumer invokes the claims and errors procedure, the card-issuer charges the amount back to the merchant.

As with the billing error procedure, a card issuer cannot make an adverse credit report based on the consumer's

withholding payment in accordance with these claims and defenses procedures "until the dispute is settled or judgment rendered," n11 though it may report the amount as disputed. n12 The card issuer is not prohibited from undertaking normal collection activities for delinquent accounts. n13 (Amounts being withheld in accordance with these procedures, of course, are not "delinquent," and may not be the basis for collection efforts until the matter is resolved.)

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionCredit Card AgreementsGeneral OverviewBanking LawConsumer ProtectionCredit Card AgreementsDispute ResolutionBanking LawConsumer ProtectionCredit Card AgreementsLiability

FOOTNOTES:
(n1)Footnote 1. See National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 11.6.5.5 (7th ed. 2008 and supp.), for an in-depth discussion of claims and defenses against card issuers.

(n2)Footnote 2. In an unauthorized use situation, in contrast, the card must have been presented.

(n3)Footnote 3. In *Montgomery Ward v. Horgan, 141 Vt. 315, 448 A.2d 151 (1982)* , the buyer had called and written notes on payment stubs. This was found to be a reasonable effort, even though the creditor claimed it had no record of the complaints.

(n4)Footnote 4. Reg. Z § 226.12(c)(3)(ii).

(n5)Footnote 5. Reg. Z § 226.12(c)(3)(ii).

(n6)Footnote 6. *Hyland v. First USA Bank, 1995 U.S. Dist. LEXIS 14794* (E.D. Pa. Sept. 28, 1995) (card issuer's assurances and attempts of assistance to cardholder victimized by foreign seller states claim for relief as waiver of geographic limitation).

(n7)Footnote 7. Reg. Z § 226.12 n.26. *See also* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 11.6.5.5 (7th ed. 2008 and supp.). In addition, a card issuer may be liable for aiding and abetting a merchant's fraud. See National Consumer Law Center, Unfair and Deceptive Acts and Practices § 11.6.5.5 (7th ed. 2008 and supp.). *See also* Ch. 4 *supra*.

(n8)Footnote 8. Reg. Z § 226.12(c)(1).

(n9)Footnote 9. Official Staff Commentary § 226.12(c)-1.

(n10)Footnote 10. Official Staff Commentary § 226.12(c)-2.

(n11)Footnote 11. Reg. Z § 226.12(c)(2).

(n12)Footnote 12. Official Staff Commentary § 226.12(c)(2)-1.

(n13)Footnote 13. Official Staff Commentary § 226.12(c)(2)-1.

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 15 Credit Cards

1-15 Consumer Credit Law Manual § 15.04

§ 15.04 Customer's Liability for Unauthorized Use of a Credit Card

[1] General

TIL precludes customer (business or consumer) liability for unauthorized use of a credit card, except in narrowly defined circumstances, n1 and then limits that liability to $50. "Unauthorized use" means the use of the credit card by a person other than the cardholder who does not have actual, implied or apparent authority for such use, and from which the cardholder receives no benefit. n2

Thus, misuse by an authorized user (such as an employee or family member) is not "unauthorized use" subject to TIL's statutory liability limit. n3 Whether an authorized user is liable to the creditor depends on state law. n4 The card issuer has the burden of proving that the user had actual, implied or apparent authority and that the conditions for imposing liability on the cardholder have been met. n5

The cardholder's failure to review monthly statements to detect unauthorized use can give rise to "apparent authority" in the otherwise unauthorized user. n6 However, one court of appeals has held that a failure to review and object to unauthorized charges does not create apparent authority, because permitting liability in such instances would conflict with TILA's intent in placing the risk of fraud on card issuers, not cardholders. n7 Effective July 2010, the Commentary clarifies that a cardholder can be liable for unauthorized use by a person who has permission to use a card, even if the person is not officially listed as an authorized user. If the cardholder gives a credit card and grants authority to make transactions to a person, the cardholder is liable for transactions by that person even if the person exceeds the authority given, unless and until the cardholder has notified the creditor that use of the card by that person is no longer authorized. n8

An authorized user is different than a joint account holder, who is fully liable on the account. A recent Fourth Circuit case has revealed, however, that some credit card issuers may not be able to distinguish between who is a joint account holder versus solely an authorized user. In *Johnson v. MBNA*, n9 the card issuer attempted to hold the plaintiff liable for an account after the primary card holder filed for bankruptcy. The plaintiff claimed she was an authorized user. The card issuer was unable to show whether the plaintiff was an authorized user or joint account holder, because it did not have the original account agreement, having destroyed it pursuant to its document retention policy. Since authorized users may not be liable on a credit card account in many states, the failure of credit card issuers to distinguish between the

two statuses is highly problematic.

[2] Conditions for Creditor Imposing $50 Liability

The card issuer must prove several elements to impose the $50 maximum liability on the cardholder for unauthorized use: 1) that the card was accepted by the cardholder; n10 2) that the card issuer has provided a means to identify the cardholder or authorized user, n11 such as a signature, picture, fingerprint or other electrical or mechanical means; n12 3) that the card was actually presented; n13 4) that the card issuer gave "adequate notice" to the customer, before the unauthorized use occurred, n14 of the maximum potential liability and how to notify the card issuer of the loss or theft of the card.

An "accepted credit card" is one which the consumer has requested and received, signed, used, or authorized another to use. Thus, if a consumer did not apply for or request a credit card, the use of the card by another should be unauthorized use by definition. n15 This definition of unauthorized use may be important for consumers who are victims of identity theft, which is the fastest growing crime in this country. n16 An "accepted credit card" includes a renewal or substitute for an accepted card; however, a creditor cannot issue a renewal or substitute card if the account has been closed. n17

[3] Cardholder Notice to Card Issuer of Unauthorized Use

The cardholder or any other person may give the card issuer oral or written notice of the loss, theft, or possible unauthorized use of the credit card, n18 and can be given to the card issuer in any way, whether previously authorized by the issuer or not. n19 The notice must identify the name or card number and state that unauthorized use has or may have occurred. Once notice is given, the customer's liability for unauthorized use is frozen at the amount of unauthorized use, or $50, whichever is less. n20 Giving notice of the unauthorized use to the card issuer is not, however, a precondition to raising unauthorized use as a defense in a collection action. n21

[4] Investigation Procedures

Because unauthorized use is a type of billing error, n22 the creditor must attempt to resolve the dispute. n23 The Commentary includes guidance on what reasonable steps the creditor may take to investigate the claim of unauthorized use. n24

No investigation is necessary if the card issuer does not impose liability for the unauthorized use. n25 A card issuer can terminate the investigation if the consumer refuses to provide information solely within the consumer's knowledge or control. Otherwise, the card issuer may not deny a claim based solely on the card holder's refusal to comply with a particular request. n26

Interestingly, plaintiffs in one case alleged that a major credit card issuer has a policy of giving financial incentives to its fraud investigators by tying their salaries to their ability to contain losses. n27 One question is whether such a policy is challengeable under TILA's unauthorized use protections.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionCredit Card AgreementsGeneral OverviewBanking LawConsumer ProtectionCredit Card AgreementsLiabilityBanking LawConsumer ProtectionTruth in LendingLiability

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1643.*

(n2)Footnote 2. *15 U.S.C. § 1602(o).*

(n3)Footnote 3. *Minskoff v. American Express Travel Related Servs. Co., 98 F.3d 703 (2d Cir. 1996)* ; *Towers World Airways Inc. v. PHH Aviation Sys. Inc., 933 F.2d 174 (2d Cir. 1991)* .

(n4)Footnote 4. *Cf. FCC Nat'l Bank v. Laursen (In re Laursen), 214 B.R. 378 (Bankr. D. Neb. 1997)* (husband was not liable in contract for wife's credit card debt, but could have been liable in *quantum meruit* if bank had established that he benefited from the debt; court noted that there would have been no contractual liability even if husband had been an authorized user). *Compare Cleveland Trust Co. v. Snyder, 9 Ohio Op. 3d 329, 380 N.E.2d 354 (Ohio Ct. App. 1978)* (wife of cardholder was not liable where she was issued "related card" on husband's account but never signed agreement to be responsible for account); *Sears, Roebuck & Co. v. Stover, 513 N.E.2d 361 (Ohio Mun. Ct. 1987)* (following *Cleveland Trust v. Snyder*).

Even if authorized users are not generally liable under state law, spouses of cardholders may be liable for credit card debt in community property states or under state necessaries doctrines. *See* National Consumer Law Center, Fair Debt Collection § 14.6 (5th ed. 2004 and Supp.) for a discussion of the doctrine of necessaries. However, a creditor would be required to show that the debts were incurred for "necessaries." *See Fifth Third Bank/Visa v. Gilbert, 478 N.E.2d 1324 (Ohio Mun. 1984)* (father not liable for his minor daughter's unauthorized charges under necessaries doctrine, because none of purchases were for "necessaries").

(n5)Footnote 5. *15 U.S.C. § 1643(b). See Minskoff v. American Express Travel Related Servs. Co., 98 F.3d 703 (2d Cir. 1996)* ; *Elder-Beerman v. Nagucki, 561 N.E.2d 553 (Ohio Ct. App. 1988)* (apparent authority must be established by act of the principal, not the agent); *Blaisdell Lumber Co. v. Horton, 242 N.J. Super. 98, 575 A.2d 1386 (App. Div. 1990)* ; *but see Walker Bank & Trust Co. v. Jones, 672 P.2d 73 (Utah 1983)* .

(n6)Footnote 6. *Minskoff v. American Express Travel Related Servs. Co., 98 F.3d 703 (2d Cir. 1996)* ; *Transamerica Ins. Co. v. Standard Oil Co., 325 N.W.2d 210 (N.D. 1982) . See also O'Brien v. Sutherland Bldg. Prods., Inc., 1994 Ohio App. LEXIS 1191* (Ohio Ct. App. Mar. 24, 1994) (cardholder was negligent in failing to examine his credit card statements and detecting unauthorized use during a five-year period, and so he could not assert that the creditor was negligent in permitting the unauthorized use).

(n7)Footnote 7. *DBI Architects v. American Express Travel-Related Services Co., 388 F.3d 886 (D.C. Cir. 2004)* . The D.C. Circuit Court of Appeals drew support for its conclusion from the fact that a cardholder is not required to contest charges using the billing error procedures of FCBA in order to be protected against unauthorized use. *See* § 5.8.2, *supra*. The court ultimately concluded that the cardholder did indeed create apparent authority, not because the cardholder failed to review the statements, but because the cardholder continued to send corporate checks paying off the balances for almost a year.

(n8)Footnote 8. Official Staff Commentary § 226.12(b)(1)(ii)-3, effective July 2010. Prior case law held the same. *Minskoff v. American Express Travel Related Servs. Co., 98 F.3d 703 (2d Cir. 1996)* ; *Towers World Airways Inc. v. PHH Aviation Sys. Inc., 933 F.2d 174 (2d Cir. 1991)* ; *Stieger v. Chevy Chase Sav. Bank, 666 A.2d 479 (D.C. App. Ct. 1995)* .

(n9)Footnote 9. *357 F.3d 426 (4th Cir. 2004)* . The plaintiff brought her case under the Fair Credit Reporting Act for the card issuer's failure to properly investigate her assertion that she was merely an authorized user, and ultimately prevailed under the FCRA. *See* National Consumer Law Center, Fair Credit Reporting, § 6.5 (6th ed. 2006 and supp.).

(n10)Footnote 10. *15 U.S.C. § 1602(l)*; Reg. Z § 226.12(b)(2)(i) and n.21; *Crestar Bank, N.A. v. Cheevers, 744 A.2d 1043 (D.C. 2000)* (consumer not liable for $50 because creditor did not prove it provided means of identification).

(n11)Footnote 11. *15 U.S.C. § 1643(a)(1)(F)*; Reg. Z § 226.12(b)(2)(iii).

(n12)Footnote 12. Official Staff Commentary § 226.12(b)(2)(iii)-2.

(n13)Footnote 13. Official Staff Commentary § 226.12(b)(2)(iii)-3.

(n14)Footnote 14. Official Staff Commentary § 226.12(b)(2)(ii)-1.

(n15)Footnote 15. *See North Am. Capital Corp. v. O'Hara, 2001 N.Y. Misc. LEXIS 1078* (N.Y. Dist Ct. Aug. 24, 2001) (father not liable for charges on a credit card that was sent unsolicited to him, which his son with a similar name had used without authorization). If the consumer did not request the card, the card issuer is also in violation of the restrictions against issuing an unsolicited credit card. *See § 15.07 infra*; National Consumer Law Center, Truth in Lending, § 5A.12.3.3 (6th ed. 2009 and supp.).

(n16)Footnote 16. *See generally* National Consumer Law Center, Fair Credit Reporting (6th ed. 2006 and supp.). If an imposter requests a credit card in the consumer's name, the use of the card should be considered unauthorized since the consumer did not request the card.

(n17)Footnote 17. Official Staff Commentary § 226.12(a)(2)-1 ("renewal" does not encompass the opening of a new account after a previous account was closed).

(n18)Footnote 18. Reg. Z § 226.12(b)(3).

(n19)Footnote 19. Reg. Z § 226.12(b)(3); Official Staff Commentary § 226.12(b)(3)-1; *15 U.S.C. § 1643(a)(2)*.

(n20)Footnote 20. Official Staff Commentary § 226.12(b)(1)-2.

(n21)Footnote 21. *People's Bank v. Scarpetti, 1998 Conn. Super. LEXIS 351* (Conn. Super. Ct. Feb. 5, 1998) . Raising unauthorized use as a defense may be especially useful to challenge collection claims brought under the common law theory of "account stated" or "action on an account."

(n22)Footnote 22. Reg. Z § 226.13(a)(1).

(n23)Footnote 23. Reg. Z § 226.13(c).

(n24)Footnote 24. Official Staff Commentary § 226.12(b)-3.

(n25)Footnote 25. Official Staff Commentary § 226.12(b)-2.

(n26)Footnote 26. Official Staff Commentary § 226.12(b)-3.

(n27)Footnote 27. *Carrier v. Citibank (S.D.), N.A., 383 F. Supp. 2d 334 (D. Conn. 2005)* , *aff'd, 180 Fed. Appx. 296 (2d Cir. 2006)* (unpublished summary order).

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CHAPTER 15 Credit Cards

1-15 Consumer Credit Law Manual § 15.05

§ 15.05 Prompt Crediting of Consumer Payments

Truth in Lending requires that open-end creditors n1 and credit card issuers n2 must credit payments made as of the day of receipt of the payment unless a delay in posting does not result in a finance charge. If the creditor does not specify a manner of payment, payments can be made at any location where the creditor conducts business, during normal business hours, by cash, money order, check, or similar properly negotiable instrument. If the creditor and consumer agree, the payment can also be made by electronic funds transfer. n3 As a practical matter, it may be difficult to establish when a check was received. If payment is by check, the reverse side of the canceled check will show a stamp from the creditor's bank showing when the check was deposited, which may be later than when it was received. If payment is sent by wire transfer, a receipt can be generated indicating when the funds were transmitted.

If the creditor does specify the manner of payment, the rules must be reasonable. n4 These rules could include "no cash," U.S. dollars only, one address for payments to be sent to, etc. n5 If the creditor accepts a payment made in a different manner than that specified, it can deliberately wait five days to credit the payment, even though this will result in a finance charge. n6 If the creditor and consumer agree, the payment can also be made by electronic funds transfer. n7

In recent years, several class action lawsuits have been filed against major credit card banks alleging noncompliance with prompt posting requirements for consumer payments. n8 Failure to post a credit to an account at all may violate other laws or constitute fraud. n9

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1666c*; Reg. Z § 226.2(a)(17).

(n2)Footnote 2. Reg. Z § 226.2(a)(17).

(n3)Footnote 3. Official Staff Commentary § 226.10(b)-4. Section 913 of the Electronic Fund Transfer Act

prohibits creditors from specifying that payment be made by electronic fund transfer.

(n4)Footnote 4. Official Staff Commentary § 226.10(b)-2.

(n5)Footnote 5. Official Staff Commentary § 226.10(b)(1).

(n6)Footnote 6. Reg. Z § 226.10(b); Official Staff Commentary § 226.10(b)-3.

(n7)Footnote 7. Official Staff Commentary § 226.10(b)-4.

(n8)Footnote 8. *See, e.g.*, Bray v. Beneficial Nat'l Bank, C.A. No. 98-CV-2564 (E.D. Pa. May 16, 1998) (challenging lender's policy of waiting for checks to clear before posting them to borrower's account); Storm v. First Union Nat'l Bank of Ga., C.A. No. CV-98-AR-1370-S (N.D. Ala. May 29, 1998) (challenging delays in posting). *See Landreneau v. Fleet Fin. Group, 197 F. Supp. 2d 551 (M.D. La. 2002)* (challenging policy of posting cut-off of 9:00 a.m.); *Bond v. Fleet Bank, 2002 U.S. Dist. LEXIS 22324* (D.R.I. Oct. 10, 2002) (challenging policy of posting cut-off of 9:00 a.m.); *Mangone v. First USA Bank, 206 F.R.D. 222 (S.D. Ill. 2001)* (approving class action settlement agreement); Schwartz v. Citibank (S.D.), Clearinghouse No. 53,023 (C.D. Cal. May 5, 2000) (class action settlement notice in case challenging failure to credit payments on date of receipt). *See also In re* Providian Nat'l Bank, Consent Order No. 2000-53 (Dep't of the Treasury, Office of the Comptroller of the Currency June 28, 2000), *available at* www.occ.treas.gov/FTP/EAs/ea2000-53.pdf (consent order requiring major credit card bank to make restitution for late fees charged in connection with payments received by due date). *Cf.* Johnson v. Capital One Bank, *15 Cal. Rptr. 3d 917 (Cal. Ct. App. 2004)* (breach of contract claim for failing to promptly post payments; summary judgment granted for defendant on basis that Virginia state law limits defendant's liability to TILA for conduct that could be subject of TIL claim).

(n9)Footnote 9. *See, e.g.*, *Gillespie v. HSBC North Am. Holdings, 2006 U.S. Dist. LEXIS 68540* (M.D. Fla. Sept. 25, 2006) .

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1-15 Consumer Credit Law Manual § 15.06

§ 15.06 Treatment of Credit Balances

For credit cards, charge cards, and open-end accounts, creditors must appropriately identify on periodic statements any credit balance, n1

Under the Fair Credit Reporting Act, a creditor is permitted to use lists of consumers provided by credit bureaus to extend "firm offers of credit" to these consumers. n2 However, if a "firm offer of credit" is accompanied by the credit card itself, it will violate TILA's prohibition against unsolicited issuance, despite being permissible under the FCRA. n3 and refund the amount within seven business days n4 from receipt of a written request from the consumer. Oral requests are not sufficient to trigger the creditor's responsibility to refund credit balances. n5 Violations of the requirement to refund credit balances may occur as creditors become aggressive in their fraud prevention methods. n6

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionTruth in LendingGeneral Overview

FOOTNOTES:
(n1)Footnote 1. Official Staff Commentary §§ 226.7(a)-1; 226.7(i)-1.

(n2)Footnote 2. *15 U.S.C. § 1681b(c)(1)(B)*; *see* National Consumer Law Center, Fair Credit Reporting, § 7.3.4 (6th ed. 2006 and supp.).

(n3)Footnote 3. *Munoz v. Seventh Ave., Inc., 2004 U.S. Dist. LEXIS 13715* (N.D. Ill. July 14, 2004) ("firm offer of credit" accompanied by form preprinted with account number constituted "credit card" that was issued unsolicited in violation of TILA).

(n4)Footnote 4. *15 U.S.C. § 1666d*; Reg. Z § 226.11.

(n5)Footnote 5. *Fatahi v. Fleet Bank (R.I.) N.A., 2002 Mass. Super. LEXIS 240* (Mass. Super. Ct. Feb. 19, 2002) (creditor did not violate the Truth in Lending Act [hereinafter TILA] when it refused consumer's requests for refund of

credit balance because consumer failed to establish that requests were in writing).

(n6)Footnote 6. *See, e.g., Fatahi v. Fleet Bank (R.I.) N.A., 2002 Mass. Super. LEXIS 240* (Mass. Super. Ct. Feb. 19, 2002) (creditor refused to issue a refund for several weeks because it had placed a "fraud" warning on the account due to the large amount of the credit balance; creditor did not violate TILA only because the consumer had not made a request in writing).

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1-15 Consumer Credit Law Manual § 15.07

§ 15.07 Restrictions on Issuing a Credit Card

A credit card issuer may not issue a credit card, or add credit to a noncredit card, except in response to an explicit oral or written request or application for a credit card from a consumer or business (or when renewing a card which the customer has already accepted). n1

Under the Fair Credit Reporting Act, a creditor is permitted to use lists of consumers provided by credit bureaus to extend "firm offers of credit" to these consumers. n2 However, if a "firm offer of credit" is accompanied by the credit card itself, it will violate TILA's prohibition against unsolicited issuance, despite being permissible under the FCRA. n3 The card issuer may solicit the consumer's request or application, by mail, telephone, print or broadcast advertising. n4

Initial disclosures need not be provided to the customer until just before the first transaction by which the customer becomes obligated on the plan, and sometimes not even then. n5 The initial disclosures need not be made before an application fee is taken, if a creditor assesses an application fee on everyone who applies for credit. n6

Once the consumer has accepted the card, by inactivity or use, the card can be renewed n7 or issued to others whom the requesting party has designated as authorized users on the account. n8

In 1999, in response to a widespread marketing of cards that from the outset had both credit and noncredit features, the Federal Reserve Board tightened the Commentary provisions that define when a creditor can issue an unsolicited non-credit device that has potential credit features. n9 The changes were made effective March 31, 1999, although compliance was optional until March 31, 2000. The new Commentary allows a creditor to add a credit feature to an unsolicited non-credit card at the consumer's specific request. However, an unsolicited non-credit card can be issued only if the issuer does not propose to connect the card to any credit plan. If the issuer includes promotional materials about credit features when it sends the card to the customer, this demonstrates that the issuer proposes to connect the card to a credit plan and makes unsolicited issuance unlawful. n10 Likewise, making the TIL credit disclosures or an account agreement along with the card shows that the creditor is proposing to connect it to a credit plan. n11 The fact that the consumer has to contact the issuer and activate the card to access credit makes no difference--it is still unlawful to send the consumer the card. n12

The creditor can issue *noncredit* card devices, such as a check guarantee card, a debit card, or an ATM card, without a

specific request, even though these devices can be transformed into credit devices upon the customer's request. n13 In addition, the creditor can issue unsolicited PINs (personal identification numbers such as those used for automated tellers or point-of-sale terminals) to existing cardholders as long as the PINs cannot be used alone to obtain credit, but must be used in conjunction with the card. n14

TILA statutory damages, as well as actual damages, are available for violations of the prohibition against issuance of unsolicited credit cards. n15

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionCredit Card AgreementsGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer ReportsBanking LawConsumer ProtectionTruth in LendingDisclosureBanking LawConsumer ProtectionTruth in LendingLiability

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1642*; Reg. Z § 226.12(a).

(n2)Footnote 2. *15 U.S.C. § 1681b(c)(1)(B)*; *see* National Consumer Law Center, Fair Credit Reporting, § 7.3.4 (6th ed. 2006 and supp.).

(n3)Footnote 3. *Munoz v. Seventh Ave., Inc., 2004 U.S. Dist. LEXIS 13715* (N.D. Ill. July 14, 2004) ("firm offer of credit" accompanied by form preprinted with account number constituted "credit card" that was issued unsolicited in violation of TILA).

(n4)Footnote 4. An example of a prohibited solicitation would be "I'm calling from Money Center Bank to *inform* you that we are sending you our Mastercard."

(n5)Footnote 5. Official Staff Commentary § 226.5(b)(1)-1.

(n6)Footnote 6. Official Staff Commentary § 226.5(b)(1)-1.

(n7)Footnote 7. Reg. Z § 226.12(a)(2).

(n8)Footnote 8. Official Staff Commentary § 226.12(a)(1)-6.

(n9)Footnote 9. Official Staff Commentary § 226.12(a)(1)-7, *published at 46 Fed. Reg. 16,614* (Apr. 6, 1999) .

(n10)Footnote 10. Official Staff Commentary § 226.12(a)(1)-7(ii).

(n11)Footnote 11. Official Staff Commentary § 226.12(a)(1)-7(ii).

(n12)Footnote 12. Official Staff Commentary § 226.12(a)(1)-7(ii). See also Official Staff Commentary § 226.2(a)(15)-2, which was revised at the same time as § 226.12(a)(1)-7 to add as an example of a credit card "a card or device that can be activated upon receipt to access credit, even if the card has a substantive use other than credit, such as a purchase-price discount card." The Commentary underscores the point by adding that "[s]uch a card or device is a credit card notwithstanding the fact that the recipient must first contact the issuer to access or activate the credit feature."

(n13)Footnote 13. Official Staff Commentary § 226.12(a)(1)-7.

(n14)Footnote 14. Official Staff Commentary § 226.12(a)(1)-8.

(n15)Footnote 15. *15 U.S.C. § 1640(a)*. The prohibition against unsolicited issuance is contained in Part B of TILA (which § 1640 refers to as "this part"). TILA's restrictions on statutory damages liability apply only to certain disclosures referred to in §§ 1637 and 1638, not to § 1642's prohibition against unsolicited issuance of credit cards.

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1-15 Consumer Credit Law Manual § 15.08

§ 15.08 Credit Card Advertising

Any credit card advertising must be truthful, in that if it mentions specific credit terms, it may state only those terms that the creditor actually plans to make available and must disclose specified information. n1

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral Overview

FOOTNOTES:
(n1)Footnote 1. Reg. Z § 226.16(b); Official Staff Commentary § 226.16(b).

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1-15 Consumer Credit Law Manual § 15.09

§ 15.09 Creditor Cannot Offset Consumer's Deposit Account to Pay Credit Card Account

TILA provides that the card issuer cannot freeze a checking or savings account or take funds out of a deposit account (set-off) to satisfy a credit card debt except under an automatic payment plan previously authorized by the cardholder in writing, n1 and only as to amounts not in dispute. n2

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionTruth in LendingGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1666h*.

(n2)Footnote 2. Reg. Z § 226.13(d)(1). The card issuer can attach or levy upon funds under procedures which are constitutionally available to other creditors. *15 U.S.C. § 1666h(b)*; Reg. Z § 226.12(d)(2).

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1-15 Consumer Credit Law Manual § 15.10

§ 15.10 Allowable Interests in the Consumer's Deposit Account

Any credit card security interest which allows set-off must be affirmatively agreed to by the consumer, be disclosed in the initial disclosures, and be taken and enforced only through procedures equally available to other creditors. n1 There must be some affirmative indication that the consumer is aware that a security interest is a condition for an account and specifically intends to grant the security interest, such as by initialing the agreement separately.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionCredit Card AgreementsGeneral Overview

FOOTNOTES:
(n1)Footnote 1. Official Staff Commentary § 226.12(d)(2)-1.

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1-15 Consumer Credit Law Manual § 15.11

§ 15.11 The Creditor-Merchant-Cardholder Relationship

TIL includes some restrictions on the relationship between the card issuer, the cardholder, and the person or entity honoring the card (referred to herein as the merchant or seller, since that is most often the case).

[1] Tie-Ins

The TILA provides that the card issuer may not require a seller to open an account or procure any service from the card issuer (or other person such as an affiliate, agent, or subsidiary) as a condition to participation in the credit card plan, unless essential to the operation of the credit card. n1

[2] Prompt Crediting of Refunds

When a credit card has been used to purchase merchandise or services from a third party seller, and the merchant accepts a return or otherwise forgives the debt, the merchant must transmit a credit to the card issuer within seven business days, n2 through normal channels. The card issuer must then credit the consumer's account within three business days from its receipt of the credit.

If the third party merchant gives cash refunds to cash customers, it must also give credit or cash refunds to credit card customers, unless it discloses at the time the card is used that credit or cash refunds for credit card returns are not given. n3 The merchant may refuse to give credit when a credit card customer returns the merchandise, if that policy was disclosed at the time of the transaction (and, presumably, if state law permits).

[3] Disclosure of Finance Charge

Truth in Lending requires a third party merchant, not the card issuer, to disclose any finance charge imposed at the time of the transaction, such as a surcharge for use of the credit card, or, in some cases, a discount to encourage cash payment, before the consumer becomes obligated. n4

[4] Discounts and Surcharges

A merchant may allow a discount of any size from the regular price to induce payment by cash or check rather than by

use of a charge or credit card. n5 The discount must be offered to all customers, and its availability must be clearly and conspicuously disclosed. If these conditions are met, the discount is not a finance charge. If the conditions are not met, the discount is a finance charge which must be disclosed in advance. n6

The card issuer may not prevent a third party seller from offering discounts to encourage payment by cash or other means instead of by use of a credit card account, but may prevent a seller from imposing a surcharge on the use of a credit card. Unless prohibited by the card issuer or by law, the merchant may impose a surcharge for use of a charge or credit card. n7 This surcharge is a finance charge and must be disclosed in advance. n8 The merchant must disclose the finance charge, or how it will be determined, either orally or in writing. The amount financed and annual percentage rate are not required disclosures in this instance. n9

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionCredit Card AgreementsGeneral OverviewBanking LawConsumer ProtectionTruth in LendingGeneral OverviewBanking LawConsumer ProtectionTruth in LendingDisclosure

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1666g*.

(n2)Footnote 2. *15 U.S.C. § 1666e*; Reg. Z § 226.12(e)(3). *See, e.g., FTC v. World Travel Vacation Brokers, Inc., 861 F.2d 1020 (7th Cir. 1988)* (processing of credits routinely delayed on a regular basis to allow cross checking and for cash flow/economic reasons).

(n3)Footnote 3. *15 U.S.C. § 1666e*; Reg. Z § 226.12(e)(3).

(n4)Footnote 4. Reg. Z § 226.9(d).

(n5)Footnote 5. *15 U.S.C. § 1666f(b)*.

(n6)Footnote 6. Reg. Z §§ 226.4(b)(9), 226.4(c)(8).

(n7)Footnote 7. Some states prohibit credit card surcharges. *See, e.g., Conn. Gen. Stat. § 42-133ff*; N.Y. Gen. Bus. Laws § 518.

(n8)Footnote 8. Reg. Z § 226.9(d).

(n9)Footnote 9. Reg. Z § 226.5 n.7; Official Staff Commentary § 226.9 (References).

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CHAPTER 16 Fair Credit Reporting

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1A-16 Consumer Credit Law Manual

Editor's Note:

The Fair Credit Reporting Act ("FCRA") was amended by the Fair and Accurate Credit Transactions Act of 2003 ("FACTA"), Pub. L. No. 108-159, *117 Stat. 1952* (Dec. 4, 2003). Please see Vol. 1B *infra* for a reprinted version of the FCRA without the FACTA amendments and a reprinted version of the FCRA with the FACTA amendments.

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1-16 Consumer Credit Law Manual § 16.01

§ 16.01 Introduction

Lenders, credit sellers, insurance companies, employers, and others often seek information about consumers to minimize the risk of extending credit, selling insurance, or hiring new employees. Although the consumer who applies for credit, insurance, or employment supplies much of this information, credit bureaus (sometimes called credit reporting agencies or consumer reporting agencies) can provide additional information about the applicant. Credit bureaus collect enormous quantities of information on consumers, condense it into consumer credit reports (also called consumer reports) and then resell the credit reports to third parties such as banks, retailers and other potential creditors, prospective employers, landlords and insurers. To obtain a report, the credit bureau's customer typically uses a credit reporting terminal linked to the credit bureaus with whom the customer has a subscription agreement, or connects through a computer modem using specially developed software. Once passwords and consumer identifying information have been inputted, the bureau returns reports within seconds that match the identifying information.

A consumer credit report contains personal information such as name, age, social security number, home and business addresses, job, previous addresses, marital status, spouse's name and number of children. Estimated income, value of car and home, bank accounts, credit accounts, payment history and credit limits, mortgages and other financial information also comprise a credit report, as does public information such as tax liens, bankruptcies and court judgments. A report also indicates who has requested the consumer's credit report within the last two years. Reports sent to credit grantors often include a "credit score" or rating of a consumer's so-called creditworthiness. n1

"Investigative reports" are specialized credit reports that contain far more information than standard consumer credit reports and are used most often by insurance companies and prospective employers. In addition to the usual credit, financial and public record information, investigative reports provide information relating to a consumer's character, general reputation, personal characteristics or mode of living. This information comes from personal interviews with the consumer's friends, neighbors, and colleagues.

The FCRA n2 regulates the activities of credit reporting agencies, users of credit reports, and those who furnish information about consumers to reporting agencies. The statute also sets forth various consumer rights related to credit reporting. The FCRA was extensively amended by the Consumer Credit Reporting Reform Act of 1996, as part of the Omnibus Consolidated Appropriations Act of 1996, Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).

In general, the Act applies when a person collects information on a "consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living" and this information is used by a third party as a basis for denying or increasing the charge for "credit or insurance to be used primarily for personal, family, or household purposes." n3 The Act also applies if the information is used for purposes relating to employment opportunities, government benefits, or certain business transactions. n4

The FCRA is intended to protect consumers from invasion of privacy and the dissemination of false, outdated, or misleading information by placing various obligations on persons who use or disseminate credit information about consumers. Consumer reporting agencies must adopt reasonable procedures to ensure that the information they disseminate is accurate and up-to-date and that it is furnished only to users with certain permissible purposes. n5

Disclosure obligations for both reporting agencies and users are designed to ensure that consumers will know when a consumer report has been used as the basis of action adverse to their interest. n6 The disclosure rules also ensure that consumers will be informed about the nature of information being disseminatedabout them. n7 Reporting agencies also have an obligation to reinvestigate information which consumers dispute and to inform users of the report of the dispute. n8 Those who furnish information to consumer reporting agencies must participate in the reinvestigation conducted by the consumer reporting agency. n9

If these obligations are not met or if the consumer sustains damage notwithstanding eventual compliance with the obligations, the consumer may bring a civil suit under the Act. n10 Additionally, it is a criminal offense for a user to obtain information on a consumer under false pretenses n11 and for an officer or an employee of a reporting agency to furnish such information to an unauthorized person. n12 Finally, the FCRA provides for public enforcement.

Congress recently amended the FCRA to allow the Federal Trade Commission ("FTC") and other administrative enforcement agencies to prescribe trade regulation rules and other rules in relation to the FCRA. n13 The FTC has issued a Statement of General Policy or Interpretation: Appendix--Commentary on the Fair Credit Reporting Act, n14 better known as the Official Staff Commentary, which interprets many particulars of the Act. Although the courts need not show deference to Commentary interpretations, they may do so because they reflect the enforcement policy of the primary federal agency with responsibility for the FCRA. n15

In addition to general rulemaking authority, n16 the agencies are specifically authorized to issue regulations pursuant to several provisions of the Fair and Accurate Credit Transactions Act of 2003 (FACTA), amendments to the FCRA. n17 As of mid-2006, only some of the regulations required by the FACTA amendments have been finalized by the FTC and other identified agencies. n18

FACTA's rulemaking scheme is extremely complex because there are several sets of regulations issued by different federal agencies. The FTC has promulgated regulations that apply to the CRAs and non-bank furnishers. The FRB has promulgated a limited number of regulations and model forms that generally apply to all furnishers or all non-bank furnishers. Finally, the banking regulators have promulgated regulations that govern the respective financial institutions that they supervise.

In 2001, Congress passed the U.S.A. Patriot Act which, among other things, reduced the requirements for the FBI to gain access to consumer credit information. n19 Specifically, Congress amended section 1681u, to reduce the administrative certification requirements for FBI access to credit information. This amendment was one of many contained in the U.S.A. Patriot Act intended to protect against international terrorism. Investigations pursuant to this section of the FCRA may not be solely based on activities protected by the First Amendment to the United States Constitution. n20

The FTC staff also issues informal opinion letters which do not bind even the FTC. n21 The weight accorded these letters should depend on their persuasiveness, but do bear the imprimatur of an FTC employee. n22

[1] Privacy Protection n23

As the world goes digital, consumers' records, both financial and otherwise, are increasingly vulnerable to exposure. Unregulated databases, escalating numbers of corporate mergers and the proliferation of information brokers--private investigators who specialize in obtaining computerized records--all threaten privacy. The Internet raises particular privacy concerns, as information sent over the Internet may pass through dozens of different computer systems, each of which can snatch and hold it. In addition, web site owners can track consumers' online behavior and thereby gather information about their preferences, often without their knowledge.

The FCRA protects only a tiny corner of our privacy. It seeks only to limit the disclosure by private parties of consumer financial information to be used, for the most part, for credit, insurance, or employment purposes. n24 It does not give consumers the right to prohibit a consumer reporting agency from disclosing accurate information to those deemed to have a permissible purpose.

Additional federal and local laws exist to protect personal privacy from invasion by federal or local government, n25 to codify the common law tort of invasion of privacy, n26 and to prohibit private parties from gaining n27 or disclosing n28 specific types of information. Work continues in the movement to expand privacy laws to cover the vast amount of consumer information now gathered and available digitally. n29

[2] The Fair and Accurate Credit Transactions Act of 2003

In 2003, Congress made significant changes to the FCRA by passing the Fair and Accurate Credit Transactions Act (FACTA). n30

[a] Key Provisions

The FACTA contains several provisions intended to assist consumers with credit reporting problems. The Act provides for free annual credit reports from the three national credit reporting repositories and newly defined national specialty reporting credit bureaus (that is, tenant screening, insurance, and employment). n31 In addition to permanently extending existing preemption provisions in the FCRA, it added a long list of new preemptions that significantly limit states' abilities to regulate much of the FCRA's subject matter and conduct requirements. The full extent of the preemption and limitation of liability provisions is uncertain and will likely remain this way until courts interpret the various provisions added to the FCRA by the FACTA. To combat identity theft, the FACTA allows consumers to place fraud alerts in their credit files n32 and to block information caused by identity theft or fraud. n33 Active military duty personnel can also add an alert to their files. n34

The FACTA provided the FTC and other federal regulatory agencies with significant rulemaking authority, something the FTC lacked for many years. n35 In addition, the FACTA requires various studies or reports by the FTC and other agencies and in some cases by credit reporting agencies.

Congress also created a new right for consumers to receive notices relating to risk-based pricing. n36 Whenever a creditor extends credit on terms "materially less favorable than the most favorable terms available to a substantial proportion of consumers," the creditor must provide to consumers a notice that explains that the terms are based on information in a credit report and that the consumers can request a free copy of the report. This notice requirement will address a current flaw in the FCRA relating to failure by creditors to provide notice to consumers when they charge higher interest, fees, or other amounts based on a consumer's credit report.

The FACTA also modified the standard of accuracy for furnishers of information. n37 New duties for furnishers include requirements to prevent the "repollution" of consumer reports. n38 Furnishers must also have reasonable procedures in place to prevent them from refurnishing information that is the result of identity theft. n39

Under the FACTA, debt collectors are prohibited from selling or transferring for consideration, or placing for collection, a debt that they are on notice for and that is the result of identity theft. Third-party debt collectors, once on notice that a debt may be the result of identity theft, must notify the creditor that the information may be the result of identity theft and, upon the request of the consumer, disclose to the consumer information about the transaction. n40

The Act also provides for the truncation of credit card numbers and social security numbers. Persons who accept credit cards or debit cards may print no more than the last five digits of the card or the expiration date on any receipt provided at the point of sale. This provision is only applicable to electronically printed receipts. n41 Consumers may also request that credit reporting agencies truncate the consumer's social security number and limit disclosure to the last five numbers of the social security number. n42

The prior version of the FCRA specifically provided that agencies were not required to disclose credit scores to consumers, n43 though it did not preempt states from requiring their disclosure. The FCRA now requires disclosure of credit scores and will standardize the fees for the disclosure, but it also preempts states from imposing new requirements. n44 Mortgage lenders of loans secured by one to four units of residential real property must also disclose a credit score and related information that the lender obtained from an agency or, if the lender uses an automated underwriting system, must disclose that system's credit score and the score's key factors. n45 Mortgage lenders must also give a prescribed notice to the consumer. n46 Although state laws regarding these disclosures are preempted, several existing state laws are exempt from the preemption. n47 The FCRA now requires agencies to give consumers the FTC's summary of rights to dispute information and obtain credit scores; n48 under the prior version, agencies could substitute their own summary.

The FACTA was signed into law on December 4, 2003, and certain provisions without a designated effective date went into effect on this date. However, the effective dates of most provisions are to be determined by the FTC and other federal agencies, and these agencies have adopted regulations specifying effective dates for these provisions. n49 Still other FACTA provisions do not become effective until the FTC or other federal agencies enact regulations interpreting the provisions. At this time only some of the required regulations have been finalized by the FTC and others identified agencies. n50

[3] Legislation Since FACTA

In 2006, Congress modified the Fair Credit Reporting Act to respond to the perceived need for additional confidentiality in national security investigations. n51 The Act was amended to allow the FBI to prohibit a CRA from disclosing that the FBI sought information from the CRA. n52 Similarly, if "the head of a government agency authorized to conduct investigations of intelligence or counterintelligence activities or analysis related to international terrorism, or his designee" makes the same certification, the agency must also maintain the confidentiality of the request for consumer information. n53 In the USA PATRIOT Act Additional Reauthorizing Amendments Act of 2005, n54 Congress modified these provisions slightly to clarify that someone to whom a national security letter is issued need not disclose the name of an attorney from whom the letter recipient plans to seek legal advice about the letter. n55

The FACTA Amendments of 2003 provided that persons who accept credit cards or debit cards may print no more than the last five digits of the card or the expiration date on any electronically-printed receipt provided at the point of sale. n56 In 2008, Congress amended the FCRA's provision authorizing suits for willful noncompliance to specify that a merchant's failure to comply with the prohibition on printing card expiration dates would not be the basis of an action for willful noncompliance, so long as the receipt was printed on or before June 3, 2008. n57 Congress made the provision retroactive. n58 However, this "amnesty" period has since ended, and the expiration date provision can once again be the basis of an action for willful noncompliance.

In 2009, Congress enacted the Credit Card Accountability, Responsibility and Disclosure Act. n59 As part of these

reforms to the credit card industry, Congress added two new provisions to the Fair Credit Reporting Act, both effective February 22, 2010. The first addresses deceptive practices in the marketing of credit reports by requiring that any advertisement for a "free" credit report must display a notice that free credit reports are available pursuant to federal law at annualcreditreport.com. n60 The second restricts the use of prescreened credit reports to make "firm offers of credit" to young consumers by prohibiting CRAs from furnishing prescreened reports on consumers younger than twenty-one years of age. n61

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer Reports

FOOTNOTES:
(n1)Footnote 1. A detailed discussion of how to read the consumer reports produced by Equifax, Trans Union and Experian appears in National Consumer Law Center, Fair Credit Reporting Act, App. I (6th ed. 2006 and supp.).

(n2)Footnote 2. *15 U.S.C. §§ 1681-1681u*, *reprinted in* Vol. 1A *infra*.

(n3)Footnote 3. *15 U.S.C. § 1681a(d)*.

(n4)Footnote 4. *15 U.S.C. § 1681(b)*; *see also 15 U.S.C. § 1681b(a)(3)*, *1681d*, *1681m*.

(n5)Footnote 5. *15 U.S.C. §§ 1681e*, *1681k*, *1681l*.

(n6)Footnote 6. *15 U.S.C. § 1681m*.

(n7)Footnote 7. *15 U.S.C. §§ 1681d*, *1681g*, *1681h*.

(n8)Footnote 8. *15 U.S.C. § 1681i*.

(n9)Footnote 9. Fair Credit Reporting Act [hereinafter FCRA] § 623, *15 U.S.C. § 1681s-2*, as added by Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996).

(n10)Footnote 10. *15 U.S.C. §§ 1681n*, *1681 o*.

(n11)Footnote 11. *15 U.S.C. § 1681q*.

(n12)Footnote 12. *15 U.S.C. § 1681r*.

(n13)Footnote 13. Pub. L. No. 106-102, *113 Stat. 1338 (1999)* (striking *15 U.S.C. § 1681s(a)(4)*).

(n14)Footnote 14. 16 C.F.R. pt. 600. The Commentary supersedes earlier statements of general policy and interpretations, Compliance With The Fair Credit Reporting Act, and unofficial staff opinion letters issued prior to May 4, 1990.

(n15)Footnote 15. *Yonter v. Aetna Fin. Co., 777 F. Supp. 490 (E.D. La. 1991)* .

(n16)Footnote 16. *15 U.S.C. § 1681s(e)*.

(n17)Footnote 17. Pub. L. No. 108-159 (2003).

(n18)Footnote 18. *See* National Consumer Law Center, Fair Credit Reporting Act, App. B (6th ed. 2006 and Supp.)

(n19)Footnote 19. *15 U.S.C. § 1681u*, *as amended by* U.S.A. Patriot Act, Pub. L. No. 107-56, *115 Stat. 272 (2001)*.

(n20)Footnote 20. *15 U.S.C. § 1681u*, *as amended by* U.S.A. Patriot Act, Pub. L. No. 107-56, *115 Stat. 272 (2001)*.

(n21)Footnote 21. These letters are indexed and reprinted at National Consumer Law Center, Fair Credit Reporting Act, CD-ROM, and App. E (6th ed. 2006 and Supp.).

(n22)Footnote 22. *See Fischl v. GMAC, 708 F.2d 143, 149 n.4 (5th Cir. 1983)* .

(n23)Footnote 23. *See generally* National Consumer Law Center, Fair Credit Reporting Act, § 1.3.3.2. (6th ed. 2006 and Supp.).

(n24)Footnote 24. The Act additionally imposes some restrictions on users of credit reports and imposes obligations on those who furnish information to consumer reporting agencies to provide accurate information.

(n25)Footnote 25. *See, e.g., U.S. Const. amend. IV*; *5 U.S.C. §§ 552*, *552a(b)*; *18 U.S.C. §§ 2710*, 2721-2725; *26 U.S.C. § 6103*. Long, FTC Informal Staff Opinion Letter, July 6, 2000 (a typical residential lease does not involve credit and an attorney therefore does not have a permissible purpose to use a consumer report to collect a debt not reduced to judgment).

(n26)Footnote 26. *See generally* W.P. Keeton, Prosser & Keeton on the Law of Torts 849-69 (5th ed. 1984); *see, e.g., N.Y. Civ. Rights Law § 50*. Note that some statutes enacted to combat computer crime may protect against unauthorized access to databases more effectively than tort laws, though without providing a private cause of action. *See 18 U.S.C. § 1030*; *see* National Consumer Law Center, Fair Credit Reporting Act, § 16.4.2 (6th ed. 2006 and Supp.)

(n27)Footnote 27. For example, through wiretapping. *See, e.g., 18 U.S.C. § 2510*; *Cal. Penal Code §§ 631*-637; *Conn. Gen. Stat. Ann. § 53a-187*; *Haw. Rev. Stat. § 711-1111*.

(n28)Footnote 28. For example, the disclosure of customers' videotape rentals. *See, e.g., Cal. Civ. Code § 1799.3*; *Conn. Gen. Stat. Ann. § 53-450*; *Iowa Code Ann. § 727.11*.

(n29)Footnote 29. *See* National Consumer Law Center, Fair Credit Reporting Act, Ch. 16 (6th ed. 2006 and Supp.).

(n30)Footnote 30. Pub. L. No. 108-159 (2003).

(n31)Footnote 31. *15 U.S.C. § 1681j(a)(1)(C)*, *added by* Pub. L. No. 108-159, § 211(a)(2) (2003). The FTC is to issue regulations to establish a mechanism through which consumers can obtain reports from nationwide specialty consumer reporting agencies.

(n32)Footnote 32. *15 U.S.C. §§ 1681c-1(a)*, *(b)*, *added by* Pub. L. No. 108-159, § 112 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(i)*, *added by 69 Fed. Reg. 6526 (Feb. 11, 2003)* .

(n33)Footnote 33. *15 U.S.C. § 1681c-2*, *added by* Pub. L. No. 108-159, § 152 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(v)*, *added by 69 Fed. Reg. 6526* (Feb. 11, 2003) .

(n34)Footnote 34. *15 U.S.C. § 1681c-1(c)*, *added by* Pub. L. No. 108-159, § 112 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(i)*, *added by 69 Fed. Reg. 6526* (Feb. 11, 2003) .

(n35)Footnote 35. *15 U.S.C. §§ 1681b(g)(5)(A)*, *1681c(h)(2)(A)*, *1681i(e)(4)*, *1681m(e)*, *1681m(h)*6), 1681s/-/2(a)(8)(A), 1681t(e)(1), 1681x, *added by* Pub. L. No. 108-159 (2003).

(n36)Footnote 36. Pub. L. No. 108-159, § 311 (2003), amending *15 U.S.C. § 1681m(h)*. This provision became

effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(xiii)*, *added by 69 Fed. Reg. 6526* (Feb. 11, 2003) .

(n37)Footnote 37. *15 U.S.C. § 1681s/-/2(a)*, *as amended by* Pub. L. No. 108-159, § 312(b). This new accuracy provision became effective December 1, 2004. *16 C.F.R. § 602.1(c)(3)(xiv)*, *added by 69 Fed. Reg. 6526* (Feb. 11, 2003) .

(n38)Footnote 38. *Id.*

(n39)Footnote 39. *Id.*

(n40)Footnote 40. *15 U.S.C. § 1681m(g)*, *as amended by* Pub. L. No. 108-159, § 312(d). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(viii)*, *added by 69 Fed. Reg. 6526* (Feb. 11, 2003) .

(n41)Footnote 41. *15 U.S.C. § 1681c(g)*, *added by* Pub. L. No. 108-159, § 113 (2003). This provision incorporates staggered effective dates. *Id.*

(n42)Footnote 42. *15 U.S.C. § 1681g(a)(1) , amended by* Pub. L. No. 108-159, § 115 (2003).

(n43)Footnote 43. *15 U.S.C. § 1681g(a)*, *as amended by* Pub. L. No. 108-159, § 211 (2003).

(n44)Footnote 44. *15 U.S.C. § 1681g(a)*, *as amended by* Pub. L. No. 108-159, § 212 (2003).

(n45)Footnote 45. *15 U.S.C. § 1681g(a)*, *as amended by* Pub. L. No. 108-159, § 212 (2003).

(n46)Footnote 46. *Id.*

(n47)Footnote 47. *15 U.S.C. § 1681m(b)(3)*, *added by* Pub. L. No. 108-159, § 212 (2003).

(n48)Footnote 48. *15 U.S.C. § 1681g(c)*, *as amended by* Pub. L. No. 108-159, § 211 (2003).

(n49)Footnote 49. *69 Fed. Reg. 6526* (Feb. 11, 2003) (to be codified at 16 C.F.R. Part 602).

(n50)Footnote 50. See National Consumer Law Center, Fair Credit Reporting Act, App. B (6th ed. 2006 and Supp.), for copies of the final FACTA regulations issued so far.

(n51)Footnote 51. Pub. L. No. 109-177 § 116 (Mar. 9, 2006) (amending *15 U.S.C. §§ 1681u*, *1681v*).

(n52)Footnote 52. *Id., amending 15 U.S.C. § 1681v.*

(n53)Footnote 53. *Id., amending 15 U.S.C. § 1681u.*

(n54)Footnote 54. Pub. L. No. 109-178 (Mar. 9, 2006).

(n55)Footnote 55. *Id.* § 4, *amending 15 U.S.C. §§ 1681u*, *1681v.*

(n56)Footnote 56. *15 U.S.C. § 1681c(g)*, *added by* Pub. L. No. 108-159 § 113 (2003).

(n57)Footnote 57. Pub. L. No. 110-241 § 3(a) (June 3, 2008) (adding *15 U.S.C. § 1681n(d)*).

(n58)Footnote 58. *Id.* at § 3(b).

(n59)Footnote 59. Pub. L. No. 111-24, *123 Stat. 1740* (May 22, 2009).

(n60)Footnote 60. *15 U.S.C. § 1681j(g)* (effective Feb. 22, 2010), *as added by* Pub. L. No. 111-24, § 205, *123 Stat. 1740* (May 22, 2009). The FTC is required to issue implementing regulations. *Id.* at § 205(b).

(n61)Footnote 61. *15 U.S.C. § 1681b(c)(1)(B)(iv)* (effective Feb. 22, 2010), *added by* Pub. L. No. 111-24, § 302, *123 Stat. 1740* (May 22, 2009).

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1-16 Consumer Credit Law Manual § 16.02

§ 16.02 FCRA Scope

[1] General

The FCRA primarily n1 regulates "consumer reports" and "consumer reporting agencies." Businesses which furnish information about consumers to consumer reporting agencies also have obligations under the Act. The rights set forth in the FCRA generally apply only to "consumers."

A "consumer" as defined by the FCRA is "an individual." n2 This definition includes only natural persons, not artificial entities such as partnerships, corporations, trusts, estates, cooperatives, associations, governments, government subdivisions, agencies n3 or nonprofit community organizations. n4 An individual need not be involved in a consumer transaction to fall within the definition of "consumer." n5

Information communicated by anyone other than a reporting agency is not a consumer report. The term "consumer reporting agency" refers not just to credit bureaus and inspection bureaus, but any entity that meets the statutory definition.

[2] Covered Consumer Reports

[a] General

A consumer report bears on a "consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living." n6 Information which does not bear on one of the seven characteristics does not constitute a consumer report. Consumer reports involve information "used or expected to be used or collected in whole or in part for" various permissible purposes. n7 A consumer report thus includes information provided over the telephone, through the mails, or by electronic means. However, information about the consumer that is collected and kept on file, but not communicated to a third party, is not a consumer report. The disclosure to the consumer of information in her file may also not be a consumer report. n8 Instead, it is a consumer file subject to the FCRA's dispute and reinvestigation procedures. n9

If some information contained in a report was contained in a prior consumer report, the new report is also a consumer report, regardless of whether the new report was used or expected to be used for a permissible purpose. n10 If a

consumer reporting agency provides a report with the expectation that it will be used for one of the statute's permissible purposes, the report is a consumer report under the Act; the ultimate use to which it is put is irrelevant. n11 It is enough if *one* of the anticipated uses is covered by the FCRA, even if it is not the *primary* expected use.

The standard is one of reasonable expectations; that is, whether a reporting agency knows or should reasonably anticipate the use. n12 If information is originally collected for a purpose covered by the FCRA, a report containing that information remains a consumer report even if the report is later used exclusively for purposes not covered by the FCRA. n13

If information from the consumer file enters the business file, or if information from the business file is put to a consumer purpose, then all future information from the business file will consist of consumer reports as well. n14

To be a consumer report, information must be used or expected to be used or collected at least in part for the purpose of serving as a factor in establishing the consumer's eligibility n15 for (1) credit or insurance to be used primarily for personal, family or household purposes, or (2) employment purposes, or (3) other permissible purposes authorized under the FCRA (*15 U.S.C. section 1681b*). n16 The "permissible purposes" section adds five additional permissible purposes for using consumer reports: to establish eligibility for government licenses and other benefits; for use by public officials to establish child support payment levels; to respond to a legitimate business need for the information in connection with a business transaction that is initiated by the consumer; to assess prepayment and credit risk associated with a current obligation; and to review existing accounts. n17

[b] Credit, Check Guarantee Businesses, and Tenant Reports

"Credit" is defined in the FCRA n18 to have the same meaning as in the Equal Credit Opportunity Act (ECOA), which defines credit as "the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment therefore." n19

There is no requirement in the ECOA that the credit be for personal, family, or household purposes. n20 Moreover, the "personal, family or household purposes" limitation of section 1681a does not appear in section 1681b.

Check guarantee businesses collect credit information on consumers from a variety of sources and, upon request, either approve or disapprove check transactions between consumers and merchants, landlords and commercial establishments. If the check approval company approves a check, it will guarantee the check against nonpayment. Both the courts and the FTC have decided that a consumer report is implicated when a check approval company, such as Uni-Check or RENTCHECK, furnishes to merchants or landlords lists of consumers with bad check cashing histories or other information which a business would use in determining whether to accept consumers' checks tendered in transactions primarily for personal, family, or household purposes. n21 In addition, banks use check approval companies to find out whether an applicant for a checking account owes a previous bank for charges related to a checking account, and may refuse to open an account if the company reports such charges. If the checking account is sought primarily for personal, family, or household purposes, the check approval company's report should be considered a consumer report. Another variation of a check approval company is TELE-TRACK, a company that specializes in providing information to rent-to-own stores and other sub-prime merchants and lenders. Unlike traditional credit reporting agencies, this company maintains a database containing only negative information. In addition to reporting on those who have written bad checks, it also reports on consumers who purportedly have not paid rent, used false social security numbers, have stolen merchandise or automobiles or have not met terms under finance or service agreements with merchants. n22

A consumer reporting agency that maintains files on consumers' check-writing histories will now also qualify as a "nationwide specialty consumer reporting agency," a new subclass of agencies added to the FCRA by the FACTA. n23

Tenant reports compiled by tenant screening companies are consumer reports under the Act. n24 Courts have generally

reached this conclusion because the reports involve consumer credit, n25 while the FTC has relied only on the fact that the reports relate to information used in a business transaction for personal, family or household purposes. n26 Tenant reports also meet the definition of consumer report because they typically "bear" on the consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living. n27

The distinction between credit (the courts) and non-credit (the FTC) is not without consequence: notice of adverse actions is required for credit transactions based on information from a person *other* than a consumer reporting agency but not for business transactions for personal, family or household purposes and, on the other hand, credit reports may be obtained to help collect or review a credit account (debt) but not a business transaction.

Now, a consumer reporting agency that complies and maintains files on consumers on a nationwide basis relating to their residential or tenant history will be a "nationwide specialty consumer reporting agency," a new subclass of agency added to the FCRA by the FACTA. n28

[c] Business Reports

The FCRA does not cover reports on businesses or other commercial entities. n29 The proper test is whether the information was originally collected, used, or expected to be used for one or more of the permissible purposes enumerated in the Act. If it was gathered for such purposes or ever used for such purposes, the information remains a consumer report even when later used for business purposes. n30 In addition, information collected regarding a commercial transaction may be considered a consumer report if it is later used for consumer purposes regarding an individual. n30.1 On the other hand, if an individual is liable on a business' debt, and that information is reported on the individual, that is a consumer report. Information on a consumer is a consumer report even if the information relates to a business.

[d] Insurance Reports

The term consumer report includes a report to establish the consumer's eligibility for insurance to be used primarily for personal, family, or household purposes. n31 In addition, section 1681b(a)(3)(C) permits the use of consumer reports "in connection with underwriting insurance involving the consumer." These two provisions dealing with permissible insurance purposes can probably be read together harmoniously. n32 Information collected, used, and expected to be used solely for other kinds of insurance underwriting purposes than for underwriting personal insurance, such as to help an insurer decide whether to offer commercial risk insurance on an individual or a business, is not covered. n33

Eligibility for insurance coverage is different from eligibility for insurance benefits. n34 The FTC staff also maintains that the issuance of insurance benefits, which is what claims reports are usually used for, is not a business transaction involving the consumer. n35

Nevertheless, if a claims report includes information originally collected for consumer reporting purposes or originally used (or later used) for underwriting purposes, it is then a consumer report. n36 An insurance claims exchange, comprised of a group of insurance underwriters and adjusters who exchange information on consumers' prior claims in determining eligibility for insurance, issues consumer reports. n37

Health and life insurers have increasingly begun using medical information held in enormous databases on hundreds of millions of Americans, such as prescription drug information and data from clinical and pathological laboratories, in making eligibility and underwriting decisions. n37.1 This information is aggregated, analyzed, and coded to yield the expected risk that the individual will incur high medical costs or be at higher risk of death or disability.

The FCRA prohibits use of medical information for purposes of determining eligibility for credit, but not for insurance. Though use of this information raises privacy concerns, its use for insurance eligibility purposes is a permissible

purpose, and these health credit reports are consumer reports subject to the protections of the FCRA. n37.2

[e] Employment Reports, Governmental Licenses and Benefits, Government Determination of Child Support Payment Levels

Consumer reports used for "employment purposes" n38 include evaluations of the consumer for "employment, promotion, reassignment or retention as an employee." n39 Employers that use consumer reports are required to certify that the consumer has authorized the use of the report and that prior to taking adverse action, the employer will provide the consumer with a copy of the report and a summary of the consumer's rights. In addition, a reporting agency which uses adverse public record information in a consumer report must either provide a separate notice to the consumer n40 or maintain strict procedures to ensure that the public record information is complete and up to date. Reporting agencies also furnish consumer reports when used in connection with a "determination of the consumer's eligibility for a license or other benefit granted by a governmental instrumentality required by law to consider an applicant's financial responsibility or status." n41 A consumer report may include reports used to determine the consumer's eligibility for a government license, even where the agency is *not* required by law to consider an applicant's financial responsibility or status in determining whether to grant the license. n42 Reporting agencies may furnish consumer reports to government officials for use in establishing a person's capacity to make child support payments or in determining levels of child support awards. n43

The 2003 amendments to the FCRA pulled out a large chunk of employment reports from the definition of consumer report. n44 Congress, responding to employers' complaints that the FCRA's disclosure provisions hindered investigations of workplace misconduct, amended the Act to provide that certain communications made to an employer will no longer be "consumer reports." To qualify, the communication must be in connection with the investigation of either suspected misconduct by an employee or compliance with federal, state, or local laws and regulations, the rules of a self-regulatory organization, or any preexisting written policies of the employer. n45 As a safeguard, the provision requires that, to qualify for the exclusion, the communication must not have been made for the purpose of investigating the employee's credit worthiness, credit standing, or credit capacity, and the communication must not be provided to any person other than the employer, the employer's agent, a governmental agency, or a self-regulatory organization. n46 If made for any of those purposes the communication will lose its exemption and remain a consumer report. Furthermore, the FCRA does maintain some regulation over such reports, notwithstanding that they are not "consumer reports"; an employer who takes any adverse action based in whole or in part on the exempted communication must disclose to the consumer a summary of the communication, although the employer need not disclose any sources of information for use in preparing what would be, except for the exception, an investigative consumer report. n47

[f] Other Business Transactions Initiated by the Consumer

Another permissible purpose in the definition of a consumer report includes information collected for or used by a person who "otherwise has a legitimate business need for the information in connection with a business transaction that is initiated by the consumer." n48 This section refers to a business' need for information about the consumer in a transaction in the ordinary course of the business' affairs. The relationship between the consumer and the user of the credit report must involve a potential transaction or consumer relationship, n49 and, more explicitly, one initiated by the consumer. n50 Examples of permissible purposes related to business transactions for personal, family or household purposes include applications to rent an apartment, offers to pay for goods by check, applications for checking accounts or similar services, applications for inclusion in a computer dating service, situations involving the refusal to return over-payments of government benefits, n51 and applications for land contracts (even if the contract is not treated as an application for credit). n52

Some courts deny that the business purpose provision applies to the definition of consumer report, linking the cross-reference to other purposes in section 1681b only to governmental benefits. n53 The FTC Commentary squarely rejects this approach, n54 which ignores the statute's plain language n55 and provides no explanation for the inclusion

of licensing, but the exclusion of business purposes, among the purposes for a consumer report. n56

The FTC Commentary has rejected one possible application of a consumer report: law enforcement bulletins regarding individuals wanted for alleged crimes are not consumer reports because they are not collected for consumer purposes and it cannot be reasonably anticipated that they will be used for such purposes. n57

[g] Account Review and Risk Assessment of Current Obligations

The final permissible purposes of a consumer report include the collection or use of information to review current accounts or to assess the risk associated with an existing credit obligation. Prior to the enactment of the Consumer Credit Reporting Reform Act of 1996, consumer reports could be used to review credit accounts. n58 The Reform Act allows access to consumer reports to review non-credit accounts as well. n59

The 1996 Reform Act also added a provision permitting consumer reports to be used by a potential investor or servicer, or current insurer, in connection with a valuation of, or an assessment of the credit or prepayment risks associated with, an existing credit obligation. n60 Consumer contracts are bought and sold in the marketplace by investors, and consumer home mortgages are often serviced by specialty companies who bill and collect monthly payments and manage related escrow accounts.

Some credit reporting agencies offer an inquiry notification service to their subscribers, offering to report when a third party inquires about a consumer whose report the subscriber had at one time requested. It has been held that if the agency collects the information contained within an inquiry report the inquiries and identifying information--for one of the permissible purposes of section 1681(b), or if the agency expects such a report to be used for one of those purposes, the inquiry report is a consumer report and subject to the FCRA's protections. n61 Accordingly, these inquiry alert services should be considered as offering consumer reports and should be subject to all the prerequisites of any other consumer report. Although the subscriber's use of the report may possibly be permitted by the risk assessment purpose, an agency may only furnish the inquiry report if it has reason to believe the subscriber is going to use the report for that purpose, and without a request from the subscriber the agency arguably has no basis to assign any expectation of purpose to the use of the inquiry report.

[3] Statutory Exemptions to Definition of Consumer Report

Information which relates *solely* to a reporting agency's first-hand experience with the consumer is not covered by the definition of a consumer report. n62 This statutory exception allows persons doing business with the consumer to exchange "trade experience" and to provide such information to consumer reporting agencies without becoming consumer reporting agencies under the Act. n63

The definition of a consumer report specifically excludes the direct or indirect approval, by the issuer of a credit card or similar device, of a specific extension of credit. n64 If a merchant refuses to extend credit directly to a consumer because a credit card issuer has denied authorization of a credit card transaction between the merchant and the consumer, it may be that the merchant is *not* denying credit on the basis of a consumer report, and may not have to comply with the obligations of users of consumer reports.

The Act's definition of "consumer report" excludes:

> "any report in which a person who has been requested by a third party to make a specific extension of credit directly or indirectly to a consumer conveys his decision with respect to such request, if the third party advises the consumer of the name and address of the person to whom the request was made and such person makes the disclosures to the consumer required under section 1681m of the title." n65

This exemption covers attempts by retailers to obtain credit for their customers from an outside source (such as a bank or a finance company), either by requesting that the financial institution extend credit directly to the consumer or purchase the retail sales agreement from the dealer.

The Consumer Credit Reporting Reform Act of 1996 excludes from the definition of consumer report certain common communications made by employment agencies. n66 The exclusion applies only if three criteria are met. First, the communication must otherwise satisfy the definition of an investigative consumer report. Second, the communication must be made either for the purpose of procuring an employee for the employer, or for the purpose of procuring an opportunity for a consumer to work for the employer, and, furthermore, the communication may not be used by any person for any other purpose. Third, the consumer must consent to the communication and receive certain disclosures from the agency. n67

The Consumer Credit Reporting Reform Act of 1996 also excludes from the definition of a consumer report two types of information communicated among persons related by common ownership or affiliated by corporate control. n68 The first type of excluded information is information based on first hand experience of one of the affiliates. The second type is any other information shared by affiliates, provided that the sharing is disclosed to the consumer and the consumer is given the opportunity to direct that the information not be shared among related entities. n69

However, the 2003 revisions to the FCRA allow consumers to prohibit an affiliate from using information for solicitation for marketing purposes when that information avoids being a consumer report due to the affiliate exception n70 and allowed the right to opt out of such solicitations that lasts for five years and can be renewed. n71 However, the new provision dilutes the opt-out right by exempting a number of solicitations, including solicitations by an entity that has a pre-existing business relationship with the consumer, solicitations to facilitate communications to an individual to whom the entity provides employment benefit or similar services, and solicitations to perform services on behalf of an affiliate. n72

FACTA provided the FTC and other interested agencies with rulemaking authority concerning FACTA's affiliate marketing provisions. Pursuant to this authority, the FTC issued a proposed rule that in general prohibits a company from using certain information received from an affiliate to market products or services to a consumer, unless the consumer first has been given notice and an opportunity to opt out of receiving such solicitations. n73 The new affiliate marketing opt-out does not supersede or replace the affiliate sharing opt-out contained in FCRA § 1681a, although there is some overlap between the two opt-out requirements. n74

FACTA also amended the FCRA to exclude from the definition of consumer report certain communications made to an employer concerning investigations for employee misconduct or for compliance reasons. n75 Under this exclusion, even if a particular report would otherwise be a consumer report, it will fall outside of the definition by virtue of being specifically excluded. n76 To be excluded, the communication must be made to an employer and must be in connection with an investigation of one of the following: n77

- Suspected misconduct relating to employment;
- Compliance with federal, state, or local laws;
- Compliance with the rules of a self-regulatory organization; or
- Compliance with the preexisting written policies of the employer.

To limit the exclusion's scope, the FCRA further requires that the communication must *not* be for the purpose of investigating a consumer's creditworthiness, credit standing, or credit capacity (in other words, the communication must only bear on the employee's character, general reputation, personal characteristics, or mode of living). These limitations

appear designed so that consumer credit reports from credit bureaus will not fall within the exclusion. However, one court has held that even a traditional credit report is not considered to be a consumer report as a result of this provision, if it is used in connection with an employee misconduct investigation. n78

[4] The Consumer Reporting Agency

A consumer reporting agency must be a person, but "person" is broadly defined to include any individual, partnership, corporation, trust, estate, cooperative, association, government or governmental subdivision or agency, or other entity. n79 A consumer reporting agency assembles information for monetary fees, dues, or on a cooperative nonprofit basis. n80

The person must "regularly engage" in consumer reporting activities, and the practice engaged in must involve the assembly or evaluation of the information reported to third parties. n81 Under the Truth in Lending Act, which requires that a business "regularly extends" credit in order to be covered by the Act, n82 the standard set by regulation is roughly whether one extended credit more than twenty-five times a year. n83 Prior to that regulation, the standard applied was whether the extension of credit was more than "an occasional, isolated, and incidental portion" of the business' activities. n84

[5] Furnishing Consumer Reports to Third Party

The most critical part of the definition of a consumer reporting agency is the requirement that the business be gathering information to furnish consumer reports to third parties. If a company uses its own employees to gather and report information for itself, the employees are not consumer reporting agencies. n85 An independent contractor, when reporting information back to the company that hired her, may be a consumer reporting agency, even when the same report by a company employee would not be covered. Cooperative loan exchanges (offices that maintain information on applications for loans, names of finance companies, names of consumers, and amount of credit requested or extended) are consumer reporting agencies when they give this information to a finance company. n86

[6] Exception for Joint Lenders

When the person furnishing the report and the party receiving the report are joint lenders or joint users of the report, the furnisher of the report is not a credit reporting agency. n87 The joint-user exception also applies to other parties whose approval is needed before a lender grants credit, n88 and where the consumer asks one lender to forward information to a second creditor in connection with the second creditor's evaluation of the consumer's loan application. n89 The joint use exception should not apply where the information is shared for a subsequent transaction where the parties no longer share in the decision-making. n90

[7] Government Agencies

According to the FTC, government agencies such as the Office of Personnel Management and "similar federal agencies" do not fall within the scope of a consumer reporting agency. n91 Similarly, the Ninth Circuit has held that the FTC's exemption applies to all federal agencies, finding no legislative intent to cover such agencies. n92

A "consumer reporting agency" is defined in the FCRA as a "person," n93 and the definition of a "person" includes a "government or governmental subdivision or agency." n94 The FTC has made clear that state and local government entities, unlike federal agencies, can be consumer reporting agencies. But reports made by motor vehicle departments to other governmental authorities involved in licensing or law enforcement activities are not consumer reports because the definition of a consumer report does not include information passed between two governmental entities. n95

Some states have begun allowing private entities electronic access to state unemployment insurance wage reporting records for the purpose of consumer credit verification, and, by doing so, have become credit reporting agencies. n96 In

addition, some state agencies provide criminal record information to employers. FTC staff have suggested that these agencies are *not* thereby credit reporting agencies, although no statutory language providing such an exemption is evident and no court has addressed the issue. n97

States and their respective agencies are protected by sovereign immunity. Under the *Eleventh Amendment of the U.S. Constitution*, states, as sovereigns, are immune from suit in federal court absent consent or a valid abrogation of that immunity by Congress. n98 This immunity extends to state agencies as well. n99 Since Congress enacted the FCRA under the *Commerce Clause*, it was not empowered to abrogate a state's *Eleventh Amendment* immunity through the FCRA. n100 As a result, neither a state nor its officers acting in their official capacities may be held liable for money damages. However, injunctive relief may be available against state officials when they are sued in their official capacity. n101

[8] "Nationwide" Reporting Agencies

So-called "nationwide" reporting agencies have a special meaning within the FCRA to which a few unique obligations attach. Nationwide agencies, as defined by the Act, include the "Big Three" reporting agencies: Equifax, Experian, and Trans Union. n102 The significance of being a "nationwide" agency is limited. The Summary of Consumer Rights provided to consumers by reporting agencies and others must include a toll-free telephone number for nationwide agencies where appropriate. n103 A user that provides an adverse notice to a consumer because it used information from a nationwide agency must provide a toll-free number for that agency. n104 The nationwide agencies must jointly maintain a notification system for consumers to opt-out of certain junk mail or prescreening mailings. n105 The nationwide agencies must also maintain an automated reinvestigation system so that the results of a furnisher's reinvestigation are reported to all the nationwide agencies as appropriate. n106 The FACTA of 2003 imposed new obligations that are specific to nationwide agencies, including obligations to insert fraud and active military duty alerts to consumer files; n107 to refer alerts to other such agencies; n108 review complaints of inaccuracy compiled by and transmitted by the FTC, n109 provide free annual disclosures of consumer reports to consumers, n110 coordinate consumer complaints of identity theft and requesting fraud alerts or blocks, n111 and report annually to the FTC on consumer identity theft complaints and fraud alerts. n112 Nationwide consumer reporting agencies are now also specifically prohibited from using corporate or technological means to try to circumvent these new responsibilities. n113

The FACTA also created a new category called "nationwide specialty consumer reporting agencies," defined as consumer reporting agencies that compile and maintain files on a nationwide basis relating to consumers' medical records or payments, residential or tenant histories, check-writing histories, employment histories, or insurance claims. n114 The significance of being a nationwide specialty consumer reporting agency is that such agencies, like nationwide general consumer reporting agencies, n115 must provide a free credit report. n116

[a] FTC Circumvention Rule

Pursuant to FACTA, the FTC issued a final interim circumvention rule that prohibits nationwide agencies from certain types of conduct that would circumvent their responsibilities as nationwide consumer reporting agencies. The FTC rule prohibits circumvention through any means, including but not limited to corporate organization, reorganization, structuring, or restructuring, or by maintaining or merging public record and credit account information in a manner that is substantially equivalent to a nationwide agency. The rule applies to nationwide agencies that regularly engage in the practice of assembling or evaluating, and maintaining, for the purpose of furnishing consumer reports to third parties bearing on a consumer's credit worthiness, credit standing, or credit capacity, public record information and credit account information from furnishers. n117

Nationwide consumer reporting agencies have always been subjected to special obligations, in addition to those placed on all consumer reporting agencies. Prior to FACTA, nationwide agencies were required to: (1) participate in a joint

opt-out notification system for prescreened credit or insurance offers; n118 (2) maintain a toll-free telephone number during normal business hours with personnel accessible to consumers who have received their file disclosures; n119 and (3) utilize an automated system though which furnishers of information may report reinvestigation results. n120

FACTA specifically describes two types of conduct that Congress intended to prevent through the circumvention rule. The first type is corporate reorganization or restructuring, including a merger, acquisition, dissolution, divestiture, or asset sale of a consumer reporting agency. n121 The second type is "maintaining or merging public record and credit account information in a manner that is substantially equivalent to that described in § 1681a(p) of the FCRA."

The FTC also included three examples of conduct it believed would violate the circumvention rule and one example which would not. The first example is of a nationwide agency that restructures its operations so that public record information is assembled and maintained only by its corporate affiliate and the nationwide agency ceases to comply with the requirements for nationwide agencies because it no longer maintains public records. n122 The second example is of a nationwide agency that restructures its operations so that corporate affiliates separately assemble and maintain information in each state and the corporation ceases to comply with the requirements for nationwide agencies. This conduct would be a violation of the rule. n123

The third example is of a new entrant into the marketplace for consumer reports that organizes itself into two entities. One entity assembles and maintains credit account information from furnishers. The second entity assembles and maintains public record information. Neither the corporation nor its affiliated entities comply with the requirements for nationwide agencies. n124 This conduct would also violate the rule.

The final example deals with a bona fide, arms-length transaction with an unaffiliated party. A nationwide agency sells its public record information business to an unaffiliated company in a bona fide arms-length transaction. The nationwide agency ceases to assemble and maintain public record information and ceases to offer reports containing public information. This conduct would not be a violation of the circumvention rule. n125

A violation of the FTC Circumvention Rule could subject the violating CRA to liability pursuant to sections 1681n and 1681o of the FCRA. There appears to be no limitation on private enforcement of these requirements. The FTC Circumvention Rule provides a safe harbor that provides that any CRA which is otherwise in violation of the rule shall be deemed in compliance if the CRA complies with all of the responsibilities that the FCRA imposes on nationwide CRAs. n126

[9] Examples of Consumer Reporting Agencies

[a] General

In addition to the "Big Three" credit bureaus and the hundreds of smaller credit bureaus around the country, other companies and organizations may fall within the definition of a consumer reporting agency. Inspection bureaus, which assist insurance companies and employers with investigative reports, as well as medical information agencies, which assist in insurance underwriting, are consumer reporting agencies, n127 as are tenant screening companies, and check approval companies.

"Superbureaus" such as Inter-Fact, Inc., I.R.S.C, and W.D.I.A. Corp., buy large volumes of consumer reports at discount rates from the major credit bureaus and resell the data to lower volume buyers. To the extent that the superbureaus buy and sell consumer reports, they are consumer reporting agencies subject to all relevant FCRA requirements. n128

In response to the growing e-commerce market, companies such as CyberSource have started collecting and analyzing data from web merchants, and profiling consumers based on all of their purchase transactions for such characteristics as

potential for fraud. Subscribers send the information of a potential customer to the service, which then returns a risk evaluation, which may just be a number between 0 and 99. n129 These companies also meet the definition of consumer reporting agencies. n130

[b] Creditors as Reporting Agencies

Excluded from the definition of consumer reporting agency is a financial institution which reports its credit decision to a dealer who requested that the financial institution extend credit to the consumer or purchase a retail sales agreement from the dealer. A creditor that reports only information about its own experience with a consumer is not issuing a "consumer report," according to a specific exemption from the Act, n131 and so is not a consumer reporting agency when it reports its own experience about a consumer to a reporting agency. If, however, the creditor reports any information other than that obtained from its first-hand dealings with the consumer, it does become a consumer reporting agency subject to the Act.

A creditor that obtains consumer reports from consumer reporting agencies, in connection with making credit decisions, is not a consumer reporting agency itself when it releases copies of those reports to rejected credit applicants. n132 A retailer, however, whose customers finance purchases through a bank, becomes a consumer reporting agency when (to avoid paying a fee to the bank) the retailer obtains information from the customers' references and furnishes it to the bank, which then decides whether to extend credit. n133

[c] Collection Agencies and Credit Bureau Collection Departments

A collection agency that provides information about a consumer's debt to a third person may be a consumer reporting agency, n134 particularly where the collection agency regularly furnishes information outside its own experience with the consumer for use in connection with consumer transactions. n135

[d] Detective and Employment Agencies, Employers

An employment agency that prepares lists containing names of employees fired for cause is a reporting agency. n136 As a result of the Consumer Credit Reporting Reform Act of 1996, however, many communications by employment agencies that were considered consumer reports are excluded from the definition of a consumer report.

Private investigators and detective agencies that regularly obtain information about prospective employees or other information in connection with a consumer report, and furnish that information to their clients, become consumer reporting agencies. n137 Investigators hired by an employer to investigate an employee's possible misconduct or even allegations of sexual harassment also will be a consumer reporting agency. The investigator's report is often likely to be an investigative consumer report. n138 If an employer itself asks friends, neighbors, co-workers, and associates about an applicant, however, the employer is not a consumer reporting agency because it is not a business gathering information for the purpose of furnishing a report to third parties. n139

[e] Attorneys

An attorney searching land records may be a consumer reporting agency if he or she is looking for information that bears on creditworthiness, such as the existence of liens, judgments and other items affecting title, and renders an opinion that is used by third parties, such as lenders and title insurance companies, in determining whether to grant credit or insurance. n140 Also, an attorney who requests a consumer report on potential buyers to help his or her client decide which home-purchase offer to accept, when the attorney knows the buyer is going to borrow money, is a consumer reporting agency. n141 An attorney who regularly checks criminal records of a client's potential employees may be subject to the FCRA. n142 However, an attorney who merely furnishes information about a particular debt to his client without assembling or evaluating information is not a consumer reporting agency. n143

[f] College Placement Offices

A college placement office may be a consumer reporting agency if it collects and disburses information for a fee or on a cooperative nonprofit basis, and if the reports contain information not based on its own transactions or experiences with the consumer. n144

[g] Accident Reporting Bureaus and Compilers of Insurance Claim Lists

A plan to compile a listing of policyholders who have received auto claim payments in the past would render the compiler a consumer reporting agency. n145 Accident bureaus that sell motor vehicle operating records to insurance companies may be consumer reporting agencies, n146 but not the police or sheriff's departments which prepare accident reports. n147 State motor vehicle departments are consumer reporting agencies when selling information to private parties, but not when cooperating with other government agencies. n148

Insurance claim reports are generally not considered consumer reports after the reports are compiled and used by insurance companies (or adjusters) to adjust claims made by insureds. n149 If, however, the reports are furnished for use in insurance underwriting, the compilers would be consumer reporting agencies. n150

[h] Telephone Companies

When a telephone company reports to others concerning its own experience with its own customers, a consumer report is *not* involved. n151 Nevertheless, local companies, long-distance companies, and other companies exchange information on customers. For example, long-distance and 900-number companies bill through local telephone companies.

If a telephone company reports information on a customer not based on its own experience, but on the experience of another company, it is acting as a reporting agency. For example, if a consumer's old local telephone company reports to the consumer's new local telephone company the experience of a long-distance carrier with that consumer, the consumer's old local company is acting as a consumer reporting agency within the scope of the FCRA. Similarly, if various telephone companies pool information in a centralized fashion, the central repository may be a reporting agency. Both situations are common. n152

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer Reports

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1681m(b)* places certain obligations on users even when neither a consumer report nor consumer reporting agency are involved.

(n2)Footnote 2. *15 U.S.C. § 1681a(c)*; Leo Foundation, Inc. v. Dun & Bradstreet, Inc., [1974-1980 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 98,798 (D. Conn. 1974).

(n3)Footnote 3. *See* FTC Official Staff Commentary §§ 603(c), 603(d) item 3B. *American Bankers Assoc. v. Lockyer, 2004 U.S. Dist. LEXIS 12367* (E.D. Cal. June 30, 2004) ; *Moore v. Equifax Info. Servs., L.L.C., 333 F. Supp. 2d 1360 (N.D. Ga. 2004)* (FCRA does not apply to business or commercial transactions, citing *Yeager v. TRW, Inc., 961 F. Supp. 161, 162 (E.D. Tex. 1997)* ("FCRA does not apply to business transactions, even those involving consumers and their consumer credit information")). *Contra Korotki v. Attorney Services Corp., 931 F. Supp. 1269, 1277 n.23 (D. Md. 1996)* (where business debt involved individual, individual is a "consumer").

(n4)Footnote 4. *See* Carson, FTC Informal Staff Opinion Letter [1969-1973 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 99,532 (Mar. 20, 1971).

(n5)Footnote 5. *See, e.g., Korotki v. Attorney Servs. Corp., 931 F. Supp. 1269 (D. Md. 1996)* .

(n6)Footnote 6. *15 U.S.C. § 1681a(d).*

(n7)Footnote 7. *15 U.S.C. § 1681a(d).*

(n8)Footnote 8. *See Cousin v. Trans Union Corp., 246 F.3d 359* , *reh'g, en banc, denied, 254 F.3d 72 (5th Cir. 2001)* , *cert. denied, 534 U.S. 951 (2001)* .

(n9)Footnote 9. *Thomas v. Gulf Coast Credit Serv., Inc., 214 F. Supp. 2d 1228 (M.D. Ala. 2002)* .

(n10)Footnote 10. FTC Official Staff Commentary § 603(d) item 5C; *see also* Grimes, FTC Informal Staff Opinion Letter, Mar. 4, 1992; FTC Informal Staff Opinion Letter [1969-1973 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 99,424 (May 19, 1971); FTC, Compliance with the Fair Credit Reporting Act, at 47 (1977).

(n11)Footnote 11. *See Comeaux v. Brown & Williamson Tobacco Co., 915 F.2d 1264 (9th Cir. 1990)* ; *Zeller v. Samia, 758 F. Supp. 775 (D. Mass. 1991)* .

(n12)Footnote 12. FTC Official Staff Commentary § 603(d) item 5D.

(n13)Footnote 13. *See Bakker v. McKinnon, 152 F.3d 1007 (8th Cir. 1998)* ; *Ippolito v. WNS, Inc., 864 F.2d 440 (7th Cir. 1988)* , *cert. dismissed, 490 U.S. 1061, 109 S. Ct. 1975, 104 L. Ed. 2d 623 (1989)* ; d'Entremont, FTC Informal Staff Opinion Letter, Jan. 25, 1996; Grimes, FTC Informal Staff Opinion Letter, Aug. 3, 1984; FTC Informal Staff Opinion Letter [1969-1973 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 99,424 (May 19, 1971); FTC, Compliance with the Fair Credit Reporting Act, at 46 (1977).

(n14)Footnote 14. Grimes, FTC Informal Staff Opinion Letter, Mar. 4, 1992.

(n15)Footnote 15. It is not clear whether the reference to eligibility modifies each of the permissible purposes or just credit and insurance purposes. *See* Buchman, FTC Informal Staff Opinion Letter, Mar. 2, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, App. D (Supp. 2000)].

(n16)Footnote 16. *15 U.S.C. § 1681a(d).*

(n17)Footnote 17. FCRA § 604(a)(3)(D), (E), and (F), and (4), *15 U.S.C. § 1681b(a)(3)(D)*, *(E)* and *(F)*, and *(4)*, *as amended by* Pub. L. No. 104-208, § 2403, *110 Stat. 3009* (Sept. 30, 1996). *15 U.S.C. § 1681b(a)(1)* and *(2)*, respectively, also list as permissible purposes the supplying of reports in response to a court order and in accordance with the written instructions of the consumer to whom it relates.

(n18)Footnote 18. *15 U.S.C. § 1681a(r)(5).*

(n19)Footnote 19. *15 U.S.C. § 1691a(d)*; *12 C.F.R. § 202.2(j).*

(n20)Footnote 20. *See* National Consumer Law Center, Credit Discrimination, § 2.2.2.1.1 and 2.2.6.4 (5th ed. 2009).

(n21)Footnote 21. *Estiverne v. Saks Fifth Ave. & JBS, 9 F.3d 1171 (5th Cir. 1993)* ; *Greenway v. Information Dynamics, Ltd., 524 F.2d 1145 (9th Cir. 1975)* , *cert. dismissed, 424 U.S. 936, 96 S. Ct. 1153, 47 L. Ed. 2d 344 (1976)* (checks are instruments of credit, and check cashing involves credit); FTC Official Staff Commentary § 603(d) item 6E; *see Taylor v. Checkrite, Ltd., 627 F. Supp. 415 (S.D. Ohio 1986)* (franchiser of a check collection company that issued

procedural guidelines for its franchisees was found responsible for its franchisee's potential violations of the Act); Brinckerhoff, FTC Informal Staff Opinion Letter, July 16, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM, and App. E (6th ed. 2006)].

(n22)Footnote 22. *See www.teletrack.com*.

(n23)Footnote 23. FCRA § 603(w), *15 U.S.C. § 1681a(w)*, *added by* Pub. L. No. 108-159 § 111 (2003).

(n24)Footnote 24. *See Scott v. Real Estate Fin. Group, 183 F.3d 97 (2d Cir. 1999)* .

(n25)Footnote 25. *Ali v. Vikar Mgmt. Ltd., 994 F. Supp. 492 (S.D.N.Y. 1998)* (while address information acquired by landlord on tenant did not constitute a credit report, credit information did); *Cotto v. Jenney, 721 F. Supp. 5 (D. Mass. 1989)* (potential risk of allowing the applicant to occupy the apartment relates to creditworthiness); *Ferguson v. Park City Mobile Homes, 1989 U.S. Dist. LEXIS 11010* (N.D. Ill. Sept. 15, 1989) (lease to be paid in installments is a credit transaction); Franco v. Kent Farm Village, Clearinghouse No. 44,149 (D.R.I. Sept. 16, 1988) ("whether the tenant is going to be able to pay rent"); *see also Harris v. Capital Growth Invs., 52 Cal. 3d 1142, 278 Cal. Rptr. 614, 805 P.2d 873 (1991)* ; Dea, FTC Informal Staff Opinion Letter, Mar. 31, 1975; Dea, FTC Informal Staff Opinion Letter, May 1, 1974.

(n26)Footnote 26. FTC Official Staff Commentary §§ 603(d) item 6F, 604(3)(E) item 3, 615 item 10; Grimes, FTC Informal Staff Opinion Letter, Oct. 8, 1986; Brinckerhoff, FTC Informal Staff Opinion Letter, Nov. 10, 1983. *See also* Mary A. Bernard, Note, *Fair Credit Reporting Act*, *71 Minn. L. Rev. 1319, 1365 (1987)*.

(n27)Footnote 27. FTC Official Staff Commentary § 603(d) item 4G. Additional detail on the credit reporting implications of tenant reports and check guarantee businesses is found at National Consumer Law Center, Fair Credit Reporting Act, § 2.6.2 (6th ed. 2006 and Supp.).

(n28)Footnote 28. FCRA § 603(w), *15 U.S.C. § 1681a(w)*, *added by* Pub. L. No. 108-159 § 111 (2003).

(n29)Footnote 29. *See* Grimes, FTC Informal Staff Opinion Letter, July 14, 1987. For a detailed discussion of business credit and commercial reports, see National Consumer Law Center, Fair Credit Reporting Act, § 2.3.6.2 (6th ed. 2006 and Supp.).

(n30)Footnote 30. *See also Heath v. Credit Bureau of Sheridan, Inc., 618 F.2d 693 (10th Cir. 1980)* ; *Russell v. Shelter Fin. Servs., 604 F. Supp. 201 (W.D. Mo. 1984)* ; *Boothe v. TRW Credit Data, 523 F. Supp. 631 (S.D.N.Y. 1981)* , *modified, 557 F. Supp. 66 (S.D.N.Y. 1982)* ; FTC Official Staff Commentary § 603(d) item 5C; Supplementary Information published with the Commentary, *55 Fed. Reg. 18,806* (May 4, 1990) . *But see D'Angelo v. Wilmington Med. Ctr., 515 F. Supp. 1250 (D. Del. 1981)* .

(n31)Footnote 30.1. *See Johnson v. Wells Fargo Home Mortg., Inc., 2007 U.S. Dist. LEXIS 79989* (D. Nev. Oct. 29, 2007) . *See also Johnson v. Wells Fargo Home Mortg., Inc., 558 F. Supp. 2d 1114 (D. Nev. 2008)* (subsequent decision in same case concluding that information was not a consumer report because damages were sought only in connection with subsequent business transactions).

(n32)Footnote 31. *15 U.S.C. § 1681a(d)(1)(A)*. [*15 U.S.C. § 1681a(d)(1)* was renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).]

(n33)Footnote 32. *See Cochran v. Metropolitan Life Ins. Co., 472 F. Supp. 827 (N.D. Ga. 1979)* ; *see also Hovater v. Equifax, Inc., 823 F.2d 413 (11th Cir. 1987)* , *cert. denied*, *484 U.S. 977, 108 S. Ct. 490, 98 L. Ed. 2d 488 (1987)* . *But cf. Yang v. Government Employees Ins. Co., 146 F.3d 1320 (11th Cir. 1998)* (limiting the effect of *Hovater v. Equifax*); *Hoke v. Retail Credit Corp., 521 F.2d 1079 (4th Cir. 1975)* , *cert. denied*, *423 U.S. 1087, 96 S. Ct. 878, 47 L. Ed. 2d 98 (1976)* ; *Fernandez v. Retail Credit Corp., 349 F. Supp. 652 (E.D. La. 1972)* .

(n34)Footnote 33. *Cochran v. Metropolitan Life Ins. Co., 472 F. Supp. 827 (N.D. Ga. 1979)* ; FTC Official Staff Commentary § 603(d) item 6B; Conway, FTC Staff Opinion Letter, Mar. 30, 1971; *cf. Ippolito v. WNS, Inc., 864 F.2d 440 (7th Cir. 1988) , cert. dismissed, 490 U.S. 1061, 109 S. Ct. 1975, 104 L. Ed. 2d 623 (1989) . See also Fernandez v. Retail Credit Corp., 349 F. Supp. 652 (E.D. La. 1972) . But see Houghton v. New Jersey Mfrs. Ins. Co., 795 F.2d 1144 (3d Cir. 1986) , rev'g 615 F. Supp. 299 (E.D. Pa. 1985)* ; *Beresh v. Retail Credit Co., 358 F. Supp. 260 (C.D. Calif. 1973) .*

(n35)Footnote 34. *Cochran v. Metropolitan Life Ins. Co., 472 F. Supp. 827 (N.D. Ga. 1979)* ; *Kiblen v. Pickle, 653 P.2d 1338 (Wash. Ct. App. 1982) .*

(n36)Footnote 35. Brinckerhoff, FTC Informal Staff Opinion Letter, July 29, 1985; Grimes, FTC Informal Staff Opinion Letter, Aug. 3, 1984; FTC, Compliance with the Fair Credit Reporting Act, at 46 (1977); *cf.* Feldman, FTC Informal Staff Opinion Letter, Apr. 15, 1971.

(n37)Footnote 36. *See* d'Entremont, FTC Informal Staff Opinion Letter, Jan. 25, 1996; Brinckerhoff, FTC Informal Staff Opinion Letter, Mar. 4, 1994; FTC Official Staff Commentary § 603(d) items 5C, 6C, § 603(f) item 5; *Yang v. Government Employees Ins. Co., 146 F.3d 1320 (11th Cir. 1998)* (limiting the effect of *Hovater v. Equifax, Inc., 823 F.2d 413 (11th Cir. 1987) .*

(n38)Footnote 37. Grimes, FTC Informal Staff Opinion Letter, Apr. 30, 1986. *See also* FTC Official Staff Commentary § 603(f) item 5.

(n39)Footnote 37.1. *See* Ellen Nakashima, *Prescription Data Used to Assess Consumers: Records Aid Insurers but Prompt Privacy Concerns*, Washington Post, at A1 (Aug. 4, 2008), *available at* http://www.washingtonpost.com/wp-dyn/content/article/2008/08/03/AR2008080302077.html.

(n40)Footnote 37.2. The FTC filed complaints and reached consent orders against two companies, Ingenix and Milliman, charging that their medical data aggregation products, MedPoint and Intelliscript, respectively, are consumer reports and that the companies must follow the FCRA. *See 72 Fed. Reg. 55211* (Sept. 28, 2008) ; *72 Fed. Reg. 55212* (Sept. 28, 2008) .

(n41)Footnote 38. *15 U.S.C. § 1681a(d)(1)(B).* [*15 U.S.C. § 1681a(d)(2)* was renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).] See also *15 U.S.C. § 1681a(d)(1)(c)*, incorporating § 1681b(a)(3)(B), which includes employment purposes among the list of permissible purposes. [*15 U.S.C. §§ 1681a(d)(3)*, *1681b(3)(B)* were renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).]

(n42)Footnote 39. *15 U.S.C. § 1681a(h). See also* Grimes, FTC Informal Staff Opinion Letter, Oct. 23, 1985; Official Staff Commentary § 604(3)(B) item 1; FTC Official Staff Commentary § 603(h) item 2. *See also* Brinckerhoff, FTC Informal Staff Opinion Letter, July 24, 1986.

(n43)Footnote 40. *Dalton v. Capital Associated Indus., Inc. 257 F.3d 409 (4th Cir. 2001) .*

(n44)Footnote 41. *15 U.S.C. § 1681b(a)(3)(D).* [*15 U.S.C. § 1681b(3)(D)* was renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).]

(n45)Footnote 42. *Hoke v. Retail Credit Corp., 521 F.2d 1079 (4th Cir. 1975) , cert. denied, 423 U.S. 1087, 96 S. Ct. 878, 47 L. Ed. 2d 98 (1976) . See also* Grimes, FTC Informal Staff Opinion Letter, Mar. 7, 1986.

(n46)Footnote 43. *15 U.S.C. § 1681a(d)(1)(C).* The only officials who may be furnished reports for these child support purposes are designees of state or local child support enforcement agencies, with proper certification, or an agency administering a state plan for child and spousal support as part of federally funded public benefit programs.

(n47)Footnote 44. Pub. L. No. 108-159 § 611(b) (2003), *amending* FCRA § 603(d)(2)(D), *15 U.S.C. § 1681a(d)(2)(D)*.

(n48)Footnote 45. FCRA § 603(x), *15 U.S.C. § 1681a(x)*, *added by* Pub. L. No. 108-159 § 611 (2003). Eligible self-regulatory organizations are those within the definition of § 3(a)(26) of the Securities Exchange Act of 1934, *15 U.S.C. § 78a(26)*, any entity established under title I of the Sarbanes-Oxley Act of 2002, *15 U.S.C. §§ 7211-7218*, any board of trade designated by the Commodity Futures Trading Commission, and any futures association registered with such Commission. FCRA § 603(x)(3), *15 U.S.C. § 1681a(x)(3)*.

(n49)Footnote 46. FCRA §§ 603(x)(D)(i)-(iii), *15 U.S.C. §§ 1681a(x)(D)(i)-(iii)* The provision further allows for those disclosures required by law and those disclosures to governmental agencies permitted by section 608 (*15 U.S.C. § 1681f*). *Id*. at §§ 603(x)(iv), (v), *15 U.S.C. §§ 1681a(x)(iv), (v)*.

(n50)Footnote 47. FCRA § 603(x)(2), *15 U.S.C. § 1681a(x)(2)*.

(n51)Footnote 48. *15 U.S.C. § 1681b(a)(3)(F)*, incorporated by § 1681a(d). [*15 U.S.C. § 1681b(3)(E)* was renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).]

(n52)Footnote 49. *See Bakker v. McKinnon, 152 F.3d 1007 (8th Cir. 1998)* ; *Zeller v. Samia, 758 F. Supp. 775 (D. Mass. 1991)* ; *Russell v. Shelter Fin. Servs., 604 F. Supp. 201 (W.D. Mo. 1984)* ; *Henry v. Forbes, 433 F. Supp. 5 (D. Minn. 1976)* ; *Ley v. Boron Oil Co., 419 F. Supp. 1240 (W.D. Pa. 1976) . Cf. Mone v. Dranow, 945 F.2d 306 (9th Cir. 1991) .*

(n53)Footnote 50. *See* Coffey, FTC Informal Staff Opinion Letter, Feb. 11, 1998.

(n54)Footnote 51. FTC Official Staff Commentary § 604(3)(E) item 2. *See also Estiverne v. Sak's Fifth Ave., 1992 U.S. Dist. LEXIS 18089* (E.D. La. Nov. 18, 1992) (whether to accept a consumer's check); Brinckerhoff, FTC Informal Staff Opinion Letter, Feb. 5, 1985 (provisional checking accounts and similar financial services); Goldfarb, FTC Informal Staff Opinion Letter, July 9, 1980 (government agency has a permissible purpose when seeking to collect overpayments of government benefits, where the consumer has resisted initial voluntary repayment; if the consumer has made a voluntary repayment, then there is no legitimate business need, and no permissible purpose, to obtain the report). *See also Williams v. AT&T Wireless Servs., Inc., 5 F. Supp. 2d 1142 (W.D. Wash. 1998)* (whether the consumer could pay for cellular phone is similar to other permissible purposes even though no credit involved).

(n55)Footnote 52. Grimes, FTC Informal Staff Opinion Letter, Feb. 10, 1990 (purchase of VA insured property); Petruccelli, FTC Informal Staff Opinion Letter, Apr. 9, 1984.

(n56)Footnote 53. *See Ippolito v. WNS, Inc. 864 F.2d 440 (7th Cir. 1988) , cert. dismissed, 490 U.S. 1061, 109 S. Ct. 1975, 104 L. Ed. 2d 623 (1989) . See also Mone v. Dranow, 945 F.2d 306 (9th Cir. 1991)* ; *Houghton v. New Jersey Mfrs. Ins. Co., 795 F.2d 1144 (3d Cir. 1986)* ; *Arcidiacono v. American Express Co., 1993 U.S. Dist. LEXIS 4042* (D.N.J. Mar. 29, 1993) ; *Zeller v. Samia, 758 F. Supp. 775 (D. Mass. 1991) .*; *Ley v. Boron Oil Co., 419 F. Supp. 1240 (W.D. Pa. 1976)* ; G. Allan Van Fleet, Note, *Judicial Construction of the Fair Credit Reporting Act: Scope of Civil Liability, 76 Colum. L. Rev. 458 (1976). Cf. Greenway v. Information Dynamics, Ltd., 524 F.2d 1145 (9th Cir. 1975)* (dissent, Wright J.).

(n57)Footnote 54. FTC Official Staff Commentary § 603(d) items 6D, 6E.

(n58)Footnote 55. *Houghton v. New Jersey Mfrs. Ins. Co., 795 F.2d 1144, 1150 (3d Cir. 1986)* (Sloviter, J., dissenting).

(n59)Footnote 56. Courts that decline to give import to the incorporation of the business transactions language, nevertheless often, without explanation, interpret the incorporating language of the definition to include the related

license and governmental benefits provisions. *See Ippolito v. WNS, Inc., 864 F.2d 440, 451 (7th Cir. 1988)* , *cert dismissed*, *490 U.S. 1061, 109 S. Ct. 1975, 104 L. Ed. 2d 623 (1989)* .

(n60)Footnote 57. FTC Official Staff Commentary § 603(d) item 5A; Statement of General [FTC] Policy or Interpretation, *16 C.F.R. § 600.2*. *See also* Supplementary Information published with the Commentary, *55 Fed. Reg. 18,804-05* (May 4, 1990) .

(n61)Footnote 58. *15 U.S.C. § 1681b(a)(3)(A)*. [*15 U.S.C. § 1681b(3)(A)* was renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).]

(n62)Footnote 59. FCRA § 604(a)(3)(F)(ii), *15 U.S.C. § 1681b(a)(3)(F)(ii)*, *as amended by* Pub. L. No. 104-208, § 2403, *110 Stat. 3009* (Sept. 30, 1996).

(n63)Footnote 60. FCRA § 604(a)(3)(E), *15 U.S.C. § 1681b(a)(3)(E)*, *as amended by* Pub. L. No. 104-208, § 2403, *110 Stat. 3009* (Sept. 30, 1996).

(n64)Footnote 61. *Yang v. Government Employees Ins. Co., 146 F.3d 1320, 1324 (11th Cir. 1998)* ; *see also Trans Union Corp. v. Fed. Trade Comm'n, 245 F.3d 809 (D.C. Cir. 2001)* (if information is used or expected to be used for one of the enumerated purposes, it is a consumer report).

(n65)Footnote 62. *15 U.S.C. § 1681a(d)(2)(A)(i)*; *DiGianni v. Stern's, 26 F.3d 346 (2d Cir. 1994)* ; *Hodge v. Texaco, Inc., 975 F.2d 1093 (5th Cir. 1992)* (lab reports based on first-hand test not within FCRA); *Lema v. Citibank (South Dakota), N.A., 935 F. Supp. 695 (D. Md. 1996)* ; *Podell v. Citicorp Diners Club, Inc., 859 F. Supp. 701 (S.D.N.Y. 1994)* ; *Oldroyd v. Associates Consumer Disc. Co., 863 F. Supp. 237 (E.D. Pa. 1994)* ; *Chube v. Exxon Chem. Am., 760 F. Supp. 557 (M.D. La. 1991)* (lab reports based on first-hand text not within FCRA); *Nisenfeld v. American Express Co., 1989 U.S. Dist. LEXIS 8891* (D. Md. July 28, 1989) ; *Nuttleman v. Vossberg, 585 F. Supp. 133 (D. Neb. 1984)* ; *Rush v. Macy's N.Y., Inc., 596 F. Supp. 1540 (S.D. Fla. 1984)* , *aff'd*, *775 F.2d 1554 (11th Cir. 1985)* ; *Miranda Rivera v. Bank One, 145 F.R.D. 614 (D.P.R. 1993)* ; *Nikou v. INB Nat'l Bank, 638 N.E.2d 448 (Ind. Ct. App. 1994)* ; *Laracuente v. Laracuente, 252 N.J. Super. 384, 599 A.2d 968 (1991)* . *Cf. Landrum v. Board of Comm'rs, 758 F. Supp. 387 (E.D. La. 1991)* (denying lab's action to dismiss FCRA claim).

(n66)Footnote 63. *See* FTC, Compliance with the Fair Credit Reporting Act, at 42 (1977).

(n67)Footnote 64. *15 U.S.C. § 1681a(d)(2)(B)*. [*15 U.S.C. § 1681a(d)(B)* was renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).]

(n68)Footnote 65. *15 U.S.C. § 1681a(d)(2)(C)*. [*15 U.S.C. § 1681a(d)(C)* was renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).]

(n69)Footnote 66. FCRA § 603(d)(2)(D) and (*o*), *15 U.S.C. § 1681a(d)(2)(D)* and (*o*), *as amended by* Pub. L. No. 104-208, § 2402, *110 Stat. 3009* (Sept. 30, 1996).

(n70)Footnote 67. *15 U.S.C. § 1681a*(*o*).

(n71)Footnote 68. FCRA § 603(d)(2)(A)(ii) and (iii), *15 U.S.C. § 1681a(d)(2)(A)(ii)* and *(iii)*, *as amended by* Pub. L. No. 104-208, § 2402, *110 Stat. 3009* (Sept. 30, 1990).

(n72)Footnote 69. A common example of affiliate sharing occurs when a bank shares information about account holders and other customers with insurance or investment brokers and sellers affiliated with the bank. The bank may freely share customer lists and information relating to a customer's account. As first hand information, no disclosure to the consumer is required. The bank can also share information about a consumer's personal finances and transactions with other creditors which is gleaned from the consumer's application for credit submitted to the bank. Because this

information is not first hand experience of the bank, the bank must give the consumer prior notice that this kind of information may be shared with an affiliate. *See* Novak, FTC Informal Staff Opinion Letter, Sept. 9, 1998.

(n73)Footnote 70. Pub. L. No. 108-159 § 214(a)(2) (2003), adding § 624. The person must clearly and conspicuously disclose to the consumer that the information may be used for making solicitations and must provide the consumer with an opportunity to opt out and a simple method for doing so. § 624(a)(1).

(n74)Footnote 71. FCRA § 624(a)(3).

(n75)Footnote 72. § 624(a)(4). However, if using information on behalf of an affiliate, the person may not send solicitations on such affiliate's behalf if the consumer has opted out of marketing solicitations by that affiliate. § 624(a)(4)(C).

(n76)Footnote 73. *See 69 Fed. Reg. 33324-33341* (June 15, 2004) .

(n77)Footnote 74. *Id.*

(n78)Footnote 75. *15 U.S.C. § 1681a(d)(2)(D).*

(n79)Footnote 76. *15 U.S.C. § 1681a(x).*

(n80)Footnote 77. *Millard v. Miller, 2005 U.S. Dist. LEXIS 16809* (W.D. Wis. Aug. 9, 2005) (workers compensation investigation).

(n81)Footnote 78. *15 U.S.C. § 1681a(x)(1)(C).* One court has held that an employer did not lose the protection of this provision by providing the report to the employer's worker's compensation carrier, reasoning that the carrier was an agent of the employer. *Millard v. Miller, 2005 U.S. Dist. LEXIS 16809* (W.D. Wis. Aug. 9, 2005) .

(n82)Footnote 79. *15 U.S.C. § 1681a(b).*

(n83)Footnote 80. *15 U.S.C. § 1681a(f).*

(n84)Footnote 81. *See* Lee, FTC Informal Staff Opinion Letter, June 26, 1998; Islinger, FTC Informal Staff Opinion Letter, June 9, 1998; LeBlanc, FTC Informal Staff Opinion Letter, June 9, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006 and Supp.)]; *see generally* National Consumer Law Center, Fair Credit Reporting Act, § 2.5.3 (6th ed. 2006 and Supp.).

(n85)Footnote 82. *15 U.S.C. § 1602(f).*

(n86)Footnote 83. *12 C.F.R. 226.2(a)(17)* at n.3.

(n87)Footnote 84. *See Gerasta v. Hibernia Nat'l Bank, 411 F. Supp. 176, 185 (E.D. La. 1976)* , *rev'd on other grounds*, *575 F.2d 580 (5th Cir. 1978)* ; *see generally* National Consumer Law Center, Truth in Lending, § 2.3.3 (5th ed. and Supp.).

(n88)Footnote 85. FTC Official Staff Commentary § 603(f) item 8.

(n89)Footnote 86. FTC Official Staff Commentary § 603(f) item 9; *see also* 16 C.F.R. § 600.3; FTC, Compliance with the Fair Credit Reporting Act, at 24 (1977) *Cf.* Grimes, FTC Informal Staff Opinion Letter, April 30, 1986 (insurance claims exchange is a consumer reporting agency).

(n90)Footnote 87. FTC Official Staff Commentary § 603(f) item 8.

(n91)Footnote 88. FTC Official Staff Commentary § 603(f) item 8; Isaac, FTC Informal Staff Opinion Letter, June

11, 1996. It does not apply to middlemen who use credit reports to match a creditor's need to find a lender willing to make a loan to its customers. Grimes, FTC Informal Staff Opinion Letter, June 9, 1993.

(n92)Footnote 89. FTC Official Staff Commentary § 603(f) item 8. *See also* Brinckerhoff, FTC Informal Staff Opinion Letter, May 1, 1987; Throne, FTC Informal Staff Opinion Letter, Nov. 20, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006 and Supp.)].

(n93)Footnote 90. *See* Russell, FTC Informal Staff Opinion Letter, Sept. 27, 1973.

(n94)Footnote 91. FTC Official Staff Commentary § 603(f) item 11.

(n95)Footnote 92. *Ollestad v. Kelley, 573 F.2d 1109 (9th Cir. 1978)* .

(n96)Footnote 93. *15 U.S.C. § 1681a(f).*

(n97)Footnote 94. *15 U.S.C. § 1681a(b).*

(n98)Footnote 95. FTC Official Staff Commentary § 603(d) item 4C.

(n99)Footnote 96. *See* 1996 Dept. of Labor, Office of Inspector General's Report. California recently announced that its Employment Development Department will begin selling confidential wage data collected on 14 million people statewide to private information companies, car dealers, and creditors wanting to check a consumer's income with the consumer's consent. *California Plans to Sell Confidential Wage Data*, Wash. Post, June 4, 1999 at E02.

(n100)Footnote 97. Pickett, FTC Informal Staff Opinion Letter, July 10, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, App. D (Supp. 1999)].

(n101)Footnote 98. *See Kimel v. Florida Bd. of Regents, 528 U.S. 62, 120 S. Ct. 631, 145 L. Ed. 2d 522 (2000)* ; *O'Diah v. New York City, 2002 U.S. Dist. LEXIS 15507* (S.D.N.Y. Aug. 21, 2002) . One court, however, has held that such immunity is waived through the Act's definition of "person," which includes "government or governmental subdivision or agency." *See 15 U.S.C. § 1681a(b)*; *Talley v. USDA, 2007 U.S. Dist. LEXIS 50388* (N.D. Ill. July 12, 2007) . *See also Moore v. U.S. Dep't of Agric., 55 F.3d 991 (5th Cir. 1995)* (finding that an identical definition of "person" in ECOA is a wavier of sovereign immunity because the ECOA, unlike TILA (which also uses the same definition), the ECOA does not have another provision expressly preserving sovereign immunity).

(n102)Footnote 99. *Puerto Rico Aqueduct & Sewer Auth. v. Metcalf & Eddy, Inc., 506 U.S. 139, 113 S. Ct. 684, 121 L. Ed. 2d 605 (1993)* .

(n103)Footnote 100. *See Seminole Tribe of Fla. v. Florida, 517 U.S. 44, 116 S. Ct. 1114, 134 L. Ed. 2d 252 (1996)* ; *O'Diah v. New York City, 2002 U.S. Dist. LEXIS 15507* (S.D.N.Y. Aug. 21, 2002)

(n104)Footnote 101. *Ex Parte Young, 209 U.S. 123, 159-60, 28 S. Ct. 441, 52 L. Ed. 714 (1908)* .

(n105)Footnote 102. *15 U.S.C. § 1681a(p).* The phrase used throughout the Act is actually a "consumer reporting agency that compiles and maintains files on consumers on a nationwide basis."

(n106)Footnote 103. *15 U.S.C. § 1681g(c).*

(n107)Footnote 104. *15 U.S.C. § 1681m(a)(2)(A).*

(n108)Footnote 105. *15 U.S.C. § 1681b(e)(6).*

(n109)Footnote 106. *15 U.S.C. § 1681i(a)(5)(D).*

(n110)Footnote 107. FCRA §§ 605A(a)-(c), *added by* Pub. L. No. 108-159 § 112 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(i)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n111)Footnote 108. FCRA § 605A(e).

(n112)Footnote 109. FCRA § 609(e)(3), *15 U.S.C. § 1681g(e)(3)*, *added by* Pub. L. No. 108-159 § 313(a) (2003). This provision became effective on March 31, 2004. *16 C.F.R. § 602.1(c)(2)(iv)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) . Nationwide specialty consumer reporting agencies must also provide free annual reports. *Id.*

(n113)Footnote 110. FCRA § 611(a), *15 U.S.C. § 1681j(a)*, *as amended by* Pub. L. No. 108-159 § 211(a)(2) (2003).

(n114)Footnote 111. FCRA § 621(f)(1), *15 U.S.C. § 1681s(f)(1)*, *added by* Pub. L. No. 108-159 § 153 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(v)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n115)Footnote 112. *Id.*

(n116)Footnote 113. FCRA § 629, *added by* Pub. L. No. 108-159 § 211(b) (2003).

(n117)Footnote 114. Pub. L. No. 108-159 § 111 (2003), adding FCRA § 603(w), *15 U.S.C. § 1681a(w)*.

(n118)Footnote 115. FCRA § 603(p), *15 U.S.C. § 1681a(p)*.

(n119)Footnote 116. *15 U.S.C. § 1681j(a)(1)(C)*, *added by* Pub. L. No. 108-159 § 211(a)(2) (2003). The FTC is to issue regulations to establish a mechanism through which consumers can obtain reports from nationwide specialty consumer reporting agencies. *Id.*

(n120)Footnote 117. *69 Fed. Reg. 29061* (May 20, 2004) , *codified at* 16 C.F.R. pt. 611. The rules became effective June 21, 2004. *Id.*

(n121)Footnote 118. *15 U.S.C. § 1681b(e)(6)*.

(n122)Footnote 119. *15 U.S.C. § 1681g(c)(1)(B)*.

(n123)Footnote 120. *15 U.S.C. § 1681i(a)(5)(D)*.

(n124)Footnote 121. *69 Fed. Reg. 29061, 29063* /-/64 (May 20, 2004), *codified at 16 C.F.R. § 611.2(a)*.

(n125)Footnote 122. *69 Fed. Reg. 29061, 29064* (May 20, 2004) , *codified at 16 C.F.R. § 611.2(b)(1)*.

(n126)Footnote 123. *69 Fed. Reg. 29061, 29064* (May, 2004) , *codified at 16 C.F.R. § 611.2(b)(2)*.

(n127)Footnote 124. *69 Fed. Reg. 29061, 29064* (May, 2004) , *codified at 16 C.F.R. § 611.2(b)(3)*.

(n128)Footnote 125. *69 Fed. Reg. 29061, 29064* (May, 2004) , *codified at 16 C.F.R. § 611.2(b)(4)*.

(n129)Footnote 126. *15 U.S.C. § 1681a(w)*.

(n130)Footnote 127. *E.g.*, Medical Information Bureau [hereinafter MIB], 160 University Ave., Westwood MA 02090. To begin the process of obtaining a consumer's file from MIB, one must call (617) 426-3660 and leave a message or write to the above address.

(n131)Footnote 128. W.D.I.A. Corp (FTC Dkt 9258 Mar. 3, 1994) (consent order); Inter-Fact, Inc. (FTC Dkt

C-3424 1993) (consent order); I.R.S.C., Inc. (FTC Dkt C-3422 1993) (consent order); First Am. Real Estate Solutions, LLC, Case No. 952-3267 (FTC 1998) (consent agreement); Cohan, FTC Informal Staff Opinion Letter, Aug. 1, 2000. *See also Lewis v. Ohio Prof'l Elec. Network LLC, 190 F. Supp. 2d 1049 (2002)* (resellers of consumer information are subject to the FCRA even if they are not consumer reporting agencies), *summ. judgment granted, in part, summ. judgment denied, in part, 2003 U.S. Dist. LEXIS 3368* (S.D. Ohio Mar. 7, 2003) .

(n132)Footnote 129. *See* Bicknell, *Anti-Fraud That's Anti-Consumer*, Wired News, July 24, 2000.

(n133)Footnote 130. *See* National Consumer Law Center, Fair Credit Reporting Act, § 2.5 (6th ed. 2006 and Supp.).

(n134)Footnote 131. *15 U.S.C. § 1681a(d)(2)(A)(i).* [*15 U.S.C. § 1681a(d)(3)(A)* was renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).] *See Daniels v. Charter One Bank, 39 Fed. Appx. 223* (6th Cir. June 21, 2002) .

(n135)Footnote 132. *15 U.S.C. § 1681e(c).*

(n136)Footnote 133. Grimes, FTC Informal Staff Opinion Letter, Aug. 6, 1986.

(n137)Footnote 134. *See* National Consumer Law Center, Fair Credit Reporting Act, § 2.7.3 (6th ed. 2006 and Supp.) *But see Mitchell v. Surety Acceptance Corp., 838 F. Supp. 497 (D. Colo.1993)* ; *D'Angelo v. Wilmington Med. Ctr., 515 F. Supp. 1250 (D. Del. 1981)* .

(n138)Footnote 135. FTC Official Staff Commentary § 603(f) item 7. *See also* Grimes, FTC Informal Staff Opinion Letter, July 7, 1992 (not reporting agency when solely furnish information about own experience with consumer).

(n139)Footnote 136. Grimes, FTC Informal Staff Opinion Letter, Dec. 9, 1983.

(n140)Footnote 137. FTC Official Staff Commentary § 603(f) item 6. The California FCRA statute may exempt detective agencies. *Cal. Civ. Code § 1785.4* (NB: This section refers to a part of the Business and Professional Code which has since been renumbered several times, to unknown effect.); LeBlanc, FTC Informal Staff Opinion Letter, June 9, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, App. D (Supp. 1999)].

(n141)Footnote 138. *See* Vail, FTC Informal Staff Opinion Letter, Apr. 5, 1999 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)]. *But see Johnson v. Federal Express Corp., 147 F. Supp. 2d 1268 (M.D. Ala. 2001)* (handwriting analysis as part of investigation of workplace violence is not a consumer report; use of outside agency is within the exclusion for first-hand experience; declines to give deference to 1999 staff letters to Vail, Meisinger); *Hartman v. Lisle Park Dist., 158 F. Supp. 2d 869 (N.D. Ill. 2001)* (report issued to governing board by attorney it hired to investigate whistleblower and her allegations was not a consumer report because it did not bear on creditworthiness, etc., and it related solely to her dealings with the board for which attorney was acting as agent).

(n142)Footnote 139. Kahn, FTC Informal Staff Opinion Letter [1969-1973 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 99,447 (May 21, 1971); Pickett, FTC Informal Staff Opinion Letter, July 10, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006), and accompanying CD-ROM].

(n143)Footnote 140. FTC Informal Staff Opinion Letter [1969-1973 Decisions Transfer Binder], Consumer Cred. Guide (CCH) P 99,445 (May 27, 1971).

(n144)Footnote 141. *See* Peeler, FTC Informal Staff Opinion Letter, July 24, 1978; *cf.* Peeler, FTC Informal Staff

Opinion Letter, Feb. 8, 1978.

(n145)Footnote 142. Sum, FTC Informal Staff Opinion Letter, Sept. 15, 1999.

(n146)Footnote 143. *Ditty v. Checkrite, Ltd., 973 F. Supp. 1320 (D. Utah 1997)* .

(n147)Footnote 144. Russell, FTC Informal Staff Opinion Letter, May 15, 1974 (files containing recommendations from former employers of student not within "transaction or experience" exception).

(n148)Footnote 145. Brinckerhoff, FTC Informal Staff Opinion Letter, Nov. 23, 1983.

(n149)Footnote 146. Opinion of Attorney General of Pennsylvania, [1974-1980 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 98,549 (Aug. 7, 1975).

(n150)Footnote 147. Opinion of Attorney General of Wisconsin, No. 98-74, [1974-1980 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 98,736 (Sept. 17, 1974); Opinion of Attorney General of Arkansas, [1974-1980 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 98,818 (Apr. 24, 1974).

(n151)Footnote 148. FTC Official Staff Commentary § 603(d) item 4C; *see also* Opinion of Attorney General of New York, [1974-1980 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 98,781 (July 17, 1974); Opinion of Attorney General of Texas, No. H-263, [1974-1980 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 98,854 (Mar. 9, 1974).

(n152)Footnote 149. However, if a user should later use the report for other purposes, it may then subject the reporting agency to the Act's provisions. *Cf.* FTC Official Staff Commentary § 603(d) item 5D.

(n153)Footnote 150. FTC Official Staff Commentary § 603(f) item 5.

(n154)Footnote 151. *See 15 U.S.C. § 1681(d).*

(n155)Footnote 152. The application of the Act to telephone companies is discussed in detail in *When the Phone Company is Not the Phone Company: Credit Reporting in the Postdivestiture Era, 24 Clearinghouse Rev. 98 (1990).*

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1-16 Consumer Credit Law Manual § 16.03

§ 16.03 Disclosure of Consumer Reports to Consumers

[1] Information Is Reported on Virtually Every American

Virtually all Americans have files with reporting agencies. For millions of Americans, some information on file will be negative. It is also probable that some negative information will be inaccurate. While errors can often be corrected, only a small percentage of consumers ever examine the contents of their files.

The solution is simple. Consumers have a right to be informed of the contents, sources and users of their files. The consumer need not wait to be told of the adverse use of the file or that a creditor has requested information on the consumer. In many cases consumers may obtain their files by calling an 800-number or writing a single letter.

There is one important reason to consider not requesting disclosure of a consumer's file. The FCRA prevents a consumer from bringing most tort actions in the nature of defamation, invasion of privacy, or negligence with respect to the reporting of information based on information disclosed pursuant to the consumer's request from the agency for the contents of his or her file. n1 In other words, a consumer cannot bring most tort claims concerning information in a file after the consumer has exercised the FCRA right to request the contents of that file. The consumer cannot avoid this result by requesting that the file be disclosed to the consumer's attorney or other representative. n2 The FCRA has always provided consumers with the right to learn what is in their consumer files. This right was enhanced in 2003 when FACTA required the FTC to adopt regulations that establish a centralized source from which consumers may request a free annual file disclosure from each nationwide consumer reporting agency. This right is in addition to other rights to free reports provided by the FCRA before it was amended by FACTA and rights provided by certain state laws.

The FTC rules required nationwide consumer reporting agencies to establish a centralized source to enable consumers, with a single request, to obtain all annual file disclosures from all nationwide consumer reporting agencies. Under the rule, consumers may request their free annual file disclosure from each of the nationwide consumer reporting agencies through a centralized Internet website, toll-free telephone number, and postal address. n3 The rule also requires a standardized form for making requests and requires a streamlined process for consumer requests. n4 The obligations of the nationwide consumer reporting agencies are limited when the volume for disclosures is excessive. The rule permits the agencies to queue requests for disclosures during times of high volume, i.e., volume that exceeds 125% of the

rolling daily average volume. It also allows the agencies to decline to accept request during times of extraordinary volume, i.e., volume that exceeds 175% of the rolling daily average volume. n5

The FTC also allowed the consumer reporting agencies to have a gradual roll out of the centralized source. Concerned about the volume of requests, the centralized source is available to consumers in four cumulative stages that roll out from west to east. The rule provided for a transition of nine months, beginning on December 1, 2004 and ending on September 1, 2005. n6

[2] Notices Concerning Information Used or Obtained Relating to Consumer

[a] Types of Notices

Under the FCRA, a consumer may receive several different types of notices regarding the use of personal information by others. The most common is notice that adverse action has occurred based on a consumer report. A different notice may be required when adverse action is based on third party information other than a consumer report. Also, the consumer must be notified when information which has been previously deleted from a consumer's file as a result of a reinvestigation is nevertheless later re-inserted into the file. The FCRA was amended in 2003 by the Fair and Accurate Credit Transactions Act, n7 which contains additional notice requirements on a variety of subjects, including identity theft, risk-based pricing, negative information furnished by financial institutions to credit reporting agencies, key factors in credit scores, fraud alerts, blocks for identity theft information, and credit scores.

Consumers need not receive any of the notices in order to obtain disclosure of the contents of their file.

[b] When Notice of Adverse Use of Consumer Report Is Required

[i] Overview

The user n8 of a consumer report is required to notify a consumer whenever adverse action is based in whole or in part on any information contained in a consumer report. n9 The FCRA also does not state how quickly the user must provide the notice of adverse action. n10 Presumably, the notice should be simultaneous with notice of the denial or increased charge. n11

As long as the report led to the adverse action, the user must notify the consumer that the report was one of the grounds for the adverse action. It is irrelevant that the report itself is not seriously adverse to the consumer. n12 Indeed, the consumer report need not be the single or primary reason for an adverse action; the user must provide notice if the consumer report provided any grounds for the adverse action. n13

Notice is not required, however, if a user took an adverse action based on information obtained from a source other than a consumer report, even if the user received a consumer report that contained some of that information. n14

[ii] Where Adverse Use Relates to Credit Purposes

The FCRA includes in its definition of "adverse action" the definition set forth in the Equal Credit Opportunity Act ("ECOA"). Interpretations of the ECOA on what constitutes adverse action directly apply. n15

"Credit" is not defined in the FCRA. The ECOA defines the term broadly to mean the right to defer payment of debt or to incur debts and defer payment. n16

Notice should be provided even if credit is denied not for any specific reason, but because the consumer's score was below the creditor's minimum standards, as long as a credit report had some relevance to the establishment of the consumer's score. n17

Because of the number of terms involved in a credit transaction, questions arise as to when credit as requested has been denied. Clearly, notice is required where credit is denied outright, where less credit is provided than requested, where an increase in the amount of credit is denied, or where the charge for the credit is increased. n18

A larger down payment could result in a *lower* charge for the credit, but notice is still required. Similarly, a notice will be required where a bank, based on a consumer report, requires the consumer to obtain a cosigner or put up collateral, even if the bank then lowers the interest rate because of the lower risk of the loan as restructured. Any refusal to grant credit on the terms originally requested by the consumer should be a denial of credit which requires notice of adverse action.

Some courts have ruled that there is no denial if the consumer accepts a counteroffer made by the creditor, n19 but such a conclusion is not necessarily controlling and arguments can be made that acceptance of counteroffer terms adverse to the consumer still violate the FCRA. There is also no adverse action if credit is denied because the creditor does not provide the kind of credit plan requested by the consumer.

[iii] Check Cashing Reports

A merchant's denial of check writing privileges based on a check cashing report is an adverse action requiring notice to the consumer. n20 This is because the consumer's proffer of a personal check can be considered either an application to make payment by check or an essential element of a purchase transaction initiated by the consumer. Either way, the merchant, as user of a check cashing report, would have to notify the consumer of the adverse action based on a consumer report.

[iv] Cosigners

Often in consumer credit transactions, more than one party signs a credit application--as a co-maker, guarantor or surety. The disclosures which must be made to the primary applicant for credit must also be made to any co-maker, guarantor, or surety to whom the information relates. n21

[v] Prescreening

Prescreening is the process whereby consumer reporting agencies compile or edit lists of consumers who meet specific criteria, often specified by the user, and then provide the lists to users who solicit consumers with firm offers for credit and insurance purposes.

Creditors often offer credit to those on a mailing list that has been prescreened by a reporting agency. The FTC has indicated that users of prescreening lists need not notify those deleted from the list that a consumer report has led to denial of credit because such people did not request, and, therefore, were not denied credit. n22

[vi] When Adverse Use Relates to Employment Purposes

Prior to the FACTA, n23 notice of adverse action was required whenever adverse employment decisions were based, at least in part, on consumer reports. Additional disclosures prior to the adverse action were required as well. However, the FACTA significantly reduced the circumstances in which adverse action notices will be given to employees.

Before the FACTA, employers were required to give notice of adverse action whenever they made any employment decision that was adverse to the interests of the consumer and which either 1) used the consumer's credit information, or 2) was based on the use of an investigative report to make the decision. n24

The FACTA does not change the requirement that employers provide adverse action notices (or other notices required

by the FCRA) to 1) consumers who are being investigated for a new position or a new job by a third party hired by the employer for that purpose, or 2) any consumers, whether they are existing employees or not, whom the employer decides to evaluate via a consumer credit report in the employment context. As before, employers are required to disclose their reliance on a consumer report--or a third-party investigative report--any time they deny initial employment, promotion, or job transfer to an employee. n25

However, there are new requirements of the FACTA of 2003 for all adverse actions which are applicable to employers' investigations of existing employees. In response to employers' complaints that the FCRA's disclosure provisions hindered investigations of workplace misconduct, the FACTA provides that certain communications made to an employer will no longer be "consumer reports." n26 Because of this new exemption, even if a particular investigation would otherwise be an investigative consumer report, it will fall outside of the definition by virtue of being specifically exempted from the definition of "consumer report." n27 To fall within the exclusion the communication must be made to an employer and must be in connection with an investigation of one of the following:

- suspected misconduct relating to employment;
- compliance with federal, state, or local laws;
- compliance with the rules of a self-regulatory organization; or
- compliance with the preexisting written policies of the employer. n28

Accordingly, for investigations that meet the exemption, upon adverse action the employee will not be entitled to the standard adverse action notice of § 1681m. Instead, these employees will have the right to a summary of the report and not to a Summary of Rights. n29 In contrast to other employment-related investigations, the employer need not provide any notice beforehand. n30

In addition to the notice of adverse action which is required when an adverse action is taken, an employer intending to take adverse action based at least in part on a consumer report must provide to the consumer beforehand a copy of the consumer report itself and a FTC Summary of Consumer Rights. n31 This prior disclosure is unique to employment decisions.

The FCRA generally excludes from the definition of consumer report information communicated by an employment agency to a prospective employer. Thus, the employer who declines to hire a consumer recommended by an employment agency, even if the decision is based on information gleaned by the agency from a consumer report, is normally not required to make any disclosure of adverse action.

Even if an employer or employment agency has no duty in certain situations to disclose use of a consumer report to the consumer, the FCRA requires a *consumer reporting agency* to notify the consumer whenever the agency provides a consumer report to a user with an employment purpose and the report contains public record information that is likely to have an adverse effect on the consumer's ability to obtain employment. n32 The notice also contains the name and address of the report user. The reporting agency can avoid this disclosure requirement by maintaining strict procedures to insure that the public record information is complete and up to date.

[vii] When Adverse Action Relates to Insurance Purposes

Whenever insurance is denied or the charge for the insurance is increased either wholly or partly because of information contained in a consumer report, the insurer must notify the consumer. Notification is also required for any other adverse or unfavorable change in the terms or amount of insurance. n33 An Alabama district court certified a class action against an insurer who allegedly raised premiums by fifty percent or more in reliance on information contained in

consumer reports and allegedly failed to send adverse action notice pursuant to section 1681m. n34 The insurer used Insurance Bureau Codes ("ICBs") as one factor in setting the amounts of homeowners' renewal premiums. ICBs are generated by Fair Issac, Inc. based on information contained in credit reports. n35

Insurers sometimes use CRAs specializing in medical information, such as Medical Information Bureau (MIB), in making their underwriting and ratesetting decisions. For years, MIB argued that insurers that receive MIB information did not have to provide the consumers with an adverse action notice when insurance was denied, or made more expensive, based wholly or in part on an MIB report. However, in 1995, the FTC and MIB agreed to a policy requiring MIB members to inform applicants (1) that insurance had been denied, or made more expensive, because of information obtained from an investigation conducted as a result of MIB information; (2) of the applicant's right to obtain a summary of the MIB report at no charge; and (3) of a street address and telephone number at which the applicant can contact MIB. n35.1

[viii] When Adverse Action Relates to Government Benefits and Licenses

Government agencies, which are required by law to consider an individual applicant's financial responsibility or status in order to determine eligibility for a license or other benefit, may use consumer reports. Whenever such an agency denies, conceals, increases a charge, or otherwise imposes an adverse or unfavorable change in the terms of a license or government benefit, based in whole or in part on a consumer report, the agency must notify the consumer. n36 This notification requirement may arise in a number of common situations, ranging from granting and denying professional licenses to using consumer reports in connection with public housing and welfare benefits.

[ix] When Adverse Use Relates to Other Purposes

The most sweeping of all adverse notice provisions requires notification whenever any action adverse to the interests of the consumer is taken in connection with an application made by the consumer or in connection with any transaction initiated by the consumer. n37 Such transactions include a landlord's denial of an apartment rental or decision to increase the required deposit; denial of check writing privileges by merchants or by financial institutions; property sales; investment and other business transactions; as well as a wide array of other potential arrangements which a consumer may seek. When this provision was added in 1966, it removed a number of contentious issues over the Act's scope and coverage and recognized that user notice is fundamentally important in assuring the accuracy of consumer reports.

Many businesses periodically review their accounts to determine whether consumers continue to meet account requirements. If a user has relied upon a consumer report to take an adverse action with respect to a consumer's account, the user must notify the consumer. n38

[c] Enforcement of Right

The FACTA amendments to the FCRA in 2003 cast serious doubt upon the ability of consumers to privately enforce the adverse action notice requirements of the FCRA. As part of those amendments, Congress added the following language to *15 U.S.C. § 1681m*:

Enforcement

(A) No civil actions

Sections 1681n and 1681o of this title shall not apply to any failure by any person to comply with this section.

(B) Administrative enforcement

This section shall be enforced exclusively under section 1681s of this title by the Federal agencies and officials identified in that section.

Based upon this language, the Seventh Circuit and several district courts have issued decisions concluding that section 1681m is not privately enforceable. n39

[d] Content of Notice of Adverse Use of Consumer Report

[i] Disclosure That Report Was Basis for Adverse Action

The user must advise the consumer that adverse action was based in whole or in part on information contained in a consumer report. n40 The user need not explain what in the report was considered adverse or disclose the contents of the report. The consumer will later have to seek the contents of the report from the reporting agency.

Users must certify to reporting agencies that they will not share information in a report with others, but this does not apply to the sharing of the information with the consumer. n41

Reporting agencies also commonly require agreements with users, which prohibit disclosures of the contents of reports to consumers, but a user may not be prohibited from disclosing the contents of the report, however, if it was a basis for adverse action. n42

While the FCRA notice need not specify the exact reason for the adverse action, creditors must also provide consumers with a notice under the ECOA which will.

[ii] Disclosure of Identity of Reporting Agency

The user must tell the consumer the name and address of the reporting agency which made the report. n43 The user must provide the telephone number of the agency, and in the case of one of the big three nationwide agencies, a toll-free number. n44 This basic information must be accompanied by three additional disclosures:

- Disclosure of the consumer's sixty-day right to a free copy of the report from the reporting agency.
- Disclosure of the consumer's right to dispute with the reporting agency the accuracy or completeness of the report.
- A statement that the reporting agency did not make the adverse decision and will not be able to specify the reasons for it.

[iii] Must Disclosure Be in Writing?

The notice of adverse action and the accompanying disclosures may be provided "orally, in writing, or electronically." n45 The FTC Commentary recommends that the notice be in writing so that users have written evidence that they have taken reasonable steps to comply. n46

The recently enacted Electronic Signatures in Global and National Commerce Act ("E-Sign") n47 provides that disclosures *required* to be made in writing to consumers may be made electronically if several conditions are met. These conditions include informing the consumer as to the rights under the Act, providing a statement of the hardware and software necessary for access and retention of the electronic record, and having the consumer either consent

electronically or confirm consent electronically. n48 However, as the FCRA does not require that the adverse action notice and accompanying disclosures be made in writing, and already provides that they may be made electronically without any additional procedures, E-Sign's safeguards likely do not apply to an FCRA-compelled notice or disclosure.

[e] Notice of Adverse Use of Information Other Than Consumer Report

The FCRA places an additional notice requirement on creditors which deny or increase the charge for credit for personal, family, or household purposes based on information obtained from a person *other than* a reporting agency. n49 The notice does not apply where the creditor obtained the information from its own files or directly from the consumer, but the notice provisions should apply when the creditor obtains information on its own as a result of obtaining information from a consumer reporting agency. n50

Notice of an adverse credit action based on information from a third party other than a reporting agency must either set forth the reasons for the adverse action or clearly and accurately disclose the consumer's right to make a written request within sixty days for the reasons for the adverse action. n51

Within a "reasonable time" after the consumer's *written* request, the user must disclose the "nature of the information" upon which the adverse action was based. n52 A disclosure which complies with the ECOA satisfies the FCRA as well; n53 the ECOA requires that the statement of reasons contain "specific reasons for the adverse action taken."

Information which is shared among companies affiliated by common ownership or corporate control is excluded from the definition of consumer report and from the protections that normally attach to the use of consumer reports. Even so, notice is required when an adverse action is based on information obtained from the user's affiliate. The affiliate must notify the consumer of the adverse action, and tell the consumer that it will disclose the nature of the information upon which the action was based within thirty days of the consumer's request. n54 There is no requirement that this disclosure be made in writing.

The adverse actions which trigger this notice requirement are less inclusive than when consumer reports provide grounds for an adverse action. Included are credit transactions, but only for adverse actions taken in connection with a transaction initiated by the consumer, employment uses, and uses in connection with insurance underwriting. Excluded are other transactions initiated by consumers; consumer applications; account reviews; and governmental licenses and benefits.

In addition, adverse actions by affiliates are covered only if the information bears on the creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living of the consumer.

[f] ECOA Notices Concerning Adverse Action

The ECOA n55 requires creditors to provide borrowers and potential borrowers with notice of any adverse action taken by the creditor. n56 This notice requirement does not apply to adverse employment or insurance actions.

The ECOA notice must be given within thirty days of a credit *application*, n57 whereas the FCRA notice should be sent at the same time as the *denial*, but there is no requirement that the denial meet any time deadlines.

The ECOA notice provides a statement of the action taken, the creditor's name and address, the name and address of the federal agency with enforcement authority of the transaction, and the specific reasons for the action taken or a statement of the applicant's right to a statement of those reasons. n58

Listing only one of several reasons is not sufficient. The creditor must list the principal reasons, although the Federal Reserve Board ("FRB") has suggested that more than four reasons is not likely to be helpful to the applicant. n59

The FRB has provided creditors with a model form that combines both the FCRA notice and the ECOA notice separately on the same disclosure. n60 While the forms are illustrative and not mandatory, proper use of the FRB forms will satisfy the ECOA notice requirement. n61 Compliance with just the FCRA notice requirements will ordinarily not satisfy the ECOA requirement. n62

[i] Users Must Provide Consumers With a Risk-Based Pricing Notice

One problem Congress sought to address with the passage of the FACTA is the frequent occurrences of creditors reviewing consumers' credit reports and making risk-based adjustments to the terms offered to consumers without giving consumers adverse action notices. n63

Consumers now have a right to a new notice relating to risk-based pricing. n64 Whenever a creditor extends credit on terms "materially less favorable than the most favorable terms available to a substantial proportion of consumers," the creditor must provide to consumers a notice that explains that the terms are based on information in a credit report and that the consumers can request a free copy of the report. This notice requirement addresses a current flaw that creditors will use as a basis for arguing that they do not need to provide notice to a consumer when they charge higher-interest fees or other charges based on a credit report. The "risk-based pricing" notice must be given at the time of application or communication of the approval. n65 This notice may be given orally, in writing, or electronically. n66

The FTC and the FRB are to jointly promulgate regulations. These regulations will further define the term "materially less favorable," the required content of the notice, when the notice is required, and what rights the notice triggers. n67 The true meaning of this new requirement will not be apparent until the FTC/FCRA regulations are available. n68

A major drawback to the new risk-based pricing notice requirement is that it can only be enforced through federal agencies and officials under § 1681s of the FCRA, n69 and states are preempted from regulating the subject matter of the provision. n70

[g] Notices Required When a User Has Requested Information

[i] Public Record Information for Employment Purposes

The FCRA establishes a limited disclosure requirement for *reporting agencies* when they *first* furnish "items of information on consumers which are matters of public record and are likely to have an adverse effect upon a consumer's ability to obtain employment" n71 or to retain employment or obtain promotion. n72

The reporting agency must comply with at least one of two procedures, neither of which can be waived by the consumer. n73 Most reporting agencies choose to notify the consumer that public record information is being furnished to a user, together with the name and address of the user. n74

The other option is to maintain strict procedures to insure that the public record information is complete and up to date. n75 For arrests, indictments, convictions, suits, tax liens, and outstanding judgments, "up to date" means the status of the item as of the time of the report. n76

[ii] Investigative Consumer Reports

A user who requests an investigative consumer report must disclose to the consumer within three days of the request the existence of the request, the nature of the information sought, and the consumer's right to seek additional disclosures from the user. If the consumer then requests additional disclosure, the user must describe completely and accurately the types of questions asked, the number and types of persons interviewed, and the name and address of the investigating agency. n77 The user need not provide the names of investigative sources.

[iii] Notice When Information Is Used for Prescreening Purposes

A user of a prescreening list must accompany solicitations with certain disclosures which inform consumers that (a) consumer reports have been used, and (b) consumers may take steps to prevent future use. n78 Each written solicitation must include a clear and conspicuous statement containing each of the following items of information:

- Information from the consumer's consumer report has been used;
- The consumer met the criteria for the solicitation;
- Nevertheless, the offered credit or insurance may not be extended if it turns out the consumer does not meet the criteria for the solicitation, if the consumer does not meet any applicable criteria bearing on creditworthiness or insurability, or if the consumer does not furnish any required collateral (this part of the notice is required only if it is applicable);
- The consumer can prohibit the use of information in the consumer's consumer reporting files from being used in future solicitations. The statement must include the toll-free telephone number and address of the notification system which the consumer must notify to opt out of future such solicitations. The consumer's request is valid for only two years, however.

The prescreening use notices are required by section 1681m of the FCRA. Revisions to the FCRA by the FACTA amendments have been interpreted as removing any private rights of action to enforce the provisions of section 1681m or its prescreening notice requirements. n79 As such, the viability of any claims for violation of these notice requirements are in flux. n80

[iv] Notice Required Before Federal Agency May Disclose Debtor Information

The Debt Collection Act amended the Federal Claims Collection Act to authorize federal agencies to disclose debtor information to credit reporting agencies. n81 However, prior to such a disclosure, the head of the agency must notify the consumer in writing that the claim is overdue and that the agency intends to notify a consumer reporting agency of the debt no sooner than sixty days from the date of the notice, and must describe the specific information the agency intends to disclose to the credit reporting agency. n82 The head of the agency must also disclose to the credit reporting agency that it has given the prescribed notice to the consumer. n83 Furthermore, the agency cannot contact a credit reporting agency at all if a repayment plan has been agreed upon or administrative review requested. n84 An agency planning to release information to a credit reporting agency must establish procedures for ensuring that the information held remains accurate and up to date, and for insuring that the consumer reporting agency is complying with the FCRA and other applicable statutes concerning consumer credit information. n85

[h] Notices Required From Users Prior to a Request for Information

[i] Notice That Government Official Plans to Obtain a Consumer Report for Child Support Purposes

State and local government officials have a permissible purpose to obtain consumer reports to help determine an individual's capacity to make child support payments. Usually, notice to the consumer will not be necessary because the requesting agency is administering a state plan as provided by federal welfare laws. However, if the request comes from any other official, the official must certify to the agency that a prior notice to the consumer has been provided. The notice must be sent by certified or registered mail to the last known address of the consumer, at least ten days in advance of the request.

[ii] Notice from an Employer That It May Obtain a Consumer Report

An employer must make two disclosures to an employee prior to requesting a consumer report and, if adverse action is taken, make disclosures again prior to the adverse action. The disclosures, which must be made around the time of adverse action, are described in an earlier section. n86 However, the FACTA of 2003 amended the FCRA to remove certain communications from the definition of consumer report. n87 Communications are not consumer reports if they are made to employers in connection with the investigation of suspected employment-related misconduct or the employee's compliance with federal, state, or local laws and regulations, the rules of a self-regulatory organization, or any preexisting written policies of the employer. Such communications must also not have been made for the purpose of investigating an employee's credit worthiness, credit standing, or credit capacity, and the communication must only have been made to the employer, the employer's agent, a governmental agency, or a self-regulatory organization. n88 This amendment substantially limits situations in which employees will receive notice under the FCRA and the timing of any notice employees will receive, if any, with respect to employment. Only new applicants and employees being subject to transfer or promotion will receive notice prior to any adverse action being taken. Investigations of existing employees for alleged misconduct fall within the exception and do not require prior notice.

If an employer asks an agency to check references or to do a background check for a job applicant or a candidate for transfer or promotion, the report will almost certainly be an investigative consumer report. These types of investigations are not affected by the FACTA amendments described above. Unless the communications fall outside the definition of a consumer report pursuant to the FACTA amendments, employers must certify to a reporting agency that they have been authorized by the consumer to obtain the report. Briefly, the certification is intended to ensure that the employer has taken two steps. First, the employer must provide a clear and conspicuous notice to the consumer, in writing and in a separate document, that it may obtain a consumer report for employment purposes. n89 Second, the employee must also have provided to the employer, in writing, prior authorization to obtain a consumer report. n90

[iii] Notice That Medical Information May Be Obtained From a Consumer Reporting Agency

A reporting agency may not release medical information for insurance, employment, or credit purposes, or for prescreening and other direct marking transactions, unless the consumer consents. n91

The FACTA of 2003 continued the prohibition against agencies furnishing a report for employment purposes or in connection with a credit or insurance transaction that contains medical information without the consent of the consumer. n92 Now the consumer's consent to furnishing such a report must be written, must be specific, and must describe the use for which the agency will furnish the information. n93 However, an agency may furnish medical information that pertains solely to financial transactions if the agency uses codes so as not to identify, or provide information sufficient to infer, the specific provider of medical services or the nature of such services, products, or devices. The FACTA also reduced consumer protections by providing several exceptions to the general prohibition on the release without consumer consent of a consumer report that includes medical information. n94 The federal banking agencies, NCUA, and the FTC have been granted rulemaking authority to make exceptions that are "necessary and appropriate to protect legitimate operational, transactional, risk, consumer, and other needs ... ." n95

[iv] Notice When Certain Information Is Used by Affiliates

Information based on a company's own experience with the consumer may be shared with other affiliated businesses without notice or warning to the consumer. n96 Information obtained from "outside" the affiliate group, however, may be shared among affiliates only after the consumer has been notified of the opportunity to direct that such information not be communicated. Absent this notice, the information may be considered a consumer report under the Act.

The notice to the consumer must clearly and conspicuously disclose to the consumer that the information may be communicated among affiliates. A written notice is not required, but any other method of disclosure is subject to attack as less than conspicuous.

The FACTA amended the FCRA to provide that a consumer may opt out of the use by an affiliate of this exempt information to market its products or services, and affiliates must also notify the consumer both of the possibility that an affiliate may use the consumer's information for marketing and of the consumer's right to opt out of such use. n97 The opt-out lasts for five years and consumers may extend it for an additional five years. n98 States are preempted from regulating the subject matter of this provision. n99

[v] Special State Law Requirements

Some state laws pose additional disclosure requirements when information is first gathered or reported. For example, Minnesota requires written disclosure to the consumer prior to preparation of a report for employment purposes. n100 California requires creditors to notify consumers and cosigners when first furnishing negative credit reports to a reporting agency. n101

[A] Notice of Key Factor in Credit Score

The FACTA amended the FCRA to require the disclosure of enquiries if they are a factor in determining a consumer's credit score. Any consumer reporting agency that furnishes a consumer report containing any credit score or other risk score or predictor must include in the report a clear and conspicuous statement that a key factor (as defined in § 1681g(f)(2)(B)) which adversely affected such score or predictor was the number of enquiries, if such a predictor was in fact a key factor that adversely affected such score. n102 This notice requirement does not apply to check services companies which issues authorizations for the purpose of approving or processing checks or other negotiable instruments, electronic transfers, or similar methods of payments, to the extent they are engaged in such activities. n103

[B] Notice in Cases of Fraud Alert That Consumer May Request a Free Copy of the File

When credit reporting agencies include a fraud alert in a consumer file, the agency must disclose that the consumer may request two free copies of their file during the twelve-month period beginning on the date on which the fraud alert was included in the file. n104 This notice must include the summary of rights of identity theft victims. n105

Under the FACTA amendments to the FCRA in 2003, consumers have the right to seek a block of the reporting of information resulting from identity theft. n106 If a consumer reporting agency (CRA) declines to block identity theft information or rescinds a block, the effected consumer must be notified promptly. n107

[C] Notice to Consumer If Agency Refuses to Block Alleged Identity Theft Information

Under amendments by the FACTA, if a credit reporting agency declines or rescinds a block of information alleged to be the result of identity theft, the affected consumer must be notified promptly and in the same manner that consumers are notified when information is reinserted into their file upon certification of accuracy. n108 Consumers must be notified regarding the reinsertion of information within five days of the agency's reinsertion of information. This five-day period should be the same limitation for purposes of notification when a block is declined or rescinded.

Resellers that maintain consumer files must also promptly provide notice to consumers of a decision to block the file relating to identity theft information. n109 Such notice must contain the name, address, and telephone number of each consumer reporting agency from which the consumer information was obtained for resale. n110

[D] Disclosure of Credit Scores and Notice to Home Loan Applicant

Under amendments by the FACTA, users of credit reports who make credit or insurance solicitations must also disclose their address and telephone number. The disclosure must be prepared in such format and type as to be reasonably understood, in compliance with rules to be adopted by the FTC, in consultation with federal banking agencies and NCUA. n111

[E] Notice When Negative Information Provided by Financial Institutions

The FACTA amended the FCRA to require a one-time consumer notice when a financial institution furnishes negative information about that customer. n112 However, a financial institution may take advantage of a safe-harbor provision if it maintained reasonable compliance policies and procedures or reasonably believed that it was prohibited from contacting the consumer. n113 Once notified about an account, it appears that there is no other requirement entitling the consumer to receive further notices when additional negative information is reported about that account. n114 This provision appears not to be enforceable by private consumers' actions. n115

[i] Notice That Deleted Information Is Reinserted Into a Consumer Report File

Reporting agencies must notify the consumer whenever once-deleted informa-tion is reinserted into the files. n116 However, the notice of reinsertion is required only if the reinserted information was deleted as a result of an earlier notice of dispute provided to the agency by the consumer. The reinsertion notice must be in writing and must be made not later than five business days following the reinsertion. Electronic notice, or notice by other means, is also permitted, if authorized by the consumer.

In addition to that basic notice, the agency must provide the business name and address and phone number (if reasonably available) of any furnisher of information that was contacted by the agency or that contacted the agency in connection with the reinsertion of the information. The notice must also disclose the consumer's right to add a statement to the consumer's file disputing the accuracy or completeness of the disputed information. This notice also must be provided within five business days, and must be in writing, even if other means were used to notify the consumer of the reinsertion. The statement that the disputed information has been reinserted must also be included.

The failure of a CRA to deliver notice of reinsertion of previously deleted material is subject to the usual private remedies of the FCRA under sections 1681n and 1681o.

[j] Reasonable Procedures as a Defense

For a user who fails to satisfy the FCRA notice requirements in connection with taking an adverse action, requesting an investigative consumer report, or using a prescreened report, the FCRA provides a defense if the user can show by a preponderance of the evidence that, at the time of the alleged notice violation, it maintained reasonable procedures to assure compliance. n117 The reasonable procedures defense does not apply to users or reporting agencies with respect to any notices to consumers which users must certify they have provided before getting a consumer report.

In one of the few FCRA cases to consider this defense, n118 the court adopted the requirements imposed by the Seventh Circuit in a TIL n119 case, *Mirabal v. General Motors Acceptance Corp.*, n120 in which the court said:

> Congress required more than just the maintenance of procedures which were designed to provide proper disclosure calculations. Rather, it required procedures designed to avoid and prevent errors which might slip through procedures aimed at good faith compliance. This means that the procedures which Congress had in mind were to contain an extra preventive step, a safety catch or a re-checking mechanism. Congress left the exact nature of the preventive mechanism undefined. It is clear, however, that Congress required more than just a showing that a well-trained and careful clerk made a mistake.

The reasonable procedures defense was rejected where failure to give notices to non-hired employment applicants was not an isolated instance. A senior manager had made a policy decision without consulting the company's Human Resources manual. n121

An FTC informal staff opinion letter suggests that one user may contract with another to provide required notices to

consumers. The circumstances involved a mortgage insurer contacted by a lender. Although the insurer relied upon consumer reports (often provided by the lender) when deciding whether to issue mortgage insurance for specific consumer transactions, the insurer never had direct communication with the consumer. The insurer could reasonably comply with the adverse action notice requirement if it contracted with a responsible lender to deliver the notice to the consumer *and* appropriately monitored the lender as well. n122 Another related interpretation is an FTC opinion concerning the FCRA's requirement of reasonable procedures to assure accuracy of consumer reports:

> One of the most significan t compliance procedures ... will be the training of new personnel and the retraining of current employees from time to time. Even isolated instances of error should be followed up and procedures adjusted in order to correct the cause of the error. n123

The user has a somewhat different defense concerning failure to comply with the ECOA notice of adverse action. n124 An inadvertent error is not a violation of the notification requirements provided that the creditor corrects the error as soon as possible after discovering it. n125 This defense applies to clerical mistakes, computer malfunctions, and printing errors, but does not apply to errors of legal judgment or to a creditor having insufficient staff to respond in a timely fashion.

There is no statutory defense for the credit reporting agency's failure to comply with the notice requirement concerning use of public record information. A reporting agency that fails to provide notice may instead maintain strict procedures dealing with such information. But if a reporting agency fails to do either, there is an FCRA violation.

[3] Right of Consumer to Know Contents of Own File

Upon a consumer's request and proper identification, the consumer reporting agency must clearly and accurately disclose to the consumer all information then in the consumer's file. n126 In addition, as of December 1, 2004, a consumer will have a new right to learn the credit score and the key factors adversely affecting the credit score. n127 A reporting agency violates the FCRA by refusing to provide this information n128 or by providing only partial disclosure. n129 Although major credit bureaus will provide consumers with the contents of their files, some entities which may not consider themselves reporting agencies actually do fall within the FCRA definition.

Notwithstanding a consumer's right to know what is in her file, the information disclosed to a consumer will often not look like or contain the same information as the report furnished to an inquiring creditor. For example, practitioners report that agencies will hide information in the files by truncating or deleting account numbers, or deleting subscriber addresses, which hinders a consumer in directly disputing an account with a creditor. This sort of vandalism to the information associated with a consumer is in direct violation of the Act. The most significant piece of information that will be hidden from the consumer is the consumer's credit score. n130

Reports provided to users also have a different legal status than reports provided to the consumer. Only reports provided to a third party are considered "consumer reports" under the FCRA; n130.1 and are subject to the requirements for "consumer reports under the Act. Reports to consumers--sometimes called "consumer disclosures"--must include all information in the consumer's "file," n130.2 including information that may not be provided to a user.

While consumers or their attorneys may want to obtain the user versions of consumer reports, this has not always been an easy task. For many years, consumer reporting agencies prohibited users from sharing their versions of consumer reports with the consumer.

The FCRA was amended to prohibit CRAs from preventing users from disclosing the contents of a consumer report to the consumer, if the user takes an adverse action against the consumer based in whole or in part on the consumer report. n130.3 The user is not required to provide the report to the consumer, but the CRA cannot prevent the user from doing so, unless the user has taken no adverse action against the consumer.

[4] How to Obtain the Contents of a Consumer's File

[a] General

[i] Consumer Must Request Disclosure

The consumer may specify any reasonable means of disclosure available from the agency, but if the consumer specifies in-person disclosure at the agency's place of business, reasonable notice is required. n131 A casual inquiry to a reporting agency's telephone receptionist asking generally what is going on is not a proper request for disclosure. n132

[ii] Timing of Disclosures

The FCRA does not require the consumer reporting agency to make disclosures immediately upon request, but undue delays are not permissible. n133 There is no explicit standard as to how quickly reporting agencies must respond to a written request. Although major reporting agencies claim to respond within a week or two, a response may take as long as a month.

In contrast, the new provision requiring nationwide consumer reporting agencies to provide consumers with one free annual credit report requires those agencies to provide those reports within fifteen days, so long as the consumer uses the centralized source for making the request. n134 An additional avenue to a free report lies in the new extended fraud alert provision, n135 through which a consumer may obtain from the agency to which the consumer directs the alert all of the information in the consumer's file. n136 The agency must provide the information within three business days of the request, without charge. n137

[iii] In-Person and Telephone Disclosures

Disclosures must be available to consumers in person, at the reporting agency's office, by telephone, electronically, or by any other reasonable means which is available from the reporting agency. n138 The consumer reporting agency may provide disclosures through a national consumer relations center, rather than through its local offices. n139

For all disclosures, the consumer must provide proper identification. n140 For telephone disclosures, the FCRA requires a prior written consent with proper identification. n141 The FTC Commentary, however, allows telephone disclosure without written request if the consumer is properly identified, but reporting agencies can still insist on a written request. n142

The consumer reporting agency should endeavor to make it as convenient as possible for the consumer to obtain the disclosure, although it is not required to make disclosures outside its normal business hours.

[iv] Written Disclosure

Disclosure must be in writing, unless the consumer authorizes some other form of disclosure that is reasonably available from the agency. n143 Although the FCRA does not specifically provide for disclosures by mail, the FTC Commentary allows mail disclosures with the consumer's actual or implied consent. n144 In-person, electronic and telephonic disclosures are specifically contemplated by the Act. If the consumer appears in person at the reporting agency and requests oral disclosure, the consumer has a right to such a disclosure. n145 Nevertheless, consumers are usually better off having a written record of the agency's disclosure, since it provides a record of the agency's compliance or noncompliance with the Act.

[v] Employees Explaining Disclosures

Reporting agencies are required to have trained employees who will provide a full account of all information that the

consumer is entitled to receive and explain all disclosed items. n146 When Congress passed FACTA it amended the FCRA disclosure requirements, but it maintained the requirement that nationwide consumer reporting agencies have toll free numbers and personnel that are accessible to consumers within normal working hours. n147

[vi] Consumer May Bring Another Person When Receiving Disclosures

Consumers are entitled to receive disclosures in the presence of one other person whom they have chosen to accompany them. n148 The consumer reporting agency may require the consumer to furnish written permission for the agency to discuss the consumer's file in front of the other person and may also require the other person to furnish reasonable identification. n149

[vii] Special Rules for Affiliates

There are a number of apparent differences between the disclosure required of an affiliate, which takes an adverse action based on information from another affiliate, n150 and the disclosure required by a consumer reporting agency. First, only the nature of the information, not the information itself or the contents of the file on the consumer, must be disclosed. Second, the request must be made by the consumer in writing. Third, the affiliate can take up to sixty days to make the disclosure, in contrast to the shorter time frames allowed reporting agencies. Fourth, the consumer has little flexibility for requiring a variety of forms of disclosure, even if they are reasonably available from the affiliate.

[b] Making the Request

The FACTA of 2003 amended the FCRA to provide consumers with the right to one free report per year. n151 To obtain such a report from a nationwide consumer reporting agency n152 the consumer must make the request through a centralized source that the FTC and nationwide agencies have set up pursuant to FTC regulations. n153 The nationwide CRAs jointly design, fund, and operate the centralized source, and consumers can request a report from that source by any of the following three methods:

- On-line at www.annualcreditreport.com;
- By telephone, to 877-322-8228; or
- By letter to Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30374-5281. n154

The consumer may be asked detailed information about existing credit accounts and employment, as a form of identification, in addition to the usual forms of identification. Requests for reports from nationwide specialty consumer reporting agencies n155 will not be made through a centralized source but rather pursuant to forthcoming regulations that will require such agencies to provide, at a minimum, a toll-free telephone number for consumers to use to request a free report. n156 The effective date of the free credit report provision may be delayed until December 4, 2004, or even beyond. n157 Aside from that provision the Act does not specify any particular manner for the consumer to request disclosure of the information in the consumer's file. Each of the nationwide consumer reporting agencies, Experian, TransUnion, and Equifax, allow consumers to obtain credit reports by following procedures designated on their websites. n158

In addition, Any notice that a consumer report contributed to a denial will identify the agency which provided the report. The consumer should request a report from that agency to learn about the report and to check for inaccuracies. Because of the recent adverse use of the report, the disclosure to the consumer will be free. National consumer reporting agencies are required to maintain toll-free telephone numbers staffed during normal business hours.

For a full picture of a consumer's credit record, it is generally advised to request disclosure from the three major

reporting agencies, in addition to any of the smaller agencies specifically mentioned in any notice of denial due to a consumer report.

The consumer should expressly request all of the information in the consumer's file, not just the credit report. Disclosure should then include not only all information about the consumer, but also sources for the information in the file, information about persons who have procured a report on the consumer, and a record of inquiries. Information which may not be disclosed includes credit scoring, risk scores, or other predictors. n159

Credit monitoring services, such as America Online's Credit Alert, offer to compile credit information from all three major credit bureaus, reformat the information for ease of understanding, and provide driving records and even medical information. They can also periodically notify a consumer of all inquiries made regarding the consumer's credit report. These services raise privacy and security concerns, and the fees charged can greatly exceed what it would cost a consumer to obtain reports directly from the reporting agencies themselves.

[c] Proof of Consumer's Identification or Authorization

[i] Proof of Identification

Proper identification is required for all forms of disclosure. n160 Because the reporting agency may be held liable for furnishing consumer reports to persons who do not have permissible purposes for obtaining them, n161 the reporting agency is given some flexibility in designing identification procedures. The need for proper identification may not be used, however, as a pretext for collecting information which is not essential for that purpose. n162

FTC regulations require that CRAs develop and implement reasonable requirements for what proof of identity the consumer must provide. n162.1 The information the consumer supplies must be sufficient to enable the CRA to match the consumer with its files and to make sure the consumer is not misidentified. Such proof might involve enough information to obtain a file match, such as the consumer's full name, other names, current and recent addresses, Social Security Number, and date of birth. The consumer might also be asked for additional proof of identity, such as copies of various documents or answering questions only the consumer would know. n162.2

While CRAs will routinely ask for the consumer's Social Security Number, Experian and other CRAs admit that they will make the disclosure to the consumer and provide reports to creditors without this number if other identifying information is provided. n162.3 A consumer who refuses to provide a Social Security Number increases the risk that the disclosure will be incomplete or will include information from a different consumer. Of course, this may be helpful information to know, because creditors that are also requesting reports without a Social Security Number may be seeing similar errors.

[ii] Proof of Consumer's Authorization

A reporting agency may furnish a consumer report in accordance with the consumer's written instructions. n163 The FTC has indicated that an attorney acting on behalf of a client may request disclosure of all information to which the client would also have access, under a valid power of attorney, n164 the power of attorney being written instructions from the consumer. n165

The agency may also disclose the information directly to the consumer. n166 This apparently means that the agency can supply the information directly to the consumer *rather* than to the third party. n167

Spouses are not authorized to release or obtain reports on their partners. Reportedly, if a consumer requests a report on a spouse, the agencies will provide the report by sending it to the spouse at the spouse's address. Even this precaution is probably not adequate because the request is not made by the subject of the report.

[d] Unreasonable Preconditions or Requests for Information

The agency "shall" disclose the contents of the consumer's file. n168 The agency may not add conditions not set out in the FCRA as a prerequisite to the required disclosure. n169

[e] Consumer Payment for File Disclosure

[i] Where FCRA Prohibits Payment

A reporting agency may not impose charges when the consumer requests disclosure within sixty days after being given notice of a user's denial based on a consumer report, or after receiving notice from a debt collection agency affiliated with the reporting agency that his or her credit rating has been or may be adversely affected. n170

Even if the user's original denial is subsequently reversed, the consumer retains the sixty-day right to disclosure without charge. n171 The right to free disclosure has been said to apply only to agencies whose report was used in the denial. n172

A consumer who is unemployed and seeking employment is entitled to one free report in any twelve-month period. n173 The consumer must provide written certification that he or she is unemployed and intends to apply for employment in the sixty-day period beginning on the date of the certification.

A consumer who is receiving public welfare assistance is also entitled to one free report in any twelve-month period. n174 The Act does not define the term public welfare assistance. Presumably, the term would include family welfare benefits to low-income children and households, social security benefits to elder Americans and SSI benefits to others, state and federal food stamp programs, workers compensation benefits, fuel assistance benefits, Medicare and Medicaid coverage, and other state and federal and local benefit programs. The Act does not require the consumer to certify or reveal more than that the consumer is a "recipient of public welfare assistance."

A consumer who reasonably believes that her file contains inaccurate information due to fraud is also entitled to one free report in any twelve-month period. n175 The consumer must provide written certification of the belief, although the certification need not explain or detail the basis of the belief.

Continuing concern for identity theft led Congress to add a provision in 2003 allowing an identity theft victim to obtain an expedited free report. A consumer who has requested an extended fraud alert under the new provision allowing for such alerts n176 may obtain from the agency to which the consumer directs the alert all of the information in the consumer's file. n177 The agency must provide the information within three business days of the request, without charge. n178

[A] No Charge for Annual Report Made Through Centralized Source

Once the FTC issues final regulations establishing a centralized source through which consumers can request a free report, consumers will be entitled to one free credit report annually. n179 In addition, many specialty consumer reporting agencies compile information about consumers on a nationwide basis relating to a specific subject, such as medical records, tenant history, check writing history, employment history, or insurance claims. The Act specifically prohibits agencies from imposing a charge for such a report. n180 The Credit Card Accountability, Responsibility and Disclosure (CARD) Act of 2009 amended the FCRA to require that any advertisement for a "free" credit report disclose that free credit reports are available under Federal law at www.AnnualCreditReport.com. n180.1 For TV and radio advertisements, the disclaimer will only state: "This is not the free credit report provided by Federal law." n180.2 The Credit CARD Act requires the Federal Trade Commission to mandate the specific wording of the disclaimer for all other advertisements. n180.3

[ii] Where State Law Limits Payment

State law can limit the amount that a reporting agency may charge, and a number of state statutes either require that the first report in a year be free or limit the amount the agency may charge. The Ninth Circuit has affirmed that the FCRA does not preempt a state statute limiting fees that consumer reporting agencies charge for report disclosures to consumers. n181

[iii] Payment Amounts Where Allowed

Ten dollars is the present maximum charge for a report which does not follow a denial based on a consumer report, or fall within one of the special circumstances when free reports are available once a year, and where state law does not otherwise limit the charge. n182 The maximum charge may increase from year to year to reflect changes in the Consumer Price Index.

[5] File Information That Must Be Disclosed

[a] General

Except for information concerning credit scores, risk scores or other predictors, and FBI security clearance checks, all information in the consumer's file at the time of the consumer's request must be provided to the consumer. n183

The disclosure requirement applies to every item of information which the consumer reporting agency has in its possession at the time that the consumer requests disclosure, "regardless of how the information is stored." n184 Once a consumer has requested disclosure, the agency should not change the file before disclosing it to the consumer. n185

The consumer may request less than the complete file and, in such a circumstance, the agency would not have to disclose all information. This issue arose in correspondence between a consumer reporting agency and the FTC about whether social security and consumer account numbers could be scrambled as a security measure. FTC staff opined that all information in the file must be disclosed, including unscrambled numbers, unless the consumer is given the option and does not ask for less. n186

A summary of consumer rights must also be included with the disclosures. n187

[b] Audit Trail and Other Ancillary Information

According to FTC Commentary, the consumer's "file" does not include the audit trail of changes made by the agency. n188 The consumer can, however, seek audit trail information through discovery if an action is filed in court.

The consumer's "file" also excludes other information which will not be included in a consumer report or used as a basis for preparing future reports. n189 Such other information includes billing records, consumer relations information, and the like. n190

[c] Credit Scores Do Not Have to Be Disclosed

For a discussion of the disclosure of credit scores, see *§ 16.03[2]*[g.4] and *16.01[2][a], supra* .

[d] Medical Information

Reporting agencies must disclose to consumers medical information in their files. State laws may also grant consumers access to personal medical records.

Medical information provided by reporting agencies is commonly used for insurance underwriting purposes, and many insurers are members of the Medical Information Bureau, or MIB. Members provide MIB with adverse or negative information acquired when underwriting individual life, health or disability insurance policies. This information is then available to members for other underwriting decisions.

Consumers may learn what information about them is on file at MIB by contacting the Medical Information Bureau, 160 University Avenue, Westwood, MA 02090-2307, telephone (617) 426-3660.

However, most consumers will never know that personal adverse medical information is circulating unless they are told by the insurers who use it. For years, MIB argued that insurers that receive MIB information did not have to provide the consumers with a notice that insurance was denied, or made more expensive, based wholly or in part on an MIB report. n191 However, in 1995, the FTC and MIB agreed to a policy requiring MIB members to inform applicants (1) that insurance has been denied, or made more expensive, because of information obtained from an investigation conducted as a result of MIB information; (2) the applicant's right to obtain a summary of the MIB report at no charge within 60 days; and (3) of a street address and telephone number at which the applicant can contact MIB. n192 Shortly after reaching agreement with MIB, the FTC published a brochure for insurers explaining FCRA obligations, including providing the required notice to applicants. n193

In addition, a consumer reporting agency may not furnish for employment purposes, or in connection with a credit or insurance transaction or direct marketing transaction, a consumer report that contains medical information about the consumer unless the consumer consents n194 to the furnishing of such a report.

The FACTA of 2003 revised the FCRA's definition of "medical information" to remove the requirement that the information have been obtained with the consumer's consent and to remove from the definition information that does not relate to the consumer's physical, mental, or behavioral health or condition. n195

Assuming that the MIB falls within the Act's new definition of nationwide specialty consumer reporting agency, n196 eventually consumers will be entitled to a free credit report from MIB, though that right may be delayed until the FTC issues final regulations. n197

[e] Sources of Information

Pursuant to the consumer's general request for disclosure of the contents of the file, the consumer reporting agency must reveal its sources of information. n198 The consumer's right does not extend to sources of the *investigative* consumer report. n199 This applies only if the information was "acquired solely for use in preparing an investigative consumer report and actually used for no other purpose." n200

[f] Identification of Users Receiving Reports

The consumer reporting agency must disclose the names of all recipients of consumer reports about the consumer that were furnished within one year prior to the consumer's request for disclosure. Additionally, the reporting agency must disclose the names of any persons who received consumer reports on the consumer for employment purposes within two years before the request. n201

Where the agency has provided the report to a user at the request of another reporting agency, the agency must disclose the ultimate recipient of the report, not just the name of the requesting agency. n202 The list of recipients must also include any recipient of prescreened lists containing the consumer's name. n203 Exceptions exist for federal agencies using consumer reports for security clearance purposes and for FBI counterintelligence investigations. n204 These uses may not have to be disclosed, or indeed disclosure may be prohibited. n205

Recipients of consumer reports, like the sources of information contained in the reports, must be identified pursuant to the consumer's general request for disclosure of the consumer's file, whether or not the consumer specifically requested that the recipients' names be disclosed. n206 The recipient must be identified by name or, if applicable, the full trade name under which the person does business. The agency must also disclose the address and telephone number of the recipient, but only if specifically requested by the consumer. n207

[g] Identification of Checks Upon Which Are Based Adverse Characterization of the Consumer

The FCRA also requires disclosure of the dates, original payees, and amounts of any checks upon which is based any adverse characterization of the consumer included in the file at the time of the disclosure. n208 For example, if a consumer reporting agency has information about a bounced check in the consumer's file, disclosure of the contents of that file must include the date, payee, and amount of that bounced check.

[h] Few Rules Exist for Disclosures by Affiliates

Entities with common ownership or corporate control may share information with few restrictions.

[6] The Summary of Consumer Rights

Every time a consumer reporting agency provides a consumer with a written report, it must include with the report a "Summary of Rights." n209 The FTC form summary, the use of which or anything "substantially similar" is *a priori* in compliance:

- A brief description of the FCRA;
- A summary of all rights of the consumer under the Act;
- An explanation of how the consumer may exercise these rights;
- A toll-free telephone number, in the case of a nationwide consumer reporting agency, which is staffed during normal business hours;
- A statement that the agency is not required to remove accurate information which is not obsolete;
- A list of all federal enforcement agencies "in a form which will assist the consumer in selecting the appropriate agency"; and
- A reminder that the consumer may have additional rights under state law.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer ReportsBanking LawConsumer ProtectionFair Credit ReportingIdentity Theft

FOOTNOTES:
(n1)Footnote 1. *See 15 U.S.C. § 1681h(e).*

(n2)Footnote 2. FTC Official Staff Commentary § 610 item 6.

(n3)Footnote 3. 12 C.F.R. § 610.2(b)(1)(i)(ii) and (iii).

(n4)Footnote 4. *See* FTC's Statement of Basis and Purpose, *69 Fed. Reg. 35468* (June 24, 2004) .

(n5)Footnote 5. *Id.*

(n6)Footnote 6. See National Consumer Law Center, Fair Credit Reporting Act, § 3.3.2 (6th ed. 2006 and Supp.) for more detailed information on the centralized source for free annual credit reports.

(n7)Footnote 7. Fair and Accurate Credit Transactions Act of 2003, Pub. L. No. 108-159 (2003).

(n8)Footnote 8. The FCRA does not define the term "user" of a consumer report. The courts state that anyone receiving a consumer report and applying it to a consumer is a user and must comply with the Act. *Zeller v. Samia, 758 F. Supp. 775 (D. Mass. 1991)* ; *Rylewicz v. Beaton Servs., Ltd., 698 F. Supp. 1391, 1400 (N.D. Ill. 1988)* , *aff'd, 888 F.2d 1175 (7th Cir. 1989)* (user includes persons who acquire report for another); *Boothe v. TRW Credit Data, 557 F. Supp. 66, 71 (S.D.N.Y. 1982)* ; *see also Klapper v. Shapiro, 586 N.Y.S.2d 846 (Sup. Ct. 1992)* (attorney who submitted credit report as evidence is a user); *Yohay v. City of Alexandria Employees Credit Union, Inc., 827 F.2d 967, 973 (4th Cir. 1987)* .

(n9)Footnote 9. *15 U.S.C. § 1681m(a). See Grab v. American Lawyers Co., 2007 U.S. Dist. LEXIS 19437* (D. Haw. Mar. 19, 2007) (denying cross-motions for summary judgment when an issue of fact existed as to whether the plaintiff's credit report led to the defendant's adverse action of de-listing the plaintiff, an attorney, from its directory of attorneys).

(n10)Footnote 10. *Cf. Fischl v. General Motors Acceptance Corp., 708 F.2d 143 (5th Cir. 1983)* .

(n11)Footnote 11. *See Carroll v. Exxon Co., U.S.A., 434 F. Supp. 557 (E.D. La. 1977)* ; Conf. Rep. No. 1587, 91st Cong., 2d Sess., *reprinted in* 1970 U.S.C.C.A.N. 4416 ("immediately upon denial"); *see also* H.R. 15073, 91st Cong., 2d Sess., 116 Cong. Rec. 36571 (1970) ("assuring immediate notification").

(n12)Footnote 12. FTC official Staff Commentary § 615 item 11. *See also Fischl v. GMAC, 708 F.2d 143, 149-50 (5th Cir. 1983)* (notice required where credit was denied because a generally excellent report was not considered sufficient in the lender's eyes).

(n13)Footnote 13. *15 U.S.C. § 1681m(a)*; FTC Official Staff Commentary § 615 item 14.

(n14)Footnote 14. *Wood v. Holiday Inns, Inc., 508 F.2d 167 (5th Cir. 1975)* .

(n15)Footnote 15. *See* Ch. 5 *supra*. *See also* National Consumer Law Center, Credit Discrimination (6th ed. 2006 and Supp.); *Cannon v. Metro Ford, Inc., 242 F. Supp. 2d 1322 (S.D. Fla. 2002)* (repossession could be adverse action if based on credit report); *Castro v. Union Nissan, Inc., 2002 U.S. Dist. LEXIS 12917* (N.D. Ill. July 3, 2002) (same); *Barnette v. Brook Road, 457 F. Supp. 2d 647, 657 (E.D. Va. 2006)* (for purposes of the FCRA, car dealer took an adverse action against car buyer when it cancelled the sale to the buyer and repossessed the car after a lender denied credit); *Gillom v. Ralph Thayer Auto. Livonia, Inc., 444 F. Supp. 2d 763, 772 (E.D. Mich. 2006)* (denying cross-motions for summary judgment when parties disputed whether the defendant, a car seller, merely asked the plaintiff, a car buyer, to re-sign paperwork she had already signed or whether it instead had told the plaintiff that the dealership had not charged her enough to be able to obtain financing); *Robertson v. TJB Enters., Inc., 2006 U.S. Dist. LEXIS 40072* (W.D. Va. June 16, 2006) (denying summary judgment to car dealer who had cancelled a sale and repossessed the plaintiff's car after a lender denied credit).

(n16)Footnote 16. *See* Ch. 5 *supra*.

(n17)Footnote 17. FTC Official Staff Commentary § 615 item 9.

(n18)Footnote 18. FTC Official Staff Commentary § 615 item 9.

(n19)Footnote 19. *See § 5.07[3] supra*; *Harper v. Lindsay Chevrolet Oldsmobile, L.L.C., 212 F. Supp. 2d 582 (E.D. Va. 2002)* ; *Mayberry v. Ememessay Inc., 201 F. Supp. 2d 687 (W.D. Va. 2002)* ; *Austin v. J.C. Penney Co., 162 F. Supp. 2d 495 (E.D. Va. 2001)* (without deciding the conflicting authority as to whether a check is a credit instrument, court determines that initial refusal to accept check due to credit report, and acceptance of the check 45 minutes later is adverse action within the meaning of FCRA. Court deems notice burden on merchants too great.); National Consumer Law Center, Credit Discrimination § 10.5.4.2 (5th ed. 2009); National Consumer Law Center, Fair Credit Reporting, § 8.2.6.4.3.5 (6th ed. 2006 and Supp.). The FTC has issued contradictory staff opinion letters relating to this issue. The first FTC staff opinion letter (Brinckerhoff, FTC Informal Staff Opinion Letter, May 31, 1996) supports the argument that a counteroffer with adverse terms is the type of action for which the FCRA notice was created. The example used in the opinion letter is an applicant for an auto loan who had to pay more to finance an automobile purchase than she would have been charged if her credit record had been better. According to this opinion, the increase in charge triggers the notice required under § 1681m of the FCRA. A subsequent FTC staff opinion letter does not address the analysis and conclusion contained in the Brinckerhoff letter and instead simply follows the definition of adverse action contained in Regulation B. Keller, FTC Staff Opinion Letter, July 14, 2000; Berger, FTC Staff Opinion Letter, June 28, 2003.

(n20)Footnote 20. *Greenway v. Information Dynamics, Ltd., 524 F.2d 1145 (9th Cir. 1975)* , *cert. dismissed*, *424 U.S. 936, 96 S. Ct. 1153, 47 L. Ed. 2d 344 (1976)* .

(n21)Footnote 21. Guidelines for Financial Institutions in Complying with the Fair Credit Reporting Act Question 9 (1971).

(n22)Footnote 22. *See* FTC Official Staff Commentary § 615 item 5.

(n23)Footnote 23. Pub. L. No. 108-159 (2003).

(n24)Footnote 24. Keller, FTC Informal Staff Opinion Letter, April 5, 1999, National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)

(n25)Footnote 25. *See 15 U.S.C. § 1681a(h). See also* Silbergeld, FTC Informal Staff Opinion Letter, April 15, 1971. FTC, Compliance with the Fair Credit Reporting Act 41. *Cf.* Maloney, FTC Staff Opinion Letter, Sept. 4, 1984 (reproduced on the accompanying CD-Rom).

(n26)Footnote 26. Pub. L. No. 108-159, § 611(b) (2003), *amending 15 U.S.C. § 1681a(d)(2)(D).*

(n27)Footnote 27. *15 U.S.C. § 1681a(d)(2)(D)*, *amended by* Pub. L. No. 108-159, § 611(b) (2003).

(n28)Footnote 28. *Id.*

(n29)Footnote 29. *15 U.S.C. § 1681a(d)(2)(D)(x)*, *added by* Pub. L. No. 108-159, § 111 (2003).

(n30)Footnote 30. *See 15 U.S.C. § 1681b(b)(3).*

(n31)Footnote 31. *15 U.S.C. § 1681b(b)(3)*; *Obabueki v. International Bus. Machs. Corp., 145 F. Supp. 2d 371* , *mot. denied, 2001 U.S. Dist. LEXIS 11810* (S.D.N.Y. Aug. 14, 2001) , *aff'd*, *319 F.3d 87 (2d Cir. 2003)* .

(n32)Footnote 32. *15 U.S.C. § 1681k.*

(n33)Footnote 33. FCRA §§ 615(a) and 603(k), *15 U.S.C. §§ 1681m* and *1681a*, *as amended by* Pub. L. No. 104-208, §§ 2411 and 2402, *110 Stat. 3009* (Sept. 30, 1996). *See* Isaac, FTC Informal Staff Opinion Letter, Oct. 13, 1995 ("Insurers, unlike creditors under the Equal Credit Opportunity Act, are not required to disclose to consumers the specific reasons for denying insurance. However, we would encourage insurers to disclose this information, especially if the denial was based on information obtained for a consumer reporting agency, as this would better enable consumers to readily identify and correct any inaccurate information being reported about them.") [*See* National Consumer Law

Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)]. *See also Razilov v. Nationwide Mutual Ins. Co., 242 F. Supp. 2d 977 (D. Or. 2003)* (obligation limited to issuer; does not extend to underwriter; only the actual insurer must give notice; affiliates involved in the decision are not subject to the adverse action requirement); *Ashby v. Farmers Group, Inc., 261 F. Supp. 2d 1213 (D. Or. 2003)* ; *Spano v. Safeco Ins. Co., 215 F.R.D. 601 (D. Or. 2003))* .

(n34)Footnote 34. *Braxton v. Farmers Ins. Group, 209 F.R.D. 654 (N.D. Ala. 2002)* .

(n35)Footnote 35. *Braxton v. Farmers Ins. Group, 209 F.R.D. 654 (N.D. Ala. 2002)* .

(n36)Footnote 35.1. Medine, F.T.C. Informal Staff Opinion Letter (May 31, 1995). *See also* Isaac, F.T.C. Informal Staff Opinion Letter (July 5, 1995).

(n37)Footnote 36. FCRA §§ 615(a) and 603(k), *15 U.S.C. §§ 1681m* and *1681a*, *as amended by* Pub. L. No. 104-208, §§ 2411 and 2402, *110 Stat. 3009* (Sept. 30, 1996).

(n38)Footnote 37. FCRA §§ 615(a) and 603(k), *15 U.S.C. §§ 1681m* and *1681a*, *as amended by* Pub. L. No. 104-208, §§ 2411 and 2402, *110 Stat. 3009* (Sept. 30, 1996).

(n39)Footnote 38. FCRA §§ 615(a) and 603(k), *15 U.S.C. §§ 1681m* and *1681a*, *as amended by* Pub. L. No. 104-208, §§ 2411 and 2402, *110 Stat. 3009* (Sept. 30, 1996).

(n40)Footnote 39. *Perry v. First Nat'l Bank, 459 F.3d 816 (7th Cir. 2006)* (collecting cases); *Putkowski v. Irwin Home Equity Corp., 423 F. Supp. 2d 1053, 1060-1062 (N.D. Cal. 2006)* ; *Villagran v. Freeway Ford, Ltd., 2006 U.S. Dist. LEXIS 25563* (S.D. Tex. Jan. 19, 2006) .

(n41)Footnote 40. *15 U.S.C. § 1681m(a). See also Fischl v. GMAC, 708 F.2d 143, 150 (5th Cir. 1983)* ; *Wiggins v. District Cablevision, Inc., 853 F. Supp. 484 (D.D.C. 1994)* .

(n42)Footnote 41. FTC Official Staff Commentary § 607 item 2B.

(n43)Footnote 42. FCRA § 607(c), *15 U.S.C. § 1681e(c)*, *as amended by* Pub. L. No. 104-208, § 2407, *110 Stat. 3009* (Sept. 30, 1996).

(n44)Footnote 43. FTC Official Staff Commentary § 615 item 13. When disclosing a reporting agency's address, the user must disclose the complete street address of the agency, and not merely the post office box number, so that the consumer may ascertain the exact location of the agency involved. FTC Official Staff Commentary § 615 item 12. *See also* Bragg, FTC Informal Staff Opinion Letter, Dec. 3, 1971. However, one court has determined that disclosing only the name of the report maker, where the consumer was subsequently able to determine the address of the agency, was "substantial compliance" and sufficient under the Act. *Kiblen v. Pickle, 653 P.2d 1338, 1342 (Wash. Ct. App. 1982)* .

(n45)Footnote 44. FCRA § 615(a), *15 U.S.C. § 1681m(a)*, *as amended by* Pub. L. No. 104-208, § 2411, *110 Stat. 3009* (Sept. 30, 1996).

(n46)Footnote 45. FCRA § 615(a), *15 U.S.C. § 1681m(a)*, *as amended by* Pub. L. No. 104-208, § 2411, *110 Stat. 3009* (Sept. 30, 1996). The previous law contained no specific language on the issue.

(n47)Footnote 46. FTC Official Staff Commentary § 615 item 3; *see also* FTC, Compliance with the Fair Credit Reporting Act, at 38-39 (1977).

(n48)Footnote 47. *15 U.S.C. §§ 7701-7031*.

(n49)Footnote 48. *15 U.S.C. § 7001(c)(1)(A)-(D)*.

(n50)Footnote 49. *15 U.S.C. § 1681m(b)*. *See also* FTC Official Staff Commentary § 615 item 15; Brinckerhoff, FTC Informal Staff Opinion Letter, Dec. 28, 1984.

(n51)Footnote 50. *See* FTC Official Staff Commentary § 615 item 15.

(n52)Footnote 51. *15 U.S.C. § 1681m(b)*; FTC Official Staff Commentary § 615 item 16. *See also* Brinckerhoff, FTC Informal Staff Opinion Letter, Feb. 16, 1989.

(n53)Footnote 52. *15 U.S.C. § 1681m(b)*.

(n54)Footnote 53. FTC Official Staff Commentary § 615 item 16.

(n55)Footnote 54. FCRA § 615(b), *15 U.S.C. § 1681m(b)*, *as amended by* Pub. L. No. 104-208, § 2411, *110 Stat. 3009* (Sept. 30, 1996).

(n56)Footnote 55. *15 U.S.C. § 1691*.

(n57)Footnote 56. *See 12 C.F.R. § 202.9(a)*; *see also §§ 5.02[1]*, *5.07[5] supra* .

(n58)Footnote 57. *12 C.F.R. § 202.9(a)(1)(i)*.

(n59)Footnote 58. *12 C.F.R. § 202.9(a)(2)*.

(n60)Footnote 59. FRB Official Staff Commentary on Regulation B § 202.9(b)(2)-1.

(n61)Footnote 60. 12 C.F.R. § 202 app. C Form C-1.

(n62)Footnote 61. 12 C.F.R. § 202 app. C.

(n63)Footnote 62. FTC Official Staff Commentary § 615 item 1.

(n64)Footnote 63. Sen. Rep. No. 312, at 20 (Oct. 17, 2003).

(n65)Footnote 64. *15 U.S.C. § 1681m(h)(6)*, *as amended by* Pub. L. No. 108-159, § 311 (2003).

(n66)Footnote 65. Pub. L. No. 108-159, § 311 (2003).

(n67)Footnote 66. *Id*.

(n68)Footnote 67. *15 U.S.C. § 1681m(h)(6)*, *as amended by* Pub. L. No. 108-159, § 311 (2003).

(n69)Footnote 68. The risk-based pricing notice is in addition to any other notices that are required under the FCRA. An adverse action required under § 1681m(a) cannot substitute for the risk-based pricing notice. *15 U.S.C. § 1681m(h)*4).

(n70)Footnote 69. *15 U.S.C. § 1681m(h)(8)(A)*, *added by* Pub. L. No. 108-159, § 311 (2003).

(n71)Footnote 70. *15 U.S.C. § 1681t(b)(1)(I)*, *added by* Pub. L. No. 108-159, § 311 (2003).

(n72)Footnote 71. *15 U.S.C. § 1681k*.

(n73)Footnote 72. FTC, Compliance with the Fair Credit Reporting Act, at 35 (1977).

(n74)Footnote 73. FTC Official Staff Commentary § 613 item 5.

(n75)Footnote 74. *15 U.S.C. § 1681k(1)*.

(n76)Footnote 75. *15 U.S.C. § 1681k(2)*.

(n77)Footnote 76. *15 U.S.C. § 1681k(2)*.

(n78)Footnote 77. FTC Official Staff Commentary § 606 item 7. *See also* Feldman, FTC Informal Staff Opinion Letter, Aug. 21, 1974.

(n79)Footnote 78. *15 U.S.C. § 1681b(c)*, *(f)*, m(d).

(n80)Footnote 79. *Perry v. First Nat'l Bank, 459 F.3d 816 (7th Cir. 2006)* ; *Putkowski v. Irwin Home Equity Corp., 423 F. Supp. 2d 1053 (N.D. Cal. 2006)* ; *Villagran v. Freeway Ford, Ltd., 2006 U.S. Dist. LEXIS 25563* (S.D. Tex. Jan. 19, 2006) . *But see Barnette v. Brook Road, Inc., 429 F. Supp. 2d 741 (E.D. Va. 2006)* .

(n81)Footnote 80. See National Consumer Law Center, Fair Credit Reporting Act, § 8.2.6.5 (6th ed. 2006 and Supp.).

(n82)Footnote 81. *31 U.S.C. § 3711(e)*. Information that may be released is limited to the name, address and social security number of the obligor, the amount of the claim, and the agency involved. *31 U.S.C. § 3711(e)(1)(F)*.

(n83)Footnote 82. *31 U.S.C. § 3711(e)(1)(C)*.

(n84)Footnote 83. *31 U.S.C. § 3711(e)(1)*.

(n85)Footnote 84. *31 U.S.C. § 3711(e)(1)*.

(n86)Footnote 85. *31 U.S.C. § 3711(e)(1)(E)*.

(n87)Footnote 86. *See § 16.03[2][b][vi]*, *supra*.

(n88)Footnote 87. *15 U.S.C. § 1681a(d)*(2(D), *as amended by* Pub. L. No. 108-159, § 611(b) (2003).

(n89)Footnote 88. *15 U.S.C. § 1681a(x)(D)(i)-(iii)*, *added by* Pub. L. No. 108-159, § 611 (2003).

(n90)Footnote 89. *15 U.S.C. § 1681b(b)(2)*.

(n91)Footnote 90. *15 U.S.C. § 1681b(b)(3)*.

(n92)Footnote 91. *15 U.S.C. § 1681b(g)*. *See also Cal. Civ. Code § 1785.13(f)* (credit reporting agencies may not include medical information in their files or furnish medical information for employment, insurance or credit purposes in a consumer credit report without the consumer's consent).

(n93)Footnote 92. *15 U.S.C. § 1681b*, *as amended by* Pub. L. No. 108-159, § 411 (2003).

(n94)Footnote 93. *15 U.S.C. § 1681b(g)(1)(B)(ii)*, *added by* Pub. L. No. 108-159, § 412 (2003).

(n95)Footnote 94. *15 U.S.C. §§ 1681b(g)(1)(A)-(C)*, *as amended by* Pub. L. No. 108-159, § 411 (2003).

(n96)Footnote 95. *15 U.S.C. § 1681b(g)(5)(A)*, *as amended by* Pub. L. No. 108-159, § 411(a) (2003).

(n97)Footnote 96. *15 U.S.C. § 1681a(d)(2)(A)*.

(n98)Footnote 97. *15 U.S.C. § 1681s-3*, *added by* Pub. L. No. 108-159, § 214 (2003). Certain exemptions apply. *15*

U.S.C. § 1681s-3(a)((4).

(n99)Footnote 98. *15 U.S.C. § 1681s-3(a)(3)*, *added by* Pub. L. No. 108-159, § 214 (2003).

(n100)Footnote 99. *15 U.S.C. § 1681t(b)(1)(H)*, *added by* Pub. L. No. 108-159, § 214 (2003).

(n101)Footnote 100. *Minn. Stat. § 13C.02*.

(n102)Footnote 101. *Cal. Civ. Code § 1785.26*.

(n103)Footnote 102. *15 U.S.C. § 1681g(d)(2)*, *added by* Pub. L. No. 108-159, § 212(d) (2003). The effective date for this provision is December 1, 2004. *69 Fed. Reg. 6526-6531* (Feb. 11, 2004) .

(n104)Footnote 103. *Id*.

(n105)Footnote 104. *15 U.S.C. § 1681c-1*, *added by* Pub. L. No. 108-159, § 112 (2003). The effective date for this requirement is December 1, 2004. *69 Fed. Reg. 6526-6531* (Feb. 11, 2004) .

(n106)Footnote 105. *Id*.

(n107)Footnote 106. *15 U.S.C. § 1681c-2(a)*.

(n108)Footnote 107. *15 U.S.C. § 1681c-2(c)(2)*.

(n109)Footnote 108. *See 15 U.S.C. § 1681i(a)(5)(B)*.

(n110)Footnote 109. *15 U.S.C. § 1681c-2(d)(3)*, *added by* Pub. L. No. 108-159, § 112 (2003).

(n111)Footnote 110. *Id*.

(n112)Footnote 111. *15 U.S.C. § 1681m(b)(2)(B)*, *added by* Pub. L. No. 108-159, § (2003). The effective date for this provision is December 1, 2004. *69 Fed. Reg. 6526-6531* (Feb. 11, 2004) .

(n113)Footnote 112. *15 U.S.C. § 1681s-2(a)(7)*, *added by* Pub. L. No. 108-159, § 217 (2003).

(n114)Footnote 113. *15 U.S.C. § 1681s-2(a)(7)(F)*.

(n115)Footnote 114. *15 U.S.C. § 1681s-2(a)(7)(A)(ii)*.

(n116)Footnote 115. *15 U.S.C. § 1681s-2(c)(1)*, *as amended by* Pub. L. No. 108-159, § 312 (2003).

(n117)Footnote 116. *15 U.S.C. § 1681i(a)(5)(B)*.

(n118)Footnote 117. *15 U.S.C. §§ 1681d(c)*, *1681m(c)*. *See Yohay v. City of Alexandria Employees Credit Union, Inc., 827 F.2d 967 (4th Cir. 1987)* ; *Carroll v. Exxon Co., U.S.A., 434 F. Supp. 557 (E.D. La. 1977)* .

(n119)Footnote 118. *Carroll v. Exxon Co., U.S.A., 434 F. Supp. 557 (E.D. La. 1977)* .

(n120)Footnote 119. *15 U.S.C. § 1640(c)* provides that a creditor may not be held liable if he shows by a preponderance of the evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid such errors.

(n121)Footnote 120. *537 F.2d 871, 878 (7th Cir. 1976)* , *cert. denied, 439 U.S. 1039 (1978)* .

(n122)Footnote 121. *Matthews v. Government Employees Ins. Co., 23 F. Supp. 2d 1160 (S.D. Cal. 1998)* .

(n123)Footnote 122. Schieber, FTC Informal Staff Opinion Letter, Mar. 3, 1998. *Cf. Sapia v. Regency Motors, 276 F.3d 747 (5th Cir. 2002)* (where only one of several lenders contacted by the auto dealer failed to provide notice of adverse action, the dealer's failure to give the required notice did not give rise to actual damages.).

(n124)Footnote 123. FTC, Compliance with the Fair Credit Reporting Act, at 26 (1977).

(n125)Footnote 124. *See § 5.07[5] supra.*

(n126)Footnote 125. *12 C.F.R. § 202.14(c).*

(n127)Footnote 126. FCRA § 609, *15 U.S.C. § 1681g*, *as amended by* Pub. L. No. 108-159 (2003). Section 1681j also mandates disclosure after a credit denial. Note that the obligation to disclose to the consumer is mandatory. See Pub. L. No. 90-321, § 502 (May 29, 1968), *82 Stat. 146, 147.*

(n128)Footnote 127. *15 U.S.C. § 1681g(f)*, *added by* Pub. L. No. 108-159, § 212 (2003); *16 C.F.R. § 602.1(c)(3)(x)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) . The agency need not disclose more than four key factors that adversely affected the consumer's credit score, with the proviso that if the number of enquiries to the consumer's file was a key factor in the score, that factor must be disclosed and is not counted under the cap. *15 U.S.C. §§ 1681g(f)(1)(C)*, *(f)(9).* Under the prior version of the Act, consumers were not entitled to learn their credit scores.

(n129)Footnote 128. *See, e.g., Heath v. Credit Bureau of Sheridan, Inc., 618 F.2d 693 (10th Cir. 1980)* ; *Hauser v. Equifax, Inc., 602 F.2d 811 (8th Cir. 1979)* ; *Ackerley v. Credit Bureau of Sheridan, Inc., 385 F. Supp. 658 (D. Wyo. 1974) . Cf. Wiggins v. Equifax Servs., Inc., 848 F. Supp. 213 (D.D.C. 1993) .*

(n130)Footnote 129. *See, e.g., Collins v. Retail Credit Co., 410 F. Supp. 924 (E.D. Mich. 1976) .*

(n131)Footnote 130. *See § 16.03[5][c] infra.*

(n132)Footnote 130.1. *15 U.S.C. § 1681a(d).*

(n133)Footnote 130.2. *15 U.S.C. §§ 1681a(g)*, *1681g(a).*

(n134)Footnote 130.3. *15 U.S.C. § 1681e(c).*

(n135)Footnote 131. *15 U.S.C. § 1681h(b).*

(n136)Footnote 132. *Clay v. Equifax, Inc., 762 F.2d 952 (11th Cir. 1985) .*

(n137)Footnote 133. *Millstone v. O'Hanlon Reports, Inc., 383 F. Supp. 269 (E.D. Mo. 1974)* , *aff'd*, *528 F.2d 829 (8th Cir. 1976) .*

(n138)Footnote 134. *15 U.S.C. § 1681j(a)(2)*, *added by* Pub. L. No. 108-159, § 211(a) (2003). The agencies that must comply with the free report provision are those described in *15 U.S.C. § 1681a(p).* However, requests from nationwide specialty consumer reporting agencies, those defined by *15 U.S.C. § 1681a(w)*, will not be made through a centralized source but rather pursuant to forthcoming regulations that will require such agencies to provide, at a minimum, a toll-free telephone number for consumers to use to request a free report. *15 U.S.C. § 1681j(a)(C)(i)*, *added by* Pub. L. No. 108-159, § 211(a) (2003). The free report provision will not apply to consumer reporting agencies that have been furnishing consumer reports to third parties for fewer than twelve months prior to the date of the consumer's request. *15 U.S.C. § 1681j(a)(4).* However, with respect to requests for reports from nationwide specialty agencies through forthcoming regulations, or through the extended fraud alert provision,

(n139)Footnote 135. *15 U.S.C. § 1681c-1(b)*, *added by* Pub. L. No. 108-159, § 112 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(i)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n140)Footnote 136. As allowed by *15 U.S.C. § 1681g*, *as amended by* Pub. L. No. 108-159, § 115 (2003).

(n141)Footnote 137. *15 U.S.C. § 1681c-1(b)*, *added by* Pub. L. No. 108-159, § 112 (2003).

(n142)Footnote 138. *15 U.S.C. § 1681h(b)*.

(n143)Footnote 139. Brinckerhoff, FTC Informal Staff Opinion Letter, Sept. 11, 1987.

(n144)Footnote 140. FCRA § 610(a)(1), *15 U.S.C. § 1681h(a)(1)*, *as amended by* Pub. L. No. 104-208, § 2408, *110 Stat. 3009* (Sept. 30, 1996).

(n145)Footnote 141. *15 U.S.C. § 1681h(b)(2)*.

(n146)Footnote 142. FTC Official Staff Commentary § 609 item 3.

(n147)Footnote 143. *15 U.S.C. § 1681h(a)(2)*.

(n148)Footnote 144. FTC Official Staff Commentary § 610 item 3.

(n149)Footnote 145. *See* Feldman, FTC Informal Staff Opinion Letter, May 22, 1974.

(n150)Footnote 146. *15 U.S.C. § 1681h(c)*. *See also* FTC Official Staff Commentary § 609 item 5. *See also Millstone v. O'Hanlon Reports, Inc., 383 F. Supp. 269 (E.D. Mo. 1974)* , *aff'd*, *528 F.2d 829 (8th Cir. 1976)* .

(n151)Footnote 147. *15 U.S.C. § 1681g(c)(2)*, *as amended by* Pub. L. No 108-159, § 211(2003).

(n152)Footnote 148. *15 U.S.C. § 1681h(d)*.

(n153)Footnote 149. *15 U.S.C. § 1681h(d)*. *See also* Bragg, FTC Informal Staff Opinion Letter, May 15, 1972. Unless the consumer refuses to comply with those requirements, the reporting agency may not refuse to make disclosure in the presence of another person. *See Collins v. Retail Credit Co., 410 F. Supp. 924 (E.D. Mich. 1976)* .

(n154)Footnote 150. *15 U.S.C. § 1681m(b)*.

(n155)Footnote 151. *15 U.S.C. § 1681j(a)*, *15 U.S.C. § 1681j(a)*, *amended by* Pub. L. No. 108-159, § 212(a)(2) (2003).

(n156)Footnote 152. Defined in § 603(p), *15 U.S.C. § 1681a(p)*.

(n157)Footnote 153. *69 Fed. Reg. 35468-35502* (June 24, 2004) .

(n158)Footnote 154. *16 C.F.R. § 610.2(b)(1)*. The exact website and mailing addresses and phone number are selected by the nationwide CRAs, and so could change in the future.

(n159)Footnote 155. Those defined by *15 U.S.C. § 1681a(w)*, *added by* Pub. L. No. 108-159, § 111(2003).

(n160)Footnote 156. *15 U.S.C. § 1681j(a)(C)(i)*, *added by* Pub. L. No. 108-159, § 211(a) (2003). *See* National Consumer Law Center, Fair Credit Reporting Act, § 3.4.2.3 (6th ed. 2006)

(n161)Footnote 157. Pub. L. No. 108-159, § 211 (2003). The provision does not apply to a nationwide agency that has not been furnishing consumer reports on a continuing basis for the twelve months preceding a consumer's request. *15 U.S.C. § 1681j(a)(4)*, *added by* Pub. L. No. 108-159, § 211 (2003). The FACTA provides that the FTC has six months from the effective date of the Act to issue regulations that will create the centralized source through which consumers are to make their requests and the regulations will not become effective until six months after they become

final. *Id*. However, the FTC's proposed regulations would implement a "cumulative regional roll-out" for the centralized source that would delay complete access to the source to September 1, 2005. *69 Fed. Reg. 13198* (Mar. 19, 2004) .

(n162)Footnote 158. The websites are www.experian.com, www.transunion.com, and www.equifax.com respectively.

(n163)Footnote 159. For details on requesting information from the three major reporting agencies, see National Consumer Law Center, Fair Credit Reporting Act, 3.3.2 (6th ed. 2006 and Supp.). For information about ordering reports from Equifax, the consumer should call (800) 997-2493. A consumer can order a report on-line via www.equifax.com, or by requesting the report in writing from Equifax, P.O. Box 740241, Atlanta, GA 30374-0241. Experian's telephone number to call to order reports is (888) EXPERIAN ((888) 397-3742); a report can also be ordered from Experian's web site, www.experian.com. Consumers can also send a written request to Experian, National Consumer Assistance Center, P.O. Box 2104, Allen, TX 75013-2104. Trans Union provides information about ordering reports at (800) 916-8800; a report can also be ordered from Trans Union's web site, www.transunion.com. Residents of Colorado, Georgia, Maryland, Massachusetts, New Jersey and Vermont and consumers of any state who have been denied credit on the basis of a Trans Union report and who requests a report within sixty days of the denial can order a free report by calling (800) 888-4213.

(n164)Footnote 160. FCRA § 610(a)(1), *15 U.S.C. § 1681h(a)(i). Sarver v. Experian Info. Solutions, Inc., 299 F. Supp. 2d 875 (N.D. Ill. 2004)* , *aff'd on other grounds*, *390 F.3d 969 (7th Cir. 2004)* (reasonable to request Social Security Number).

(n165)Footnote 161. *15 U.S.C. § 1681e(a)*.

(n166)Footnote 162. *Equifax, Inc., 96 F.T.C. 844 (1980)* , *rev'd in part on other grounds*, *678 F.2d 1047 (11th Cir. 1982)* (consumer reporting agency agreed to stop collecting more information than it actually needed to verify identification). *See also American Serv. Bureau, Inc., 92 F.T.C. 330, 336 (1978)* ; *Credit Bureau Assocs., 92 F.T.C. 837, 840 (1978)* .

(n167)Footnote 162.1. *16 CFR § 614.1(a)*.

(n168)Footnote 162.2. *16 CFR § 614.1(b)*.

(n169)Footnote 162.3. *See Cordero v. Financial Assistance, Inc., 2006 U.S. Dist. LEXIS 86694* (N.D. Cal. Nov. 29, 2006) (plaintiff's computer consultant able to obtain plaintiff's credit report without SSN from both a CRA terminal and a subscriber terminal).

(n170)Footnote 163. *15 U.S.C. § 1681b(2)*. The FACTA of 2003 added, among other privacy protections, a provision allowing the consumer requesting the report to require the agency to truncate the first five digits of the consumer's social security number from the report, so long as the agency has received adequate proof of the requesting consumer's identity; this provision will go into effect December 1, 2004. *15 U.S.C. 1681g(a)(1)(A)*, *amended by* Pub. L. No. 108-159, § 115 (2003); *16 C.F.R. § 602.1(c)(3)(iii)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n171)Footnote 164. Grimes, FTC Informal Staff Opinion Letters, Oct. 8, 1986, and Dec. 15, 1986.

(n172)Footnote 165. Practitioners have reported, however, that some bureaus have refused to comply with an attorney's request for a report, even when the request asks for the report to be sent directly to the consumer client.

(n173)Footnote 166. FTC Official Staff Commentary § 609 item 4.

(n174)Footnote 167. Supplementary information published with the Commentary, *55 Fed. Reg. 18,805* (May 4, 1990) . *See also A- 1 Credit & Assurance v. Trans Union Credit Info., 678 F. Supp. 1147 (E.D. Pa. 1988)* .

(n175)Footnote 168. *15 U.S.C. §§ 1681g, 1681h.*

(n176)Footnote 169. *See* FTC Official Staff Commentary § 610 item 2.

(n177)Footnote 170. *15 U.S.C. § 1681j(b)*, Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).

(n178)Footnote 171. FTC Official Staff Commentary § 612 item 1.

(n179)Footnote 172. *See* Grimes, FTC Informal Staff Opinion Letters, Jan. 17, 1989.

(n180)Footnote 173. FCRA § 612(c), *15 U.S.C. § 1681j(c)*, *as amended by* Pub. L. No. 104-208, § 2410, *110 Stat. 3009* (Sept. 30, 1996).

(n181)Footnote 174. FCRA § 612(c), *15 U.S.C. § 1681j(c)*, *as amended by* Pub. L. No. 104-208, § 2410, *110 Stat. 3009* (Sept. 30, 1996).

(n182)Footnote 175. FCRA § 612(c), *15 U.S.C. § 1681j(c)*, *as amended by* Pub. L. No. 104-208, § 2410, *110 Stat. 3009* (Sept. 30, 1996).

(n183)Footnote 176. *15 U.S.C. § 1681c-1(b)*, *added by* Pub. L. No. 108-159, § 112 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(i)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n184)Footnote 177. As allowed by *15 U.S.C. 1681g*, *as amended by* Pub. L. No. 108-159, § 115 (2003).

(n185)Footnote 178. *15 U.S.C. § 1681c-1(b)*, *added by* Pub. L. No. 108-159, § 112 (2003).

(n186)Footnote 179. The effective date of this provision allowing consumers a free annual credit report from nationwide consumer reporting agencies may be delayed since the FTC has six months to issue regulations that will create the centralized source through which consumers are to make their requests, and the regulations will not become effective until 6 months after they become final. Pub. L. No. 108-159, § 211 (2003); *15 U.S.C. § 1681j(a)*, *amended by* Pub. L. No. 108-159, § 212 (2003). Furthermore, the FTC's proposed regulations would implement a "cumulative regional roll-out" for the centralized source that would delay complete access to the source to September 1, 2005. *69 Fed. Reg. 13198* (Mar. 19, 2004) .

(n187)Footnote 180. *15 U.S.C. § 1681j(f)*, *amended by* Pub. L. No. 108-159, § 211(a)(6) (2003). However, the provision does not apply to a nationwide agency that has not been furnishing consumer reports on a continuing basis for the twelve months preceding a consumer's request. *15 U.S.C. § 1681j(a)(4)*, *added by* Pub. L. No. 108-159, § 211 (2003).

(n188)Footnote 180.1. Pub. L. No. 111-24, § 205(a), *123 Stat. 1734,* § 205(a) (May 22, 2009) (adding section § 612(g) of the Fair Credit Reporting Act, to be codified at *15 U.S.C. § 1681j(g)*).

(n189)Footnote 180.2. *Id.*

(n190)Footnote 180.3. *Id.* § 205(b).

(n191)Footnote 181. *Credit Data of Ariz., Inc. v. Arizona, 602 F.2d 195 (9th Cir. 1979) .*

(n192)Footnote 182. *71 Fed. Reg. 74913* (Dec. 13, 2006) . The maximum charge may increase from year to year. By January 1st of each year, the FTC is required to adjust the maximum charge to reflect changes in the Consumer Price Index.

(n193)Footnote 183. *15 U.S.C. § 1681g(a).* Prior to 1996, only the "nature and substance" of information in the

file, sources of information, and the recipients of credit reports had to be disclosed. *See* Cohan, FTC Informal Staff Opinion Letter, August 1, 2001.

(n194)Footnote 184. FTC Official Staff Commentary § 609 item 5. However, nothing in the FCRA requires that consumer reporting agencies retain information that they use in files for any specific duration.

(n195)Footnote 185. Federbush, FTC Informal Staff Opinion Letter, Mar. 10, 1983. *See also* Cong. Rec. H36,572, Oct. 13, 1970, 91st Cong. 2d Sess.; *In re Equifax, 96 F.T.C. 844 (1980)* , *limited reversal on other grounds*, *678 F.2d 1047 (11th Cir. 1982)* .

(n196)Footnote 186. Darcy, FTC Informal Staff Opinion Letter, June 30, 2000 [*reproduced at* National Consumer Law Center, Fair Credit reporting Act, App. E (6th ed. 2006 and Supp.).

(n197)Footnote 187. *15 U.S.C. § 1681g(c)(1)(B)*.

(n198)Footnote 188. FTC Official Staff Commentary § 603(g) items 2, 3. *See also* Federbush, FTC Informal Staff Opinion Letter, Mar. 10, 1983.

(n199)Footnote 189. FTC Official Staff Commentary § 609 item 7; *see also* Federbush, FTC Informal Staff Opinion Letter, Mar. 10, 1983.

(n200)Footnote 190. FTC Official Staff Commentary § 609 item 7. *See also* Jerison, FTC Informal Staff Opinion Letter, Aug. 5, 1988.

(n201)Footnote 191. *15 U.S.C. § 1681m(a)*.

(n202)Footnote 192. Medine, FTC Informal Staff Opinion Letter, May 31, 1995 [reproduced in National Consumer Law Center, Fair Credit reporting Act, App. E (6th ed. 2006 and Supp.). *See also* Isaac, FTC Informal Staff Opinion Letter, July 5, 1995 [reproduced in National Consumer Law Center, Fair Credit reporting Act, App. E (6th ed. 2006 and Supp.). The terms of the agreement provided for the applicant's right to obtain a summary of the MIB report at no charge within 30 days following adverse action. Since, the statute was amended to require free charges for reports obtained within 60 days of adverse action. Presumably, the statutory change applies to MIB.

(n203)Footnote 193. FTC, Consumer Reports: What Insurers Should Know About Using Them (June, 1995).

(n204)Footnote 194. FCRA § 604(g), *15 U.S.C. § 1681b(g)*. Some states have started to regulate medical information in consumer reports. For example, credit reporting agencies in California may not include medical information in their files or furnish medical information for employment, insurance or credit purposes in a consumer credit report without the consumer's consent. *Cal. Civ. Code § 1785.13(f)*.

(n205)Footnote 195. *15 U.S.C. § 1681a(i)*, *amended by* Pub. L. No. 108-159, § 411(c) (2003). This provision became effective on June 1, 2004, 180 days after passage of the FACTA. Pub. L. No. 108-159, § 411(d) (2003).

(n206)Footnote 196. *15 U.S.C. § 1681a(c)*, *added by* Pub. L. No. 108-159, § 111 (2003).

(n207)Footnote 197. *15 U.S.C. § 1681j(a)(1)(C)*, *added by* Pub. L. No. 108-159, § 211 (2003).

(n208)Footnote 198. *15 U.S.C. § 1681g(a)(1)*.

(n209)Footnote 199. *15 U.S.C. § 1681g(a)(2)*.

(n210)Footnote 200. *15 U.S.C. § 1681g(a)(2)*.

(n211)Footnote 201. *15 U.S.C. § 1681g(a)(3)*.

(n212)Footnote 202. *15 U.S.C. § 1681g(a)(3)(A)*. *See also* FTC Official Staff Commentary § 609 item 10; Jerison, FTC Informal Staff Opinion Letter, Aug. 3, 1988; *see also* Benner, FTC Informal Staff Opinion Letter, Apr. 10, 1999 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006 and Supp.)].

(n213)Footnote 203. *15 U.S.C. § 1681g(a)(5)*. *See also* FTC Official Staff Commentary § 609 item 11.

(n214)Footnote 204. *15 U.S.C. § 1681g(a)(3)(c)*.

(n215)Footnote 205. *15 U.S.C. § 1681u(d)*.

(n216)Footnote 206. Guidelines for Financial Institutions in Complying with the Fair Credit Reporting Act (1971). *See also* FTC, Compliance with the Fair Credit Reporting Act, at 30 (1977).

(n217)Footnote 207. *15 U.S.C. § 1681g(a)(3)(B)(ii)*. It is not clear that the name, address, or phone number of recipients of prescreened lists containing the consumer's name must be provided or disclosed. The statute could be read as requiring on the disclosure of "a record of all [such] inquiries," *15 U.S.C. § 1681g(a)(5)*, although disclosure of all information in the file is elsewhere required.

(n218)Footnote 208. *15 U.S.C. § 1681g(a)(4)*.

(n219)Footnote 209. *15 U.S.C. § 1681g(c)*, *as amended by* Pub. L. No. 108-159, § 211(c) (2003). As required by FACTA, the FTC issued revised summary of consumer rights. *69 Fed. Reg. 42616-26* , Appx. F, (July 16. 2004), *codified at* 16 C.F.R. Part 698. The FTC interpreted FACTA to provide the agencies with flexibility as to the structure of the disclosure because it is a "model" form and a "substantially similar" summary will comply with the Commission's rule and statutory requirement. *Id. at 42617*.

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1-16 Consumer Credit Law Manual § 16.04

§ 16.04 Furnishing Consumer Reports to Users

In order to safeguard the confidentiality of information about consumers and to protect individual privacy, the FCRA contains specific restrictions on the release of consumer reports. The FCRA was amended by the Fair and Accurate Credit Transactions Act of 2003. Privacy and the protection of consumer financial information from identity theft were two of the major objectives behind many of the amendments. n1 Most of these amendments are addressed in other sections in this chapter, however some of the amendments affect the furnishing of information to users of credit reports.

[1] When Reports May Be Released

[a] General

Consumer reports can only be disseminated for the purposes designated under the FCRA and for *no* other purpose. A person who wants information about a consumer for a purpose not listed in the FCRA must obtain the information from a source other than a consumer report. The fact that a report's use is impermissible does not make the report no longer a consumer report. If a report at any point in time qualifies as a consumer report, then users without permissible purposes, as specifically listed in the FCRA, cannot have access to that report.

If a user has a permissible purpose, the consumer cannot stop the reporting agency from furnishing the report. n2 A reporting agency may, however, refuse a user's request for a consumer report, n3 or establish any conditions it wishes on provision of the report. n4

A user with a permissible use cannot obtain a report and then put the report to an impermissible use. n5 Nor can a user with a permissible purpose pass the report on to a third party with an impermissible use. n6

[b] Agents of the User

An agent of a party with a permissible purpose may obtain a consumer report on behalf of the principal where the agent is involved in the decision that gives rise to the permissible purpose. n7 Such involvement may include the agent's making a decision or taking action for the principal, or helping to evaluate the information. n8 By implication, an agent without such an involvement does not have a permissible purpose. n9 A car dealer is not vicariously liable if it induces a finance company to impermissibly obtain a report; only the finance company is liable. n10

[c] Release by One Reporting Agency to Another

A consumer reporting agency may furnish a consumer report to another consumer reporting agency for it to furnish to a requesting subscriber. In this circumstance, one reporting agency is acting on behalf of another. n11 The agency receiving a request from a subscriber is responsible for determining the subscriber's permissible purpose, and the agency providing the report to the other agency need only determine if the requesting agency's purpose is to provide the report to a subscriber with a permissible purpose. However, the second agency, often a "reseller," is responsible for complying with all the requirements imposed by the FCRA on credit reporting agencies. n12

[d] Is Information a Consumer Report if Released for Impermissible Purposes?

Consumer reporting agencies often attempt to defend having furnished information for an impermissible purpose by arguing that the information does not fall within the definition of a consumer report because it was not used for a purpose specified in the Act. Consequently, they argue, there can be no FCRA violation because the FCRA does not apply.

The FTC and the courts generally reject this rationale. n13 If the information was originally *collected* for a permissible purpose, or the reporting agency expected it to be used for a permissible purpose, the Act applies to the information, regardless of its actual use. n14 The requirement that consumer reports be given only to users with permissible purposes would be meaningless if the courts did not look beyond the actual use of the information in the case being litigated. n15

[e] Discovering an Impermissible Use

Probably the best approach to discovering whether a consumer report has been used for an impermissible purpose is to request a copy from Experian, Equifax, and Trans Union. If any of the prior users named on the report are not familiar to the consumer, or the consumer's contact with a particular user does not seem to give rise to a legitimate business reason for obtaining a consumer report, the consumer may have a cause of action against the user and/or the reporting agency. Nevertheless, when a consumer is added to a prescreening list (e.g., for solicitation for a credit card or another offer), the user requesting the list will be added to the consumer's file as a user. It is thus important to differentiate between users of prescreening lists and those who do not have a permissible purpose to receive a report on the consumer. It can sometimes be difficult for consumers to determine whether the inquiries are permissible or not because creditors use many different names, some of which may not be familiar to the consumer.

[2] Permissible Uses

[a] In Response to a Court Order

A report may be furnished "[i]n response to the order of a court having jurisdiction to issue such an order, or a subpoena issued in connection with proceedings before a Federal grand jury." n16

Four statutory provisions explicitly enlarge on the court order permissible purpose. First, the Tax Code now requires reporting agencies to open their files upon receipt of a summons and a specific IRS certificate that the subject of the files has not moved in a timely fashion to quash the summons. n17

Second, information may be released pursuant to a subpoena issued in connection with proceedings before a *federal* grand jury. n18 A *state* grand jury subpoena, however, provides a permissible purpose to release a consumer report only if the subpoena is signed by a judge or magistrate.

Third, the FTC has the power to subpoena consumer reports in connection with any investigation under the FCRA. n19 Other federal agencies with enforcement authority under the FCRA should have the same power, n20 as should state officials with authority under state "little FCRA" statutes. n21

Fourth, the FBI may obtain identifying information and banking information from reporting agencies for counterintelligence purposes. The FBI may seek more complete information about an individual for similar reasons by *ex parte* application and *in camera* consideration by a court.

[b] The Consumer's Written Instructions

A consumer report may be furnished when the consumer gives the reporting agency written instructions or permission to provide a report to the user, n22 regardless of whether the report would otherwise be for a permissible purpose. n23 Under the federal E-Sign Act, an electronic authorization may suffice. n24

[c] Identifying Information Furnished to the Government

Although consumer reporting agencies must furnish consumer reports only to users with permissible purposes, reporting agencies may furnish certain "identifying information" to governmental agencies. n25 This information is the consumer's name, address, former addresses, places of employment, or former places of employment.

[d] Permissible Use in Connection With Credit

[i] General

Users have a permissible use for a consumer report "in connection with a credit transaction involving the consumer ... and involving the extension of credit to, or review or collection of an account of, the consumer." n26 A user has a permissible purpose to obtain a consumer report on the person it thinks is applying for credit, even though applicant is an identity thief. n27 On the other hand, if the credit application was taken for the purpose of identity theft, a jury could determine that there was no permissible purpose. n28 "Credit" is defined in the FCRA n29 to have the same meaning as in section 1691a of the Equal Credit Opportunity Act (ECOA). Under the ECOA, credit is defined as "the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment therefor." n30

One troubling consequence of this permissible purpose can arise when a merchant, such as a car dealer, uses it to shop for financing for the consumer, which can result in many inquiries added all at once to the consumer's file. Not only can multiple inquiries pull down a credit score, creditors may find the multiple inquiries, in and of themselves, reflect poorly on the consumer's credit history and deny credit on that basis. n31 If a key factor that adversely affects a consumer's credit score consists of the number of enquiries made with respect to a consumer report, that factor must be included in the disclosures of a credit score, a new requirement under the FACTA of 2003. n32 This requirement is not subject to the disclosure limitation of only four key factors that adversely affect a credit score. n33

It is not enough that a potential sales transaction may be financed by an extension of credit to the consumer. A consumer may comparison shop, *i.e.,* ask about price and financing, without indicating an intent to purchase or finance a transaction. The seller or creditor may obtain a consumer report for credit purposes only when it becomes evident that the consumer has made an offer or otherwise initiated a credit transaction, n34 or when an existing credit transaction is involved. If, for example, an automobile dealer wishes to see a consumer's credit report before answering questions about the availability of financing, the dealer must request the consumer's formal authorization. n35 Sufficient reason for obtaining a credit report does not exist simply to see if the consumer is a potential customer.

[ii] Collection of Credit Accounts, Judgment Debts

A consumer report may be used in reviewing or collecting an existing credit account. n36 This allows the use of consumer reports for "skip tracing," in which the creditor hires a person to locate a debtor to facilitate the collection of a consumer account. n37 Collection agencies may obtain consumer reports and a reporting agency may furnish a

consumer report to an attorney for use in a lawsuit involving a credit account. n38

Even in the case of credit accounts, collection is not a permissible purpose for obtaining a consumer report once the account is no longer collectible, i.e., because it has been discharged in bankruptcy. n38.1

The FTC Staff Commentary states that a party attempting to collect on a returned check has a permissible purpose to obtain a report concerning the maker of the check, n38.2 although the FTC has been inconsistent about whether check writing involves credit.

Whether a residential lease is a credit transaction, which would allow use of consumer reports to collect past-due rent, is not uniformly resolved. The FTC takes the view that residential leases do not involve credit, and therefore an attorney cannot legitimately seek a consumer report to collect past-due rent unless she is enforcing a judgment. n38.3 This approach is consistent with interpretations of the term "credit" under the ECOA, n38.4 which is now incorporated into the FCRA. On the other hand, before the FCRA was linked to the ECOA, courts usually held that a lease is a credit transaction, allowing access to consumer reports for collection purposes.

The FTC Commentary indicates that, even if there originally was no credit relationship between a consumer and another, the relationship becomes a creditor/debtor relationship when judgment is secured against the consumer. Thereafter, the judgment creditor may obtain a consumer report on the judgment debtor in an effort to locate the consumer or the consumer's assets. n39 However, one court has held that the 2003 amendments to the FCRA may repudiate the earlier view of the FTC and most courts that consumer reports may be used to collect on non-credit-related judgment debts. n39.1 The 2003 amendments added a definition of "credit." The court held that a child support order could not meet that definition, because a typical child-support arrangement does not involve one party granting rights to another to defer payment, as required under the definition. Moreover, the definition of "credit" incorporates the definition of "creditor," n39.2 and a party to a child support order does not "regularly extend" credit, as required under that definition. The court rejected the argument that collection of a judgment debt need not bear a nexus to a credit transaction and found that an agency retained by one parent to collect child support did not have a permissible purpose to obtain a credit report. This reasoning, if followed by other courts, would apply to other types of non-credit-related judgment debts as well.

The child support collection unit of a district attorney's office may obtain a consumer report to determine whether court-ordered support payments should be increased, if the intent of the unit is to collect amounts due and not to initiate criminal prosecution. n40 Consumer reports may also be furnished to child support enforcement agencies where quasi-judicial administrative orders which establish liability for the payments have been entered. n41 Once the obligation is established, whether by court decree or administrative order, the child support agency becomes a judgment creditor having a permissible purpose to obtain a consumer report, n42 as does the parent/creditor. n43

[iii] Business Credit as Permissible Purpose

A consumer report cannot be furnished to a creditor to determine an individual's or businesses' eligibility for business credit. If a partnership or corporation applies for credit, a reporting agency may not furnish a consumer report about an individual partner, owner, or officer of the business, n44 absent specific authorization or application from the individual. n45

While the FTC limits the permissible purpose of determining eligibility for credit only to credit for personal, family or household purposes, the FTC defines "personal, family and household purposes" to include credit for securities transactions and real estate investments, as long as the consumer is not engaged in such transactions as a business. n46

[iv] Assessment and Review of Existing Credit Obligations

Creditors may obtain a consumer report as part of a review of an existing account or credit obligation. n47 Reviews frequently occur when creditors seek to determine whether to retain, close out, or modify current terms of an account for better or for worse. This permissible purpose does not permit access to consumer report information for the purpose of offering unrelated products or services. n48

Third parties who are considering buying or investing in a consumer credit transaction, or merely servicing a current credit obligation, also have a permissible purpose to obtain a consumer report. n49

[e] Permissible Use in Connection With Employment

[i] Employment Purposes

Another permissible purpose for which a consumer report may be furnished to a user is for "employment purposes," n50 which is defined to mean "evaluating a consumer for employment, promotion, reassignment or retention as an employee." n51 This includes employers who are "considering the possibility" of actions, such as termination, n52 investigating a current employee concerning disappearance of money from the employment premises (because the employee's retention is at issue), n53 and determining whether a government contractor's employee should have security clearance. n54 It also includes trucking firms who are hiring drivers as independent contractors. n55 However, certain employee investigations are now excluded from the definition of a consumer report. n56 Jury duty is a civic duty, not employment, and therefore counsel has no permissible purpose to obtain reports on potential jurors. n57 Further, the evaluation of Workers Compensation Fund claims is unrelated to the enumerated employment purposes, and is not a permissible reason to obtain a consumer report. n58

An employer may not obtain a consumer report on someone other than the subject of its decision-making. n59 A user may not obtain consumer reports on an employment applicant's relatives, even where the applicant is being considered for a security-sensitive position. n60 Before obtaining a report for employment purposes, the employer must have the employee's written consent. n61

The Fourth Circuit found that a state licensing board has an employment purpose in receiving a consumer report in order to evaluate an applicant for a professional license, n62 even if there is no employer-employee relationship between the board and the applicant.

Once an employment relationship has ended, and re-employment is not contemplated, the former employer no longer has an "employment purpose" for a consumer report on the former employee. If the employer takes adverse action based in any part on the consumer report, the employer must provide an adverse action notice to the employee (or prospective employee). n63 Note that some states may have statutes restricting use of consumer reports for employment purposes. n63.1

[ii] Employer Must Provide Prior Certification

A consumer reporting agency may not release a consumer report for employment purposes without certain certifications by the employer. n64 This requirement applies so long as the report does not fall within the excluded communications provision that was added to the FCRA by the FACTA of 2003. n65 The employer must certify that it has clearly and conspicuously disclosed to the consumer that a consumer report may be obtained for employment purposes, and that the consumer has authorized in writing the procurement of the report. In addition, the employer must certify that prior to taking adverse action based in full or in part on the consumer report, the employer will give the consumer a copy of the consumer report along with a Summary of Consumer Rights as prescribed by the FTC. The reporting agency is required only to have received the employer's certification; it is not required to obtain further evidence of compliance. n66 Exceptions exist for security clearance related employment decisions by United States government agencies and for the tracking industry. n67 In addition, the FACTA of 2003 provides for exceptions for certain communications relating to

employer investigation of employees. n68

[iii] Agency Must Enclose Summary of Consumer Rights

The reporting agency may release a consumer report for employment purposes only if it provides with the report a Summary of Consumer Rights. n69 The employer, in turn, is required to provide an employee or potential employee with a copy of this Summary in the event the employer takes adverse action on the basis of the consumer report. However, if the report pertains to an employee investigation that falls outside coverage as a consumer report under the FACTA amendments, the employee is only entitled to a summary of the report if adverse action is taken. They will are not entitled to the Summary of Rights. n70

[f] Permissible Use in Connection With Insurance

Another permissible purpose for furnishing consumer reports to users is "in connection with the underwriting of insurance involving the consumer." n71 Underwriting activities include deciding whether to issue or cancel a policy and determination of coverage, terms, rates and similar items. n72 Underwriting does not include investigating an insurance claim after the insurance has been written.

Consumer reports may be furnished for insurance use only when the insurance is for personal, non-business purposes. n73

[g] Permissible Use in Connection With Government Licenses or Other Benefits

Another permissible use of a consumer report is "in connection with a determination of the consumer's eligibility for a license or other benefit granted by a governmental instrumentality required by law to consider an applicant's financial responsibility or status." n74

The user of the report need not be the governmental instrumentality itself. Any party charged by law (including regulations having the force of law) with responsibility for assessing the consumer's eligibility for the benefit has a permissible purpose. n75 If the governmental body has reason to believe a particular consumer's eligibility is in doubt, or wishes to conduct random checks to confirm eligibility, it has a permissible purpose. n76

[h] Permissible Use by Child Support Enforcement Agencies

Another permissible purpose is in connection with state or local agency determination and enforcement of child support awards. n77 Only a public agency may obtain a consumer report under this provision.

Consumer reports for child support enforcement purposes may be provided two different ways. An agency administering a state plan under *42 U.S.C. section 654* may obtain a consumer report to use to set an initial child support award or to later modify it.

A state or local agency may, with proper certification, also obtain a consumer report for child support enforcement purposes even if it is not the agency administering the state plan.

[i] Permissible Use in Connection With Business Transactions

[i] User's Business Purpose, Where Individual Has a Consumer Purpose

A consumer reporting agency may furnish a consumer report to any user with a legitimate business need for the information in connection with a business transaction initiated by the consumer. n78 The transaction must involve the individual as a consumer. Consumer reports can thus be furnished to a user in connection with a business transaction

where the consumer enters the transaction for personal, family, or household purposes. n79

[ii] Where Individual Has a Business Purpose

If a report is used, expected to be used, and collected for purely business or commercial reasons, then a consumer report is *not* involved, the FCRA does not apply, and the FCRA does not restrict the possible use of such a non-consumer report. On the other hand, if a report qualifies as a consumer report, then the prevailing view, as discussed below, is that the report cannot be furnished for transactions the *consumer* enters into for business or commercial reasons as opposed to personal, family or household purposes. (Of course, the consumer can consent in writing to such use.)

The FTC takes the position that the reference to business transactions as a permissible purpose is limited to transactions for personal, family, or household purposes. n80 One would expect the FTC position now to be adopted uniformly by the courts, except that courts may question the lack of statutory language limiting the business transactions provision to just personal, family, or household purposes. n81 Normally, courts will not import language or meaning into a statute unless no other way exists to resolve a conflict. Moreover, unlike other consumer protection legislation, consumer is defined to mean an individual, n82 without any limitation as to the purposes of the consumer's actions.

To avoid this problem, some courts have held that any business use of a consumer report is permissible. n83 Such an interpretation does not incorporate the predominant view that consumer reports cannot be furnished to evaluate an individual's or business' eligibility for business or commercial credit or insurance, or for evaluating any type of insurance claim.

[j] Permissible Use by FBI for Counterintelligence Purposes

The FCRA grants to the FBI secret access to information from consumer reporting agencies for counterintelligence purposes. n84 This access is not to be reported to consumers. If this section is violated, the consumer may claim statutory damages of one hundred dollars in addition to actual and punitive damages and attorneys fees. Injunctive relief is also available.

[3] Reports Issued for Impermissible Purposes

[a] Use in Alimony, Child Support or Paternity Proceedings

A person seeking to enforce a child support order has a permissible purpose to obtain the consumer's report. A child support order, whether judicial or administrative, creates a debtor-creditor relationship with the consumer. n85 Certain public officials also have a permissible purpose to use consumer reports to help determine child support levels. Prior to the amendment permitting this use, in contrast to the enforcement of a child support order, a child support agency seeking to establish paternity or the duty to pay child support did not have a permissible purpose for obtaining a consumer report. n86 Similar logic would indicate that a consumer report cannot be used to establish a property settlement or child custody in a divorce proceeding, but can be used in an attempt to collect alimony after a payment schedule is set by a court.

[b] Use in Tax Collection Proceedings

A tax collection agency has no general permissible purpose to obtain a consumer report to collect delinquent tax accounts because, until the tax amount is reduced to some kind of judgment, there is no debtor-creditor relationship. n87

A tax collection agency does have a permissible purpose after it has acquired a tax lien having the same effect as a judgment or after it has obtained a judgment. n88 In addition, the Internal Revenue Service ("IRS"), but not other tax collection agencies, was given in 1976 special statutory authority to require a consumer reporting agency to furnish a consumer report in response to an IRS summons.

[c] Use in Civil or Criminal Litigation

Generally, a party involved or potentially involved in litigation does not have a permissible purpose to receive a consumer report because litigation is not a permissible purpose. In addition, litigation between two parties usually does not come under the business transaction permissible purpose. n89

Potential plaintiffs may not use consumer reports to determine whether potential defendants are worth suing, unless the litigation otherwise involves a permissible purpose (such as a suit on a credit account, actions to collect on a judgment, or a business transaction between the two parties). n90 The FTC would also say that a suit against a former tenant does not involve credit and a consumer report may not be used for this purpose. n91 If there is no permissible purpose relating to the litigation, there is no permissible purpose to obtain a consumer report for the purpose of locating a defendant, for service of process or otherwise, in connection with litigation. n92 Likewise, it is impermissible to obtain a defendant's credit report with the intent of forcing a party to settle litigation. n93

An attorney may have a permissible purpose to obtain a consumer report on a prospective client, however, if a consumer is seeking legal assistance from an attorney for personal, family, or household purposes. n94 An attorney for a collection agency has no immunity from suit under the FCRA simply because he obtained and used a credit report in the course of his duties as a lawyer in the context of litigation. n95

[d] Use by Investigators

Detectives and other investigators are covered by the same permissible purposes rules that apply to their clients. Thus, consumer reports could be furnished to a detective for skip tracing purposes while investigating a consumer for employment, insurance, credit, or debt collection purposes, or, in relationship to a business transaction, but not for other purposes. n96

[e] Use of Reports on the Consumer's Spouse, Relatives, or Other Third Parties

There is no permissible purpose to obtain a consumer report on one individual to assist the user in making a determination on a different individual.

Nevertheless, certain specific situations exist where a *creditor* can obtain information about an applicant's spouse or other third party involved in a credit transaction. A permissible purpose exists to obtain a report on a third party:

- At the time of a credit application where the consumer is relying on the third party's income or assets to establish credit, or the third party will be an authorized user on the account; or

- At the time of account collection if the third party is liable on the account. n97

If none of these narrow exceptions apply, then the creditor cannot obtain a consumer report on the spouse. n98

According to the FTC Commentary, a permissible purpose for making a consumer report on a nonapplicant spouse can *never* exist under the FCRA where Equal Credit Opportunity Act Regulation B prohibits the creditor from requesting the information, n99 or where a nonapplicant is a former spouse, a legally separated spouse, or has otherwise indicated an intent to legally disassociate with the marriage. n100 On the other hand, it may be that there is a permissible purpose to seek information on a divorced spouse if alimony or child support payments from that spouse are relied upon by the applicant to qualify for credit. n101 A former spouse also has a permissible purpose to obtain a joint credit report of her former husband when the information contained in the report related to the creditworthiness, credit standing and credit capacity of the parties' ability to discharge their parental duties under state law. n102 An ex-spouse may access the former spouse's credit report as long as she reasonably believes the former spouse owes her a debt (even if it is not

actually owed). n103

[f] Use in Connection With Insurance Claims

Most courts and FTC opinions have held that insurance claims reports are not consumer reports when information is used, expected to be used, and collected solely for that purpose.

Nevertheless, there is still the question whether a consumer report can be furnished to a user whose purpose involves investigation of an insurance claim.

The FTC Commentary finds no permissible purpose to use consumer reports for insurance claims purposes. n104 The FCRA lists as permissible insurance purposes only those uses "connected with the underwriting of insurance." n105

Practitioners report that insurance companies utilize waivers containing vague but broad language in connection with processing insurance claims. Such waivers are then used as grounds to access consumer reports and gather information on the consumers. This practice undermines the FCRA's protections against accessing consumer reports for impermissible purposes.

[g] Use of Lists of Consumers, Marketing Research, and Prescreening

[i] General

Users often seek from reporting agencies lists of consumers with certain characteristics, or lists which specify the varying characteristics of individuals on the list. Whether reporting agencies can provide such lists to users will turn on three questions--whether the lists are consumer reports (and thus covered by the FCRA), whether the user has a permissible purpose for obtaining the list, and whether the user has a permissible purpose for obtaining information on every member of the list.

[ii] Requirement That Lists Be Coded

Lists of consumers are prohibited, unless at the time the list is furnished to the user, the user is involved in a transaction with *every* consumer on the list. A list of consumers and their characteristics is actually a consumer report on each named individual on the list, n106 and the user must have a permissible purpose to obtain the information from each consumer on the list. n107

The FTC Commentary provides an important exception to this rule, however: such lists are not consumer reports and can be provided to users as long as the list is coded (for example, by social security number) so that the consumer's identity is not disclosed. n108

The list becomes a series of consumer reports when the list is decoded. n109 At that time, the user must have a permissible purpose for each report (i.e., on each individual) that is decoded. For example, a reporting agency might provide a user with a list of individually coded bad check writers. The agency also provides the user with additional information to "break" the code. This is permissible as long as the user does not break the code on an individual until that individual seeks to write a check with that creditor. n110

[iii] Permissible Purpose Also Required

Lists compiled for marketing research cannot be used under the FCRA because marketing research is not a permissible purpose. n111

[iv] Prescreening Lists

Prescreening is the process whereby consumer reporting agencies compile or edit lists of consumers who meet specific criteria, and then provide the lists to users who solicit consumers with a firm offer for the users' products or services. n112 Prescreening is at the heart of the pre-approved credit card solicitations that inundate many households. The FCRA allows prescreening for credit and insurance purposes only; n113 prescribes limitations on prescreening; and requires that the reporting agencies maintain an elaborate system permitting consumers to elect to be excluded from prescreened lists. n114

The section of the FCRA governing prescreening is titled Furnishing Reports in Connection With Credit or Insurance Transactions That Are Not Initiated by the Consumer. In the vernacular, however, this simply means prescreening.

[A] Prescreened Lists Are a Type of Consumer Report

Consumer reporting agencies do in fact compile and sell many kinds of mailing lists to retailers to use to solicit business from consumers, many of which are not prescreened reports. These so-called target marketing lists compete with thousands of other mailing lists of consumers sold to every imaginable kind of business. The question is when a mailing list of consumers from a consumer reporting agency is a prescreened list and when is it a target marketing list. If it is a prescreened list, the list may be sold, but only for credit or insurance purposes and only to be used by the retailer to make a "firm offer" to the consumer. If it is a target marketing list, its use may be altogether unrestricted.

In a settlement with TRW (now Experian) in the early 1990s, the FTC distinguished between the use of generic identification information to generate mailing lists and lists compiled from credit information (and presumably employment or insurance information) used as a factor in determining a consumer's creditworthiness. Thus, TRW could freely use names, telephone numbers, mother's maiden names, addresses, zip codes, years of birth, ages, generational definitions, social security numbers, and "substantially similar" identifiers to compile lists of consumers for marketing purposes. n115 Such target marketing lists the FTC considers outside the scope of the FCRA and FCRA restrictions do not apply.

Trans Union goes much further. Its target marketing lists are compiled from information collected and used by retailers in determining creditworthiness. That is, the lists reflect specific credit-based factors, such as number of car loans, open credit card accounts and credit limits, presence of second mortgages, and/or credit scores. n116 These lists are heavily marketed to send catalogues, sweepstakes promotions, product offers, and invitations to apply for services.

Following remand from the U.S. Court of Appeals, n117 the FTC recently affirmed an administrative law judge's ruling, on remand from the U.S. Court of Appeals, that such lists are prescreening lists that may be used only for permissible purposes enumerated by the FCRA. n118 The Commission interpreted "factor in establishing the consumer's eligibility for credit" n119 to include *any* information considered by lenders in prescreening. The D.C. Court of Appeals denied Trans Union's subsequent petition for review, n120 finding substantial evidence to support the Commission's finding that Trans Union allowed marketers to request lists based on any of five categories of information: credit limits, open dates of loans, number of tradelines, type of tradeline and existence of a tradeline, and that lenders consider each of these five categories of information in prescreening or credit scoring models. n121 Accordingly, the Commission was justified in finding that the target marketing lists were "consumer reports." In dissenting from the denial of Trans Union's petition for *certiorari*, Justice Kennedy recognized, "Prescreening entails the disclosure of detailed credit performance information, including bill payment history. Release of this information is far more invasive of consumer privacy than release of the names and addresses contained in petitioner's marketing lists." n122

In prescreening, the user may provide a list of consumers to a reporting agency, which then edits out consumers with credit problems. Alternatively, the consumer reporting agency may generate lists from its own files. The prescreened list is a series of consumer reports because the list conveys information on each individual's creditworthiness or insurability, n123 and the user wishes to mail an offer to individuals on the list. The user can receive little more than the

name and the address of the consumer. n124 An identifier may be provided, but it must not be unique to the consumer, such as a social security number is, and is to be used solely for the purpose of verifying the identity of the consumer. Other information about the consumer may be provided, but it must not identify the relationship or the experience of the consumer with a particular creditor, insurer, or other entity.

[B] A Firm Offer Is Required

A consumer reporting agency may provide a prescreened list of consumers only if the user makes a so-called "firm offer" of credit or insurance to each consumer on the list, or if the consumer authorizes an agency to include the consumer's name and address on prescreening lists. A firm offer is necessary in the logic of the statute because the report can be used only in connection with a consumer transaction. Having a firm offer apparently is close enough.

A "firm offer" does not have to be very firm or include specific terms, such as interest rate. n125 The general rule is that the offer of credit or insurance will be honored if, based on the information in the consumer report, the consumer meets the criteria specified for the prescreening list. However, the definition of firm offer allows three contingencies. n126 First, the user may require and rely on the consumer's application for whatever product or service is offered. The second, the user may retain the right to verify that the consumer meets the criteria used to select the prescreening list. The third, the consumer may be required to provide sufficient collateral for the offered credit or insurance. The collateral requirement must be disclosed to the consumer in the offer.

The Seventh Circuit has ruled that "sham" offers--those that provide no meaningful benefit to consumers in exchange for giving up statutorily protected privacy rights in credit reports--are not "firm offers." The court rejected defendant's claim that guarantee of at least $300 credit line to buy a car at interest rates anywhere from 2.9% to 24.9% is a firm offer. Defendant argued that a firm offer can be of any amount, but the court disagreed, concluding that such a definition would eviscerate the statutory purpose behind the FCRA to protect consumer data and privacy. In reversing the lower court the Seventh Circuit found that the "*entire* offer and the effect of *all* material conditions that comprise the credit product in question" must be considered. n127

On the other hand, another Seventh Circuit panel found 2-1, over a strong dissent, that a credit card offer had value even though the card was admittedly not an attractive deal for "the great majority" of consumers. n128 The defendant offered a credit card with a $250 credit limit and with $184 in fees for opening the account. The court noted that the offer did specify the material terms and might have value to a consumer who charged and paid off $250 in purchases each month and was trying to build up or reestablish credit.

The rigor of the "firm offer" test varies considerably from judge to judge, even in the same court. n128.1 Some courts reject offers that treat prescreened consumers no differently than other consumers, n128.2 but others strain to find value even in totally vague offers with significant contingencies. n128.3 Some courts outside of the Seventh Circuit have rejected the idea that an offer must have some value to be firm. n128.4

Note that a firm offer of credit may not be accompanied by a credit card; if it is, the issuer has violated the Truth in Lending Act's prohibition against unsolicited credit cards. n129 A lender has a permissible purpose to request a credit report to verify eligibility even if the lender previously represented that the consumer was preapproved for credit. The Act specifically permits lenders to make purportedly "firm offers of credit" that are conditioned on verification "using information in a consumer report" that the consumer continues to meet the criteria used to make the offer. n129.1

[C] Consumers Can Elect to Be Excluded From Prescreening Lists

Recognizing the intrusive nature of direct marketing campaigns, the FCRA requires that consumer reporting agencies which prepare prescreening lists also maintain a system by which consumers may elect to have their names omitted from such lists. n130 Consumer reporting agencies must establish and maintain a notification system, including a

toll-free number, which permits any consumer to notify agencies of the consumer's election to keep his or her name and address off such marketing lists. The nationwide reporting agencies must operate a joint notification system, so that an opt-out notice to one is effectively an opt-out notice to the others and their affiliates. To remove oneself from future prescreened offers and solicitations for more than two years, the consumer must submit a signed notice of election issued by the agency. n131 Indications are that consumers overwhelmingly choose to opt out permanently. n132 As of December 1, 2004, the term of the opt-out period changed from two years to five. n133 This right to opt-out of prescreening lists should not be confused with the new right of consumers to opt-out of the use of their information by affiliates for marketing purposes. This right, added by the FACTA, applies to information that falls outside of the FCRA's definition of consumer report pursuant to either the first-hand knowledge exception or the affiliate exception. n134 Pursuant to a FACTA requirement, the FTC issued a final rule for the prescreened offer notice in which consumers are informed of their right to opt out of receiving future prescreened offers. n135 The effective date for this regulation is August 1, 2005. n136 Each prescreened offer must contain a short statement informing consumers of their right to opt out and listing the toll-free number to call, as well as a longer statement providing additional information about prescreening. Agencies must present the notice in that format and must also include the address and telephone number of the opt-out notification system. n137

[v] No FCRA Restriction Where List Does Not Involve Consumer Reports

Lists which are not used, expected to be used, or collected for evaluating consumers for credit, insurance, employment, or other permissible purposes are not consumer reports and are not subject to the Act. Examples may include telephone directories, lists of individuals with checking accounts, lists used only for law enforcement purposes, target marketing, and lists of insurance agents. n138 Whether a list is a series of consumer reports is a factual issue which must be resolved based on the expected and actual uses of the lists. However, although the FCRA may not prohibit a consumer reporting agency from reporting lists that do not involve consumer reports, if the information on the list falls within the Gramm-Leach-Bliley Act's definition of nonpublic personal information, n139 it may be protected from disclosure by that Act.

[4] Agency Procedures Insuring That Only Users With Permissible Purposes Obtain Reports

[a] General

Consumer reporting agencies have two separate obligations concerning when they can release consumer reports to users, and they should be liable under the FCRA for failing to comply with *either* provision. Agencies cannot furnish consumer reports for impermissible purposes, and both negligent and willful violations of this requirement are actionable under the Act. n140 In addition, reporting agencies must "maintain reasonable procedures ... to limit the furnishing of consumer reports to the purposes listed." n141 Failure to comply with this provision should be actionable under the FCRA as well. That is, agencies are liable if they *either* furnish reports for impermissible purposes or if they do not maintain reasonable procedures. n142

[b] User Identification and Certifications

[i] Nature of Certification

The reporting agency must obtain a specific, *written* certification that the recipient will obtain reports for certain specific purposes and for no others. n143 If the report is obtained by a reseller to furnish to someone else, the reseller must identify the end-user. In addition, if an investigative consumer report has been requested, the user must certify to the agency that it has already made the required disclosures to the subject of the report, and, further, that, upon written request, the user will make a complete and accurate disclosure of the nature and scope of the investigation requested.

Reports used for employment purposes and some reports requested by child support enforcement agencies are subject to additional certification requirements which are discussed elsewhere.

[ii] Blanket Certifications

The user may provide a blanket certification stating that it will use all reports only for particular specified permissible purposes and for no others. As long as there is no reason to believe the user may be violating its certification, additional certification need not be provided for each individual report furnished. n144

Some auto dealers have been reported to pull customer reports before any actual application for credit has been made in order to increase negotiating power; Louisiana has even specifically addressed this abuse by statute, prohibiting dealers from requesting, obtaining or reviewing a consumer's credit report in connection with: (1) a test drive; (2) a request for information about pricing or financing; or (3) for negotiating with the consumer, unless the dealer received an application from the consumer to lease or finance or has written authorization from the consumer to obtain or review the credit report. n145 The abuse may be sufficiently widespread that a credit reporting agency may not reasonably rely on a dealer's blanket certification, but should require additional separate certifications from the dealer to ensure that the dealer has a permissible purpose, such as an application for financing or for a lease, to obtain the report.

[iii] Follow-Up and Continuing Reports

If there is a risk that follow-up reports will not be used for a permissible purpose, the reporting agency will have to obtain a separate certification for each follow-up report. n146

Similarly, if a reporting agency provides to a creditor activity reports on customers with open-end accounts, it must make certain that the creditor will notify the agency when an account is closed and paid in full. Once the account is closed, the creditor no longer has a permissible purpose to receive the report. n147

[c] Agency Verification Procedures

It is not enough that the reporting agency obtain a certification from the user. The agency must have a system to verify that it is dealing with a legitimate business having a legitimate permissible purpose for the requested report. n148 What constitutes adequate verification will vary with the circumstances. n149

When doubt arises concerning a particular user's compliance with its contractual certification, the reporting agency must take steps to insure compliance, such as requiring from that user a separate, advance certification for each report it furnishes or auditing the user to verify that it is obtaining reports only for a permissible purpose. n150

[d] Electronic Communication of Reports

Electronic communication of consumer reports to users is common. The FTC Commentary permits users to access the files of consumer reporting agencies through in-house computer terminals. n151 Agencies must, however, take the necessary steps to insure that the users have a permissible purpose. n152 The agency must also be able to know and retain a record of what users have obtained access to consumer reports on which consumers. n153

[e] Retention of Request Records

The consumer has the right to request from the reporting agency disclosure of the names of all persons who have received a report issued for any permissible purpose within the past six months, and the names of all persons who have received a report furnished for employment purposes within the preceding two years. n154 If the consumer discovers that the consumer report contains inaccurate or inadequate information, the consumer will want to ensure that all past users of the report are notified of corrections or additions to the consumer report. Additionally, the consumer will be able to discover users that may have used the report for impermissible purposes or under false pretenses. n155

[5] Liability of Reporting Agency Employees for Impermissible Uses

"Any officer or employee of a consumer reporting agency who knowingly and willfully provides information ... from the agency's files to a person not authorized to receive that information" is subject to criminal liability under the Act. n156 While the FTC has not issued an interpretation of this FCRA provision, and no criminal suits have been brought under it, it is likely that there is a private civil action under the FCRA to enforce this provision.

Where a reporting agency employee acts beyond the scope of employment, issues may arise as to whether the reporting agency is liable for the employee's release of information for an impermissible use. The consumer may be able to obtain a judgment against an employee who acts without the reporting agency's knowledge, even if there is no cause of action against the reporting agency. If an employee of the consumer reporting agency has violated the criminal provision of the Act, n157 and the reporting agency cannot be held liable for violating the Act's substantive permissible purposes requirement, n158 the reporting agency nevertheless may be liable for failing to comply with the Act's procedural requirement. n159

[6] User Liability for Impermissible Purposes n160

It is unclear whether consumers can bring FCRA actions against users for negligently obtaining information for impermissible purposes. Users are liable under the Act for actual damages and attorney fees if they negligently fail to comply with any FCRA requirement, n161 and for punitive damages as well as for willful violations. n162 The question is whether a user may be liable for negligently or willfully causing a report to be prepared for impermissible purposes in violation of section 1681b, the section on permissible purposes. n163

The more direct approach to suing is to tie liability to a user's certification violation, or to use the FCRA's false pretenses provision. Civil liability under the Act applies to users who willfully fail to comply with any FCRA requirement. n164 Furthermore, the false pretenses section provides that "[a]ny person who knowingly and willfully obtains information on a consumer from a consumer reporting agency under false pretenses" will be subject to criminal penalties. n165 Thus, consumers may bring a civil suit under the FCRA for violation of the criminal provision dealing with false pretenses. n166

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer ReportsBanking LawConsumer ProtectionFair Credit ReportingLiability

FOOTNOTES:
(n1)Footnote 1. Fair and Accurate Credit Transactions Act of 2003, Pub. L. No. 108-159 (2003).

(n2)Footnote 2. *Frederick v. Marquette Nat'l Bank, 911 F.2d 1 (7th Cir. 1990)* ;

(n3)Footnote 3. FTC Official Staff Commentary § 604(2) item 2.

(n4)Footnote 4. FTC Official Staff Commentary § 604(2) item 2. An agency's refusal to issue a report to a user because of a consumer's exercise of FCRA rights should be a violation of the Equal Credit Opportunity Act. *See 15 U.S.C. § 1691(a)(3)*; National Consumer Law Center, Credit Discrimination § 3.4.4 (5th ed. 2009) (1993 and Supp.).

(n5)Footnote 5. *Henry v. Forbes, 433 F. Supp. 5 (D. Minn. 1976)* .

(n6)Footnote 6. *See, e.g., Hansen v. Morgan, 582 F.2d 1214 (9th Cir. 1978)*

(n7)Footnote 7. *Trans Union Corp. v. FTC, 81 F.3d 228 (D.C. Cir. 1996)* ; FTC Official Staff Commentary § 604(3)(E) item 6A. *See also* Petruccelli, FTC Informal Staff Opinion Letter, Apr. 9, 1984; Garman, FTC Informal Staff

Opinion Letter, June 17, 1985. *Cf.* FTC Official Staff Commentary § 603(f) item 8.

(n8)Footnote 8. FTC Official Staff Commentary § 604(3)(E) item 6A.

(n9)Footnote 9. *Scott v. Real Estate Fin. Group, 956 F. Supp. 375 (E.D.N.Y. 1997)* ; *Daley v. Haddonfield Lumber, Inc., 943 F. Supp. 464 (D.N.J. 1996)* .

(n10)Footnote 10. *Mayberry v. Ememessay Inc., 201 F. Supp. 2d 687 (W.D. Va. 2002)* ; *Castro v. Union Nissan, Inc., 2002 U.S. Dist. LEXIS 12917* (N.D. Ill. July 3, 2002) .

(n11)Footnote 11. FTC Official Staff Commentary § 604--General item 1.

(n12)Footnote 12. *See, e.g.,* First Am. Real Estate Solutions, LLC, Case No. 952-3267 (FTC 1998) (consent agreement).

(n13)Footnote 13. *See*, *e.g.*, *Ippolito v. WNS, Inc., 864 F.2d 440 (7th Cir. 1988)* , *cert dismissed*, *490 U.S. 1061, 109 S. Ct. 1975, 104 L. Ed. 2d 623 (1989)* ; *Heath v. Credit Bureau of Sheridan, Inc., 618 F.2d 693 (10th Cir. 1980)* ; *Boothe v. TRW Credit Data, 523 F. Supp. 631 (S.D.N.Y. 1981)* , *modified*, *557 F. Supp. 66 (S.D.N.Y. 1982)* ; Supplementary Information, Official Staff Commentary paragraph number 5; *see also* Grimes, FTC Informal Staff Opinion Letter, Aug. 22, 1990; FTC Informal Staff Opinion Letter [1969-1973 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 99,424 (May 19, 1971); FTC, Compliance with the Fair Credit Reporting Act, at 47 (1977).

(n14)Footnote 14. *15 U.S.C. § 1681a(d).*

(n15)Footnote 15. *Belshaw v. Credit Bureau, 392 F. Supp. 1356 (D. Ariz. 1975) . But see Henry v. Forbes, 433 F. Supp. 5 (D. Minn. 1976)* (actual use is dispositive).

(n16)Footnote 16. *15 U.S.C. § 1681b*; *Hahn v. Star Bank, 190 F.3d 708 (6th Cir. 1999)* , *cert. denied, 592 U.S. 1020 (2000)* (leaves unresolved issue of whether a subpoena actually issued by court order); *Etefia v. Credit Techs., Inc., 628 N.W.2d 577 (Mich. Ct. App. 2001)* (a subpoena issued by an attorney was an order of the court for purposes of § 1681b(a)(1) of the FCRA). *See also Schoka v. General Motors Acceptance Corp., 1 F.3d 1247 (9th Cir. 1993)* (subpoena issued by court creates a permissible purpose); Morris, FTC Informal Staff Opinion Letter, July 26, 1979 (state and local child support enforcement agencies may receive report if used to collect child support enforcement payments subject to existing court order); *cf.* White, FTC Informal Staff Opinion Letter, Feb. 18, 1977 (county attorney does not have permissible purpose if used to investigate welfare fraud; needs court order); Scholl, FTC Informal Staff Opinion Letter, Dec. 10, 1976 (law enforcement not permissible purpose). *See also* FTC Official Staff Commentary § 604(i), item (a subpoena is not an order of the court unless signed by a judge). *Contra Etefia v. Credit Techs., Inc., 245 Mich. App. 466, 628 N.W.2d 577 (2001)* (subpoena issued by attorney is a court order).

(n17)Footnote 17. *26 U.S.C. § 7609. See also* FTC Official Staff Commentary § 604(1) item 2.

(n18)Footnote 18. *15 U.S.C. § 1681b(1).*

(n19)Footnote 19. *15 U.S.C. § 1681s(a)*; *FTC v. Manager, Retail Credit Co., Miami Branch Office, 515 F.2d 988 (D.C. Cir. 1975) . See also FTC v. TRW Inc., 628 F.2d 207 (D.C. Cir. 1980)* ; FTC Official Staff Commentary § 622 item 4.

(n20)Footnote 20. *See* FTC Official Staff Commentary § 622 item 4.

(n21)Footnote 21. *See* FTC Official Staff Commentary § 622 item 4.

(n22)Footnote 22. *15 U.S.C. § 1681b(2).*

(n23)Footnote 23. *Hammons v. Enterprise Leasing Co.-Southwest, 993 F. Supp. 1388 (W.D. Okla. 1998)* . FTC Official Staff Commentary § 604(2) item 1; *see also* Brinckerhoff, FTC Informal Staff Opinion Letter, Feb. 5, 1985; Petruccelli, FTC Informal Staff Opinion Letter, Apr. 9, 1984.

(n24)Footnote 24. Electronic Signatures in Global and National Commerce Act (E-Sign Act), *15 U.S.C. §§ 7001-7031*. Such an electronic authorization must be in a form capable of being retained and reproduced for later reference. *See also* Zalenski, FTC Informal Staff Opinion Letter, May 24, 2001.

(n25)Footnote 25. *15 U.S.C. § 1681f*; FTC Official Staff Commentary § 608 item 1.

(n26)Footnote 26. *15 U.S.C. § 1681b(a)(3)(A)*, *as amended by* Pub. L. No. 104-208, § 2403, *110 Stat. 3009* (Sept. 30, 1996).

(n27)Footnote 27. *Kennedy v. Victoria's Secret Stores Inc., 2004 U.S. Dist. LEXIS 19525* (E.D. La. Sept. 29, 2004) .

(n28)Footnote 28. *Lukens v. Dunphy Nissan, Inc., 2004 U.S. Dist. LEXIS 14528* (E.D. Pa. July 26, 2004) (alternatively, use of the information for identity theft purposes would violate the section).

(n29)Footnote 29. *15 U.S.C. § 1681a(r)(5).*

(n30)Footnote 30. *15 U.S.C. § 1691a(d)*; *12 C.F.R. § 202.2(j).*

(n31)Footnote 31. *See Andrews v. Trans Union Corp., 7 F. Supp. 2d 1056, 1075 (C.D. Cal. 1998)* (presence of inquiry, resulting from identity theft, that suggested that plaintiff had applied for credit raised issue of material fact as to whether listing of inquiry was misleading), *aff'd in part, rev'd in part on other grounds sub nom. Andrews v. TRW Inc., 225 F.3d 1063 (9th Cir. 2000) , cert. granted, 121 S. Ct. 1223 (2001) , rev'd, 122 S. Ct. 441 , and aff'd on remand, 275 F.3d 893 (9th Cir. 2001)* ; *see also* National Consumer Law Center, Fair Credit Reporting Act, § 7.2.3.2 (6th ed. 2006). Some credit scoring models try to adjust for the effect of multiple inquiries related to a single transaction by omitting or clustering them. *Id. See Castro v. Union Nissan, Inc., 2002 U.S. Dist. LEXIS 12917* (N.D. Ill. July 3, 2002) (consumers never filled out credit applications from lending institutions that pulled their credit reports, nor did they authorize dealership to "shop around" their credit report).

(n32)Footnote 32. *15 U.S.C. § 1681g(f)(9)*, *added by* Pub. L. No. 108-159, § 212 (2003).

(n33)Footnote 33. *15 U.S.C. § 1681g(f)(1)(C)*, *added by* Pub. L. No. 108-159, § 212 (2003).

(n34)Footnote 34. *Fisher v. Quality Hyundai, Inc., 2002 U.S. Dist. LEXIS 407* (N.D. Ill. Jan. 11, 2002) (allegation that consumer told dealer she did not want credit because she had loan from credit union withstands motions to dismiss on impermissible access/false pretenses claim); *Scott v. Real Estate Fin. Group, 956 F. Supp. 375 (E.D.N.Y. 1997)* (discussion between the parties had progressed to the point prospective tenants had made an offer), *aff'd in part, rev'd in part, remanded, 183 F.3d 97 (2d Cir. 1999)* (offer was conditioned by insistence that a credit report not be used); Shibley, FTC Informal Staff Opinion Letter, June 8, 1999 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)] (dentist has no permissible purpose for obtaining a consumer report when a patient comes in for a free office visit); Coffey, FTC Informal Staff Opinion Letter, Feb. 11, 1998.

(n35)Footnote 35. Coffey, FTC Informal Staff Opinion Letter, Feb. 11, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)]; Medine, FTC Informal Staff Opinion Letter, Feb. 11, 1998; *see also La. Rev. Stat. Ann. § 9:3571.2* (limiting circumstances under which a motor vehicle dealer may request, obtain or review a consumer's credit report).

(n36)Footnote 36. *15 U.S.C. § 1681b(a)(3)(A)*, as renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30,

1996); FTC Official Staff Commentary §§ 604 item 1A, 604(3)(A) item 1A.

(n37)Footnote 37. FTC Official Staff Commentary § 604(3)(A) item 1A; *see Phillips v. Grendahl, 312 F.3d 357 (8th Cir. 2002)* .

(n38)Footnote 38. *Allen v. Kirkland & Ellis, 1992 U.S. Dist. LEXIS 12383* (N.D. Ill. Aug. 14, 1992) ; FTC Official Staff Commentary § 604(3)(A) item 1A (attorney use in deciding whether to sue); *see also* Brinckerhoff, FTC Informal Staff Opinion Letter, Nov. 22, 1991. *Cf.* FTC Informal Staff Opinion Letter [1969-1973 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 99,444 (May 18, 1971).

(n39)Footnote 38.1. *See Thomas v. U.S. Bank, N.A., 2007 U.S. Dist. LEXIS 17516* (D. Or. Mar. 8, 2007) (denying summary judgment for bank because of fact issue whether bank knew account was discharged).

(n40)Footnote 38.2. FTC Official Staff Commentary § 604(3)(A) item 9. *See also* Grimes, FTC Informal Staff Opinion Letter (Feb. 10, 1987).

(n41)Footnote 38.3. *See* Long, FTC Informal Staff Opinion Letter (July 6, 2000), reprinted on the companion website to this manual.

(n42)Footnote 38.4. *See Laramore v. Richie Realty Mgmt. Co., 397 F.3d 544 (7th Cir. 2005)* ; National Consumer Law Center, Credit Discrimination § 2.2.2.2.4 (4th ed. 2005 and Supp.).

(n43)Footnote 39. FTC Official Staff Commentary § 604(3)(A) item 2. *Sather v. Weintraut, 2003 U.S. Dist. LEXIS 12435* (D. Minn. July 10, 2003) (attorney may not obtain report of someone who is not personally liable for the judgment, such as owner or officer of corporation against whom judgment was entered).

(n44)Footnote 39.1. *See Miller v. Trans Union L.L.C., 2007 U.S. Dist. LEXIS 14315* (N.D. Ill. Feb. 28, 2007) .

(n45)Footnote 39.2. *See § 16.02[2], supra.*

(n46)Footnote 40. FTC Official Staff Commentary § 604(3)(A) item 3; *see also* Isaac, FTC Informal Staff Opinion Letter, Oct. 30, 1986. *Hasbun v. County of Los Angeles, 323 F.3d. 801 (9th Cir. 2003)* (no need to comply with certification requirements when collecting overdue support).

(n47)Footnote 41. Fortney, FTC Informal Staff Opinion Letter, Dec. 2, 1983. *See also* Isaac, FTC Informal Staff Opinion Letter, Oct. 30, 1986.

(n48)Footnote 42. Fortney, FTC Informal Staff Opinion Letter, Dec. 2, 1983.

(n49)Footnote 43. *Baker v. Bronx-Westchester Investigations, Inc., 850 F. Supp. 260 (S.D.N.Y. 1994)* .

(n50)Footnote 44. *Cf. Cook v. Equifax Info. Sys., Inc., 1992 U.S. Dist. LEXIS 17921* (D. Md. Nov. 20, 1992) ; *Allen v. Kirkland & Ellis, 1992 U.S. Dist. LEXIS 12383* (N.D. Ill. Aug. 14, 1992) ; *Sizemore v. Bambi Leasing Corp., 360 F. Supp. 252 (N.D. Ga. 1973)* .

(n51)Footnote 45. *15 U.S.C. § 1681b(2).*

(n52)Footnote 46. *See* FTC Official Staff Commentary § 615 item 7; Grimes, FTC Informal Staff Opinion Letter, Feb. 17, 1993.

(n53)Footnote 47. *15 U.S.C. § 1681b(a)(3)(A)*, and FCRA § 604(a)(3)(F), *15 U.S.C. § 1681b(a)(3)(F)*, *as amended by* Pub. L. No. 104-208, § 2403, *110 Stat. 3009* (Sept. 30, 1996). Gowen, FTC Informal Staff Opinion Letter, Apr. 29, 1999 [reproduced at National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)].

(n54)Footnote 48. S. Rep. No. 185, 104th Cong., 1st Sess. at 35 (Dec. 14, 1995). *See* Gowen, FTC Informal Staff Opinion Letter, Apr. 29, 1999.

(n55)Footnote 49. *15 U.S.C. § 168b*(a)(3)(E).

(n56)Footnote 50. *15 U.S.C. § 1681b(a)(3)(B)*.

(n57)Footnote 51. *15 U.S.C. § 1681a(h)*; *Wiggins v. Philip Morris, Inc., 853 F. Supp. 470 (D.D.C. 1994)* .

(n58)Footnote 52. Grimes, FTC Informal Staff Opinion Letter, Oct. 23, 1985.

(n59)Footnote 53. Official Staff Commentary § 604(3)(B) item 1. [Author Note: Presumably, such use is permissible only if the consumer's employment is likely to be affected.]

(n60)Footnote 54. FTC Official Staff Commentary § 603(h) item 2.

(n61)Footnote 55. Allison, FTC Informal Staff Opinion Letter, Feb. 23, 1998.

(n62)Footnote 56. *15 U.S.C. § 1681a(d)(2)(D)(x)*, *added by* Pub. L. No. 108-159, § 111 (2003).

(n63)Footnote 57. *Cf.* FTC Official Staff Commentary § 604(3)(B) item 3.

(n64)Footnote 58. Greathouse, FTC Informal Staff Opinion Letter, Oct. 20, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)].

(n65)Footnote 59. FTC Official Staff Commentary § 604(3)(B) item 2.

(n66)Footnote 60. *Zamora v. Valley Fed. Sav. & Loan Ass'n, 811 F.2d 1368 (10th Cir. 1987)* .

(n67)Footnote 61. *15 U.S.C. § 1681b(b)(2)*; *Kelchner v. Sycamore Manor Health Ctr., 305 F. Supp. 2d 429 (M.D. Pa. 2004)* (employee who refuses to give authorization may be terminated).

(n68)Footnote 62. *Hoke v. Retail Credit Corp., 521 F.2d 1079 (4th Cir. 1975)* , *cert. denied*, *423 U.S. 1087, 96 S. Ct. 878, 47 L. Ed. 2d 98 (1976)* .

(n69)Footnote 63. *See § 16.03[2] supra*.

(n70)Footnote 63.1. *See, e.g.*, *Wash. Rev. Code § 19.182.020* (prohibiting pre-employment use of consumer credit reports unless the information is substantially job related and various procedures are followed).

(n71)Footnote 64. *15 U.S.C. § 1681b(b)*.

(n72)Footnote 65. *See 15 U.S.C. § 1681a(d)(2)(D)(x)*, *added by* Pub. L. No. 108-159, § 111 (2003).

(n73)Footnote 66. *See* Kilgo, FTC Informal Staff Opinion Letter, July 28, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)].

(n74)Footnote 67. *See § 16.04[2][j] infra*.

(n75)Footnote 68. *15 U.S.C. § 1681a(d)(2)(D)(x)*, *added by* Pub. L. No. 108-159, § 111 (2003).

(n76)Footnote 69. FCRA § 604(b), *15 U.S.C. § 1681b(b)*, *as amended by* Pub. L. No. 104-208, § 2403, *110 Stat. 3009* (Sept. 30, 1996). The FACTA of 2003 amended the FCRA to require the FTC to revise the model Summary of Rights. *15 U.S.C. § 1681g*, *added by* Pub. L. No. 108-159, § 211 (2003).

(n77)Footnote 70. *15 U.S.C. § 1681a(d)(2)(D)(x), added by* Pub. L. No. 108-159, § 111 (2003).

(n78)Footnote 71. *15 U.S.C. § 1681b(3)(C).*

(n79)Footnote 72. *See* FTC Official Staff Commentary § 604(3)(C) item 1.

(n80)Footnote 73. FTC Official Staff Commentary § 604 item 1B.

(n81)Footnote 74. *15 U.S.C. § 1681b(a)(3)(D).*

(n82)Footnote 75. FTC Official Staff Commentary § 604(3)(D) item 1.

(n83)Footnote 76. FTC Official Staff Commentary § 604(3)(D) item 3.

(n84)Footnote 77. *15 U.S.C. § 1681b(a)(4).*

(n85)Footnote 78. *15 U.S.C. § 1681b(a)(3)(F). See Bakker v. McKinnon, 152 F.3d 1007 (8th Cir. 1998)* ; *see also Duncan v. Handmaker, 149 F.3d 424 (6th Cir. 1998)* (attorney defending mortgage company in negligence suit by consumers had no permissible purpose in accessing consumer's report; business transaction in underlying suit did not extend to the litigation itself); *Ali v. Vikar Mgmt., 994 F. Supp. 492 (S.D.N.Y. 1998)* (landlord had no permissible business purpose to access credit report on tenant who was entitled to lease renewal without regard to her creditworthiness).

(n86)Footnote 79. FTC Official Staff Commentary § 604(3)(E) item 2.

(n87)Footnote 80. FTC Official Staff Commentary § 604(3)(E) item 2; Noonan, FTC Informal Staff Opinion Letter, Aug. 22, 1990. Tatelbaum, FTC Informal Staff Opinion Letter, July 26, 2000 [reproduced at National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)].

(n88)Footnote 81. *See The Fair Credit Reporting Act: Are Business Credit Reports Regulated?,* 1971 Duke L. Rev. 1229.

(n89)Footnote 82. *15 U.S.C. § 1681a(c).*

(n90)Footnote 83. *E.g., Korotki v. Attorney Servs. Corp., 931 F. Supp. 1269 (D. Md. 1996)* (permissible to obtain consumer's credit report in course of collecting a business debt), *aff'd without published op., 131 F.3d 135 (4th Cir. 1997)* , *cert. denied, 523 U.S. 1118, 118 S. Ct. 1797, 140 L. Ed. 2d 938 (1998)* ; *Advanced Conservation Sys., Inc. v. Long Island Lighting Co., 934 F. Supp. 53 (E.D.N.Y. 1996)* (permissible to access report of sole shareholders of business contractor); *Ippolito v. WNS, Inc., 864 F.2d 440 (7th Cir. 1988)* , *cert dismissed, 490 U.S. 1061, 109 S. Ct. 1975, 104 L. Ed. 2d 623 (1989)* .

(n91)Footnote 84. *15 U.S.C. § 1681u.*

(n92)Footnote 85. FTC Official Staff Commentary § 604(3)(A) item 3.

(n93)Footnote 86. FTC Official Staff Commentary § 604(3)(A) item 3.

(n94)Footnote 87. FTC Official Staff Commentary § 604(3)(A) item 4.

(n95)Footnote 88. FTC Official Staff Commentary § 604(3)(A) item 4.

(n96)Footnote 89. *See Bakker v. McKinnon, 152 F.3d 1007 (8th Cir. 1998)* ; *Duncan v. Handmaker, 149 F.3d 424 (6th Cir. 1998)* ; *Comeaux v. Brown & Williamson Tobacco Co., 915 F.2d 1264 (9th Cir. 1990)* ; FTC Official Staff Commentary § 604(3)(E) item 4.

(n97)Footnote 90. FTC Official Staff Commentary § 604(3)(E) item 4.

(n98)Footnote 91. Long, FTC Staff Opinion Letter, July 6, 2000. *But see § 16.02[2][b] supra*.

(n99)Footnote 92. FTC Informal Staff Opinion Commentary § 604(3)(E) item 4.

(n100)Footnote 93. *Bakker v. McKinnon, 152 F.3d 1007 (8th Cir. 1998) . Chester v. Purvis, 260 F. Supp. 2d 711 (S.D. Ind. 2003) .*

(n101)Footnote 94. Carson, FTC Informal Staff Opinion Letter, Apr. 29, 1971.

(n102)Footnote 95. *Chester v. Purvis, 260 F. Supp. 2d 711 (S.D. Ind. 2003) .*

(n103)Footnote 96. FTC Official Staff Commentary § 604(3)(E) item 6C. *Cf. Liu v. DeFelice, 6 F. Supp. 2d 106 (D. Mass. 1998) . Phillips v. Grendahl, 312 F.3d 357 (8th Cir. 2002)* (investigation of boyfriend not permissible purpose).

(n104)Footnote 97. Peeler, FTC Informal Staff Opinion Letter, May 27, 1982.

(n105)Footnote 98. FTC Official Staff Commentary § 604(3)(A) item 5B.

(n106)Footnote 99. Statements of General Policy or Interpretations Under the Fair Credit Reporting Act, 16 C.F.R. § 600.8.

(n107)Footnote 100. FTC Official Staff Commentary § 604(3)(A) item 5B.

(n108)Footnote 101. FTC, Compliance with the Fair Credit Reporting Act, at 20 (1977); *cf.* Petruccelli, FTC Informal Staff Opinion Letter, Feb. 13, 1984.

(n109)Footnote 102. *Spencer v. Spencer, 52 Fed. Appx. 874 (9th Cir. 2002)* (local court rules may limit citation to this case.). *See* 9th Cir. R. 36-3.

(n110)Footnote 103. *Marzluff v. Verizon Wireless, 785 N.E.2d 805 (Ohio Ct. App. 2003) .*

(n111)Footnote 104. FTC Official Staff Commentary § 604(3)(C) item 2; *see also* Greathouse, FTC Informal Staff Opinion Letter, Oct. 10, 1998 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)].

(n112)Footnote 105. *15 U.S.C. § 1681b(2)(c).*

(n113)Footnote 106. FTC Official Staff Commentary § 603(d) item 4B; FTC Official Staff Commentary § 604(3)(A) item 8.

(n114)Footnote 107. FTC Official Staff Commentary § 604(3)(A) item 8.

(n115)Footnote 108. FTC Official Staff Commentary § 603(d) item 4B; FTC Official Staff Commentary § 604(3)(A) item 8.

(n116)Footnote 109. FTC Official Staff Commentary § 603(d) item 4B.

(n117)Footnote 110. *See* FTC Informal Staff Opinion Letter, [1980-1989 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 96,733 (Dec. 10, 1982).

(n118)Footnote 111. See Carson, FTC Informal Staff Opinion Letter, Apr. 29, 1971; FTC, Compliance with the

Fair Credit Reporting Act, at 23 (1977).

(n119)Footnote 112. FTC Official Staff Commentary § 604(3)(A) item 6; *Cole v. U.S. Capital, Inc., 2002 U.S. Dist. LEXIS 20676* (N.D. Ill. Oct. 24, 2002) ; *Gamble v. Citifinancial, 2002 U.S. Dist. LEXIS 22446* (D. Conn. Nov. 19, 2002) .

(n120)Footnote 113. Previously, prescreening was permitted for offers of credit only, not for insurance. Grimes, FTC Informal Staff Opinion Letter, June 2, 1994; Medine, FTC Informal Staff Opinion Letter, Mar. 30, 1994.

(n121)Footnote 114. FCRA § 604(c), (e), *15 U.S.C. § 1681b(c), (f), as amended by* Pub. L. No. 104-208, § 2404, *110 Stat. 3009* (Sept. 30, 1996). State laws regarding prescreening are generally preempted by the FCRA.

(n122)Footnote 115. FTC v. TRW, Inc. (consent order, Dec. 10, 1991) (Agreed Order Amending Consent Decree).

(n123)Footnote 116. *In re* Trans Union Corp., No. 9255 (FTC 1998).

(n124)Footnote 117. In *Trans Union Corp. v. FTC, 81 F.3d 228 (D.C. Cir. 1996)* , the appeals court found that such target marketing lists do not serve a legitimate business purpose under the FCRA but remanded the case to the FTC for a factual determination of whether Trans Union's reports actually do convey information used by credit grantors in eligibility determinations.

(n125)Footnote 118. *In re* Trans Union Corp., No. 9255 (FTC Feb. 10, 2000) (final order).

(n126)Footnote 119. *15 U.S.C. § 1681a(d)(1).*

(n127)Footnote 120. *Trans Union Corp. v. FTC, 245 F.3d 809 (D.C. Cir. 2001)* .

(n128)Footnote 121. *Trans Union Corp. v. FTC, 245 F.3d 809, 815 (D.C. Cir. 2001)* . The court rejected Trans Union's arguments that the Commission's ruling violated the First and *Fifth Amendments of the U.S. Constitution. Id. at 817-18* .

(n129)Footnote 122. *Trans Union L.L.C. v. FTC, 536 U.S. 915, 917, 122 S. Ct. 2386, 2387, 153 L. Ed. 2d 199, 200 (2002)* .

(n130)Footnote 123. FTC Official Staff Commentary § 604(3)(A) item 6.

(n131)Footnote 124. *15 U.S.C. § 1681b(c)(2).*

(n132)Footnote 125. *Tucker v. Olympia Dodge of Countryside, Inc., 2003 U.S. Dist. LEXIS 9201* (N.D. Ill. May 28, 2003) (firm offer is defined in terms of a creditor's intention to honor an offer of credit in accordance with creditor's own undisclosed, predetermined criteria). *Perry v. First Nat'l Bank, 459 F.3d 816 (7th Cir. 2006)* (finding preapproval language evidence that the offer was guaranteed and likely would be honored). *But see Murray v. GMAC Mortgage Corp., 483 F. Supp. 2d 636 (N.D. Ill. 2007)* (though loan agents had no discretion to deviate from the formulas outlined on the rate sheet, the offer was not firm when "the process is identical to that which any other [non-prescreened] customer would face"), *reconsideration granted on other grounds, 532 F. Supp. 2d 938, 2007 U.S. Dist. LEXIS 53777* (N.D. Ill. July 23, 2007) .

(n133)Footnote 126. *15 U.S.C. § 1681a(l).*

(n134)Footnote 127. *Cole v. U.S. Capital, Inc., 389 F.3d 719 (7th Cir. 2004) See also Hyde v. RDA, Inc., 389 F. Supp. 2d 658 (D. Md. 2005) . But see Putkowski v. Irwin Home Equity Corp., 423 F. Supp. 2d 1053 (N.D. Cal. 2006)* (amicus brief in support of the plaintiff is available at www.ftc.gov/ogc/briefs/cole.pdf).

(n135)Footnote 128. *Perry v. First National Bank, 459 F.3d 816 (7th Cir. 2006)* (Evans, dissenting).

(n136)Footnote 128.1. *Compare Murray v. HSBC Auto Fin., Inc., 2006 U.S. Dist. LEXIS 74128* (N.D. Ill. Sept. 27, 2006) (finding a firm offer despite few specific details and several conditions); *Murray v. New Cingular Wireless Serv., Inc., 432 F. Supp. 2d 788 (N.D. Ill. 2006)* (same) *with Murray v. GMAC Mortgage Corp.,483 F. Supp. 2d 636 (N.D. Ill. 2007)* , *reconsideration granted on other grounds*, *532 F. Supp. 2d 938, 2007 U.S. Dist. LEXIS 53777* (N.D. Ill. July 23, 2007) (finding that defendant was not objectively unreasonable in erroneously believing that the court would find a firm offer despite the "lack of *any* terms and the presence of *a multitude* of *opaque* conditions," because other courts have done so).

(n137)Footnote 128.2. *Murray v. GMAC Mortgage Corp., 483 F. Supp. 2d 636 (N.D. Ill. 2007)* (noting that "the process is identical to that which any other customer would face"), *reconsideration granted on other grounds*, *532 F. Supp. 2d 938, 2007 U.S. Dist. LEXIS 53777* (N.D. Ill. July 23, 2007) ; *Bonner v. Home123 Corp., 2007 U.S. Dist. LEXIS 18006* (N.D. Ind. Mar. 9, 2007) (same).

(n138)Footnote 128.3. *Poehl v. Countrywide Home Loans, Inc., 464 F. Supp. 2d 882* (E.D. Mo. Nov. 1, 2006) .

(n139)Footnote 128.4. *See Gross v. Washington Mut., Inc., 2007 U.S. Dist. LEXIS 34837* (S.D.N.Y. May 10, 2007) ; *Putkowski v. Irwin Home Equity Corp., 423 F. Supp. 2d 1053 (N.D. Cal. 2006)* .

(n140)Footnote 129. *Munoz v. Seventh Avenue, Inc., 2004 U.S. Dist. LEXIS 13715* (N.D. Ill. July 15, 2004) .

(n141)Footnote 129.1. *See Enoch v. Dahle/Meyer Imps., L.L.C., 2007 U.S. Dist. LEXIS 85000* (D. Utah Nov. 16, 2007) .

(n142)Footnote 130. *15 U.S.C. § 1681b(e)*.

(n143)Footnote 131. FCRA § 604(e), *15 U.S.C. § 1681b(e)*, *as amended by* Pub. L. No. 104-208, § 2404, *110 Stat. 3009* (Sept. 30, 1996).

(n144)Footnote 132. *In re* Trans Union Corp., No. 9255 (FTC 1998) [excerpt reproduced in National Consumer Law Center, Fair Credit Reporting Act, App. H.3.4 (5th ed. 2002 and Supp.).

(n145)Footnote 133. *15 U.S.C. §§ 1681b(e)(3)(A)*, *(e)(4)(B)(1)*, *amended by* Pub. L. No. 108-159 § 213(c) (2003); *16 C.F.R. § 602.1(c)(3)(xi)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n146)Footnote 134. *15 U.S.C. § 1681s-3*, *added by* Pub. L. No. 108-159 § 213(c) (2003).

(n147)Footnote 135. *70 Fed. Reg. 5022* (Jan. 31, 2005) , *codified at 16 C.F.R. § 642.3*.

(n148)Footnote 136. Fed. Reg. 5022 (Jan. 31, 2005), *codified at 16 C.F.R. § 642.3*.

(n149)Footnote 137. *15 U.S.C. § 1681m(d)(2)*, *as amended by* Pub. L. No. 108-159, § 213 (2003).

(n150)Footnote 138. FTC Official Staff Commentary § 603(d) item 5B; *see also* Grimes, FTC Informal Staff Opinion Letter, Jan. 22, 1991.

(n151)Footnote 139. Pub. L. No. 106-102, § 509(4); *16 C.F.R. 313.3(p)*.

(n152)Footnote 140. *See 15 U.S.C. §§ 1681b*, *1681n*, *1681o* . *Centuori v. Experian Info. Solutions, Inc., 431 F. Supp. 2d 1002 (D. Ariz. 2006)* (jury could find that Experian acted recklessly "by devoting so few resources to reviewing [internet access] applications, hiring underqualified staff, and failing to train them in the 'grave responsibilities' of the FCRA").

(n153)Footnote 141. *15 U.S.C. § 1681e(a).*

(n154)Footnote 142. *Cf. Batdorf v. Equifax, 949 F. Supp. 777 (D. Haw. 1996)* (describing TRW's extensive procedures), *aff'd without op, 176 F.3d 481* , *reported in full, 1999 U.S. App. LEXIS 7380* (9th Cir. Apr. 14, 1999) ; *Kennedy v. Border City Sav. & Loan Ass'n, 747 F.2d 367 (6th Cir. 1984)* ; New Palm Gardens, Inc. v. Bentley, [1980-1989 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 96,648 (D. Mass. 1983); Peeler, FTC Informal Staff Opinion Letter, Aug. 27, 1977. *But see Dotzler v. Perot, 876 F. Supp. 207 (E.D. Mo. 1995)* ; *Dobson v. Holloway, 828 F. Supp. 975 (M.D. Ga. 1993)* .

(n155)Footnote 143. FTC Official Staff Commentary § 607 item 2B.

(n156)Footnote 144. FTC Official Staff Commentary § 607 items 2B, 2C. *See also* Peeler, FTC Informal Staff Opinion Letter, Aug. 27, 1977; Dea, FTC Informal Staff Opinion Letter, Apr. 2, 1975; Dea, FTC Informal Staff Opinion Letter, Nov. 28, 1974; FTC Informal Staff Opinion, [1969-1973 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 99,493 (May 16, 1971); *Greenhouse v. TRW, Inc., 1998 U.S. Dist. LEXIS 1973* (E.D. La. Feb. 12, 1998) ; *Davis v. Asset Servs., 46 F. Supp. 2d 503 (M.D. La. 1998)* .

(n157)Footnote 145. *La. Rev. Stat. Ann. § 9:3571.2* (limiting circumstances under which a motor vehicle dealer may request, obtain or review a consumer's credit report).

(n158)Footnote 146. *Equifax, Inc., 96 F.T.C. 844 (1980)* , *rev'd in part on other grounds, 678 F.2d 1047 (11th Cir. 1982)* ; *see also Southern Md. Credit Bureau, Inc., 101 F.T.C. 19, 23 (1983)* (consent order).

(n159)Footnote 147. FTC Official Staff Commentary § 607 item 2G.

(n160)Footnote 148. FTC Official Staff Commentary § 607 item 2A.

(n161)Footnote 149. FTC Official Staff Commentary § 607 item 2G. One large reporting agency, TRW, has asserted it conducts both precautionary and investigative activities on the uses to which its clients put the reports. *Klapper v. Shapiro, 154 Misc. 2d 459, 586 N.Y.S.2d 846 (Sup. Ct. 1992)* .

(n162)Footnote 150. FTC Official Staff Commentary § 607 item 2D. *See Commonwealth v. Source One Assocs., 436 Mass. 118, 763 N.E.2d 42 (2002)* (Equifax terminated user's account after receiving and investigating consumer complaint and concluding that defendants were using credit reports for impermissible purposes).

(n163)Footnote 151. FTC Official Staff Commentary § 607 item 2D. *See also Russell v. Shelter Fin. Servs., 604 F. Supp. 201 (W.D. Mo. 1984)* ; *Boothe v. TRW Credit Data, 557 F. Supp. 66, 71 (S.D.N.Y. 1982)* .

(n164)Footnote 152. FTC Official Staff Commentary § 607 item 2D.

(n165)Footnote 153. FTC Official Staff Commentary § 607 item 2D.

(n166)Footnote 154. *See 15 U.S.C. § 1681g(a)(3).*

(n167)Footnote 155. Such users would then be liable under *15 U.S.C. § 1681q.*

(n168)Footnote 156. *15 U.S.C. § 1681r.*

(n169)Footnote 157. *15 U.S.C. § 1681r.*

(n170)Footnote 158. *15 U.S.C. § 1681b.*

(n171)Footnote 159. *15 U.S.C. § 1681e(a).*

(n172)Footnote 160. *See generally* National Consumer Law Center, Fair Credit Reporting Act, § 7.7 (6th ed. 2006 and Supp.).

(n173)Footnote 161. *15 U.S.C. § 1681 o.*

(n174)Footnote 162. *15 U.S.C. § 1681n.*

(n175)Footnote 163. This proposition was accepted by the litigants in *Ippolito v. WNS, Inc., 864 F.2d 440 (7th Cir. 1988)* , *cert. dismissed, 490 U.S. 1061, 109 S. Ct. 1975, 104 L. Ed. 2d 623 (1989)* , although questioned by the court in dicta. In *Frederick v. Marquette Nat'l Bank, 911 F.2d 1 (7th Cir. 1990)* , the Seventh Circuit rejected the proposition and found users could not be liable under this section of FCRA. *Accord Letscher v. Swiss Bank Corp., 1996 U.S. Dist. LEXIS 4908* (S.D.N.Y. Apr. 16, 1996) (no user liability for negligence); *DiCarlo v. Maryland Auto Ins. Fund, 855 F. Supp. 823 (D. Md. 1994) . But see Wiggins v. Philip Morris, Inc., 853 F. Supp. 470 (D.D.C. 1994)* .

(n176)Footnote 164. *15 U.S.C. § 1681n. See Phillips v. Grendahl, 312 F.3d 357 (8th Cir. 2002)* (Familiarity with the FCRA or general knowledge that reports can be obtained under limited circumstances is sufficient to support an inference of willfulness, or knowingly obtaining a consumer report in conscious disregard of the target's legal rights.).

(n177)Footnote 165. *15 U.S.C. § 1681q.*

(n178)Footnote 166. *Comeaux v. Brown & Williamson Tobacco Co., 915 F.2d 1264 (9th Cir. 1990)* ; *Zamora v. Valley Fed. Sav. & Loan Ass'n, 811 F.2d 1368 (10th Cir. 1987)* ; *Yohay v. City of Alexandria Employees Credit Union, Inc., 827 F.2d 967 (4th Cir. 1987)* ; *Kennedy v. Border City Sav. & Loan Ass'n, 747 F.2d 367 (6th Cir. 1984)* (§ 617, not § 616, gives rise to the private cause of action); *Hansen v. Morgan, 582 F.2d 1214 (9th Cir. 1978) . See also Cohen v. Shehy Ford of Springfield, 27 Va. Cir. 161 (1992)* (employer who cloaked employees with actual or apparent authority to obtain credit information could be vicariously liable, and possibly directly liable, for the wrongful accessing of plaintiff's credit information by an employee, regardless of whether that employee acted outside the scope of his authority.

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1-16 Consumer Credit Law Manual § 16.05

§ 16.05 Furnishing Information to Consumer Reporting Agencies

While the FCRA imposes standards and obligations upon those who furnish information about consumers to consumer reporting agencies, there is no private enforcement and no statutory remedy for violations. In some circumstances, tort actions may be brought but often the only realistic civil remedy available to the consumer will be for violations of the duty of a furnisher to adequately reinvestigate the accuracy or completeness of information after the consumer has disputed the accuracy of that information with the consumer reporting agency.

The FACTA of 2003 placed additional duties on furnishers, some of which are completely new and many of which relate to existing duties. Such duties include the duty to reinvestigate certain consumer disputes received directly from consumers, the duty of financial institutions to notify consumers when they submit negative information, and the duty to block unverifiable information. Additional duties were placed on furnishers with respect to identity theft.

[1] Creditors and Others Who Furnish Information to Consumer Reporting Agencies

[a] Limitations on Who Is a Furnisher

The rules of the FCRA, including those that apply to furnishers, generally do not apply to companies furnishing information to other entities affiliated by common ownership or corporate control, even if the receiving affiliate functions as an in-house credit bureau. n1

Creditors sometimes sell lists of customers meeting specified criteria to other creditors, direct marketers and mass mailing houses, and to other compilers of marketing databases. Although a creditor or other business may be furnishing information, it is not furnishing information to a consumer reporting agency. Other privacy regulations may apply, n2 but the FCRA rules on furnishers and on consumer reporting agencies do not.

In addition, the FCRA preempts all state laws regarding the furnishing of information to consumer reporting agencies, with the exception of California and Massachusetts.

[b] Who Qualifies as a Furnisher

Practically anyone who furnishes consumer information to a consumer reporting agency is a "furnisher" of information

under the FCRA. The terms furnisher and furnishing are not defined. Furnishers include creditors, insurers, employers, landlords, banks, doctors, lawyers, and even those who do not regularly report information to reporting agencies. The Act simply uses language like "any person who furnishes information about a consumer to a consumer reporting agency."

Public agencies may be furnishers as well, in which case special rules may apply. Federal agencies are authorized to disclose debtor information to consumer reporting agencies, but restrictions apply to the nature of the information which may be furnished and when it may be furnished. n3 Federal law actually requires that defaults on student loans be reported to consumer reporting agencies as a means of encouraging debt repayment. A few restrictions apply.

The information which is furnished must be about a consumer and must be furnished to a consumer reporting agency. A consumer is essentially any individual natural person. n4 A consumer reporting agency may be a credit bureau, tenant screening business, check verification company, or a variety of other compilers of databases. n5

[2] Furnishing Information to Consumer Reporting Agencies

[a] Most Information Is Furnished Electronically

While not required by law, the practical reality is that virtually all information furnished to and used by consumer reporting agencies is transmitted electronically. Users of consumer reporting agencies regularly dump information about their customers into an electronic computer-to-computer communication or onto a disk provided to the reporting agency. Rarely is information furnished by hard copy, and it is generally discouraged. Information from courts, city halls, tax offices, and departments of motor vehicles is usually available and reported electronically as well, although sometimes agencies will use contractors to collect the information by hand for conversion to electronic form.

One consequence of this reliance upon electronic communication even by furnishers of information is that a correction of inaccurate information by a creditor is of limited effectiveness if it is not reflected with precision in the same database used to report current information on a weekly or monthly basis to the consumer reporting agencies. Any resolution of a dispute with a furnisher should ensure that the outcome is properly reported to the agency and also properly added to the correct database.

The computer reporting software used by most creditors is "Metro 2." n6 It was designed by the credit reporting industry, including the so-called "Big Three": Equifax, Experian, and Trans Union. The program and instructions are available for users from the Consumer Data Industry Association, Inc. ("CDIA") an industry trade association, and from each of the major reporting agencies. CDIA's website also contains valuable information about Metro 2, including instructions on how to access the Metro 2 format and frequently asked questions and answers about Metro 2 reporting. n7

[b] The Furnishing of Disputed Information Is Restricted

Under the FCRA, if a consumer has disputed with the creditor or other furnisher the accuracy or completeness of information, the furnisher may not report that information to a consumer reporting agency unless it also provides notice that the information is disputed. n8 In turn, the agency must note the dispute in each consumer report which contains the disputed information. n9

Private enforcement of this furnisher obligation, like so many others, is severely restricted. However, the additional restrictions on furnishing disputed information to a reporting agency can give rise to claims of civil liability under other statutory provisions. Under the Fair Debt Collection Practices Act, n10 a debt collector is required to cease all collection efforts if a written dispute is received within the thirty-day validation period, until verification is provided. n11 Reporting an outstanding debt to a reporting agency is a "powerful tool" to force payment. n12 (The validation period

commences when the collector sends a required validation notice to the consumer at the beginning of the collection efforts.) An informal FTC staff opinion n13 states that reporting a charged-off debt to a reporting agency is collection activity and that the debt may not be reported at all during this period. If the collector ceases collection activity altogether during this period, it still may not report the debt. Further, if an agency has already reported the debt to a credit reporting agency (for example, in the period before a written dispute is received), the debt collection act requires the collector to report the dispute. n14 In addition, false threats or threats to report false information to a credit bureaus are prohibited by the Fair Debt Collection Practices Act when they are made by a debt collector, and the same behavior by creditors may likewise be proscribed by state statutes or be deceptive under state unfair and deceptive acts and practices laws. n15

The Fair Credit Billing Act ("FCBA") regulates creditor activity when a consumer complains of a billing error. n16 The FCBA applies to credit card bills and other open-end credit, although there is some possibility that the FCBA may also apply to closed-end loans. n17 A billing error is defined quite broadly to cover a wide variety of consumer complaints. n18 After receiving the consumer's written notification of a billing error, the creditor may not directly or indirectly threaten to report to any person (such as a consumer reporting agency) that the consumer has failed to pay an amount which is due. The creditor is permitted to report that the consumer has disputed the amount.

Federal law also allows credit card holders to raise defenses against a card issuer based on the card holder's claims against the merchant. n19 The card holder must have first made a good faith attempt to resolve the dispute with the merchant, the amount involved must exceed $50, and the transaction must have occurred in the consumer's state or within one hundred miles of the consumer's residence. n20 The card holder loses the right to raise defenses if payment for that charge has already been made to the card issuer. This is a common reason for a consumer to dispute the accuracy of a credit card bill.

Once the consumer has notified the card issuer that payment is being withheld because claims and defenses are being asserted, the amount is in dispute and may not be reported as a delinquent amount, at least until the dispute is settled or judgment rendered. n21 The creditor may report the amount as in dispute. n22 The card issuer can pursue normal collection routines on the disputed amount, including filing suit, but the consumer can then raise the merchant's misconduct as a defense in the suit. Often the card issuer will simply remove the debit from the consumer's account and charge back the amount to the merchant, although this is not required.

The Real Estate Settlement Procedures Act ("RESPA") n23 provides certain rights to consumers to dispute the amount owed under all of these different types of loans and offers the consumer protection from adverse credit reports during the dispute period. RESPA applies to federally related mortgage loans, which is a defined term that includes virtually all loans secured by a first or junior lien on residential real property (including individual condominium and cooperative units) designed for occupancy of one to four families. n24 If a consumer disputes an amount being sought on a loan covered by RESPA, the consumer can send the servicer a qualified written request. n25 Within sixty days the servicer must make any necessary corrections to the account or provide the consumer with a statement why the servicer believes the account is correct. During the sixty-day period when a servicer is evaluating a borrower's qualified written request relating to a dispute regarding the borrower's payments or a request for information, a servicer may not provide any information to a reporting agency regarding an overdue payment that relates to the consumer's qualified written request. n26

Noncompliance with these RESPA requirements subjects the servicer to an action for attorney fees, actual damages, and (if there is a pattern or practice of noncompliance) up to $1000 in statutory damages for each individual or up to $500,000 or one percent of the servicer's net worth in the case of a class action. n27

The ECOA prohibits creditors from discriminating against consumers in credit transactions n28 including discrimination in the "furnishing of credit information."

Federal agencies may report debts to consumer reporting agencies, but only to a limited extent and only if certain procedures are established and followed. n29 Perhaps more importantly, the internal procedures which must be followed include prior notice to the consumer and the agency keeping reported information up to date. Compliance with the FCRA is also required.

[c] Standards of Accuracy for Furnishers

The Fair Credit Reporting Act and the FACTA of 2003 establish minimum standards of accuracy for creditors and other furnishers initially providing information about consumers to consumer reporting agencies. n30

The duties of accuracy contained in the FCRA may be enforced by the Federal Trade Commission, state attorneys general, and other public officials, but may not be enforced by private right of action. n31 The only privately enforceable FCRA standards of accuracy covering the furnishers of information are those involving the reinvestigation which a creditor must perform after a consumer requests that a consumer reporting agency reinvestigate. (Reinvestigations standards are discussed below). In particularly egregious cases, involving malice, a creditor may be liable for defamation or other torts, n32 but otherwise FCRA liability for furnishers derives from consumer reporting agency reinvestigations and not from any independent standard of accuracy applicable to furnishers.

The FCRA previously prohibited a furnisher from furnishing information that the furnisher "knows or consciously avoids knowing is inaccurate." n33 This standard was changed by the FACTA of 2003 to prohibit a furnisher from furnishing information that the furnisher "knows or has reasonable cause to believe" is inaccurate. n34 The term "reasonable cause to believe" is defined as "having specific knowledge, other than solely allegations by the consumer, that would cause a reasonable person to have substantial doubts about the accuracy of the information." n35 This standard, however, is not applicable to furnishers who maintain a special address for notification of inaccuracies. n36 The FCRA also prohibits furnishers from furnishing information that is in fact inaccurate, but only if the consumer has complained. n37 This provision was not amended by the FACTA.

The two accuracy provisions must also be read in conjunction with the subsection that immediately follows them establishing a duty to promptly correct and update furnished information determined to be incomplete or inaccurate, a provision that also was not amended by the FACTA. n38 This duty is applicable to furnishers that regularly and in the ordinary course of business furnish information to credit reporting agencies. n39

[i] Furnisher Accuracy and Integrity Guidelines

The Fair and Accurate Credit Transactions Act of 2003 (FACTA) required the Federal Trade Commission and the banking regulators n40 (referred to collectively as "Regulators") to issue guidelines for furnishers regarding the accuracy and integrity of information they furnish to the consumer reporting agencies (CRAs). n41 The Regulators must also issue regulations requiring furnishers to establish reasonable policies and procedures for implementing those guidelines. n42

Violation of the furnisher accuracy and integrity guidelines does not subject the furnisher to the private right of action under sections 1681n and 1681o of the FCRA. n43 However, these guidelines may influence what constitutes a "reasonable investigation" when the furnisher must respond to a dispute pursuant to section 1681s-2(b) that the consumer made to a CRA.

The effective date of the furnisher accuracy and integrity guidelines is July 1, 2010. n44 States are preempted from regulating the subject matter of the provision. n45

[A] Furnishers Required to Have Policies and Procedures for Accuracy and Integrity

The furnisher accuracy and integrity guidelines are divided into two parts--the Guidelines themselves and a mandatory regulation. The regulation requires furnishers to establish and implement reasonable policies and procedures regarding the accuracy and integrity of the information that they furnish to CRAs. n46 However, while having a set of policies and procedures is mandatory, compliance with all of the Guidelines is not. n47

A furnisher's policies and procedures regarding accuracy and integrity must be in writing. n48 The regulation requires the policies and procedures to be appropriate to the business's nature, size. n49

Furnishers are required to periodically review and update their policies and procedures for accuracy and integrity as necessary to ensure their continued effectiveness. n50

[B] Definitions

The regulation defines accuracy and integrity for the purposes of both the accuracy and integrity guidelines and the direct dispute regulation.

Under the regulations, "accuracy" is defined to mean that information a furnisher provides to a CRA about an account or other relationship with the consumer correctly:

(1) Reflects the terms of and liability for the account or other relationship; n51

(2) Reflects the consumer's performance and other conduct with respect to the account or other relationship; n52 and

(3) Identifies the appropriate consumer. n53

"Integrity" is defined to mean that information provided by a furnisher to a CRA about an account or other relationship with the consumer:

(1) Is substantiated by the furnisher's records *at the time it is furnished* [emphasis added]; n54

(2) Is furnished in a form and manner that is designed to minimize the likelihood that the information may be incorrectly reflected in a consumer report; n55 and

(3) Includes the information in the furnisher's possession about the account or other relationship that the [applicable regulator] has:

(i) Determined that the absence of which would likely be materially misleading in evaluating a consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living; n56 and

(ii) Listed in section I(b)(2)(iii) of Appendix E. n57 (Appendix E is where the accuracy and integrity Guidelines are located).

A "furnisher" is defined as an entity that furnishes information relating to consumers to one or more CRAs for inclusion in a consumer report. n58 The definition excludes certain entities from being a furnisher, including:

- An entity that provides information to a CRA solely to obtain a consumer report in accordance with sections 1681b(a) and (f), that is, as part of an inquiry; n59

- A "consumer reporting agency" as defined in section 1681a(f); n60

- The consumer himself or herself to whom the furnished information pertains; n61 or

- A neighbor, friend, or associate of the consumer, or another individual, with whom the consumer is acquainted or who may have knowledge about the consumer and who provides information about the consumer's character, general reputation, personal characteristics, or mode of living in response to a specific request from a CRA. n62

The last exception is intended to apply to persons from whom information is collected in connection with an investigative consumer report. n63

[C] The Guidelines

The guidelines are located in Appendix E of each Regulator's FCRA regulations. They are divided into three parts: Nature, Score, and Objectives; Establishing and Implementing Policies and Procedures; and Specific Components of Policies and Procedures.

The first part of the guidelines sets forth the objectives that a furnisher's accuracy and integrity policies and procedures should have. These objectives include:

- Furnishing information that is accurate and has integrity. These objectives restate the definition of accuracy and integrity but expand upon the latter by requiring the furnishing of credit limits. n64

- Conducting reasonable investigations of consumer disputes and taking appropriate action based on the outcomes; n65 and

- Updating information as necessary to reflect the current status of the consumer's account or other relationship, including any transfer of an account (for example, sale or assignment for collection) or cure of the consumer's failure to abide by the terms of the account or other relationship. n66

The second part of the guidelines involves what furnishers should do when establishing and implementing policies and procedures for accuracy and integrity. Furnishers should identify practices or activities that can compromise the accuracy or integrity of information by:

- Reviewing existing practices and activities, including the technology and methods used to furnish information to CRAs and the frequency and timing of furnishing of information; n67

- Reviewing historical records relating to accuracy or integrity or to disputes; n68

- Reviewing other information relating to the accuracy or integrity of information; n69

- Considering the types of errors, omissions, or other problems that may have affected the accuracy or integrity of information; n70

- Obtaining feedback from the furnisher's staff; n71

- Considering the potential impact of the furnisher's policies and procedures on consumers; n72 and

- Considering feedback received from CRAs, consumers, or other appropriate parties. n73

The final and most critical part of the guidelines is a section of specific components that furnishers should consider including in their policies and procedures on accuracy and integrity. Some of these specific components include:

- Using standard data reporting formats when feasible. n74 This component presumably suggests that furnisher use the Metro 2 reporting format. n75

- Maintaining records for a reasonable period of time, not less than any applicable recordkeeping requirement, in order to substantiate the accuracy of any information about consumers it furnishes that is subject to a direct dispute. n76

- Establishing and implementing appropriate internal controls regarding the accuracy and integrity of information furnished to CRAs, such as by implementing standard procedures and verifying random samples of information provided to CRAs. n77

- Training appropriate staff. n78

- Providing for appropriate and effective oversight of relevant service providers. n79

- Furnishing information following mergers, portfolio acquisitions, or sales or other acquisitions or transfers of accounts in a manner that prevents:

    -- Re-aging of information,

    -- Duplicative reporting, or

    -- Other similar problems. n80

- Deleting, updating, and correcting information in the furnisher's records, as appropriate, to avoid furnishing inaccurate information. n81

- Designing technological and other means of communication with CRAs to prevent:

    -- Duplicative reporting of accounts,

    -- Erroneous association of information with the wrong consumer(s), and

    -- Other problems. n82

- Providing sufficient identifying information in the furnisher's possession about consumers. n83

If a consumer disputes the accuracy or completeness of any information which has been furnished to a consumer reporting agency, the furnisher may not in the future report this information to a reporting agency unless it notes that it has been disputed. n84 Even if the creditor determines that the disputed information was neither inaccurate nor incomplete, or is unable to make any determination about the dispute raised by the consumer, the creditor must note that the information is disputed whenever it furnishes the information to a reporting agency in the future.

Accounts placed for collection or charged to profit and loss may not be included in consumer reports after seven years. n85 The information is then considered obsolete. The seven-year period begins when the account is placed for collection or charged to profit and loss. Any person who provides information about a delinquent account placed for

collection or written off must also inform the reporting agency when the preceding delinquency commenced. n86 FACTA amended the FCRA to require that a date of delinquency be reported within 90 days from the date the item of information is furnished to the credit reporting agency. n87 This requirement assists in determining the seven year obsolescence period and any proper tolling of the period. Before this amendment problems persisted because the month and year to report as the date of delinquency were not synonymous with the date of initial default, nor were they linked to a specific event. This caused significant compliance problems and the debt collection industry sought a fix, which resulted in the aforementioned amendment.

[ii] Consumers May Dispute Furnished Information Directly With the Furnisher Under the FACTA

The prior version of the FCRA had no provision by which a consumer could formally dispute an inaccurate item of information and request a reinvestigation directly with the furnisher; rather, the consumer had to dispute the item with the agency, which was then required by the FCRA to notify the furnisher. n88 The FCRA, prior to amendment by the FACTA, required the furnisher to reinvestigate the item only upon receiving the agency's notice; a notice from the consumer was irrelevant and ineffective. n89 Now a consumer may trigger a furnisher's responsibility to reinvestigate by disputing the item directly with the furnisher when the circumstances of the dispute meet the conditions of to-be-prescribed regulations. n90 This new provision specifically provides, however, that such a reinvestigation responsibility will not be initiated by a notice from or prepared by a credit repair organization, n91 and furnishers need not respond to "frivolous" or "irrelevant" disputes. n92 However, if the furnisher considers the dispute frivolous, the furnisher must notify the consumer within five business days of this determination, the reason it considers the dispute frivolous, and what information the consumer must provide to convert the dispute into one that will trigger a reinvestigation. n93 The furnisher must investigate the dispute and report the results back to the consumer in the same time frame allowed credit reporting agencies for reinvestigation. n94 If the furnisher finds the information to be inaccurate, the furnisher must correct the information with each agency to which the furnisher furnished the information. n95 As with the pre-existing reinvestigation responsibilities that arise upon notice from an agency, states are preempted from regulating the subject matter of this provision; n96 however, unlike those responsibilities, under this law it appears that consumers may not privately enforce this provision against furnishers. n97

The regulations concerning this obligation will impact what constitutes a "reasonable investigation" when the furnisher must reinvestigate a dispute pursuant to section 1681s-2(b) that the consumer made to a CRA. Some of the requirements contained in the regulations can be used to show the recurring problems that furnishers now must be on notice for and thus take reasonable steps to deal with in a section 1681s-2(b) investigation. Indeed, the Regulators have noted the parallel between the furnisher's duties of investigation under the direct dispute provision and under Section 1681s-2(b), stating that "a furnisher's investigation resulting from a direct dispute would be required to meet the same standard of reasonableness as it would if the notice of dispute were received through a CRA." n98

The effective date of the direct dispute regulations is July 1, 2010. States are preempted from regulating the subject matter of this provision. n99

[3] Consumer Reporting Agency Investigation Must Involve Furnisher

After a consumer has initiated a reinvestigation of inaccurate or incomplete information by submitting a dispute to a consumer reporting agency, the agency must notify any persons who furnished any of the disputed information. n100 This notice of dispute must be delivered within five days and, by statute, must include all relevant information provided by the consumer. If the agency receives additional information from the consumer before the furnisher completes its own investigation, that information too must be forwarded to the furnisher.

After receiving notice from a consumer reporting agency that information provided by the furnisher has been disputed, the furnisher must conduct its own investigation of the accuracy and completeness of the disputed information. n101 The investigation must be relatively swift. Results are normally to be reported back to the reporting agency within a

month, sometimes a little longer. n102

The act does not specify standards or procedures for the investigation. Courts are, however, adopting the "reasonable investigation" standard, n103 the same standard as applicable to credit reporting agencies under section 1681i. The adequacy of the investigation will be a question of fact for jury determination. n104 An inadequate investigation may be actionable if it is negligent or willful behavior. n105 At least one defendant argued unsuccessfully that a furnisher's duty to "investigate" has no qualitative component to it. Their theory, that "any" investigation is sufficient, no matter how cursory, was rejected by a district court in Virginia in an unpublished opinion. n106

Because the furnisher must actually conduct an investigation and because the accuracy of the information is so important to both credit grantors and consumers, the furnisher may not instruct deletion instead of conducting a reasonable investigation. n107 Similarly, a consumer may maintain a claim to redress the furnisher's failure to conduct a reasonable investigation irrespective of whether the information is in fact inaccurate or incomplete. n108

[4] Furnisher Must Report Investigation Results

When its investigation determines that disputed information is "inaccurate or incomplete or cannot be verified," the furnisher must, "as appropriate," modify, delete, and/or "permanently block the reporting of that item of information" to prevent its re-reporting. n109 Because this duty is codified as part of section 1681s-2(b), it is subject to private enforcement under the same terms that recognize the consumer's private right of action to enforce the formal investigation duties. n110

Reinvestigations conducted by reporting agencies and initiated by a consumer's dispute must be completed within thirty days, with one extension allowed. n111 The thirty-day period begins on the date the agency receives the consumer's notice of dispute. At the end of the reinvestigation period, the disputed information must be deleted if it cannot be verified, or corrected or modified in light of the reinvestigation.

One fifteen-day extension of the reinvestigation period is allowed but only if, during the original thirty-day period, additional information relevant to the reinvestigation is received from the consumer. If it is reinserted into the consumer's file later, perhaps after the agency has obtained verification from the furnisher, the consumer must at the time be provided notice of the reinsertion. n112

Failure to complete the reinvestigation within the required statutory time limit subjects the agency to actual damages and attorney fees if the action is negligent. n113 If the failure is willful, the agency can also be liable for punitive damages. n114 To help ensure that corrected information is appropriately disseminated, an investigation which finds that the disputed information was inaccurate or incomplete must be reported by the furnisher to all agencies that operate on a nationwide basis and to which the information had been furnished. n115 Unlike section 1681*i*, which allows a CRA to terminate its investigation under certain circumstances if the consumer fails to provide it with sufficient information, n116 section 1681s-2(b) contains no similar provision, and a furnisher must still meet its duty to conduct a reasonable investigation even if the consumer fails or refuses to provide it with requested documentation. n117

[5] Creditor and Furnisher Liability For Information Furnished To Consumer Reporting Agencies

[a] Liability Under the FCRA

The single most important fact about furnisher liability is that private enforcement under the FCRA against creditors and others who furnish information to consumer reporting agencies is virtually eliminated except when the furnisher has failed to properly investigate, correct or update information in response to a notice of dispute received, not from the consumer, but from a consumer reporting agency. While tort liability may be available, state law claims are otherwise preempted

A furnisher who fails to comply with the requirements of the reinvestigation process is liable to the consumer for its negligent or willful acts. n118 The act generally provides that any person who negligently or willfully violates any of its provisions may be sued for actual, statutory and punitive damages. n119 No exception is made for furnishers who violate their obligations as part of the Act's reinvestigation procedures. Any furnisher who negligently fails to comply with any of these requirements is liable to the consumer for any actual damages, the costs of litigation and attorney's fees. If the failure of the furnisher is willful, the furnisher is liable for actual damages of not less than $100 and not more than $1000, and for punitive damages, as well as for costs and attorney's fees.

The strongest cases for furnisher liability arise when the creditor has clearly been informed of its error and failed to make corrections. A consumer puts herself in a strong position when the creditor is informed in writing of a dispute (with appropriate details of the error) and of the importance to the consumer of an accurate credit record, and when a copy of the dispute given to the reporting agency is also given to the creditor.

[b] Furnisher Liability for Related Torts

The FCRA limits a consumer's right to bring a proceeding in the nature of defamation, invasion of privacy, or negligence with respect to the reporting of information against any person who furnishes information to a consumer reporting agency. n120 There are two important caveats about this qualified immunity of furnishers. First, if the furnisher provides false information with malice or a willful intent to injure the consumer, the FCRA provides no immunity for such an act. n121 The consumer can then bring a tort action against the creditor or other party furnishing the information and, in such circumstances, often should also seek punitive damages.

Second, the limited immunity only applies when the information at issue was disclosed to the consumer pursuant to one of the various FCRA disclosure requirements to consumers disclosure of the contents of the consumer's file or disclosure after a consumer report leads to a denial of credit, insurance or employment. n122 If the consumer obtained the information directly from the furnisher, the immunity should not apply. Similarly, the immunity should not apply if the consumer obtained the information from a user who did not notify the consumer of a denial of employment, insurance or credit based on the report. n123 Concurrently with adopting in 1996 the furnisher provisions of section 1681s-2(b), Congress also expanded the preemption provisions to further insulate furnishers from most state law obligations. n124

Several cases have considered the effects of section 1681t's preemption. Two different phrases in section 1681t have caused confusion: the meaning of "requirement or prohibition" and the meaning of "subject matter regulated under ... section 1681s-2."

A Texas district court interpreted "requirement or prohibition" to include only state statutes, not common law actions, on the reasoning that the two specific state laws exempted from the preemption provision were both credit reporting statutes that specifically referenced furnishers. n125 A Kansas district court, however, seems to have assumed that the "requirement or prohibition" language includes common law tort actions, and not just state statutes. n126

More thoughtful analyses have sought to reconcile the two provisions by reading the preemption provision restrictively. For example, a Minnesota district court rejected a furnisher's argument that the immunity and preemption provisions together barred any action based on any matter regulated by section 1681s-2 because that reading would render the general immunity provision superfluous as to furnishers. n127

The other phrase that determines the scope of section 1681t's preemption is "subject matter regulated under ... section 1681s-2." n128 The cases discussing whether a claim encompasses such subject matter have more or less fallen into two schools of thought. The first, the before-and-after school, focuses on when the conduct that gave rise to the plaintiff's claim against the furnisher occurred, on the theory that section 1681s-2 regulates furnisher conduct only after a specific

event has occurred: the furnisher has reported information with actual knowledge of errors (triggering section 1681s-2(a)(1)(A)); the furnisher has received notice from a consumer that specific information is inaccurate (triggering section 1681s-2(a)(1)(B)); or a consumer reporting agency has notified that furnisher that a reported item is in dispute (triggering section 1681s-2(b)). Under this analysis, claims based on the furnisher's behavior after the furnisher's responsibilities under section 1681s-2 have arisen are barred by the preemption provision. So, for example, in *Aklagi v. Nationscredit Financial*, n129 the court held that any defamation claim brought by an identity theft victim based on a furnisher furnishing inaccurate information to a consumer reporting agen cy after the furnisher received notice that the consumer disputed the information was wholly preempted.

Other courts have not focused on when the furnisher received notice of the inaccuracy, but rather have directed their attention towards the elements of the alleged cause of action itself, and how those elements compare with section 1681s-2. In short, this school of thought asks whether the essence of the claim the plaintiff seeks to bring is too similar to the subject matter of section 1681s-2 to escape preemption. So, for example, in another identity theft case, *Carlson v. Trans Union, L.L.C.*, n130 the court framed its analysis around the elements of the particular claims, and held that a consumer's defamation claim against a telephone company that had furnished allegedly false reports withstood preemption under 1681t. The court noted that the scope of the preemption provision is limited to those state claims that relate to any "subject matter regulated under" section 1681s-2.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer ReportsBanking LawConsumer ProtectionFair Credit ReportingLiability

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C § 1681a(d)(2)(A)(ii)* and *(iii)*.

(n2)Footnote 2. *See generally* National Consumer Law Center, Fair Credit Reporting Act, Ch. 6 (6th ed. 2006 and Supp.).

(n3)Footnote 3. *See* National Consumer Law Center, Collection Actions, § 11.2.3 (1st ed. 2008 and Supp.).

(n4)Footnote 4. *15 U.S.C. § 1681a(c)*.

(n5)Footnote 5. *15 U.S.C. § 1681a(f)*.

(n6)Footnote 6. *See generally* National Consumer Law Center, Fair Credit Reporting Act, Ch. 6 (6th ed. 2006 and Supp.).

(n7)Footnote 7. *See www.cdiaonline.org/data.cfm*.

(n8)Footnote 8. *15 U.S.C. § 1681s-2(a)(3)*.

(n9)Footnote 9. *15 U.S.C. § 1681c(f)*.

(n10)Footnote 10. *15 U.S.C. § 1682; see* National Consumer Law Center, Fair Debt Collection (6th ed. 2008 and Supp.).

(n11)Footnote 11. *15 U.S.C. § 1682g*(b).

(n12)Footnote 12. *Sullivan v. Equifax, Inc., 2002 U.S. Dist. LEXIS 7884* (E.D. Pa. Apr. 19, 2002) (and authorities cited therein), *aff'd sub nom. Trans Union, L.L.C. v. FTC, 295 F.3d 42 (D.C. Cir. 2002)* .

(n13)Footnote 13. LeFevre, FTC Informal Staff Opinion Letter, Dec. 23, 1997.

(n14)Footnote 14. *15 U.S.C. § 1682e*(8).

(n15)Footnote 15. *See* National Consumer Law Center, Fair Debt Collection, § 5.5.11 (6th ed. 2008 and Supp.).

(n16)Footnote 16. *15 U.S.C. § 1666*; *see also § 15.03*; National Consumer Law Center, Truth in Lending, § 5.8 (6th ed. 2007 and Supp.).

(n17)Footnote 17. *15 U.S.C. § 1666* does not explicitly limit its scope to open-end credit. *But see* National Consumer Law Center, Truth in Lending, § 5.8.1 (6th ed. 2007 and Supp.).

(n18)Footnote 18. *See 12 C.F.R. § 226.2(j)*.

(n19)Footnote 19. *15 U.S.C. § 1666i*; *see also* National Consumer Law Center, Truth in Lending, § 5.9.5 (6th ed. 2007 and Supp.).

(n20)Footnote 20. The latter two requirements do not apply when the card issuer and merchant are closely connected. *See* Reg. Z § 226 n.26.

(n21)Footnote 21. *12 C.F.R. § 226.12(c)(2)*. This would also violate the consumer's rights under the Equal Credit Opportunity Act. *15 U.S.C. § 1691(e)*.

(n22)Footnote 22. FRB Official Staff Commentary to Regulation Z § 226.12(c)(2)-1.

(n23)Footnote 23. *12 U.S.C. § 2601*. *See* National Consumer Law Center, Cost of Credit, § 12.2.1 (4th ed. 2009).

(n24)Footnote 24. *12 U.S.C. § 2602(1)(A)*. The loan must involve a federally insured or regulated lender; the loan must be guaranteed by the FHA, FmHA, the VA, or other federal agency; the loan must be intended to be sold to FNMA, Freddie Mac, or GNMA; or the creditor must have more than $1 million a year in residential real estate loans. *12 U.S.C. § 2602(1)(B)*. The major area to which RESPA may not apply involves a private individual making a small number of mortgage loans, where a major institution acts as a broker for that and numerous other individuals who are acting as lenders.

(n25)Footnote 25. *12 U.S.C. § 2605(e)(1)*.

(n26)Footnote 26. *12 U.S.C. § 2605(e)(3)*.

(n27)Footnote 27. *12 U.S.C. § 2605(f)*.

(n28)Footnote 28. *15 U.S.C. § 1691(a)*; *12 C.F.R. § 202.2(m)*. *See generally* National Consumer Law Center, Credit Discrimination Ch. 3 (5th ed. 2009).

(n29)Footnote 29. *31 U.S.C. § 3711(f)*; *see* National Consumer Law Center, Fair Credit Reporting Act § 5.5.3 (6th ed. 2006 and Supp.).

(n30)Footnote 30. *15 U.S.C. § 1681s/-/2*, *as amended by* Pub. L. No. 108-159, § 312(b) (2003).

(n31)Footnote 31. *15 U.S.C. § 1681s-2(d)*; *see* Ch. 14 *infra*; *Riley v. General Motors Acceptance Corp., 226 F. Supp. 2d 1316 (S.D. Ala. 2002)* ; *Vazquez-Garcia v. Trans Union de Puerto Rico, 222 F. Supp. 2d 150 (D.P.R. 2002)* ; *Hasvold v. First USA Bank, N.A., 194 F. Supp. 2d 1228 (D. Wyo. 2002)* .

(n32)Footnote 32. *See § 16.05[5][b] infra*; National Consumer Law Center, Fair Credit Reporting Act § 10.5 (6th ed. 2006 and Supp.).

(n33)Footnote 33. *Id*., prior to amendment by Pub. L., No. 108-159, § 312(b) (2003).

(n34)Footnote 34. *15 U.S.C. § 1681s-2(a)(1)(A)*, *as amended by* Pub. L. No. 108-159, § 312(b) (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(xiv)*, *added by 69 Fed. Reg. 6526* /-/31 (Feb. 5, 2004).

(n35)Footnote 35. *15 U.S.C. § 1681s/-/2(a)(1)(D)*, *added by* Pub. L. No. 108-159, § 312(b) (2003).

(n36)Footnote 36. *15 U.S.C. § 1681s/-/2(a)(1)(C)*..

(n37)Footnote 37. *15 U.S.C. § 1681s/-/2*.

(n38)Footnote 38. *15 U.S.C. § 1681s/-/2(a)(2)(B)*.

(n39)Footnote 39. *Id*.

(n40)Footnote 40. Office of the Comptroller of Currency (OCC) for national banks; Office of Thrift Supervision (OTS) for federal thrifts; Federal Deposit Insurance Corporation (FDIC) for certain state banks; National Credit Union Administration (NCUA) for federal credit unions; the Federal Reserve Board (FRB) for a set of other banks; and the Federal Trade Commission (FTC) for all non-bank furnishers.

(n41)Footnote 41. *15 U.S.C. § 1681s-2(e)*.

(n42)Footnote 42. *Id*.

(n43)Footnote 43. *15 U.S.C. § 1681s-2(c)(1)* and *(2)*.

(n44)Footnote 44. *74 Fed. Reg. 31484* (July 1, 2009) .

(n45)Footnote 45. *15 U.S.C. § 1681t(b)(1)(F)*.

(n46)Footnote 46. *12 C.F.R. §§ 41.42(a) (OCC)*, *222.42(a) (FRB)*, *334.42(a)* (FDIC), 571.42(a) (OTS), 717.42(a) (NCUA); *16 C.F.R. § 660.3(a)(FTC)*.

(n47)Footnote 47. *12 C.F.R. §§ 41.42(b) (OCC)*, *222.42(b) (FRB)*, *334.42(b)* (FDIC), 571.42(b) (OTS), 717.42(b) (NCUA); *16 C.F.R. § 660.3(b)(FTC)*.

(n48)Footnote 48. *74 Fed. Reg. 31484, 31492* (July 1, 2009) .

(n49)Footnote 49. *12 C.F.R. §§ 41.42(a) (OCC)*, *222.42(a) (FRB)*, *334.42(a)*(FDIC), 571.42(a) (OTS), 717.42(a) (NCUA); *16 C.F.R. § 660.3(a) (FTC)*.

(n50)Footnote 50. *12 C.F.R. §§ 41.42(c) (OCC)*, *222.42(c) (FRB)*, *334.42(c)* (FDIC), 571.42(c) (OTS), 717.42(c) (NCUA); *16 C.F.R. § 660.3(c) (FTC)*.

(n51)Footnote 51. *12 C.F.R. §§ 41.41(a)(1) (OCC)*, *222.41(a)(1) (FRB)*, *334.41(a)(1)* (FDIC), 571.41(a)(1) (OTS), 717.41(a)(1) (NCUA); *16 C.F.R. § 660.2(a)(1) (FTC)*.

(n52)Footnote 52. *12 C.F.R. §§ 41.41(a)(2) (OCC)*, *222.41(a)(2) (FRB)*, *334.41(a)(2)* (FDIC), 571.41(a)(2) (OTS), 717.41(a)(2) (NCUA); *16 C.F.R. § 660.2(a)(2) (FTC)*.

(n53)Footnote 53. *12 C.F.R. §§ 41.41(a)(3) (OCC)*, *222.41(a)(3) (FRB)*, *334.41(a)(3)* (FDIC), 571.41(a)(3) (OTS), 717.41(a)(3) (NCUA); *16 C.F.R. § 660.2(a)(3) (FTC)*.

(n54)Footnote 54. *12 C.F.R. §§ 41.41(e)(1) (OCC)*, *222.41(e)(1) (FRB)*, *334.41(e)(1)* (FDIC), 571.41(e)(1) (OTS), 717.41(e)(1) (NCUA); *16 C.F.R. § 660.2(e)(1) (FTC)*.

(n55)Footnote 55. *12 C.F.R. §§ 41.41(e)(2) (OCC)*, *222.41(e)(2) (FRB)*, *334.41(e)(2)* (FDIC), 571.41(e)(2) (OTS), 717.41(e)(2) (NCUA); *16 C.F.R. § 660.2(e)(2) (FTC)*.

(n56)Footnote 56. *12 C.F.R. §§ 41.41(e)(3)(i) (OCC)*, *222.41(e)(3)(i) (FRB)*, *334.41(e)(3)(i)* (FDIC), 571.41(e)(3)(i) (OTS), 717.41(e)(3)(i) (NCUA); *16 C.F.R. § 660.2(e)(3)(i) (FTC)*.

(n57)Footnote 57. *12 C.F.R. §§ 41.41(e)(3)(ii) (OCC)*, *222.41(e)(3)(ii) (FRB)*, *334.41(e)(3)(ii)* (FDIC), 571.41(e)(3)(ii) (OTS), 717.41(e)(3)(ii) (NCUA); *16 C.F.R. § 660.2(e)(3)(ii) (FTC)*.

(n58)Footnote 58. *12 C.F.R. §§ 41.41(c) (OCC)*, *222.41(c) (FRB)*, *334.41(c)* (FDIC), 571.41(c) (OTS), 717.41(c) (NCUA); *16 C.F.R. § 660.2(c) (FTC)*.

(n59)Footnote 59. *12 C.F.R. §§ 41.41(c)(1) (OCC)*, *222.41(c)(1) (FRB)*, *334.41(c)(1)* (FDIC), 571.41(c)(1) (OTS), 717.41(c)(1) (NCUA); *16 C.F.R. § 660.2(c)(1) (FTC)*.

(n60)Footnote 60. *12 C.F.R. §§ 41.41(c)(2) (OCC)*, *222.41(c)(2) (FRB)*, *334.41(c)(2)* (FDIC), 571.41(c)(2) (OTS), 717.41(c)(2) (NCUA); *16 C.F.R. § 660.2(c)(2) (FTC)*.

(n61)Footnote 61. *12 C.F.R. §§ 41.41(c)(3) (OCC)*, *222.41(c)(3) (FRB)*, *334.41(c)(3)* (FDIC), 571.41(c)(3) (OTS), 717.41(c)(3) (NCUA); *16 C.F.R. § 660.2(c)(3) (FTC)*.

(n62)Footnote 62. *12 C.F.R. §§ 41.41(c)(4) (OCC)*, *222.41(c)(4) (FRB)*, *334.41(c)(4)* (FDIC), 571.41(c)(4) (OTS), 717.41(c)(4) (NCUA); *16 C.F.R. § 660.2(c)(4) (FTC)*.

(n63)Footnote 63. *74 Fed. Reg. 31492* (July 1, 2009) .

(n64)Footnote 64. Appx. E, § I(b)(2).

(n65)Footnote 65. *Id.* § I(b)(3).

(n66)Footnote 66. *Id.* § I(b)(4).

(n67)Footnote 67. *Id.* § II(a)(1).

(n68)Footnote 68. *Id.* § II(a)(2). A furnisher need only review historical records in furnisher's possession. *74 Fed. Reg. 31495* (July 1, 2009) .

(n69)Footnote 69. Appx. E, § II(a)(2).

(n70)Footnote 70. *Id.*

(n71)Footnote 71. *Id.* § II(a)(4).

(n72)Footnote 72. *Id.* § II(a)(5).

(n73)Footnote 73. *Id.* § II(a)(5).

(n74)Footnote 74. *Id.* § III(b).

(n75)Footnote 75. *See* National Consumer Law Center, Fair Credit Reporting, §§ 6.3.2, 6.3.3 (6th ed. 2006 an supp.) (discussion of Metro 2).

(n76)Footnote 76. Appx. E, § III(f). The Regulators declined to include a requirement that furnishers must keep records for as long as account is being reported. *74 Fed. Reg. 31496* (July 1, 2009).

(n77)Footnote 77. Appx. E, § III(d).

(n78)Footnote 78. *Id.* § III(e).

(n79)Footnote 79. *Id.* § III(f).

(n80)Footnote 80. *Id.* § III(g).

(n81)Footnote 81. *Id.* § III(h).

(n82)Footnote 82. *Id.* § III(j).

(n83)Footnote 83. *Id.* § III(k).

(n84)Footnote 84. *15 U.S.C. § 1681s-2(a)(3)*. As the FCRA does not require that the consumer notify the furnisher of the dispute in writing, a consumer's oral notice should be sufficient. *Cf. Brady v. Credit Recovery Co., 160 F.3d 64 (1st Cir. 1998)* (Fair Debt Collection Practices Act does not require a consumer to notify a debt collector in writing that the consumer disputes the debt to prevent collector from reporting the debt to credit reporting agencies).

(n85)Footnote 85. *15 U.S.C. § 1681c(a)(4)*.

(n86)Footnote 86. *15 U.S.C. § 1681s-2(a)(5)*.

(n87)Footnote 87. *15 U.S.C. § 1681s-2(a)*.

(n88)Footnote 88. *15 U.S.C. § 1681i(a)(2)*.

(n89)Footnote 89. *15 U.S.C. § 1681s/-/2(b)*.

(n90)Footnote 90. *15 U.S.C. § 1681s/-/2(a)(8)*, *added by* Pub. L. No. 108-159, § 312 (2003). The effective date for the new regulations is December 1, 2003. *16 C.F.R. § 602.1(c)(3)(xiv)*, *added by 69 Fed. Reg. 6526* /-/31 (Feb. 5, 2004).

(n91)Footnote 91. *15 U.S.C. § 1681s/-/2(a)(8)(G)*. Even notices from or prepared by organizations that are not defined to be credit repair organizations under the Credit Repair Organizations Act *(16 U.S.C. § 1679a)* because of their non-profit status will not trigger a reinvestigation. *Id.*

(n92)Footnote 92. Such a determination may arise by reason of the consumer's failure to provide sufficient information to allow the furnisher to investigate the disputed information, *15 U.S.C. § 1681s/-/2(a)(8)(F)(i)(I)*, or when the submitted dispute reiterates a dispute made by the consumer to either the furnisher or an agency and which the furnisher has already reinvestigated, *15 U.S.C. § 1681s-2(a)(8)(F)(i)(II)*.

(n93)Footnote 93. *15 U.S.C. § 1681t(a)(8)(F)*.

(n94)Footnote 94. *15 U.S.C. § 1681t (a)(8)(E)*, *added by* Pub. L. No. 108-159, § 312 (2003).

(n95)Footnote 95. *Id.*

(n96)Footnote 96. *15 U.S.C. § 1681t (b)(1)(F)*.

(n97)Footnote 97. *15 U.S.C. § 1681t (c)(1)*, *added by* Pub. L. No. 108-159, § 312 (2003).

(n98)Footnote 98. *74 Fed. Reg. 31497* (July 1, 2009) (citing *Johnson v. MBNA America Bank, N.A., 357 F.3d 426 (4th Cir. 2004))* .

(n99)Footnote 99. *74 Fed. Reg. 31484* (July 1, 2009) .

(n100)Footnote 100. *15 U.S.C. § 1681i(a)(2).*

(n101)Footnote 101. *15 U.S.C. § 1681s-2(b)*; Cohan, Informal Staff Opinion Letter, Aug. 1, 2000. Practitioners report, however, that many furnishers fail to comply with this provision of the Act.

(n102)Footnote 102. *See* National Consumer Law Center, Fair Credit Reporting Act, §§ 6.10.3, 6.10.6 (6th ed. 2006 and Supp.).

(n103)Footnote 103. *Bruce v. First U.S.A. Bank, N.A., 103 F. Supp. 2d 1135 (E.D. Mo. 2000)* .

(n104)Footnote 104. *Bruce v. First U.S.A. Bank, N.A., 103 F. Supp. 2d 1135 (E.D. Mo. 2000) . See also Dalton v. Capital Associated Indus., Inc., 257 F.3d 409, 418 (4th Cir. 2001)* .

(n105)Footnote 105. *15 U.S.C. §§ 1681n, 1681o. See Olwell v. Medical Info. Bureau, 2003 U.S. Dist. LEXIS 442* (D. Minn. Jan. 7, 2003) (a reasonable jury could find that failure to contact outside sources during reinvestigation was unreasonable).

(n106)Footnote 106. Johnson v. Equifax Info., Civ. Action No. 3:02CV523 (E.D. Va. Feb. 24, 2003) (unpublished opinion).

(n107)Footnote 107. *McKeown v. Sears Roebuck & Co., 335 F. Supp. 2d 917 (W.D. Wis. 2004)* .

(n108)Footnote 108. *Rosenberg v. Cavalry Invs., 2005 U.S. Dist. LEXIS 22788* (D. Conn. Sept. 30, 2005) .

(n109)Footnote 109. *15 U.S.C. § 1681s-2(b)(1)(E).*

(n110)Footnote 110. See § [5] *infra.*

(n111)Footnote 111. *15 U.S.C. § 1681(a)(1).*

(n112)Footnote 112. *15 U.S.C. § 1681i(a)(5)(B).*

(n113)Footnote 113. *See 15 U.S.C. § 1681n*; *Stevenson v. TRW, Inc., 987 F.2d 288 (5th Cir. 1993)* .

(n114)Footnote 114. *See 15 U.S.C. § 1681o. But cf. Stevenson v. TRW, Inc., 987 F.2d 288 (5th Cir. 1993)* (no willfulness found).

(n115)Footnote 115. *15 U.S.C. § 1681s-2(b)(1)(D).*

(n116)Footnote 116. *15 U.S.C. § 1681 i*(a)(3)(A). *See* § 4.5.2.4, *supra.*

(n117)Footnote 117. *Defer v. World Fin. Network Nat'l Bank, 2007 U.S. Dist. LEXIS 76188* (E.D. Mich. Oct. 15, 2007) .

(n118)Footnote 118. Senator Bond, introducing the bill which was later enacted, explained: "When a consumer goes through the reinvestigation process with the credit bureau and the problem is still not fixed, our bill gives the consumer the right to sue the creditor who will not fix the information it submitted to the credit bureau." 141 Cong. Rec. S5449 (Apr. 6, 1995). *See Yutesler v. Sears Roebuck & Co., 263 F. Supp. 2d 1209 (D. Minn. 2003)* ; *Olwell v. Medical Info. Bureau, 2003 U.S. Dist. LEXIS 442* (D. Minn. Jan. 7, 2003) ; *Redhead v. Winston & Winston, P.C., 2002 U.S. Dist.*

LEXIS 17780 (S.D.N.Y. Sept. 20, 2003) ; *Vasquez-Garcia v. Trans Union de Puerto Rico, 222 F. Supp. 2d 150 (D.P.R. 2002)* .

(n119)Footnote 119. *See § 16.09 infra*; National Consumer Law Center, Fair Credit Reporting Act, Ch. 10 (6th ed. 2006 and Supp.).

(n120)Footnote 120. *15 U.S.C. § 1681h(e)*. This provision is discussed in more detail at National Consumer Law Center, Fair Credit Reporting Act, § 6.12 (6th ed. 2006 and Supp.).

(n121)Footnote 121. *15 U.S.C. § 1681h(e)*; *see also* National Consumer Law Center, Fair Credit Reporting Act § 6.12 (6th ed. 2006 and Supp.).

(n122)Footnote 122. *15 U.S.C. § 1681h(e)*.

(n123)Footnote 123. *See* National Consumer Law Center, Fair Credit Reporting Act, § 6.12 (6th ed. 2006 and Supp.).

(n124)Footnote 124. *15 U.S.C. § 1681t(b)(F)* (preempting any state law "requirement or prohibition ... relating to the responsibilities of persons who furnish information to consumer reporting agencies," except specific portions of Massachusetts and California statutes).

(n125)Footnote 125. *Carlson v. Trans Union, L.L.C., 259 F. Supp. 2d 517 (N.D. Tex. 2003) . See Sheffer v. Experian Info. Solutions, Inc., 249 F. Supp. 2d 560 (E.D. Pa. 2003)* (refusing to dismiss plaintiff's defamation claim on grounds that neither § 1681h(e) or § 1681t(b)(1) apply when false information is furnished with malice or willful intent to injure, an interpretation that grafts the qualification of § 1681h(e)'s immunity onto § 1681t, but without thorough analysis).

(n126)Footnote 126. *See, e.g., Aklagi v. Nationscredit Fin., 196 F. Supp. 2d 1186, 1195 (D. Kan. 2002)* (holding defamation action preempted).

(n127)Footnote 127. *Yutesler v. Sears Roebuck & Co., 263 F. Supp. 2d 1209 (D. Minn. 2003)* (holding that plaintiff's common law claim for defamation of credit that asserted gross negligence survived both the general immunity and supplemental preemption provisions).

(n128)Footnote 128. *16 U.S.C. § 1681t*(b)(1)(F).

(n129)Footnote 129. *196 F. Supp. 2d 1186, 1195 (D. Kan. 2002) . See Mendoza v. Experian Info. Solutions, Inc., 2003 U.S. Dist. LEXIS 7121* (S.D. Tex. Mar. 24, 2003) (whether cause of action survived depended upon whether consumer reporting agencies fulfilled their responsibilities to notify furnisher of dispute; if they did, state claims were preempted; if they did not, claims could survive because cause of action would not relate to subject matter regulated under § 1681s-2(b)).

(n130)Footnote 130. *259 F. Supp. 2d 517 (N.D. Tex. 2003) . See Dornhecker v. Ameritech Corp. 99 F. Supp. 2d 918, 931 (N.D. Ill. 2000) . But see Stafford v. Cross Country Bank, 262 F. Supp. 2d 776 (W.D. Ky. 2003)* (court focused on the role of the defendant at the time the actionable conduct occurred, and ruled that the plaintiff's defamation claim *was* preempted); *Riley v. General Motors Acceptance Corp., 226 F. Supp. 2d 1316 (S.D. Ala. 2002)* (§ 1681t preempts all state causes of action against furnishers, both statutory and common law, where the state law claim is based on the same conduct that gives rise to the FCRA claim); *Carney v. Experian Info. Solutions, Inc., 57 F. Supp. 2d 496 (W.D. Tenn. 1999)* (§ 1681t preempted state UDAP claim based on furnisher's failure to provide accurate information after being notified by a consumer of a dispute).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1-16 Consumer Credit Law Manual § 16.06

§ 16.06 Obsolete Information

[1] General

The FCRA prohibits the reporting of most *adverse* information which is more than seven years old, n1 but does not restrict reporting information that is not adverse. n2 Agencies can thus report favorable information beyond the seven year period. n3 Certain information has been characterized as neutral by the FTC staff, and, as neutral information, it may be reported indefinitely. n4 Education records of graduation and degrees and dates of past employment are not considered adverse information.

Agencies can delete adverse or favorable information from reports whenever they wish before the seven year period, n5 although they should not purge favorable information sooner than adverse information. n6

It is improper to indicate or imply the existence of obsolete adverse information, even if the information itself is not reported. n7 A reporting agency may not report that a creditor (whose debt is now obsolete) cannot locate the debtor. n8 Similarly, the reporting agency cannot include information that the consumer was denied a job with a certain employer because of a criminal record, if that criminal record is obsolete. n9

[2] Maximum Time Periods to Retain Adverse Information

Under the FCRA, the various time periods for determining if information is obsolete relate to the *occurrence* of unfavorable events; the date the consumer reporting agency *acquired* the adverse information is irrelevant. n10

The FCRA provides specific time frames for five specialized types of information--bankruptcies, suits and judgments, paid tax liens, accounts placed for collection or charged to profit or loss, and records relating to a crime--and then provides a general rule for "any other adverse item of information," n11 excepting "records of convictions of crimes." No limit applies to criminal convictions. n12

The section of the FCRA specifying time frames for the five specialized types of information to become obsolete was as amended by the Fair and Accurate Credit Transactions Act of 2003(FACTA) to also exclude certain types of medical information from being reported. FACTA amended the FCRA to specify how debt collectors should designate the date of delinquency to ensure that the date precedes the date the creditor placed the account for collection. n13

[a] Any Other Adverse Item

The general rule that adverse items (other than criminal conviction records and the five exceptions listed in the statute) cannot antedate the report by more than seven years applies to most information about delinquent loans other than those placed for collection or charged to profit and loss. n14 The existence of a delinquent account may be reported for seven years from the date of the last regularly scheduled payment before the account became delinquent. n15 Criminal convictions do not fall within the rule and may effectively be reported without limit. n16 Third, large transactions and high-paying jobs are exempted and are also discussed in a following section. n17

[b] Accounts Placed for Collection or Charged Off

Accounts placed for collection and charged to profit and loss are subject to a slightly different seven year rule. n18 The seven year rule for these accounts is modified by tying the calculation to the preceding delinquency and allowing an extra half year. n19 If an account is placed for collection, charged to profit or loss, or subjected to similar action more than 180 days after the preceding delinquency, the debt may still be included in consumer reports for only seven years and 180 days from the beginning of the delinquency, or about seven and a half years. This limit, which did not exist before the 1996 amendment to the Fair Credit Reporting Act, is effective for any item added to a consumer's reporting agency file after December 29, 1997. n20 In addition, the seven year period may commence sometime between the date of delinquency and 180 days afterwards.

The FTC Staff Commentary details specific standards as to when the seven year period begins. An account is placed for collection (thus triggering a seven year period) when dunning notices or other collection efforts begin, though not when the initial past-due notices are sent. n21 The collection efforts may be those either initiated by the creditor in-house or by an outside collection agency, whichever occurs first. The reporting period is not extended by assignment to another entity for further collection, or by a partial or full payment of an account. n22 However, the Commentary states that if the account is brought completely up to date, and another default occurs subsequently, the seven-year reporting period will run from the date of the new default. n23

Even though accounts may be listed as charge offs and may not be reported after the applicable obsolescence period has elapsed, creditors may still attempt to collect on the accounts. Charge offs are mere accounting procedures and creditors or debt collectors may still attempt to collect upon the underlying debt even after the account has become obsolete for credit reporting purposes. Such collection efforts remain subject to the applicable statute of limitations defense, so long as the consumer has not made any payments, which would renew the statute.

It is unclear whether the seven-year limitation period should begin anew if the consumer signs a repayment agreement. Such agreements, in effect, are one type of collection tool to assure that the original debt is paid in full or in part. In this sense, it should be treated as a repayment which does not extend the limitations period. To do otherwise will punish those who agree to repay and reward those who do not. However, one FTC staff opinion letter and the FTC Commentary say that a repayment agreement may be considered a new transaction with a new seven-year limitation period. n24 It may be separately reported as long as the report does not imply that there was a default prior to the repayment agreement.

[c] Furnisher's Duty

Unless informed by the creditor or person furnishing information about a delinquency, a CRA has no way of knowing when the delinquency commenced and hence when the information must be eliminated from reports as obsolete. The FCRA requires that any person who furnishes information about a delinquent account placed for collection or written off, must also inform the CRA when the preceding delinquency commenced. n25 The date of delinquency does not have to be provided until ninety days following the time the information is first furnished to the CRA. A CRA which does not receive the date of delinquency within ninety days risks reporting obsolete information.

The restrictions on reporting obsolete information under section 1681(c)(a) specifically apply to CRAs. Thus, furnishers of information have no liability under that section. n26 Furnishers, however, are subject to accuracy and dispute investigation requirements under another section of the FCRA. n27 Only the dispute investigation requirements are privately enforceable by consumers, but consumers can challenge the furnisher's reporting of obsolete information by using this mechanism. n28

Under this section, furnishers have an obligation to provide the date of delinquency from which the obsolescence period is calculated. n29 Debt collectors must follow specific rules in furnishing the date of delinquency to ensure that it precedes the date on which the account was placed for collection. n30 Again, these duties are not directly enforceable by consumers, but a consumer could send a dispute raising these duties.

[d] Suits and Judgments

Information concerning suits and judgments is obsolete after seven years from the "date of entry" or until the governing statute of limitations has expired, whichever is longer. n31 For suits, the "date of entry" is the date the suit was initiated and, for judgments, the "date of entry" is the date judgment was rendered. n32

[e] Paid Tax Liens

Paid tax liens may not be reported more than seven years after the date of payment. n33 On the face of the statute, unpaid tax liens and other liens, whether paid or unpaid, are within the catch-all seven-year limitations for any other adverse item of information. The FTC Staff Commentary, nevertheless, takes the position that unpaid tax or other types of liens may be reported as long as they remain filed and effective. n34

[f] Criminal Records

In 1998, *15 U.S.C. section 1681c* was amended to remove records of indictment and criminal convictions from the seven year limit. n35 The effective date of the new provision is retroactive to September 30, 1998. Records of arrest still become obsolete after seven years or the expiration of the statute of limitations, whichever is longer. n36 Acquittals and dismissed charges may be reported for seven years from the date of acquittal or dismissal. n37

[g] Bankruptcy Reports Considered Obsolete After Ten Years

Bankruptcies more than ten years old cannot be included in a consumer report. n38 The ten year rule applies to all bankruptcy filings under the U.S. Bankruptcy Code, whether they be under chapters 7, 11, 12, or 13. n39 Both direct and indirect references to a consumer's bankruptcy should be deleted from reports after ten years.

The ten year limitation on bankruptcy reporting begins from the date of entry of the order for relief or date of adjudication under the Bankruptcy Code. n40 This refers to the actual entry of the order, not a judge's oral utterance during a hearing. n41 In a voluntary bankruptcy case, the filing by the consumer of the bankruptcy petition itself is the entry of the order for relief from which the ten year limitation is measured. n42

The ten year limit for reporting bankruptcy cases does not appear to extend the seven year limit for reporting specific debts discharged in bankruptcy. n43

[h] Prescreening Inquiries

Prescreening is the process whereby consumer reporting agencies compile or edit mailing lists of consumers who meet particular credit or insurance-related criteria, used by creditors or insurers to offer services or products to those consumers. Agencies must keep a record for one year of all such "inquiries" that identified a consumer for such a list,

and include that information in any file disclosure made to the consumer. n44 On the other hand, the agency may not include such information in any consumer report furnished to others. n45

[i] Student Loans

The Higher Education Act sets out two rules as to when reports on defaulted, federally backed student loans become obsolete.

Federal Family Education Loans ("FFELs") (including guaranteed student or Stafford loans, SLS loans, and PLUS loans) are obligations owed to a lender, which are guaranteed by a guaranty agency and then reinsured by the United States. FFEL defaults may be included in consumer reports for seven years from the later of three dates: (1) when the Secretary of Education or the guaranty agency pays a claim to the loan holder on the guaranty, which could be months or even years after default; (2) when the Secretary of Education, guaranty agency, lender, or any other loan holder first reported the account to the consumer reporting agency; or (3) if a borrower re-enters repayment after defaulting on a loan, when the borrower subsequently goes into default on the loan. n46 In contrast, Perkins loans are not subject to any limit on reporting. n47 Student loan borrowers are also entitled to certain procedural rights before a guaranty agency can report a student loan delinquency to a CRA. The borrower must have an opportunity to inspect and copy the records concerning the debt and to obtain an administrative review of the enforceability of the debt and whether the student loan is past due. n48

[3] Exemptions Allow Reporting of Obsolete Information

The FCRA specifies three exemptions to the rules about obsolete information. Agencies may furnish consumer reports containing information that would normally be considered obsolete, namely: n49

- A "credit transaction involving, or which may reasonably be expected to involve, a principal amount of $150,000 or more"; n50
- The "underwriting of life insurance involving, or which may reasonably be expected to involve, a principal amount of $150,000 or more"; n51 or
- The "employment of any individual at an annual salary which equals, or which may reasonably be expected to equal, $75,000 or more." n52

Because of these exemptions, reporting agencies have legitimate grounds for retaining otherwise obsolete information in their files, n53 as long as the agency reports this information only when the user's need falls within one of the three itemized situations. Nevertheless, to reduce the danger of obsolete information making its way into a report not involving any of the three exemptions, agencies must establish procedural safeguards. These procedures should insure that obsolete information is only released after an internal decision is made that the release will not violate the statute. n54

[a] Preemption of State Obsolescence Laws

State laws that have obsolescence periods which differ from those in the FCRA are preempted unless they were in effect on September 30, 1996. n55

[4] Reasonable Procedures Concerning Obsolete Information

[a] General

A consumer reporting agency must "maintain reasonable procedures designed to avoid violations" of the requirements dealing with obsolete information. n56 FTC Commentary also states that consumer reporting agencies should establish procedures with its sources of adverse information that will avoid the risk of reporting obsolete information. n57 The FCRA imposes two separate obligations: (1) reporting agencies cannot supply obsolete information in violation of the Act; and (2) reporting agencies must also follow reasonable procedures designed to avoid violations of the Act's obsolete information requirements. Private remedies under the FCRA are available, however, only if an agency's action is negligent.

An agency's failure to follow its own procedures is evidence of negligence. Similarly, adoption of improper procedures makes the report of obsolete information at least negligent. But there will be an issue whether there is negligence when an agency strictly follows its own reasonable procedures, but where obsolete information is still reported.

While reporting of obsolete information should generally involve negligence, it is probably the case that a reporting agency is not liable for punitive damages (i.e., its actions are not willful) n58 where it maintains reasonable procedures and followed those procedures, even if obsolete information was reported. On the other hand, the failure of an agency to adopt any standards or the adoption of clearly inadequate procedures may be evidence of willfulness, leading to punitive damages. Intentional violation of a reporting agency's own procedures may also be evidence of willfulness.

[b] What Are "Reasonable" Procedures?

Whether procedures are "reasonable" will depend on whether the consumer reporting agency used procedures which "a reasonably prudent person would [exercise] under the circumstances." n59 The types of procedures required "may vary depending on the size of the agency and the type and volume of reports that it issues." n60 The cost, in time and money, of imposing specific procedural requirements on the consumer reporting agency will obviously be one factor that the court will consider in determining reasonableness in any given case. n61

[c] Procedures Determining Whether an Exemption Applies

If an agency reports obsolete information pursuant to one of the three exceptions, it must first verify that the user's purpose falls within one of the three designated situations. Consequently, the consumer reporting agency must maintain procedures which "require that prospective users of the information identify themselves, certify the purposes for which the information is sought, and certify that the information will be used for no other purpose." n62

The FTC has interpreted this section to require written certification by the user of the purpose for which the consumer report will be used, n63 or, at least, to require the reporting agency to keep a written record of the user's oral certification. n64 The Act explicitly requires the reporting agency to verify the prospective user's identity and stated purpose only if it is a user to which the reporting agency has not previously furnished a consumer report. n65

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer Reports

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. § 1681c(a)*; FTC Official Staff Commentary § 605 item 1.

(n2)Footnote 2. FTC Official Staff Commentary § 605 item 2.

(n3)Footnote 3. *See* Conway, FTC Informal Staff Opinion Letter, Sept. 11, 1973.

(n4)Footnote 4. Ovadell, FTC Informal Staff Opinion Letter, Dec. 10, 1998.

(n5)Footnote 5. FTC Official Staff Commentary § 605 item 4. *See also* Grimes, FTC Informal Staff Opinion Letter, Aug. 28, 1986 (creditor may delete favorable file information after five years or any other chosen time period). *But see* Opinion of the Nebraska Attorney General, [1980-1989 Decisions Transfer Binder] Consumer Cred. Guide P 96,018 (No. 87015, Feb. 2, 1987) (state may not set a shorter time period for reporting of bankruptcy history).

(n6)Footnote 6. *Trans Union Credit Info. Co., 102 F.T.C. 1109 (1983)* (consent order).

(n7)Footnote 7. *See* FTC Official Staff Commentary § 605 item 6; *see also Equifax, Inc., 96 F.T.C. 844 (1977)* (initial opinion), *aff'd, 96 F.T.C. 1045 (1980)* (final opinion), *rev'd in part on other grounds, 678 F.2d 1047 (11th Cir. 1982) . Cf.* Brinckerhoff, FTC Informal Staff Opinion Letter, May 31, 1988.

(n8)Footnote 8. FTC Official Staff Commentary § 605 item 6.

(n9)Footnote 9. FTC, Compliance with the Fair Credit Reporting Act, at 28-29 (1977). *Cf.* FTC Official Staff Commentary § 605(a)(5) item 1.

(n10)Footnote 10. FTC Official Staff Commentary § 605 item 7.

(n11)Footnote 11. *15 U.S.C. § 1681c(a)(5), as amended by* Pub. L. No. 105-347, § 5, *105 Stat. 3208* (Nov. 2, 1998).

(n12)Footnote 12. *15 U.S.C. § 1681c(a)(5), as amended by* Pub. L. No. 105-347, § 5, *105 Stat. 3208* (Nov. 2, 1998).

(n13)Footnote 13. *15 U.S.C. § 1681s-2(a)(5).*

(n14)Footnote 14. FTC Official Staff Commentary § 605(a)(6) item 1.

(n15)Footnote 15. FTC Official Staff Commentary § 605(a)(6) item 1.

(n16)Footnote 16. Pub. L. No. 905-347, *112 Stat. 3208* (Nov. 2, 1998). *See §16.06[2][e] infra.*

(n17)Footnote 17. *15 U.S.C. § 1681c(b)(1)*; *15 U.S.C. § 1681c(b)(2)*; *15 U.S.C. § 1681c(b)(3).*

(n18)Footnote 18. *15 U.S.C. § 1681c(c).*

(n19)Footnote 19. FCRA § 605(c), *15 U.S.C. § 1681c(c)*, added by Pub. L. No. 104-208, § 2406, *110 Stat. 3009* (Sept. 30, 1996).

(n20)Footnote 20. Prior to this date, the seven year period for accounts placed for collection or charged off commenced at the time of placement or charge-off, and this rule still applies to all accounts thus placed or charged off prior to December 29, 1997. The effect of the older rule was to extend the time many delinquent accounts could remain in a consumer's credit report file.

(n21)Footnote 21. FTC Official Staff Commentary § 605(a)(4) item 1.

(n22)Footnote 22. FTC Official Staff Commentary § 605(a)(4) item 1.

(n23)Footnote 23. *See* FTC Official Staff Commentary § 605(a)(4) item 1. *But cf.* Brinckerhoff, FTC Informal Staff Opinion Letter, July 26, 1985; Peeler, FTC Informal Staff Opinion Letter, Aug. 8, 1979 [reproduced in National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006)].

(n24)Footnote 24. FTC Official Staff Commentary § 605(a)(4) item 1. *See also* Fortney, FTC Informal Staff Opinion Letter, Aug. 24, 1984.

(n25)Footnote 25. *15 U.S.C. § 1681s-2(a)(5)(A).*

(n26)Footnote 26. *Maloney v. LVNV Funding, L.L.C., 2006 U.S. Dist. LEXIS 76454* (N.D. Tex. Oct. 20, 2006) ; *Jonas v. International Airline Employees F.C.U., 2006 U.S. Dist. LEXIS 34150* (S.D.N.Y. May 19, 2006) .

(n27)Footnote 27. *15 U.S.C. § 1681s-2. See* §§ 6.4 and 6.10, *infra* .

(n28)Footnote 28. *Thomas v. U.S. Bank, N.A., 2007 U.S. Dist. LEXIS 17516* (D. Ore. Mar. 8, 2007) . *See* § 6.10, *infra*.

(n29)Footnote 29. *See* National Consumer Law Center, Fair Credit Reporting § 5.2.3.3.3 (6th ed. 2006 and Supp.).

(n30)Footnote 30. *See* National Consumer Law Center, Fair Credit Reporting § 5.2.3.3.6 (6th ed. 2006 and Supp.).

(n31)Footnote 31. *15 U.S.C. § 1681c(a)(2).*

(n32)Footnote 32. FTC Official Staff Commentary § 605(a)(2) item 1. *See also* Fitzpatrick, FTC Informal Staff Opinion Letter, Mar. 8, 1985 (date judgment is entered); Grimes, FTC Informal Staff Opinion Letter, Dec. 9, 1983.

(n33)Footnote 33. *15 U.S.C. § 1681c(a)(3).*

(n34)Footnote 34. FTC Official Staff Commentary § 605(a)(3) item 1.

(n35)Footnote 35. Pub. L. No. 105-347, § 5, *105 Stat. 3208* (Nov. 2, 1998).

(n36)Footnote 36. *15 U.S.C. § 1681c(a)(2), as amended by* Pub. L. No. 105-347, § 5, *105 Stat. 3208* (Nov. 2, 1998).

(n37)Footnote 37. *See* F.T.C. Official Staff Commentary § 605(a)(5) item 2.

(n38)Footnote 38. *15 U.S.C. § 1681c(a)(1).* This section provides that no consumer reporting agency may report "[c]ases under Title 11 or under the Bankruptcy Act that, from the date of entry of the order for relief or the date of adjudication, as the case may be, antedate the report by more than 10 years." The filing of a voluntary petition constitutes an order for relief. Pub. L. No. 95-598, *92 Stat. 2558 (1978).* Accordingly, for voluntary bankruptcies the time period runs from the date of filing and *not* from the subsequent date of discharge. According to one state attorney general, a state may not set a shorter time period for reporting of bankruptcy history. *See* Opinion of the Nebraska Attorney General, [1980-1989 Decisions Transfer Binder] Consumer Cred. Guide P 96,018 (No. 87015, Feb. 2, 1987).

(n39)Footnote 39. *See* FTC Official Staff Commentary § 605(a)(1) item 2.

(n40)Footnote 40. *15 U.S.C. § 1681c(a)(1).*

(n41)Footnote 41. 2 *Collier on Bankruptcy P 102.07* (15th ed. rev.).

(n42)Footnote 42. FTC Official Staff Commentary § 605(a)(1) item 3. *See also Matter of Tynan, 773 F.2d 177 (7th Cir. 1985)* ; *In re Martinson, 731 F.2d 543 (8th Cir. 1984)* ; *First Nat'l Sav. & Loan Ass'n v. Winkler, 29 B.R. 771 (N.D. Ill. 1983)* ; Fortney, FTC Informal Staff Opinion Letter, Nov. 15, 1985.

(n43)Footnote 43. *See* Fitzpatrick, FTC Informal Staff Opinion Letter, Aug. 26, 1988; Grimes, FTC Informal Staff Opinion Letter, Apr. 11, 1986. *See also* FTC Official Staff Commentary § 605(a)(1) item 1. *Cf. Learn v. Credit Bureau of Lancaster County, 664 F. Supp. 962 (E.D. Pa. 1987) , rev'd and remanded without published opinion, 838 F.2d 461*

(3d Cir. 1989) (holding that discharged debts may be reported for ten years).

(n44)Footnote 44. *15 U.S.C. § 1681g(a)(5)*; FCRA § 609(a)(5).

(n45)Footnote 45. *15 U.S.C. § 1681b(c)(3)*.

(n46)Footnote 46. *20 U.S.C. § 1080a*, *as amended by* Pub. L. No. 102-325, § 424, *106 Stat. 543* (July 23, 1992).

(n47)Footnote 47. *20 U.S.C. § 1087cc(c)(3)*, *as amended by* Pub. L. No. 105-224, § 3, *112 Stat. 1585 (1998)*. Prior to the 1998 amendments, the time limit was seven years from the date on which the Secretary accepted assignment or referral of the loan from the school or first reported the account to a reporting agency, whichever was later. Both of these dates typically occur months or even years after default.

(n48)Footnote 48. *See* National Consumer Law Center, Fair Credit Reporting Act § 12.4.5 (6th ed. 2006 and Supp.).

(n49)Footnote 49. FCRA § 605(b), *15 U.S.C. § 1681c(b)*, *as amended by* Pub. L. No. 104-208, § 2406, *110 Stat. 3009* (Sept. 30, 1996).

(n50)Footnote 50. FCRA § 605(b)(1), *15 U.S.C. § 1681c(b)(1)*, *as amended by* Pub. L. No. 104-208, § 2406, *110 Stat. 3009* (Sept. 30, 1996).

(n51)Footnote 51. FCRA § 605(b)(2), *15 U.S.C. § 1681c(b)(2)*, *as amended by* Pub. L. No. 104-208, § 2406, *110 Stat. 3009* (Sept. 30, 1996).

(n52)Footnote 52. FCRA § 605(b)(3), *15 U.S.C. § 1681c(b)(3)*, *as amended by* Pub. L. No. 104-208, § 2406, *110 Stat. 3009* (Sept. 30, 1996). The limitation, which prior to the 1996 Reform Act was $20,000, was intended to apply to the initial or starting salaries. *See* Conf. Rep. No. 1587, 91st Cong., 2d Sess. (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394, 4911, 4915.

(n53)Footnote 53. *See Herring v. Retail Credit Co., 224 S.E.2d 663 (S.C. 1976) . See also* Brinckerhoff, FTC Informal Staff Opinion Letter, July 30, 1985.

(n54)Footnote 54. FTC Official Staff Commentary § 607 item 1B.

(n55)Footnote 55. *15 U.S.C. § 1681t (b)(1)(E)*.

(n56)Footnote 56. *15 U.S.C. § 1681e(a)*.

(n57)Footnote 57. FTC Official Staff Commentary § 607 item 1A.

(n58)Footnote 58. Under the Act, willful violations may result in punitive damages.

(n59)Footnote 59. *Thompson v. San Antonio Retail Merchs. Ass'n, 682 F.2d 509, 513 (5th Cir. 1982)* ; *see also Bryant v. TRW, Inc., 689 F.2d 72 (6th Cir. 1982)* .

(n60)Footnote 60. FTC, Compliance with the Fair Credit Reporting Act, at 26 (1977).

(n61)Footnote 61. *Cf. Austin v. Bankamerica Serv. Corp., 419 F. Supp. 730 (N.D. Ga. 1974)* .

(n62)Footnote 62. *15 U.S.C. § 1681e(a)*.

(n63)Footnote 63. Carson, FTC Informal Staff Opinion Letter, Apr. 8, 1971.

(n64)Footnote 64. FTC, Compliance with the Fair Credit Reporting Act, at 26 (1977).

(n65)Footnote 65. *15 U.S.C. § 1681e(a).*

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Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1-16 Consumer Credit Law Manual § 16.07

§ 16.07 Inaccurate Consumer Reports

[1] Introduction

Evidence suggests that inaccurate consumer reports are quite frequent. A recent study showed that better than 20% of all complaints received by the FTC involved consumer reports. n1

Seven types of errors frequently occur in consumer reports: n2

- *Creditor errors* occur when creditors dump erroneous computerized records of customer accounts into the files of reporting agencies. Correcting the error at a reporting agency will not automatically correct the creditor's files, and some time after the reporting agency has corrected the error, it will copy the creditor's computer tape again and once again include the same inaccurate information in the consumer's credit report.

- *Errors in the collection of public record information* occur when the public record contains errors, or when people make mistakes in copying (particularly when copying manually), interpreting or understanding the information in public records.

- *Mixed or mismerged files* result when credit information relating to one consumer is placed in the file of another, thus creating a false description of both consumers' credit histories.

- *Identity theft* occurs when an impostor uses information about a consumer to obtain credit in the consumer's name, and then runs up a string of debts. In the normal course of events, information about these debts and defaults on these debts is furnished to consumer reporting agencies. n3

- *Transcription errors* occur when information coming to a reporting agency is not on computer tape and must be manually transcribed into the reporting agency's computer system.

- *Illogical files* contain inconsistent information. For example, a consumer could be listed as current on a credit account and also as seriously in default on the same account.

- *Incomplete files* do not illustrate the consumer's full credit history. Such files might contain information from credit bureau subscribers and public records, but lack payment history to landlords, utilities, or others.

FACTA amended the FCRA to allow consumers to dispute information directly with furnishers, but no private enforcement is available. n4 Federal banking agencies and the National Credit Union Administration have rulemaking authority to identify circumstances under which a furnisher shall be required to reinvestigate a dispute concerning the accuracy of information, based on a direct request from the consumer. n5 As of mid-2005, no regulations have been proposed by the agencies. This section examines consumer rights concerning inaccurate information. n6

[2] Contacting the Creditor or Other Party Furnishing Inaccurate Information

Often the best approach to correcting an inaccurate report is to contact the party who furnished the inaccurate information to the reporting agency. The FCRA requires the furnisher of information to participate in a reinvestigation by a consumer reporting agency. Furthermore, the information furnisher risks civil liability if it fails to conduct its own reinvestigation. Of course, a creditor may correct its own records, but not pass the correction on to all relevant reporting agencies, and the reporting agencies themselves may not enter the information properly in the consumer's file. n7 Note that when a credit reporting agency sells credit report information to a reselling agency, the first credit reporting agency becomes a furnisher subject to the new obligations imposed on furnishers.

[a] Furnishers May Have a Special Address for Notification of Inaccurate Information

In general, the FCRA prohibits the furnishing of information to a consumer reporting agency if the information furnisher knows or consciously avoids knowing that the information is inaccurate. n8 The FCRA imposes no affirmative duty, however, to furnish only accurate information or even, arguably, to maintain reasonable procedures to assure that only accurate information is furnished.

This general rule does not apply, however, to any furnisher of information who clearly and conspicuously specifies to the consumer an address for complaints about inaccuracies. n9 When a consumer complaint address is maintained, the furnisher is barred only from furnishing information which has been specified by the consumer as inaccurate in a notice sent to the address specified, and which, in fact, is inaccurate.

[b] The Furnisher of Information Has a Duty to Correct and Update Information

A person who furnishes information "regularly and in the ordinary course of business" to a consumer reporting agency has a limited duty to correct and update that information. n10 If the furnisher determines that reported information was not accurate or complete, then it must provide the reporting agency with information which will make the report correct or complete. The correction must be made whether the determination is based on information in the control of the furnisher or on information provided by the consumer.

If a furnisher has determined that reported information is inaccurate or incomplete, it must act "promptly" to provide the corrected or updated information to the reporting agency. Any delay may cause harm to the consumer. Moreover, once corrected or updated information is provided to the agency, the furnisher may not thereafter furnish any information which remains inaccurate or incomplete.

[c] Furnisher of Information Must Note Consumer Disputes

If a consumer disputes the accuracy or completeness of any information which has been furnished to a consumer reporting agency, the furnisher may not in the future report that information to a reporting agency unless it notes that it has been disputed. n11

This rule does not apply to consumer disputes with reporting agencies, even though the reporting agency notifies the furnisher of the dispute and forwards to the furnisher the notice of dispute submitted by the consumer. If the furnisher of information is a collection agency, the collection agency must report the debt as disputed under not only the FCRA, but also under the Fair Debt Collection Practices Act. Unlike the FCRA, the Fair Debt Collection Practices Act allows the consumer to collect actual and statutory damages along with attorneys' fees for failure to notify the agency of the disputed nature of the debt. n12

[3] Reporting Agency Reinvestigation and Correction of Disputed Information

[a] Consumer Request for Reinvestigation

[i] When a Reporting Agency Must Reinvestigate

If a consumer disputes the completeness or accuracy of any item of information in the consumer's file with a reporting agency, the agency must conduct a reinvestigation n13 free of charge to the consumer. n14 However, the reporting agency may avoid conducting a reinvestigation by simply deleting the disputed information within three business days. n15 The obligation to reinvestigate is not contingent upon the consumer having been denied credit, employment or other benefits, having requested a copy of the consumer report, or having asserted any other rights under the FCRA. n16 The agency also cannot refuse to reinvestigate because consumers say they will conduct their own investigation or threaten to sue. n17

An agency may not impose unreasonable preconditions to a reinvestigation, for example, by requiring the consumer to authorize the agency to obtain information from creditors, medical practitioners, employers, and the like. n18

The FACTA of 2003 creates special provisions for resellers. n19 Although resellers are exempt from the general reinvestigation requirement, n20 as of December 1, 2004, they must investigate a consumer's dispute made to the reseller. If the reseller determines that the information is incomplete or inaccurate as a result of the reseller's act or omission, the reseller must correct or delete the information within twenty days. n21 If, however, the reseller does not find that the alleged inaccuracy resulted from the reseller's act or omission, the reseller must notify the agency from whom the reseller obtained the information, and the agency must then reinvestigate the information. n22 Once notified, the providing agency must reinvestigate n23 and then report the results of its reinvestigation back to the reseller, who must then reconvey the results back to the consumer. n24 This provision basically treats the reseller as a consumer for purposes of the agency's reinvestigation responsibilities.

[ii] Frivolous Requests to Reinvestigate

A reporting agency may refuse to delete or reinvestigate the information only if it has reasonable grounds to believe that the dispute is frivolous or irrelevant. n25 The consumer's failure to provide sufficient information to investigate the disputed information is grounds for determining that the dispute is frivolous. n26

The FTC Commentary states that reporting agencies must assume that a consumer's dispute is bona fide, unless there is evidence to the contrary. n27 Such evidence may include letters disputing all information in the file without allegations concerning the specific items in the file. n28

A reporting agency may not refuse to reinvestigate the consumer's dispute on the grounds that it is frivolous "unless it is clearly 'beyond credulity' or made in bad faith." n29

A consumer's repeated request for an investigation, after the agency has already reinvestigated the same item, may be viewed as frivolous. n30 But the repeat request is not frivolous if the consumer provides additional evidence that the item is inaccurate or incomplete or alleges changed circumstances. n31 When a reporting agency adds new information

to a file (even as a result of a reinvestigation), the consumer can again dispute the new information, and the agency must then conduct another reinvestigation. n32

Within five business days after determining that the dispute is frivolous or irrelevant, the agency must notify the consumer of the determination by mail, or, if authorized by the consumer, by any other means available to the agency. n33 This notice must give the reasons for the determination and identify any information required to investigate the disputed information. n34 State laws, n35 which establish deadlines for the agency to inform the consumer of its decision not to reinvestigate, are preempted by the FCRA unless in effect on September 30, 1996. n36

[iii] Agency's Reinvestigation Must Involve the Party Who Furnished the Disputed Information to the Agency

The creditor or other party who furnished the information disputed by the consumer must participate in the reinvestigation conducted by the consumer reporting agency. The only exceptions are if the agency has determined the dispute to be frivolous or has deleted the disputed information pursuant to an expedited dispute resolution process.

[iv] Consumer Reporting Agency Must Notify the Furnisher of the Disputed Information

Within five business days of receipt of a notice of dispute from a consumer, the consumer reporting agency must provide to the person who provided any disputed information a notice of the dispute. n37 If during the dispute resolution period the reporting agency receives additional, relevant information from the consumer, that information too must be promptly provided to the furnisher.

[v] Furnisher of Disputed Information Must Conduct a Reinvestigation

After receiving notice from a consumer reporting agency that information provided by the furnisher has been disputed, the furnisher must conduct its own reinvestigation of the accuracy and completeness of the disputed information. n38 Although the FCRA does not specify standards or procedures for furnisher reinvestigations, the furnisher must review all relevant information provided to it by the agency.

The results of the investigation must be reported to the consumer reporting agency in time for the agency to complete its reinvestigation in timely fashion, usually thirty days from the day the agency received notice of dispute. The furnisher, then, will have less than thirty days for most reinvestigations. The reasonableness standard imposed on reporting agencies for a reinvestigation is also applicable to furnishers. n39

[vi] Results of the Furnisher's Reinvestigation Must Also Be Reported to All Nationwide Consumer Reporting Agencies

All furnishers of information must report the results of reinvestigations to every nationwide consumer reporting agency to which the disputed information was reported. n40 Such reports must be made by the same deadline as the report to the consumer reporting agency which initiated the reinvestigation. The nationwide consumer reporting agencies must create and maintain automated systems through which furnishers of information may report to other national consumer reporting agencies the results of a reinvestigation that finds incomplete or inaccurate information. n41

[vii] Deadline for Reporting Agency to Respond

The deadline for the consumer reporting agency to respond to the consumer's notification depends upon the process through which the consumer obtained the inaccurate information. The Fair and Accurate Credit Transaction Act of 2003 added a new provision granting every consumer the right to a free annual credit report from nationwide consumer reporting agencies. n42 To receive the report from a nationwide agency other than the nationwide specialty consumer reporting agency, n43 the consumer must use a centralized source to make the request, a source that the FTC is to create

by regulation. n44 The FTC will also create a separate process through which consumers may request a free report from nationwide specialty consumer reporting agencies. n45 Normally, reinvestigations conducted by CRAs must be completed within thirty days, with one extension allowed when the CRA receives additional information from the consumer in the interim. n46 The thirty-day period begins on the date that the CRA receives the consumer's notice of dispute. n47 If, however, the consumer discovered the basis for the dispute through a free annual report provided pursuant to section 1681j(a), the CRA has forty-five days in which to complete the investigation. n48

[viii] Nature of Reinvestigation

A reinvestigation must be a good faith effort to determine the accuracy of the disputed item. n49 The agency cannot merely tell users that the consumer disputes the report. n50 Reinvestigation requires more than returning to the original source, asking the same question, and receiving the same answer. n51 At a minimum, the agency must check with both the original sources and other reliable sources (such as those suggested by the consumer) of the disputed information. n52 Before the FACTA of 2003, the FCRA did not specify a standard by which the agency must reinvestigate. As of December 1, 2004, the Act clarifies that the reinvestigation must be "reasonable." n53 Despite this requirement, the CRAs have developed an entirely automated, perfunctory investigation system which consists of nothing more than translating consumer disputes into a two-or three-digit code, forwarding that code and a one-page electronic form to the furnisher, and "parroting" whatever the furnisher states in response. n53.1

Several courts have held that, in the context of a claim brought under section 1681*i*, the CRAs could be found to have failed to fulfill their obligations to conduct a reasonable investigation when they use this automated system. However, it appears that this entire automated investigation system fails to ensure maximum possible accuracy in consumer credit reports. Thus, a few courts have held that this automated system may violate section 1681e(b). n53.2

There are limits, however, as to what constitutes a reasonable reinvestigation. Usually, a review of the furnishing creditor's ledger sheets should be sufficient--the reporting agency need not review actual sales slips or similar documentation. n54

[ix] Correction or Deletion of Disputed Information

If the reinvestigation reveals that the disputed information is inaccurate or that it can no longer be verified, the consumer reporting agency is required to delete the information, and the current status of the information must be recorded in the consumer's file. n55 If the item was disputed as incomplete, the reinvestigation should correct the item so that the information is now complete. n56 The agency should act promptly. n57

In some instances, a consumer reporting agency will want to delete information disputed by a consumer without initiating a reinvestigation. The agency may resolve the dispute in expedited fashion by deleting the disputed information within three business days from receipt of the dispute. n58 In fact, even prior to this statutory provision for expedited dispute resolution, Equifax and Experian (formerly TRW) agreed to accept the consumer's version of a dispute if accompanied by documentation from the original source confirming the consumer's version (unless Equifax or TRW in good faith doubt the documentation's authenticity). n59 In many other instances in which the consumer does *not* provide documentation from the original source, agencies will want to delete information and forego a reinvestigation.

An expedited resolution of the dispute requires notice to the consumer, and frees the agency from other requirements of reinvestigation. A consumer must be promptly notified, by telephone, that the disputed information has been deleted. In addition, within five business days of the deletion, written confirmation and a copy of the current, corrected report must be provided to the consumer. As part of either the telephone notification, or the written confirmation, the consumer must be informed of the right to have previous recipients of the report receive an updated, corrected report.

The FACTA of 2003 added a provision that requires an agency to not only notify the consumer of the results of the reinvestigation but also the furnisher of the information when the agency corrects or deletes the information as a result of the reinvestigation. n60 Such a notice should trigger a separate responsibility of the furnisher--to cease furnishing any information if the furnisher "knows or has reason to believe" the information to be inaccurate n61--since the correction/deletion notice from the agency should serve as reason to believe that the information was inaccurate.

[x] Notice to Consumer of Results of Reinvestigation

A consumer reporting agency must, within five business days of the completion of the reinvestigation, notify the consumer of its results. n62 Notice shall be by mail, or, if authorized by the consumer, other means available to the agency. A written statement that the investigation is completed, together with a copy of any corrected report, is also required within the same five-day period. It should not be surprising if a single written notice is provided to fulfill both notice requirements.

The written communication must also inform the consumer of the right to request a description of the reinvestigation procedure, including the business name and address, and, if reasonably available, the telephone number of any furnisher contacted during the reinvestigation. If requested, this description must be provided within fifteen days.

If a dispute remains after the reinvestigation is complete, the consumer may elect to have a statement of dispute included in the consumer's file. The written communication must also include a notice of this right, as well as the right to have the agency notify past users of a disputed report.

[xi] Consumer Follow-Up Steps Where Corrections Made

After the reporting agency has corrected or deleted the disputed items, the consumer should obtain another copy of the information in the consumer's file to confirm that the corrections and deletions were made. Second, the consumer should check if other agencies have files on the consumer with the same error. The consumer should obtain a copy of the consumer's file again three or six months later to see if the offending information has been reinserted. n63 A consumer should also consider asking the agency to notify past users of the correction.

[xii] Reinsertion of Information Previously Deleted From Consumer's File

The Consumer Credit Reporting Reform Act of 1996 promulgated rules specifically designed to prevent abuses long associated with the reinsertion of information that had been corrected or deleted because it was inaccurate, incomplete, or unverifiable. n64 The provision on the reinsertion of previously deleted material has three parts: (1) consumer reporting agencies must maintain reasonable procedures to prevent the reappearance of material, except as specifically allowed; (2) for previously deleted material to be reinserted, the material must be certified as accurate and complete by the furnisher; and (3) if material is reinserted, the consumer must be notified within five business days.

Notice to the consumer must be in writing or, if authorized by the consumer for this purpose, by any other means available to the agency. Separately, or together, but also within the same five day period, the agency must provide a written statement that the disputed information has been reinserted. The written notice must disclose the business name and address, and, if reasonably available, the telephone number of any furnisher which contacted the agency with regard to the information. In many instances, the consumer will find it necessary to dispute the accuracy with the furnisher if not also with the agency. Finally, the notice must include a statement that the consumer has the right to add a statement to the consumer's file disputing the accuracy or completeness of the disputed information. The FACTA of 2003 added another layer of protection against the refurnishing of inaccurate information; as of December 1, 2004, a furnisher who receives notice from a consumer reporting agency that the consumer has disputed an item of information and who finds upon reinvestigation that the information is inaccurate, incomplete, or unverifiable, must modify, delete, or permanently block the information in its files for purposes of reporting to a consumer reporting agency. n65

[4] Inclusion of Consumer's Statement of Dispute in Consumer's File

[a] Consumer's Right to File Statement of Dispute

[i] Statement Concerning Incomplete or Inaccurate Items

If reinvestigation does not resolve the dispute, the consumer may file a brief statement setting forth the nature of the dispute. n66 Agencies cannot charge consumers for filing this statement of dispute. n67 The consumer should file the statement of dispute with every reporting agency whose file contains the inaccuracy.

Despite the statement's importance, the FCRA does not explicitly require the agency to inform the consumer of the right to file a dispute statement, and courts have held that the agency has no affirmative duty to disclose this right. n68 In addition, consumers should be warned that the statement, which appears at the bottom of the credit report, may not be seen by a potential creditor and likely will not be incorporated into the computation of a credit score.

If a reporting agency assists the consumer in writing a clear summary of the dispute, the statement may be limited to one hundred words for each disputed item of information. n69 If the agency does not assist the consumer, there is no explicit length of statement (although the statute describes it as a "brief" statement setting forth the nature of the dispute). n70 It is an FCRA violation for an agency even indirectly to represent that the statement must be limited to 100 words (unless the agency assists the consumer). n71

The consumer's right to dispute the completeness or accuracy of an item does not also create a right to explain the reasons for an unfavorable item. The agency can, however, include consumer explanations and charge a fee for inserting such information. n72 Nor does the right to dispute information require agencies to add new items of information to a file, create a file for a consumer for whom it has no file, or add new lines of information about accounts not reflected in the existing file, n73 unless the new information increases the completeness or accuracy of an item already in the file.

If a consumer has filed a statement of dispute, n74 the reporting agency must, in any subsequent consumer report containing the information in question, clearly note that the consumer disputes the information and also provide either the consumer's statement or "a clear and accurate codification or summary" of that statement. n75

The agency cannot tell the recipient of a subsequent report that the consumer's statement is on file, and will be provided when requested. The report must contain the actual statement or a summary of that statement. n76 When a user makes a telephonic request for information, the agency must read the dispute statement or summary to the user *before* disclosing the disputed information in the consumer's file. n77

The practical importance of the statement is somewhat unclear. Creditors will usually give more weight to the credit report than to explanatory statements, n78 or may ignore them altogether. Moreover, explanatory statements will not effect credit scores used by a growing number of creditors. The FACTA of 2003 gave to consumers a powerful right to add what should be far more effective notices to a file: fraud alerts, extended fraud alerts, and active military duty alerts, a provision that becomes effective on December 1, 2004. n79 These alerts, unlike the Statement of Dispute discussed below, impose specific obligations on users of reports that contain such alerts. n80

[5] Notification of Previous Users Who Received Disputed Information

[a] Consumer Request for Notification

Following the deletion of information from the consumer's file pursuant to a reinvestigation or following the consumer's filing of a statement of dispute, the reporting agency must provide notice to past recipients of the consumer's report. n81 The notice must indicate what items were deleted, the consumer's statement, or a codification or summary of that statement. n82

This notice requirement is triggered only by the consumer's request that the notice be sent, and only to past users of the report specifically designated by the consumer. n83 The consumer may only specify users who received the report within the prior six months (or two years if the user received the report for employment purposes). n84

An agency cannot even indirectly report that an item has been deleted from the consumer's file to anyone other than those who were previously informed of the disputed item. n85 For example, where the agency's records contain the notation "cancelled" or "purged," these notations cannot appear in subsequent consumer reports. n86

Moreover, the reporting agency may not routinely send corrected or updated reports even to past recipients of the disputed report unless so directed by the consumer. The FCRA restricts reports to users with permissible purposes, n87 and there is no guarantee that past users with permissible purposes still would have a permissible purpose to receive the report.

[6] Liability for Furnishing and Reinvestigating Information

Those who furnish information to consumer reporting agencies are subject to liability in two main regards. First, there are certain obligations which only public officials have the power to enforce. These obligations relate to the furnishing of accurate and up-to-date information and consumer disputes regarding accuracy and completeness. Second, consumers can bring private lawsuits against information furnishers who fail to participate in reinvestigations.

In addition, a furnisher of information who falls within the definition of a consumer reporting agency, for example, by furnishing information beyond its own first-hand experience with a consumer could face FCRA liability for violating reporting agency requirements.

[a] Furnisher Liability Regarding Information Furnished to Consumer Reporting Agencies

The FCRA contains five standards regarding the accuracy or current status of information furnished to reporting agencies. A furnisher violating these obligations may be subject to enforcement actions by public officials.

Of the five standards imposed upon furnishers by the FCRA, n88 three relate generally to information which may be furnished to a consumer reporting agency and two relate only to closed or delinquent accounts. The five standards are:

- If a furnisher of information clearly and conspicuously specifies an address for consumers to use for the purpose of informing the furnisher that specific information is inaccurate, then the furnisher may not provide an agency with information that is in fact inaccurate when the consumer has notified the furnisher that the particular information is inaccurate. If the furnisher does not clearly and conspicuously provide an address for these consumer complaints, then the furnisher may not furnish information it knows to be inaccurate;

- A furnisher who regularly and in the ordinary course of business furnishes information must update and correct information previously reported to a consumer reporting agency;

- Any furnisher must note when a consumer has disputed information being furnished to a consumer reporting agency;

- A furnisher who regularly and in the ordinary course of business furnishes information to a consumer reporting agency must note when an account has been voluntarily closed; and

- Within ninety days of furnishing information about any delinquent account that has been placed for

collection, charged to profit or loss, or the like, the furnisher must notify the agency of the month and the year of the preceding delinquency.

The FCRA does not explicitly require that furnishers maintain reasonable procedures to assure accuracy, as it does for consumer reporting agencies.

[b] Private Enforcement of Standards for Furnishers Providing Information to Consumer Reporting Agencies

Although private enforcement is the hallmark of the FCRA, the standards for furnishers providing information to consumer reporting agencies may not be enforced under the FCRA by consumer litigation for damages. n89 That is, the FCRA provisions regarding negligent and willful noncompliance with the Act do not apply to any failure by information furnishers to comply with the five reporting standards for furnishers. n90

[c] Furnisher Liability for Reinvestigation Activities

The furnisher of disputed information must participate in the reinvestigation process. Any furnisher which negligently fails to comply with any of these requirements is liable to the consumer for any actual damages, the costs of litigation, and attorney's fees. If the failure of the furnisher is willful, the furnisher is liable for actual damages of not less than $100 and not more than $1000, and for punitive damages, as well as for costs and attorneys' fees. n91

[7] Agency Liability for Reporting Inaccurate Information

[a] General

Consumer reporting agencies are not liable under the FCRA merely for reporting inaccurate information. n92 Instead, liability arises when an agency, in preparing a consumer report, fails to follow reasonable procedures to assure maximum possible accuracy of the information about the consumer. n93

A reporting agency also is liable, even if it has enacted reasonable procedures, when it does not correctly handle a consumer's dispute over the accuracy or completeness of information. n94 The consumer's right to have inaccuracies and incompleteness corrected does not depend on the consumer having first disputed the information, however. n95 The right to dispute and correct inaccuracies is merely an alternative to a lawsuit over agency procedures. n96

[b] Is the Information Inaccurate: The First Test

The FCRA requires that agencies use reasonable procedures to assure maximum possible accuracy. Courts have inferred from this requirement that the information at issue must in fact be inaccurate before an agency can be found liable under this provision. n97 A report is clearly inaccurate if a source provided inaccurate information, if public record information was inaccurately copied, interpreted or transcribed, if files were mismerged, or if two conflicting pieces of information were both reported.

A grey area is where information is technically accurate, but where additional information would make the file more accurate or less misleading. Courts disagree as to when the lack of clarifying information makes a report inaccurate. n98

[c] Reasonable Procedures: The Second Test

The agency must follow reasonable procedures to assure "maximum possible accuracy." n99 It must adopt procedures not just to catch many of the errors, but to assure "maximum" possible accuracy. If the agency's review of its procedures reveals, or the agency should reasonably be aware of, steps it can take to improve the accuracy of its reports at a reasonable cost, it must take such steps. n100

When an a gency learns or should reasonably be aware of errors in its reports that may indicate systematic problems, it must review its procedures for assuring accuracy. n101 This is the case whether the agency discovers the problem from consumers, users, or its own internal reviews. n102

When an agency sees systematic errors, it must revise its procedures. But even when only one error is brought to its attention, the agency should correct that consumer's file even if it does not warrant a change in overall procedures. n103

Some courts apply a "reasonable person" test which may vary greatly in application. n104

The Seventh Circuit held that despite evidence that a consumer's file contained facially inconsistent information concerning an account in bankruptcy, Experian's procedures for assuring maximum possible accuracy were reasonable as a matter of law. The court relied upon Experian's expert to conclude that it would be unduly burdensome and unreasonable to require Experian to evaluate each computer record for anomalous information given the enormous volume of information processed. n105 In effect, this decision says that credit reporting agencies are not on notice of facially inconsistent information in their own files. Thus it becomes even more important for practitioners to prove actual notice of inaccurate information, through depositions or other appropriate evidence. Arguing that the credit reporting agencies knew or should have known of the inaccuracy based on the facially inaccurate information may not be enough, at least not in the Seventh Circuit.

[d] Inaccurate Sources

Agencies must insure that information provided by sources is accurate. n106 This includes adopting reasonable procedures to eliminate systematic errors generated by the sources, n107 for example, by requiring a frequently erroneous source to revise its procedures or by ceasing to report information from that source. n108

[e] Public Record Information

Special problems exist with respect to the accuracy of public record information. In addition to the many possible causes of human error, records themselves are constantly changing due to corrections of errors or changes in a matter's status.

While the agency may not have to engage in extensive analysis to discover errors in public records, n109 it should institute certain procedures for dealing with public records.

Even where the agency used a "match logic" program and had a legal department review report of judgments, its procedure may be found unreasonable when the form used to report judgments has no space to indicate which defendant was subject to the judgment. n110

[f] Mismerged Information and Wrong Consumer Identification

To furnish a report on the wrong consumer is to furnish a report without a permissible purpose. n111 Even a single occurrence should be an FCRA violation leading to a cause of action, even if the agency has adopted reasonable procedures to prevent such misidentifications. n112

In addition, the consumer reporting agency must follow reasonable procedures to assure maximum possible accuracy of the information "concerning the individual about whom the report relates." n113 When receiving information on a consumer, an agency must exercise reasonable care to verify that the subject is in fact the consumer into whose file it inserts the information, and that the individual whose report is furnished to a user is the same individual that is requested by the user. n114 Relying exclusively on social security numbers alone, however, may be inadequate, n115

especially in light of the possibility of identity theft or the presence of other possibly inconsistent information.

Agencies also must take reasonable steps to insure that mismerged information that is corrected does not reoccur at a later date. n116 The same weakness in a system that created one mismatch could create another.

[g] Transcription, Data Communication, and Interpretation

An agency must establish reasonable procedures to assure maximum possible accuracy where it is transcribing information into the agency's data system. n117 A common, therefore reasonable, procedure in data entry is to enter the data twice, by separate data entry clerks, and then compare the two transcriptions.

According to the FTC Commentary, agencies that send data electronically should have reasonable procedures to assure that the data is accurately converted into machine-readable format and not distorted by machine malfunction or transmission failure. Agencies must adopt reasonable security procedures to minimize theft or alteration of information, either by authorized or unauthorized users. n118

[h] Internal Inconsistencies and Illogical Entries

Reporting agencies must have procedures to compare recently obtained information with information added to the file earlier to discover and correct inconsistent or contradictory information. n119

[i] Identity Theft

Identity theft (where the thief, using personal information about the consumer, runs up debts in the name of the consumer) poses serious problems for consumers. It remains a rapidly growing phenomenon, causing substantial injury and frustration to consumers.

Concerns with identity theft were a primary force behind the FACTA of 2003. n120 That Act created a variety of new tools for consumers to use both to prevent identity theft and to restore credit records polluted by a thief's transactions. The most significant provisions allow consumers who believe that they are or are about to be the victim of fraud, including identity theft, to require an agency to include a ninety-day fraud alert in their files. n121 The new alert is called a "one-call" alert because the agency must refer the alert to other nationwide agencies, and all the agencies must not only include the alert in the consumer's file but provide the alert each time they generate that consumer's credit score. n122 Agencies must also refer identity theft complaints and fraud alerts to each other. n123 The agencies must present to any user a "clear and conspicuous" view of the statement that notifies users of the consumer's report that the consumer may be a victim of fraud, including identity theft. n124 Those consumers who supply an agency with an identity theft report can obtain a seven-year fraud alert. n125 As of December 1, 2004, a consumer can also require an agency to block fraud related information in the consumer's file; the agency must also notify the original furnisher that the information was blocked and the reason for it. n126 Furnishers must have reasonable procedures to respond to such notices to prevent them from refurnishing the blocked information. n127 Effective December 1, 2004, the Act requires agencies to notify a user when the user's request for a report contains an address for the consumer different from that in the agency's files, n128 requiring the creation of red flag guidelines and regulations to help financial institutions and creditors to identify identity theft, n129 requiring debt collectors to notify creditors of fraudulent debts, n130 and prohibit the sale or transfer of identity theft debts. n131 Forthcoming regulations will establish accuracy and integrity guidelines for furnishers. n132 Consumers may obtain certain transaction information from businesses that have done business with an identity thief. n133 Finally, the Act requires designated agencies to come up with regulations that will require those who use consumer information from consumer reports to dispose of it properly, which could eventually curb thieves' access to consumer financial information. n134

However, while many of these provisions could assist consumers in preventing identity theft, locating identity thieves,

and ultimately restoring their credit reports, Congress correspondingly preempted many provisions of state laws targeting identity theft. State laws with "requirements and prohibitions" with respect to the conduct required by the specific preemptions enumerated are thus preempted. n135 However, states should nonetheless be able to enact and enforce identity theft laws with respect to other conduct.

Preexisting provisions of the FCRA can also be used to counter identity theft: the requirement that agencies follow reasonable procedures to ensure maximum possible accuracy, n136 and the provisions requiring that the accuracy of information challenged by consumers be reinvestigated. n137

Given that in the nature of identity theft, the thief is posing as the consumer, accuracy procedures that are otherwise considered reasonable may not be sufficiently designed to catch fraudulent activities that are reported to a victim's account, at least before the agency learns of the fraud. Moreover, as identity theft has become increasingly more common, a reporting agency's failure to increase the sophistication of its procedures to respond to this problem is itself unreasonable. n138 In fact, each of the big three consumer reporting agencies now advertises enhanced fraud detecting software that takes a consumer's name, address, telephone number and social security number and other information and tries to verify them against a number of other data sources. n139 These products, developed to help businesses prevent losses suffered from application fraud, would do a great deal to help consumers prevent losses suffered from identity fraud, and the failure to use them for that purpose may be arguably unreasonable.

Even if a consumer reporting agency maintains reasonable procedures to assure accurate information, once an identity theft victim contests a false item on the report, the agency must reinvestigate the disputed information. One of the earliest identity theft cases, *Stevenson v. TRW, Inc.*, n140 ruled that the defendant agency had not reinvestigated reasonably. The consumer discovered that someone had opened as many as sixteen fraudulent accounts in his name. He notified TRW, which completed a reinvestigation and claimed that all fraud-related items were deleted. Nonetheless, false data continued to appear and reappear, either because it had never been deleted or because it had been reinserted. The consumer sued, alleging the agency had negligently and willfully violated its duty to reinvestigate under the FCRA and had libeled him, and won actual and punitive damages at a bench trial. On appeal, the Fifth Circuit affirmed the court's judgment as to negligence. n141 In reinvestigating, TRW had simply asked each person who furnished the original information to verify its accuracy. The court held that TRW's actions were insufficient: "In a reinvestigation of the accuracy of credit reports, a credit bureau must bear some responsibility for evaluating the accuracy of information obtained from subscribers." n142

Identity theft victims often find that false data excluded upon the first reinvestigation reappears in later reports. Since the cases discussed above, the FCRA has been amended to require a reporting agency to notify a consumer within five business days that a previously deleted item has been reinserted, n143 so a victim should at least be able to track this problem and challenge the reasonableness of any reinsertion of false information.

[j] Incomplete and Outdated Items in the File

[i] Information That Was Incomplete When Collected

There should be no question that an agency should adopt reasonable procedures to assure that information when collected is complete, and not just a partial statement of the facts as then known. n144 The agency must balance whether the report's potential to mislead outweighs the availability of more accurate information and the burden of producing such information. n145

[ii] Guarantors and Reports Relating to a Bankruptcy

Certain special rules have developed (through the FTC Commentary, the courts, or legislative history) on when certain information is on its face so incomplete that it is inaccurate to report, apparently no matter the cost of obtaining

complete information. An agency must have procedures to insure that where an individual is acting solely as a guarantor of a debt, that any nonpayment of that debt be listed in that individual's file with a notation that the individual is only the guarantor and not the primary obligator. n146

In addition, any consumer report of a consumer's bankruptcy should clarify whether the bankruptcy action is a proceeding under chapter 7 (a straight bankruptcy) or under chapter 13 (a reorganization or wage earner plan). n147 The Consumer Credit Reporting Reform Act of 1996 added statutory language requiring that any report of a bankruptcy case also identify the chapter under which the case arises, "if provided by the source of the information." Thus bankruptcies should commonly be reported as arising under chapter 7 or chapter 13.

In reporting a debt discharged in bankruptcy, the balance should be reported as "0," although the report can indicate that the debt was not paid for a time and then was discharged in bankruptcy. n148

[iii] Reasonable Methods to Acquire Updated Information

Consumer reporting agencies must apply reasonable procedures to assure that information is not outdated, even if the information is accurately reported as being current only as of a certain date, because the report produces a misleading picture of the consumer. n149

This requirement is emphasized by the language of the Act that requires accuracy when the report is "prepared," n150 implying that the information must be accurate *each time* the information from the file is furnished to a user. n151

A balancing test will determine when an agency must find additional or updated information to make a file more accurate. The agency's interest in speed and expense must be weighed against the consumer's interest in maximum possible accuracy. In terms better fit for a trier of fact, the accessibility of correct or missing information must be weighed against the likelihood of harm to the consumer. n152

[iv] Must Report All Updated Information That Is Furnished to the Agency

If an agency is informed of later developments relating to an item in the consumer's file, either by the source of the information or by the consumer, the agency must update the file. n153 An agency must report significant, verified information it possesses about an item. n154 Even where the consumer does not formally dispute the accuracy of a report, if the consumer provides additional information on an incomplete file, then the agency must include the statement. n155

If an agency has reported an account as delinquent and obtains verified information that the account is paid, it must add that information to the file. n156 The same is true of information that a debt is discharged in bankruptcy or that a bankruptcy was involuntarily dismissed. n157 The Consumer Credit Reporting Reform Act of 1996 has added statutory language requiring that if an agency is notified by the furnisher of information that a consumer account has been voluntarily closed by the consumer, the agency must indicate that fact in any consumer report. n158

[v] Updated Information That Need Not Be Reported

The FTC Commentary indicates that four types of new information do not have to be added to the consumer's file, even when the information is furnished to the agency. The agency does not have to:

- Open a new file on a consumer;
- Report new credit accounts not already listed in the consumer's file;

- Add explanations for why a debt was not paid; or

- Report the reasons that credit or some other benefit was denied when reporting on the existence of that denial.

If, however, additional information regarding extenuating circumstances would enhance the accuracy of the report *and* reasonable procedures could result in its inclusion, an agency may not arbitrarily ignore or exclude it from its files and reports. The reasonableness of procedures including or excluding information of extenuating circumstances will depend upon an appropriate balancing of interests.

[k] Procedures for Reports of Adverse Public Record Information for Employment Purposes

The Act mandates specific procedures when the consumer reporting agency furnishes "items of information on consumers which are matters of public record and are likely to have an adverse effect upon a consumer's ability to obtain employment." n159 The type of information that is covered includes "items ... relating to arrests, indictments, convictions, suits, tax liens, and outstanding judgments." n160

Consumers may be denied jobs or terminated from employment as a result of an arrest record, where the employer may not realize that the arrest never led to a conviction, that the arrest was due to a case of mistaken identity, that the arrest occurred when a personal foe filed a baseless criminal complaint and the charges were dropped as soon as the police conducted an initial inquiry, or where the arrest occurred when the individual was a juvenile. n161 An employer may also view negatively an unsatisfied court judgment against an individual not knowing that the case involved only a default judgment which the consumer has since paid.

A consumer reporting agency must comply with the special FCRA protections for public record information even if information is received from another reporting agency, n162 and even if the agency does not actually include the public record information in the consumer report.

When public record information is likely to have an adverse effect on employment, the reporting agency must comply with at least one of the following two procedures, neither of which can be waived by the consumer. n163 The option most reporting agencies seem to choose is to notify the consumer that the reporting agency is furnishing the public record information to a user, together with the name and address of the person to whom such information is being furnished. n164 The Commentary indicates the notice can be by first class mail. n165 The second option is to maintain strict procedures to insure that the public record information is complete and up to date. n166 For records relating to arrests, indictments, conviction, suits, tax liens, and outstanding judgments, "up to date" means "current" at the time of the report. n167 Relying upon database records updated every thirty days does not suffice. n168

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer ReportsBanking LawConsumer ProtectionFair Credit ReportingIdentity Theft

FOOTNOTES:
(n1)Footnote 1. U.S. Public Interest Research Group [hereinafter U.S. PIRG], *Credit Bureaus: Public Enemy #1 at the FTC*, Oct. 1993. The total number of such complaints that the FTC received from 1990 through the first half of 1993 was 30,901. *See also* Consumer Federation of America and National Credit Reporting Association, *Credit Score Accuracy and Implications for Consumers,* December 17, 2002, *available at* www.consumerfed.org/121702CFA_NCRA_Credit_Score_Report_Final.pdf.

(n2)Footnote 2. For a more detailed discussion of various types of inaccurate information and why it becomes

included in consumer reports, *See* National Consumer Law Center, Fair Credit Reporting Act Ch. 4 (6th ed. 2006 and Supp.).

(n3)Footnote 3. The FTC has established a website featuring statistics about identity theft drawn from a database of consumer complaints: http://www.consumer.gov/idtheft. The FTC has also established a hotline, at 877-IDTHEFT, which allows consumers to report identity theft problems.

(n4)Footnote 4. *15 U.S.C. § 1681s-2(a)(8)*, *amended by* Pub. L. No. 108-159, § 312(c) (2003).

(n5)Footnote 5. *Id.*

(n6)Footnote 6. See National Consumer Law Center, Fair Credit Reporting Act, Ch. 12 (6th ed. 2006 and Supp.), for a discussion of how to cope with or clean up an accurate but blemished credit record, the validity of threats to damage a credit rating, and disputing debts with the creditor. See also National Consumer Law Center, Fair Credit Reporting Act,§ 12.8 (6th ed. 2006 and Supp.) for how to deal with a non-existent or insufficient credit history.

(n7)Footnote 7. *See* U.S. Public Interest Research Group, *Credit Bureaus: Public Enemy #1 at the FTC*, October 1993 (11% of complaints studied involved cases where the reporting creditor had fixed an error, but the credit bureau had not).

(n8)Footnote 8. FCRA § 623(a)(1)(A), *15 U.S.C. § 1681s-2(a)(1)(A)*, as added by Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996).

(n9)Footnote 9. FCRA § 623(a)(1)(B) and (C), *15 U.S.C. § 1681s-2(a)(1)(B)* and *(a)(1)(c)*, as added by Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996).

(n10)Footnote 10. FCRA § 623(a)(2), *15 U.S.C. § 1681s-2(a)(2)*, as added by Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996).

(n11)Footnote 11. FCRA § 623(a)(3), *15 U.S.C. § 1681s-2(a)(3)*, as added by Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996).

(n12)Footnote 12. *15 U.S.C. § 1692k*; *see Brady v. Credit Recovery Co., 160 F.3d 64 (1st. Cir. 1998)* .

(n13)Footnote 13. *15 U.S.C. § 1681i(a)*; FTC Official Staff Commentary § 611 item 5. Note that the reinvestigation requirement also applies to "resellers," agencies that collect information from all three of the big credit reporting agencies and blend it into one "instant merge report." *See In re* First Am. Real Estate Solutions, LLC, No. 952-3267 (FTC 1998) (consent agreement).

(n14)Footnote 14. FTC Official Staff Commentary § 612 item 2.

(n15)Footnote 15. *15 U.S.C. § 1681i(a).*

(n16)Footnote 16. *See* FTC Official Staff Commentary § 611 item 9; *Yolder v. Credit Bureau of Montgomery, L.L.C., 131 F. Supp. 2d 1275 (M.D. Ala. 2001)* (insurer's oral dispute notice obligated agency to supply verification request form).

(n17)Footnote 17. *Equifax, Inc., 96 F.T.C. 1045 (1980)* , *rev'd in part on other grounds*, *678 F.2d 1047 (11th Cir. 1982)* .

(n18)Footnote 18. Cisneros v. U.D. Registry, Consumer Cred. Guide (CCH) P 95,361 (Cal. App. Oct. 19, 1995); *see also Equifax, Inc., 96 F.T.C. 1045 (1980)* , *rev'd in part on other grounds*, *678 F.2d 1047 (11th Cir. 1982)* ; Russell, FTC Informal Staff Opinion Letter, Sept. 18, 1973.

(n19)Footnote 19. Pub. L. No. 108-159, § 316(b) (2003).

(n20)Footnote 20. *15 U.S.C. § 1681i(f)(1)*, *added by* Pub. L. No. 108-159, § 316 (2003).

(n21)Footnote 21. *15 U.S.C. § 1681i(f)*, *added by* Pub. L. No. 108-159, § 316 (2003); *16 C.F.R. § 602.1(c)(3)(xviii)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n22)Footnote 22. *Id.*

(n23)Footnote 23. *15 U.S.C. § 1681i(a)*, *as amended by* Pub. L. No. 108-159, § 316 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(xvii)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n24)Footnote 24. *15 U.S.C. § 1681i(f)*, *added by* Pub. L. No. 108-159, § 316 (2003).

(n25)Footnote 25. FCRA § 611(a)(3)(A), *15 U.S.C. § 1681i(a)(3)(A)*, *as amended by* Pub. L. No. 104-208, § 2409, *110 Stat. 3009* (Sept. 30, 1996).

(n26)Footnote 26. FCRA § 611(a)(3)(A), *15 U.S.C. § 1681i(a)(3)(A)*, *as amended by* Pub. L. No. 104-208, § 2409, *110 Stat. 3009* (Sept. 30, 1996).

(n27)Footnote 27. *See* FTC Official Staff Commentary § 611 item 11. *See also* FTC, Compliance with the Fair Credit Reporting Act, at 32 (1977).

(n28)Footnote 28. FTC Official Staff Commentary § 611 item 11.

(n29)Footnote 29. *Equifax, Inc., 96 F.T.C. 1045, 1046 (1980) , rev'd in part on other grounds*, *678 F.2d 1047 (11th Cir. 1982)* .

(n30)Footnote 30. FTC Official Staff Commentary § 611 item 11. *See also Hauser v. Equifax, Inc., 602 F.2d 811 (8th Cir. 1979)* (reporting agency not liable for failing to reinvestigate the disputed portion of the consumer report because agency had "indirectly reinvestigated" the information when it prepared a subsequent, but undisclosed, report containing an accurate version of the disputed item. It would nonetheless appear that the reporting agency violated the Act by failing to delete the inaccurate information from the portion of the consumer's file that was disclosed to him.).

(n31)Footnote 31. FTC Official Staff Commentary § 611 item 11.

(n32)Footnote 32. *Dynes v. TRW Credit Data, 652 F.2d 35 (9th Cir. 1981)* .

(n33)Footnote 33. FCRA § 611(a)(3)(B), *15 U.S.C. § 1681i(a)(3)(B)*, *as amended by* Pub. L. No. 104-208, § 2409, *110 Stat. 3009* (Sept. 30, 1996).

(n34)Footnote 34. FCRA § 611(a)(3)(C)(i) and (ii), *15 U.S.C. § 1681i(a)(3)(c)(i)* and *(ii)*, *as amended by* Pub. L. No. 104-208, § 2409, *110 Stat. 3009* (Sept. 30, 1996).

(n35)Footnote 35. *See, e.g., Cal. Civ. Code § 1785.16*; *Me. Rev. Stat. Ann. tit. 10, § 1317(2)* (*see also* Me. Advisory Rulings of Bureau of Consumer Protection). *See also Mass. Gen. Laws ch. 93, § 58*; *Wash. Rev. Code § 19.182.090*.

(n36)Footnote 36. FCRA § 624(b)(1)(B) (formerly § 623), *15 U.S.C. § 1681t(b)(1)(B)*, *as amended by* Pub. L. No. 104-208, § 2419, *110 Stat. 3009* (Sept. 30, 1996).

(n37)Footnote 37. FCRA § 611(a)(2), *15 U.S.C. § 1681i(a)(2)*, *as amended by* Pub. L. No. 104-208, § 2409, *110 Stat. 3009* (Sept. 30, 1996).

(n38)Footnote 38. FCRA § 624(b), *15. U.S.C. § 1681s-2(b)*, as added by Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996).

(n39)Footnote 39. *Bruce v. First U.S.A. Bank, 103 F. Supp. 2d 1135 (E.D. Mo. 2000)* (furnisher that consulted only its own records could be found negligent).

(n40)Footnote 40. FCRA § 623(b)(1)(D), *15 U.S.C. § 1681s-2(b)(1)(D)*, as added by Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996).

(n41)Footnote 41. FCRA § 611(a)(5)(D), *15 U.S.C. § 1681i(a)(5)(D)*, *as amended by* Pub. L. No. 104-208, § 2409, *110 Stat. 3009* (Sept. 30, 1996).

(n42)Footnote 42. Pub. L. 108-159, § 211(a) (2003), *amending 15 U.S.C. § 1681j(a)*. The agencies that must provide free annual reports are those defined in *15 U.S.C. § 1681a(p)*.

(n43)Footnote 43. These agencies are defined in *15 U.S.C. § 1681a(w)*, *added by* Pub. L. No. 108-159, § 111 (2003).

(n44)Footnote 44. The nationwide credit reporting agency does not have to respond to a request unless the consumer uses the special centralized source to be established by the FTC to make the request. The FTC's regulations provided for a cumulative roll out from the West Coast to the East during a nine month period beginning December 1, 2004. As of September 1, 2004, free reports will be available to all consumers, regardless of where they live. *69 Fed. Reg. 35468* /-/35502 (June 24, 2004).

(n45)Footnote 45. *15 U.S.C. § 1681j(a)(1)(C)*, *amended by* Pub. L. No. 108-159, § 211(a) (2003). The FTC must also establish regulations pertaining to this process within six months. *15 U.S.C. § 1681j(a)(1)(C)(iv)(II)*, *amended by* Pub. L. No. 108-159, § 211(a) (2003). *See also 69 Fed. Reg. 13208 -13209* (Mar. 19, 2004) (proposing new regulation for nationwide specialty consumer reporting agencies).

(n46)Footnote 46. *15 U.S.C. § 1681i(a)(1)*.

(n47)Footnote 47. *15 U.S.C. § 1681i(a)(1)(A)*.

(n48)Footnote 48. *15 U.S.C. § 1681j(a)(3)*.

(n49)Footnote 49. FTC Official Staff Commentary § 611 item 2; *Curtis v. Trans Union, L.L.C., 2002 U.S. Dist. LEXIS 23471* (N.D. Ill. Dec. 6, 2002) .

(n50)Footnote 50. *Equifax, Inc., 96 F.T.C. 1045 (1980)* , *rev'd in part on other grounds*, *678 F.2d 1047 (11th Cir. 1982)* .

(n51)Footnote 51. *Zala v. Trans Union, L.L.C., 2001 U.S. Dist. LEXIS 549* (N.D. Tex. Jan. 17, 2001) ; *Frost v. Experian, 1998 U.S. Dist. LEXIS 17276* (S.D.N.Y. Oct. 30, 1998) , *mot. to strike denied, summ. judgment granted, in part, summ. judgment denied, in part, 1999 U.S. Dist. LEXIS 6783* (S.D.N.Y. May 6, 1999) ; *Cushman v. Trans Union Corp., 115 F.3d 220 (3d Cir. 1997)* ; FTC, Compliance with the Fair Credit Reporting Act, at 33 (1977). *See also* FTC Official Staff Commentary § 611 item 2. Increasingly, consumer disputes are being investigated pursuant to a process developed by Associated Credit Bureaus, Inc., a trade organization of consumer reporting agencies. The process, called the Automated Consumer Dispute Verification (ACDV) Process, allows the consumer reporting agency to transmit information it has received about a dispute from a consumer directly to the furnisher's electronic mailbox. The furnisher then is supposed to research the disputed information and transmit a response back. However, merely accepting the furnisher's response does not fulfill the agency's responsibility to reinvestigate if all the response does is to confirm the original information. *Zala v. Trans Union, L.L.C., 2001 U.S. Dist. LEXIS 549* (N.D. Tex. Jan. 17, 2001) .

(n52)Footnote 52. FTC Official Staff Commentary § 611 item 2. *See also MIB, Inc., 101 F.T.C. 415, 423 (1983)* (consent order); FTC, Compliance with the Fair Credit Reporting Act, at 33 (1977); *Olwell v. Medical Info. Bureau, 2003 U.S. Dist. LEXIS 442* (D. Minn. Jan. 7, 2003) (failure to contact outside source could be unreasonable investigation); *Curtis v. Trans Union, L.L.C., 2002 U.S. Dist. LEXIS 23471* (N.D. Ill. Dec. 6, 2002) . *But see Roseman v. Retail Credit Co., 428 F. Supp. 643 (E.D. Pa. 1977)* (agency not required to contact additional sources where consumer disputes reasons given by former employer for consumer's dismissal).

(n53)Footnote 53. *15 U.S.C. § 1681i(a)*, *amended by* Pub. L. No. 108-159, § 317 (2003); *16 C.F.R. § 602.1(c)(3)(xviii)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n54)Footnote 53.1. *See* Chi Chi Wu, National Consumer Law Center, Automated Injustice: How a Mechanized Dispute System Frustrates Consumers Seeking to Fix Errors in Their Credit Reports (Jan. 2009), *available at* www.nclc.org/issues/credit_reporting/content/automated_injustice.pdf.

(n55)Footnote 53.2. *Saindon v. Equifax Info. Serv., 608 F. Supp. 2d 1212 (N.D. Cal. 2009)* ; *Gorman v. Experian Info. Solutions, Inc., 2008 U.S. Dist. LEXIS 94083* (S.D.N.Y. Nov. 19, 2008) .

(n56)Footnote 54. FTC Official Staff Commentary § 611 item 2. *See also* Brinckerhoff, FTC Informal Staff Opinion Letter, Jan. 31, 1985.

(n57)Footnote 55. *15 U.S.C. § 1681i(a)(5)*. [*15 U.S.C. § 1681i(a)* was renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).] *See also Trans Union Credit Info. Co., 102 F.T.C. 1109 (1983)* (consent order); *MIB, Inc., 101 F.T.C. 415, 423 (1983)* (consent order).

(n58)Footnote 56. *MIB, Inc., 101 F.T.C. 415, 423 (1983)* (consent order) (agency must update incomplete item by "adding additional information learned through the reinvestigation and necessary for a proper understanding of the disputed item"). *See also* FTC Official Staff Commentary § 611 item 6.

(n59)Footnote 57. *See Stevenson v. TRW, Inc., 987 F.2d 288 (5th Cir. 1993)* .

(n60)Footnote 58. *15 U.S.C. § 1681i(a).*

(n61)Footnote 59. *FTC v. TRW, Inc., 784 F. Supp. 361 (N.D. Tex. 1991)* (consent order) [reprinted at National Consumer Law Center, Fair Credit Reporting, App. H.1 (5th ed. 2002)], *mot. granted, amended, 1993 U.S. Dist. LEXIS 21392* (N.D. Tex. Jan. 14, 1993) ; Equifax Agreement with Eighteen State Attorneys General Offices (June 22, 1992) [*see* National Consumer Law Center, Fair Credit Reporting, App. K.2 (6th ed. 2006 and Supp.)].

(n62)Footnote 60. Pub. L. 108-159, § 314(a) (2003), *amending 15 U.S.C. § 1681i(a)(5)(A).*

(n63)Footnote 61. *15 U.S.C. § 1681s-2(a)(1)(A)*, *amended by* Pub. L. No. 108-159, § 312(b) (2003). Prior to the revision, the FCRA only prohibited furnishers from furnishing information to a consumer reporting agency that the furnisher knew or "consciously avoided" knowing was inaccurate.

(n64)Footnote 62. FCRA § 611(a)(6), *15 U.S.C. § 1681i(a)(6)*, *as amended by* Pub. L. No. 104-208, § 2409, *110 Stat. 3009* (Sept. 30, 1996).

(n65)Footnote 63. TRW and Equifax have agreed to implement procedures so this should not occur. *FTC v. TRW, Inc., 784 F. Supp. 361 (N.D. Tex. 1991)* (consent order); Equifax Agreement with Eighteen State Attorneys General Offices (June 22, 1992). *See also Guimond v. Trans Union Credit Info. Co., 45 F.3d 1329 (9th Cir. 1995)* .

(n66)Footnote 64. FCRA § 611(a)(5)(B), *15 U.S.C. § 1681i(a)(5)(B)*, *as amended by* Pub. L. No. 104-208, § 2409, *110 Stat. 3009* (Sept. 30, 1996).

(n67)Footnote 65. *15 U.S.C. § 1681s-2(b)(1)(E), added by* Pub. L. No. 108-159, § 314(b) (2003); *16 C.F.R. § 602.1(c)(3)(xv), added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n68)Footnote 66. *15 U.S.C. § 1681i(b).*

(n69)Footnote 67. FTC Official Staff Commentary § 612 item 2.

(n70)Footnote 68. *Roseman v. Retail Credit Co., 428 F. Supp. 643 (E.D. Pa. 1977)* ; *Middlebrooks v. Retail Credit Co., 416 F. Supp. 1013 (N.D. Ga. 1976)* .

(n71)Footnote 69. *15 U.S.C. § 1681i(b)*; FTC Official Staff Commentary § 611 item 13. *See also* Conway, FTC Informal Staff Opinion Letter, Aug. 27, 1973.

(n72)Footnote 70. *15 U.S.C. § 1681i(b).*

(n73)Footnote 71. *MIB, Inc., 101 F.T.C. 415, 423 (1983)* (consent order).

(n74)Footnote 72. Official Staff Commentary § 611 item 4. *See also Boothe v. TRW Credit Data, 768 F. Supp. 434 (S.D.N.Y. 1991)* .

(n75)Footnote 73. FTC Official Staff Commentary § 611 item 3.

(n76)Footnote 74. *Guimond v. Trans Union Credit Info. Co., 45 F.3d 1329 (9th Cir. 1995)* ; *Mirocha v. TRW, Inc., 805 F. Supp. 663 (S.D. Ind. 1992)* .

(n77)Footnote 75. *15 U.S.C. § 1681i(c)*; FTC Official Staff Commentary § 611 item 14.

(n78)Footnote 76. FTC Official Staff Commentary § 611 item 14.

(n79)Footnote 77. *Trans Union Credit Info. Co., 102 F.T.C. 1109 (1983)* (consent order).

(n80)Footnote 78. *Sepulvado v. CSC Credit Servs., Inc., 158 F.3d 890 (5th Cir. 1998)* , *cert. denied, 526 U.S. 1044, 119 S. Ct. 1344, 143 L. Ed. 2d 507 (1999)* .

(n81)Footnote 79. *15 U.S.C. § 1681c-1, added by* Pub. L. No. 108-159, § 112 (2003); *16 C.F.R. § 602.1(c)(3)(i), added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n82)Footnote 80. *Id.*

(n83)Footnote 81. *15 U.S.C. § 1681i(d).*

(n84)Footnote 82. *15 U.S.C. § 1681i(d).*

(n85)Footnote 83. *15 U.S.C. § 1681i(d). See also* Koros v. Credit Bureau, Inc., [1974-1980 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 97,856 (N.D. Ga. 1977), *aff'd, 577 F.2d 144 (5th Cir. 1977)* , *cert. denied, 439 U.S. 966, 99 S. Ct. 455, 58 L. Ed. 2d 425 (1978)* , *reh'g denied, 439 U.S. 1104, 99 S. Ct. 884, 59 L. Ed. 2d 65 (1979)* .

(n86)Footnote 84. *15 U.S.C. § 1681i(d).*

(n87)Footnote 85. *MIB, Inc., 101 F.T.C. 415, 423 (1983)* (consent order).

(n88)Footnote 86. *101 F.T.C. at 417* .

(n89)Footnote 87. *See § 16.04[2] supra.*

(n90)Footnote 88. FCRA § 623(a), *15 U.S.C. § 1681s-2(a)*, added by Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996).

(n91)Footnote 89. *Rivera-Lebron v. Cellular One, 13 F. Supp. 2d 235 (D.P.R. 1998)* (dismissing theft of identity case as to furnisher).

(n92)Footnote 90. FCRA § 623(c), *15 U.S.C. § 1681s-2(c)*, added by Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996).

(n93)Footnote 91. *See § 16.09[1][f] infra*.

(n94)Footnote 92. *Guimond v. Trans Union Credit Info. Co., 45 F.3d 1329 (9th Cir. 1995)* ; *Bryant v. TRW Inc., 689 F.2d 72 (6th Cir. 1982)* ; *Ladner v. Equifax Credit Info. Servs., Inc., 828 F. Supp. 427 (S.D. Miss. 1993)* ; *Jones v. Credit Bureau of Garden City, Inc., 703 F. Supp. 897 (D. Kan. 1988)* .

(n95)Footnote 93. *15 U.S.C. § 1681e(b)*.

(n96)Footnote 94. *See also Stevenson v. TRW, Inc., 987 F.2d 288 (5th Cir. 1993)* .

(n97)Footnote 95. *Thompson v. San Antonio Retail Merchants Ass'n, 682 F.2d 509 (5th Cir. 1982)* . *Cf. Spence v. TRW, Inc., 92 F.3d 380 (6th Cir. 1996)* .

(n98)Footnote 96. *See* Grimes, FTC Informal Staff Opinion Letter, July 31, 1986 and Brinckerhoff, FTC Informal Staff Opinion Letter, Aug. 4, 1987.

(n99)Footnote 97. *See, e.g., Spence v. TRW, Inc., 92 F.3d 380 (6th Cir. 1996)* ; *Guimond v. Trans Union Credit Info. Co., 45 F.3d 1329 (9th Cir. 1995)* ; *Cahlin v. General Motors Acceptance Corp., 936 F.2d 1151 (11th Cir. 1991)* ; *Batdorf v. Equifax, 949 F. Supp. 777 (D. Haw. 1996)* , *aff'd without op, 176 F.3d 481* , *reported in full, 1999 U.S. App. LEXIS 7380* (9th Cir. Apr. 14, 1999) ; *Grant v. TRW, Inc., 789 F. Supp. 690 (D. Md. 1992)* ; *Hargrow v. Long, 760 F. Supp. 1 (D.D.C. 1989)* ; *Middlebrooks v. Retail Credit Co., 416 F. Supp. 1013 (N.D. Ga. 1976)* .

(n100)Footnote 98. *See generally 81 ALR Fed. 207 (1987)* (case annotation on accuracy plus practice hints). *See, e.g., Saunders v. Branch Bank & Trust Co., 526 F.3d 142 (4th Cir. 2008)* ("a consumer report that contains technically accurate information may be deemed 'inaccurate' if the statement is presented in such a way that it creates a misleading impression"); *Krajewski v. American Honda Fin. Corp., 557 F. Supp. 2d 596, 614 (E.D. Pa. 2008)* ; *Yourke v. Experian Info. Solutions, Inc., 2007 U.S. Dist. LEXIS 47558* (N.D. Cal. June 20, 2007) ; *Jianqing Wu v. Trans Union, 2006 U.S. Dist. LEXIS 96712* (D. Md. May 2, 2006) .

(n101)Footnote 99. *15 U.S.C. § 1681e(b)*.

(n102)Footnote 100. FTC Official Staff Commentary § 607 item 3B.

(n103)Footnote 101. FTC Official Staff Commentary § 607 item 3A.

(n104)Footnote 102. FTC Official Staff Commentary § 607 item 3A.

(n105)Footnote 103. FTC Official Staff Commentary § 607 item 3A.

(n106)Footnote 104. *Pinner v. Schmidt, 805 F.2d 1258 (5th Cir. 1986)* , *cert. denied, 483 U.S. 1022, 107 S. Ct. 3267, 97 L. Ed. 2d 766 (1987)* ; *Thompson v. San Antonio Retail Merchs. Ass'n, 682 F.2d 509 (5th Cir. 1982)* ; *Jones v. Credit Bureau of Garden City, Inc., 703 F. Supp. 897 (D. Kan. 1988)* .

(n107)Footnote 105. *Sarver v. Experian Info. Solutions, Inc., 390 F.3d 969 (7th Cir. 2004)* .

(n108)Footnote 106. *Bryant v. TRW, Inc., 487 F. Supp. 1234, 1237 (E.D. Mich. 1980)* , *aff'd, 689 F.2d 72 (6th Cir. 1982)* .

(n109)Footnote 107. FTC Official Staff Commentary § 607 item 3B.

(n110)Footnote 108. FTC Official Staff Commentary § 607 item 3B. *Saenz v. Trans Union, LLC, 2007 U.S. Dist. LEXIS 61059* (D. Or. Aug. 15, 2007) (citing *Henson*); *Jianqing Wu v. Trans Union, 2006 U.S. Dist. LEXIS 96712* (D. Md. May 2, 2006) (CRA permitted to rely upon information from a source it has identified as trustworthy without undertaking investigation of that source).

(n111)Footnote 109. *Henson v. CSC Credit Servs., 29 F.3d 280 (7th Cir. 1994)* ; *Evans v. Credit Bureau, 904 F. Supp. 123 (W.D.N.Y. 1995)* .

(n112)Footnote 110. *Matise v. Trans Union Corp., 1998 U.S. Dist. LEXIS 19775* (N.D. Tex. Nov. 30, 1998) .

(n113)Footnote 111. *See § 16.04[6] supra.*

(n114)Footnote 112. *See § 16.07[7][f] supra.*

(n115)Footnote 113. *15 U.S.C. § 1681e(b).*

(n116)Footnote 114. *Philbin v. Trans Union Corp., 101 F.3d 957 (3d Cir. 1996)* ; *Thompson v. San Antonio Retail Merchs. Ass'n, 682 F.2d 509 (5th Cir. 1982)* ; *Jones v. Credit Bureau of Garden City, 1989 U.S. Dist. LEXIS 11054* (D. Kan. Aug. 28, 1989) ; *Jones v. Credit Bureau of Garden City, Inc., 703 F. Supp. 897 (D. Kan. 1988)* ; Miller v. Credit Bureau, Inc., [1969-1973 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 99,173 (D.C. Super Ct. 1972). *Cf. Lowry v. Credit Bureau, Inc. of Ga., 444 F. Supp. 541 (N.D. Ga. 1978) . But see Crabill v. Trans Union, L.L.C., 92 F. Supp. 2d 796 (C.D. Ill. 2000)* (when *pro se* consumer and his brother had a one-digit difference in their social security numbers, court ruled that matching first letter of first name, last name, house number range, state of residence, and 8/9 of social security number was reasonable), *aff'd, 259 F.3d 662 (7th Cir. 2001)* .

(n117)Footnote 115. *Andrews v. TRW Inc., 225 F.3d 1063 (9th Cir. 2000)* , *cert. granted, 532 U.S. 902, 121 S. Ct. 1223, 149 L. Ed. 2d 134* , *rev'd, 534 U.S. 19, 122 S. Ct. 441, 151 L. Ed. 2d 339* , *and aff'd, on remand, 275 F.3d 893 (9th Cir. 2001)* .

(n118)Footnote 116. *FTC v. TRW, 784 F. Supp. 361 (N.D. Tex. 1991)* .

(n119)Footnote 117. *But cf.* Brinckerhoff and Grimes, FTC Informal Staff Opinion Letter, Mar. 8, 1988 (a single "data entry error, standing alone" does not violate the "reasonable procedures" requirement).

(n120)Footnote 118. FTC Official Staff Commentary § 607 item 3C.

(n121)Footnote 119. *Bryant v. TRW, Inc., 487 F. Supp. 1234, 1237 (E.D. Mich. 1980)* , *aff'd, 689 F.2d 72 (6th Cir. 1982)* .

(n122)Footnote 120. *See, e.g.,* Explanatory Statement of the Conference Committee, 149 Cong. Rec. H12214 (daily ed. Nov. 21, 2003) ("While criminal prosecutions and strict fraud detection protocols can curtail identity theft, and punish the wrongdoers, not enough had been done heretofore to aid the real victims of this crime--the consumer whose identity is assumed, and can spend months or years trying to rehabilitate their credit and re-order their affairs.").

(n123)Footnote 121. *15 U.S.C. § 1681c-1*, *added by* Pub. L. No. 108-159, § 112 (2003); *16 C.F.R. § 602.1(c)(3)(i)*, *added by 69 Fed. Reg. 6526* /-/31 (Feb. 5, 2004). Active military duty consumers may also place an alert of their status in their files. *Id.* at § 168Ic/-/1(c).

(n124)Footnote 122. *Id.*

(n125)Footnote 123. *15 U.S.C. § 168Ic/-/*1(e).

(n126)Footnote 124. *15 U.S.C. § 1681a(q)(2)(B)*, *added by* Pub. L. No. 108-159, § 111 (2003).

(n127)Footnote 125. *15 U.S.C. § 168Ic/-/*1(b)(1).

(n128)Footnote 126. *15 U.S.C. § 1681c-2*, *added by* Pub. L. No. 108-159, 152 (2003).

(n129)Footnote 127. *15 U.S.C. § 1681s/-/2(a)(6)*, *added by* Pub. L. No. 108-159, 154 (2003); *16 C.F.R. § 602.1(c)(3)(vii)*, *added by 69 Fed. Reg. 6526 /-/*31 (Feb. 5, 2004).

(n130)Footnote 128. *15 U.S.C. § 1681m(e)*, *added by* Pub. L. No. 108-159, § 114 (2003); *16 C.F.R. § 602.1(c)(3)(ii)*, *added by 69 Fed. Reg. 6526 /-/*31 (Feb. 5, 2004).

(n131)Footnote 129. *Id.*

(n132)Footnote 130. *15 U.S.C. § 1681m(g)*, *added by* Pub. L. No. 108-159, § 155 (2003); *16 C.F.R. § 602.1(c)(3)(viii)*, *added by 69 Fed. Reg. 6526 /-/*31 (Feb. 5, 2004).

(n133)Footnote 131. *15 U.S.C. § 1681m(f)*, *added by* Pub. L. No. 108-159, § 154 (2003); *16 C.F.R. § 602.1(c)(3)(vii)*, *added by 69 Fed. Reg. 6526 /-/*31 (Feb. 5, 2004).

(n134)Footnote 132. *15 U.S.C. § 1681s/-/2(e)*, *added by* Pub. L. No. 108-159, § 312 (2003).

(n135)Footnote 133. *15 U.S.C. § 1681g(e)*, *added by* Pub. L. No. 108-159, § (2003); *16 C.F.R. § 602.1(c)(3)(iv)*, *added by 69 Fed. Reg. 6526 /-/*31 (Feb. 5, 2004).

(n136)Footnote 134. *15 U.S.C. § 1681w*, *added by* Pub. L. No. 108-159, 216.

(n137)Footnote 135. *15 U.S.C. § 1681t(b)(5)*, *added by* Pub. L. No. 108-159, § 711 (2003).

(n138)Footnote 136. *15 U.S.C. § 1681e(b).*

(n139)Footnote 137. *15 U.S.C. § 1681i.*

(n140)Footnote 138. See FTC Commentary § 607, which states that "when a consumer reporting agency learns or should be reasonably aware of errors in its reports that may indicate systematic problems ... it must be review its procedures for assuring accuracy." *See Andrews v. TRW, Inc., 225 F.3d 1063 (9th Cir. 2000) , rev'd on other grounds, 534 U.S. 19, 122 S. Ct. 441, 151 L. Ed. 2d 339 (2001) .*

(n141)Footnote 139. For example, Equifax offers "FraudScan Plus," Experian offers "Fraud Shield" (advertised as recognizing, among other warning signs, a high chance that a social security number belongs to another consumer), and Trans Union offers "Fraud Detect."

(n142)Footnote 140. *987 F.2d 288 (5th Cir. 1993) .*

(n143)Footnote 141. The judgment of willful non-compliance was reversed.

(n144)Footnote 142. *Stevenson, 987 F.2d at 293 . See Cushman v. Trans Union Corp., 115 F.3d 220 (3d Cir. 1997)* (Once consumer alerted defendant that the accounts had been obtained fraudulently, and defendant had received creditors' reiteration of inaccurate information, defendant should have known that the creditors were "unreliable.").

(n145)Footnote 143. *15 U.S.C. § 1681i(a)(5)(C).*

(n146)Footnote 144. *Pinner v. Schmidt, 805 F.2d 1258 (5th Cir. 1986) , aff'g in part and rev'g in part 617 F. Supp. 342 (E.D. La. 1985) , cert. denied, 483 U.S. 1022, 107 S. Ct. 3267, 97 L. Ed. 2d 766 (1987)* ; *Koropoulos v. Credit Bureau, Inc., 734 F.2d 37, 45 (D.C. Cir. 1984)* ; *Alexander v. Moore & Assocs., Inc., 553 F. Supp. 948 (D. Hawaii 1982)* ; Miller v. Credit Bureau, Inc., [1969-1973 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 99,173 (D.C. Super. Ct. 1972). When Senate Bill 823, the bill which eventually became the FCRA, was first introduced, one of its principal targets was the reporting of incomplete information. 115 Cong. Rec. 2411-12 (1969).

(n147)Footnote 145. *Koropoulos v. Credit Bureau, Inc., 734 F.2d 37, 45 (D.C. Cir. 1984)* ; *Alexander v. Moore & Assocs., Inc., 553 F. Supp. 948 (D. Haw. 1982) . See also Some Lenders Hold Back Good Reports from Credit Bureaus in Bid to Keep Top Customers*, Washington Post, May 22, 1999, at G03.

(n148)Footnote 146. FTC Official Staff Commentary § 607 item 3F(3).

(n149)Footnote 147. *See* Conf. Rep. No. 1587, 91st Cong., 2d Sess. (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394, 4411, 4415.

(n150)Footnote 148. FTC Official Staff Commentary § 607 item 6.

(n151)Footnote 149. *See, e.g., Thompson v. San Antonio Retail Merchs. Ass'n, 682 F.2d 509, 513 (5th Cir. 1982)* ; *Pinner v. Schmidt, 617 F. Supp. 342 (E.D. La. 1985) , aff'd in part and rev'd in part on other grounds, 805 F.2d 1252 (5th Cir. 1986) , cert. denied, 483 U.S. 1022, 107 S. Ct. 3267, 97 L. Ed. 2d 766 (1987) .*

(n152)Footnote 150. *15 U.S.C. 1681e(b).*

(n153)Footnote 151. *See* FTC, Compliance with the Fair Credit Reporting Act, at 27 (1977).

(n154)Footnote 152. *See, e.g., Stewart v. Credit Bureau, Inc., 734 F.2d 47 (D.C. Cir. 1984)* ; *Koropoulos v. Credit Bureau, Inc., 734 F.2d 37 (D.C. Cir. 1984)* ; *Jones v. Credit Bureau of Garden City, Inc., 703 F. Supp. 897 (D. Kan. 1988)* ; *Alexander v. Moore & Assocs., 553 F. Supp. 948 (D. Haw. 1982) .*

(n155)Footnote 153. FTC Official Staff Commentary § 607 item 3F(1).

(n156)Footnote 154. FTC Official Staff Commentary § 607 item 3F(2).

(n157)Footnote 155. Oliver, FTC Informal Staff Opinion Letter, June 10, 1983; Peeler, FTC Informal Staff Opinion Letter, July 25, 1978; Peeler, FTC Informal Staff Opinion Letter, Aug. 23, 1976; Feldman, FTC Informal Staff Opinion Letter, Aug. 30, 1974; Feldman, FTC Informal Staff Opinion Letter, May 31, 1974.

(n158)Footnote 156. FTC Official Staff Commentary § 607 item 3F(2).

(n159)Footnote 157. FTC Official Staff Commentary § 607 item 3F(2).

(n160)Footnote 158. FCRA § 605(e), *15 U.S.C. § 1681c(e), as amended by* Pub. L. No. 104-208, § 2406, *110 Stat. 3009* (Sept. 30, 1996).

(n161)Footnote 159. *15 U.S.C. § 1681k.* The FTC indicates that this section also applies when the information will adversely affect the consumer's ability to retain employment or obtain promotion. FTC, Compliance with the Fair Credit Reporting Act, at 35 (1977). A consumer reporting agency must comply with this section even if the public record information is received from another reporting agency. *See* FTC Official Staff Commentary § 613 item 3.

(n162)Footnote 160. *15 U.S.C. § 1681k(2).*

(n163)Footnote 161. *See Wiggins v. Equifax Servs., Inc., 848 F. Supp. 213 (D.D.C. 1993)* . State or federal laws, such as juvenile laws, might prohibit making arrest or conviction records public. The consumer's attorney should check the laws of the jurisdiction to see if the agency has complied. *See generally Fite v. Retail Credit Co., 386 F. Supp. 1045 (D. Mont. 1975)* , *aff'd*, *537 F.2d 384 (9th Cir. 1976)* ; *Goodnough v. Alexander's, Inc., 82 Misc. 2d 662, 370 N.Y.S.2d 388 (Sup. Ct. 1975)* .

(n164)Footnote 162. *See* FTC Official Staff Commentary § 613 item 3.

(n165)Footnote 163. FTC Official Staff Commentary § 613 item 5.

(n166)Footnote 164. *15 U.S.C. § 1681k(1).*

(n167)Footnote 165. FTC Official Staff Commentary § 613 item 4.

(n168)Footnote 166. *15 U.S.C. § 1681k(2).*

(n169)Footnote 167. *15 U.S.C. § 1681k(2).*

(n170)Footnote 168. Allan, FTC Informal Staff Opinion Letter, May 5, 1999, *reprinted in* National Consumer Law Center, Fair Credit Reporting Act, CD-ROM and App. E (6th ed. 2006 and Supp.).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1-16 Consumer Credit Law Manual § 16.08

§ 16.08 Investigative Consumer Reports

[1] What Is an Investigative Consumer Report?

[a] FCRA Definition

The FCRA defines "investigative consumer report" as a consumer report or portion n1 thereof:

> "in which information on a consumer's character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on or with others with whom he is acquainted or who may have knowledge concerning any such items of information. However, such information shall not include specific factual information on a consumer's credit record obtained directly from a creditor of the consumer or from a consumer reporting agency when such information was obtained directly from a creditor of the consumer or from the consumer." n2 The FACTA of 2003 amended the FCRA to exclude certain reports of employee behavior from the definition of "consumer report," and thereby from the definition of "investigative consumer report." Nonetheless, employers must make certain disclosures to benefit from the exclusion. n3

The report must concern character, general reputation, personal characteristics, or mode of living. The FTC has suggested that the subject matter of an investigative report involves subjective information. n4

An investigative report must contain information obtained by a "personal interview" with neighbors, friends, associates or others. n5 "Personal interview" includes inquiries made by telephone or other method of transmission. n6 But information obtained by observing a consumer's home is not an investigative report because there is no interview. n7 The interview could be with members of the consumer's family, n8 but probably not the consumer, as the consumer is not a third party. n9 This section summarizes FCRA law in this area. n10

The Act specifically excludes from the definition of "investigative consumer report" a report that consists *solely* of specific factual information on a consumer's credit record obtained directly from a creditor or a consumer reporting agency (where the reporting agency obtained the information from a creditor or the consumer). n11 A report with both

non-investigative and investigative information is still an investigative consumer report, since the statutory definition of an "investigative consumer report" is a consumer report "or portion thereof" that contains investigative information. n12

In addition, any report excluded from the definition of "consumer report" will be excluded from the definition of "investigative consumer report."

[i] Reports Excluded from the Definition; Certain Employee Investigations

The FACTA of 2003 met a rising demand by employers to exempt certain reports about employees from the requirements for consumer reports. n13 Nonetheless the Act still requires employers to disclose certain information to an employee in connection with such a report. n14 Because of this new exemption, even if a particular investigation would otherwise be an investigative consumer report, it will fall outside of the definition by virtue of being specifically exempted from the definition of "consumer report." n15 To fall within the exclusion the communication must be made to an employer and must be in connection with an investigation of one of the following:

- suspected misconduct relating to employment;
- compliance with federal, state, or local laws;
- compliance with the rules of a self-regulatory organization; or
- compliance with the preexisting written policies of the employer. n16

To limit the exemption's scope the FACTA further requires that the communication must not be for the purpose of investigating a consumer's creditworthiness, credit standing, or credit capacity (in other words, the communication must only bear on the employee's character, general reputation, personal characteristics, or mode of living) and must not be provided to anyone other than the employer (or the employer's agent), a governmental authority, or a self-regulatory organization with regulatory authority over the employer. n17 The FACTA defines a self-regulatory organization to be "any self-regulatory organization (as defined in section 3(a)(26) of the Securities Exchange Act of 1934[*15 U.S.C. § 78c(a)(26)*]), any entity established under title I of the Sarbanes-Oxley Act of 2002 [*15 U.S.C. §§ 7211-7218*], any board of trade designated by the Commodity Futures Trading Commission, and any futures association registered with such Commission." n18

Employees will have a right to a notice containing a summary of the nature and substance of the communications if the employer takes adverse action based on communications resulting from an investigation. n19

[b] Types of Investigative Reports

Three main types of investigative reports predominate: reports for employment purposes, insurance purposes, and reports for landlords. Employment purposes include not only hiring, but also promotions, demotions, transfers, discharges, and related employment decisions, n20 including investigations of alleged sexual harassment. n21

The Consumer Credit Reporting Reform Act of 1996 excludes employment agencies in many circumstances from the definition of consumer reporting agency. To combat potential invasions of privacy, the Reform Act requires employers to obtain written permission from the consumer before requesting any consumer report, be it investigative or non-investigative. n22 The employer must also certify to the reporting agency (1) that it has notified the consumer that a consumer report may be obtained, (2) that the consumer has authorized in writing the procurement of the report, and (3) that information in the consumer report will not be used in violation of any federal or state equal employment opportunity law.

The other most common form of an investigative consumer report is for insurance purposes. Under the FCRA, a permissible purpose for a consumer report is the "underwriting" of insurance involving the consumer. n23

Investigative reports prepared for landlords may involve personal interviews of a tenant's former landlords, employers, or other references. A growing number of tenant screening companies in effect blacklist certain tenants because of their past practices. The screening companies obtain their information not only by culling information from court dockets (not likely to entail an investigative consumer report), but also by interviewing former landlords.

[2] Disclosure to Consumer of Investigative Report's Existence

[a] Notice That User Has Requested an Investigative Report

No person may procure an investigative consumer report unless the consumer is notified that an investigative report may be made. n24 Notice of the investigative report must be mailed to the consumer within three days of the user's first request to the reporting agency for a report on the consumer. n25 It is the obligation of the person requesting the report, not the reporting agency, to send notice of the request to the consumer. n26 If the user requesting an investigative consumer report is an employer, additional requirements apply. Whether or not a requested consumer report is an investigative report, employers must have disclosed in a separate document that a report may be obtained for employment purposes.

The notice should inform the consumer that a request for an investigative consumer report has been made and should describe the types of information that the report will seek, including, as applicable, information on the consumer's character, general reputation, personal characteristics, and mode of living. n27 The disclosure must also state that an investigative consumer report involves personal interviews with sources such as friends, neighbors, and associates. n28

The notice must be in writing, n29 must be mailed or otherwise delivered to the consumer, n30 and the information in the notice must be clearly and accurately disclosed. n31 The FTC staff has drafted and published a form which it deems adequate. n32 A user may not procure an investigative report without certifying to the consumer reporting agency that it has notified the consumer of the investigative report and that it will, upon written request from the consumer, completely and accurately disclose the nature and scope of the investigation. n33

The user of any consumer report, investigative or otherwise, must notify the consumer when it takes an adverse action based at least in part on information in a consumer credit report, and must supply the name, address, and telephone number of the reporting agency making the report. The user must also notify the consumer of the right to obtain a free copy of the report within sixty days.

As discussed above, however, if a report qualifies as an employee investigation report the report will be exempt from the definition of consumer report and accordingly from the related definition of investigative consumer report. n34 In such a case the employer need not comply with these requirements, though the employer must comply with the special disclosure provisions imposed on employee investigation reports. n35

[b] Consumer's Right to Additional Disclosures

Within a reasonable period of time after the consumer receives notice that an investigative consumer report has been requested, the consumer can seek from the person requesting the report a complete and accurate disclosure of the nature and scope of the investigation. n36 The requester's disclosure must include a complete and accurate description of the types of questions asked, the number and types of persons interviewed, and the name and address of the investigating agency. n37 The reporting agency must provide a free copy of the report if the consumer requests it following an adverse action.

Furthermore, reporting agencies may not prohibit users from disclosing the contents of the consumer report when adverse action has been taken. n38 The reporting agencies enter into agreements with users covering use of reports, and such an agreement may specify that users cannot disclose contents of reports to consumer subjects. n39

The FTC Commentary states that users need not disclose sources of information (i.e., the names of the individuals interviewed). n40 For the FCRA exception concerning sources of investigative consumer reports to apply, however, the information must have been "acquired solely for use in preparing an investigative consumer report and actually used for no other purpose." n41

The second, more detailed disclosure to the consumer must be made in writing, and must be mailed or otherwise delivered to the consumer within five days of receipt of the consumer's request for the disclosure. n42

[c] Reporting Agency Must Disclose Nature of Consumer Report

Whenever the consumer requests, a reporting agency must disclose all information in the consumer's file at the time of the request, other than information concerning credit or other risk scores or predictors. Upon request, the reporting agency must also provide the names, addresses, and telephone numbers of any recipients of a report on the consumer within the last year (two years for reports with employment purposes). In addition, following an adverse action based in part on a consumer report, the reporting agency must provide a free copy of the report to the consumer upon the consumer's request. n43

[d] Reasonable Procedures Defense

Users cannot be held liable for a violation of any of their three disclosure requirements relating to investigative reports if the user can show "by a preponderance of the evidence that at the time of the violation he maintained reasonable procedures to assure compliance" with these requirements. n44

The Act does not specify the types of procedures that must be shown to avoid liability under this section. Ordinarily, the reasonableness of procedures is a question of fact. n45

[e] Waiver of Consumer Rights

Persons requesting investigative reports may attempt to avoid the FCRA notice requirements by seeking a waiver from the consumer. The FTC has determined that a reporting agency cannot condition disclosure upon the execution by the consumer of a waiver of claims, even where the waiver closely conforms to the language contained in the Act. n46 Waivers are strictly construed against the drafter; preprinted waivers with potential employees of unequal bargaining power demand careful judicial scrutiny when they are "so broad as to afford protection for all conduct no matter how egregious." n47

[3] Procedures for Investigative Reports

[a] Procedures Required for Any Consumer Report

Reporting agencies have an obligation to insure that information in consumer reports is accurate and not obsolete. These requirements apply to investigative reports as they do to any other consumer reports.

[b] Information From Personal Interviews

To guard against the inclusion of unsubstantiated information in investigative consumer reports, a reporting agency which interviews a consumer's neighbor, friend, or other associate must follow "reasonable procedures" to confirm the interview information with an additional source having independent and direct knowledge of the information. The

agency may escape the confirmation requirement, however, if the person interviewed is the "best possible source of the information." n48

[c] Adverse Information Based on Public Records

Certain adverse information which is a matter of public record must be verified before the release of the investigative report. A consumer reporting agency may not furnish an investigative consumer report that includes public record information relating to an arrest, indictment, conviction, civil judicial action, tax lien, or outstanding judgment, unless the agency has verified the accuracy of the information within thirty days prior to releasing the information. n49

[d] Verification of Information for Re-Use in Subsequent Investigative Report

If information in an investigative report is adverse, the consumer reporting agency may not include that information in a subsequent consumer report unless it "has been verified in the process of making such subsequent consumer report." n50 Reverification may not be required when a user requests a copy of an old report, no new report is prepared, and the copy supplied clearly states that it is dated and does not provide fresh information. n51 Verification also is not required for information that is a matter of public record, unless the public record information is adverse and relates to criminal or civil legal records. In addition, investigative information that "was received within the three-month period preceding the date the subsequent report is furnished" is also exempted from the reverification requirement.

[4] State Laws on Investigative Reports

Several states also have laws regulating investigative reports, n52 often filling the void left by the FCRA, and providing consumers with enhanced protections against the unfair and improper use of investigative reports for employment and insurance purposes. Most of these statutes use the same definition of an investigative report found in the FCRA, but California's statute does not require a personal interview, part of the FCRA's definition. n53 State laws on consumer investigative reports usually govern insurance and employment investigative reports and typically require certain disclosures and notices when such reports are requested.

For example, in California, if an investigative report is for insurance purposes, a written disclosure must be provided to the consumer at the time the consumer signs the application, medical form or binder. If there is no signed application, medical form or binder, the disclosure must be made in writing and mailed or otherwise delivered within three days after the report was first requested. n54 However, a California appellate court recently held that the state's investigative report statute was unconstitutionally vague as applied to tenant screening reports that include unlawful detainer records. n55 The court reasoned that the investigative report statute was intended to apply to information pertaining to character, while the less strict credit reporting statute was intended to cover information pertaining to creditworthiness, but unlawful detainer records could fall within both categories. n56 The problem is that each statute expressly excludes information covered by the other, leaving landlords uncertain as to which statute they must comply with. n57

The disclosure warns the consumer that an investigative report regarding the consumer's character, general reputation, personal characteristics, and mode of living may be made. The disclosure must include the name and address of the investigative consumer reporting agency conducting the investigation and the nature and scope of the investigation requested.

For investigative reports for an employment purpose, California law requires employers to show the consumer the report and identify who asked for the report and how to contact them. n58 The California statute has an exception similar to that found in the FCRA. Notice is not required if the reports are made because of a "suspicion of wrongdoing by the subject of the investigation. n59

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer ReportsBanking LawConsumer ProtectionState LawGeneral Overview

FOOTNOTES:
(n1)Footnote 1. *See Ippolito v. WNS, Inc., 864 F.2d 440, 448 (7th Cir. 1988)* , *cert. dismissed*, *490 U.S. 1061, 109 S. Ct. 1975, 104 L. Ed. 2d 623 (1989)* ; FTC Official Staff Commentary § 603(e) item 1.

(n2)Footnote 2. *15 U.S.C. § 1681a(e).*

(n3)Footnote 3. *See § 16.03[2][b][vi]*, *supra*.

(n4)Footnote 4. FTC, Compliance with the Fair Credit Reporting Act, at 23.

(n5)Footnote 5. *15 U.S.C. § 1681a(e).*

(n6)Footnote 6. FTC Official Staff Commentary § 603(e) item 4; Peeler, FTC Informal Staff Opinion Letter, May 5, 1976.

(n7)Footnote 7. FTC Official Staff Commentary § 603(e) item 7.

(n8)Footnote 8. An early FTC informal opinion, [1969-1973 Decisions Transfer Binder] Consumer Cred. Guide (CCH) P 99,425 (May 20, 1971), to the contrary has clearly been overturned. *See* FTC Official Staff Commentary § 603(e) item 3; Dea, FTC Informal Staff Opinion Letter, Sept. 24, 1975.

(n9)Footnote 9. FTC Official Staff Commentary § 603(e) item 3.

(n10)Footnote 10. *See also* National Consumer Law Center, Fair Credit Reporting Act, Ch. 13 (6th ed. 2006 and Supp.).

(n11)Footnote 11. *15 U.S.C. § 1681a(e).*

(n12)Footnote 12. FTC Official Staff Commentary § 603(e) item 6.

(n13)Footnote 13. *See* 149 Cong. Rec. H8123 (daily ed. Sept. 10, 2003).

(n14)Footnote 14. *15 U.S.C. § 1681a(x)(D)(v)*, *added by* Pub. L. No. 108-159, § 611 (2003).

(n15)Footnote 15. *15 U.S.C. § 1681a(d)(2)(D)*, *amended by* Pub. L. No. 108-159, § 611(b) (2003).

(n16)Footnote 16. *15 U.S.C. § 1681a(x)*, *added by* Pub. L. No. 108-159, § 611(a) (2003).

(n17)Footnote 17. *15 U.S.C. § 1681a(x)(1)(C).*

(n18)Footnote 18. *Id.* at § 1681a(x)(3).

(n19)Footnote 19. *Id.* at § 1681a (x)(2).

(n20)Footnote 20. *15 U.S.C. § 1681a(h).*

(n21)Footnote 21. Vail, Informal Staff Opinion Letter, Mar. 25, 1999, *reprinted in* National Consumer Law Center, Fair Credit Reporting Act, App. D (6th ed. 2006 and Supp.). If the report is prepared and furnished to render legal advice (and not for the purpose of evaluating the employee or taking adverse action), it is not within the *FCRA*. *Robinson v. Time Warner, Inc. 187 F.R.D. 144 (S.D.N.Y. 1999) . See Rugg v. HANAC Inc., 2002 U.S. Dist. LEXIS*

18101 (S.D.N.Y. Sept. 23, 2002) (approving *Johnson*'s criticism of FTC opinion letters, however declining to decide if employer consultant was a "consumer reporting agency" under the FCRA).

(n22)Footnote 22. FCRA § 604(b)(2); *15 U.S.C. § 1681b(b)(2)*, *as amended by* Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).

(n23)Footnote 23. *15 U.S.C. § 1681b(a)(3)(c)*. [*15 U.S.C. § 1681b(3)(c)* was renumbered by Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).] *See also* FTC Official Staff Commentary § 604(3)(C) item 1. There is no permissible purpose under the FCRA for furnishing a consumer report in order to evaluate an insurance claim.

(n24)Footnote 24. FCRA § 606(a)(1), *15 U.S.C. § 1681d(a)(1)*, Pub. L. No. 104-208, § 2414, *110 Stat. 3009* (Sept. 30, 1996).

(n25)Footnote 25. *15 U.S.C. § 1681d(a)(1)*.

(n26)Footnote 26. FTC Official Staff Commentary § 606 item 2.

(n27)Footnote 27. *15 U.S.C. § 1681d(a)(1)*. *See* Wilmore, FTC Informal Staff Opinion Letter, Jan. 18, 1994.

(n28)Footnote 28. FTC Official Staff Commentary § 606 item 6; *see also* Petruccelli, FTC Informal Staff Opinion Letter, Nov. 14, 1983; FTC, Compliance with the Fair Credit Reporting Act, at 40-41 (1977); *National Indem. Co., 92 F.T.C. 426, 428 (1978)* (consent order).

(n29)Footnote 29. *15 U.S.C. § 1681d(a)(1)*; FTC Official Staff Commentary § 606 item 5. *See also* Bragg, FTC Informal Staff Opinion Letter, Sept. 16, 1971.

(n30)Footnote 30. *15 U.S.C. § 1681d(a)(1)*; FTC Official Staff Commentary § 606 item 5. *See also* Bragg, FTC Informal Staff Opinion Letter, Sept. 16, 1971.

(n31)Footnote 31. *15 U.S.C. § 1681d(a)(1)*; FTC Official Staff Commentary § 606 item 5. *See also* Bragg, FTC Informal Staff Opinion Letter, Sept. 16, 1971.

(n32)Footnote 32. *See* Feldman, FTC Informal Staff Opinion Letter, Mar. 12, 1971; *see also* White, FTC Informal Staff Opinion Letter, Dec. 22, 1975.

(n33)Footnote 33. FCRA § 606(a), *15 U.S.C. § 1681d(a)(2)*, *as amended by* Pub. L. No. 104-208, § 2414, *110 Stat. 3009* (Sept. 30, 1996).

(n34)Footnote 34. *15 U.S.C. § 1681a(d)(2)(D)*, *amended by* Pub. L. No. 108-159, § 611(b) (2003).

(n35)Footnote 35. *See §§ 16.03[2][b][vi]*, *supra*.

(n36)Footnote 36. *15 U.S.C. § 1681d(b)*.

(n37)Footnote 37. FTC Official Staff Commentary § 606 item 7. *See also* Feldman, FTC Informal Staff Opinion Letter, Aug. 21, 1974.

(n38)Footnote 38. FCRA § 607(c), *15 U.S.C. § 1681e(c)*, *as amended by* Pub. L. No. 104-208, § 2407, *110 Stat. 3009* (Sept. 30, 1996).

(n39)Footnote 39. *See, e.g., A- 1 Credit & Assurance v. Trans Union Credit Info., 678 F. Supp. 1147, 1148 (E.D. Pa. 1988)* .

(n40)Footnote 40. FTC Official Staff Commentary § 606 item 7. *See also* Feldman, FTC Informal Staff Opinion

Letter, Aug. 21, 1974.

(n41)Footnote 41. *15 U.S.C. § 1681g(a)(2).*

(n42)Footnote 42. *15 U.S.C. § 1681d.*

(n43)Footnote 43. *15 U.S.C. § 1681g(a).*

(n44)Footnote 44. *15 U.S.C § 1681d(c).*

(n45)Footnote 45. *Feldman v. Comprehensive Info. Servs., 2003 Conn. Super. LEXIS 2781* (Conn. Super. Ct. Oct. 6, 2003) (unknown to the employer, the reporting agency did not physically inspect the criminal records but the employer required neither a physical inspection in the written contract nor an affidavit that such an inspection had been done).

(n46)Footnote 46. *MIB, Inc., 101 F.T.C. 415, 423 (1983)* (consent order). *Contra* Peeler, FTC Informal Staff Opinion Letter, Mar. 23, 1977.

(n47)Footnote 47. *Feldman v. Comprehensive Info. Servs., 2003 Conn. Super. LEXIS 2781* (Conn. Super. Ct. Oct. 6, 2003) .

(n48)Footnote 48. FCRA § 606(d)(4), *15 U.S.C. § 1681d(d)(4)*, *as amended by* Pub. L. No. 104-208, § 2414, *110 Stat. 3009* (Sept. 30, 1996).

(n49)Footnote 49. FCRA § 606(d)(3), *15 U.S.C. § 1681d(d)(3)*, *as amended by* Pub. L. No. 104-208, § 2414, *110 Stat. 3009* (Sept. 30, 1996).

(n50)Footnote 50. *15 U.S.C. § 1681 l.*

(n51)Footnote 51. *Clay v. Equifax, Inc., 762 F.2d 952 (11th Cir. 1985)* .

(n52)Footnote 52. *See e.g., Ariz. Rev. Stat. § 20-2107*; *Cal. Civ. Code § 1786.16*; Ill. Ins. Code, ch. 215, § 1008.73; *Kan. Stat. Ann. § 50-705*; Me. Rev. Stat. Ann. tit. 10, § 1312-1319; Me. Rev. Stat. Ann. tit. 24, § 2209; *Mass. Gen. Laws ch. 93, § 53*; *Minn. Stat. § 72A.491*; *Va. Code Ann. § 38.2-602*; *Wyo. Stat. Ann. § 26-1-102.*

(n53)Footnote 53. *Cal. Civ. Code § 1786.2.*

(n54)Footnote 54. Cal. Civ. Code § 1781.16(a)(1).

(n55)Footnote 55. Ortiz v. Lyon Mgmt. Group, Inc., *69 Cal. Rptr. 3d 66, 75 (Cal. Ct. App. 2007)* ; Trujillo v. First Am. Registry, Inc., *68 Cal. Rptr. 3d 732, 740-741 (Cal. Ct. App. 2007)* (companion

(n56)Footnote 56. *Id.* at 71-72 .

(n57)Footnote 57. *Id.* at 75 .

(n58)Footnote 58. *Id.*

(n59)Footnote 59. Cal. Civ. Code § 1781.16(a)(2).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1-16 Consumer Credit Law Manual § 16.09

§ 16.09 FCRA Litigation

[1] Available FCRA Claims

[a] General

This section provides an overview of important FCRA litigation considerations. n1 The FCRA establishes civil liability for noncompliance with its requirements that is negligent n2 or willful. n3 This subsection details when an FCRA violation involves negligence. Willful noncompliance is only relevant for the awarding of punitive damages.

The FCRA provides that any "person" who fails to comply with certain requirements with respect to a consumer will be liable to that consumer. n4 Potential defendants include consumer reporting agencies, users of information, and furnishers of information.

The general standard is that the consumer must show that the defendant's noncompliance was negligent. Whether a defendant is negligent may depend upon industry standards, although normal practices within the industry may themselves fall below a reasonable standard of care. n5 One of the most dramatic aspects of the recently enacted FACTA is that a sizable portion of the new obligations imposed on businesses, creditors, furnishers, and financial institutions are not enforceable under an FCRA private cause of action. n6 The new obligations that have no private enforcement include: n7

- The new responsibility of businesses that have transacted with an identity thief to provide the victim, upon the victim's request, with transaction information n8

- The obligation of financial institutions or creditors to establish policies to implement the red flag guidelines that appointed agencies will issue to curb identity theft n9

- The new requirement that creditors issue risk-based pricing notices when they offer credit on "material terms that are materially less favorable" than those offered to other consumers n10

- The revised obligation of furnishers to refrain from furnishing information about a consumer to an agency if the furnisher knows or has reason to believe that the information is inaccurate n11

[b] Claims Against Reporting Agencies for Inaccurate Reports

The FCRA does not create liability merely for inaccurate consumer reports. The consumer must show that the reporting agency was negligent in failing to follow reasonable procedures to assure the maximum possible accuracy of the reported information. n12

Where procedures are not in place that should be in place, this provision presents little difficulty for the consumer litigant. The FCRA section regarding "maximum possible accuracy" requires the agency to "follow" reasonable procedures. n13 Claims based on plaintiff's being a third party beneficiary of the subscriber's contract with the reporting bureau have been dismissed. n14 A warning that the information may be inaccurate does not shield the agency from liability. n15

The reasonable procedures standard should be considered violated when a consumer reporting agency returns a report in response to an inquiry about one consumer that mixes in, or mismerges, information about another consumer. However, a recent Seventh Circuit opinion agreed with Trans Union that such mismerging may be justified, reasoning that it is more important to overinclude information that may, but may not, refer to the subject consumer than to omit an item that was intended to be tagged to that consumer but, because of data miscollection, was not. n16 The court appeared to misread the language of the statute to require only that the consumer reporting agency must have reasonable procedures to "avoid inaccuracy," not to "assure maximum possible accuracy." n17

To prove negligent noncompliance, the consumer must show by a preponderance of evidence, that (1) the report contained an inaccurate entry; (2) the inaccuracy was due to defendant's failure to follow procedures to assure maximum possible accuracy; (3) the consumer suffered injury; (4) the injury was caused, in part, by the inaccuracy. n18

Where it is difficult to show that the agency was negligent in failing to follow reasonable procedures, a better approach may be to show that the agency was negligent in failing to correct the report after the inaccuracy was brought to the agency's attention. The FCRA specifies, in detail, requirements on handling consumer disputes of inaccurate or incomplete information. Note, however that the consumer can recover under § 1681e(b) even if the consumer has not provided notice of the inaccuracy to the agency. n19

[c] Claims Against Reporting Agencies for Obsolete Reports

An agency is liable if it is negligent in making any consumer report that contains any obsolete information. n20 The agency is also liable if it is negligent in maintaining reasonable procedures designed to avoid reporting of obsolete information. n21

[d] Claims Against Reporting Agencies for Furnishing Reports for Impermissible Purposes

An agency is liable if it is negligent in furnishing any consumer report in any circumstance other than those explicitly permitted in the statute. n22 The agency is also liable if it is negligent in maintaining reasonable procedures designed to avoid such reporting. n23

What is reasonable depends in part on patterns and practices of abuse by particular users or groups of users. When a consumer reporting agency has reason to doubt a user's compliance, it has an obligation to take additional steps to ensure compliance or to deny the user access to reports altogether. n24 When Vermont found that Equifax was failing to reasonably ensure that users obtained prior consumer consent to access credit reports, as required Vermont law, Equifax agreed to require audits of user practices and to terminate users who fail to sign promises to follow new prophylactic procedures imposed by Equifax. n25

[e] Claims Relating to Medical Information Reported Without Consumer Consent

Prior to the FACTA, consumer reporting agencies were prohibited from furnishing medical information about consumers for employment purposes, or in connection with credit, insurance or direct marketing transactions without consumer consent. n26 The FACTA continues to prohibit agencies from issuing a report for employment purposes or in connection with a credit or insurance transaction that contains medical information without the consumer's consent. n27

In addition, as of June 1, 2004, a consumer's consent must be in writing, must be specific, and must describe the use for which the agency will furnish the information. n28 These requirements are applicable if the report is for employment purposes or in connection with a credit or insurance transaction. n29 An agency may provide medical information that pertains solely to financial transactions as long as it insures that the information does not disclose a specific provider of medical services or the nature of services. n30 The FACTA also prohibits users from re-disclosing such reports. n31

The FACTA also prohibits reporting agencies from including the name, address, and telephone information of medical information furnishers in consumer reports unless the agency formats the information to prevent the disclosure either of the specific provider or the nature of the medical services. However, the agency may provide such information in a report to an insurance agency. n32

Consistent with the FCRA prior to amendment by the FACTA, these requirements are violated if the medical information is negligently reported. There is no "reasonable procedures" defense to the improper furnishing of medical information without the required consumer consent. If medical information is released without such consent, it should create a prima facie case, or at least a rebuttable presumption, of negligence.

[f] Claims Against Reporting Agencies for Failure to Disclose Content of the Consumer's File or to Handle Consumer Disputes and Reinvestigations Properly

The FCRA requires that agencies disclose the contents of the consumer's file to the consumer under specified conditions, and in specified ways. n33 Negligent or willful failure to comply with these requirements is actionable.

Reporting agencies must follow certain procedures when the consumer has disputed the accuracy of a report. n34 Negligent or willful failure to follow those procedures is actionable. n35

[g] Claims Against Reporting Agencies for Failure to Reverify Investigative Reports

Agencies must reverify adverse information in subsequent investigative reports even if verified for the first investigative report. n36 Any negligent or willful failure to comply should be actionable.

[h] Claims Against Reporting Agencies Relating to Adverse Public Record Information for Employment Purposes

Another obligation is that a consumer reporting agency must notify the consumer that adverse public record information is being reported for employment purposes, or the agency must maintain strict procedures to insure the information is complete and up to date. n37 The FACTA excludes certain employee investigation communications from FCRA requirements. n38 To fall within the exclusion, the communication must not be for the purpose of investigating the employee's credit worthiness, credit standing, personal characteristics or mode of living, and must not be provided to anyone other than the employer or employer's agent, a governmental authority, or a self-regulatory organization with regulatory authority over the employer. n39

[i] Claims Against Reporting Agencies Relating to Prescreening Lists

Reporting agencies must create and maintain a system to allow consumers to "opt out" of the prescreening process. n40 The negligent failure to provide a consumer with the opportunity to opt out, or the failure to comply with a consumer's

decision to opt out, is actionable. The provision by a reporting agency of a prescreened list for impermissible purposes is actionable.

[j] Claims Against Resellers or Superbureaus

Failure by a reseller of consumer reports to establish reasonable procedures to ensure that reports are resold only for permissible purposes and to previously identified end-users is sufficient to show negligent noncompliance with the requirements. Resellers must also comply with the FCRA's reinvestigation requirements. n41

[k] Claims Against Users for Failure to Provide Required Notices

The FCRA requires users of information to provide certain notices to consumers. n42 Negligent or willful failure to provide such notices is actionable.

[l] Claims for Failure to Comply With Disclosure and Certification Requirements for Investigative Reports

The FCRA prohibits any person from procuring an investigative consumer report without disclosure to the consumer and places various disclosure and certification obligations on both users and reporting agencies. n43 In addition, the FCRA also prohibits consumer reporting agencies from making inquiries in connection with investigative consumer reports for employment purposes if the making of such inquiries by an employer would violate any federal or state equal employment opportunity law. Negligent or willful failure to comply with the disclosure and certification requirements is actionable.

[m] Claims Against Those Obtaining Reports Without a Permissible Purpose or Under False Pretenses

The FCRA prohibits any person from using or obtaining a consumer report unless the report is obtained for a permissible purpose and such purpose is certified by the user in accordance with the Act. n44 A "user" includes the person who actually requests or obtains the report, the person who is the ultimate destination of the report, and one who fraudulently causes a report to be issued (such as an impostor who applies for credit using someone else's personal identifiers). n45 The FCRA also contains special sanctions against any person who obtains a consumer report under false pretenses or knowingly without a permissible purpose. Such a person is liable to both the consumer and the consumer reporting agency which furnished the report for actual damages or $1,000, whichever is greater, as well as punitive damages, costs, and attorney's fees. n46

[n] Claims Against Information Furnishers

The FCRA imposes specific obligations for businesses (typically creditors) who furnish information to consumer reporting agencies. n47 A furnisher can be liable to the consumer for negligently or willfully violating the provisions regarding reinvestigation, but not for improperly reporting information to a reporting agency in the first instance. n48 Several district courts have confirmed that the statute allows consumers to bring a private action for civil damages against furnishers who fail to comply with their reinvestigation obligations. n49 Only one decision, which grows increasingly isolated with each new opinion upholding private actions, has misconstrued the provision as only allowing consumer reporting agencies--and not consumers--to bring civil actions. n50 An allegation that the consumer has notified the reporting agency of a dispute is essential to triggering the furnisher's liability. n51 Furthermore, if a collection agency furnishes information, the Fair Debt Collection Practices Act, which is not preempted by FCRA, requires the collection agency to report the debt as disputed once the consumer disputes it, and allows actual and statutory damages along with attorney's fees for violation of the Act. n52 The FACTA of 2003 also requires the FTC and other agencies to issue accuracy guidelines for furnishers; however, enforcement of these guidelines is limited to federal and state officials. n53

[2] FCRA Immunity From Tort Claims

The FCRA prohibits any action:

> in the nature of defamation, invasion of privacy, or negligence with respect to the reporting of information against any consumer reporting agency, any user of information, or any person who furnishes information to a consumer reporting agency, based on information disclosed pursuant to [the sections concerning disclosures to consumers, conditions of disclosure to consumers, and disclosure requirements for users of consumer reports] or based on information disclosed by a user of a consumer report to or for a consumer against whom the user has taken adverse action, based in whole or in part on the report, except as to false information furnished with malice or willful intent to injure such consumer. n54

This section establishes a limited qualified immunity for the reporting agency, user, and provider of information from liability under three tort theories, unless the conduct involves malice or willful intent. n55 Immunity arises only for claims based on information disclosed to consumers n56 pursuant to three FCRA sections requiring specified disclosures to consumers. n57 Two of the sections require agencies to disclose to consumers the information in their files about the consumer (other than information concerning credit scores or any other risk scores or predictors). n58

The third FCRA disclosure section requires users to disclose to consumers the fact that an adverse action has been taken on the basis of information contained in a consumer report or that credit was denied on the basis of other third party information, including information provided by an affiliate. n59 The immunity does not extend to information disclosed or obtained by means *other than* the reporting agency's disclosure to the consumer of the contents of the file or the user's disclosure to the consumer of the adverse action. n60

The qualified immunity applies only to actions and proceedings in the "nature of" defamation, invasion of privacy, and negligence. The immunity thus should not apply to other tort claims and claims based on state credit reporting statutes, state deceptive practices statutes, and state debt collection statutes. n61

The FCRA's limited tort immunity applies to "any person who furnishes information to a consumer reporting agency." n62 The immunity does not apply when the person furnishes information to someone other than a consumer reporting agency. For example, the immunity does not apply to a creditor reporting its own experience with its customer to another creditor.

The FCRA's qualified immunity raises the level of proof required by a consumer to prevail in state defamation, privacy, and negligence actions. The qualified immunity requires that the consumer prove that the defendant acted with malice or willful intent to injure, and that the reported information was false.

Some of the new responsibilities imposed by the FACTA of 2003 may be eligible for qualified immunity protection to the extent that a plaintiff's action is based on information that the defendant disclosed to fulfill the responsibility. While the FACTA did not amend the qualified immunity provision itself, it did amend two of the three sections, 609 (§ 1681g) and 615 (§ 1681m), that benefit from the immunity section's protection. Accordingly, plaintiffs may have to meet the elevated proof requirements when bringing actions based on the failure of a party to comply with any of the following new (or amended) provisions:

- An agency's responsibility, upon the consumer's request, to truncate the first five digits of the consumer's social security number when making a disclosure pursuant to the consumer's request n63

- An agency's new responsibility to disclose to consumers the forthcoming summary, to be prepared by the FTC, of consumer's rights to obtain and dispute information and to obtain credit scores n64

- An agency's new responsibility to provide identity theft victims with a statement of their rights n65

- The new responsibility of businesses that have done business with an identity thief to provide the victim, upon the victim's request, with transaction information (to the extent such a provision is a "disclosure") n66

In addition, a new disclosure provision requires businesses that have done business with an identity thief to disclose transaction information to the thief's victim upon the victim's request. n67 Accordingly, the qualified immunity provision may protect the business from suit to the extent that the suit is in the nature of defamation, invasion of privacy, or negligence, but only to the extent that the action is "with respect to the reporting of information." n68

The same reasoning applies to the new responsibilities of debt collectors who are notified that information related to the debt may be fraudulent or the result of identity theft. n69

[3] FCRA Preemption of State Credit Reporting Statutes

Most states have credit reporting laws. The FCRA provides:

> Except as provided in subsections (b) and (c), [the Act] does not annul, alter, affect, or exempt any person subject to the provisions of this [Act] from complying with the laws of any State with respect to the collection, distribution, or use of any information on consumers, except to the extent that those laws are inconsistent with any provision of this [Act], and then only to the extent of the inconsistency. n70

According to this savings clause, the FCRA does not generally preempt state credit reporting or other laws, unless there is a specific inconsistency between the FCRA and the state law, n71 or unless certain explicit FCRA exceptions apply. Courts have consistently found that this savings clause shows that Congress did not intend to comprehensively preempt states from the field of credit reporting regulation. n72 Furthermore, in 2003, Congress added to the savings clause state laws "for the prevention or mitigation of identity theft." This evinces a strong presumption in favor of the rights of states to protect their citizens from identity theft. n73

Despite the general rule limiting preemption of state law, the Consumer Credit Reporting Reform Act of 1996 adds specific provisions which preempt any state law which differs from the federal provision, regardless of whether the state law is inconsistent or provides the consumer greater protection.

These specific preemptions of state law do not affect any settlement agreement or consent judgment between any state attorney general and any consumer reporting agency in effect on September 30, 1996. More importantly, these preemption rules may be temporary. Any state law enacted after January 1, 2004, which states explicitly that it is intended to supplement the FCRA and gives greater protection to consumers than is provided under the FCRA, will not be superseded. n74

The following is a summary of the new federal preemptions of state laws: n75

- State laws regulating the creation and use of prescreened reports are preempted. n76

- State laws relating to the time by which a reporting agency must handle the various aspects of a consumer dispute and reinvestigation, including the times by which various notices must be given, are preempted, except for those state laws in effect on September 30, 1996. n77

- State laws relating to the duties of persons who take adverse actions against consumers, based on information in consumer reports or information provided by third parties other than consumer reporting

agencies, are preempted. n78

- State laws relating to users of prescreened reports, specifically to the duties of creditors and insurance companies who use consumer reports to make solicitations of credit or insurance, where the transactions are not initiated by consumers and involve a firm offer, are preempted. n79

- State laws concerning the contents of consumer reports, such as standards of obsolescence, reports of account closings, and which transactions are not covered because of size or amount, are preempted, except for those state laws in effect on September 30, 1996. n80

- State laws regarding the responsibilities of furnishers of information to consumer reporting agencies are preempted, except certain laws in Massachusetts and California in effect September 30, 1996. n81 For instance, the California law prohibiting any report if the furnisher "knows or should know" is inaccurate (parallel to section 1681s-2(a)) is not preempted, but the California law providing a private right of action to enforce the prohibition is preempted. n82

- State laws with respect to the exchange of information between affiliates are preempted, except the law in Vermont in effect September 30, 1996. n83

- State laws are preempted with regard to the summary of rights which must be provided to consumers by consumer reporting agencies. n84

- States must use the FCRA's meaning of "firm offer of credit or insurance" for any equivalent term under state law. n85

The recently enacted FACTA preempts states from governing much of the new territory added to the FCRA. Prior to the FACTA, the FCRA preempted any "requirement or prohibition" of a state with respect to the "subject matter" of identified FCRA provisions. n86 The FACTA added additional preemptions, the largest group of which forbids states from regulating the "conduct required by" certain identified FCRA provisions. n87 In addition, the state statute itself may impose limitations on its use in conjunction with the FCRA. n88

Nonetheless, these preemptions should have a much narrower effect than the preexisting (and supplemented) "subject matter" preemption provision since the preemption should not apply to state laws regulating the subject matter of the provision beyond the specific conduct that the provision demands. n89 In addition, the Act preempts state laws with respect to the required disclosures of the FCRA rights of identity theft victims, n90 to the new provision allowing consumers to opt out of some use by affiliates of consumer information for solicitation purposes, n91 and to the new responsibility of creditors to provide risk-based pricing notices to credit applicants when they offer credit on "material terms that are materially less favorable" than those offered to other consumers. n92

[4] FCRA Claims May Be Brought in Federal or State Court

FCRA suits may be brought in federal courts without regard to the amount in controversy, or in any other court of competent jurisdiction. n93 Bringing an action in state court will not alter substantive rights. n94

[5] Enforceability of Arbitration Agreements

Increasingly, credit and sales agreements contain binding arbitration provisions that may affect a consumer's FCRA claim against the other party to a consumer contract. n95 Arbitration clauses are found in most consumer contracts, including agreements for credit cards, loans, and utilities. Credit reporting agencies have also included such clauses in agreements with consumers who seek disclosure of their own credit reports, at least those who order their reports online

through the centralized source and directly through the agency's websites. The legality of including arbitration clauses as a requirement for consumers to obtain their own credit reports, as allowed under the FCRA, is questionable and this practice may have a short life, depending on whether the FTC finds this an objectionable practice.

[6] FCRA Limitations Period

The FACTA amended the FCRA's statute of limitations to provide that the two-year limitations period dates from the consumer's discovery of the violation, not the date of the violation itself. This effectively overrules *Andrews v. TRW*, n96 which held that the discovery rule did not apply to the FCRA's limitations period. However, the consumer must bring the action within five years of the date of the violation, regardless of the discovery rule. n97 The effective date for this change to the statute of limitation is March 31, 2004. n98 Republication by the CRA of the same inaccurate information as had appeared in earlier credit reports that plaintiff was aware of does not serve to restart the statute of limitations. n99

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingConsumer ReportsBanking LawConsumer ProtectionFair Credit ReportingLiability

FOOTNOTES:
(n1)Footnote 1. For discussion concerning tort, UDAP, and state credit reporting statute litigation relating to consumer credit reports, see National Consumer Law Center, Fair Credit Reporting Act, Ch. 10 (6th ed. 2006 and Supp.). In addition, sample pleadings and discovery relating to negligent and willful noncompliance are in National Consumer Law Center, Fair Credit Reporting Act, App. J (6th ed. 2006 and Supp.) and, especially, National Consumer Law Center, Consumer Law Pleadings With Disk, Number Two, Ch. 10 (1995).

(n2)Footnote 2. *15 U.S.C. § 1681 o.*

(n3)Footnote 3. *15 U.S.C. § 1681n.*

(n4)Footnote 4. FCRA §§ 616, 617, *15 U.S.C. §§ 1681, 1681n, 1681o, as amended by* Pub. L. No. 104-208, § 2412, *110 Stat. 3009* (Sept. 30, 1996).

(n5)Footnote 5. *See Beard v. Goodyear Tire & Rubber Co., 587 A.2d 195 (D.C. Ct. App. 1991)* (non-FCRA case).

(n6)Footnote 6. *15 U.S.C. §§ 1681n, 1681o.*

(n7)Footnote 7. *15 U.S.C. § 1681s-2(c)(1), amended by* Pub. L. No. 108-159, § 312(e) (2003).

(n8)Footnote 8. *15 U.S.C. § 1681g(e)(6), added by* Pub. L. No. 108-159, § 151 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(iv), added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n9)Footnote 9. *15 U.S.C, § 1681s-2(c)(3), added by* Pub. L. No. 108-159, § 314(b) (2003).

(n10)Footnote 10. *15 U.S.C. § 1681m(h)(8)(A), added by* Pub. L. No. 108-159, § 311 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(xiii), added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n11)Footnote 11. *15 U.S.C. § 1681s-2(a)(1)(A), amended by* Pub. L. No. 108-159, § 312(b) (2003).

(n12)Footnote 12. *15 U.S.C. §§ 1681e(b), 1681 o.*

(n13)Footnote 13. *15 U.S.C. § 1681e(b).*

(n14)Footnote 14. *Whiteside v. Equifax Credit Info. Servs., Inc., 125 F. Supp. 2d 807 (W.D. La. 2000)* ; *Lazar v. Trans Union, L.L.C., 195 F.R.D. 665 (C.D. Cal. 2000)* .

(n15)Footnote 15. *Wilson v. Rental Research Servs., Inc., 165 F.3d 642* , *vacated, reh'g, en banc, granted, 191 F.3d 911 (8th Cir. 1999)* , *later proceeding, 206 F.3d 810 (8th Cir. 2000)* . The Fifth Circuit has declined to rule whether publication and denial of credit is required to award damages for an inaccurate report. Instead, the court, over a dissent, imposed unreasonably high standards of proof of intangible damages to void a jury award. *Cousin v. Trans Union Corp., 246 F.3d 359 (5th Cir. 2001)* .

(n16)Footnote 16. *Crabill v. Trans Union, L.L.C., 259 F.3d 662, 663 (7th Cir. 2001)* . However, the court did find that, once the agency was notified that it was mismerging the information, it might not be reasonable for the agency to continue to supply information about both consumers in response to an inquiry about just one and, in such a case, summary judgment would not be appropriate. *259 F.3d 662, 664 (7th Cir. 2001)* .

(n17)Footnote 17. *259 F.3d 662, 663 (7th Cir. 2001)* . *See 15 U.S.C. § 1681e(b).*

(n18)Footnote 18. *Philbin v. Trans Union Corp., 101 F.3d 957 (3d Cir. 1996)* . *Zala v. Trans Union, L.L.C., 2001 U.S. Dist. LEXIS 549* (N.D. Tex. Jan. 17, 2001) ; *see also Crabill v. Trans Union, L.L.C., 259 F.3d 662, 664 (7th Cir. 2001)* (granting summary judgment to defendant consumer reporting agency on grounds that plaintiff failed to show that the credit denial he had suffered was due to the inaccurate information in the report).

(n19)Footnote 19. *Lang v. Trans Union Corp., 1999 U.S. Dist. LEXIS 18584* (W.D. Pa. July 16, 1999) .

(n20)Footnote 20. *15 U.S.C. §§ 1681c*, *1681 o*.

(n21)Footnote 21. *15 U.S.C. §§ 1681e(a)*, *1681 o*.

(n22)Footnote 22. *See* FCRA § 604(a), *15 U.S.C. §§ 1681*, *1681b(a)*, *as amended by* Pub. L. No. 104-208, § 2403, *110 Stat. 3009* (Sept. 30, 1996).

(n23)Footnote 23. *15 U.S.C. §§ 1681e(a)*, *1681o*.

(n24)Footnote 24. *Cf.* FTC Official Staff Commentary § 607 item 2.

(n25)Footnote 25. Summaries of government enforcement actions against the credit bureaus are contained in National Consumer Law Center, Fair Credit Reporting, App. K (6th ed. 2006 and Supp.). For discussion of agency liability for impermissible use, see generally *Andrews v. TRW Inc., 225 F.3d 1063 (9th Cir. 2000)* , *cert. granted, 532 U.S. 902, 121 S. Ct. 1223, 149 L. Ed. 2d 134* , *rev'd and remanded, 534 U.S. 19, 122 S. Ct. 441, 151 L. Ed. 2d 339 (2001)* ; *Spence v. TRW, Inc., 92 F.3d 380, 382 (6th Cir. 1996)* (dicta); *Greenhouse v. TRW, Inc., 1998 U.S. Dist. LEXIS 1973* (E.D. La. Feb. 12, 1998) ; *King v. MTA Bridges & Tunnels, 933 F. Supp. 220 (E.D.N.Y. 1996)* ; *Dobson v. Holloway, 828 F. Supp. 975, 977 (M.D. Ga. 1993)* ; *Zeller v. Samia, 758 F. Supp. 775 (D. Mass. 1991)* ; *Klapper v. Shapiro, 586 N.Y.S.2d 846 (Sup. Ct. 1992)* .

(n26)Footnote 26. *15 U.S.C. § 1681b(g).*

(n27)Footnote 27. *15 U.S.C. § 1681b(g)*, *added by* Pub. L. No. 108-159, § 411 (2003).

(n28)Footnote 28. Pub. L. No. 108-159, § 411(d) (2003).

(n29)Footnote 29. *Id.*

(n30)Footnote 30. *15 U.S.C. § 1681b(g)(1)(C)*, *added by* Pub. L. No. 108-159, § 411 (2003). This provision became effective on June 1, 2004, 180 days after passage of the FACTA. Pub. L. No. 108-159, § 411(d) (2003).

(n31)Footnote 31. *15 U.S.C. § 1681b(g)(4)*, *added by* Pub. L. No. 108-159, § 411 (2003). This provision became effective on June 1, 2004, 180 days after passage of the FACTA. Pub. L. No. 108-159, § 411(d) (2003).

(n32)Footnote 32. *15 U.S.C. § 1681c(a)(6)*, *added by* Pub. L. No. 108-159, § 412 (2003).

(n33)Footnote 33. *15 U.S.C. §§ 1681g*, *1681h*.

(n34)Footnote 34. *15 U.S.C. § 1681i*.

(n35)Footnote 35. *15 U.S.C. §§ 1681n*, *1681 o*. *Dennis v. BEH-1, L.L.C., 520 F.3d 1066, 1071 (9th Cir. 2008)* (granting summary judgment to the plaintiff on claim that the consumer reporting agency negligently failed to conduct a reasonable investigation of the consumer's dispute where the consumer reporting agency's investigator mistakenly concluded that a judgment had been entered against the consumer).

(n36)Footnote 36. *15 U.S.C. § 1681 l*.

(n37)Footnote 37. *15 U.S.C. § 1681k*.

(n38)Footnote 38. *See § 16.08[1][a]*, *supra*.

(n39)Footnote 39. *15 U.S.C. § 1681a(x)(1)(C)*, *added by* 108-159, § 611 (2003).

(n40)Footnote 40. *15 U.S.C. § 1681b(c)*.

(n41)Footnote 41. *See, e.g.,* First Am. Real Estate Solutions, LLC, No. 952-3267 (FTC 1998) (consent agreement).

(n42)Footnote 42. *15 U.S.C. §§ 1681d*, *1681m*.

(n43)Footnote 43. FCRA § 606, *15 U.S.C. § 1681d*, *as amended by* Pub. L. No. 104-208, § 2414, *110 Stat. 3009* (Sept. 30, 1996).

(n44)Footnote 44. FCRA § 604(f), *15 U.S.C. § 1681b(f)*, *as amended by* Pub. L. No. 104-208, § 2404, *110 Stat. 3009* (Sept. 30, 1996).

(n45)Footnote 45. *Adams v. Phillips, 2002 U.S. Dist. LEXIS 24888 (W.D. La. 2002)* .

(n46)Footnote 46. FCRA § 616, *15 U.S.C. § 1681n*, *as amended by* Pub. L. No. 104-208, § 2412, *110 Stat. 3009* (Sept. 30, 1996).

(n47)Footnote 47. FCRA § 623(d), *as amended by* Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996).

(n48)Footnote 48. FCRA § 623(c), *as amended by* Pub. L. No. 104-208, § 2413, *110 Stat. 3009* (Sept. 30, 1996); *Redhead v. Winston & Winston, P.C., 2002 U.S. Dist. LEXIS 17780* (S.D.N.Y. Sept. 20, 2002) ; *Thomas v. Trans Union, L.L.C., 197 F. Supp. 2d 1233 (D. Or. 2002)* .

(n49)Footnote 49. *See, e.g., Thomasson v. Bank One, 137 F. Supp. 2d 721, 723 (E.D. La. 2001)* ; *McMillan v. Experian Info. Servs., Inc., 119 F. Supp. 2d 84, 86, 88 (D. Conn. 2000)* ; *Bruce v. First U.S.A. Bank, 103 F. Supp. 2d 1135, 1142-43 (E.D. Mo. 2000)* ; *DiMezza v. First USA Bank, Inc., 103 F. Supp. 2d 1296, 1299 (D.N.M. 2000)* ; Campbell v. *Baldwin, 90* F. Supp. 2d 754, 756 (E.D. Tex. 2000) ; *Dornhecker v. Ameritech Corp., 99 F. Supp. 2d 918 (N.D. Ill. 2000)* .

(n50)Footnote 50. *Carney v. Experian Info. Solutions, Inc. 57 F. Supp. 2d 496 (W.D. Tenn. 1999)* .

(n51)Footnote 51. *Parker v. Parker, 124 F. Supp. 2d 1216 (N.D. Ala. 2000)* ; *Bruce v. First U.S.A. Bank, 103 F.*

Supp. 2d 1135 (E.D. Mo. 2000) .

(n52)Footnote 52. *15 U.S.C. § 1692e(8)*; *see* National Consumer Law Center, Fair Debt Collection § 9.6.7 (6th ed. 2008 and Supp.); *Brady v. Credit Recovery Co., 160 F.3d 64 (1st Cir. 1998)* .

(n53)Footnote 53. *15 U.S.C. § 15* U.S.C. § 1681s-2(e), *added by* Pub. L. No. 108-159, § 312 (2003).

(n54)Footnote 54. FCRA § 610(e), *15 U.S.C. § 1681h(e)*, *as amended by* Pub. L. No. 104-208, § 2408, *110 Stat. 3009* (Sept. 30, 1996).

(n55)Footnote 55. *Gibson v. Decatur Fed. S&L Ass'n, 235 Ga. App. 160, 508 S.E.2d 788 (1998)* , *cert. denied*, *1999 Ga. LEXIS 236* (Ga. Feb. 26, 1999) ; *Rhodes v. Ford Motor Credit Co., 951 F.2d 905 (8th Cir. 1991)* ; *Laracuente v. Laracuente, 252 N.J. Super. 384, 599 A.2d 968 (1991)* ; *Matthews v. Deland State Bank, 334 So. 2d 164 (Fla. App. 1976)* .

This section does not create any federal cause of action. *Alvarez Melendez v. Citibank, 705 F. Supp. 67 (D.P.R. 1988)* ; *Mitchell v. First Nat'l Bank of Dozier, 505 F. Supp. 176 (M.D. Ala. 1981)* ; *Borner v. Zale Lipshy Univ. Hosp., 2002 U.S. Dist. LEXIS 4787* (N.D. Tex. Mar. 20, 2002) (false report quickly corrected shows lack of malice).

(n56)Footnote 56. The FTC Commentary treats, for purposes of the immunity, disclosure to a consumer's representative the same as information disclosed to the consumer directly. FTC Official Staff Commentary § 610 item 6.

(n57)Footnote 57. *15 U.S.C. §§ 1681g*, *1681h*, *1681m*.

(n58)Footnote 58. FCRA §§ 609(a), 610, *15 U.S.C. §§ 1681g*, *1681h*, *as amended by* Pub. L. No. 104-208, § 2408, *110 Stat. 3009* (Sept. 30, 1996).

(n59)Footnote 59. *15 U.S.C. § 1681m*.

(n60)Footnote 60. FTC Official Staff Commentary § 610 item 6. The Senate Committee Report similarly found no immunity where information is "acquired by a consumer through other means." S. Rep. No. 517, 91st Cong., 1st Sess. 6 (1969) (Report on S. 823 § 610). *Whiteside v. Equifax Credit Info. Servs., Inc., 125 F. Supp. 2d 807 (W.D. La. 2000)* (no immunity based on information provided to potential creditor).

(n61)Footnote 61. *But see Greenwood Trust Co. v. Conley, 938 P.2d 1141 (Colo. 1997)* .

(n62)Footnote 62. *15 U.S.C. § 1681h(e)*.

(n63)Footnote 63. *15 U.S.C. § 1681g(a)(1)(A)*, *amended by* Pub. L. No. 108-159, § 115 (2003). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(i)*, *added by 69 Fed. Reg. 6526-31* (Feb. 5, 2004) .

(n64)Footnote 64. *5 U.S.C. § 1681g*(c), *added by* Pub. L. No. 108-159, § 211(c) (2003).

(n65)Footnote 65. *15 U.S.C. § 1681g(e)*, *added by* Pub. L. No. 108-159, § 151 (2003). (2004).

(n66)Footnote 66. *15 U.S.C. § 1681g(d)*, *added by* Pub. L. No. 108-159, § 151 (2003).

(n67)Footnote 67. *15 U.S.C. § 1681(g)(e)*, *added by* Pub. L. No. 108-159, § 151 (2003). The victim must first adequately establish his or her identity. *Id*.

(n68)Footnote 68. *15 U.S.C. § 1681h(e)*.

(n69)Footnote 69. *15 U.S.C. § 1681m(e)*, *added by* Pub. L. No. 108-159, § 155 (2003).

(n70)Footnote 70. FCRA § 624(a), *15 U.S.C. § 1681t(a)*, *as amended by* Pub. L. No. 104-208, § 2419, *110 Stat. 3009* (Sept. 30, 1996) (adding exceptions provided in subsections (b) and (c)).

(n71)Footnote 71. *Credit Data of Arizona, Inc. v. Arizona, 602 F.2d 195 (9th Cir. 1979)* ; *Sherron v. Private Issue By Discover, 977 F. Supp. 804 (N.D. Miss. 1997)* ; *Hughes v. Fidelity Bank, 709 F. Supp. 639, 641 (E.D. Pa. 1989)* ; *Equifax Servs., Inc. v. Cohen, 420 A.2d 189, 211 (Me. 1980)* , *cert. denied*, *450 U.S. 916 (1981)* .

(n72)Footnote 72. *American Bankers Ass'n v. Lockyer, 2004 U.S. Dist. LEXIS 12367* (E.D. Cal. June 30, 2004) (upholding California Financial Information Privacy Act against preemption challenge); *Sehl v. Safari Motor Coaches, Inc., 2001 U.S. Dist. LEXIS 12638* (N.D. Cal. Aug. 13, 2001) (FCRA preemption not complete, therefore removal of plaintiff's libel action was improper); *Watkins v. Trans Union, L.L.C., 118 F. Supp. 2d 1217, 1222 (N.D. Ala. 2002)* (holding that court did not have removal jurisdiction). *But see Pinson v. Equifax Credit Info. Servs., Inc., 2008 U.S. Dist. LEXIS 27299* (N.D. Okla. Mar. 31, 2008) (ruling that the plaintiff's state law claim was preempted without adopting a construction of the preemption provision; granting summary judgment to Litton Loan Servicing); *Bosarge v. T-Mobile United States, Inc., 2008 U.S. Dist. LEXIS 20952* (S.D. Ala. Mar. 17, 2008) (ruling that all of the plaintiff's claims were preempted); *Johnson v. JP Morgan Chase Bank, 536 F. Supp. 2d 1207, 1214-1215 (E.D. Cal. 2008)* (ruling that all of the plaintiff's claims were preempted); *Allmond v. Bank of Am., 2008 U.S. Dist. LEXIS 4788* (M.D. Fla. Jan. 23, 2008) (dismissing state law claim); *Dvorak v. AMC Mortg. Servs., 2007 U.S. Dist. LEXIS 86604* (E.D. Wash. Nov. 26, 2007) (dismissing defamation claim based on the same conduct as that regulated by § 1681s-2); *Dawe v. Capital One Bank, 456 F. Supp. 2d 236 (D. Mass. 2006)* (dismissing common law claims); *Knudson v. Wachovia Bank, 513 F. Supp. 2d 1255, 1259-1261 (M.D. Ala. 2007)* (dismissing claims); *Woods v. Prot. One Alarm Monitoring, Inc., 2007 U.S. Dist. LEXIS 61664* (E.D. Cal. Aug. 16, 2007) (dismissing defamation claim based on conduct regulated by § 1681s-2(a)).

(n73)Footnote 73. For a full discussion of preemption of state credit reporting laws, *see* National Consumer Law Center, Fair Credit Reporting Act, § 10.7 (6th ed. 2006 and Supp.)

(n74)Footnote 74. FCRA § 624(d), *15 U.S.C. § 1681t(d)*, *as amended by* Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).

(n75)Footnote 75. FCRA § 624(b) and (c), *15 U.S.C. § 1681t(b)* and *(c)*, *as amended by* Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996).

(n76)Footnote 76. *15 U.S.C. § 1681t(b)(1)(A). See 15 U.S.C. § 1681b(c)*, *(e)*.

(n77)Footnote 77. *15 U.S.C. § 1681t(b)(1)(B). See 15 U.S.C. § 1681i*.

(n78)Footnote 78. *15 U.S.C. § 1681t(b)(1)(C). See 15 U.S.C. § 1681m(a)*, *(b)*.

(n79)Footnote 79. *15 U.S.C. § 1681t(b)(1)(D). See 15 U.S.C. § 1681m(d)*. The reference is to prescreening.

(n80)Footnote 80. *15 U.S.C. § 1681t(b)(1)(E). See 15 U.S.C. § 1681c*.

(n81)Footnote 81. *15 U.S.C. § 1681t(b)(1)(F). See 15 U.S.C. § 1681s-2*. The Massachusetts law is referred to as § 54A of Chapter 93 of Massachusetts Annotated Laws. The California law is referred to as *§ 1785.25(a) of the California Civil Code*.

(n82)Footnote 82. *Lin v. Universal Card Servs. Corp., 238 F. Supp. 2d 1147 (N.D. Cal. 2002)* ; *see Riley v. General Motors Acceptance Corp., 226 F. Supp. 2d 1316 (S.D. Ala. 2002)* (cannot assert state law claims for violation of § 1681s-2(a)).

(n83)Footnote 83. *15 U.S.C. § 1681t(b)(2). See 15 U.S.C. § 1681a(d).* The Vermont law is referred to as § (a) and (c)(1) of § 2480e of title 9, Vermont Statute Annotated.

(n84)Footnote 84. *15 U.S.C. § 1681t(b)(3). See 15 U.S.C. § 1681g(c).*

(n85)Footnote 85. *15 U.S.C. § 1681t(c). See 15 U.S.C. § 1681a(l).*

(n86)Footnote 86. *15 U.S.C. § 1681t(b).*

(n87)Footnote 87. FCRA § 625(b)(5), *added by* Pub. L. No. 108-159, § 711(2) (2003). *See* National Consumer Law Center, Fair Credit Reporting, § 10.7 (6th ed. 2006 and Supp.) for further discussion of pre-emption under FACTA.

(n88)Footnote 88. *See, e.g., Cal. Civ. Code § 1785.34* ("[a]ny consumer credit reporting agency ... against whom an action brought pursuant to *Section 1681n* or *1681o of Title 15 of the United States Code* is pending shall not be subject to suit for the same act or omission under [the state credit reporting act]"); *Drew v. Equifax Info. Servs., L.L.C., 2009 U.S. Dist. LEXIS 18965* (N.D. Cal. Mar. 5, 2009) (dismissing state claims as duplicative of FCRA claims).

(n89)Footnote 89. *15 U.S.C. § 1681t(b)(5), added by* Pub. L. No. 108-159, § 711(2) (2003).

(n90)Footnote 90. *15 U.S.C. § 1682t*(b)(1)(G), *added by* Pub. L. No. 108-159, § 151(2) (2003).

(n91)Footnote 91. *15 U.S.C. § 1682t*(b)(1)(H), *added by* Pub. L. No. 108-159, § (2003).

(n92)Footnote 92. *15 U.S.C. § 1682t*(b)(1)(H), *added by* Pub. L. No. 108-159, § 214(d)(2)(B) (2003).

(n93)Footnote 93. *15 U.S.C. § 1681p.*

(n94)Footnote 94. *Ackerley v. Credit Bureau of Sheridan, Inc., 385 F. Supp. 658 (D. Wyo. 1974)* ; *Emerson v. J.F. Shea Co., 76 Cal. App. 3d 579, 143 Cal. Rptr. 170 (1978)* .

(n95)Footnote 95. The enforceability of such provisions, ways to avoid arbitration, and the effects of arbitration on consumers are all discussed in detail in *§ 6.08[5][i] supra*, and National Consumer Law Center, *Consumer Arbitration Agreements* (7th ed. 2007 and Supp.).

(n96)Footnote 96. *15 U.S.C. § 1681x, added by* Pub. L. No. 108-159, § 211 (2003).

(n97)Footnote 97. *15 U.S.C. § 1681p, as amended by* Pub. L. No. 108-159, § 156 (2003).

(n98)Footnote 98. *69 Fed. Reg. 6530* (Feb. 11, 2004) .

(n99)Footnote 99. *See, e.g., Pinson v. Equifax Credit Info. Servs., Inc., 2008 U.S. Dist. LEXIS 27300* (N.D. Okla. Mar. 31, 2008) , *aff'd, 316 Fed. Appx. 744 (10th Cir. 2009)* ; *Sweitzer v. American Express Centurion Bank, 554 F. Supp. 2d 788 (S.D. Ohio 2008)* ; *Benjamin v. Coker, 2007 U.S. Dist. LEXIS 8399* (D. Ariz. Feb. 6, 2007) (retroactive application would impair existing rights); *Webb v. Bob Smith Chevrolet, Inc., 2005 U.S. Dist. LEXIS 21483* (W.D. Ky. Aug. 24, 2005) (same).

Consumer Credit Law Manual

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PART I Consumer Credit
CHAPTER 16 Fair Credit Reporting

1-16 Consumer Credit Law Manual § 16.10

§ 16.10 Private Remedies

[1] Introduction

A person who negligently fails to comply with any most FCRA requirements is liable to the consumer for actual damages sustained as a result of the failure and, in the case of a successful action, the costs of the action together with reasonable attorney's fees. n1 A person who willfully fails to comply with the FCRA is liable for either (a) actual damages sustained by the consumer as a result of the violation or (b) damages ranging from $100 to $1000. n2 A natural person who obtains a consumer report under false pretenses or knowingly without a permissible purpose is liable to the consumer for actual damages or $1000, whichever is greater. n3 In addition, a person who willfully fails to comply with the FCRA is liable for such punitive damages as the court may allow. n4

[a] FACTA Limitations on Private Enforcement

[i] FACTA Expands FCRA's Qualified Immunity Provision

The FCRA provides a qualified immunity to any agency, user or furnisher against any state law claim "in the nature of defamation, invasion of privacy, or negligence" based in whole or in part on a consumer report. n5

The FACTA adds eight actions, based on new FACTA requirements, that also come under this qualified immunity:

- Requirements that agencies to withhold the last five digits of a consumer's social security number from the disclosure of the consumer's file if the consumer so requests n6

- Requirements that agencies provide certain information with their disclosure of a file to a consumer, including the FTC's summary of consumers' rights to obtain and dispute information in consumer reports and to obtain and dispute credit scores n7

- Requirements for agencies to provide consumers who believe they are or may be the victim of identity theft with an FTC-issued summary of their right to use the FCRA's new procedures for remedying the fraud n8

- Rights for identity theft victims to obtain business transaction information from businesses that have done business with the thief n9

- Requirements for agencies to disclose credit scores and certain related information n10

- Requirements for mortgage lenders to disclose credit scores to loan applicants and to provide them with a designated notice n11

- Requirements that users making credit or insurance solicitations present the required prescreening notice in a format, size, type, and manner to be established by the FTC n12

- Requirements for creditors to issue risk-based pricing notices n13

[ii] No Private Enforcement of Certain New Furnisher Obligations

The following new furnisher obligations, n14 are protected from private enforcement: n15

- The requirement that furnishers have procedures for responding to identity theft notifications from agencies and that prohibits furnishers from re-submitting fraudulent information n16

- The requirement that financial institutions notify customers that they are furnishing negative information to agencies about that customer n17

- The requirement that consumers be allowed to dispute information directly with a furnisher and that furnishers must reinvestigate a dispute when it meets certain conditions, complete the investigation within the designated time, and notify each agency to whom the furnisher furnished the information if the furnisher finds that it was inaccurate n18

- The requirement that persons in the business of providing medical services, products, or devices and who furnish information to agencies notify the agencies of their status as medical information furnishers n19

[iii] No Private Enforcement for Certain Other New FACTA Requirements

The FACTA also adds a number of other limitations on private enforcements as to new responsibilities created by the Act. Identity theft victims may not enforce their new rights to business transaction information from businesses that have done business with the thief. n20 Consumers may not enforce the new obligations of users to provide risk-based pricing notices. n21 Consumers also may not enforce the obligation of the federal banking agencies, the National Credit Union Administration, and the FTC to establish accuracy and integrity guidelines for furnishers and to prescribe regulations requiring furnishers to establish reasonable policies and procedures for implementing those guidelines. n22 Finally, consumers may not enforce the obligation of agencies to issue red flag guidelines and regulations. n23 Nonetheless, as long as none of these guidelines and regulations apply to other furnisher requirements in which private claims may be brought, consumers should be able to pursue private actions in accordance with the FCRA's willful and negligent liability provisions. n24

[2] Actual Damages

For a consumer to recover for a defendant's negligent failure to comply with the FCRA, the consumer will have to prove actual damages n25 which were a result of the defendant's failure to comply with an FCRA requirement. n26 These damages can be intangible (such as pain and suffering or humiliation) and need not be pecuniary. The consumer is

under no duty to mitigate actual damages by exhausting other FCRA remedies or rights. n27 Nominal damages may be recoverable for procedural violations. n28

An inaccurate consumer report may cause a denial of credit, the loss of a job opportunity, or the refusal of an insurance policy. These denials may result in financial loss, which, if proved, entitles the consumer to an actual damage award. n29 To the extent that the FCRA does not envision recovery of business or commercial damages, the plaintiff may recover said damages under normal consumer law theories. n30 In many cases, the most significant damage sustained by a consumer is the emotional distress and vexation of dealing with the repercussions of an inaccurate consumer report and the often frustrating ordeal of trying to correct the record. n31 If emotional distress damages will be claimed, examine the law of the jurisdiction to determine whether expert testimony may be required to obtain those damages. n32

[3] Punitive Damages

A person who willfully fails to comply with the FCRA is liable for such punitive damages as the court will allow. n33 It is unnecessary to prove malice or evil motive, or any other element that may be required for recovery under a common law tort theory. n34 Intent may be deduced by circumstantial evidence. n35 Courts generally find that the consumer need not prove actual damages in order to collect punitive damages. n36 The FCRA does not limit the size of punitive damages in either an individual or a class action; punitive damages are determined at the discretion of the courts. Credit reporting agencies and other defendants may be unwilling to produce information on net worth without a claim for punitive damages. Consumers must thus include an allegation in their complaint that the defendant acted willfully, in violation of section 1681n, in order to establish a claim for punitive damages, justifying the request for information on net worth.

[4] Statutory Minimum Damages

Any person who willfully fails to comply with the FCRA with respect to any consumer is liable to the consumer for either (a) actual damages sustained or (b) damages ranging from $100 to $1000. n37 In 2007, the standard to be used in determining whether a violation is "willful" was clarified by the Supreme Court in *Safeco Insurance Company v. Burr*. n38 Consumers should normally request in their pleadings the greater of actual damages or statutory damages. A natural person who obtains a consumer report under false pretenses or knowingly without a permissible purpose is liable to the consumer for the greater of actual damages or $1000. n39 The FCRA does not provide for minimum statutory damages for negligence actions, nor does it authorize multiple damages. n40

[5] Attorney's Fees and Costs

The FCRA provides that a defendant is liable to a consumer, in the case of a successful action, in an amount equal to the costs of the action, as well as reasonable attorney's fees as determined by the court. n41 Costs may also be awarded to the prevailing defendant under the federal rules. n42

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingLiability

FOOTNOTES:
(n1)Footnote 1. FCRA § 617(a), *15 U.S.C. § 1681o(a)*, Pub. L. No. 104-208, § 2412, *110 Stat. 3009* (Sept. 30, 1996).

(n2)Footnote 2. FCRA § 616(a), *15 U.S.C. § 1681n(a)*, *as amended by* Pub. L. No. 104-208, § 2412, *110 Stat. 3009* (Sept. 30, 1996).

(n3)Footnote 3. FCRA § 616(a), *15 U.S.C. § 1681n(a)*, Pub. L. No. 104-208, § 2412, *110 Stat. 3009* (Sept. 30, 1996). In addition, any person who obtains a consumer report from a consumer reporting agency under false pretenses or knowingly without a permissible purpose is liable to the agency for the greater of actual damages or $1000. FCRA § 616(b), *15 U.S.C. § 1681n(b)*, *as amended by* Pub. L. No. 104-208, § 2412, *110 Stat. 3009* (Sept. 30, 1996).

(n4)Footnote 4. FCRA § 616(a)(2), *15 U.S.C. § 1681n(a)(2)*, *as amended by* Pub. L. No. 104-208, § 2412, *110 Stat. 3009* (Sept. 30, 1996).

(n5)Footnote 5. *15 U.S.C. § 1681g(e)*. *See § 16.09[2]*, *supra*.

(n6)Footnote 6. *15 U.S.C. § 1681g(a)(1)(A)*. This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(i)*, *added by 69 Fed. Reg. 6526* /-/31 (Feb. 5, 2004).

(n7)Footnote 7. *15 U.S.C. § 1681g(c)*. This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(ix)*, *added by 69 Fed. Reg. 6526* /-/31 (Feb. 5, 2004).

(n8)Footnote 8. *15 U.S.C. § 1681g(d)*.

(n9)Footnote 9. *15 U.S.C. § 1681g(e)*.

(n10)Footnote 10. *15 U.S.C. § 1681g(f)*. This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(x)*, *added by 69 Fed. Reg. 6526* /-/31 (Feb. 5, 2004).

(n11)Footnote 11. *15 U.S.C. § 1681g(g)*.

(n12)Footnote 12. *15 U.S.C. § 1681m(d)*2).

(n13)Footnote 13. *15 U.S.C. § 1681m(h)*. This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(xiii)*, *added by 69 Fed. Reg. 6526* /-/31 (Feb. 5, 2004).

(n14)Footnote 14. Added to § 1681s/-/2(a), by Pub. L. No. 108-159, §§ 154, 217, 312, and 412 (2003).

(n15)Footnote 15. Pursuant to § 1681s/-/2(c).

(n16)Footnote 16. § 1681s/-/2(a)(6). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(vii)*, *added by 69 Fed. Reg. 6526* /-/31 (Feb. 5, 2004).

(n17)Footnote 17. *15 U.S.C. § 1681s/-/2(a)(7)*. This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(xii)*, *added by 69 Fed. Reg. 6526* /-/31 (Feb. 5, 2004).

(n18)Footnote 18. § 1681s/-/2(a)(8). This provision became effective on December 1, 2004. *16 C.F.R. § 602.1(c)(3)(xiv)*, *added by 69 Fed. Reg. 6526* /-/31 (Feb. 5, 2004).

(n19)Footnote 19. *15 U.S.C. § 1681s/-/2(a)(9)*. This provision became effective until March 4, 2005. Pub. L. No. 108-159, § 412 (2003).

(n20)Footnote 20. § 1681g(e)(6), *added by* Pub. L. No. 108-159, § 151 (2003).

(n21)Footnote 21. § 1681m(h)(8), *added by* Pub. L. No. 108-159, § 311 (2003).

(n22)Footnote 22. § 1681s/-/2(c)(2), *added by* Pub. L. No. 108-159, § 312 (2003).

(n23)Footnote 23. *Added by* Pub. L. No. 108-159, § 312 (2003).

(n24)Footnote 24. *15 U.S.C. §§ 1681n* and *1681o*.

(n25)Footnote 25. *Guimond v. Credit Bureau Inc., 955 F.2d 41 (4th Cir. 1992)* (no inaccurate information; no damages; challenge only to disclosure procedures); *Cahlin v. General Motors Acceptance Corp., 936 F.2d 1151 (11th Cir. 1991)* .

(n26)Footnote 26. *Casella v. Equifax Credit Info. Servs., 56 F.3d 469 (2d Cir. 1995)* (consumer did not show any person had access to false derogatory information), *cert. denied, 517 U.S. 1150, 116 S. Ct. 1452, 134 L. Ed. 2d 571 (1996)* ; *Guimond v. Trans Union Credit Info. Co., 45 F.3d 1329 (9th Cir. 1995)* (consumer must show damages flow from failure to follow reasonable procedures, and need not show damages arise from transmission of the report to third parties); *Gill v. Kostroff, 2000 U.S. Dist. LEXIS 1161* (M.D. Fla. Feb. 8, 2000) (consumer satisfied *Casella* standards by showing credit denied).

(n27)Footnote 27. *Cushman v. Trans Union Corp., 115 F.3d 220 (3d Cir. 1997)* ; *Thompson v. San Antonio Retail Merchs. Ass'n, 682 F.2d 509 (5th Cir. 1982)* .

(n28)Footnote 28. *Gray v. Experian Info. Solutions, Inc., 2001 U.S. Dist. LEXIS 5466* (D. Ariz. Mar. 21, 2001) (failure to provide notice of dispute to furnisher within five business days).

(n29)Footnote 29. One court has wrongly asserted that a plaintiff may not recover business damages, citing the fact that the FCRA is a consumer protection act. *Hussain v. Carteret Sav. Bank, F.A., 704 F. Supp. 567, 569 (D.N.J. 1989)* (dicta). *Contra Jones v. Credit Bureau of Huntington, Inc., 399 S.E.2d 694 (W. Va. 1990)* (evidence showed reduction in plaintiff's business). The Fifth Circuit has declined to rule whether publication and denial of credit is required to award damages for an inaccurate report. Instead, the court, over a dissent, imposed unreasonably high standards of proof of intangible damages to avoid a jury award. *Cousin v. Trans Union Corp., 246 F.3d 359 (5th Cir. 2001)* . *Alley v. First Am. Credco, 2007 U.S. Dist. LEXIS 4659* (N.D. Ill. Jan. 19, 2007) (summary judgment for defendant denied as plaintiff presented sufficient evidence that her mortgage loan application was denied due to defendant's allegedly inaccurate report); *Florence v. Trans Union, L.L.C., 2006 U.S. Dist. LEXIS 9986* (N.D. Ga. Feb. 24, 2006) (partial summary judgment for CRA granted based on un-rebutted affidavit of lender that consumer's credit score was not a factor in its selection of the interest rate offered).

(n30)Footnote 30. *Frost v. Experian, 1998 U.S. Dist. LEXIS 17276* (S.D.N.Y. Oct. 30, 1998) , *mot. to strike denied, summ. judgment granted, in part, summ. judgment denied, in part, 1999 U.S. Dist. LEXIS 6783* (S.D.N.Y. May 6, 1999) ; *see also Hughes v. Fidelity Bank, 709 F. Supp. 639 (E.D. Pa. 1989)* .

(n31)Footnote 31. More on proving FCRA actual damages is found at National Consumer Law Center, Fair Credit Reporting, § 11.10.2 (6th ed. 2006 and Supp.)

(n32)Footnote 32. *See, e.g, Wecht v. PG Publishing Co., 1999 Pa. Super. 28, 725 A.2d 788 (1999)* (plaintiff who claimed false light invasion of privacy must prove emotional distress damages through expert testimony).

(n33)Footnote 33. FCRA § 616(a)(2), *15 U.S.C. § 1681n(a)(2)*, Pub. L. No. 104-208, § 2412, *110 Stat. 3009* (Sept. 30, 1996). Punitive damages are also expressly allowed for the willful violation of obtaining a consumer report under false pretenses or knowingly without a permissible purpose.

(n34)Footnote 34. *Philbin v. Trans Union Corp., 101 F.3d 957 (3d Cir. 1996)* ; *Oppenheimer v. Guzco Guar. de Puerto Rico, Inc., 977 F. Supp. 549 (D.P.R. 1997)* .

(n35)Footnote 35. *E.g., Cushman v. Trans Union Corp., 920 F. Supp. 80 (E.D. Pa. 1996)* (in theft of identity case, jury could conclude that credit reporting agency acted willfully by failing to adequately reinvestigate). *See Zala v. Trans Union, L.L.C., 2001 U.S. Dist. LEXIS 549* (N.D. Tex. Jan. 17, 2001) (policy of refusal to deal with credit repair clinic could show malice; for agency to send out credit reports with proof in hand of the errors shows reckless disregard);

Bruce v. First U.S.A. Bank, 103 F. Supp. 2d 1135 (E.D. Mo. 2000) .

(n36)Footnote 36. *Lodise v. Lodise, 9 F.3d 108 (6th Cir. 1993)* ($1 nominal damages, but $500 punitive damages); *Matise v. Trans Union Corp., 1998 U.S. Dist. LEXIS 19775* (N.D. Tex. Nov. 30, 1998) ; *Washington v. CSC Credit Servs., Inc., 178 F.R.D. 95 (E.D. La. 1998)* , *rev'd, in part, vacated, in part, remanded, 199 F.3d 263 (5th Cir. 2000)* .

(n37)Footnote 37. FCRA § 616(a), *15 U.S.C. § 1681n(a)*, *as amended by* Pub. L. No. 104-208, § 2414, *110 Stat. 3009* (Sept. 30, 1996).

(n38)Footnote 38. *127 S. Ct. 2201 (2007)* .

(n39)Footnote 39. FCRA 616(a), *15 U.S.C. § 1681n(a)*, Pub. L. No. 104-208, § 2412, *110 Stat. 3009* (Sept. 30, 1996).

(n40)Footnote 40. A narrow exception provides for statutory damages for violations of the provision granting the FBI secret access to information for counterintelligence purposes.

(n41)Footnote 41. FCRA §§ 616(a)(3), 617(a)(2), *15 U.S.C. §§ 1681n(a)(3)*, *1681 o*(a)(2), Pub. L. No. 104-208, § 2412, *110 Stat. 3009* (Sept. 30, 1996). *See Sheffer v. Experian Info. Solutions, 290 F. Supp. 2d 538 (E.D. Pa. 2003)* . For a full discussion of attorney's fees and costs, see National Consumer Law Center, Fair Credit Reporting Act, § 11.14 (6th ed. 2006).

(n42)Footnote 42. *Waggoner v. Trans Union, LLC, 2003 U.S. Dist. LEXIS 21491* (N.D. Tex. Nov. 24, 2003) (awarding $6000 in costs to Trans Union).

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PART I Consumer Credit
CHAPTER 17 Credit Repair Agencies

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§ 17.syn Synopsis to Chapter 17: Credit Repair Agencies

§ 17.01 General

§ 17.02 Federal Repair Organizations Act

[1] Introduction

[2] Substantive Regulation of Credit Repair Organizations

[3] Private Remedies for CROA Violations

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[5] Relation to State Laws

[6] Federal and State Enforcement of the CROA

§ 17.03 State Credit Repair Laws

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PART I Consumer Credit
CHAPTER 17 Credit Repair Agencies

1-17 Consumer Credit Law Manual § 17.01

§ 17.01 General

Recent years have seen the spread of organizations promising to assist consumers improve poor credit ratings or credit records. Calling themselves "credit repair" or "credit service" agencies, "credit clinics" and the like, they are widely reported to be disreputable. n1 The Federal Trade Commission ("FTC") has charged many such organizations and their principals with misleading consumers by falsely and deceptively claiming the ability to improve credit records and by not honoring refund guarantees. n2

The agencies offer, usually for a substantial fee, to remove negative items from a credit history. Sometimes, they encourage consumers to establish a new credit identity by using an Employer Identification Number instead of their social security number, a seemingly fraudulent and possibly criminal solution to a bad situation. Generally, these agencies do nothing consumers cannot do for themselves free of charge. Indeed, consumers may be better positioned to deal with their credit histories by themselves, as some credit bureaus refuse to deal with credit repair agencies.

The FCRA allows credit reporting agencies to disregard disputes of items on consumers' credit reports that are generated by credit repair organizations. n3 The credit reporting agency must notify the consumer that it has deemed the request frivolous. n4 Creditors who furnish information to credit reporting agencies may also disregard disputes sent by credit repair organizations. n5

Other credit repair agencies do not promise to make the actual improvements to the consumer's credit report, but sell credit repair books, CD-ROMs, or other materials, often accompanied by a promise to provide personal credit repair advice to the consumer. There have been reports of creditors selling these services, or even requiring consumers to buy them, as a condition of an extension of credit.

A portion of the blame for the ready market for credit repair agencies lies squarely with the credit reporting industry, which continues to hold a very poor record with regard to the quality of its product. With a huge percentage of all consumer reports flawed by error, the credit repair agencies have learned to turn a chaotic reporting industry to their advantage. Credit repair agencies are actually successful in having negative (but accurate) information removed from consumers' files. Already inundated with legitimate disputes, the credit reporting agencies are ill-equipped to handle the barrage of additional disputes generated by credit repair agencies. All too often the easiest alternative for the reporting agency is to delete the disputed information. Thus, the rash of inaccurate and unreliable credit reporting generates more

disputes, reporting agencies find themselves less capable of responding properly, and credit reports become more inaccurate and unreliable, all to the detriment of the entire consumer credit system.

Tools to combat the credit repair agencies include the Federal Credit Repair Organizations Act ("CROA"), state credit repair acts, the FTC's Telemarketing Sales Rule (limited to credit repair services that are sold through telephone calls), and state unfair and deceptive practices acts. n6 Credit repair laws do not impinge on First Amendment rights. n7

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionUnfair & Deceptive Credit Practices

FOOTNOTES:
(n1)Footnote 1. For a discussion of credit repair organizations, see Nehf, *Legislative Framework for Reducing Fraud in the Credit Repair Industry*, *70 N.C. L. Rev. 781 (1992)*.

(n2)Footnote 2. See National Consumer Law Center, Fair Credit Reporting Act, § App. K (6th ed. 2006 and supp.), for a list of consent orders and other enforcement actions against credit repair agencies and *id*. at App. H.5, for an example of an enforcement action against a credit repair clinic. *See also* Ch. 16 *supra*.

(n3)Footnote 3. *15 U.S.C. § 1681i(a)(3)*; FTC Official Staff Commentary § 611 item 11.

(n4)Footnote 4. *15 U.S.C. § 1681i(a)(3)(B)*.

(n5)Footnote 5. *15 U.S.C. § 623*(a)(8)(G), *added by* Pub. L. No. 108-159, § 312 (2003).

(n6)Footnote 6. More detail on the Federal Trade Commission [hereinafter FTC] Rule and the state unfair and deceptive practices acts can be found in Chs. 4 and 14 *supra*.

(n7)Footnote 7. *In re National Credit Mgmt. Group, L.L.C., 21 F. Supp. 2d 424 (D.N.J. 1998)* .

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PART I Consumer Credit
CHAPTER 17 Credit Repair Agencies

1-17 Consumer Credit Law Manual § 17.02

§ 17.02 Federal Repair Organizations Act

[1] Introduction

The CROA n1 imposes stringent limitations on the activities of credit repair agencies. Enacted as part of the 1997 Omnibus Appropriations Act, the CROA seeks to provide consumers "with the information necessary to make an informed decision regarding the purchase of [credit repair] services" and "to protect the public from unfair or deceptive advertising and business practices by credit repair organizations." n2

[2] Substantive Regulation of Credit Repair Organizations

The CROA contains an exceptionally broad definition of credit repair organizations subject to its requirements. n3 A credit repair organization may be any person who performs or offers to perform any service, for a fee or other valuable consideration, for the purpose of improving a consumer's credit record, credit history, or credit rating. The definition includes individuals engaging in credit repair activities. n4 An organization that merely advises or assists a consumer in credit repair is covered even if all actual credit repair steps are undertaken by the consumer. n5 The definition also requires that the organization use an instrumentality of interstate commerce or the mail. n6 It also does not apply unless the organization uses any instrumentality of interstate commerce, such as mail or telephone, an unlikely event.

The definition includes an element of intent. To be a credit repair organization, one must act for the "express or implied purpose" of improving a consumer's credit record or provide advice and assistance towards that end. The application of the Act to lawyers may prove particularly troubling. Nothing in the Act explicitly exempts lawyers who, for example, advertise and solicit customers for the express purpose of "fixing" or improving their credit reports. n7

Some retailers, lenders, and professionals advertise and offer services to consumers with bad credit histories and promise to improve the consumer's credit record. For example, a growing segment of the used car market targets customers perceived as having bad credit and promises not only to find them financing but also, in the process, to help them reestablish credit or improve their credit records. n8 Whether car dealers or other retailers are included within a credit repair statute depends on its language. n9 For instance, Ohio courts were divided on coverage of used car dealers who advertised they could obtain financing for those with bad credit. The Ohio Court of Appeals found the state credit repair act did not apply unless money or its equivalent was paid specifically for the credit services. n10 In contrast, the language of the Illinois law was held broad enough to include retailers who helped consumers get credit. n11

An entity is a credit repair organization even if its services are offered for the implied rather than the express purpose of credit repair. n12 Promising that accepting an offered credit card will improve the consumer's credit rating, n13 or that debt consolidation plans will "help repair bad credit negatives on your credit report" n14 may be sufficient to establish coverage. Using terms such as "establish," "rebuild," "raise," and "improve" to describe the effect of the organization's services on a consumer's credit rating is sufficient, even if some of these representations refer to free products or services. n15 A contract that implicitly promises to attempt to improve the consumer's credit record, history, or rating falls within the definition even if it uses phrases from the FCRA and other consumer protection statutes to describe the services that will be performed and even if it states that the contracting party is not a credit repair organization. n16

A credit repair organization may provide no services until three days after a written and dated contract has been signed. n17 The contract must state the terms and conditions of payment, including the total of all payments due; "a full and detailed description of the services to be performed," including "all guarantees of performance," an estimate of the date by which performance will be completed, and the time necessary to perform the services; and a conspicuous, bold face disclosure of a three-day right to cancel placed "in immediate proximity" to the consumer's signature. n18 The consumer must also be provided in duplicate with a form Notice of Cancellation. n19 The credit repair organization must also provide on a separate document a required disclosure that details consumer rights to self-help concerning their credit reports under the Fair Credit Reporting Act ("FCRA") and the consumer's rights under the CROA. n20 Consumers must receive a copy of the contract and any other document that they sign. n21

Cancellation may be effectuated by sending the signed and dated Notice of Cancellation form or any other written notice to the credit repair organization. n22 The right to cancel extends until midnight of the third business day after execution of the contract or after the contract becomes enforceable. n23 Since a contract not meeting the requirements of the CROA is void and unenforceable, n24 the unqualified right to cancel is effectively extended until three days after the credit repair organization complies with the CROA. No credit repair organization may charge or receive payment for services before the services are "fully performed." n25

The CROA lists a number of prohibited practices. n26 A credit repair organization cannot make any statements which are false or misleading (or which upon the exercise of reasonable care should be known to be false or misleading), provide any misleading advice to consumers, or attempt to or actually engage in any other form of deception directed at the consumer, a credit reporting agency, or any person "to whom the consumer has applied or is applying for an extension of credit." n27 Misrepresenting that an organization is a non-profit is a violation. n28 The organizations cannot make any statement to encourage consumers to alter their identification. n29

Any waiver of any consumer protection under the CROA is void and may not be enforced by any court or other person, and the attempt to obtain the waiver is a violation of the CROA. n30 The CROA also prohibits credit repair organizations from charging or receiving payment for their services until the service is fully performed. n31

[3] Private Remedies for CROA Violations

Contracts not in compliance with the CROA are treated as void and may not be enforced by any court or person. n32 In addition, individual consumers or a class of consumers can recover for any violation of the CROA the sum of:

- The greater of actual damages or the amount paid to the organization;
- Such additional punitive damages as the court may allow;
- Costs and reasonable attorney's fees. n33

In awarding punitive damages, courts will use as factors the frequency, persistence, and nature of the noncompliance,

the extent to which the violation was intentional, and, in a class action, the number of consumers adversely affected. n34 The Act allows the court to consider "other relevant factors" as well, n35 and one court has allowed discovery of a defendant's net worth as relevant to punitive damages. n36

Unlike other titles of the Consumer Credit Protection Act, which provide for enforcement through private rights of action, n37 the CROA does not contain a specific grant of jurisdiction in the federal district courts. Whether this omission will deny federal courts jurisdiction to hear private claims or whether jurisdiction is created under the general federal question statute n38 remains to be seen. As is the case with regard to the other titles, the CROA is silent as to the right to trial by jury. Consistent with the *Seventh Amendment* and the case law under these related statutes, a jury should be available. n39 The CROA allows attorney's fees for a prevailing plaintiff, n40 but contains no allowance for attorney's fees to a prevailing defendant. In addition, since consumers seek the services of a credit repair organization only when they are in dire financial straits, an arbitration clause that imposes high up-front costs on the consumer is particularly vulnerable to an unconscionability challenge. n41

The statute of limitations for an action under the CROA is five years from the occurrence of the violation. n42 Where the violation relates to the organization's material and willful failure to disclose, the five years begins to run from when the consumer discovers the misrepresentation. n43 Other entities that are directly or indirectly involved in deception or other violations of the Act--such as assignees of a credit repair organization's contracts, related corporations involved in a deceptive credit repair scheme, n44 the owner or employees of the credit repair organization, n45 creditors who agree to accept referrals from the credit repair organization, n46 or persons who assist in concealment of a credit applicant's identification or in misrepresentation of an applicant's creditworthiness--may be liable. In addition, a court may apply the state "alter ego" or veil-piercing doctrine, tailored to CROA, to hold related entities liable for the acts of a credit repair organization. n47

The Act specifically contemplates class actions. It sets forth a special rule for determining the amount of punitive damages in a class action: the aggregate amount the court allows for each named plaintiff, plus the aggregate amount it allows for each other class member without regard to any minimum individual recovery. n48 Class actions must meet the usual requirements of *Rule 23 of the Federal Rules of Civil Procedure*. n49

[4] Does an Arbitration Clause Apply to CROA Claims?

Credit repair organizations may include clauses in their consumer contracts that require any dispute to be resolved by binding arbitration, thus attempting to keep consumer litigation out of the courts.

CROA states that any contract for services which does not comply with the Act is void, and this might lead to an argument that the arbitration clause is void as well. n50 But the U.S. Supreme Court, in *Buckeye Check Cashing, Inc. v. Cardegna*, established a bright-line test as to whether a court or an arbitrator decides if an arbitration agreement is enforceable. n51 The arbitration clause is treated as a separate agreement. A court decides a challenge directed to that separate agreement - such as that it is unconscionable or misrepresented. An arbitrator decides challenges to the rest of the contract. Thus a claim that a credit repair contract is void for violating CROA goes to the contract as a whole, and not specifically to the arbitration clause. Therefore an arbitrator, not the court, decides if CROA has been violated, making the contract void.

If the consumer instead takes advantage of the CROA right to cancel the contract by sending timely notice to the repair organization, however, the result should be different. If the defendant does not dispute the effectiveness of the cancellation (i.e., does not dispute that it received a timely cancellation notice), then the contract and with it the arbitration clause are cancelled. n52 Any subsequent litigation can proceed in court.

Of special significance for CROA cases, a federal decision in *Alexander v. U.S. Credit Management, Inc.* holds that a mandatory arbitration requirement conflicts with congressional intent in enacting CROA. n53 CROA has an unusually

specific anti-waiver clause: "Any waiver by any consumer of any protection provided by or any right of the consumer under this subchapter shall be treated as void; and may not be enforced by any Federal or State court of any other person." n54 CROA also states: "Any attempt by any person to obtain a waiver from any consumer of any protection provided by or any right of the consumer under this subchapter shall be treated as a violation of this subchapter." n55 *Alexander* thus holds that it is the arbitration clause that is void as an impermissible waiver, not the whole contract. Since this challenge goes to the arbitration clause and not to the contract as a whole, *Alexander* is consistent with the U.S. Supreme Court ruling in *Cardegna* that a court and not an arbitrator determines the challenge to the arbitration clause specifically.

Alexander looks to CROA's explicit language requiring disclosure to the consumer of the "right to sue a credit repair organization that violates the Credit Repair Organization Act." n56 It finds the right to sue in court (not some other proceeding) specifically protected by the Act. An arbitration clause would waive this right, and is thus unenforceable. n57 *Alexander* distinguishes CROA from other statutes both in the explicit nature of the right to sue and the detailed anti-waiver provision, and also by examining CROA's legislative history in detail. n58

Moreover, the anti-waiver provision is particularly applicable where the arbitration clause either explicitly or by reference to the rules of an arbitration service provider limits the consumer's right to punitive damages, attorney fees, or a class claim, all of which are rights explicitly granted by CROA. Although some courts will only strike an arbitration clause where it limits the consumer's substantive rights, *Alexander* states that it is not necessary to determine if punitive damages, attorney fees, or class claims are substantive CROA rights, because the anti-waiver language applies to any waiver. n59 Since *Alexander*, another district court has agreed with its reasoning and held that arbitration clauses are unenforceable as to CROA claims. n60 However, the Third Circuit has held such clauses to be enforceable. n61 The court took a strained and very narrow interpretation of the anti-waiver clause and treated CROA's references to class actions and the consumer's right to "sue" as mere surplusage. In addition, a federal district court judge in Michigan has issued two decisions finding such clauses enforceable, n62 and one other district court has issued a similar ruling. n63

Of course, other grounds to challenge an arbitration clause also apply to CROA cases as well. For example, since consumers seek the services of a credit repair organization only when they are in dire financial straits, an arbitration clause that imposes high up-front costs on the consumer is particularly vulnerable to an unconscionability challenge. n64 A detailed analysis of unconscionability and other challenges to arbitration clauses is found at NCLC's *Consumer Arbitration Agreements*. n65

[5] Relation to State Laws

The CROA does not preempt state credit repair statutes, except to the extent to which the two are inconsistent, and then only to the extent of such inconsistency. n66 Determination of any such inconsistency and the effect of this provision should proceed under the same principles which are employed to test the identical standard under the FCRA. The advocate can use state unfair and deceptive acts and practices ("UDAP") and consumer law remedies in addition to statutory remedies. n67

[6] Federal and State Enforcement of the CROA

The FTC enforces the CROA under the FTC Act, whether or not the organization comes under the jurisdictional tests for the FTC Act. n68 In one case against a lawyer, the FTC obtained equitable disgorgement of $1.3 million for numerous violations. n69 In addition, state enforcement officials can bring actions under the CROA to enjoin violations, to act on behalf of its residents to recover damages that the residents could have recovered in private actions, and to recover its own costs and attorney's fees. n70

The joint enforcement by the FTC and state enforcement officials continues cooperation that already existed with respect to FTC Telemarketing Rule enforcement. For example, in 1996, as part of "Operation Payback," the FTC and

ten state attorney general offices filed fifteen fraud cases against credit repair clinics. n71 Likewise, federal and state officials teamed up recently to stop a company from misrepresenting the nature of its credit repair business. n72 Under New Jersey law, the company engaged in deceptive representation and omissions, as well as fraudulent and unconscionable commercial practices.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionUnfair & Deceptive Credit Practices

FOOTNOTES:
(n1)Footnote 1. *15 U.S.C. §§ 1679-1679j*, Pub. L. No. 104-208, *110 Stat. 3009* (Sept. 30, 1996). The Credit Repair Organizations Act [hereinafter CROA] is reprinted in Vol. 1A *infra*.

(n2)Footnote 2. *15 U.S.C. § 1679(b)*.

(n3)Footnote 3. *15 U.S.C. § 1679a(3)*.

(n4)Footnote 4. *Baker v. Family Credit Counseling Corp., 440 F. Supp. 2d 392 (E.D. Pa. 2006)* ; *Polacsek v. Debticated Consumer Counseling, Inc., 413 F. Supp. 2d 539, 547 n.4 (D. Md. 2005)* (individual's control of credit repair organization and participation in or acquiescence in CROA violations sufficient for liability); *Limpert v. Cambridge Credit Counseling Corp., 328 F. Supp. 2d 360 (E.D.N.Y. 2004)* (individuals may be credit repair organizations). *But see Asmar v. Benchmark Literacy Group, Inc., 2005 U.S. Dist. LEXIS 23197* (E.D. Mich. Oct. 11, 2005) (corporate officers not credit repair organizations where they did not personally perform credit repair activities but only made decisions, formulated policies, and directed the companies). *See, e.g., Cortese v. Edge Solutions, Inc., 2007 U.S. Dist. LEXIS 70687* (E.D.N.Y. Sept. 24, 2007) (denying defendant's motion for summary judgment when debt settlement company provided credit repair services to clients who had paid at least $600); *Banks v. Capital Credit Alliance, Inc., 2005 U.S. Dist. LEXIS 13614* (N.D. Ill. June 28, 2005) (denial of motion to dismiss) (requirement of additional consideration may be met when defendants withdrew $200 fee from plaintiff's bank account in connection with offer of credit card that would allegedly improve plaintiff's credit rating).

(n5)Footnote 5. *15 U.S.C. § 1679a(3)(A)(ii)*.

(n6)Footnote 6. *Rannis v. Fair Credit Lawyers, Inc., 489 F. Supp. 2d 1110 (C.D. Cal. 2007)* (use of intrastate mail is sufficient); *Hillis v. Equifax Consumer Servs., Inc., 237 F.R.D. 491, 511 (N.D. Ga. 2006)* (use of Internet is sufficient).

(n7)Footnote 7. *See, e.g., State of Tennessee v. Lexington Law Firms, 1997 U.S. Dist. LEXIS 7403* (M.D. Tenn. May 14, 1997) (defendant law firm, seeking to establish exemption from the FTC Telemarketing Rule, claimed to be governed by the CROA).

(n8)Footnote 8. *See, e.g.,* Hall v. Jack Walker Pontiac, Toyota, Inc., Clearinghouse No. 52,143 (Ohio Comm. Pl. Mar. 15, 1999) (relying in part on legislative history of the federal statute); Sannes v. Jeff Wyler Chevrolet, Inc., Clearinghouse No. 52,144 (Ohio Comm. Pl. Mar. 15, 1999).

(n9)Footnote 9. See *Wojcik v. Courtesy Auto Sales, 2002 U.S. Dist. LEXIS 22731* (D. Neb. Nov. 25, 2002) (must be additional fee for credit repair service for auto dealer to be credit repair organization). *But cf. Wojcik v. Courtesy Auto Sales, 2002 U.S. Dist. LEXIS 22731* (D. Neb. Nov. 25, 2002) (auto dealer not credit repair organization where plaintiffs were not lured in by any credit repair advertising).

(n10)Footnote 10. *Snook v. Ford Motor Co., 142 Ohio App. 3d 212, 755 N.E.2d 380 (2001)* , *discretionary appeal*

not allowed, 93 Ohio St. 3d 1416, 754 N.E.2d 262 (2001) .

(n11)Footnote 11. *Midstate Siding & Window Co. v. Rogers, 731 N.E.2d 765 (Ill. 2000)* (unpublished), *granting appeal of 309 Ill. App. 3d 610, 722 N.E.2d 1156 (1999)* (modified opinion filed after denial of rehearing Feb. 1, 2000).

(n12)Footnote 12. *15 U.S.C. § 1679a(3)(A)* ("for the express or implied purpose"). *See Helms v. ConsumerInfo.com, Inc., 436 F. Supp. 2d 1220, 1232 (N.D. Ala. 2005) . See also Hillis v. Equifax Consumer Servs., Inc., 237 F.R.D. 491, 517 (N.D. Ga. 2006)* (Act requires that "the" purpose, not "a" purpose, of the service be credit repair, so does not cover services when credit repair purpose is merely ancillary to some other purpose).

(n13)Footnote 13. *Banks v. Capital Credit Alliance, Inc., 2005 U.S. Dist. LEXIS 13614* (N.D. Ill. June 28, 2005) .

(n14)Footnote 14. *Baker v. Family Credit Counseling Corp., 440 F. Supp. 2d 392 (E.D. Pa. 2006)* .

(n15)Footnote 15. *Helms v. ConsumerInfo.com, Inc., 436 F. Supp. 2d 1220, 1232 (N.D. Ala. 2005) . See Zimmerman v. Cambridge Credit Counseling Corp., 529 F. Supp. 2d 254 (D. Mass. 2008)* ; *Limpert v. Cambridge Credit Counseling Corp., 328 F. Supp. 2d 360, 364 (E.D.N.Y. 2004)* (distinguishing legitimate credit counseling that seeks to gradually improve clients' credit records by encouraging creditworthy behavior going forward; CROA may apply if credit counseling agency represented that it would re-establish clients' spotty credit reports). *See also Reynolds v. Credit Solutions, Inc., 541 F. Supp. 2d 1248 (N.D. Ala. 2008)* (debt settlement company that claimed its efforts would improve consumer's credit score is credit repair organization).

(n16)Footnote 16. *Rannis v. Fair Credit Lawyers, Inc., 489 F. Supp. 2d 1110 (C.D. Cal. 2007)* .

(n17)Footnote 17. *15 U.S.C. § 1679d(a)(2).*

(n18)Footnote 18. *15 U.S.C. § 1679d(b).*

(n19)Footnote 19. *15 U.S.C. § 1679e.*

(n20)Footnote 20. *15 U.S.C. § 1679c.*

(n21)Footnote 21. *15 U.S.C. § 1679e(c).*

(n22)Footnote 22. *15 U.S.C. § 1679e(b).*

(n23)Footnote 23. *15 U.S.C. § 1679e(a).*

(n24)Footnote 24. *15 U.S.C. § 1679f(c).*

(n25)Footnote 25. *15 U.S.C. § 1679b(b). See In re Zuniga, 332 B.R. 760, 788 (Bankr. S.D. Tex. 2005)* (finding violation).

(n26)Footnote 26. *15 U.S.C. § 1679b.*

(n27)Footnote 27. *15 U.S.C. § 1679b(a). See* FTC v. IRC Servs. (N.D. Ill. Aug. 11, 2003) (consent order against credit repair organization that made untrue and misleading statements to credit reporting agencies), *available at* www.ftc.gov/opa/2003/08/nationwide.htm.

(n28)Footnote 28. *Zimmerman v. Cambridge Credit Counseling Corp., 529 F. Supp. 2d 254, 279-280 (D. Mass. 2008)* .

(n29)Footnote 29. *15 U.S.C. § 1679b(a)(2).*

(N30)Footnote 30. *15 U.S.C. § 1679f.*

(n31)Footnote 31. *15 U.S.C. § 1679b(b). See Rannis v. Fair Credit Lawyers, Inc., 489 F. Supp. 2d 1110 (C.D. Cal. 2007)* (finding violation when some of the services were performed before and some after consumer paid).

(n32)Footnote 32. *15 U.S.C. § 1679f(c).*

(n33)Footnote 33. *15 U.S.C. § 1679g(a).*

(n34)Footnote 34. *15 U.S.C. § 1679g(b).*

(n35)Footnote 35. *Id.*

(n36)Footnote 36. *Iosello v. Lawrence, 2004 U.S. Dist. LEXIS 9768* (N.D. Ill. May 26, 2004) .

(n37)Footnote 37. The Fair Credit Reporting Act, as well as the Equal Credit Opportunity Act, *15 U.S.C. §§ 1691-1691f*, the Truth in Lending Act, *15 U.S.C. §§ 1601-1167e*, the Fair Debt Collection Practices Act, *15 U.S.C. §§ 1692-1692 o*, and the Electronic Fund Transfer Act, *15 U.S.C. §§ 1693-1693r*, all provide for private rights of action.

(n38)Footnote 38. *28 U.S.C. § 1331.*

(n39)Footnote 39. *See Sibley v. Fulton DeKalb Collection Serv., 677 F.2d 830 (11th Cir. 1982)* ; *Barber v. Kimbrell's Inc., 577 F.2d 216 (4th Cir. 1978)* .

(n40)Footnote 40. *15 U.S.C. § 1679g(a)(3).*

(n41)Footnote 41. *See Plattner v. Edge Solutions, Inc., 2003 U.S. Dist. LEXIS 25596* (N.D. Ill. Dec. 1, 2003) (finding arbitration clause in credit repair contract unconscionable). *See generally* National Consumer Law Center, Consumer Arbitration Agreements Ch. 4 (3d ed. 2003).

(n42)Footnote 42. *15 U.S.C. § 1679i.*

(n43)Footnote 43. *15 U.S.C. § 1679i.*

(n44)Footnote 44. *Zimmerman v. Cambridge Credit Counseling Corp., 529 F. Supp. 2d 254, 271, 272 (D. Mass. 2008)* (holding for-profit companies liable under CROA when they participated in a deceptive credit counseling scheme with other companies); *Baker v. Family Credit Counseling Corp., 440 F. Supp. 2d 392, 402-404 (E.D. Pa. 2006)* .

(n45)Footnote 45. *Zimmerman v. Cambridge Credit Counseling Corp., 529 F. Supp. 2d 254, 271, 272 (D. Mass. 2008)* (holding company owner liable); *Polacsek v. Debticated Consumer Counseling, Inc., 413 F. Supp. 2d 539, 547 n.4 (D. Md. 2005)* (individual's control of credit repair organization and participation in or acquiescence in CROA violations sufficient for liability). *But see Asmar v. Benchmark Literacy Group, Inc., 2005 U.S. Dist. LEXIS 23197* (E.D. Mich. Oct. 11, 2005) (corporate officers not liable under CROA and not credit repair organizations when they did not personally perform credit repair activities but only made decisions, formulated policies, and directed the companies).

(n46)Footnote 46. *Vance v. National Benefit Ass'n, 1999 U.S. Dist. LEXIS 13846* (N.D. Ill. Aug. 26, 1999) .

(n47)Footnote 47. *Zimmerman v. Cambridge Credit Counseling Corp., 529 F. Supp. 2d 254, 272 (D. Mass. 2008)* .

(n48)Footnote 48. *15 U.S.C. § 1679g(2)(B)(ii). See also 15 U.S.C. § 1679g(b)(4)* (specifically referring to class actions in listing the factors for determining the amount of punitive damages).

(n49)Footnote 49. *Iosello v. Lawrence, 2004 U.S. Dist. LEXIS 9768* (N.D. Ill. May 26, 2004) (denying class

certification because of insufficient evidence of numerosity and failure to narrow class to those who entered into same contract or viewed same website). *See also Helms v. ConsumerInfo.com, Inc., 236 F.R.D. 561 (N.D. Ala. 2005)* denying class certification because classwide statutory damages would be overwhelming, even though all requirements of Rule 23 were met).

(n50)Footnote 50. *See Cortese v. Edge Solutions, Inc., 2005 U.S. Dist. LEXIS 43544* (E.D.N.Y. July 28, 2005) .

(n51)Footnote 51. *Buckeye Check Cashing, Inc v. Cardegna, 126 S. Ct. 1204, 163 L. Ed. 2d 1038 (2006) 546 U.S. 440* .

(n52)Footnote 52. *See Chapman v. Mortgage One Corp., 359 F. Supp. 2d 831* (E.D. Mo. Mar. 8, 2005) . *See also Large v. Conseco Fin. Servicing Corp., 292 F.3d 49, 55 (1st Cir. 2002)* (distinguishing cases where cancellation not in dispute from those where there is a dispute).

(n53)Footnote 53. *Alexander v. U.S. Credit Mgmt., Inc., 384 F. Supp. 2d 1003 (N.D. Tex. 2005) . But see Rex v. CSA-Credit Solutions of Am., Inc., 507 F. Supp. 2d 788 (W.D. Mich. 2007) . But cf. Vertucci v. Orvis, 2006 U.S. Dist. LEXIS 39320* (D. Conn. May 30, 2006) (requiring arbitration of CROA claim, but not addressing whether arbitration clause conflicted with CROA).

(n54)Footnote 54. *15 U.S.C. § 1679f(a).*

(n55)Footnote 55. *15 U.S.C. § 1679f(b).*

(n56)Footnote 56. *15 U.S.C. § 1679c(a).*

(n57)Footnote 57. *Alexander v. U.S. Credit Mgmt., Inc., 384 F. Supp. 2d 1003 (N.D. Tex. 2005)*

(n58)Footnote 58. *Id.*

(n59)Footnote 59. *Alexander v. U.S. Credit Mgmt., Inc., 384 F. Supp. 2d 1003 (N.D. Tex. 2005) .*

(n60)Footnote 60. *Reynolds v. Credit Solutions, Inc., 541 F. Supp. 2d 1248 (N.D. Ala. 2008) .*

(n61)Footnote 61. *Gay v. CreditInform, 511 F.3d 369 (3d Cir. 2007) .*

(n62)Footnote 62. *Vegter v. Forecast Fin. Corp., 2007 U.S. Dist. LEXIS 85653* (W.D. Mich. Nov. 20, 2007) (finding arbitration clause valid as to CROA claims, except for unconscionable distant forum requirement); *Rex v. CSA-Credit Solutions of Am., Inc., 507 F. Supp. 2d 788 (W.D. Mich. 2007) .*

(n63)Footnote 63. *Schreiner v. Credit Advisors, Inc., 2007 U.S. Dist. LEXIS 74014* (D. Neb. Oct. 2, 2007) (magistrate's decision). *Cf. Vertucci v. Orvis, 2006 U.S. Dist. LEXIS 39320* (D. Conn. May 30, 2006) (requiring arbitration of CROA claim, but not addressing whether arbitration clause conflicted with CROA).

(n64)Footnote 64. *See Plattner v. Edge Solutions Inc., 2003 U.S. Dist. LEXIS 25596* (N.D. Ill. Dec. 1, 2003) (finding arbitration clause in credit repair contract unconscionable).

(n65)Footnote 65. (4th ed. 2004 and Supp.).

(n66)Footnote 66. *15 U.S.C. § 1679j.*

(n67)Footnote 67. *In re National Credit Mgmt. Group, L.L.C., 21 F. Supp. 2d 424 (D.N.J. 1998) . See also Rannis v. Fair Credit Lawyers, Inc., 489 F. Supp. 2d 1110 (C.D. Cal. 2007) . See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices § 3.2.7 (7th ed. 2008 and supp.).

(n68)Footnote 68. *15 U.S.C. § 1679h(a), (b).*

(n69)Footnote 69. *FTC v. Gill, 71 F. Supp. 2d 1030 (C.D. Cal. 1999)* , *mot. granted, 183 F. Supp. 2d 1171* (C.D. Cal.) , *aff'd, 265 F.3d 944 (9th Cir. 2001)* . The case describes a litany of activities fully justifying the need for the CROA.

(n70)Footnote 70. *15 U.S.C. § 1679h(c).*

(n71)Footnote 71. *See 66 Banking Rep. (BNA) 655* (Apr. 15, 1996).

(n72)Footnote 72. *In re National Credit Mgmt. Group, L.L.C., 21 F. Supp. 2d 424 (D.N.J. 1998)* .

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PART I Consumer Credit
CHAPTER 17 Credit Repair Agencies

1-17 Consumer Credit Law Manual § 17.03

§ 17.03 State Credit Repair Laws

Many states have passed statutes to address problems that have arisen with credit repair organizations. n1 While often similar to the CROA, the differences can be important and should be carefully considered. These laws typically require written contracts that describe specific services to be provided, the right of rescission of contract, the requirement of bond posting with the state, a description of rights under the FCRA, and remedies under state deceptive practices statutes for violations. These state laws have been applied to credit card issuers, n2 retailers "who provide credit assistance in the course of the transaction for the sale of goods," n3 and loan brokers. n4 The requirement that a fee be paid to a repair organization has been fulfilled when credit has been just a part of the transaction for which the consumer pays, even if no separate fee or payment is identifiable. n5 Most credit repair abuses should also be state UDAP violations, and the CROA explicitly states that state laws are not preempted.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingGeneral OverviewBanking LawConsumer ProtectionState LawGeneral OverviewBanking LawConsumer ProtectionState LawRemedies

FOOTNOTES:
(n1)Footnote 1. See National Consumer Law Center, Fair Credit Reporting Act, § App. H (6th ed. 2006 and Supp.), for a summary of state credit repair statutes.

(n2)Footnote 2. *Vance v. National Benefit Ass'n, 1999 U.S. Dist. LEXIS 13846* (N.D. Ill. Aug. 26, 1999) .

(n3)Footnote 3. Hall v. Jack Walker Pontiac, Toyota, Inc., Clearinghouse No. 52,143 (Ohio Comm. Pl. Mar. 15, 1999) (slip op. at 18) (dicta). *Premium Air, Inc. v. Luchinski, 303 Wis. 2d 748, 735 N.W.2d 194, 2007 WI App 162 (Wis. App. 2007)* (state credit repair law covered a company that routinely arranged credit for potential customers; money the company received for its product via the financing it arranged satisfied the requirement that its services be "in return for the payment of money or for other valuable consideration.").

(n4)Footnote 4. *Arnold v. United Cos. Leasing Corp., 204 W. Va. 229, 511 S.E.2d 854 (1998) . See also Lewis v.*

Delta Funding Corp. (In re Lewis), 290 B.R. 541 (Bankr. E.D. Pa. 2003) (mortgage loan broker met Pennsylvania's definition of credit services organization).

(n5)Footnote 5. Hall v. Jack Walker Pontiac, Toyota, Inc., Clearinghouse No. 52,143 (Ohio Comm. Pl. Mar. 15, 1999); Sannes v. Jeff Wyler Chevrolet, Inc., Clearinghouse No. 52,144 (Ohio Comm. Pl. Mar. 15, 1999).

See also Oslan v. Collection Bureau, 206 F.R.D. 109 (E.D. Pa. 2001) (debt collector is covered by federal CROA only if receives or solicits payment beyond repayment of debt).

But see Cannon v. William Chevrolet/Geo, Inc., 341 Ill. App. 3d 674, 276 Ill. Dec. 593, 794 N.E.2d 843 (2003) (finding car dealership not to be a credit repair organization even though it required consumer to pay a 4.5 percent higher interest rate than bank required).

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PART I Consumer Credit
CHAPTER 17 Credit Repair Agencies

1-17 Consumer Credit Law Manual § 17.04

§ 17.04 Federal Telemarketing Statutes and Regulations

In 1995, the FTC adopted its Telemarketing Rule ("the Rule"), n1 which applies to credit repair services that are marketed through at least one interstate telephone call without a face-to-face meeting. n2 The Rule was extensively amended effective March 31, 2003, n3 but the amendments do not have a significant impact on the restrictions that apply to credit repair organizations. It specifically covers cases where the consumer makes the first call to the credit repair organization in response to an advertisement or direct mail solicitation, including those transmitted by fax, e-mail, or similar methods. n4 It does not, however, cover 900-number calls to credit repair clinics because these are regulated by different statutes and rules. n5

One area in which the Telemarketing Rule provides greater consumer protection than the CROA is payment for services. The CROA prohibits credit repair organizations from charging or receiving payment for their services until the service is fully performed. n6 The FTC's Telemarketing Rule, on the other hand, prohibits a credit repair clinic from requesting or receiving any payment for its services until it has provided the consumer with a credit report, issued at least six months after the credit repair services were provided, that demonstrates that the promised results have been achieved. n7 In 1996, the FTC, in cooperation with state attorneys general, announced a crackdown on fraudulent credit repair clinics and began filing suits to enforce the prohibition against advance payment. n8 Other FTC actions have been taken against companies that deceptively represent that they can delete accurate information from a consumer's credit record. n9

As credit repair clinics have difficulty achieving an improvement in the consumer's credit record that lasts six months, the FTC Rule comes close to outlawing credit repair organizations to the extent that they fall within its coverage. Because of the Rule's limited coverage, however, the CROA should prove to be more useful. The CROA offers strong private remedies, while the FTC Rule provides no direct private remedy. The restrictions imposed by the CROA strike at the heart of the tactics used by credit repair agencies, and the prohibition on receiving payment before services are fully performed threatens to eliminate the financial imbalance that has made the organizations profitable. Perhaps most important is that credit reporting agencies, which have both the incentive and resources to act, have standing to enforce the CROA and can be expected to use it aggressively to police, if not abolish, credit repair agencies.

The 2003 amendments to the Rule established a nationwide do-not-call list. n10 Consumers who have received telephone solicitations from credit repair organizations should consider adding their names to the do-not-call list. n11

Consumers who have received telephone solicitations from credit repair organizations should consider adding their names to the do-not-call list.

The Federal Telephone Consumer Protection Act of 1991 n12 provides certain protections against telemarketing calls. It covers both interstate and intrastate calls. n13 FCC regulations under this statute prohibit telephone solicitations before 8:00 a.m. or after 9:00 p.m., local time. n14

The statute and regulations also prohibit:

- The use of a telephone fax machine, a computer, or any other device to send an unsolicited advertisement to a telephone fax machine; n15

- Placing calls by means of an automatic dialing system or using an artificial or pre-recorded voice to emergency telephone lines, to patient or guest rooms at nursing homes, hospitals, and similar health facilities, or to pagers, cellular phones, or other services in which the called party is charged for the call; n16

- Placing a call that uses an artificial or pre-recorded voice to a residence, unless the caller is a tax-exempt nonprofit organization, the call is for emergency purposes, the caller has an established business relationship with the called party, the call is for non-commercial purposes, or the call is for commercial purposes but does not include any unsolicited advertisements. n17

The Act explicitly grants consumers the right to bring suit for violations in state court "if otherwise permitted by the laws or rules of court" of the state. n18 Several federal courts have held that federal courts do not have jurisdiction over consumer suits to enforce the statute. n19 However, one federal court has reached the opposite result, holding that federal courts do have federal question jurisdiction. n20

The consumer may seek an injunction or the greater of actual monetary loss or up to $500 for each violation. n21 The consumer need not prove actual damages in order to recover the statutory damages. n22 The court may treble the damages if it finds that the defendant willfully or knowingly violated this section. n23 Courts have differed about whether class certification is appropriate for unsolicited fax claims. n24 The federal statute does not provide for an attorney fee award, but the consumer may be able to assert a parallel claim under the state UDAP statute and win fees under that statute.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawConsumer ProtectionGeneral OverviewBanking LawConsumer ProtectionFair Credit ReportingGeneral OverviewCommunications LawPrivacyTelemarketing & Consumer Fraud & Abuse Prevention Act

FOOTNOTES:
(n1)Footnote 1. 16 C.F.R. pt. 310. The Rule was published at *60 Fed. Reg. 43,842* (Aug. 23, 1995) (effective Dec. 31, 1995). The FTC has initiated a review of this rule. *65 Fed. Reg. 10,428* (Feb. 28, 2000) .

(n2)Footnote 2. *16 C.F.R. §§ 310.2(cc)* (definition of telemarketing), 310.6(b)(3), *as amended by 68 Fed. Reg. 4,530* (Jan. 29, 2003) [former §§ 310.2(u), 310.6(c)].

(n3)Footnote 3. *68 Fed. Reg. 4,530* (Jan. 29, 2003) .

(n4)Footnote 4. *16 C.F.R. § 310.6(b)(5), (6), as amended by 68 Fed. Reg. 4,530* (Jan. 29, 2003) . The former version of these sections of the rule, *16 C.F.R. § 310.6(e), (f)*, did not specifically mention fax and e-mail transmission.

(n5)Footnote 5. *16 C.F.R. § 310.6(b)(1), as amended by 68 Fed. Reg. 4,530* (Jan. 29, 2003) [formerly § 310.6(a)]. See *47 U.S.C. § 228*, *15 U.S.C. § 5711*, *47* C.F.R. pt. 64, and 16 C.F.R. pt. 308, for the statutes, Federal Communications Commission [hereinafter FCC] rules, and FTC rules relating to 900-number abuses.

(n6)Footnote 6. *15 U.S.C. § 1679b(b).*

(n7)Footnote 7. *16 C.F.R. § 310.4(a)(2).*

(n8)Footnote 8. FTC v. Ellis, 5 *Trade Reg. Rep. (CCH) P 23,978 (C.D. Cal. 1996)* (TRO); *66 Banking Rep. (BNA) 655* (Apr. 15, 1996) . *See also* FTC v. G. Andrew Watson & Midwest Mgmt. Assocs., Inc., 5 *Trade Reg. Rep. (CCH) P 24,514 (N.D. Ill. 1998)* (order); FTC v. Donald Quaite, 5 *Trade Reg. Rep. (CCH) P 24,495 (N.D. Tex. 1998)* (consent decree); FTC v. John Mancini, 5 *Trade Reg. Rep. (CCH) P 24,495 (N.D. Tex. 1998);* FTC v. National Credit Mgmt. Group, 5 *Trade Reg. Rep. (CCH) P 24,521 (N.J. 1998)* (proposed consent decree).

(n9)Footnote 9. For a discussion of recent FTC actions, see National Consumer Law Center, Unfair and Deceptive Acts and Practices, § 5.1.2.2 (6[th] ed. 2004 and Supp.).

(n10)Footnote 10. *16 C.F.R. § 310.4(b)(iii)(B), as amended by 68 Fed. Reg. 4,530* (Jan. 29, 2003) .

(n11)Footnote 11. Consumers may add their names to the do-not-call list by calling 1-888-382-1222 (TTY 1-866-290-4236) or on-line at www.ftc.gov/donotcall.

(n12)Footnote 12. *47 U.S.C. § 227*. The TCPA is discussed in detail in National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.9.3 (7th ed. 2008 and supp.).

(n13)Footnote 13. *47 U.S.C. § 152(b). See Hooters of Augusta, Inc. v. Nicholson, 245 Ga. App. 363, 537 S.E.2d 468 (2000) , cert. denied, 2001 Ga. LEXIS 76* (Ga. Jan. 19, 2001) .

(n14)Footnote 14. *47 C.F.R. § 64.1200(e)(1).*

(n15)Footnote 15. *47 U.S.C. § 227(b)(1)(C)*; *47 C.F.R. § 64.1200(a)(3).*

(n16)Footnote 16. *47 C.F.R. § 64.1200(a)(1).*

(n17)Footnote 17. *47 U.S.C. § 227(b)(1)(B)*; *47 C.F.R. § 64.1200(a)(2), (c).*

(n18)Footnote 18. *47 U.S.C. § 227(b)(3), (c)(5).* In addition, complaints can be filed through the FCC's website, http://www.fcc.gov/ccb/enforce/index-complaints.html.

(n19)Footnote 19. *Murphey v. Lanier, 204 F.3d 911 (9th Cir. 2000)* ; *Erienet, Inc. v. Velocity Net, 156 F.3d 513 (3d Cir. 1998)* ; *Nicholson v. Hooters of Augusta, Inc., 136 F.3d 1287 , amended, reh'g granted, 140 F.3d 898 (11th Cir. 1998)* ; *Chair King, Inc. v. Houston Cellular Corp., 131 F.3d 507 (5th Cir. 1997)* ; *International Science & Tech. Inst. v. Inacom Communs., 106 F.3d 1146 (4th Cir. 1997)* .

(n20)Footnote 20. *Kenro, Inc. v. Fax Daily, Inc., 962 F. Supp. 1162 (S.D. Ind. 1997)* .

(n21)Footnote 21. *47 U.S.C. § 227(b)(3), (c)(5).*

(n22)Footnote 22. *Kaplan v. Democrat & Chronicle, 266 A.D.2d 848, 698 N.Y.S.2d 799 (1999)* (statutory damages are punitive, not compensatory, in nature). The court noted at page 801 that "[T]he legislative history of TCPA indicates that the statute was intended to provide a remedy to consumers for telemarketing abuses, and to encourage consumers to sue and obtain monetary awards based on a violation of the statute."

(n23)Footnote 23. *47 U.S.C. § 227(b)(3).*

(n24)Footnote 24. *Compare Hooters of Augusta, Inc. v. Nicholson, 245 Ga. App. 363, 537 S.E.2d 468 (2000)* (affirming class certification), *cert. denied, 2001 Ga. LEXIS 76* (Ga. Jan. 19, 2001) , *with Kenro, Inc. v. Fax Daily, 962 F. Supp. 1162 (S.D. Ind. 1997)* (determination of class membership would inappropriately require addressing the merits of the claim, particularly, determining whether faxes were in fact, unsolicited), *and Forman v. Data Transfer, Inc., 164 F.R.D. 400 (E.D. Pa. 1995)* (same).

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CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT

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Authority: ***15 U.S.C. 1691-1691f.***

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1B- Consumer Credit Law Manual § 202.1

§ 202.1 Authority, scope and purpose.

(a) *Authority and scope*. This regulation is issued by the Board of Governors of the Federal Reserve System pursuant to title VII (Equal Credit Opportunity Act) of the Consumer Credit Protection Act, as amended (*15 U.S.C. 1601 et seq*.). Except as otherwise provided herein, this regulation applies to all persons who are creditors, as defined in § 202.2(1). Information collection requirements contained in this regulation have been approved by the Office of Management and Budget under the provisions of *44 U.S.C. 3501 et seq*. and have been assigned OMB No. 7100-0201.

(b) *Purpose*. The purpose of this regulation is to promote the availability of credit to all creditworthy applicants without regard to race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract); to the fact that all or part of the applicant's income derives from a public assistance program; or to the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The regulation prohibits creditor practices that discriminate on the basis of any of these factors. The regulation also requires creditors to notify applicants of action taken on their applications; to report credit history in the names of both spouses on an account; to retain records of credit applications; to collect information about the applicant's race and other personal characteristics in applications for certain dwelling-related loans; and to provide applicants with copies of appraisal reports used in connection with credit transactions.

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1B- Consumer Credit Law Manual § 202.2

§ **202.2 Definitions.**

For the purposes of this regulation, unless the context indicates otherwise, the following definitions apply.

(a) *Account* means an extension of credit. When employed in relation to an account, the word use refers only to open-end credit.

(b) *Act* means the Equal Credit Opportunity Act (title VII of the Consumer Credit Protection Act).

(c) *Adverse action*.

(1) The term means:

(i) A refusal to grant credit in substantially the amount or on substantially the terms requested in an application unless the creditor makes a counteroffer (to grant credit in a different amount or on other terms) and the applicant uses or expressly accepts the credit offered;

(ii) A termination of an account or an unfavorable change in the terms of an account that does not affect all or substantially all of a class of the creditor's accounts; or

(iii) A refusal to increase the amount of credit available to an applicant who has made an application for an increase.

(2) The term does not include:

(i) A change in the terms of an account expressly agreed to by an applicant.

(ii) Any action or forbearance relating to an account taken in connection with inactivity, default, or delinquency as to that account;

(iii) A refusal or failure to authorize an account transaction at point of sale or loan, except when the refusal is a termination or an unfavorable change in the terms of an account that does not affect all or substantially all of a class of the creditor's accounts, or when the refusal is a denial of an application for an increase in the amount of credit available under the account;

(iv) A refusal to extend credit because applicable law prohibits the creditor from extending the credit requested; or

(v) A refusal to extend credit because the creditor does not offer the type of credit or credit plan requested.

(3) An action that falls within the definition of both paragraphs (c)(1) and (c)(2) of this section is governed by paragraph (c)(2) of this section.

(d) *Age* refers only to the age of natural persons and means the number of fully elapsed years from the date of an applicant's birth.

(e) *Applicant* means any person who requests or who has received an extension of credit from a creditor, and includes any person who is or may become contractually liable regarding an extension of credit. For purposes of § 202.7(d), the term includes guarantors, sureties, endorsers, and similar parties.

(f) *Application* means an oral or written request for an extension of credit that is made in accordance with procedures

used by a creditor for the type of credit requested. The term application does not include the use of an account or line of credit to obtain an amount of credit that is within a previously established credit limit. A *completed application* means an application in connection with which a creditor has received all the information that the creditor regularly obtains and considers in evaluating applications for the amount and type of credit requested (including, but not limited to, credit reports, any additional information requested from the applicant, and any approvals or reports by governmental agencies or other persons that are necessary to guarantee, insure, or provide security for the credit or collateral). The creditor shall exercise reasonable diligence in obtaining such information.

(g) *Business credit* refers to extensions of credit primarily for business or commercial (including agricultural) purposes, but excluding extensions of credit of the types described in § 202.3(a)-(d).

(h) *Consumer credit* means credit extended to a natural person primarily for personal, family, or household purposes.

(i) *Contractually liable* means expressly obligated to repay all debts arising on an account by reason of an agreement to that effect.

(j) *Credit* means the right granted by a creditor to an applicant to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment therefor.

(k) *Credit card* means any card, plate, coupon book, or other single credit device that may be used from time to time to obtain money, property, or services on credit.

(l) *Creditor* means a person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of the credit. The term creditor includes a creditor's assignee, transferee, or subrogee who so participates. For purposes of § 202.4(a) and (b), the term creditor also includes a person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made. A person is not a creditor regarding any violation of the Act or this regulation committed by another creditor unless the person knew or had reasonable notice of the act, policy, or practice that constituted the violation before becoming involved in the credit transaction. The term does not include a person whose only participation in a credit transaction involves honoring a credit card.

(m) *Credit transaction* means every aspect of an applicant's dealings with a creditor regarding an application for credit or an existing extension of credit (including, but not limited to, information requirements; investigation procedures; standards of creditworthiness; terms of credit; furnishing of credit information; revocation, alteration, or termination of credit; and collection procedures).

(n) *Discriminate against an applicant* means to treat an applicant less favorably than other applicants.

(o) *Elderly* means age 62 or older.

(p) *Empirically derived and other credit scoring systems--*

(1) *A credit scoring system* is a system that evaluates an applicant's creditworthiness mechanically, based on key attributes of the applicant and aspects of the transaction, and that determines, alone or in conjunction with an evaluation of additional information about the applicant, whether an applicant is deemed creditworthy. To qualify as an empirically derived, demonstrably and statistically sound, credit scoring system, the system must be:

(i) Based on data that are derived from an empirical comparison of sample groups or the population of creditworthy and noncreditworthy applicants who applied for credit within a reasonable preceding period of time;

(ii) Developed for the purpose of evaluating the creditworthiness of applicants with respect to the legitimate business interests of the creditor utilizing the system (including, but not limited to, minimizing bad debt losses and operating expenses in accordance with the creditor's business judgment);

(iii) Developed and validated using accepted statistical principles and methodology; and

(iv) Periodically revalidated by the use of appropriate statistical principles and methodology and adjusted as necessary to maintain predictive ability.

(2) A creditor may use an empirically derived, demonstrably and statistically sound, credit scoring system obtained from another person or may obtain credit experience from which to develop such a system. Any such system must satisfy the criteria set forth in paragraph (p)(1)(i) through (iv) of this section; if the creditor is unable during the development process to validate the system based on its own credit experience in accordance with paragraph (p)(1) of this section, the system must be validated when sufficient credit experience becomes available. A system that fails this validity test is no longer an empirically derived, demonstrably and statistically sound, credit scoring system for that creditor.

(q) *Extend credit and extension of credit* mean the granting of credit in any form (including, but not limited to, credit granted in addition to any existing credit or credit limit; credit granted pursuant to an open-end credit plan; the

refinancing or other renewal of credit, including the issuance of a new credit card in place of an expiring credit card or in substitution for an existing credit card; the consolidation of two or more obligations; or the continuance of existing credit without any special effort to collect at or after maturity).

(r) *Good faith* means honesty in fact in the conduct or transaction.

(s) *Inadvertent error* means a mechanical, electronic, or clerical error that a creditor demonstrates was not intentional and occurred notwithstanding the maintenance of procedures reasonably adapted to avoid such errors.

(t) *Judgmental system of evaluating applicants* means any system for evaluating the creditworthiness of an applicant other than an empirically derived, demonstrably and statistically sound, credit scoring system.

(u) *Marital status* means the state of being unmarried, married, or separated, as defined by applicable state law. The term "unmarried" includes persons who are single, divorced, or widowed.

(v) *Negative factor or value*, in relation to the age of elderly applicants, means utilizing a factor, value, or weight that is less favorable regarding elderly applicants than the creditor's experience warrants or is less favorable than the factor, value, or weight assigned to the class of applicants that are not classified as elderly and are most favored by a creditor on the basis of age.

(w) *Open-end credit* means credit extended under a plan in which a creditor may permit an applicant to make purchases or obtain loans from time to time directly from the creditor or indirectly by use of a credit card, check, or other device.

(x) *Person* means a natural person, corporation, government or governmental subdivision or agency, trust, estate, partnership, cooperative, or association.

(y) *Pertinent element of creditworthiness*, in relation to a judgmental system of evaluating applicants, means any information about applicants that a creditor obtains and considers and that has a demonstrable relationship to a determination of creditworthiness.

(z) *Prohibited basis* means race, color, religion, national origin, sex, marital status, or age (provided that the applicant has the capacity to enter into a binding contract); the fact that all or part of the applicant's income derives from any public assistance program; or the fact that the applicant has in good faith exercised any right under the Consumer Credit

Protection Act or any state law upon which an exemption has been granted by the Board.

(aa) *State* means any state, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or possession of the United States.

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CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
12 C.F.R. Part 202 REGULATION B--EQUAL CREDIT OPPORTUNITY

1B- Consumer Credit Law Manual § 202.3

§ **202.3 Limited exceptions for certain classes of transactions.**

(a) *Public utilities credit* --

(1) *Definition*. Public utilities credit refers to extensions of credit that involve public utility services provided through pipe, wire, or other connected facilities, or radio or similar transmission (including extensions of such facilities), if the charges for service, delayed payment, and any discount for prompt payment are filed with or regulated by a government unit.

(2) *Exceptions*. The following provisions of this regulation do not apply to public utilities credit:

(i) Section 202.5(d)(1) concerning information about marital status; and

(ii) Section 202.12(b) relating to record retention.

(b) *Securities credit* --

(1) *Definition*. Securities credit refers to extensions of credit subject to regulation under section 7 of the Securities Exchange Act of 1934 or extensions of credit by a broker or dealer subject to regulation as a broker or dealer under the

Securities Exchange Act of 1934.

(2) *Exceptions*. The following provisions of this regulation do not apply to securities credit:

(i) Section 202.5(b) concerning information about the sex of an applicant;

(ii) Section 202.5(c) concerning information about a spouse or former spouse;

(iii) Section 202.5(d)(1) concerning information about marital status;

(iv) Section 202.7(b) relating to designation of name to the extent necessary to comply with rules regarding an account in which a broker or dealer has an interest, or rules regarding the aggregation of accounts of spouses to determine controlling interests, beneficial interests, beneficial ownership, or purchase limitations and restrictions;

(v) Section 202.7(c) relating to action concerning open-end accounts, to the extent the action taken is on the basis of a change of name or marital status;

(vi) Section 202.7(d) relating to the signature of a spouse or other person;

(vii) Section 202.10 relating to furnishing of credit information; and

(viii) Section 202.12(b) relating to record retention.

(c) *Incidental credit* --

(1) *Definition*. Incidental credit refers to extensions of consumer credit other than the types described in paragraphs (a) and (b) of this section:

(i) That are not made pursuant to the terms of a credit card account;

(ii) That are not subject to a finance charge (as defined in Regulation Z, *12 CFR 226.4*); and

(iii) That are not payable by agreement in more than four installments.

(2) *Exceptions*. The following provisions of this regulation do not apply to incidental credit:

(i) Section 202.5(b) concerning information about the sex of an applicant, but only to the extent necessary for medical records or similar purposes;

(ii) Section 202.5(c) concerning information about a spouse or former spouse;

(iii) Section 202.5(d)(1) concerning information about marital status;

(iv) Section 202.5(d)(2) concerning information about income derived from alimony, child support, or separate maintenance payments;

(v) Section 202.7(d) relating to the signature of a spouse or other person;

(vi) Section 202.9 relating to notifications;

(vii) Section 202.10 relating to furnishing of credit information; and

(viii) Section 202.12(b) relating to record retention.

(d) *Government credit* --

(1) *Definition*. Government credit refers to extensions of credit made to governments or governmental subdivisions, agencies, or instrumentalities.

(2) *Applicability of regulation*. Except for § 202.4(a), the general rule against discrimination on a prohibited basis, the requirements of this regulation do not apply to government credit.

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1B- Consumer Credit Law Manual § 202.4

§ **202.4 General rules.**

(a) *Discrimination*.A creditor shall not discriminate against an applicant on a prohibited basis regarding any aspect of a credit transaction.

(b) *Discouragement*. A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage on a prohibited basis a reasonable person from making or pursuing an application.

(c) *Written applications*. A creditor shall take written applications for the dwelling-related types of credit covered by § 202.13(a).

(d) *Form of disclosures*. --

(1) *General rule*. A creditor that provides in writing any disclosures or information required by this regulation must provide the disclosures in a clear and conspicuous manner and, except for the disclosures required by §§ 202.5 and 202.13, in a form the applicant may retain.

(2) *Disclosures in electronic form*. The disclosures required by this part that are required to be given in writing may be provided to the applicant in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (*15 U.S.C. 7001 et seq*.).

Where the disclosures under §§ 202.5(b)(1), 202.5(b)(2), 202.5(d)(1), 202.5(d)(2), 202.13, and 202.14(a)(2)(i) accompany an application accessed by the applicant in electronic form, these disclosures may be provided to the applicant in electronic form on or with the application form, without regard to the consumer consent or other provisions of the E-Sign Act.

(e) *Foreign-language disclosures*. Disclosures may be made in languages other than English, provided they are available in English upon request.

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1B- Consumer Credit Law Manual § 202.5

§ **202.5 Rules concerning requests for information.**

(a) *General rules* --

(1) *Requests for information*. Except as provided in paragraphs (b) through (d) of this section, a creditor may request any information in connection with a credit transaction. n1

(2) *Required collection of information*. Notwithstanding paragraphs (b) through (d) of this section, a creditor shall request information for monitoring purposes as required by § 202.13 for credit secured by the applicant's dwelling. In addition, a creditor may obtain information required by a regulation, order, or agreement issued by, or entered into with, a court or an enforcement agency (including the Attorney General of the United States or a similar state official) to monitor or enforce compliance with the Act, this regulation, or other federal or state statutes or regulations.

(3) *Special-purpose credit*. A creditor may obtain information that is otherwise restricted to determine eligibility for a special purpose credit program, as provided in § 202.8(b), (c), and (d).

(b) *Limitation on information about race, color, religion, national origin, or sex*. A creditor shall not inquire about the race, color, religion, national origin, or sex of an applicant or any other person in connection with a credit transaction, except as provided in paragraphs (b)(1) and (b)(2) of this section.

(1) *Self-test*. A creditor may inquire about the race, color, religion, national origin, or sex of an applicant or any other

person in connection with a credit transaction for the purpose of conducting a self-test that meets the requirements of § 202.15. A creditor that makes such an inquiry shall disclose orally or in writing, at the time the information is requested, that:

(i) The applicant will not be required to provide the information;

(ii) The creditor is requesting the information to monitor its compliance with the federal Equal Credit Opportunity Act;

(iii) Federal law prohibits the creditor from discriminating on the basis of this information, or on the basis of an applicant's decision not to furnish the information; and

(iv) If applicable, certain information will be collected based on visual observation or surname if not provided by the applicant or other person.

(2) *Sex*. An applicant may be requested to designate a title on an application form (such as Ms., Miss, Mr., or Mrs.) if the form discloses that the designation of a title is optional. An application form shall otherwise use only terms that are neutral as to sex.

(c) *Information about a spouse or former spouse* --

(1) *General rule*. Except as permitted in this paragraph, a creditor may not request any information concerning the spouse or former spouse of an applicant.

(2) *Permissible inquiries*. A creditor may request any information concerning an applicant's spouse (or former spouse under paragraph (c)(2)(v) of this section) that may be requested about the applicant if:

(i) The spouse will be permitted to use the account;

(ii) The spouse will be contractually liable on the account;

(iii) The applicant is relying on the spouse's income as a basis for repayment of the credit requested;

(iv) The applicant resides in a community property state or is relying on property located in such a state as a basis for repayment of the credit requested; or

(v) The applicant is relying on alimony, child support, or separate maintenance payments from a spouse or former spouse as a basis for repayment of the credit requested.

(3) *Other accounts of the applicant*. A creditor may request that an applicant list any account on which the applicant is contractually liable and to provide the name and address of the person in whose name the account is held. A creditor may also ask an applicant to list the names in which the applicant has previously received credit.

(d) *Other limitations on information requests* --

(1) *Marital status*. If an applicant applies for individual unsecured credit, a creditor shall not inquire about the applicant's marital status unless the applicant resides in a community property state or is relying on property located in such a state as a basis for repayment of the credit requested. If an application is for other than individual unsecured credit, a creditor may inquire about the applicant's marital status, but shall use only the terms married, unmarried, and separated. A creditor may explain that the category unmarried includes single, divorced, and widowed persons.

(2) *Disclosure about income from alimony, child support, or separate maintenance*. A creditor shall not inquire whether income stated in an application is derived from alimony, child support, or separate maintenance payments unless the creditor discloses to the applicant that such income need not be revealed if the applicant does not want the creditor to consider it in determining the applicant's creditworthiness.

(3) *Childbearing, childrearing*. A creditor shall not inquire about birth control practices, intentions concerning the bearing or rearing of children, or capability to bear children. A creditor may inquire about the number and ages of an applicant's dependents or about dependent-related financial obligations or expenditures, provided such information is requested without regard to sex, marital status, or any other prohibited basis.

(e) *Permanent residency and immigration status*. A creditor may inquire about the permanent residency and immigration status of an applicant or any other person in connection with a credit transaction.

FOOTNOTES:

(n1)Footnote 1. This paragraph does not limit or abrogate any Federal or State law regarding privacy, privileged information, credit reporting limitations, or similar restrictions on obtainable information.

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1B- Consumer Credit Law Manual § 202.5a

§ **202.5a [Removed. 68 FR 13144, 13161, Mar. 18, 2003.]**

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1B- Consumer Credit Law Manual § 202.6

§ 202.6 Rules concerning evaluation of applications.

(a) *General rule concerning use of information*. Except as otherwise provided in the Act and this regulation, a creditor may consider any information obtained, so long as the information is not used to discriminate against an applicant on a prohibited basis. n2

(b) *Specific rules concerning use of information*. --

(1) Except as provided in the Act and this regulation, a creditor shall not take a prohibited basis into account in any system of evaluating the creditworthiness of applicants.

(2) *Age, receipt of public assistance*.

(i) Except as permitted in this paragraph, a creditor shall not take into account an applicant's age (provided that the applicant has the capacity to enter into a binding contract) or whether an applicant's income derives from any public assistance program.

(ii) In an empirically derived, demonstrably and statistically sound, credit scoring system, a creditor may use an applicant's age as a predictive variable, provided that the age of an elderly applicant is not assigned a negative factor or value.

(iii) In a judgmental system of evaluating creditworthiness, a creditor may consider an applicant's age or whether an applicant's income derives from any public assistance program only for the purpose of determining a pertinent element of creditworthiness.

(iv) In any system of evaluating creditworthiness, a creditor may consider the age of an elderly applicant when such age is used to favor the elderly applicant in extending credit.

(3) *Childbearing, childrearing*. In evaluating creditworthiness, a creditor shall not make assumptions or use aggregate statistics relating to the likelihood that any category of persons will bear or rear children or will, for that reason, receive diminished or interrupted income in the future.

(4) *Telephone listing*. A creditor shall not take into account whether there is a telephone listing in the name of an applicant for consumer credit but may take into account whether there is a telephone in the applicant's residence.

(5) *Income*. A creditor shall not discount or exclude from consideration the income of an applicant or the spouse of an applicant because of a prohibited basis or because the income is derived from part-time employment or is an annuity, pension, or other retirement benefit; a creditor may consider the amount and probable continuance of any income in evaluating an applicant's creditworthiness. When an applicant relies on alimony, child support, or separate maintenance payments in applying for credit, the creditor shall consider such payments as income to the extent that they are likely to be consistently made.

(6) *Credit history*. To the extent that a creditor considers credit history in evaluating the creditworthiness of similarly qualified applicants for a similar type and amount of credit, in evaluating an applicant's creditworthiness a creditor shall consider:

(i) The credit history, when available, of accounts designated as accounts that the applicant and the applicant's spouse are permitted to use or for which both are contractually liable;

(ii) On the applicant's request, any information the applicant may present that tends to indicate the credit history being considered by the creditor does not accurately reflect the applicant's creditworthiness; and

(iii) On the applicant's request, the credit history, when available, of any account reported in the name of the applicant's spouse or former spouse that the applicant can demonstrate accurately reflects the applicant's

creditworthiness.

(7) *Immigration status*. A creditor may consider the applicant's immigration status or status as a permanent resident of the United States, and any additional information that may be necessary to ascertain the creditor's rights and remedies regarding repayment.

(8) *Marital status*. Except as otherwise permitted or required by law, a creditor shall evaluate married and unmarried applicants by the same standards; and in evaluating joint applicants, a creditor shall not treat applicants differently based on the existence, absence, or likelihood of a marital relationship between the parties.

(9) *Race, color, religion, national origin, sex*. Except as otherwise permitted or required by law, a creditor shall not consider race, color, religion, national origin, or sex (or an applicant's or other person's decision not to provide the information) in any aspect of a credit transaction.

(c) *State property laws*. A creditor's consideration or application of state property laws directly or indirectly affecting creditworthiness does not constitute unlawful discrimination for the purposes of the Act or this regulation.

FOOTNOTES:
(n2)Footnote 2. The legislative history of the Act indicates that the Congress intended an "effects test" concept, as outlined in the employment field by the Supreme Court in the cases of *Griggs v. Duke Power Co., 401 U.S. 424 (1971)* , and *Albemarle Paper Co. v. Moody, 422 U.S. 405 (1975)* , to be applicable to a creditor's determination of creditworthiness.

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1B- Consumer Credit Law Manual § 202.7

§ **202.7 Rules concerning extensions of credit.**

(a) *Individual accounts*.A creditor shall not refuse to grant an individual account to a creditworthy applicant on the basis of sex, marital status, or any other prohibited basis.

(b) *Designation of name*. A creditor shall not refuse to allow an applicant to open or maintain an account in a birth-given first name and a surname that is the applicant's birth-given surname, the spouse's surname, or a combined surname.

(c) *Action concerning existing open-end accounts* --

(1) *Limitations*. In the absence of evidence of the applicant's inability or unwillingness to repay, a creditor shall not take any of the following actions regarding an applicant who is contractually liable on an existing open-end account on the basis of the applicant's reaching a certain age or retiring or on the basis of a change in the applicant's name or marital status:

(i) Require a reapplication, except as provided in paragraph (c)(2) of this section;

(ii) Change the terms of the account; or

(iii) Terminate the account.

(2) *Requiring reapplication*. A creditor may require a reapplication for an open-end account on the basis of a change in the marital status of an applicant who is contractually liable if the credit granted was based in whole or in part on income of the applicant's spouse and if information available to the creditor indicates that the applicant's income may not support the amount of credit currently available.

(d) *Signature of spouse or other person* --

(1) *Rule for qualified applicant*. Except as provided in this paragraph, a creditor shall not require the signature of an applicant's spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested. A creditor shall not deem the submission of a joint financial statement or other evidence of jointly held assets as an application for joint credit.

(2) *Unsecured credit*. If an applicant requests unsecured credit and relies in part upon property that the applicant owns jointly with another person to satisfy the creditor's standards of creditworthiness, the creditor may require the signature of the other person only on the instrument(s) necessary, or reasonably believed by the creditor to be necessary, under the law of the state in which the property is located, to enable the creditor to reach the property being relied upon in the event of the death or default of the applicant.

(3) *Unsecured credit -- community property states*. If a married applicant requests unsecured credit and resides in a community property state, or if the applicant is relying on property located in such a state, a creditor may require the signature of the spouse on any instrument necessary, or reasonably believed by the creditor to be necessary, under applicable state law to make the community property available to satisfy the debt in the event of default if:

(i) Applicable state law denies the applicant power to manage or control sufficient community property to qualify for the credit requested under the creditor's standards of creditworthiness; and

(ii) The applicant does not have sufficient separate property to qualify for the credit requested without regard to community property.

(4) *Secured credit*. If an applicant requests secured credit, a creditor may require the signature of the applicant's spouse or other person on any instrument necessary, or reasonably believed by the creditor to be necessary, under applicable state law to make the property being offered as security available to satisfy the debt in the event of default,

for example, an instrument to create a valid lien, pass clear title, waive inchoate rights, or assign earnings.

(5) *Additional parties*. If, under a creditor's standards of creditworthiness, the personal liability of an additional party is necessary to support the credit requested, a creditor may request a cosigner, guarantor, endorser, or similar party. The applicant's spouse may serve as an additional party, but the creditor shall not require that the spouse be the additional party.

(6) *Rights of additional parties*. A creditor shall not impose requirements upon an additional party that the creditor is prohibited from imposing upon an applicant under this section.

(e) *Insurance*. A creditor shall not refuse to extend credit and shall not terminate an account because credit life, health, accident, disability, or other credit-related insurance is not available on the basis of the applicant's age.

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1B- Consumer Credit Law Manual § 202.8

§ **202.8 Special purpose credit programs.**

(a) *Standards for programs*. Subject to the provisions of paragraph (b) of this section, the Act and this regulation permit a creditor to extend special purpose credit to applicants who meet eligibility requirements under the following types of credit programs:

(1) Any credit assistance program expressly authorized by federal or state law for the benefit of an economically disadvantaged class of persons;

(2) Any credit assistance program offered by a not-for-profit organization, as defined under *section 501(c) of the Internal Revenue Code of 1954*, as amended, for the benefit of its members or for the benefit of an economically disadvantaged class of persons; or

(3) Any special purpose credit program offered by a for-profit organization, or in which such an organization participates to meet special social needs, if:

(i) The program is established and administered pursuant to a written plan that identifies the class of persons that the program is designed to benefit and sets forth the procedures and standards for extending credit pursuant to the program; and

(ii) The program is established and administered to extend credit to a class of persons who, under the organization's

customary standards of creditworthiness, probably would not receive such credit or would receive it on less favorable terms than are ordinarily available to other applicants applying to the organization for a similar type and amount of credit.

(b) *Rules in other sections* --

(1) *General applicability*. All the provisions of this regulation apply to each of the special purpose credit programs described in paragraph (a) of this section except as modified by this section.

(2) *Common characteristics*. A program described in paragraph (a)(2) or (a)(3) of this section qualifies as a special purpose credit program only if it was established and is administered so as not to discriminate against an applicant on any prohibited basis; however, all program participants may be required to share one or more common characteristics (for example, race, national origin, or sex) so long as the program was not established and is not administered with the purpose of evading the requirements of the Act or this regulation.

(c) *Special rule concerning requests and use of information*. If participants in a special purpose credit program described in paragraph (a) of this section are required to possess one or more common characteristics (for example, race, national origin, or sex) and if the program otherwise satisfies the requirements of paragraph (a) of this section, a creditor may request and consider information regarding the common characteristic(s) in determining the applicant's eligibility for the program.

(d) *Special rule in the case of financial need*. If financial need is one of the criteria under a special purpose credit program described in paragraph (a) of this section, the creditor may request and consider, in determining an applicant's eligibility for the program, information regarding the applicant's marital status; alimony, child support, and separate maintenance income; and the spouse's financial resources. In addition, a creditor may obtain the signature of an applicant's spouse or other person on an application or credit instrument relating to a special purpose credit program if the signature is required by federal or state law.

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1B- Consumer Credit Law Manual § 202.9

§ **202.9 Notifications.**

(a) *Notification of action taken, ECOA notice, and statement of specific reasons* --

(1) *When notification is required*. A creditor shall notify an applicant of action taken within:

(i) 30 days after receiving a completed application concerning the creditor's approval of, counteroffer to, or adverse action on the application;

(ii) 30 days after taking adverse action on an incomplete application, unless notice is provided in accordance with paragraph (c) of this section;

(iii) 30 days after taking adverse action on an existing account; or

(iv) 90 days after notifying the applicant of a counteroffer if the applicant does not expressly accept or use the credit offered.

(2) *Content of notification when adverse action is taken*. A notification given to an applicant when adverse action is taken shall be in writing and shall contain a statement of the action taken; the name and address of the creditor; a

statement of the provisions of § 701(a) of the Act; the name and address of the federal agency that administers compliance with respect to the creditor; and either:

(i) A statement of specific reasons for the action taken; or

(ii) A disclosure of the applicant's right to a statement of specific reasons within 30 days, if the statement is requested within 60 days of the creditor's notification. The disclosure shall include the name, address, and telephone number of the person or office from which the statement of reasons can be obtained. If the creditor chooses to provide the reasons orally, the creditor shall also disclose the applicant's right to have them confirmed in writing within 30 days of receiving the applicant's written request for confirmation.

(3) *Notification to business credit applicants*. For business credit, a creditor shall comply with the requirements of this section in the following manner:

(i) With regard to a business that had gross revenues of $1 million or less in its preceding fiscal year (other than an extension of trade credit, credit incident to a factoring agreement, or other similar types of business credit), a creditor shall comply with paragraphs (a)(1) and (2) of this section, except that:

(A) The statement of the action taken may be given orally or in writing, when adverse action is taken;

(B) Disclosure of an applicant's right to a statement of reasons may be given at the time of application, instead of when adverse action is taken, provided the disclosure contains the information required by paragraph (a)(2)(ii) of this section and the ECOA notice specified in paragraph (b)(1) of this section;

(C) For an application made entirely by telephone, a creditor satisfies the requirements of paragraph (a)(3)(i) of this section by an oral statement of the action taken and of the applicant's right to a statement of reasons for adverse action.

(ii) With regard to a business that had gross revenues in excess of $1 million in its preceding fiscal year or an extension of trade credit, credit incident to a factoring agreement, or other similar types of business credit, a creditor shall:

(A) Notify the applicant, within a reasonable time, orally or in writing, of the action taken; and

(B) Provide a written statement of the reasons for adverse action and the ECOA notice specified in paragraph (b)(1) of this section if the applicant makes a written request for the reasons within 60 days of the creditor's notification.

(b) *Form of ECOA notice and statement of specific reasons*. --

(1) *ECOA notice*. To satisfy the disclosure requirements of paragraph (a)(2) of this section regarding section 701(a) of the Act, the creditor shall provide a notice that is substantially similar to the following: The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is [name and address as specified by the appropriate agency listed in appendix A of this regulation].

(2) *Statement of specific reasons*. The statement of reasons for adverse action required by paragraph (a)(2)(i) of this section must be specific and indicate the principal reason(s) for the adverse action. Statements that the adverse action was based on the creditor's internal standards or policies or that the applicant, joint applicant, or similar party failed to achieve a qualifying score on the creditor's credit scoring system are insufficient.

(c) *Incomplete applications* --

(1) *Notice alternatives*. Within 30 days after receiving an application that is incomplete regarding matters that an applicant can complete, the creditor shall notify the applicant either:

(i) Of action taken, in accordance with paragraph (a) of this section; or

(ii) Of the incompleteness, in accordance with paragraph (c)(2) of this section.

(2) *Notice of incompleteness*. If additional information is needed from an applicant, the creditor shall send a written notice to the applicant specifying the information needed, designating a reasonable period of time for the applicant to provide the information, and informing the applicant that failure to provide the information requested will result in no further consideration being given to the application. The creditor shall have no further obligation under this section if the applicant fails to respond within the designated time period. If the applicant supplies the requested information

within the designated time period, the creditor shall take action on the application and notify the applicant in accordance with paragraph (a) of this section.

(3) *Oral request for information*. At its option, a creditor may inform the applicant orally of the need for additional information. If the application remains incomplete the creditor shall send a notice in accordance with paragraph (c)(1) of this section.

(d) *Oral notifications by small-volume creditors*. In the case of a creditor that did not receive more than 150 applications during the preceding calendar year, the requirements of this section (including statements of specific reasons) are satisfied by oral notifications.

(e) *Withdrawal of approved application*. When an applicant submits an application and the parties contemplate that the applicant will inquire about its status, if the creditor approves the application and the applicant has not inquired within 30 days after applying, the creditor may treat the application as withdrawn and need not comply with paragraph (a)(1) of this section.

(f) *Multiple applicants*. When an application involves more than one applicant, notification need only be given to one of them but must be given to the primary applicant where one is readily apparent.

(g) *Applications submitted through a third party*. When an application is made on behalf of an applicant to more than one creditor and the applicant expressly accepts or uses credit offered by one of the creditors, notification of action taken by any of the other creditors is not required. If no credit is offered or if the applicant does not expressly accept or use the credit offered, each creditor taking adverse action must comply with this section, directly or through a third party. A notice given by a third party shall disclose the identity of each creditor on whose behalf the notice is given.

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1B- Consumer Credit Law Manual § 202.10

§ **202.10 Furnishing of credit information.**

(a) *Designation of accounts*. A creditor that furnishes credit information shall designate:

(1) Any new account to reflect the participation of both spouses if the applicant's spouse is permitted to use or is contractually liable on the account (other than as a guarantor, surety, endorser, or similar party); and

(2) Any existing account to reflect such participation, within 90 days after receiving a written request to do so from one of the spouses.

(b) *Routine reports to consumer reporting agency*. If a creditor furnishes credit information to a consumer reporting agency concerning an account designated to reflect the participation of both spouses, the creditor shall furnish the information in a manner that will enable the agency to provide access to the information in the name of each spouse.

(c) *Reporting in response to inquiry*. If a creditor furnishes credit information in response to an inquiry, concerning an account designated to reflect the participation of both spouses, the creditor shall furnish the information in the name of the spouse about whom the information is requested.

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§ **202.11 Relation to state law.**

(a) *Inconsistent state laws*. Except as otherwise provided in this section, this regulation alters, affects, or preempts only those state laws that are inconsistent with the Act and this regulation and then only to the extent of the inconsistency. A state law is not inconsistent if it is more protective of an applicant.

(b) *Preempted provisions of state law*. --

(1) A state law is deemed to be inconsistent with the requirements of the Act and this regulation and less protective of an applicant within the meaning of section 705(f) of the Act to the extent that the law:

(i) Requires or permits a practice or act prohibited by the Act or this regulation;

(ii) Prohibits the individual extension of consumer credit to both parties to a marriage if each spouse individually and voluntarily applies for such credit;

(iii) Prohibits inquiries or collection of data required to comply with the Act or this regulation;

(iv) Prohibits asking about or considering age in an empirically derived, demonstrably and statistically sound, credit

scoring system to determine a pertinent element of creditworthiness, or to favor an elderly applicant; or

(v) Prohibits inquiries necessary to establish or administer a special purpose credit program as defined by § 202.8.

(2) A creditor, state, or other interested party may request that the Board determine whether a state law is inconsistent with the requirements of the Act and this regulation.

(c) *Laws on finance charges, loan ceilings*. If married applicants voluntarily apply for and obtain individual accounts with the same creditor, the accounts shall not be aggregated or otherwise combined for purposes of determining permissible finance charges or loan ceilings under any federal or state law. Permissible loan ceiling laws shall be construed to permit each spouse to become individually liable up to the amount of the loan ceilings, less the amount for which the applicant is jointly liable.

(d) *State and federal laws not affected*. This section does not alter or annul any provision of state property laws, laws relating to the disposition of decedents' estates, or federal or state banking regulations directed only toward insuring the solvency of financial institutions.

(e) *Exemption for state-regulated transactions*. --

(1) *Applications*. A state may apply to the Board for an exemption from the requirements of the Act and this regulation for any class of credit transactions within the state. The Board will grant such an exemption if the Board determines that:

(i) The class of credit transactions is subject to state law requirements substantially similar to those of the Act and this regulation or that applicants are afforded greater protection under state law; and

(ii) There is adequate provision for state enforcement.

(2) *Liability and enforcement*.

(i) No exemption will extend to the civil liability provisions of section 706 of the Act or the administrative enforcement provisions of section 704 of the Act.

(ii) After an exemption has been granted, the requirements of the applicable state law (except for additional requirements not imposed by federal law) will constitute the requirements of the Act and this regulation.

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1B- Consumer Credit Law Manual § 202.12

§ **202.12 Record retention.**

(a) *Retention of prohibited information*. A creditor may retain in its files information that is prohibited by the Act or this regulation for use in evaluating applications, without violating the Act or this regulation, if the information was obtained:

(1) From any source prior to March 23, 1977;

(2) From consumer reporting agencies, an applicant, or others without the specific request of the creditor; or

(3) As required to monitor compliance with the Act and this regulation or other federal or state statutes or regulations.

(b) *Preservation of records* --

(1) *Applications*. For 25 months (12 months for business credit, except as provided in paragraph (b)(5) of this section) after the date that a creditor notifies an applicant of action taken on an application or of incompleteness, the creditor shall retain in original form or a copy thereof:

(i) Any application that it receives, any information required to be obtained concerning characteristics of the

applicant to monitor compliance with the Act and this regulation or other similar law, and any other written or recorded information used in evaluating the application and not returned to the applicant at the applicant's request;

(ii) A copy of the following documents if furnished to the applicant in written form (or, if furnished orally, any notation or memorandum made by the creditor):

(A) The notification of action taken; and

(B) The statement of specific reasons for adverse action; and

(iii) Any written statement submitted by the applicant alleging a violation of the Act or this regulation.

(2) *Existing accounts*. For 25 months (12 months for business credit, except as provided in paragraph (b)(5) of this section) after the date that a creditor notifies an applicant of adverse action regarding an existing account, the creditor shall retain as to that account, in original form or a copy thereof:

(i) Any written or recorded information concerning the adverse action; and

(ii) Any written statement submitted by the applicant alleging a violation of the Act or this regulation.

(3) *Other applications*. For 25 months (12 months for business credit, except as provided in paragraph (b)(5) of this section) after the date that a creditor receives an application for which the creditor is not required to comply with the notification requirements of § 202.9, the creditor shall retain all written or recorded information in its possession concerning the applicant, including any notation of action taken.

(4) *Enforcement proceedings and investigations*. A creditor shall retain the information beyond 25 months (12 months for business credit, except as provided in paragraph (b)(5) of this section) if the creditor has actual notice that it is under investigation or is subject to an enforcement proceeding for an alleged violation of the Act or this regulation, by the Attorney General of the United States or by an enforcement agency charged with monitoring that creditor's compliance with the Act and this regulation, or if it has been served with notice of an action filed pursuant to section 706 of the Act and § 202.17 of this regulation. The creditor shall retain the information until final disposition of the matter, unless an earlier time is allowed by order of the agency or court.

(5) *Special rule for certain business credit applications*. With regard to a business that had gross revenues in excess of $1 million in its preceding fiscal year, or an extension of trade credit, credit incident to a factoring agreement, or other similar types of business credit, the creditor shall retain records for at least 60 days after notifying the applicant of the action taken. If within that time period the applicant requests in writing the reasons for adverse action or that records be retained, the creditor shall retain records for 12 months.

(6) *Self-tests*. For 25 months after a self-test (as defined in § 202.15) has been completed, the creditor shall retain all written or recorded information about the self-test. A creditor shall retain information beyond 25 months if it has actual notice that it is under investigation or is subject to an enforcement proceeding for an alleged violation, or if it has been served with notice of a civil action. In such cases, the creditor shall retain the information until final disposition of the matter, unless an earlier time is allowed by the appropriate agency or court order.

(7) *Prescreened solicitations*. For 25 months after the date on which an offer of credit is made to potential customers (12 months for business credit, except as provided in paragraph (b)(5) of this section), the creditor shall retain in original form or a copy thereof:

(i) The text of any prescreened solicitation;

(ii) The list of criteria the creditor used to select potential recipients of the solicitation; and

(iii) Any correspondence related to complaints (formal or informal) about the solicitation.

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1B- Consumer Credit Law Manual § 202.13

§ **202.13 Information for monitoring purposes.**

(a) *Information to be requested*. --

(1) A creditor that receives an application for credit primarily for the purchase or refinancing of a dwelling occupied or to be occupied by the applicant as a principal residence, where the extension of credit will be secured by the dwelling, shall request as part of the application the following information regarding the applicant(s):

(i) Ethnicity, using the categories Hispanic or Latino, and not Hispanic or Latino; and race, using the categories American Indian or Alaska Native, Asian, Black or African American, Native Hawaiian or Other Pacific Islander, and White;

(ii) Sex;

(iii) Marital status, using the categories married, unmarried, and separated; and

(iv) Age.

(2) *Dwelling* means a residential structure that contains one to four units, whether or not that structure is attached to

real property. The term includes, but is not limited to, an individual condominium or cooperative unit and a mobile or other manufactured home.

(b) *Obtaining information*. Questions regarding ethnicity, race, sex, marital status, and age may be listed, at the creditor's option, on the application form or on a separate form that refers to the application. The applicant(s) shall be asked but not required to supply the requested information. If the applicant(s) chooses not to provide the information or any part of it, that fact shall be noted on the form. The creditor shall then also note on the form, to the extent possible, the ethnicity, race, and sex of the applicant(s) on the basis of visual observation or surname.

(c) *Disclosure to applicant(s)*. The creditor shall inform the applicant(s) that the information regarding ethnicity, race, sex, marital status, and age is being requested by the federal government for the purpose of monitoring compliance with federal statutes that prohibit creditors from discriminating against applicants on those bases. The creditor shall also inform the applicant(s) that if the applicant(s) chooses not to provide the information, the creditor is required to note the ethnicity, race and sex on the basis of visual observation or surname.

(d) *Substitute monitoring program*. A monitoring program required by an agency charged with administrative enforcement under section 704 of the Act may be substituted for the requirements contained in paragraphs (a), (b), and (c) of this section.

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1B- Consumer Credit Law Manual § 202.14

§ **202.14 Rules on providing appraisal reports.**

(a) *Providing appraisals*. A creditor shall provide a copy of an appraisal report used in connection with an application for credit that is to be secured by a lien on a dwelling. A creditor shall comply with either paragraph (a)(1) or (a)(2) of this section.

(1) *Routine delivery*. A creditor may routinely provide a copy of an appraisal report to an applicant (whether credit is granted or denied or the application is withdrawn).

(2) *Upon request*. A creditor that does not routinely provide appraisal reports shall provide a copy upon an applicant's written request.

(i) *Notice*. A creditor that provides appraisal reports only upon request shall notify an applicant in writing of the right to receive a copy of an appraisal report. The notice may be given at any time during the application process but no later than when the creditor provides notice of action taken under § 202.9 of this regulation. The notice shall specify that the applicant's request must be in writing, give the creditor's mailing address, and state the time for making the request as provided in paragraph (a)(2)(ii) of this section.

(ii) *Delivery*. A creditor shall mail or deliver a copy of the appraisal report promptly (generally within 30 days) after the creditor receives an applicant's request, receives the report, or receives reimbursement from the applicant for the report, whichever is last to occur. A creditor need not provide a copy when the applicant's request is received more than 90 days after the creditor has provided notice of action taken on the application under § 202.9 of this regulation or 90 days after the application is withdrawn.

(b) *Credit unions*. A creditor that is subject to the regulations of the National Credit Union Administration on making copies of appraisal reports available is not subject to this section.

(c) *Definitions*. For purposes of paragraph (a) of this section, the term dwelling means a residential structure that contains one to four units whether or not that structure is attached to real property. The term includes, but is not limited to, an individual condominium or cooperative unit, and a mobile or other manufactured home. The term appraisal report means the document(s) relied upon by a creditor in evaluating the value of the dwelling.

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1B- Consumer Credit Law Manual § 202.15

§ **202.15 Incentives for self-testing and self-correction.**

(a) *General rules* --

(1) *Voluntary self-testing and correction*. Voluntary self-testing and correction. The report or results of a self-test that a creditor voluntarily conducts (or authorizes) are privileged as provided in this section. Data collection required by law or by any governmental authority is not a voluntary self-test.

(2) *Corrective action required*. The privilege in this section applies only if the creditor has taken or is taking appropriate corrective action.

(3) *Other privileges*. The privilege created by this section does not preclude the assertion of any other privilege that may also apply.

(b) *Self-test defined* --

(1) *Definition*. A self-test is any program, practice, or study that:

(i) Is designed and used specifically to determine the extent or effectiveness of a creditor's compliance with the Act

or this regulation; and

(ii) Creates data or factual information that is not available and cannot be derived from loan or application files or other records related to credit transactions.

(2) *Types of information privileged*. The privilege under this section applies to the report or results of the self-test, data or factual information created by the self-test, and any analysis, opinions, and conclusions pertaining to the self-test report or results. The privilege covers workpapers or draft documents as well as final documents.

(3) *Types of information not privileged*. The privilege under this section does not apply to:

(i) Information about whether a creditor conducted a self-test, the methodology used or the scope of the self-test, the time period covered by the self-test, or the dates it was conducted; or

(ii) Loan and application files or other business records related to credit transactions, and information derived from such files and records, even if the information has been aggregated, summarized, or reorganized to facilitate analysis.

(c) *Appropriate corrective action* --

(1) *General requirement*. For the privilege in this section to apply, appropriate corrective action is required when the self-test shows that it is more likely than not that a violation occurred, even though no violation has been formally adjudicated.

(2) *Determining the scope of appropriate corrective action*. A creditor must take corrective action that is reasonably likely to remedy the cause and effect of a likely violation by:

(i) Identifying the policies or practices that are the likely cause of the violation; and

(ii) Assessing the extent and scope of any violation.

(3) *Types of relief*. Appropriate corrective action may include both prospective and remedial relief, except that to establish a privilege under this section:

(i) A creditor is not required to provide remedial relief to a tester used in a self-test;

(ii) A creditor is only required to provide remedial relief to an applicant identified by the self-test as one whose rights were more likely than not violated; and

(iii) A creditor is not required to provide remedial relief to a particular applicant if the statute of limitations applicable to the violation expired before the creditor obtained the results of the self-test or the applicant is otherwise ineligible for such relief.

(4) *No admission of violation*. Taking corrective action is not an admission that a violation occurred.

(d) *Scope of privilege* --

(1) *General rule*. The report or results of a privileged self-test may not be obtained or used:

(i) By a government agency in any examination or investigation relating to compliance with the Act or this regulation; or

(ii) By a government agency or an applicant (including a prospective applicant who alleges a violation of § 202.4(b)) in any proceeding or civil action in which a violation of the Act or this regulation is alleged.

(2) *Loss of privilege*. The report or results of a self-test are not privileged under paragraph (d)(1) of this section if the creditor or a person with lawful access to the report or results:

(i) Voluntarily discloses any part of the report or results, or any other information privileged under this section, to an applicant or government agency or to the public;

(ii) Discloses any part of the report or results, or any other information privileged under this section, as a defense to charges that the creditor has violated the Act or regulation; or

(iii) Fails or is unable to produce written or recorded information about the self-test that is required to be retained under § 202.12(b)(6) when the information is needed to determine whether the privilege applies. This paragraph does not limit any other penalty or remedy that may be available for a violation of § 202.12.

(3) *Limited use of privileged information*. Notwithstanding paragraph (d)(1) of this section, the self-test report or results and any other information privileged under this section may be obtained and used by an applicant or government agency solely to determine a penalty or remedy after a violation of the Act or this regulation has been adjudicated or admitted. Disclosures for this limited purpose may be used only for the particular proceeding in which the adjudication or admission was made. Information disclosed under this paragraph (d)(3) remains privileged under paragraph (d)(1) of this section.

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1B- Consumer Credit Law Manual § 202.16

§ **202.16 Enforcement, penalties and liabilities.**

(a) *Administrative enforcement* --

(1) As set forth more fully in section 704 of the Act, administrative enforcement of the Act and this regulation regarding certain creditors is assigned to the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Board of Directors of the Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration, Surface Transportation Board, Secretary of Agriculture, Farm Credit Administration, Securities and Exchange Commission, Small Business Administration, and Secretary of Transportation.

(2) Except to the extent that administrative enforcement is specifically assigned to other authorities, compliance with the requirements imposed under the Act and this regulation is enforced by the Federal Trade Commission.

(b) *Penalties and liabilities* --

(1) Sections 702(g) and 706(a) and (b) of the Act provide that any creditor that fails to comply with a requirement imposed by the Act or this regulation is subject to civil liability for actual and punitive damages in individual or class actions. Pursuant to sections 702(g) and 704(b), (c), and (d) of the Act, violations of the Act or this regulation also constitute violations of other federal laws. Liability for punitive damages can apply only to nongovernmental entities and is limited to $10,000 in individual actions and the lesser of $500,000 or 1 percent of the creditor's net worth in class actions. Section 706(c) provides for equitable and declaratory relief and section 706(d) authorizes the awarding of costs and reasonable attorney's fees to an aggrieved applicant in a successful action.

(2) As provided in section 706(f), a civil action under the Act or this regulation may be brought in the appropriate United States district court without regard to the amount in controversy or in any other court of competent jurisdiction within two years after the date of the occurrence of the violation, or within one year after the commencement of an administrative enforcement proceeding or of a civil action brought by the Attorney General of the United States within two years after the alleged violation.

(3) If an agency responsible for administrative enforcement is unable to obtain compliance with the Act or this regulation, it may refer the matter to the Attorney General of the United States. If the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, or the National Credit Union Administration has reason to believe that one or more creditors have engaged in a pattern or practice of discouraging or denying applications in violation of the Act or this regulation, the agency shall refer the matter to the Attorney General. If the agency has reason to believe that one or more creditors violated section 701(a) of the Act, the agency may refer a matter to the Attorney General.

(4) On referral, or whenever the Attorney General has reason to believe that one or more creditors have engaged in a pattern or practice in violation of the Act or this regulation, the Attorney General may bring a civil action for such relief as may be appropriate, including actual and punitive damages and injunctive relief.

(5) If the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, or the National Credit Union Administration has reason to believe (as a result of a consumer complaint, a consumer compliance examination, or some other basis) that a violation of the Act or this regulation has occurred which is also a violation of the Fair Housing Act, and the matter is not referred to the Attorney General, the agency shall:

(i) Notify the Secretary of Housing and Urban Development; and

(ii) Inform the applicant that the Secretary of Housing and Urban Development has been notified and that remedies may be available under the Fair Housing Act.

(c) *Failure of compliance*. A creditor's failure to comply with §§ 202.6(b)(6), 202.9, 202.10, 202.12 or 202.13 is not a violation if it results from an inadvertent error. On discovering an error under §§ 202.9 and 202.10, the creditor shall correct it as soon as possible. If a creditor inadvertently obtains the monitoring information regarding the ethnicity, race, and sex of the applicant in a dwelling-related transaction not covered by § 202.13, the creditor may retain information and act on the application without violating the regulation.

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1B- Consumer Credit Law Manual § 202.17

§ **202.17 [This section was redesignated as § 202.16. See 72 FR 63445, 63451, Nov. 9, 2007.]**

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Appendix A to Part 202 Federal Enforcement Agencies

1B Consumer Credit Law Manual Appendix A to Part 202

Appendix A to Part 202 Federal Enforcement Agencies

The following list indicates the federal agencies that enforce Regulation B for particular classes of creditors. Any questions concerning a particular creditor should be directed to its enforcement agency. Terms that are not defined in the Federal Deposit Insurance Act (*12 U.S.C. 1813(s)*) shall have the meaning given to them in the International Banking Act of 1978 (*12 U.S.C. 3101*).

National banks, and federal branches and federal agencies of foreign banks: Office of the Comptroller of the Currency, Customer Assistance Group, 1301 McKinney Street, Suite 3450, Houston, TX 77010-9050.

State member banks, branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act: Federal Reserve Consumer Help Center, P.O. Box 1200, Minneapolis, MN 55480.

Nonmember Insured Banks and Insured State Branches of Foreign Banks: FDIC Consumer Response Center, 2345 Grand Boulevard, Suite 100, Kansas City, Missouri 64108

Savings institutions insured under the Savings Association Insurance Fund of the FDIC and federally chartered savings banks insured under the Bank Insurance Fund of the FDIC (but not including state-chartered savings banks insured under the Bank Insurance Fund). Office of Thrift Supervision, Consumer Response Unit, 1700 G Street, NW., Washington, DC 20552.

Federal Credit Unions: Regional office of the National Credit Union Administration serving the area in which the federal credit union is located.

Air carriers: Assistant General Counsel for Aviation Enforcement and Proceedings, Department of Transportation, 400 Seventh Street, SW., Washington, DC 20590

Creditors Subject to Surface Transportation Board: Office of Proceedings, Surface Transportation Board, Department of Transportation, 1925 K Street NW., Washington, DC 20423

Creditors Subject to Packers and Stockyards Act: Nearest Packers and Stockyards Administration area supervisor.

Small Business Investment Companies: Associate Deputy Administrator for Capital Access, United States Small Business Administration, 409 Third Street, SW., 8th Floor, Washington, DC 20416.

Brokers and Dealers: Securities and Exchange Commission, Washington, DC 20549.

Federal Land Banks, Federal Land Bank Associations, Federal Intermediate Credit Banks, and Production Credit Associations: Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

Retailers, Finance Companies, and All Other Creditors Not Listed Above: FTC Regional Office for region in which the creditor operates or Federal Trade Commission, Equal Credit Opportunity, Washington, DC 20580.
[50 FR 48026, Nov. 20, 1985, as amended at *54 FR 53539,* Dec. 29, 1989; *56 FR 51322* , Oct. 11, 1991; *57 FR 20399* , May 13, 1992; *63 FR 16392, 16394* , April 3, 1998; *68 FR 13144, 13170* , Mar. 18, 2003; *71 FR 11296* , March 7, 2006; *71 FR 28563* , May 17, 2006; *72 FR 55020* , Sept. 28, 2007; *73 FR 33662, 33663* , June 13, 2008; *73 FR 53685* , Sept. 17, 2008]

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Appendix B to Part 202 Model Application Forms

1B Consumer Credit Law Manual Appendix B to Part 202

Appendix B to Part 202 Model Application Forms

1. This appendix contains five model credit application forms, each designated for use in a particular type of consumer credit transaction as indicated by the bracketed caption on each form. The first sample form is intended for use in open-end, unsecured transactions; the second for closed-end, secured transactions; the third for closed-end transactions, whether unsecured or secured; the fourth in transactions involving community property or occurring in community property states; and the fifth in residential mortgage transactions which contains a model disclosure for use in complying with § 202.13 for certain dwelling-related loans. All forms contained in this appendix are models; their use by creditors is optional.

2. The use or modification of these forms is governed by the following instructions. A creditor may change the forms: by asking for additional information not prohibited by § 202.5; by deleting any information request; or by rearranging the format without modifying the substance of the inquiries. In any of these three instances, however, the appropriate notices regarding the optional nature of courtesy titles, the option to disclose alimony, child support, or separate maintenance, and the limitation concerning marital status inquiries must be included in the appropriate places if the items to which they relate appear on the creditor's form.

3. If a creditor uses an appropriate Appendix B model form, or modifies a form in accordance with the above instructions, that creditor shall be deemed to be acting in compliance with the provisions of paragraphs (b), (c) and (d) of § 202.5 of this regulation.

Click here to view image.

[Reg. B, *50 FR 48026* , Nov. 20, 1985; *68 FR 13144, 13171* , Mar. 18, 2003; *68 FR 53491, 53492* , Sept. 11, 2003]

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Appendix C to Part 202 Sample Notification Forms

1B Consumer Credit Law Manual Appendix C to Part 202

Appendix C to Part 202 Sample Notification Forms

1. This appendix contains ten sample notification forms. Forms C-1 through C-4 are intended for use in notifying an applicant that adverse action has been taken on an application or account under §§ 202.9(a)(1) and (2)(i) of this regulation. Form C-5 is a notice of disclosure of the right to request specific reasons for adverse action under §§ 202.9(a)(1) and (2)(ii). Form C-6 is designed for use in notifying an applicant, under § 202.9(c)(2), that an application is incomplete. Forms C-7 and C-8 are intended for use in connection with applications for business credit under § 202.9(a)(3). Form C-9 is designed for use in notifying an applicant of the right to receive a copy of an appraisal under § 202.14. Form C-10 is designed for use in notifying an applicant for nonmortgage credit that the creditor is requesting applicant characteristic information.

2. Form C-1 contains the Fair Credit Reporting Act disclosure as required by sections 615(a) and (b) of that act. Forms C-2 through C-5 contain only the section 615(a) disclosure (that a creditor obtained information from a consumer reporting agency that played a part in the credit decision). A creditor must provide the section 615(a) disclosure when adverse action is taken against a consumer based on information from a consumer reporting agency. A creditor must provide the section 615(b) disclosure when adverse action is taken based on information from an outside source other than a consumer reporting agency. In addition, a creditor must provide the section 615(b) disclosure if the creditor obtained information from an affiliate other than information in a consumer report or other than information concerning the affiliate's own transactions or experiences with the consumer. Creditors may comply with the disclosure requirements for adverse action based on information in a consumer report obtained from an affiliate by providing either the section 615(a) or section 615(b) disclosure.

3. The sample forms are illustrative and may not be appropriate for all creditors. They were designed to include some of the factors that creditors most commonly consider. If a creditor chooses to use the checklist of reasons provided in one

of the sample forms in this appendix and if reasons commonly used by the creditor are not provided on the form, the creditor should modify the checklist by substituting or adding other reasons. For example, if "inadequate down payment" or "no deposit relationship with us" are common reasons for taking adverse action on an application, the creditor ought to add or substitute such reasons for those presently contained on the sample forms.

4. If the reasons listed on the forms are not the factors actually used, a creditor will not satisfy the notice requirement by simply checking the closest identifiable factor listed. For example, some creditors consider only references from banks or other depository institutions and disregard finance company references altogether; their statement of reasons should disclose "insufficient bank references," not "insufficient credit references." Similarly, a creditor that considers bank references and other credit references as distinct factors should treat the two factors separately and disclose them as appropriate. The creditor should either add such other factors to the form or check "other" and include the appropriate explanation. The creditor need not, however, describe how or why a factor adversely affected the application. For example, the notice may say "length of residence" rather than "too short a period of residence."

5. A creditor may design its own notification forms or use all or a portion of the forms contained in this appendix. Proper use of Forms C-1 through C-4 will satisfy the requirement of § 202.9(a)(2)(i). Proper use of Forms C-5 and C-6 constitutes full compliance with §§ 202.9(a)(2)(ii) and 202.9(c)(2), respectively. Proper use of Forms C-7 and C-8 will satisfy the requirements of § 202.9(a)(2)(i) and (ii), respectively, for applications for business credit. Proper use of Form C-9 will satisfy the requirements of § 202.14 of this part. Proper use of Form C-10 will satisfy the requirements of § 202.5(b)(1).Form C-1 Sample Notice of Action Taken and Statement of Reasons

Statement of Credit Denial, Termination or Change

Date: _____

Applicant's Name: _____

Applicant's Address: _____

Description of Account, Transaction, or Requested Credit: _____

Description of Action Taken: _____ _____

Part I Principal Reason(s) for Credit Denial, Termination, or Other Action Taken Concerning Credit.

This section must be completed in all instances.

_____ Credit application incomplete

_____ Insufficient number of credit references provided

_____ Unacceptable type of credit references provided

_____ Unable to verify credit references

_____ Temporary or irregular employment

_____ Unable to verify employment

_____ Length of employment

_____ Income insufficient for amount of credit requested

_____ Excessive obligations in relation to income

_____ Unable to verify income

_____ Length of residence

_____ Temporary residence

_____ Unable to verify residence

_____ No credit file

_____ Limited credit experience

_____ Poor credit performance with us

_____ Delinquent past or present credit obligations with others

_____ Collection action or judgment

_____ Garnishment or attachment

_____ Foreclosure or repossession

_____ Bankruptcy

_____ Number of recent inquiries on credit bureau report

_____ Value or type of collateral not sufficient

_____ Other, specify: _____

Part II Disclosure of Use of Information Obtained from an Outside Source.

This section should be completed if the credit decision was based in whole or in part on information that has been obtained from an outside source.

_____ Our credit decision was based in whole or in part on information obtained in a report from the consumer reporting agency listed below. You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. You also have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute

the matter with the reporting agency.

Name: _____

Address: _____

_____

[Toll-free] Telephone number: _____

_____ Our credit decision was based in whole or in part on information obtained from an outside source other than a consumer reporting agency. Under the Fair Credit Reporting Act, you have the right to make a written request, no later than 60 days after you receive this notice, for disclosure of the nature of this information.

If you have any questions regarding this notice, you should contact:

Creditor's name: _____

Creditor's address: _____

Creditor's telephone number: _____

Notice:

The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in appendix A).

Form C-2 SAMPLE NOTICE OF ACTION TAKEN AND STATEMENT OF REASONS

Date: _____

Dear Applicant:

Thank you for your recent application. Your request for [a loan/a credit card/an increase in your credit limit] was carefully considered, and we regret that we are unable to approve your application at this time, for the following reason(s):

Your Income:

_____ is below our minimum requirement.

_____ is insufficient to sustain payments on the amount of credit requested.

_____ could not be verified.

Your Employment:

_____ is not of sufficient length to qualify.

_____ could not be verified.

Your Credit History:

_____ of making payments on time was not satisfactory.

_____ could not be verified.

Your Application:

_____ lacks a sufficient number of credit references.

_____ lacks acceptable types of credit references.

_____ reveals that current obligations are excessive in relation to income.

Other: _____

The consumer reporting agency contacted that provided information that influenced our decision in whole or in part was [name, address and [toll-free] telephone number of the reporting agency]. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency. You also have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency. Any questions regarding such information should be directed to [consumer reporting agency].

If you have any questions regarding this letter, you should contact us at [creditor's name, address and telephone number].

Notice:

The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in appendix A).

Form C-3 SAMPLE NOTICE OF ACTION TAKEN AND STATEMENT OF REASONS (CREDIT SCORING)

Date: _____

Dear Applicant:

Thank you for your recent application for _____.

We regret that we are unable to approve your request.

Your application was processed by a credit scoring system that assigns a numerical value to the various items of information we consider in evaluating an application. These numerical values are based upon the results of analyses of repayment histories of large numbers of customers.

The information you provided in your application did not score a sufficient number of points for approval of the application. The reasons you did not score well compared with other applicants were:

- Insufficient bank references
- Type of occupation
- Insufficient credit experience
- Number of recent inquiries on credit bureau report

In evaluating your application the consumer reporting agency listed below provided us with information that in whole or in part influenced our decision. The consumer reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency. It can be obtained by contacting: [name, address, and [toll-free] telephone number of the consumer reporting agency]. You also have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency.

If you have any questions regarding this letter, you should contact us at

Creditor's Name: _____

Address: _____

_____

Telephone: _____

Sincerely,

Notice:
The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (with certain limited exceptions); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in appendix A).

Form C-4 SAMPLE NOTICE OF ACTION TAKEN, STATEMENT OF REASONS AND COUNTEROFFER

Date: _____

Dear Applicant:

Thank you for your application for _____. We are unable to offer you credit on the terms that you requested for the following reason(s):

_____

We can, however, offer you credit on the following terms: _____

_____

If this offer is acceptable to you, please notify us within [amount of time] at the following address:
_____

Our credit decision on your application was based in whole or in part on information obtained in a report from [name, address and [toll-free] telephone number of the consumer reporting agency]. You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. You also have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency.

You should know that the federal Equal Credit Opportunity Act prohibits creditors, such as ourselves, from discriminating against credit applicants on the basis of their race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract), because they receive income from a public assistance program, or because they may have exercised their rights under the Consumer Credit Protection Act. If you believe there has been discrimination in handling your application you should contact the [name and address of the appropriate federal enforcement agency listed in appendix A].

Sincerely,
Form C-5 SAMPLE DISCLOSURE OF RIGHT TO REQUEST SPECIFIC REASONS FOR CREDIT DENIAL

Date: _____

Dear Applicant:

Thank you for applying to us for _____

After carefully reviewing your application, we are sorry to advise you that we cannot [open an account for you/grant a loan to you/increase your credit limit] at this time. If you would like a statement of specific reasons why your application was denied, please contact [our credit service manager] shown below within 60 days of the date of this letter. We will provide you with the statement of reasons within 30 days after receiving your request.

Creditor's Name

Address

Telephone number

If we obtained information from a consumer reporting agency as part of our consideration of your application, its name, address, and [toll-free] telephone number is shown below. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. [You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency.] You have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you received is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency. You can find out about the information contained in your file (if one was used) by contacting:

Consumer reporting agency's name
Address

[Toll-free] Telephone number

Sincerely,

Notice:

The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in appendix A).

Form C-6 SAMPLE NOTICE OF INCOMPLETE APPLICATION AND REQUEST FOR ADDITIONAL INFORMATION

Creditor's name
Address
Telephone number

Date

Dear Applicant:

Thank you for your application for credit. The following information is needed to make a decision on your application:

_____

_____

We need to receive this information by (date). If we do not receive it by that date, we will regrettably be unable to give further consideration to your credit request.

Sincerely,

Form C-7 SAMPLE NOTICE OF ACTION TAKEN AND STATEMENT OF REASONS (BUSINESS CREDIT)

Creditor's name
Creditor's address
Date

Dear Applicant: Thank you for applying to us for credit. We have given your request careful consideration, and regret that we are unable to extend credit to you at this time for the following reasons:

(Insert appropriate reason, such as: Value or type of collateral not sufficient; Lack of established earnings record; Slow or past due in trade or loan payments)

Sincerely,

Notice:

The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit

applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is [name and address as specified by the appropriate agency listed in appendix A].

Form C-8 SAMPLE DISCLOSURE OF RIGHT TO REQUEST SPECIFIC REASONS FOR CREDIT DENIAL GIVEN AT TIME OF APPLICATION (BUSINESS CREDIT)

Creditor's name

Creditor's address

If your application for business credit is denied, you have the right to a written statement of the specific reasons for the denial. To obtain the statement, please contact [name, address and telephone number of the person or office from which the statement of reasons can be obtained] within 60 days from the date you are notified of our decision. We will send you a written statement of reasons for the denial within 30 days of receiving your request for the statement.

Notice:

The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is [name and address as specified by the appropriate agency listed in appendix A].

Form C-9 SAMPLE DISCLOSURE OF RIGHT TO RECEIVE A COPY OF AN APPRAISAL

You have the right to a copy of the appraisal report obtained in connection with your application for credit. If you wish a copy, please write to us at the mailing address we have provided. We must hear from you no later than 90 days after we notify you about the action taken on your credit application or you withdraw your application.

[In your letter, give us the following information:]Form C-10 SAMPLE DISCLOSURE ABOUT VOLUNTARY DATA NOTATION

We are requesting the following information to monitor our compliance with the federal Equal Credit Opportunity Act, which prohibits unlawful discrimination. You are not required to provide this information. We will not take this information (or your decision not to provide this information) into account in connection with your application or credit transaction. The law provides that a creditor may not discriminate based on this information, or based on whether or not you choose to provide it. [If you choose not to provide the information, we will note it by visual observation or surname].

[Reg. B, *50 FR 48026,* Nov. 20, 1985, as amended at *54 FR 50486,* Dec. 7, 1989; *58 FR 65662* , Dec. 16, 1993; *63 FR 16392, 16394* , April 3, 1998; *68 FR 13144, 13184,* Mar. 18, 2003, as corrected at *68 FR 14476,* Mar. 25, 2003]

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12 C.F.R. Part 202 REGULATION B--EQUAL CREDIT OPPORTUNITY
Appendix D to Part 202 Issuance of Staff Interpretations

1B Consumer Credit Law Manual Appendix D to Part 202

Appendix D to Part 202 Issuance of Staff Interpretations

1. *Official Staff Interpretations*. Officials in the Board's Division of Consumer and Community Affairs are authorized to issue official staff interpretations of this regulation. These interpretations provide the protection afforded under section 706(e) of the Act. Except in unusual circumstances, such interpretations will not be issued separately but will be incorporated in an official commentary to the regulation, which will be amended periodically.

2. *Requests for Issuance of Official Staff Interpretations*. A request for an official staff interpretation should be in writing and addressed to the Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551. The request should contain a complete statement of all relevant facts concerning the issue, including copies of all pertinent documents.

3. *Scope of Interpretations*. No staff interpretations will be issued approving creditors' forms or statements. This restriction does not apply to forms or statements whose use is required or sanctioned by a government agency.
[*50 FR 48026* , Nov. 20, 1985; *68 FR 13144, 13186* , Mar. 18, 2003]

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1B Consumer Credit Law Manual Supp I to Part 202

Supp I to Part 202 Official Staff Interpretations to Regulation B

Following is an official staff interpretation of Regulation B (12 CFR part 202) issued under authority delegated by the Federal Reserve Board to officials in the Division of Consumer and Community Affairs. References are to sections of the regulation or the Equal Credit Opportunity Act (*15 U.S.C. 1601 et seq.*).

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1B- Consumer Credit Law Manual CFR

§ **CFR Introduction**

1. *Official status*. Section 706(e) of the Equal Credit Opportunity Act protects a creditor from civil liability for any act done or omitted in good faith in conformity with an interpretation issued by a duly authorized official of the Federal Reserve Board. This commentary is the means by which the Division of Consumer and Community Affairs of the Federal Reserve Board issues official staff interpretations of Regulation B. Good-faith compliance with this commentary affords a creditor protection under section 706(e) of the Act.

2. *Issuance of interpretations*. Under Appendix D to the regulation, any person may request an official staff interpretation. Interpretations will be issued at the discretion of designated officials and incorporated in this commentary following publication for comment in the Federal Register. Except in unusual circumstances, official staff interpretations will be issued only by means of this commentary.

3. *Status of previous interpretations*. Interpretations of Regulation B previously issued by the Federal Reserve Board and its staff have been incorporated into this commentary as appropriate. All other previous Board and staff interpretations, official and unofficial, are superseded by this commentary.

4. *Footnotes*. Footnotes in the regulation have the same legal effect as the text of the regulation, whether they are explanatory or illustrative in nature.

5. *Comment designations*. The comments are designated with as much specificity as possible according to the particular regulatory provision addressed. Each comment in the commentary is identified by a number and the regulatory section or paragraph that it interprets. For example, comments to § 202.2(c) are further divided by subparagraph, such as

comment 2(c)(1)(ii)-1 and comment 2(c)(2)(ii)-1.

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1B- Consumer Credit Law Manual § 202.1

§ 202.1 Authority, Scope, and Purpose

1(a) Authority and scope.

1. *Scope*. The Equal Credit Opportunity Act and Regulation B apply to all credit-commercial as well as personal-without regard to the nature or type of the credit or the creditor. If a transaction provides for the deferral of the payment of a debt, it is credit covered by Regulation B even though it may not be a credit transaction covered by Regulation Z (Truth in Lending) (12 CFR part 226). Further, the definition of creditor is not restricted to the party or person to whom the obligation is initially payable, as is the case under Regulation Z. Moreover, the Act and regulation apply to all methods of credit evaluation, whether performed judgmentally or by use of a credit scoring system.

2. *Foreign applicability*. Regulation B generally does not apply to lending activities that occur outside the United States. The regulation does apply to lending activities that take place within the United States (as well as the Commonwealth of Puerto Rico and any territory or possession of the United States), whether or not the applicant is a citizen.

3. *Board*. The term Board, as used in this regulation, means the Board of Governors of the Federal Reserve System.

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1B- Consumer Credit Law Manual § 202.2

§ **202.2 Definitions**

2(c) Adverse action.

Paragraph 2(c)(1)(i)

1. *Application for credit*. If the applicant applied in accordance with the creditor's procedures, a refusal to refinance or extend the term of a business or other loan is adverse action.

Paragraph 2(c)(1)(ii)

1. *Move from service area*. If a credit card issuer terminates the open-end account of a customer because the customer has moved out of the card issuer's service area, the termination is adverse action unless termination on this ground was explicitly provided for in the credit agreement between the parties. In cases where termination is adverse action, notification is required under § 202.9.

2. *Termination based on credit limit*. If a creditor terminates credit accounts that have low credit limits (for example, under $400) but keeps open accounts with higher credit limits, the termination is adverse action and notification is required under § 202.9.

Paragraph 2(c)(2)(ii)

1. *Default -- exercise of due-on-sale clause*. If a mortgagor sells or transfers mortgaged property without the consent

of the mortgagee, and the mortgagee exercises its contractual right to accelerate the mortgage loan, the mortgagee may treat the mortgagor as being in default. An adverse action notice need not be given to the mortgagor or the transferee. (See comment 2(e)-1 for treatment of a purchaser who requests to assume the loan.)

2. *Current delinquency or default*. The term adverse action does not include a creditor's termination of an account when the accountholder is currently in default or delinquent on that account. Notification in accordance with § 202.9 of the regulation generally is required, however, if the creditor's action is based on a past delinquency or default on the account.

Paragraph 2(c)(2)(iii)

1. *Point-of-sale transactions*. Denial of credit at point of sale is not adverse action except under those circumstances specified in the regulation. For example, denial at point of sale is not adverse action in the following situations:

i. A credit cardholder presents an expired card or a card that has been reported to the card issuer as lost or stolen.

ii. The amount of a transaction exceeds a cash advance or credit limit.

iii. The circumstances (such as excessive use of a credit card in a short period of time) suggest that fraud is involved.

iv. The authorization facilities are not functioning.

v. Billing statements have been returned to the creditor for lack of a forwarding address.

2. *Application for increase in available credit*. A refusal or failure to authorize an account transaction at the point of sale or loan is not adverse action except when the refusal is a denial of an application, submitted in accordance with the creditor's procedures, for an increase in the amount of credit.

Paragraph 2(c)(2)(v)

1. *Terms of credit versus type of credit offered*. When an applicant applies for credit and the creditor does not offer the credit terms requested by the applicant (for example, the interest rate, length of maturity, collateral, or amount of downpayment), a denial of the application for that reason is adverse action (unless the creditor makes a counteroffer that

is accepted by the applicant) and the applicant is entitled to notification under § 202.9.

2(e) Applicant.

1. *Request to assume loan*. If a mortgagor sells or transfers the mortgaged property and the buyer makes an application to the creditor to assume the mortgage loan, the mortgagee must treat the buyer as an applicant unless its policy is not to permit assumptions.

2(f) Application.

1. *General*. A creditor has the latitude under the regulation to establish its own application process and to decide the type and amount of information it will require from credit applicants.

2. *Procedures used*. The term "procedures" refers to the actual practices followed by a creditor for making credit decisions as well as its stated application procedures. For example, if a creditor's stated policy is to require all applications to be in writing on the creditor's application form, but the creditor also makes credit decisions based on oral requests, the creditor's procedures are to accept both oral and written applications.

3. *When an inquiry or prequalification request becomes an application*. A creditor is encouraged to provide consumers with information about loan terms. However, if in giving information to the consumer the creditor also evaluates information about the consumer, decides to decline the request, and communicates this to the consumer, the creditor has treated the inquiry or prequalification request as an application and must then comply with the notification requirements under § 202.9. Whether the inquiry or prequalification request becomes an application depends on how the creditor responds to the consumer, not on what the consumer says or asks. (See comment 9-5 for further discussion of prequalification requests; see comment 2(f)-5 for a discussion of preapproval requests.)

4. *Examples of inquiries that are not applications*. The following examples illustrate situations in which only an inquiry has taken place:

i. A consumer calls to ask about loan terms and an employee explains the creditor's basic loan terms, such as interest rates, loan-to-value ratio, and debt-to-income ratio.

ii. A consumer calls to ask about interest rates for car loans, and, in order to quote the appropriate rate, the loan officer asks for the make and sales price of the car and the amount of the downpayment, then gives the consumer the rate.

iii. A consumer asks about terms for a loan to purchase a home and tells the loan officer her income and intended downpayment, but the loan officer only explains the creditor's loan-to-value ratio policy and other basic lending policies, without telling the consumer whether she qualifies for the loan.

iv. A consumer calls to ask about terms for a loan to purchase vacant land and states his income and the sales price of the property to be financed, and asks whether he qualifies for a loan; the employee responds by describing the general lending policies, explaining that he would need to look at all of the consumer's qualifications before making a decision, and offering to send an application form to the consumer.

5. *Examples of an application*. An application for credit includes the following situations:

i. A person asks a financial institution to "preapprove" her for a loan (for example, to finance a house or a vehicle she plans to buy) and the institution reviews the request under a program in which the institution, after a comprehensive analysis of her creditworthiness, issues a written commitment valid for a designated period of time to extend a loan up to a specified amount. The written commitment may not be subject to conditions other than conditions that require the identification of adequate collateral, conditions that require no material change in the applicant's financial condition or creditworthiness prior to funding the loan, and limited conditions that are not related to the financial condition or creditworthiness of the applicant that the lender ordinarily attaches to a traditional application (such as certification of a clear termite inspection for a home purchase loan, or a maximum mileage requirement for a used car loan). But if the creditor's program does not provide for giving written commitments, requests for preapprovals are treated as prequalification requests for purposes of the regulation.

ii. Under the same facts as above, the financial institution evaluates the person's creditworthiness and determines that she does not qualify for a preapproval.

6. *Completed application -- diligence requirement*. The regulation defines a completed application in terms that give a creditor the latitude to establish its own information requirements. Nevertheless, the creditor must act with reasonable diligence to collect information needed to complete the application. For example, the creditor should request information from third parties, such as a credit report, promptly after receiving the application. If additional information is needed from the applicant, such as an address or a telephone number to verify employment, the creditor should contact the applicant promptly. (But see comment 9(a)(1)-3, which discusses the creditor's option to deny an application on the basis of incompleteness.)

2(g) Business credit.

1. *Definition*. The test for deciding whether a transaction qualifies as business credit is one of primary purpose. For example, an open-end credit account used for both personal and business purposes is not business credit unless the primary purpose of the account is business-related. A creditor may rely on an applicant's statement of the purpose for

the credit requested.

2(j) Credit.

1. *General*. Regulation B covers a wider range of credit transactions than Regulation Z (Truth in Lending). Under Regulation B, a transaction is credit if there is a right to defer payment of a debt -- regardless of whether the credit is for personal or commercial purposes, the number of installments required for repayment, or whether the transaction is subject to a finance charge.

2(l) Creditor.

1. *Assignees*. The term creditor includes all persons participating in the credit decision. This may include an assignee or a potential purchaser of the obligation who influences the credit decision by indicating whether or not it will purchase the obligation if the transaction is consummated.

2. *Referrals to creditors*. For certain purposes, the term creditor includes persons such as real estate brokers, automobile dealers, home builders, and home-improvement contractors who do not participate in credit decisions but who only accept applications and refer applicants to creditors, or select or offer to select creditors to whom credit requests can be made. These persons must comply with § 202.4(a), the general rule prohibiting discrimination, and with § 202.4(b), the general rule against discouraging applications.

2(p) Empirically derived and other credit scoring systems.

1. *Purpose of definition*. The definition under § 202.2(p)(1)(i) through (iv) sets the criteria that a credit system must meet in order to use age as a predictive factor. Credit systems that do not meet these criteria are judgmental systems and may consider age only for the purpose of determining a "pertinent element of creditworthiness." (Both types of systems may favor an elderly applicant. See § 202.6(b)(2).)

2. *Periodic revalidation*. The regulation does not specify how often credit scoring systems must be revalidated. The credit scoring system must be revalidated frequently enough to ensure that it continues to meet recognized professional statistical standards for statistical soundness. To ensure that predictive ability is being maintained, the creditor must periodically review the performance of the system. This could be done, for example, by analyzing the loan portfolio to determine the delinquency rate for each score interval, or by analyzing population stability over time to detect deviations of recent applications from the applicant population used to validate the system. If this analysis indicates that the system no longer predicts risk with statistical soundness, the system must be adjusted as necessary to reestablish its predictive ability. A creditor is responsible for ensuring its system is validated and revalidated based on the creditor's own data.

3. *Pooled data scoring systems*. A scoring system or the data from which to develop such a system may be obtained

from either a single credit grantor or multiple credit grantors. The resulting system will qualify as an empirically derived, demonstrably and statistically sound, credit scoring system provided the criteria set forth in paragraph (p)(1)(i) through (iv) of this section are met. A creditor is responsible for ensuring its system is validated and revalidated based on the creditor's own data when it becomes available.

4. *Effects test and disparate treatment*. An empirically derived, demonstrably and statistically sound, credit scoring system may include age as a predictive factor (provided that the age of an elderly applicant is not assigned a negative factor or value). Besides age, no other prohibited basis may be used as a variable. Generally, credit scoring systems treat all applicants objectively and thus avoid problems of disparate treatment. In cases where a credit scoring system is used in conjunction with individual discretion, disparate treatment could conceivably occur in the evaluation process. In addition, neutral factors used in credit scoring systems could nonetheless be subject to challenge under the effects test. (See comment 6(a)-2 for a discussion of the effects test).

2(w) Open-end credit.

1. *Open-end real estate mortgages*. The term "open-end credit" does not include negotiated advances under an open-end real estate mortgage or a letter of credit.

2(z) Prohibited basis.

1. *Persons associated with applicant*. As used in this regulation, prohibited basis refers not only to characteristics -- the race, color, religion, national origin, sex, marital status, or age -- of an applicant (or officers of an applicant in the case of a corporation) but also to the characteristics of individuals with whom an applicant is affiliated or with whom the applicant associates. This means, for example, that under the general rule stated in § 202.4(a), a creditor may not discriminate against an applicant because of that person's personal or business dealings with members of a certain religion, because of the national origin of any persons associated with the extension of credit (such as the tenants in the apartment complex being financed), or because of the race of other residents in the neighborhood where the property offered as collateral is located.

2. *National origin*. A creditor may not refuse to grant credit because an applicant comes from a particular country but may take the applicant's immigration status into account. A creditor may also take into account any applicable law, regulation, or executive order restricting dealings with citizens (or the government) of a particular country or imposing limitations regarding credit extended for their use.

3. *Public assistance program*. Any federal, state, or local governmental assistance program that provides a continuing, periodic income supplement, whether premised on entitlement or need, is "public assistance" for purposes of the regulation. The term includes (but is not limited to) Temporary Aid to Needy Families, food stamps, rent and mortgage supplement or assistance programs, social security and supplemental security income, and unemployment compensation. Only physicians, hospitals, and others to whom the benefits are payable need consider Medicare and Medicaid as public assistance.

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1B- Consumer Credit Law Manual § 202.3

§ 202.3 Limited Exceptions for Certain Classes of Transactions

1. *Scope*. Under this section, procedural requirements of the regulation do not apply to certain types of credit. All classes of transactions remain subject to § 202.4(a), the general rule barring discrimination on a prohibited basis, and to any other provision not specifically excepted.

3(a) Public-utilities credit.

1. *Definition*. This definition applies only to credit for the purchase of a utility service, such as electricity, gas, or telephone service. Credit provided or offered by a public utility for some other purpose -- such as for financing the purchase of a gas dryer, telephone equipment, or other durable goods, or for insulation or other home improvements -- is not excepted.

2. *Security deposits*. A utility company is a creditor when it supplies utility service and bills the user after the service has been provided. Thus, any credit term (such as a requirement for a security deposit) is subject to the regulation's bar against discrimination on a prohibited basis.

3. *Telephone companies*. A telephone company's credit transactions qualify for the exceptions provided in § 202.3(a)(2) only if the company is regulated by a government unit or files the charges for service, delayed payment, or any discount for prompt payment with a government unit.

3(c) Incidental credit.

1. *Examples*. If a service provider (such as a hospital, doctor, lawyer, or merchant) allows the client or customer to defer the payment of a bill, this deferral of debt is credit for purposes of the regulation, even though there is no finance charge and no agreement for payment in installments. Because of the exceptions provided by this section, however, these particular credit extensions are excepted from compliance with certain procedural requirements as specified in § 202.3(c).

3(d) Government credit.

1. *Credit to governments*. The exception relates to credit extended to (not by) governmental entities. For example, credit extended to a local government is covered by this exception, but credit extended to consumers by a federal or state housing agency does not qualify for special treatment under this category.

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1B- Consumer Credit Law Manual § 202.4

§ **202.4 General Rules**

Paragraph 4(a)

1. *Scope of rule*. The general rule stated in § 202.4(a) covers all dealings, without exception, between an applicant and a creditor, whether or not addressed by other provisions of the regulation. Other provisions of the regulation identify specific practices that the Board has decided are impermissible because they could result in credit discrimination on a basis prohibited by the Act. The general rule covers, for example, application procedures, criteria used to evaluate creditworthiness, administration of accounts, and treatment of delinquent or slow accounts. Thus, whether or not specifically prohibited elsewhere in the regulation, a credit practice that treats applicants differently on a prohibited basis violates the law because it violates the general rule. Disparate treatment on a prohibited basis is illegal whether or not it results from a conscious intent to discriminate.

2. *Examples*.

i. Disparate treatment would exist, for example, in the following situations:

A. A creditor provides information only on "subprime" and similar products to minority applicants who request information about the creditor's mortgage products, but provides information on a wider variety of mortgage products to similarly situated nonminority applicants.

B. A creditor provides more comprehensive information to men than to similarly situated women.

C. A creditor requires a minority applicant to provide greater documentation to obtain a loan than a similarly situated nonminority applicant.

D. A creditor waives or relaxes credit standards for a nonminority applicant but not for a similarly situated minority applicant.

ii. Treating applicants differently on a prohibited basis is unlawful if the creditor lacks a legitimate nondiscriminatory reason for its action, or if the asserted reason is found to be a pretext for discrimination.

Paragraph 4(b)

1. *Prospective applicants*. Generally, the regulation's protections apply only to persons who have requested or received an extension of credit. In keeping with the purpose of the Act -- to promote the availability of credit on a nondiscriminatory basis -- § 202.4(b) covers acts or practices directed at prospective applicants that could discourage a reasonable person, on a prohibited basis, from applying for credit. Practices prohibited by this section include:

i. A statement that the applicant should not bother to apply, after the applicant states that he is retired.

ii. The use of words, symbols, models or other forms of communication in advertising that express, imply, or suggest a discriminatory preference or a policy of exclusion in violation of the Act.

iii. The use of interview scripts that discourage applications on a prohibited basis.

2. *Affirmative advertising*. A creditor may affirmatively solicit or encourage members of traditionally disadvantaged groups to apply for credit, especially groups that might not normally seek credit from that creditor.

Paragraph 4(c)

1. *Requirement for written applications*. Model application forms are provided in Appendix B to the regulation, although use of a printed form is not required. A creditor will satisfy the requirement by writing down the information that it normally considers in making a credit decision. The creditor may complete an application on behalf of an applicant and need not require the applicant to sign the application.

2. *Telephone applications*. A creditor that accepts applications by telephone for dwelling-related credit covered by § 202.13 can meet the requirement for written applications by writing down pertinent information that is provided by the applicant.

3. *Computerized entry*. Information entered directly into and retained by a computerized system qualifies as a written application under this paragraph. (See the commentary to § 202.13(b), Applications through electronic media and Applications through video.)

Paragraph 4(d)

1. *Clear and conspicuous*. This standard requires that disclosures be presented in a reasonably understandable format in a way that does not obscure the required information. No minimum type size is mandated, but the disclosures must be legible, whether typewritten, handwritten, or printed by computer.

2. *Form of disclosures*. Whether the disclosures required to be on or with an application must be in electronic form depends upon the following:

i. If an applicant accesses a credit application electronically (other than as described under ii below), such as online at a home computer, the creditor must provide the disclosures in electronic form (such as with the application form on its website) in order to meet the requirement to provide disclosures in a timely manner on or with the application. If the creditor instead mailed paper disclosures to the applicant, this requirement would not be met.

ii. In contrast, if an applicant is physically present in the creditor's office, and accesses a credit application electronically, such as via a terminal or kiosk (or if the applicant uses a terminal or kiosk located on the premises of an affiliate or third party that has arranged with the creditor to provide applications to consumers), the creditor may provide disclosures in either electronic or paper form, provided the creditor complies with the timing, delivery, and retainability requirements of the regulation.

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1B- Consumer Credit Law Manual § 202.5

§ 202.5 Rules Concerning Requests for Information

5(a) General rules.

Paragraph 5(a)(1)

1. *Requests for information*. This section governs the types of information that a creditor may gather. Section 202.6 governs how information may be used.

Paragraph 5(a)(2)

1. *Local laws*. Information that a creditor is allowed to collect pursuant to a "state" statute or regulation includes information required by a local statute, regulation, or ordinance.

2. *Information required by Regulation C*. Regulation C generally requires creditors covered by the Home Mortgage Disclosure Act (HMDA) to collect and report information about the race, ethnicity, and sex of applicants for home-improvement loans and home-purchase loans, including some types of loans not covered by § 202.13.

3. *Collecting information on behalf of creditors*. Persons such as loan brokers and correspondents do not violate the ECOA or Regulation B if they collect information that they are otherwise prohibited from collecting, where the purpose of collecting the information is to provide it to a creditor that is subject to the Home Mortgage Disclosure Act or another federal or state statute or regulation requiring data collection.

5(d) Other limitations on information requests.

Paragraph 5(d)(1)

1. *Indirect disclosure of prohibited information*. The fact that certain credit-related information may indirectly disclose marital status does not bar a creditor from seeking such information. For example, the creditor may ask about:

i. The applicant's obligation to pay alimony, child support, or separate maintenance income.

ii. The source of income to be used as the basis for repaying the credit requested, which could disclose that it is the income of a spouse.

iii. Whether any obligation disclosed by the applicant has a co-obligor, which could disclose that the co-obligor is a spouse or former spouse.

iv. The ownership of assets, which could disclose the interest of a spouse.

Paragraph 5(d)(2)

1. *Disclosure about income*. The sample application forms in appendix B to the regulation illustrate how a creditor may inform an applicant of the right not to disclose alimony, child support, or separate maintenance income.

2. *General inquiry about source of income*. Since a general inquiry about the source of income may lead an applicant to disclose alimony, child support, or separate maintenance income, a creditor making such an inquiry on an application form should preface the request with the disclosure required by this paragraph.

3. *Specific inquiry about sources of income*. A creditor need not give the disclosure if the inquiry about income is specific and worded in a way that is unlikely to lead the applicant to disclose the fact that income is derived from alimony, child support, or separate maintenance payments. For example, an application form that asks about specific types of income such as salary, wages, or investment income need not include the disclosure.

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1B- Consumer Credit Law Manual § 202.6

§ 202.6 Rules Concerning Evaluation of Applications

6(a) General rule concerning use of information.

1. *General*. When evaluating an application for credit, a creditor generally may consider any information obtained. However, a creditor may not consider in its evaluation of creditworthiness any information that it is barred by § 202.5 from obtaining or from using for any purpose other than to conduct a self-test under § 202.15.

2. *Effects test*. The effects test is a judicial doctrine that was developed in a series of employment cases decided by the U.S. Supreme Court under Title VII of the Civil Rights Act of 1964 (*42 U.S.C. 2000e et seq.*), and the burdens of proof for such employment cases were codified by Congress in the Civil Rights Act of 1991 (*42 U.S.C. 2000e-2*). Congressional intent that this doctrine apply to the credit area is documented in the Senate Report that accompanied H.R. 6516, No. 94-589, pp. 4-5; and in the House Report that accompanied H.R. 6516, No. 94-210, p.5. The Act and regulation may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact. For example, requiring that applicants have income in excess of a certain amount to qualify for an overdraft line of credit could mean that women and minority applicants will be rejected at a higher rate than men and nonminority applicants. If there is a demonstrable relationship between the income requirement and creditworthiness for the level of credit involved, however, use of the income standard would likely be permissible.

6(b) Specific rules concerning use of information.

Paragraph 6(b)(1)

1. *Prohibited basis -- special purpose credit*. In a special purpose credit program, a creditor may consider a prohibited basis to determine whether the applicant possesses a characteristic needed for eligibility. (See § 202.8.)

Paragraph 6(b)(2)

1. *Favoring the elderly*. Any system of evaluating creditworthiness may favor a credit applicant who is age 62 or older. A credit program that offers more favorable credit terms to applicants age 62 or older is also permissible; a program that offers more favorable credit terms to applicants at an age lower than 62 is permissible only if it meets the special-purpose credit requirements of § 202.8.

2. *Consideration of age in a credit scoring system*. Age may be taken directly into account in a credit scoring system that is "demonstrably and statistically sound," as defined in § 202.2(p), with one limitation: applicants age 62 years or older must be treated at least as favorably as applicants who are under age 62. If age is scored by assigning points to an applicant's age category, elderly applicants must receive the same or a greater number of points as the most favored class of nonelderly applicants.

i. *Age-split scorecards*. Some credit systems segment the population and use different scorecards based on the age of an applicant. In such a system, one card may cover a narrow age range (for example, applicants in their twenties or younger) who are evaluated under attributes predictive for that age group. A second card may cover all other applicants, who are evaluated under the attributes predictive for that broader class. When a system uses a card covering a wide age range that encompasses elderly applicants, the credit scoring system is not deemed to score age. Thus, the system does not raise the issue of assigning a negative factor or value to the age of elderly applicants. But if a system segments the population by age into multiple scorecards, and includes elderly applicants in a narrower age range, the credit scoring system does score age. To comply with the Act and regulation in such a case, the creditor must ensure that the system does not assign a negative factor or value to the age of elderly applicants as a class.

3. *Consideration of age in a judgmental system*. In a judgmental system, defined in § 202.2(t), a creditor may not decide whether to extend credit or set the terms and conditions of credit based on age or information related exclusively to age. Age or age-related information may be considered only in evaluating other "pertinent elements of creditworthiness" that are drawn from the particular facts and circumstances concerning the applicant. For example, a creditor may not reject an application or terminate an account because the applicant is 60 years old. But a creditor that uses a judgmental system may relate the applicant's age to other information about the applicant that the creditor considers in evaluating creditworthiness. As the following examples illustrate, the evaluation must be made in an individualized, case-by-case manner:

i. A creditor may consider the applicant's occupation and length of time to retirement to ascertain whether the applicant's income (including retirement income) will support the extension of credit to its maturity.

ii. A creditor may consider the adequacy of any security offered when the term of the credit extension exceeds the life expectancy of the applicant and the cost of realizing on the collateral could exceed the applicant's equity. An elderly applicant might not qualify for a 5 percent down, 30-year mortgage loan but might qualify with a larger downpayment or a shorter loan maturity.

iii. A creditor may consider the applicant's age to assess the significance of length of employment (a young applicant may have just entered the job market) or length of time at an address (an elderly applicant may recently have retired and moved from a long-term residence).

4. *Consideration of age in a reverse mortgage*. A reverse mortgage is a home-secured loan in which the borrower receives payments from the creditor, and does not become obligated to repay these amounts (other than in the case of default) until the borrower dies, moves permanently from the home, or transfers title to the home, or upon a specified maturity date. Disbursements to the borrower under a reverse mortgage typically are determined by considering the value of the borrower's home, the current interest rate, and the borrower's life expectancy. A reverse mortgage program that requires borrowers to be age 62 or older is permissible under § 202.6(b)(2)(iv). In addition, under § 202.6(b)(2)(iii), a creditor may consider a borrower's age to evaluate a pertinent element of creditworthiness, such as the amount of the credit or monthly payments that the borrower will receive, or the estimated repayment date.

5. *Consideration of age in a combined system*. A creditor using a credit scoring system that qualifies as "empirically derived" under § 202.2(p) may consider other factors (such as a credit report or the applicant's cash flow) on a judgmental basis. Doing so will not negate the classification of the credit scoring component of the combined system as "demonstrably and statistically sound." While age could be used in the credit scoring portion, however, in the judgmental portion age may not be considered directly. It may be used only for the purpose of determining a "pertinent element of creditworthiness." (See comment 6(b)(2)-3.)

6. *Consideration of public assistance*. When considering income derived from a public assistance program, a creditor may take into account, for example:

i. The length of time an applicant will likely remain eligible to receive such income.

ii. Whether the applicant will continue to qualify for benefits based on the status of the applicant's dependents (as in the case of Temporary Aid to Needy Families, or social security payments to a minor).

iii. Whether the creditor can attach or garnish the income to assure payment of the debt in the event of default.

Paragraph 6(b)(5)

1. *Consideration of an individual applicant*. A creditor must evaluate income derived from part-time employment, alimony, child support, separate maintenance payments, retirement benefits, or public assistance on an individual basis, not on the basis of aggregate statistics; and must assess its reliability or unreliability by analyzing the applicant's actual circumstances, not by analyzing statistical measures derived from a group.

2. *Payments consistently made*. In determining the likelihood of consistent payments of alimony, child support, or separate maintenance, a creditor may consider factors such as whether payments are received pursuant to a written agreement or court decree; the length of time that the payments have been received; whether the payments are regularly received by the applicant; the availability of court or other procedures to compel payment; and the creditworthiness of the payor, including the credit history of the payor when it is available to the creditor.

3. *Consideration of income*.

i. A creditor need not consider income at all in evaluating creditworthiness. If a creditor does consider income, there are several acceptable methods, whether in a credit scoring or a judgmental system:

A. A creditor may score or take into account the total sum of all income stated by the applicant without taking steps to evaluate the income for reliability.

B. A creditor may evaluate each component of the applicant's income, and then score or take into account income determined to be reliable separately from other income; or the creditor may disregard that portion of income that is not reliable when it aggregates reliable income.

C. A creditor that does not evaluate all income components for reliability must treat as reliable any component of protected income that is not evaluated.

ii. In considering the separate components of an applicant's income, the creditor may not automatically discount or exclude from consideration any protected income. Any discounting or exclusion must be based on the applicant's actual circumstances.

4. *Part-time employment, sources of income*. A creditor may score or take into account the fact that an applicant has more than one source of earned income-a full-time and a part-time job or two part-time jobs. A creditor may also score or treat earned income from a secondary source differently than earned income from a primary source. The creditor may

not, however, score or otherwise take into account the number of sources for income such as retirement income, social security, supplemental security income, and alimony. Nor may the creditor treat negatively the fact that an applicant's only earned income is derived from, for example, a part-time job.

Paragraph 6(b)(6)

1. *Types of credit references*. A creditor may restrict the types of credit history and credit references that it will consider, provided that the restrictions are applied to all credit applicants without regard to sex, marital status, or any other prohibited basis. On the applicant's request, however, a creditor must consider credit information not reported through a credit bureau when the information relates to the same types of credit references and history that the creditor would consider if reported through a credit bureau.

Paragraph 6(b)(7)

1. *National origin -- immigration status*. The applicant's immigration status and ties to the community (such as employment and continued residence in the area) could have a bearing on a creditor's ability to obtain repayment. Accordingly, the creditor may consider immigration status and differentiate, for example, between a noncitizen who is a long-time resident with permanent resident status and a noncitizen who is temporarily in this country on a student visa.

2. *National origin -- citizenship*. A denial of credit on the ground that an applicant is not a United States citizen is not per se discrimination based on national origin.

Paragraph 6(b)(8)

1. *Prohibited basis -- marital status*. A creditor may consider the marital status of an applicant or joint applicant for the purpose of ascertaining the creditor's rights and remedies applicable to the particular extension of credit. For example, in a secured transaction involving real property, a creditor could take into account whether state law gives the applicant's spouse an interest in the property being offered as collateral.

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1B- Consumer Credit Law Manual § 202.7

§ 202.7 Rules Concerning Extensions of Credit

7(a) Individual accounts.

1. *Open-end credit -- authorized user*. A creditor may not require a creditworthy applicant seeking an individual credit account to provide additional signatures. But the creditor may condition the designation of an authorized user by the account holder on the authorized user's becoming contractually liable for the account, as long as the creditor does not differentiate on any prohibited basis in imposing this requirement.

2. *Open-end credit -- choice of authorized user*. A creditor that permits an account holder to designate an authorized user may not restrict this designation on a prohibited basis. For example, if the creditor allows the designation of spouses as authorized users, the creditor may not refuse to accept a nonspouse as an authorized user.

3. *Overdraft authority on transaction accounts*. If a transaction account (such as a checking account or NOW account) includes an overdraft line of credit, the creditor may require that all persons authorized to draw on the transaction account assume liability for any overdraft.

7(b) Designation of name.

1. *Single name on account*. A creditor may require that joint applicants on an account designate a single name for purposes of administering the account and that a single name be embossed on any credit cards issued on the account. But the creditor may not require that the name be the husband's name. (See *§ 202.10* for rules governing the furnishing of credit history on accounts held by spouses.)

7(c) Action concerning existing open-end accounts.

Paragraph 7(c)(1)

1. *Termination coincidental with marital status change*. When an account holder's marital status changes, a creditor generally may not terminate the account unless it has evidence that the account holder is now unable or unwilling to repay. But the creditor may terminate an account on which both spouses are jointly liable, even if the action coincides with a change in marital status, when one or both spouses:

i. Repudiate responsibility for future charges on the joint account.

ii. Request separate accounts in their own names.

iii. Request that the joint account be closed.

2. *Updating information*. A creditor may periodically request updated information from applicants but may not use events related to a prohibited basis -- such as an applicant's retirement or reaching a particular age, or a change in name or marital status -- to trigger such a request.

Paragraph 7(c)(2)

1. *Procedure pending reapplication*. A creditor may require a reapplication from an account holder, even when there is no evidence of unwillingness or inability to repay, if (1) the credit was based on the qualifications of a person who is no longer available to support the credit and (2) the creditor has information indicating that the account holder's income may be insufficient to support the credit. While a reapplication is pending, the creditor must allow the account holder full access to the account under the existing contract terms. The creditor may specify a reasonable time period within which the account holder must submit the required information.

7(d) Signature of spouse or other person.

1. *Qualified applicant*. The signature rules ensure that qualified applicants are able to obtain credit in their own names. Thus, when an applicant requests individual credit, a creditor generally may not require the signature of another person unless the creditor has first determined that the applicant alone does not qualify for the credit requested.

2. *Unqualified applicant*. When an applicant requests individual credit but does not meet a creditor's standards, the creditor may require a cosigner, guarantor, endorser, or similar parties -- but cannot require that it be the spouse. (See commentary to § 202.7(d)(5) and (6).)

Paragraph 7(d)(1)

1. *Signature of another person*. It is impermissible for a creditor to require an applicant who is individually creditworthy to provide a cosigner -- even if the creditor applies the requirement without regard to sex, marital status, or any other prohibited basis. (But see comment 7(d)(6)-1 concerning guarantors of closely held corporations.)

2. *Joint applicant*. The term "joint applicant" refers to someone who applies contemporaneously with the applicant for shared or joint credit. It does not refer to someone whose signature is required by the creditor as a condition for granting the credit requested.

3. *Evidence of joint application*. A person's intent to be a joint applicant must be evidenced at the time of application. Signatures on a promissory note may not be used to show intent to apply for joint credit. On the other hand, signatures or initials on a credit application affirming applicants' intent to apply for joint credit may be used to establish intent to apply for joint credit. (See Appendix B). The method used to establish intent must be distinct from the means used by individuals to affirm the accuracy of information. For example, signatures on a joint financial statement affirming the veracity of information are not sufficient to establish intent to apply for joint credit.

Paragraph 7(d)(2)

1. *Jointly owned property*. If an applicant requests unsecured credit, does not own sufficient separate property, and relies on joint property to establish creditworthiness, the creditor must value the applicant's interest in the jointly owned property. A creditor may not request that a nonapplicant joint owner sign any instrument as a condition of the credit extension unless the applicant's interest does not support the amount and terms of the credit sought.

i. *Valuation of applicant's interest*. In determining the value of an applicant's interest in jointly owned property, a creditor may consider factors such as the form of ownership and the property's susceptibility to attachment, execution, severance, or partition; the value of the applicant's interest after such action; and the cost associated with the action. This determination must be based on the existing form of ownership, and not on the possibility of a subsequent change. For example, in determining whether a married applicant's interest in jointly owned property is sufficient to satisfy the creditor's standards of creditworthiness for individual credit, a creditor may not consider that the applicant's separate property could be transferred into tenancy by the entirety after consummation. Similarly, a creditor may not consider the possibility that the couple may divorce. Accordingly, a creditor may not require the signature of the nonapplicant spouse in these or similar circumstances.

ii. *Other options to support credit*. If the applicant's interest in jointly owned property does not support the amount

and terms of credit sought, the creditor may offer the applicant other options to qualify for the extension of credit. For example:

A. Providing a co-signer or other party (§ 202.7(d)(5));

B. Requesting that the credit be granted on a secured basis (§ 202.7(d)(4)); or

C. Providing the signature of the joint owner on an instrument that ensures access to the property in the event of the applicant's death or default, but does not impose personal liability unless necessary under state law (such as a limited guarantee). A creditor may not routinely require however, that a joint owner sign an instrument (such as a quitclaim deed) that would result in the forfeiture of the joint owner's interest in the property.

2. *Need for signature -- reasonable belief*. A creditor's reasonable belief as to what instruments need to be signed by a person other than the applicant should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general.

Paragraph 7(d)(3)

1. *Residency*. In assessing the creditworthiness of a person who applies for credit in a community property state, a creditor may assume that the applicant is a resident of the state unless the applicant indicates otherwise.

Paragraph 7(d)(4)

1. *Creation of enforceable lien*. Some state laws require that both spouses join in executing any instrument by which real property is encumbered. If an applicant offers such property as security for credit, a creditor may require the applicant's spouse to sign the instruments necessary to create a valid security interest in the property. The creditor may not require the spouse to sign the note evidencing the credit obligation if signing only the mortgage or other security agreement is sufficient to make the property available to satisfy the debt in the event of default. However, if under state law both spouses must sign the note to create an enforceable lien, the creditor may require the signatures.

2. *Need for signature -- reasonable belief*. Generally, a signature to make the secured property available will only be needed on a security agreement. A creditor's reasonable belief that, to ensure access to the property, the spouse's signature is needed on an instrument that imposes personal liability should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general.

3. *Integrated instruments*. When a creditor uses an integrated instrument that combines the note and the security agreement, the spouse cannot be asked to sign the integrated instrument if the signature is only needed to grant a security interest. But the spouse could be asked to sign an integrated instrument that makes clear -- for example, by a legend placed next to the spouse's signature -- that the spouse's signature is only to grant a security interest and that signing the instrument does not impose personal liability.

Paragraph 7(d)(5)

1. *Qualifications of additional parties*. In establishing guidelines for eligibility of guarantors, cosigners, or similar additional parties, a creditor may restrict the applicant's choice of additional parties but may not discriminate on the basis of sex, marital status, or any other prohibited basis. For example, the creditor could require that the additional party live in the creditor's market area.

2. *Reliance on income of another person -- individual credit*. An applicant who requests individual credit relying on the income of another person (including a spouse in a non-community property state) may be required to provide the signature of the other person to make the income available to pay the debt. In community property states, the signature of a spouse may be required if the applicant relies on the spouse's separate income. If the applicant relies on the spouse's future earnings that as a matter of state law cannot be characterized as community property until earned, the creditor may require the spouse's signature, but need not do so-even if it is the creditor's practice to require the signature when an applicant relies on the future earnings of a person other than a spouse. (See § 202.6(c) on consideration of state property laws.)

3. *Renewals*. If the borrower's creditworthiness is reevaluated when a credit obligation is renewed, the creditor must determine whether an additional party is still warranted and, if not warranted, release the additional party.

Paragraph 7(d)(6)

1. *Guarantees*. A guarantee on an extension of credit is part of a credit transaction and therefore subject to the regulation. A creditor may require the personal guarantee of the partners, directors, or officers of a business, and the shareholders of a closely held corporation, even if the business or corporation is creditworthy. The requirement must be based on the guarantor's relationship with the business or corporation, however, and not on a prohibited basis. For example, a creditor may not require guarantees only for women-owned or minority-owned businesses. Similarly, a creditor may not require guarantees only of the married officers of a business or the married shareholders of a closely held corporation.

2. *Spousal guarantees*. The rules in § 202.7(d) bar a creditor from requiring the signature of a guarantor's spouse just as they bar the creditor from requiring the signature of an applicant's spouse. For example, although a creditor may require all officers of a closely held corporation to personally guarantee a corporate loan, the creditor may not automatically require that spouses of married officers also sign the guarantee. If an evaluation of the financial circumstances of an officer indicates that an additional signature is necessary, however, the creditor may require the signature of another person in appropriate circumstances in accordance with § 202.7(d)(2).

7(e) Insurance.

1. *Differences in terms*. Differences in the availability, rates, and other terms on which credit-related casualty insurance or credit life, health, accident, or disability insurance is offered or provided to an applicant does not violate Regulation B.

2. *Insurance information*. A creditor may obtain information about an applicant's age, sex, or marital status for insurance purposes. The information may only be used for determining eligibility and premium rates for insurance, however, and not in making the credit decision.

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1B- Consumer Credit Law Manual § 202.8

§ 202.8 Special Purpose Credit Programs

8(a) Standards for programs.

1. *Determining qualified programs*. The Board does not determine whether individual programs qualify for special purpose credit status, or whether a particular program benefits an "economically disadvantaged class of persons." The agency or creditor administering or offering the loan program must make these decisions regarding the status of its program.

2. *Compliance with a program authorized by federal or state law*. A creditor does not violate Regulation B when it complies in good faith with a regulation promulgated by a government agency implementing a special purpose credit program under § 202.8(a)(1). It is the agency's responsibility to promulgate a regulation that is consistent with federal and state law.

3. *Expressly authorized*. Credit programs authorized by federal or state law include programs offered pursuant to federal, state, or local statute, regulation or ordinance, or pursuant to judicial or administrative order.

4. *Creditor liability*. A refusal to grant credit to an applicant is not a violation of the Act or regulation if the applicant does not meet the eligibility requirements under a special purpose credit program.

5. *Determining need*. In designing a special purpose credit program under § 202.8(a), a for-profit organization must

determine that the program will benefit a class of people who would otherwise be denied credit or would receive it on less favorable terms. This determination can be based on a broad analysis using the organization's own research or data from outside sources, including governmental reports and studies. For example, a creditor might design new products to reach consumers who would not meet, or have not met, its traditional standards of creditworthiness due to such factors as credit inexperience or the use of credit sources that may not report to consumer reporting agencies. Or, a bank could review Home Mortgage Disclosure Act data along with demographic data for its assessment area and conclude that there is a need for a special purpose credit program for low-income minority borrowers.

6. *Elements of the program*. The written plan must contain information that supports the need for the particular program. The plan also must either state a specific period of time for which the program will last, or contain a statement regarding when the program will be reevaluated to determine if there is a continuing need for it.

8(b) Rules in other sections.

1. *Applicability of rules*. A creditor that rejects an application because the applicant does not meet the eligibility requirements (common characteristic or financial need, for example) must nevertheless notify the applicant of action taken as required by § 202.9.

8(c) Special rule concerning requests and use of information.

1. *Request of prohibited basis information*. This section permits a creditor to request and consider certain information that would otherwise be prohibited by §§ 202.5 and 202.6 to determine an applicant's eligibility for a particular program.

2. *Examples*. Examples of programs under which the creditor can ask for and consider information about a prohibited basis are:

i. Energy conservation programs to assist the elderly, for which the creditor must consider the applicant's age.

ii. Programs under a Minority Enterprise Small Business Investment Corporation, for which a creditor must consider the applicant's minority status.

8(d) Special rule in the case of financial need.

1. *Request of prohibited basis information*. This section permits a creditor to request and consider certain information that would otherwise be prohibited by §§ 202.5 and 202.6, and to require signatures that would otherwise be prohibited by § 202.7(d).

2. *Examples*. Examples of programs in which financial need is a criterion are:

i. Subsidized housing programs for low- to moderate-income households, for which a creditor may have to consider the applicant's receipt of alimony or child support, the spouse's or parents' income, etc.

ii. Student loan programs based on the family's financial need, for which a creditor may have to consider the spouse's or parents' financial resources.

3. *Student loans*. In a guaranteed student loan program, a creditor may obtain the signature of a parent as a guarantor when required by federal or state law or agency regulation, or when the student does not meet the creditor's standards of creditworthiness. (See § 202.7(d)(1) and (5).) The creditor may not require an additional signature when a student has a work or credit history that satisfies the creditor's standards.

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1B- Consumer Credit Law Manual § 202.9

§ **202.9 Notifications**

1. *Use of the term adverse action*. The regulation does not require that a creditor use the term adverse action in communicating to an applicant that a request for an extension of credit has not been approved. In notifying an applicant of adverse action as defined by § 202.2(c)(1), a creditor may use any words or phrases that describe the action taken on the application.

2. *Expressly withdrawn applications*. When an applicant expressly withdraws a credit application, the creditor is not required to comply with the notification requirements under § 202.9. (The creditor must comply, however, with the record retention requirements of the regulation. See *§ 202.12*(b)(3).)

3. *When notification occurs*. Notification occurs when a creditor delivers or mails a notice to the applicant's last known address or, in the case of an oral notification, when the creditor communicates the credit decision to the applicant.

4. *Location of notice*. The notifications required under § 202.9 may appear on either or both sides of a form or letter.

5. *Prequalification requests*. Whether a creditor must provide a notice of action taken for a prequalification request depends on the creditor's response to the request, as discussed in comment 2(f)-3. For instance, a creditor may treat the request as an inquiry if the creditor evaluates specific information about the consumer and tells the consumer the loan amount, rate, and other terms of credit the consumer could qualify for under various loan programs, explaining the process the consumer must follow to submit a mortgage application and the information the creditor will analyze in reaching a credit decision. On the other hand, a creditor has treated a request as an application, and is subject to the adverse action notice requirements of § 202.9 if, after evaluating information, the creditor decides that it will not

approve the request and communicates that decision to the consumer. For example, if the creditor tells the consumer that it would not approve an application for a mortgage because of a bankruptcy in the consumer's record, the creditor has denied an application for credit.

9(a) Notification of action taken, ECOA notice, and statement of specific reasons.

Paragraph 9(a)(1)

1. *Timing of notice -- when an application is complete*. Once a creditor has obtained all the information it normally considers in making a credit decision, the application is complete and the creditor has 30 days in which to notify the applicant of the credit decision. (See also comment 2(f)-6.)

2. *Notification of approval*. Notification of approval may be express or by implication. For example, the creditor will satisfy the notification requirement when it gives the applicant the credit card, money, property, or services requested.

3. *Incomplete application -- denial for incompleteness*. When an application is incomplete regarding information that the applicant can provide and the creditor lacks sufficient data for a credit decision, the creditor may deny the application giving as the reason for denial that the application is incomplete. The creditor has the option, alternatively, of providing a notice of incompleteness under § 202.9(c).

4. *Incomplete application -- denial for reasons other than incompleteness*. When an application is missing information but provides sufficient data for a credit decision, the creditor may evaluate the application, make its credit decision, and notify the applicant accordingly. If credit is denied, the applicant must be given the specific reasons for the credit denial (or notice of the right to receive the reasons); in this instance missing information or "incomplete application" cannot be given as the reason for the denial.

5. *Length of counteroffer*. Section 202.9(a)(1)(iv) does not require a creditor to hold a counteroffer open for 90 days or any other particular length of time.

6. *Counteroffer combined with adverse action notice*. A creditor that gives the applicant a combined counteroffer and adverse action notice that complies with § 202.9(a)(2) need not send a second adverse action notice if the applicant does not accept the counteroffer. A sample of a combined notice is contained in form C-4 of Appendix C to the regulation.

7. *Denial of a telephone application*. When an application is made by telephone and adverse action is taken, the creditor must request the applicant's name and address in order to provide written notification under this section. If the applicant declines to provide that information, then the creditor has no further notification responsibility.

Paragraph 9(a)(3)

1. *Coverage*. In determining which rules in this paragraph apply to a given business credit application, a creditor may rely on the applicant's assertion about the revenue size of the business. (Applications to start a business are governed by the rules in § 202.9(a)(3)(i).) If an applicant applies for credit as a sole proprietor, the revenues of the sole proprietorship will determine which rules govern the application. However, if an applicant applies for business credit as an individual, the rules in § 202.9(a)(3)(i) apply unless the application is for trade or similar credit.

2. *Trade credit*. The term trade credit generally is limited to a financing arrangement that involves a buyer and a seller -- such as a supplier who finances the sale of equipment, supplies, or inventory; it does not apply to an extension of credit by a bank or other financial institution for the financing of such items.

3. *Factoring*. Factoring refers to a purchase of accounts receivable, and thus is not subject to the Act or regulation. If there is a credit extension incident to the factoring arrangement, the notification rules in § 202.9(a)(3)(ii) apply, as do other relevant sections of the Act and regulation.

4. *Manner of compliance*. In complying with the notice provisions of the Act and regulation, creditors offering business credit may follow the rules governing consumer credit. Similarly, creditors may elect to treat all business credit the same (irrespective of revenue size) by providing notice in accordance with § 202.9(a)(3)(i).

5. *Timing of notification*. A creditor subject to § 202.9(a)(3)(ii)(A) is required to notify a business credit applicant, orally or in writing, of action taken on an application within a reasonable time of receiving a completed application. Notice provided in accordance with the timing requirements of § 202.9(a)(1) is deemed reasonable in all instances.

9(b) Form of ECOA notice and statement of specific reasons.

Paragraph 9(b)(1)

1. *Substantially similar notice*. The ECOA notice sent with a notification of a credit denial or other adverse action will comply with the regulation if it is "substantially similar" to the notice contained in § 202.9(b)(1). For example, a creditor may add a reference to the fact that the ECOA permits age to be considered in certain credit scoring systems, or add a reference to a similar state statute or regulation and to a state enforcement agency.

Paragraph 9(b)(2)

1. *Number of specific reasons*. A creditor must disclose the principal reasons for denying an application or taking other adverse action. The regulation does not mandate that a specific number of reasons be disclosed, but disclosure of more than four reasons is not likely to be helpful to the applicant.

2. *Source of specific reasons*. The specific reasons disclosed under §§ 202.9(a)(2) and (b)(2) must relate to and accurately describe the factors actually considered or scored by a creditor.

3. *Description of reasons*. A creditor need not describe how or why a factor adversely affected an applicant. For example, the notice may say "length of residence" rather than "too short a period of residence."

4. *Credit scoring system*. If a creditor bases the denial or other adverse action on a credit scoring system, the reasons disclosed must relate only to those factors actually scored in the system. Moreover, no factor that was a principal reason for adverse action may be excluded from disclosure. The creditor must disclose the actual reasons for denial (for example, "age of automobile") even if the relationship of that factor to predicting creditworthiness may not be clear to the applicant.

5. *Credit scoring -- method for selecting reasons*. The regulation does not require that any one method be used for selecting reasons for a credit denial or other adverse action that is based on a credit scoring system. Various methods will meet the requirements of the regulation. One method is to identify the factors for which the applicant's score fell furthest below the average score for each of those factors achieved by applicants whose total score was at or slightly above the minimum passing score. Another method is to identify the factors for which the applicant's score fell furthest below the average score for each of those factors achieved by all applicants. These average scores could be calculated during the development or use of the system. Any other method that produces results substantially similar to either of these methods is also acceptable under the regulation.

6. *Judgmental system*. If a creditor uses a judgmental system, the reasons for the denial or other adverse action must relate to those factors in the applicant's record actually reviewed by the person making the decision.

7. *Combined credit scoring and judgmental system*. If a creditor denies an application based on a credit evaluation system that employs both credit scoring and judgmental components, the reasons for the denial must come from the component of the system that the applicant failed. For example, if a creditor initially credit scores an application and denies the credit request as a result of that scoring, the reasons disclosed to the applicant must relate to the factors scored in the system. If the application passes the credit scoring stage but the creditor then denies the credit request based on a judgmental assessment of the applicant's record, the reasons disclosed must relate to the factors reviewed judgmentally, even if the factors were also considered in the credit scoring component. If the application is not approved or denied as a result of the credit scoring, but falls into a gray band, and the creditor performs a judgmental assessment and denies the credit after that assessment, the reasons disclosed must come from both components of the system. The same result applies where a judgmental assessment is the first component of the combined system. As provided in comment 9(b)(2)-1, disclosure of more than a combined total of four reasons is not likely to be helpful to the applicant.

8. *Automatic denial*. Some credit decision methods contain features that call for automatic denial because of one or

more negative factors in the applicant's record (such as the applicant's previous bad credit history with that creditor, the applicant's declaration of bankruptcy, or the fact that the applicant is a minor). When a creditor denies the credit request because of an automatic-denial factor, the creditor must disclose that specific factor.

9. *Combined ECOA-FCRA disclosures*. The ECOA requires disclosure of the principal reasons for denying or taking other adverse action on an application for an extension of credit. The Fair Credit Reporting Act (FCRA) requires a creditor to disclose when it has based its decision in whole or in part on information from a source other than the applicant or its own files. Disclosing that a credit report was obtained and used in the denial of the application, as the FCRA requires, does not satisfy the ECOA requirement to disclose specific reasons. For example, if the applicant's credit history reveals delinquent credit obligations and the application is denied for that reason, to satisfy § 202.9(b)(2) the creditor must disclose that the application was denied because of the applicant's delinquent credit obligations. To satisfy the FCRA requirement, the creditor must also disclose that a credit report was obtained and used in the denial of the application. Sample forms C-1 through C-5 of Appendix C of the regulation provide for the two disclosures.

9(c) Incomplete applications.

Paragraph 9(c)(1)

1. *Exception for preapprovals*. The requirement to provide a notice of incompleteness does not apply to preapprovals that constitute applications under § 202.2(f).

Paragraph 9(c)(2)

1. *Reapplication*. If information requested by a creditor is submitted by an applicant after the expiration of the time period designated by the creditor, the creditor may require the applicant to make a new application.

Paragraph 9(c)(3)

1. *Oral inquiries for additional information*. If an applicant fails to provide the information in response to an oral request, a creditor must send a written notice to the applicant within the 30-day period specified in § 202.9(c)(1) and (2). If the applicant provides the information, the creditor must take action on the application and notify the applicant in accordance with § 202.9(a).

9(g) Applications submitted through a third party.

1. *Third parties*. The notification of adverse action may be given by one of the creditors to whom an application was submitted, or by a noncreditor third party. If one notification is provided on behalf of multiple creditors, the notice must contain the name and address of each creditor. The notice must either disclose the applicant's right to a statement of specific reasons within 30 days, or give the primary reasons each creditor relied upon in taking the adverse action -- clearly indicating which reasons relate to which creditor.

2. *Third party notice -- enforcement agency*. If a single adverse action notice is being provided to an applicant on behalf of several creditors and they are under the jurisdiction of different federal enforcement agencies, the notice need not name each agency; disclosure of any one of them will suffice.

3. *Third-party notice -- liability*. When a notice is to be provided through a third party, a creditor is not liable for an act or omission of the third party that constitutes a violation of the regulation if the creditor accurately and in a timely manner provided the third party with the information necessary for the notification and maintains reasonable procedures adapted to prevent such violations.

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1B- Consumer Credit Law Manual § 202.10

§ 202.10 Furnishing of Credit Information

1. *Scope*. The requirements of § 202.10 for designating and reporting credit information apply only to consumer credit transactions. Moreover, they apply only to creditors that opt to furnish credit information to credit bureaus or to other creditors; there is no requirement that a creditor furnish credit information on its accounts.

2. *Reporting on all accounts*. The requirements of § 202.10 apply only to accounts held or used by spouses. However, a creditor has the option to designate all joint accounts (or all accounts with an authorized user) to reflect the participation of both parties, whether or not the accounts are held by persons married to each other.

3. *Designating accounts*. In designating accounts and reporting credit information, a creditor need not distinguish between accounts on which the spouse is an authorized user and accounts on which the spouse is a contractually liable party.

4. *File and index systems*. The regulation does not require the creation or maintenance of separate files in the name of each participant on a joint or user account, or require any other particular system of recordkeeping or indexing. It requires only that a creditor be able to report information in the name of each spouse on accounts covered by § 202.10. Thus, if a creditor receives a credit inquiry about the wife, it should be able to locate her credit file without asking the husband's name.

10(a) Designation of accounts.

1. *New parties*. When new parties who are spouses undertake a legal obligation on an account, as in the case of a

mortgage loan assumption, the creditor must change the designation on the account to reflect the new parties and must furnish subsequent credit information on the account in the new names.

2. *Request to change designation of account*. A request to change the manner in which information concerning an account is furnished does not alter the legal liability of either spouse on the account and does not require a creditor to change the name in which the account is maintained.

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1B- Consumer Credit Law Manual § 202.11

§ **202.11 Relation to State Law**

11(a) Inconsistent state laws.

1. *Preemption determination -- New York*. The Board has determined that the following provisions in the state law of New York are preempted by the federal law, effective November 11, 1988:

i. *Article 15, section 296a(1)(b) -- Unlawful discriminatory practices in relation to credit on the basis of race, creed, color, national origin, age, sex, marital status, or disability*. This provision is preempted to the extent that it bars taking a prohibited basis into account when establishing eligibility for certain special-purpose credit programs.

ii. *Article 15, section 296a(1)(c) -- Unlawful discriminatory practice to make any record or inquiry based on race, creed, color, national origin, age, sex, marital status, or disability*. This provision is preempted to the extent that it bars a creditor from requesting and considering information regarding the particular characteristics (for example, race, national origin, or sex) required for eligibility for special-purpose credit programs.

2. *Preemption determination -- Ohio*. The Board has determined that the following provision in the state law of Ohio is preempted by the federal law, effective July 23, 1990:

i. *Section 4112.021(B)(1) -- Unlawful discriminatory practices in credit transactions*. This provision is preempted to the extent that it bars asking or favorably considering the age of an elderly applicant; prohibits the consideration of

age in a credit scoring system; permits without limitation the consideration of age in real estate transactions; and limits the consideration of age in special-purpose credit programs to certain government-sponsored programs identified in the state law.

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1B- Consumer Credit Law Manual § 202.12

§ 202.12 Record Retention

12(a) Retention of prohibited information.

1. *Receipt of prohibited information*. Unless the creditor specifically requested such information, a creditor does not violate this section when it receives prohibited information from a consumer reporting agency.

2. *Use of retained information*. Although a creditor may keep in its files prohibited information as provided in § 202.12(a), the creditor may use the information in evaluating credit applications only if permitted to do so by § 202.6.

12(b) Preservation of records.

1. *Copies*. Copies of the original record include carbon copies, photocopies, microfilm or microfiche copies, or copies produced by any other accurate retrieval system, such as documents stored and reproduced by computer. A creditor that uses a computerized or mechanized system need not keep a paper copy of a document (for example, of an adverse action notice) if it can regenerate all pertinent information in a timely manner for examination or other purposes.

2. *Computerized decisions*. A creditor that enters information items from a written application into a computerized or mechanized system and makes the credit decision mechanically, based only on the items of information entered into the system, may comply with § 202.12(b) by retaining the information actually entered. It is not required to store the complete written application, nor is it required to enter the remaining items of information into the system. If the transaction is subject to § 202.13, however, the creditor is required to enter and retain the data on personal characteristics in order to comply with the requirements of that section.

Paragraph 12(b)(3)

1. *Withdrawn and brokered applications*. In most cases, the 25-month retention period for applications runs from the date a notification is sent to the applicant granting or denying the credit requested. In certain transactions, a creditor is not obligated to provide a notice of the action taken. (See, for example, comment 9-2.) In such cases, the 25-month requirement runs from the date of application, as when:

i. An application is withdrawn by the applicant.

ii. An application is submitted to more than one creditor on behalf of the applicant, and the application is approved by one of the other creditors.

12(b)(6) Self-tests

1. The rule requires all written or recorded information about a self-test to be retained for 25 months after a self-test has been completed. For this purpose, a self-test is completed after the creditor has obtained the results and made a determination about what corrective action, if any, is appropriate. Creditors are required to retain information about the scope of the self-test, the methodology used and time period covered by the self-test, the report or results of the self-test including any analysis or conclusions, and any corrective action taken in response to the self-test.

12(b)(7) Preapplication marketing information.

1. *Prescreened credit solicitations*. The rule requires creditors to retain copies of prescreened credit solicitations. For purposes of this regulation, a prescreened solicitation is an "offer of credit" as described in *15 U.S.C. 1681a(1)* of the Fair Credit Reporting Act. A creditor complies with this rule if it retains a copy of each solicitation mailing that contains different terms, such as the amount of credit offered, annual percentage rate, or annual fee.

2. *List of criteria*. A creditor must retain the list of criteria used to select potential recipients. This includes the criteria used by the creditor both to determine the potential recipients of the particular solicitation and to determine who will actually be offered credit.

3. *Correspondence*. A creditor may retain correspondence relating to consumers' complaints about prescreened solicitations in any manner that is reasonably accessible and is understandable to examiners. There is no requirement to establish a separate database or set of files for such correspondence, or to match consumer complaints with specific solicitation programs.

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1B- Consumer Credit Law Manual § 202.13

§ 202.13 Information for Monitoring Purposes

13(a) Information to be requested.

1. *Natural person*. Section 202.13 applies only to applications from natural persons.

2. *Principal residence*. The requirements of § 202.13 apply only if an application relates to a dwelling that is or will be occupied by the applicant as the principal residence. A credit application related to a vacation home or a rental unit is not covered. In the case of a two- to four-unit dwelling, the application is covered if the applicant intends to occupy one of the units as a principal residence.

3. *Temporary financing*. An application for temporary financing to construct a dwelling is not subject to § 202.13. But an application for both a temporary loan to finance construction of a dwelling and a permanent mortgage loan to take effect upon the completion of construction is subject to § 202.13.

4. *New principal residence*. A person can have only one principal residence at a time. However, if a person buys or builds a new dwelling that will become that person's principal residence within a year or upon completion of construction, the new dwelling is considered the principal residence for purposes of § 202.13.

5. *Transactions not covered*. The information-collection requirements of this section apply to applications for credit primarily for the purchase or refinancing of a dwelling that is or will become the applicant's principal residence.

Therefore, applications for credit secured by the applicant's principal residence but made primarily for a purpose other than the purchase or refinancing of the principal residence (such as loans for home improvement and debt consolidation) are not subject to the information-collection requirements. An application for an open-end home equity line of credit is not subject to this section unless it is readily apparent to the creditor when the application is taken that the primary purpose of the line is for the purchase or refinancing of a principal dwelling.

6. *Refinancings*. A refinancing occurs when an existing obligation is satisfied and replaced by a new obligation undertaken by the same borrower. A creditor that receives an application to refinance an existing extension of credit made by that creditor for the purchase of the applicant's dwelling may request the monitoring information again but is not required to do so if it was obtained in the earlier transaction.

7. *Data collection under Regulation C*. See comment 5(a)(2)-2.

13(b) Obtaining of information.

1. *Forms for collecting data*. A creditor may collect the information specified in § 202.13(a) either on an application form or on a separate form referring to the application. The applicant must be offered the option to select more than one racial designation.

2. *Written applications*. The regulation requires written applications for the types of credit covered by § 202.13. A creditor can satisfy this requirement by recording on paper or by means of computer the information that the applicant provides orally and that the creditor normally considers in a credit decision.

3. *Telephone, mail applications*.

i. A creditor that accepts an application by telephone or mail must request the monitoring information.

ii. A creditor that accepts an application by mail need not make a special request for the monitoring information if the applicant has failed to provide it on the application form returned to the creditor.

iii. If it is not evident on the face of an application that it was received by mail, telephone, or via an electronic medium, the creditor should indicate on the form or other application record how the application was received.

4. *Video and other electronic-application processes*.

i. If a creditor takes an application through an electronic medium that allows the creditor to see the applicant, the creditor must treat the application as taken in person. The creditor must note the monitoring information on the basis of visual observation or surname, if the applicant chooses not to provide the information.

ii. If an applicant applies through an electronic medium without video capability, the creditor treats the application as if it were received by mail.

5. *Applications through loan-shopping services*. When a creditor receives an application through an unaffiliated loan-shopping service, it does not have to request the monitoring information for purposes of the ECOA or Regulation B. Creditors subject to the Home Mortgage Disclosure Act should be aware, however, that data collection may be called for under Regulation C (12 CFR part 203), which generally requires creditors to report, among other things, the sex and race of an applicant on brokered applications or applications received through a correspondent.

6. *Inadvertent notation*. If a creditor inadvertently obtains the monitoring information in a dwelling-related transaction not covered by § 202.13, the creditor may process and retain the application without violating the regulation.

13(c) Disclosure to applicants.

1. *Procedures for providing disclosures*. The disclosure to an applicant regarding the monitoring information may be provided in writing. Appendix B contains a sample disclosure. A creditor may devise its own disclosure so long as it is substantially similar. The creditor need not orally request the monitoring information if it is requested in writing.

13(d) Substitute monitoring program.

1. *Substitute program*. An enforcement agency may adopt, under its established rulemaking or enforcement procedures, a program requiring creditors under its jurisdiction to collect information in addition to information required by this section.

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1B- Consumer Credit Law Manual § 202.14

§ 202.14 Rules on Providing Appraisal Reports

14(a) Providing appraisals.

1. *Coverage*. This section covers applications for credit to be secured by a lien on a dwelling, as that term is defined in § 202.14(c), whether the credit is for a business purpose (for example, a loan to start a business) or a consumer purpose (for example, a loan to finance a child's education).

2. *Renewals*. This section applies when an applicant requests the renewal of an existing extension of credit and the creditor obtains a new appraisal report. This section does not apply when a creditor uses the appraisal report previously obtained to evaluate the renewal request.

14(a)(2)(i) Notice.

1. *Multiple applicants*. When an application that is subject to this section involves more than one applicant, the notice about the appraisal report need only be given to one applicant, but it must be given to the primary applicant where one is readily apparent.

14(a)(2)(ii) Delivery.

1. *Reimbursement*. Creditors may charge for photocopy and postage costs incurred in providing a copy of the appraisal report, unless prohibited by state or other law. If the consumer has already paid for the report -- for example, as part of an application fee -- the creditor may not require additional fees for the appraisal (other than photocopy and

postage costs).

14(c) Definitions.

1. *Appraisal reports*. Examples of appraisal reports are:

i. A report prepared by an appraiser (whether or not licensed or certified), including written comments and other documents submitted to the creditor in support of the appraiser's estimate or opinion of the property's value.

ii. A document prepared by the creditor's staff that assigns value to the property, if a third-party appraisal report has not been used.

ii. An internal review document reflecting that the creditor's valuation is different from a valuation in a third party's appraisal report (or different from valuations that are publicly available or valuations such as manufacturers' invoices for mobile homes).

2. *Other reports*. The term "appraisal report" does not cover all documents relating to the value of the applicant's property. Examples of reports not covered are:

i. Internal documents, if a third-party appraisal report was used to establish the value of the property.

ii. Governmental agency statements of appraised value.

iii. Valuations lists that are publicly available (such as published sales prices or mortgage amounts, tax assessments, and retail price ranges) and valuations such as manufacturers' invoices for mobile homes.

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1B- Consumer Credit Law Manual § 202.15

§ 202.15 Incentives for Self-Testing and Self-Correction

15(a) General rules.

15(a)(1) Voluntary self-testing and correction.

1. *Activities required by any governmental authority are not voluntary self-tests*. A governmental authority includes both administrative and judicial authorities for federal, state, and local governments.

15(a)(2) Corrective action required.

1. To qualify for the privilege, appropriate corrective action is required when the results of a self-test show that it is more likely than not that there has been a violation of the ECOA or this regulation. A self-test is also privileged when it identifies no violations.

2. In some cases, the issue of whether certain information is privileged may arise before the self-test is complete or corrective actions are fully under way. This would not necessarily prevent a creditor from asserting the privilege. In situations where the self-test is not complete, for the privilege to apply the lender must satisfy the regulation's requirements within a reasonable period of time. To assert the privilege where the self-test shows a likely violation, the rule requires, at a minimum, that the creditor establish a plan for corrective action and a method to demonstrate progress in implementing the plan. Creditors must take appropriate corrective action on a timely basis after the results of the self-test are known.

3. A creditor's determination about the type of corrective action needed, or a finding that no corrective action is required, is not conclusive in determining whether the requirements of this paragraph have been satisfied. If a creditor's claim of privilege is challenged, an assessment of the need for corrective action or the type of corrective action that is appropriate must be based on a review of the self-testing results, which may require an in camera inspection of the privileged documents.

15(a)(3) Other privileges.

1. A creditor may assert the privilege established under this section in addition to asserting any other privilege that may apply, such as the attorney-client privilege or the work-product privilege. Self-testing data may be privileged under this section whether or not the creditor's assertion of another privilege is upheld.

15(b) Self-test defined.

15(b)(1) Definition.

Paragraph 15(b)(1)(i)

1. To qualify for the privilege, a self-test must be sufficient to constitute a determination of the extent or effectiveness of the creditor's compliance with the Act and Regulation B. Accordingly, a self-test is only privileged if it was designed and used for that purpose. A self-test that is designed or used to determine compliance with other laws or regulations or for other purposes is not privileged under this rule. For example, a self-test designed to evaluate employee efficiency or customers' satisfaction with the level of service provided by the creditor is not privileged even if evidence of discrimination is uncovered incidentally. If a self-test is designed for multiple purposes, only the portion designed to determine compliance with the ECOA is eligible for the privilege.

Paragraph 15(b)(1)(ii)

1. The principal attribute of self-testing is that it constitutes a voluntary undertaking by the creditor to produce new data or factual information that otherwise would not be available and could not be derived from loan or application files or other records related to credit transactions. Self-testing includes, but is not limited to, the practice of using fictitious applicants for credit (testers), either with or without the use of matched pairs. A creditor may elect to test a defined segment of its business, for example, loan applications processed by a specific branch or loan officer, or applications made for a particular type of credit or loan program. A creditor also may use other methods of generating information that is not available in loan and application files, such as surveying mortgage loan applicants. To the extent permitted by law, creditors might also develop new methods that go beyond traditional pre-application testing, such as hiring testers to submit fictitious loan applications for processing.

2. The privilege does not protect a creditor's analysis performed as part of processing or underwriting a credit application. A creditor's evaluation or analysis of its loan files, Home Mortgage Disclosure Act data, or similar types of records (such as broker or loan officer compensation records) does not produce new information about a creditor's compliance and is not a self-test for purposes of this section. Similarly, a statistical analysis of data derived from existing loan files is not privileged.

15(b)(3) Types of information not privileged.

Paragraph 15(b)(3)(i)

1. The information listed in this paragraph is not privileged and may be used to determine whether the prerequisites for the privilege have been satisfied. Accordingly, a creditor might be asked to identify the self-testing method, for example, whether preapplication testers were used or data were compiled by surveying loan applicants. Information about the scope of the self-test (such as the types of credit transactions examined, or the geographic area covered by the test) also is not privileged.

Paragraph 15(b)(3)(ii)

1. Property appraisal reports, minutes of loan committee meetings or other documents reflecting the basis for a decision to approve or deny an application, loan policies or procedures, underwriting standards, and broker compensation records are examples of the types of records that are not privileged. If a creditor arranges for testers to submit loan applications for processing, the records are not related to actual credit transactions for purposes of this paragraph and may be privileged self-testing records.

15(c) Appropriate corrective action.

1. The rule only addresses the corrective actions required for a creditor to take advantage of the privilege in this section. A creditor may be required to take other actions or provide additional relief if a formal finding of discrimination is made.

15(c)(1) General requirement.

1. Appropriate corrective action is required even though no violation has been formally adjudicated or admitted by the creditor. In determining whether it is more likely than not that a violation occurred, a creditor must treat testers as if they are actual applicants for credit. A creditor may not refuse to take appropriate corrective action under this section because the self-test used fictitious loan applicants. The fact that a tester's agreement with the creditor waives the tester's legal right to assert a violation does not eliminate the requirement for the creditor to take corrective action, although no remedial relief for the tester is required under paragraph 15(c)(3).

15(c)(2) Determining the scope of appropriate corrective action.

1. Whether a creditor has taken or is taking corrective action that is appropriate will be determined on a case-by-case basis. Generally, the scope of the corrective action that is needed to preserve the privilege is governed by the scope of the self-test. For example, a creditor that self-tests mortgage loans and discovers evidence of discrimination may focus its corrective actions on mortgage loans, and is not required to expand its testing to other types of loans.

2. In identifying the policies or practices that are a likely cause of the violation, a creditor might identify inadequate or improper lending policies, failure to implement established policies, employee conduct, or other causes. The extent and scope of a likely violation may be assessed by determining which areas of operations are likely to be affected by those policies and practices, for example, by determining the types of loans and stages of the application process involved and the branches or offices where the violations may have occurred.

3. Depending on the method and scope of the self-test and the results of the test, appropriate corrective action may include one or more of the following:

i. If the self-test identifies individuals whose applications were inappropriately processed, offering to extend credit if the application was improperly denied and compensating such persons for out-of-pocket costs and other compensatory damages;

ii. Correcting institutional policies or procedures that may have contributed to the likely violation, and adopting new policies as appropriate;

iii. Identifying and then training and/or disciplining the employees involved;

iv. Developing outreach programs, marketing strategies, or loan products to serve more effectively segments of the lender's markets that may have been affected by the likely discrimination; and

v. Improving audit and oversight systems to avoid a recurrence of the likely violations.

15(c)(3) Types of relief.

Paragraph 15(c)(3)(ii)

1. The use of pre-application testers to identify policies and practices that illegally discriminate does not require creditors to review existing loan files for the purpose of identifying and compensating applicants who might have been adversely affected.

2. If a self-test identifies a specific applicant who was discriminated against on a prohibited basis, to qualify for the privilege in this section the creditor must provide appropriate remedial relief to that applicant; the creditor is not

required to identify other applicants who might also have been adversely affected.

Paragraph 15(c)(3)(iii)

1. A creditor is not required to provide remedial relief to an applicant that would not be available by law. An applicant might also be ineligible for certain types of relief due to changed circumstances. For example, a creditor is not required to offer credit to a denied applicant if the applicant no longer qualifies for the credit due to a change in financial circumstances, although some other type of relief might be appropriate.

15(d)(1) Scope of privilege.

1. The privilege applies with respect to any examination, investigation or proceeding by federal, state, or local government agencies relating to compliance with the Act or this regulation. Accordingly, in a case brought under the ECOA, the privilege established under this section preempts any inconsistent laws or court rules to the extent they might require disclosure of privileged self-testing data. The privilege does not apply in other cases (such as in litigation filed solely under a state's fair lending statute). In such cases, if a court orders a creditor to disclose self-test results, the disclosure is not a voluntary disclosure or waiver of the privilege for purposes of paragraph 15(d)(2); a creditor may protect the information by seeking a protective order to limit availability and use of the self-testing data and prevent dissemination beyond what is necessary in that case. Paragraph 15(d)(1) precludes a party who has obtained privileged information from using it in a case brought under the ECOA, provided the creditor has not lost the privilege through voluntary disclosure under paragraph 15(d)(2).

15(d)(2) Loss of privilege.

Paragraph 15(d)(2)(i)

1. A creditor's corrective action, by itself, is not considered a voluntary disclosure of the self-test report or results. For example, a creditor does not disclose the results of a self-test merely by offering to extend credit to a denied applicant or by inviting the applicant to reapply for credit. Voluntary disclosure could occur under this paragraph, however, if the creditor disclosed the self-test results in connection with a new offer of credit.

2. The disclosure of self-testing results to an independent contractor acting as an auditor or consultant for the creditor on compliance matters does not result in loss of the privilege.

Paragraph 15(d)(2)(ii)

1. The privilege is lost if the creditor discloses privileged information, such as the results of the self-test. The privilege is not lost if the creditor merely reveals or refers to the existence of the self-test.

Paragraph 15(d)(2)(iii)

1. A creditor's claim of privilege may be challenged in a court or administrative law proceeding with appropriate jurisdiction. In resolving the issue, the presiding officer may require the creditor to produce privileged information about the self-test.

Paragraph 15(d)(3) Limited use of privileged information

1. A creditor may be required to produce privileged documents for the purpose of determining a penalty or remedy after a violation of the ECOA or Regulation B has been formally adjudicated or admitted. A creditor's compliance with such a requirement does not evidence the creditor's intent to forfeit the privilege.

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1B- Consumer Credit Law Manual § 202.16

§ 202.16 Enforcement, Penalties, and Liabilities

16(c) Failure of compliance.

1. *Inadvertent errors*. Inadvertent errors include, but are not limited to, clerical mistake, calculation error, computer malfunction, and printing error. An error of legal judgment is not an inadvertent error under the regulation.

2. *Correction of error*. For inadvertent errors that occur under §§ 202.12 and 202.13, this section requires that they be corrected prospectively.

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Appendix B Model Application Forms

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Appendix B Model Application Forms

1. *Freddie Mac/Fannie Mae form -- residential loan application*. The uniform residential loan application form (Freddie Mac 65/Fannie Mae 1003), including supplemental form (Freddie Mac 65A/Fannie Mae 1003A), prepared by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association and dated October 1992 may be used by creditors without violating this regulation. Creditors that are governed by the monitoring requirements of this regulation (which limits collection to applications primarily for the purchase or refinancing of the applicant's principal residence) should delete, strike, or modify the data-collection section on the form when using it for transactions not covered by § 202.13(a) to ensure that they do not collect the information. Creditors that are subject to more extensive collection requirements by a substitute monitoring program under § 202.13(d) or by the Home Mortgage Disclosure Act (HMDA) may use the form as issued, in compliance with the substitute program or HMDA.

2. *FHLMC/FNMA form -- home improvement loan application*. The home-improvement and energy loan application form (FHLMC 703/FNMA 1012), prepared by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association and dated October 1986, complies with the requirements of the regulation for some creditors but not others because of the form's section "Information for Government Monitoring Purposes." Creditors that are governed by § 202.13(a) of the regulation (which limits collection to applications primarily for the purchase or refinancing of the applicant's principal residence) should delete, strike, or modify the data-collection section on the form when using it for transactions not covered by § 202.13(a) to ensure that they do not collect the information. Creditors that are subject to more extensive collection requirements by a substitute monitoring program under § 202.13(d) may use the form as issued, in compliance with that substitute program.

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Appendix C Sample Notification Forms

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Appendix C Sample Notification Forms

1. *Form C-9*. Creditors may design their own form, add to, or modify the model form to reflect their individual policies and procedures. For example, a creditor may want to add:

i. A telephone number that applicants may call to leave their name and the address to which an appraisal report should be sent.

ii. A notice of the cost the applicant will be required to pay the creditor for the appraisal or a copy of the report.
[50 FR 48026, Nov. 20, 1985; as amended at *52 FR 10733,* Apr. 3, 1987; *53 FR 11045* , Apr. 5, 1988; *54 FR 9416,* Mar. 7, 1989; *55 FR 12472* , Apr. 4, 1990; *55 FR 14830* , Apr. 19, 1990; *45 FR 14462* , Apr. 10, 1991; *56 FR 16265* , Apr. 22, 1991; *57 FR 12203* , Apr. 9, 1992; *60 FR 29967 -29969,* June 7, 1995; *61 FR 50948, 50950, 50951* , Sept. 30, 1996; *62 FR 66412, 66419* , Dec. 18, 1997; *66 FR 17779, 17786* , Apr. 4, 2001; *66 FR 41439, 41440* , Aug. 8, 2001; *68 FR 13144, 13186* , Mar. 18, 2003; *72 FR 63445, 63451* , Nov. 9, 2007; *72 FR 71056, 71057* , Dec. 14, 2007]

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12 C.F.R. Part 213 REGULATION M--CONSUMER LEASING

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Authority: ***15 U.S.C. 1604*****; 1667f.**
Source: ***61 FR 52258*** **, Oct. 7, 1996, unless otherwise noted.**

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1B- Consumer Credit Law Manual § 213.1

§ 213.1 Authority, scope, purpose, and enforcement.

(a) *Authority*.The regulation in this part, known as Regulation M, is issued by the Board of Governors of the Federal Reserve System to implement the consumer leasing provisions of the Truth in Lending Act, which is Title I of the Consumer Credit Protection Act, as amended (*15 U.S.C. 1601 et seq*.). Information collection requirements contained in this regulation have been approved by the Office of Management and Budget under the provisions of *44 U.S.C. 3501 et seq*. and have been assigned OMB control number 7100-0202.

(b) *Scope and purpose*. This part applies to all persons that are lessors of personal property under consumer leases as those terms are defined in § 213.2(e)(1) and (h). The purpose of this part is:

(1) To ensure that lessees of personal property receive meaningful disclosures that enable them to compare lease terms with other leases and, where appropriate, with credit transactions;

(2) To limit the amount of balloon payments in consumer lease transactions; and

(3) To provide for the accurate disclosure of lease terms in advertising.

(c) *Enforcement and liability*. Enforcement and liability. Section 108 of the act contains the administrative enforcement provisions. Sections 112, 130, 131, and 185 of the act contain the liability provisions for failing to comply with the requirements of the act and this part.

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1B- Consumer Credit Law Manual § 213.2

§ **213.2 Definitions.**

For the purposes of this part the following definitions apply:

(a) *Act* means the Truth in Lending Act (*15 U.S.C. 1601 et seq.*) and the Consumer Leasing Act is chapter 5 of the Truth in Lending Act.

(b) *Advertisement* means a commercial message in any medium that directly or indirectly promotes a consumer lease transaction.

(c) *Board* refers to the Board of Governors of the Federal Reserve System.

(d) *Closed-end lease* means a consumer lease other than an open-end lease as defined in this section.

(e)

(1) *Consumer lease* means a contract in the form of a bailment or lease for the use of personal property by a natural person primarily for personal, family, or household purposes, for a period exceeding four months and for a total contractual obligation not exceeding $25,000, whether or not the lessee has the option to purchase or otherwise become the owner of the property at the expiration of the lease. Unless the context indicates otherwise, in this part "lease" means "consumer lease."

(2) The term does not include a lease that meets the definition of a credit sale in Regulation Z (*12 CFR 226.2(a)*). It also does not include a lease for agricultural, business, or commercial purposes or a lease made to an organization.

(3) This part does not apply to a lease transaction of personal property which is incident to the lease of real property and which provides that:

(i) The lessee has no liability for the value of the personal property at the end of the lease term except for abnormal wear and tear; and

(ii) The lessee has no option to purchase the leased property.

(f) *Gross capitalized cost* means the amount agreed upon by the lessor and the lessee as the value of the leased property and any items that are capitalized or amortized during the lease term, including but not limited to taxes, insurance, service agreements, and any outstanding prior credit or lease balance. *Capitalized cost reduction* means the total amount of any rebate, cash payment, net trade-in allowance, and noncash credit that reduces the gross capitalized cost. The *adjusted capitalized cost* equals the gross capitalized cost less the capitalized cost reduction, and is the amount used by the lessor in calculating the base periodic payment.

(g) *Lessee* means a natural person who enters into or is offered a consumer lease.

(h) Lessor means a person who regularly leases, offers to lease, or arranges for the lease of personal property under a consumer lease. A person who has leased, offered, or arranged to lease personal property more than five times in the preceding calendar year or more than five times in the current calendar year is subject to the act and this part.

(i) *Open-end lease* means a consumer lease in which the lessee's liability at the end of the lease term is based on the difference between the residual value of the leased property and its realized value.

(j) *Organization* means a corporation, trust, estate, partnership, cooperative, association, or government entity or instrumentality.

(k) *Person* means a natural person or an organization.

(l) *Personal property* means any property that is not real property under the law of the state where the property is located at the time it is offered or made available for lease.

(m) *Realized value* means:

(1) The price received by the lessor for the leased property at disposition;

(2) The highest offer for disposition of the leased property; or

(3) The fair market value of the leased property at the end of the lease term.

(n) *Residual value* means the value of the leased property at the end of the lease term, as estimated or assigned at consummation by the lessor, used in calculating the base periodic payment.

(o) *Security interest* and security mean any interest in property that secures the payment or performance of an obligation.

(p) *State* means any state, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

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1B- Consumer Credit Law Manual § 213.3

§ 213.3 General disclosure requirements.

(a) *General requirements*. A lessor shall make the disclosures required by § 213.4, as applicable. The disclosures shall be made clearly and conspicuously in writing in a form the consumer may keep, in accordance with this section. The disclosures required by this part may be provided to the lessee in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (*15 U.S.C. § 7001 et seq.*). For an advertisement accessed by the consumer in electronic form, the disclosures required by § 213.7 may be provided to the consumer in electronic form in the advertisement, without regard to the consumer consent or other provisions of the E-Sign Act.

(1) *Form of disclosures*. The disclosures required by § 213.4 shall be given to the lessee together in a dated statement that identifies the lessor and the lessee; the disclosures may be made either in a separate statement that identifies the consumer lease transaction or in the contract or other document evidencing the lease. Alternatively, the disclosures required to be segregated from other information under paragraph (a)(2) of this section may be provided in a separate dated statement that identifies the lease, and the other required disclosures may be provided in the lease contract or other document evidencing the lease. In a lease of multiple items, the property description required by § 213.4(a) may be given in a separate statement that is incorporated by reference in the disclosure statement required by this paragraph.

(2) *Segregation of certain disclosures*. The following disclosures shall be segregated from other information and shall contain only directly related information: §§ 213.4(b) through (f), (g)(2), (h)(3), (i)(1), (j), and (m)(1). The headings, content, and format for the disclosures referred to in this paragraph (a)(2) shall be provided in a manner substantially similar to the applicable model form in appendix A of this part.

(3) *Timing of disclosures*. A lessor shall provide the disclosures to the lessee prior to the consummation of a consumer lease.

(4) *Language of disclosures*. The disclosures required by § 213.4 may be made in a language other than English provided that they are made available in English upon the lessee's request.

(b) *Additional information; nonsegregated disclosures*. Additional information may be provided with any disclosure not listed in paragraph (a)(2) of this section, but it shall not be stated, used, or placed so as to mislead or confuse the lessee or contradict, obscure, or detract attention from any disclosure required by this part.

(c) *Multiple lessors or lessees*. When a transaction involves more than one lessor, the disclosures required by this part may be made by one lessor on behalf of all the lessors. When a lease involves more than one lessee, the lessor may provide the disclosures to any lessee who is primarily liable on the lease.

(d) *Use of estimates*. If an amount or other item needed to comply with a required disclosure is unknown or unavailable after reasonable efforts have been made to ascertain the information, the lessor may use a reasonable estimate that is based on the best information available to the lessor, is clearly identified as an estimate, and is not used to circumvent or evade any disclosures required by this part.

(e) *Effect of subsequent occurrence*. If a required disclosure becomes inaccurate because of an event occurring after consummation, the inaccuracy is not a violation of this part.

(f) *Minor variations*. A lessor may disregard the effects of the following in making disclosures:

(1) That payments must be collected in whole cents;

(2) That dates of scheduled payments may be different because a scheduled date is not a business day;

(3) That months have different numbers of days; and

(4) That February 29 occurs in a leap year.

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1B- Consumer Credit Law Manual § 213.4

§ **213.4 Content of disclosures.**

For any consumer lease subject to this part, the lessor shall disclose the following information, as applicable:

(a) *Description of property*. A brief description of the leased property sufficient to identify the property to the lessee and lessor.

(b) *Amount due at lease signing or delivery*. The total amount to be paid prior to or at consummation or by delivery, if delivery occurs after consummation, using the term "amount due at lease signing or delivery." The lessor shall itemize each component by type and amount, including any refundable security deposit, advance monthly or other periodic payment, and capitalized cost reduction; and in motor-vehicle leases, shall itemize how the amount due will be paid, by type and amount, including any net trade-in allowance, rebates, noncash credits, and cash payments in a format substantially similar to the model forms in appendix A of this part.

(c) *Payment schedule and total amount of periodic payments*. The number, amount, and due dates or periods of payments scheduled under the lease, and the total amount of the periodic payments.

(d) *Other charges*. The total amount of other charges payable to the lessor, itemized by type and amount, that are not included in the periodic payments. Such charges include the amount of any liability the lease imposes upon the lessee at the end of the lease term; the potential difference between the residual and realized values referred to in paragraph (k) of this section is excluded.

(e) *Total of payments*. The total of payments, with a description such as "the amount you will have paid by the end of the lease." This amount is the sum of the amount due at lease signing (less any refundable amounts), the total amount of periodic payments (less any portion of the periodic payment paid at lease signing), and other charges under paragraphs (b), (c), and (d) of this section. In an open-end lease, a description such as "you will owe an additional amount if the actual value of the vehicle is less than the residual value" shall accompany the disclosure.

(f) *Payment calculation*. In a motor-vehicle lease, a mathematical progression of how the scheduled periodic payment is derived, in a format substantially similar to the applicable model form in appendix A of this part, which shall contain the following:

(1) *Gross capitalized cost*. The gross capitalized cost, including a disclosure of the agreed upon value of the vehicle, a description such as "the agreed upon value of the vehicle [state the amount] and any items you pay for over the lease term (such as service contracts, insurance, and any outstanding prior credit or lease balance)," and a statement of the lessee's option to receive a separate written itemization of the gross capitalized cost. If requested by the lessee, the itemization shall be provided before consummation.

(2) *Capitalized cost reduction*. The capitalized cost reduction, with a description such as "the amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost."

(3) *Adjusted capitalized cost*. The adjusted capitalized cost, with a description such as "the amount used in calculating your base [periodic] payment."

(4) *Residual value*. The residual value, with a description such as "the value of the vehicle at the end of the lease used in calculating your base [periodic] payment."

(5) *Depreciation and any amortized amounts*. The depreciation and any amortized amounts, which is the difference between the adjusted capitalized cost and the residual value, with a description such as "the amount charged for the vehicle's decline in value through normal use and for any other items paid over the lease term."

(6) *Rent charge*. The rent charge, with a description such as "the amount charged in addition to the depreciation and any amortized amounts." This amount is the difference between the total of the base periodic payments over the lease term minus the depreciation and any amortized amounts.

(7) *Total of base periodic payments*. The total of base periodic payments with a description such as "depreciation

and any amortized amounts plus the rent charge."

(8) *Lease payments*. The lease payments with a description such as "the number of payments in your lease."

(9) *Base periodic payment*. The total of the base periodic payments divided by the number of payment periods in the lease.

(10) *Itemization of other charges*. An itemization of any other charges that are part of the periodic payment.

(11) *Total periodic payment*. The sum of the base periodic payment and any other charges that are part of the periodic payment.

(g) *Early termination--*

(1) *Conditions and disclosure of charges*. A statement of the conditions under which the lessee or lessor may terminate the lease prior to the end of the lease term; and the amount or a description of the method for determining the amount of any penalty or other charge for early termination, which must be reasonable.

(2) *Early-termination notice*. In a motor-vehicle lease, a notice substantially similar to the following: "Early Termination. You may have to pay a substantial charge if you end this lease early. The charge may be up to several thousand dollars. The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be."

(h) *Maintenance responsibilities*. The following provisions are required:

(1) *Statement of responsibilities*. A statement specifying whether the lessor or the lessee is responsible for maintaining or servicing the leased property, together with a brief description of the responsibility;

(2) *Wear and use standard*. A statement of the lessor's standards for wear and use (if any), which must be reasonable; and

(3) *Notice of wear and use standard*. In a motor-vehicle lease, a notice regarding wear and use substantially similar to the following: "Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use." The notice shall also specify the amount or method for determining any charge for excess mileage.

(i) *Purchase option*. A statement of whether or not the lessee has the option to purchase the leased property, and:

(1) *End of lease term*. If at the end of the lease term, the purchase price; and

(2) *During lease term*. If prior to the end of the lease term, the purchase price or the method for determining the price and when the lessee may exercise this option.

(j) *Statement referencing nonsegregated disclosures*. A statement that the lessee should refer to the lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interests, if applicable.

(k) *Liability between residual and realized values*. A statement of the lessee's liability, if any, at early termination or at the end of the lease term for the difference between the residual value of the leased property and its realized value.

(l) *Right of appraisal*. If the lessee's liability at early termination or at the end of the lease term is based on the realized value of the leased property, a statement that the lessee may obtain, at the lessee's expense, a professional appraisal by an independent third party (agreed to by the lessee and the lessor) of the value that could be realized at sale of the leased property. The appraisal shall be final and binding on the parties.

(m) *Liability at end of lease term based on residual value*. If the lessee is liable at the end of the lease term for the difference between the residual value of the leased property and its realized value:

(1) *Rent and other charges*. The rent and other charges, paid by the lessee and required by the lessor as an incident to the lease transaction, with a description such as "the total amount of rent and other charges imposed in connection with your lease [state the amount]."

(2) *Excess liability*. A statement about a rebuttable presumption that, at the end of the lease term, the residual value of the leased property is unreasonable and not in good faith to the extent that the residual value exceeds the realized value by more than three times the base monthly payment (or more than three times the average payment allocable to a

monthly period, if the lease calls for periodic payments other than monthly); and that the lessor cannot collect the excess amount unless the lessor brings a successful court action and pays the lessee's reasonable attorney's fees, or unless the excess of the residual value over the realized value is due to unreasonable or excessive wear or use of the leased property (in which case the rebuttable presumption does not apply).

(3) *Mutually agreeable final adjustment*. A statement that the lessee and lessor are permitted, after termination of the lease, to make any mutually agreeable final adjustment regarding excess liability.

(n) *Fees and taxes*. The total dollar amount for all official and license fees, registration, title, or taxes required to be paid in connection with the lease.

(o) *Insurance*. A brief identification of insurance in connection with the lease including:

(1) *Through the lessor*. If the insurance is provided by or paid through the lessor, the types and amounts of coverage and the cost to the lessee; or

(2) *Through a third party*. If the lessee must obtain the insurance, the types and amounts of coverage required of the lessee.

(p) *Warranties or guarantees*. A statement identifying all express warranties and guarantees from the manufacturer or lessor with respect to the leased property that apply to the lessee.

(q) *Penalties and other charges for delinquency*. The amount or the method of determining the amount of any penalty or other charge for delinquency, default, or late payments, which must be reasonable.

(r) *Security interest*. A description of any security interest, other than a security deposit disclosed under paragraph (b) of this section, held or to be retained by the lessor; and a clear identification of the property to which the security interest relates.

(s) *Limitations on rate information*. If a lessor provides a percentage rate in an advertisement or in documents evidencing the lease transaction, a notice stating that "this percentage may not measure the overall cost of financing this lease" shall accompany the rate disclosure. The lessor shall not use the term "annual percentage rate," "annual lease rate," or any equivalent term.

(t) *Non-motor vehicle open-end leases*. Non-motor vehicle open-end leases remain subject to section 182(10) of the act regarding end of term liability.

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1B- Consumer Credit Law Manual § 213.5

§ **213.5 Renegotiations, extensions, and assumptions.**

(a) *Renegotiation*. A renegotiation occurs when a consumer lease subject to this part is satisfied and replaced by a new lease undertaken by the same consumer. A renegotiation requires new disclosures, except as provided in paragraph (d) of this section.

(b) *Extension*. An extension is a continuation, agreed to by the lessor and the lessee, of an existing consumer lease beyond the originally scheduled end of the lease term, except when the continuation is the result of a renegotiation. An extension that exceeds six months requires new disclosures, except as provided in paragraph (d) of this section.

(c) *Assumption*. New disclosures are not required when a consumer lease is assumed by another person, whether or not the lessor charges an assumption fee.

(d) *Exceptions*. New disclosures are not required for the following, even if they meet the definition of a renegotiation or an extension:

(1) A reduction in the rent charge;

(2) The deferment of one or more payments, whether or not a fee is charged;

(3) The extension of a lease for not more than six months on a month-to-month basis or otherwise;

A substitution of leased property with property that has a substantially equivalent or greater economic value, provided no other lease terms are changed;

The addition, deletion, or substitution of leased property in a multiple-item lease, provided the average periodic payment does not change by more than 25 percent; or

(6) An agreement resulting from a court proceeding.

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1B- Consumer Credit Law Manual § 213.6

§ **213.6 [This section was removed and reserved. See 72 FR 63456, 63461, Nov. 9, 2007.]**

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1B- Consumer Credit Law Manual § 213.7

§ **213.7 Advertising.**

(a) *General rule*. An advertisement for a consumer lease may state that a specific lease of property at specific amounts or terms is available only if the lessor usually and customarily leases or will lease the property at those amounts or terms.

(b) *Clear and conspicuous standard*. Disclosures required by this section shall be made clearly and conspicuously.

(1) *Amount due at lease signing or delivery*. Except for the statement of a periodic payment, any affirmative or negative reference to a charge that is a part of the disclosure required under paragraph (d)(2)(ii) of this section shall not be more prominent than that disclosure.

(2) *Advertisement of a lease rate*. If a lessor provides a percentage rate in an advertisement, the rate shall not be more prominent than any of the disclosures in § 213.4, with the exception of the notice in § 213.4(s) required to accompany the rate; and the lessor shall not use the term "annual percentage rate," "annual lease rate," or equivalent term.

(c) *Catalogs or other multipage advertisements; electronic advertisements*. A catalog or other multipage advertisement, or an electronic advertisement (such as an advertisement appearing on an Internet Web site), that provides a table or schedule of the required disclosures shall be considered a single advertisement if, for lease terms that appear without all the required disclosures, the advertisement refers to the page or pages on which the table or schedule appears.

(d) *Advertisement of terms that require additional disclosure--*

(1) *Triggering terms*. An advertisement that states any of the following items shall contain the disclosures required by paragraph (d)(2) of this section, except as provided in paragraphs (e) and (f) of this section:

(i) The amount of any payment; or

(ii) A statement of any capitalized cost reduction or other payment (or that no payment is required) prior to or at consummation or by delivery, if delivery occurs after consummation.

(2) *Additional terms*. An advertisement stating any item listed in paragraph (d)(1) of this section shall also state the following items:

(i) That the transaction advertised is a lease;

(ii) The total amount due prior to or at consummation or by delivery, if delivery occurs after consummation;

(iii) The number, amounts, and due dates or periods of scheduled payments under the lease;

(iv) A statement of whether or not a security deposit is required; and

(v) A statement that an extra charge may be imposed at the end of the lease term where the lessee's liability (if any) is based on the difference between the residual value of the leased property and its realized value at the end of the lease term.

(e) *Alternative disclosures--merchandise tags*. A merchandise tag stating any item listed in paragraph (d)(1) of this section may comply with paragraph (d)(2) of this section by referring to a sign or display prominently posted in the lessor's place of business that contains a table or schedule of the required disclosures.

(f) *Alternative disclosures--television or radio advertisements*.--

(1) *Toll-free number or print advertisement*. An advertisement made through television or radio stating any item listed in paragraph (d)(1) of this section complies with paragraph (d)(2) of this section if the advertisement states the items listed in paragraphs (d)(2)(i) through (iii) of this section, and:

(i) Lists a toll-free telephone number along with a reference that such number may be used by consumers to obtain the information required by paragraph (d)(2) of this section; or

(ii) Directs the consumer to a written advertisement in a publication of general circulation in the community served by the media station, including the name and the date of the publication, with a statement that information required by paragraph (d)(2) of this section is included in the advertisement. The written advertisement shall be published beginning at least three days before and ending at least ten days after the broadcast.

(2) *Establishment of toll-free number*.

(i) The toll-free telephone number shall be available for no fewer than ten days, beginning on the date of the broadcast.

(ii) The lessor shall provide the information required by paragraph (d)(2) of this section orally, or in writing upon request.

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1B- Consumer Credit Law Manual § 213.8

§ **213.8 Record retention.**

A lessor shall retain evidence of compliance with the requirements imposed by this part, other than the advertising requirements under § 213.7, for a period of not less than two years after the date the disclosures are required to be made or an action is required to be taken. Exemption of certain state regulated transactions.

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1B- Consumer Credit Law Manual § 213.9

§ **213.9 Relation to state laws.**

(a) *Inconsistent state law*. A state law that is inconsistent with the requirements of the act and this part is preempted to the extent of the inconsistency. If a lessor cannot comply with a state law without violating a provision of this part, the state law is inconsistent within the meaning of section 186(a) of the act and is preempted, unless the state law gives greater protection and benefit to the consumer. A state, through an official having primary enforcement or interpretative responsibilities for the state consumer leasing law, may apply to the Board for a preemption determination.

(b) *Exemptions*.--

(1) *Application*. A state may apply to the Board for an exemption from the requirements of the act and this part for any class of lease transactions within the state. The Board will grant such an exemption if the Board determines that:

(i) The class of leasing transactions is subject to state law requirements substantially similar to the act and this part or that lessees are afforded greater protection under state law; and

(ii) There is adequate provision for state enforcement.

(2) *Enforcement and liability*. After an exemption has been granted, the requirements of the applicable state law (except for additional requirements not imposed by federal law) will constitute the requirements of the act and this part. No exemption will extend to the civil liability provisions of sections 130, 131, and 185 of the act.

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§

Form C-11 Model Open-End or Finance Vehicle Lease Disclosures

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1B Consumer Credit Law Manual Appendix B to Part 213

Appendix B to Part 213 Federal Enforcement Agencies

The following list indicates which federal agency enforces Regulation M (12 CFR Part 213) for particular classes of business. Any questions concerning compliance by a particular business should be directed to the appropriate enforcement agency. Terms that are not defined in the Federal Deposit Insurance Act (*12 U.S.C. 1813(s)*) shall have the meaning given to them in the International Banking Act of 1978 (*12 U.S.C. 3101*).

1. *National banks and federal branches and federal agencies of foreign banks*

District office of the Office of the Comptroller of the Currency for the district in which the institution is located.

2. *State member banks, branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act*

Federal Reserve Bank serving the District in which the institution is located.

3. *Nonmember insured banks and insured state branches of foreign banks*

Federal Deposit Insurance Corporation Regional Director for the region in which the institution is located.

4. *Savings institutions insured under the Savings Association Insurance Fund of the FDIC and federally chartered savings banks insured under the Bank Insurance Fund of the FDIC (but not including state-chartered savings banks*

insured under the Bank Insurance Fund)

Office of Thrift Supervision regional director for the region in which the institution is located.

5. *Federal credit unions*

Regional office of the National Credit Union Administration serving the area in which the federal credit union is located.

6. *Air carriers*

Assistant General Counsel for Aviation Enforcement and Proceedings, Department of Transportation, 400 Seventh Street, S.W., Washington, DC 20590

7. *Those subject to Packers and Stockyards Act*

Nearest Packers and Stockyards Administration area supervisor.

8. *Federal Land Banks, Federal Land Bank Associations, Federal Intermediate Credit Banks, and Production Credit Associations*

Farm Credit Administration, 490 L'Enfant Plaza, S.W., Washington, DC 20578

9. *All other lessors (lessors operating on a local or regional basis should use the address of the FTC regional office in which they operate)*

Division of Credit Practices, Bureau of Consumer Protection, Federal Trade Commission, Washington, DC 20580

[*46 FR 20951* , April 7, 1981; *46 FR 29245, 29246* , June 1, 1981; Reg. M, *61 FR 52246, 52269* , Oct. 7, 1996; Reg. M, *62 FR 53733* , Oct. 16, 1997]

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1B Consumer Credit Law Manual Appendix C to Part 213

Appendix C to Part 213 Issuance of Staff Interpretations

Officials in the Board's Division of Consumer and Community Affairs are authorized to issue official staff interpretations of this Regulation M (12 CFR Part 213). These interpretations provide the formal protection afforded under section 130(f) of the act. Except in unusual circumstances, interpretations will not be issued separately but will be incorporated in an official commentary to Regulation M (Supplement I of this part), which will be amended periodically. No staff interpretations will be issued approving lessor's forms, statements, or calculation tools or methods. [Reg. M, *46 FR 20951* , April 7, 1981; Reg. M, *61 FR 52246, 52269* , Oct. 7, 1996; Reg. M, *62 FR 53733* , Oct. 16, 1997]

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1B- Consumer Credit Law Manual CFR

§ **CFR Introduction**

1. *Official status*. The commentary in Supplement I is the vehicle by which the Division of Consumer and Community Affairs of the Federal Reserve Board issues official staff interpretations of Regulation M (12 CFR part 213). Good faith compliance with this commentary affords protection from liability under section 130(f) of the Truth in Lending Act (*15 U.S.C. 1640(f)*). Section 130(f) protects lessors from civil liability for any act done or omitted in good faith in conformity with any interpretation issued by a duly authorized official or employee of the Federal Reserve System.

2. *Procedures for requesting interpretations*. Under appendix C of Regulation M, anyone may request an official staff interpretation. Interpretations that are adopted will be incorporated in this commentary following publication in the Federal Register. No official staff interpretations are expected to be issued other than by means of this commentary.

3. *Comment designations*. Each comment in the commentary is identified by a number and the regulatory section or paragraph that it interprets. The comments are designated with as much specificity as possible according to the particular regulatory provision addressed. For example, some of the comments to § 213.4(f) are further divided by subparagraph, such as comment 4(f)(1)-1 and comment 4(f)(2)-1. In other cases, comments have more general application and are designated, for example, as comment 4(a)-1. This introduction may be cited as comments I-1 through I-4. An appendix may be cited as comment app. A-1.

4. *Illustrations*. Lists that appear in the commentary may be exhaustive or illustrative; the appropriate construction should be clear from the context. Illustrative lists are introduced by phrases such as "including," "such as," "to illustrate," and "for example."

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1B- Consumer Credit Law Manual § 213.1

§ 213.1 Authority, Scope, Purpose, and Enforcement

1. *Foreign applicability*. Regulation M applies to all persons (including branches of foreign banks or leasing companies located in the United States) that offer consumer leases to residents of any state (including foreign nationals) as defined in § 213.2(p). The regulation does not apply to a foreign branch of a U.S. bank or to a leasing company leasing to a U.S. citizen residing or visiting abroad or to a foreign national abroad.

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1B- Consumer Credit Law Manual § 213.2

§ **213.2 Definitions**

2(b) Advertisement

1. *Coverage*. The term advertisement includes messages inviting, offering, or otherwise generally announcing to prospective customers the availability of consumer leases, whether in visual, oral, print or electronic media. Examples include:

i. Messages in newspapers, magazines, leaflets, catalogs, and fliers.

ii. Messages on radio, television, and public address systems.

iii. Direct mail literature.

iv. Printed material on any interior or exterior sign or display, in any window display, in any point-of-transaction literature or price tag that is delivered or made available to a lessee or prospective lessee in any manner whatsoever.

v. Telephone solicitations.

vi. On-line messages, such as those on the Internet.

2. *Exclusions*. The term does not apply to the following:

i. Direct personal contacts, including follow-up letters, cost estimates for individual lessees, or oral or written communications relating to the negotiation of a specific transaction.

ii. Informational material distributed only to businesses.

iii. Notices required by federal or state law, if the law mandates that specific information be displayed and only the mandated information is included in the notice.

iv. News articles controlled by the news medium.

v. Market research or educational materials that do not solicit business.

3. *Persons covered*. See the commentary to § 213.7(a).

2(d) Closed-End Lease

1. *General*. In closed-end leases, sometimes referred to as "walk-away" leases, the lessee is not responsible for the residual value of the leased property at the end of the lease term.

2(e) Consumer lease

1. *Primary purposes*. A lessor must determine in each case if the leased property will be used primarily for personal, family, or household purposes. If a question exists as to the primary purpose for a lease, the fact that a lessor gives disclosures is not controlling on the question of whether the transaction is covered. The primary purpose of a lease is determined before or at consummation and a lessor need not provide Regulation M disclosures where there is a subsequent change in the primary use.

2. *Period of time*. To be a consumer lease, the initial term of the lease must be more than four months. Thus, a lease of personal property for four months, three months or on a month-to-month or week-to-week basis (even though the lease actually extends beyond four months) is not a consumer lease and is not subject to the disclosure requirements of the regulation. However, a lease that imposes a penalty for not continuing the lease beyond four months is considered to have a term of more than four months. To illustrate:

i. A three-month lease extended on a month-to-month basis and terminated after one year is not subject to the regulation.

ii. A month-to-month lease with a penalty, such as the forfeiture of a security deposit for terminating before one year, is subject to the regulation.

3. *Total contractual obligation*. The total contractual obligation is not necessarily the same as the total of payments disclosed under § 213.4(e). The total contractual obligation includes nonrefundable amounts a lessee is contractually obligated to pay to the lessor, but excludes items such as:

i. Residual value amounts or purchase-option prices;

ii. Amounts collected by the lessor but paid to a third party, such as taxes, licenses, and registration fees.

4. *Credit sale*. The regulation does not cover a lease that meets the definition of a credit sale in Regulation Z, *12 CFR 226.2(a)(16)*, which is defined, in part, as a bailment or lease (unless terminable without penalty at any time by the consumer) under which the consumer:

i. Agrees to pay as compensation for use a sum substantially equivalent to, or in excess of, the total value of the property and services involved; and

ii. Will become (or has the option to become), for no additional consideration or for nominal consideration, the owner of the property upon compliance with the agreement.

5. *Agricultural purpose*. Agricultural purpose means a purpose related to the production, harvest, exhibition, marketing, transportation, processing, or manufacture of agricultural products by a natural person who cultivates, plants, propagates, or nurtures those agricultural products, including but not limited to the acquisition of personal property and services used primarily in farming. Agricultural products include horticultural, viticultural, and dairy products,

livestock, wildlife, poultry, bees, forest products, fish and shellfish, and any products thereof, including processed and manufactured products, and any and all products raised or produced on farms and any processed or manufactured products thereof.

6. *Organization or other entity*. A consumer lease does not include a lease made to an organization such as a corporation or a government agency or instrumentality. Such a lease is not covered by the regulation even if the leased property is used (by an employee, for example) primarily for personal, family or household purposes, or is guaranteed by or subsequently assigned to a natural person.

7. *Leases of personal property incidental to a service*. The following leases of personal property are deemed incidental to a service and thus are not subject to the regulation:

i. Home entertainment systems requiring the consumer to lease equipment that enables a television to receive the transmitted programming.

ii. Security alarm systems requiring the installation of leased equipment intended to monitor unlawful entries into a home and in some cases to provide fire protection.

iii. Propane gas service where the consumer must lease a propane tank to receive the service.

8. *Safe deposit boxes*. The lease of a safe deposit box is not a consumer lease under § 213.2(e).

2(g) Lessee

1. *Guarantors*. Guarantors are not lessees for purposes of the regulation.

2(h) Lessor

1. *Arranger of a lease*. To "arrange" for the lease of personal property means to provide or offer to provide a lease that is or will be extended by another person under a business or other relationship pursuant to which the person arranging the lease (a) receives or will receive a fee, compensation, or other consideration for the service or (b) has knowledge of the lease terms and participates in the preparation of the contract documents required in connection with the lease. To illustrate:

i. An automobile dealer who, pursuant to a business relationship, completes the necessary lease agreement before forwarding it for execution to the leasing company (to whom the obligation is payable on its face) is "arranging" for the lease.

ii. An automobile dealer who, without receiving a fee for the service, refers a customer to a leasing company that will prepare all relevant contract documents is not "arranging" for the lease.

2. *Consideration*. The term "other consideration" as used in comment 2(h)-1 refers to an actual payment corresponding to a fee or similar compensation and not to intangible benefits, such as the advantage of increased business, which may flow from the relationship between the parties.

3. *Assignees*. An assignee may be a lessor for purposes of the regulation in circumstances where the assignee has substantial involvement in the lease transaction. See cf. *Ford Motor Credit Co. v. Cenance, 452 U.S. 155 (1981)* (held that an assignee was a creditor for purposes of the pre-1980 Truth in Lending Act and Regulation Z because of its substantial involvement in the credit transaction).

4. *Multiple lessors*. See the commentary to § 213.3(c).

2(j) Organization

1. *Coverage*. The term "organization" includes joint ventures and persons operating under a business name.

2(l) Personal Property

1. *Coverage*. Whether property is personal property depends on state or other applicable law. For example, a mobile home or houseboat may be considered personal property in one state but real property in another.

2(m) Realized Value

1. *General*. Realized value refers to either the retail or wholesale value of the leased property at early termination or at the end of the lease term. It is not a required disclosure. Realized value is relevant only to leases in which the lessee's liability at early termination or at the end of the lease term typically is based on the difference between the residual value (or the adjusted lease balance) of the leased property and its realized value.

2. *Options*. Subject to the contract and to state or other applicable law, the lessor may calculate the realized value in

determining the lessee's liability at the end of the lease term or at early termination in one of the three ways stated in § 213.2(m). If the lessor sells the property prior to making the determination about liability, the price received for the property (or the fair market value) is the realized value. If the lessor does not sell the property prior to making that determination, the highest offer or the fair market value is the realized value.

3. *Determination of realized value*. Disposition charges are not subtracted in determining the realized value but amounts attributable to taxes may be subtracted.

4. *Offers*. In determining the highest offer for disposition, the lessor may disregard offers that an offeror has withdrawn or is unable or unwilling to perform.

5. *Lessor's appraisal*. See commentary to § 213.4(l).

2(o) Security Interest and Security

1. *Disclosable interests*. For purposes of disclosure, a security interest is an interest taken by the lessor to secure performance of the lessee's obligation. For example, if a bank that is not a lessor makes a loan to a leasing company and takes assignments of consumer leases generated by that company to secure the loan, the bank's security interest in the lessor's receivables is not a security interest for purposes of this regulation.

2. *General coverage*. An interest the lessor may have in leased property must be disclosed only if it is considered a security interest under state or other applicable law. The term includes, but is not limited to, security interests under the Uniform Commercial Code; real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded; mechanic's, materialman's, artisan's, and other similar liens; vendor's liens in both real and personal property; liens on property arising by operation of law; and any interest in a lease when used to secure payment or performance of an obligation.

3. *Insurance exception*. The lessor's right to insurance proceeds or unearned insurance premiums is not a security interest for purposes of this regulation.

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1B- Consumer Credit Law Manual § 213.3

§ 213.3 General Disclosure Requirements

3(a) General Requirements

1. *Basis of disclosures*. Disclosures must reflect the terms of the legal obligation between the parties. For example:

i. In a three-year lease with no penalty for termination after a one-year minimum term, disclosures are based on the full three-year term of the lease. The one-year minimum term is only relevant to the early termination provisions of §§ 213.4 (g)(1), (k) and (l).

2. *Clear and conspicuous standard*. The clear and conspicuous standard requires that disclosures be reasonably understandable. For example, the disclosures must be presented in a way that does not obscure the relationship of the terms to each other; appendix A of this part contains model forms that meet this standard. In addition, although no minimum typesize is required, the disclosures must be legible, whether typewritten, handwritten, or printed by computer.

3. *Multipurpose disclosure forms*. A lessor may use a multipurpose disclosure form provided the lessor is able to designate the specific disclosures applicable to a given transaction, consistent with the requirement that disclosures be clearly and conspicuously provided.

4. *Number of transactions*. Lessors have flexibility in handling lease transactions that may be viewed as multiple

transactions. For example:

i. When a lessor leases two items to the same lessee on the same day, the lessor may disclose the leases as either one or two lease transactions.

ii. When a lessor sells insurance or other incidental services in connection with a lease, the lessor may disclose in one of two ways: as a single lease transaction (in which case Regulation M, not Regulation Z, disclosures are required) or as a lease transaction and a credit transaction.

iii. When a lessor includes an outstanding lease or credit balance in a lease transaction, the lessor may disclose the outstanding balance as part of a single lease transaction (in which case Regulation M, not Regulation Z, disclosures are required) or as a lease transaction and a credit transaction.

3(a)(1) Form of Disclosures

1. *Cross-references*. Lessors may include in the nonsegregated disclosures a cross-reference to items in the segregated disclosures rather than repeat those items. A lessor may include in the segregated disclosures numeric or alphabetic designations as cross-references to related information so long as such references do not obscure or detract from the segregated disclosures.

2. *Identification of parties*. While disclosures must be made clearly and conspicuously, lessors are not required to use the word "lessor" and "lessee" to identify the parties to the lease transaction.

3. *Lessor's address*. The lessor must be identified by name; an address (and telephone number) may be provided.

4. *Multiple lessors and lessees*. In transactions involving multiple lessors and multiple lessees, a single lessor may make all the disclosures to a single lessee as long as the disclosure statement identifies all the lessors and lessees.

5. *Lessee's signature*. The regulation does not require that the lessee sign the disclosure statement, whether disclosures are separately provided or are part of the lease contract. Nevertheless, to provide evidence that disclosures are given before a lessee becomes obligated on the lease transaction, the lessor may, for example, ask the lessee to sign the disclosure statement or an acknowledgement of receipt, may place disclosures that are included in the lease documents above the lessee's signature, or include instructions alerting a lessee to read the disclosures prior to signing the lease.

3(a)(2) Segregation of Certain Disclosures

1. *Location*. The segregated disclosures referred to in § 213.3(a)(2) may be provided on a separate document and the other required disclosures may be provided in the lease contract, so long as all disclosures are given at the same time. Alternatively, all disclosures may be provided in a separate document or in the lease contract.

2. *Additional information among segregated disclosures*. The disclosures required to be segregated may contain only the information required or permitted to be included among the segregated disclosures.

3. *Substantially similar*. See commentary to appendix A of this part.

3(a)(3) Timing of Disclosures

1. *Consummation*. When a contractual relationship is created between the lessor and the lessee is a matter to be determined under state or other applicable law.

3(b) Additional Information; Nonsegregated Disclosures 1. *State law disclosures*. A lessor may include in the nonsegregated disclosures any state law disclosures that are not inconsistent with the act and regulation under § 213.9 as long as, in accordance with the standard set forth in § 213.3(b) for additional information, the state law disclosures are not used or placed to mislead or confuse or detract from any disclosure required by the regulation.

3(c) Multiple Lessors or Lessees

1. *Multiple lessors*. If a single lessor provides disclosures to a lessee on behalf of several lessors, all disclosures for the transaction must be given, even if the lessor making the disclosures would not otherwise have been obligated to make a particular disclosure.

3(d) Use of Estimates

3(d)(1) Standard

1. *Time of estimated disclosure*. The lessor may, after making a reasonable effort to obtain information, use estimates to make disclosures if necessary information is unknown or unavailable at the time the disclosures are made.

2. *Basis of estimates*. Estimates must be made on the basis of the best information reasonably available at the time disclosures are made. The "reasonably available" standard requires that the lessor, acting in good faith, exercise due diligence in obtaining information. The lessor may rely on the representations of other parties. For example, the lessor

might look to the consumer to determine the purpose for which leased property will be used, to insurance companies for the cost of insurance, or to an automobile manufacturer or dealer for the date of delivery. See commentary to § 213.4(n) for estimating official fees and taxes.

3. *Residual value of leased property at termination*. In an open-end lease where the lessee's liability at the end of the lease term is based on the residual value of the leased property as determined at consummation, the estimate of the residual value must be reasonable and based on the best information reasonably available to the lessor (see § 213.4(m)). A lessor should generally use an accepted trade publication listing estimated current or future market prices for the leased property unless other information or a reasonable belief based on its experience provides the better information. For example:

i. An automobile lessor offering a three-year open-end lease assigns a wholesale value to the vehicle at the end of the lease term. The lessor may disclose as an estimate a wholesale value derived from a generally accepted trade publication listing current wholesale values.

ii. Same facts as above, except that the lessor discloses an estimated value derived by adjusting the residual value quoted in the trade publication because, in its experience, the trade publication values either understate or overstate the prices actually received in local used-vehicle markets. The lessor may adjust estimated values quoted in trade publications if the lessor reasonably believes based on its experience that the values are understated or overstated.

4. *Retail or wholesale value*. The lessor may choose either a retail or a wholesale value in estimating the value of leased property at termination of an open-end lease provided the choice is consistent with the lessor's general practice when determining the value of the property at the end of the lease term. The lessor should indicate whether the value disclosed is a retail or wholesale value.

5. *Labelling estimates*. Generally, only the disclosure for which the exact information is unknown is labelled as an estimate. Nevertheless, when several disclosures are affected because of the unknown information, the lessor has the option of labelling as an estimate every affected disclosure or only the disclosure primarily affected.

3(e) Effect of Subsequent Occurrence

1. *Subsequent occurrences*. Examples of subsequent occurrences include:

i. An agreement between the lessee and lessor to change from a monthly to a weekly payment schedule.

ii. An increase in official fees or taxes.

iii. An increase in insurance premiums or coverage caused by a change in the law.

iv. Late delivery of an automobile caused by a strike.

2. *Redisclosure*. When a disclosure becomes inaccurate because of a subsequent occurrence, the lessor need not make new disclosures unless new disclosures are required under § 213.5.

3. *Lessee's failure to perform*. The lessor does not violate the regulation if a previously given disclosure becomes inaccurate when a lessee fails to perform obligations under the contract and a lessor takes actions that are necessary and proper in such circumstances to protect its interest. For example, the addition of insurance or a security interest by the lessor because the lessee has not performed obligations contracted for in the lease is not a violation of the regulation.

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1B- Consumer Credit Law Manual § 213.4

§ 213.4 Content of Disclosures

4(a) Description of Property

1. *Placement of description*. Although the description of leased property may not be included among the segregated disclosures, a lessor may choose to place the description directly above the segregated disclosures.

4(b) Amount Due at Lease Signing or Delivery

1. *Consummation*. See commentary to § 213.3(a)(3).

2. *Capitalized cost reduction*. A capitalized cost reduction is a payment in the nature of a downpayment on the leased property that reduces the amount to be capitalized over the term of the lease. This amount does not include any amounts included in a periodic payment paid at lease signing or delivery.

3. *"Negative" equity trade-in allowance*. If an amount owed on a prior lease or credit balance exceeds the agreed upon value of a trade-in, the difference is not reflected as a negative trade-in allowance under § 213.4(b). The lessor may disclose the trade-in allowance as zero or not applicable, or may leave a blank line.

4. *Rebates*. Only rebates applied toward an amount due at lease signing or delivery are required to be disclosed under § 213.4(b).

5. *Balance sheet approach*. In motor-vehicle leases, the total for the column labeled "total amount due at lease signing or delivery" must equal the total for the column labeled "how the amount due at lease signing or delivery will be paid."

6. *Amounts to be paid in cash*. The term cash is intended to include payments by check or other payment methods in addition to currency; however, a lessor may add a line item under the column "how the amount due at lease signing or delivery will be paid" for non-currency payments such as credit cards.

4(c) Payment Schedule and Total Amount of Periodic Payments

1. *Periodic payments*. The phrase "number, amount, and due dates or periods of payments" requires the disclosure of all payments that are made at regular or irregular intervals and generally derived from rent, capitalized or amortized amounts such as depreciation, and other amounts that are collected by the lessor at the same interval(s), including, for example, taxes, maintenance, and insurance charges. Other periodic payments may, but need not, be disclosed under § 213.4(c).

4(d) Other charges

1. *Coverage*. Section 213.4(d) requires the disclosure of charges that are anticipated by the parties incident to the normal operation of the lease agreement. If a lessor is unsure whether a particular fee is an "other charge," the lessor may disclose the fee as such without violating § 213.4(d) or the segregation rule under § 213.3(a)(2).

2. *Excluded charges*. This section does not require disclosure of charges that are imposed when the lessee terminates early, fails to abide by, or modifies the terms of the existing lease agreement, such as charges for:

i. Late payment.

ii. Default.

iii. Early termination.

iv. Deferral of payments.

v. Extension of the lease.

3. *Third-party fees and charges*. Third-party fees or charges collected by the lessor on behalf of third parties, such as taxes, are not disclosed under § 213.4(d).

4. *Relationship to other provisions*. The other charges mentioned in this paragraph are charges that are not required to be disclosed under some other provision of § 213.4. To illustrate:

i. The price of a mechanical breakdown protection (MBP) contract is sometimes disclosed as an "other charge." Nevertheless, the price of MBP is sometimes reflected in the periodic payment disclosure under § 213.4(c) or in states where MBP is regarded as insurance, the cost is be disclosed in accordance with § 213.4(o).

5. *Lessee's liabilities at the end of the lease term*. Liabilities that the lessor imposes upon the lessee at the end of the scheduled lease term and that must be disclosed under § 213.4(d) include disposition and "pick-up" charges.

6. *Optional "disposition" charges*. Disposition and similar charges that are anticipated by the parties as an incident to the normal operation of the lease agreement must be disclosed under § 213.4(d). If, under a lease agreement, a lessee may return leased property to various locations, and the lessor charges a disposition fee depending upon the location chosen, under § 213.4(d), the lessor must disclose the highest amount charged. In such circumstances, the lessor may also include a brief explanation of the fee structure in the segregated disclosure. For example, if no fee or a lower fee is imposed for returning a leased vehicle to the originating dealer as opposed to another location, that fact may be disclosed. By contrast, if the terms of the lease treat the return of the leased property to a location outside the lessor's service area as a default, the fee imposed is not disclosed as an "other charge," although it may be required to be disclosed under § 213.4(q).

4(e) Total of payments

1. *Open-end lease*. The additional statement is required under § 213.4(e) for open-end leases because, with some limitations, a lessee is liable at the end of the lease term for the difference between the residual and realized values of the leased property.

4(f) Payment Calculation

1. *Motor-vehicle lease*. Whether leased property is a motor vehicle is determined by state or other applicable law.

2. *Multiple-items*. If a lease transaction involves multiple items of leased property, one of which is not a motor vehicle under state law, at their option, lessors may include all items in the disclosures required under § 213.4(f). See comment 3(a)-4 regarding disclosure of multiple transactions.

4(f)(1) Gross Capitalized Cost

1. *Agreed upon value of the vehicle*. The agreed upon value of a motor vehicle includes the amount of capitalized items such as charges for vehicle accessories and options, and delivery or destination charges. The lessor may also include taxes and fees for title, licenses, and registration that are capitalized. Charges for service or maintenance contracts, insurance products, guaranteed automobile protection, or an outstanding balance on a prior lease or credit transaction are not included in the agreed upon value.

2. *Itemization of the gross capitalized cost*. The lessor may choose to provide the itemization of the gross capitalized cost only on request or may provide the itemization as a matter of course. In the latter case, the lessor need not provide a statement of the lessee's option to receive an itemization. The gross capitalized cost must be itemized by type and amount. The lessor may include in the itemization an identification of the items and amounts of some or all of the items contained in the agreed upon value of the vehicle. The itemization must be provided at the same time as the other disclosures required by § 213.4, but it may not be included among the segregated disclosures.

4(f)(7) Total of Base Periodic Payment

1. *Accuracy of disclosure*. If the periodic payment calculation under § 213.4(f) has been calculated correctly, the amount disclosed under § 213.4(f)(7) -- the total of base periodic payments -- is correct for disclosure purposes even if that amount differs from the base periodic payment disclosed under § 213.4(f)(9) multiplied by the number of lease payments disclosed under § 213.4(f)(8), when the difference is due to rounding.

4(f)(8) Lease Payment

1. *Lease Term*. The lease term may be disclosed among the segregated disclosures.

4(g) Early Termination

4(g)(1) Conditions and Disclosure of Charges

1. *Reasonableness of charges*. See the commentary to § 213.4(q).

2. *Description of the method*. Section 213.4(g)(1) requires a full description of the method of determining an early termination charge. The lessor should attempt to provide consumers with clear and understandable descriptions of its

early termination charges. Descriptions that are full, accurate, and not intended to be misleading will comply with § 213.4(g)(1), even if the descriptions are complex. In providing a full description of an early termination method, a lessor may use the name of a generally accepted method of computing the unamortized cost portion (also known as the "adjusted lease balance") of its early termination charges. For example, a lessor may state that the "constant yield" method will be utilized in obtaining the adjusted lease balance, but must specify how that figure, and any other term or figure, is used in computing the total early termination charge imposed upon the consumer. Additionally, if a lessor refers to a named method in this manner, the lessor must provide a written explanation of that method if requested by the consumer. The lessor has the option of providing the explanation as a matter of course in the lease documents or on a separate document.

3. *Timing of written explanation of a named method*. While a lessor may provide an address or telephone number for the consumer to request a written explanation of the named method used to calculate the adjusted leased balance, if at consummation a consumer requests such an explanation, the lessor must provide a written explanation at that time. If a consumer requests an explanation after consummation, the lessor must provide a written explanation within a reasonable time after the request is made.

4. *Default*. When default is a condition for early termination of a lease, default charges must be disclosed under § 213.4(g)(1). See the commentary to § 213.4(q).

5. *Lessee's liability at early termination*. When the lessee is liable for the difference between the unamortized cost and the realized value at early termination, the method of determining the amount of the difference must be disclosed under § 213.4(g)(1).

4(h) Maintenance Responsibilities

1. *Standards for wear and use*. No disclosure is required if a lessor does not set standards or impose charges for wear and use (such as excess mileage).

4(i) Purchase Option

1. *Mandatory disclosure of no purchase option*. Generally the lessor need only make the specific required disclosures that apply to a transaction. In the case of a purchase option disclosure, however, a lessor must disclose affirmatively that the lessee has no option to purchase the leased property if the purchase option is inapplicable.

2. *Existence of purchase option*. Whether a purchase option exists under the lease is determined by state or other applicable law. The lessee's right to submit a bid to purchase property at termination of the lease is not an option to purchase under § 213.4(i) if the lessor is not required to accept the lessee's bid and the lessee does not receive preferential treatment.

3. *Purchase-option fee*. A purchase-option fee is disclosed under § 213.4(i), not § 213.4(d). The fee may be separately itemized or disclosed as part of the purchase-option price.

4. *Official fees and taxes*. Official fees such as those for taxes, licenses, and registration charged in connection with the exercise of a purchase option may be disclosed under § 213.4(i) as part of the purchase-option price (with or without a reference to their inclusion in that price) or may be separately disclosed and itemized by category. Alternatively, a lessor may provide a statement indicating that the purchase-option price does not include fees for tags, taxes, and registration.

5. *Purchase-option price*. Lessors must disclose the purchase-option price as a sum certain or as a sum certain to be determined at a future date by reference to a readily available independent source. The reference should provide sufficient information so that the lessee will be able to determine the actual price when the option becomes available. Statements of a purchase price as the "negotiated price" or the "fair market value" do not comply with the requirements of § 213.4(i).

4(j) Statement referencing nonsegregated disclosures

1. *Content*. A lessor may delete inapplicable items from the disclosure. For example, if a lease contract does not include a security interest, the reference to a security interest may be omitted.

4(l) Right of appraisal

1. *Disclosure inapplicable*. The lessee does not have the right to an independent appraisal merely because the lessee is liable at the end of the lease term or at early termination for unreasonable wear or use. Thus, the disclosure under § 213.4(l) does not apply. For example:

i. The automobile lessor might expect a lessee to return an undented car with four good tires at the end of the lease term. Even though it may hold the lessee liable for the difference between a dented car with bald tires and the value of a car in reasonably good repair, the disclosure under § 213.4(l) is not required.

2. *Lessor's appraisal*. If the lessor obtains an appraisal of the leased property to determine its realized value, that appraisal does not suffice for purposes of section 183(c) of the act; the lessor must disclose the lessee's right to an independent appraisal under § 213.4(l).

3. *Retail or wholesale*. In providing the disclosures in § 213.4(l), a lessor must indicate whether the wholesale or

retail appraisal value will be used.

4. *Time restriction on appraisal*. The regulation does not specify a time period in which the lessee must exercise the appraisal right. The lessor may require a lessee to obtain the appraisal within a reasonable time after termination of the lease.

4(m) Liability at end of Lease Term Based on Residual Value

1. *Open-end leases*. Section 213.4(m) applies only to open-end leases.

2. *Lessor's payment of attorney's fees*. Section 183(a) of the act requires that the lessor pay the lessee's attorney's fees in all actions under § 213.4(m), whether successful or not.

4(m)(1) Rent and other charges

1. *General*. This disclosure is intended to represent the cost of financing an open-end lease based on charges and fees that the lessor requires the lessee to pay. Examples of disclosable charges, in addition to the rent charge, include acquisition, disposition, or assignment fees. Charges imposed by a third party whose services are not required by the lessor (such as official fees and voluntary insurance) are not included in the § 213.4(m)(1) disclosure.

4(m)(2) Excess liability

1. *Coverage*. The disclosure limiting the lessee's liability for the value of the leased property does not apply in the case of early termination.

2. *Leases with a minimum term*. If a lease has an alternative minimum term, the disclosures governing the liability limitation are not applicable for the minimum term.

3. *Charges not subject to rebuttable presumption*. The limitation on liability applies only to liability at the end of the lease term that is based on the difference between the residual value of the leased property and its realized value. The regulation does not preclude a lessor from recovering other charges from the lessee at the end of the lease term. Examples of such charges include:

i. Disposition charges.

ii. Excess mileage charges.

iii. Late payment and default charges.

iv. In simple-interest accounting leases, amount by which the unamortized cost exceeds the residual value because the lessee has not made timely payments.

4(n) Fees and taxes

1. *Treatment of certain taxes*. Taxes paid in connection with the lease are generally disclosed under § 213.4(n), but there are exceptions. To illustrate:

i. Taxes paid by lease signing or delivery are disclosed under § 213.4(b) and § 213.4(n).

ii. Taxes that are part of the scheduled payments are reflected in the disclosure under § 213.4(c), (f), and (n).

iii. A tax payable by the lessor that is passed on to the consumer and is reflected in the lease documentation must be disclosed under § 213.4(n). A tax payable by the lessor and absorbed as a cost of doing business need not be disclosed.

iv. Taxes charged in connection with the exercise of a purchase option are disclosed under § 213.4(i), not § 213.4(n).

2. *Estimates*. In disclosing the total amount of fees and taxes under § 213.4(n), lessors may need to base the disclosure on estimated tax rates or amounts and are afforded great flexibility in doing so. Where a rate is applied to the future value of leased property, lessors have flexibility in estimating that value, including, but not limited to, using the mathematical average of the agreed upon value and the residual value or published valuation guides; or a lessor could prepare estimates using the agreed upon value and disclose a reasonable estimate of the total fees and taxes. Lessors may include a statement that the actual total of fees and taxes may be higher or lower depending on the tax rates in effect or the value of the leased property at the time a fee or tax is assessed.

4(o) Insurance

1. *Coverage*. If insurance is obtained through the lessor, information on the type and amount of insurance coverage

(whether voluntary or required) as well as the cost, must be disclosed.

2. *Lessor's insurance*. Insurance purchased by the lessor primarily for its own benefit, and absorbed as a business expense and not separately charged to the lessee, need not be disclosed under § 213.4(o) even if it provides an incidental benefit to the lessee.

3. *Mechanical breakdown protection and other products*. Whether products purchased in conjunction with a lease, such as mechanical breakdown protection (MBP) or guaranteed automobile protection (GAP), should be treated as insurance is determined by state or other applicable law. In states that do not treat MBP or GAP as insurance, § 213.4(o) disclosures are not required. In such cases the lessor may, however, disclose this information in accordance with the additional information provision in § 213.3(b). For MBP insurance contracts not capped by a dollar amount, lessors may describe coverage by referring to a limitation by mileage or time period, for example, by indicating that the mechanical breakdown contract insures parts of the automobile for up to 100,000 miles.

4(p) Warranties or Guarantees

1. *Brief identification*. The statement identifying warranties may be brief and need not describe or list all warranties applicable to specific parts such as for air conditioning, radio, or tires in an automobile. For example, manufacturer's warranties may be identified simply by a reference to the standard manufacturer's warranty. If a lessor provides a comprehensive list of warranties that may not all apply, to comply with § 213.4(p) the lessor must indicate which warranties apply or, alternatively, which warranties do not apply.

2. *Warranty disclaimers*. Although a disclaimer of warranties is not required by the regulation, the lessor may give a disclaimer as additional information in accordance with § 213.3(b).

3. *State law*. Whether an express warranty or guaranty exists is determined by state or other law.

4(q) Penalties and Other Charges for Delinquency

1. *Collection costs*. The automatic imposition of collection costs or attorney fees upon default must be disclosed under § 213.4(q). Collection costs or attorney fees that are not imposed automatically, but are contingent upon expenditures in conjunction with a collection proceeding or upon the employment of an attorney to effect collection, need not be disclosed.

2. *Charges for early termination*. When default is a condition for early termination of a lease, default charges must also be disclosed under § 213.4(g)(1). The § 213.4(q) and (g)(1) disclosures may, but need not, be combined. Examples of combined disclosures are provided in the model lease disclosure forms in appendix A.

3. *Simple-interest leases*. In a simple-interest accounting lease, the additional rent charge that accrues on the lease balance when a periodic payment is made after the due date does not constitute a penalty or other charge for late payment. Similarly, continued accrual of the rent charge after termination of the lease because the lessee fails to return the leased property does not constitute a default charge. But in either case, if the additional charge accrues at a rate higher than the normal rent charge, the lessor must disclose the amount of or the method of determining the additional charge under § 213.4(q).

4. *Extension charges*. Extension charges that exceed the rent charge in a simple-interest accounting lease or that are added separately are disclosed under § 213.4(q).

5. *Reasonableness of charges*. Pursuant to section 183(b) of the act, penalties or other charges for delinquency, default, or early termination may be specified in the lease but only in an amount that is reasonable in light of the anticipated or actual harm caused by the delinquency, default, or early termination, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.

4(r) Security Interest

1. *Disclosable security interests*. See § 213.2(o) and accompanying commentary to determine what security interests must be disclosed.

4(s) Limitations on Rate Information

1. *Segregated disclosures*. A lease rate may not be included among the segregated disclosures referenced in § 213.3(a)(2).

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1B- Consumer Credit Law Manual § 213.5

§ 213.5 Renegotiations, Extensions and Assumptions

1. *Coverage*. Section 213.5 applies only to existing leases that are covered by the regulation. It does not apply to the renegotiation or extension of leases with an initial term of four months or less, because such leases are not covered by the definition of consumer lease in § 213.2(e). Whether and when a lease is satisfied and replaced by a new lease is determined by state or other applicable law.

5(a) Renegotiations

1. *Basis of disclosures*. Lessors have flexibility in making disclosures so long as they reflect the legal obligation under the renegotiated lease. For example, assume that a 24-month lease is replaced by a 36-month lease. The initial lease began on January 1, 1998, and was renegotiated and replaced on July 1, 1998, so that the new lease term ends on January 1, 2001.

i. If the renegotiated lease covers the 36-month period beginning January 1, 1998, the new disclosures would reflect all payments made by the lessee on the initial lease and all payments on the renegotiated lease. In this example, since the renegotiated lease covers a 36-month period beginning January 1, 1998, the disclosures must reflect payments made since that date. On the model form, the "total of base periodic payments" disclosed under § 213.4(f)(7) should reflect periodic payments to be made over the entire 36-month term. Payments received since January 1, 1998, are added as a new line item disclosed as "total of payments received" and are subtracted from the "total of base periodic payments" in calculating a new item disclosed as the "total of base periodic payments remaining." For example, if 6 monthly payments of $300 were received since January 1, 1998, the disclosure form should include a "total of base periodic payments" line from which $1,800 is subtracted to arrive at the "total of base periodic payments remaining." The remainder of the disclosures would not change.

ii. If the renegotiated lease covers only the remaining 30 months, from July 1, 1998, to January 1, 2001, the disclosures would reflect only the charges incurred in connection with the renegotiation and the payments for the remaining period.

5(b) Extensions

1. *Time of extension disclosures*. If a consumer lease is extended for a specified term greater than six months, new disclosures are required at the time the extension is agreed upon. If the lease is extended on a month-to-month basis and the cumulative extensions exceed six months, new disclosures are required at the commencement of the seventh month and at the commencement of each seventh month thereafter for as long as the extensions continue. If a consumer lease is extended for terms of varying durations, one of which will exceed six months beyond the originally scheduled termination date of the lease, new disclosures are required at the commencement of the term that will exceed six months beyond the originally scheduled termination date.

2. *Content of disclosures for month-to-month extensions*. The disclosures for a lease extended on a month-to-month basis for more than six months should reflect the month-to-month nature of the transaction.

3. *Basis of disclosures*. The disclosures should be based on the extension period, including any upfront costs paid in connection with the extension. For example, assume that initially a lease ends on March 1, 1999. In January 1999, agreement is reached to extend the lease until October 1, 1999. The disclosure would include any extension fee paid in January and the periodic payments for the seven-month extension period beginning in March.

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1B- Consumer Credit Law Manual § 213.6

§ **213.6 [Reserved]**

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1B- Consumer Credit Law Manual § 213.7

§ **213.7 Advertising**

7(a) General Rule

1. *Persons covered*. All "persons" must comply with the advertising provisions in this section, not just those that meet the definition of a lessor in § 213.2(h). Thus, automobile dealers, merchants, and others who are not themselves lessors must comply with the advertising provisions of the regulation if they advertise consumer lease transactions. Pursuant to section 184(b) of the act, however, owners and personnel of the media in which an advertisement appears or through which it is disseminated are not subject to civil liability for violations under section 185(b) of the act.

2. "*Usually and customarily*." Section 213.7(a) does not prohibit the advertising of a single item or the promotion of a new leasing program, but prohibits the advertising of terms that are not and will not be available. Thus, an advertisement may state terms that will be offered for only a limited period or terms that will become available at a future date.

7(b) Clear and Conspicuous Standard

1. *Standard*. The disclosures in an advertisement in any media must be reasonably understandable. For example, very fine print in a television advertisement or detailed and very rapidly stated information in a radio advertisement does not meet the clear and conspicuous standard if consumers cannot see and read or hear, and cannot comprehend, the information required to be disclosed.

7(b)(1) Amount due at Lease Signing or Delivery

1. *Itemization not required*. Only a total of amounts due at lease signing or delivery is required to be disclosed, not an itemization of its component parts. Such an itemization is provided in any transaction-specific disclosures provided under § 213.4.

2. *Prominence rule*. Except for a periodic payment, oral or written references to components of the total due at lease signing or delivery (for example, a reference to a capitalized cost reduction, where permitted) may not be more prominent than the disclosure of the total amount due at lease signing or delivery.

7(b)(2) Advertisement of a Lease Rate

1. *Location of statement*. The notice required to accompany a percentage rate stated in an advertisement must be placed in close proximity to the rate without any other intervening language or symbols. For example, a lessor may not place an asterisk next to the rate and place the notice elsewhere in the advertisement. In addition, with the exception of the notice required by § 213.4(s), the rate cannot be more prominent than any other § 213.4 disclosure stated in the advertisement.

7(c) Catalogs or Other Multipage Advertisements; Electronic Advertisements

1. *General rule*. The multiple-page advertisements referred to in § 213.7(c) are advertisements consisting of a series of numbered pages-for example, a supplement to a newspaper. A mailing comprising several separate flyers or pieces of promotional material in a single envelope is not a single multiple-page advertisement.

2. *Cross references*. A catalog or other multiple-page advertisement or an electronic advertisement (such as an advertisement appearing on an Internet Web site) is a single advertisement (requiring only one set of lease disclosures) if it contains a table, chart, or schedule with the disclosures required under § 213.7(d)(2)(i) through (v). If one of the triggering terms listed in § 213.7(d)(1) appears in a catalog, or in a multiple-page or electronic advertisement, it must clearly direct the consumer to the page or location where the table, chart, or schedule begins. For example, in an electronic advertisement, a term triggering additional disclosures may be accompanied by a link that directly connects the consumer to the additional information.

7(d)(1) Triggering Terms

1. *Typical example*. When any triggering term appears in a lease advertisement, the additional terms enumerated in § 213.7(d)(2) (i) through (v) must also appear. In a multi-lease advertisement, an example of one or more typical leases with a statement of all the terms applicable to each may be used. The examples must be labeled as such and must reflect representative lease terms that are made available by the lessor to consumers.

7(d)(2) Additional Terms

1. *Third-party fees that vary by state or locality*. The disclosure of a periodic payment or total amount due at lease signing or delivery may:

i. Exclude third-party fees, such as taxes, licenses, and registration fees and disclose that fact; or

ii. Provide a periodic payment or total that includes third-party fees based on a particular state or locality as long as that fact and the fact that fees may vary by state or locality are disclosed.

7(e) Alternative Disclosures -- Merchandise Tags

1. *Multiple-item leases*. Multiple-item leases that utilize merchandise tags requiring additional disclosures may use the alternate disclosure rule.

7(f) Alternative Disclosures -- Television or Radio Advertisements

7(f)(1) Toll-Free Number or Print Advertisement

1. *Publication in general circulation*. A reference to a written advertisement appearing in a newspaper circulated nationally, for example, USA Today or the Wall Street Journal, may satisfy the general circulation requirement in § 213.7(f)(1)(ii).

2. *Toll-free number, local or collect calls*. In complying with the disclosure requirements of § 213.7(f)(1)(i), a lessor must provide a toll-free number for nonlocal calls made from an area code other than the one used in the lessor's dialing area. Alternatively, a lessor may provide any telephone number that allows a consumer to reverse the phone charges when calling for information.

3. *Multi-purpose number*. When an advertised toll-free number responds with a recording, lease disclosures must be provided early in the sequence to ensure that the consumer receives the required disclosures. For example, in providing several dialing options -- such as providing directions to the lessor's place of business -- the option allowing the consumer to request lease disclosures should be provided early in the telephone message to ensure that the option to request disclosures is not obscured by other information.

4. *Statement accompanying toll free number*. Language must accompany a telephone and television number indicating that disclosures are available by calling the toll-free number, such as "call 1-800-000-0000 for details about costs and terms."

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1B- Consumer Credit Law Manual § 213.8

§ 213.8 Record Retention

1. *Manner of retaining evidence*. A lessor must retain evidence of having performed required actions and of having made required disclosures. Such records may be retained in paper form, on microfilm, microfiche, or computer, or by any other method designed to reproduce records accurately. The lessor need retain only enough information to reconstruct the required disclosures or other records.

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1B- Consumer Credit Law Manual § 213.9

§ 213.9 Relation to State Laws

1. *Exemptions granted*. Effective October 1, 1982, the Board granted the following exemptions from portions of the Consumer Leasing Act:

i. *Maine*. Lease transactions subject to the Maine Consumer Credit Code and its implementing regulations are exempt from chapters 2, 4, and 5 of the federal act. (The exemption does not apply to transactions in which a federally chartered institution is a lessor.)

ii. *Oklahoma*. Lease transactions subject to the Oklahoma Consumer Credit Code are exempt from chapters 2 and 5 of the federal act. (The exemption does not apply to sections 132 through 135 of the federal act, nor does it apply to transactions in which a federally chartered institution is a lessor.)

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Appendix A Model Forms

1B Consumer Credit Law Manual Appendix A

Appendix A Model Forms

1. *Permissible changes*. Although use of the model forms is not required, lessors using them properly will be deemed to be in compliance with the regulation. Generally, lessors may make certain changes in the format or content of the forms and may delete any disclosures that are inapplicable to a transaction without losing the act's protection from liability. For example, the model form based on monthly periodic payments may be modified for single-payment lease transactions or for quarterly or other regular or irregular periodic payments. The model form may also be modified to reflect that a transaction is an extension. The content, format, and headings for the segregated disclosures must be substantially similar to those contained in the model forms; therefore, any changes should be minimal. The changes to the model forms should not be so extensive as to affect the substance and the clarity of the disclosures.

2. *Examples of acceptable changes*.

i. Using the first person, instead of the second person, in referring to the lessee.

ii. Using "lessee," "lessor," or names instead of pronouns.

iii. Rearranging the sequence of the nonsegregated disclosures.

iv. Incorporating certain state "plain English" requirements.

v. Deleting or blocking out inapplicable disclosures, filling in "N/A" (not applicable) or "0," crossing out, leaving blanks, checking a box for applicable items, or circling applicable items (this should facilitate use of multipurpose standard forms).

vi. Adding language or symbols to indicate estimates.

vii. Adding numeric or alphabetic designations.

viii. Rearranging the disclosures into vertical columns, except for § 213.4 (b) through (e) disclosures.

ix. Using icons and other graphics.

3. *Model closed-end or net vehicle lease disclosure*. Model A-2 is designed for a closed-end or net vehicle lease. Under the "Early Termination and Default" provision a reference to the lessee's right to an independent appraisal of the leased vehicle under § 213.4(l) is included for those closed-end leases in which the lessee's liability at early termination is based on the vehicle's realized value.

4. *Model furniture lease disclosures*. Model A-3 is a closed-end lease disclosure statement designed for a typical furniture lease. It does not include a disclosure of the appraisal right at early termination required under § 213.4(l) because few closed-end furniture leases base the lessee's liability at early termination on the realized value of the leased property. The disclosure should be added if it is applicable.
[*47 FR 20554* , May 13, 1982; Reg. M, *62 FR 16053, 16058* , April 4, 1997; Reg. M, *62 FR 53733* , Oct. 16, 1997; Reg. M, *63 FR 52107, 52115* , Sept. 29, 1998; *64 FR 16612, 16613, 16614* , Apr. 6, 1999; Reg. M, *66 FR 17322, 17328* , Mar. 30, 2001; Reg. M, *66 FR 41439, 41440* , Aug. 8, 2001; *72 FR 63456, 63461* , Nov. 9, 2007]

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PART I Consumer Credit
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1B Consumer Credit Law Manual 12 C.F.R. Part 226

12 C.F.R. Part 226 REGULATION Z--TRUTH IN LENDING

Authority: *12 U.S.C. 3806*; *15 U.S.C. 1604* and *1637(c)(5)*.
Source: Reg. Z, *46 FR 20892* , Apr. 7, 1981, unless otherwise noted.

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Subpart A General

1B- Consumer Credit Law Manual § 226.1

§ 226.1 Authority, purpose, coverage, organization, enforcement, and liability.

(a) Authority. This regulation, known as Regulation Z, is issued by the Board of Governors of the Federal Reserve System to implement the federal Truth in Lending Act, which is contained in title I of the Consumer Credit Protection Act, as amended (*15 U.S.C. 1601 et seq.*). This regulation also implements title XII, section 1204 of the Competitive Equality Banking Act of 1987 (Pub. L. 100-86, *101 Stat. 552)*. Information-collection requirements contained in this regulation have been approved by the Office of Management and Budget under the provisions of *44 U.S.C. 3501 et seq.* and have been assigned OMB No. 7100-0199.

(b) Purpose. The purpose of this regulation is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The regulation also gives consumers the right to cancel certain credit transactions that involve a lien on a consumer's principal dwelling, regulates certain credit card practices, and provides a means for fair and timely resolution of credit billing disputes. The regulation does not generally govern charges for consumer credit, except that several provisions in Subpart G set forth special rules addressing certain charges applicable to credit card accounts under an open-end (not home-secured) consumer credit plan. The regulation requires a maximum interest rate to be stated in variable-rate contracts secured by the consumer's dwelling. It also imposes limitations on home-equity plans that are subject to the requirements of § 226.5b and mortgages that are subject to the requirements of § 226.32. The regulation prohibits certain acts or practices in connection with credit secured by a consumer's principal dwelling. The regulation also regulates certain practices of creditors who extend private education loans as defined in § 226.46(b)(5).

(c) Coverage.

(1) In general, this regulation applies to each individual or business that offers or extends credit when four conditions are met:

(i) The credit is offered or extended to consumers;

(ii) The offering or extension of credit is done regularly; n1

(iii) The credit is subject to a finance charge or is payable by a written agreement in more than four installments; and

(iv) The credit is primarily for personal, family, or household purposes.

(2) If a credit card is involved, however, certain provisions apply even if the credit is not subject to a finance charge, or is not payable by a written agreement in more than four installments, or if the credit card is to be used for business purposes.

(3) In addition, certain requirements of § 226.5b apply to persons who are not creditors but who provide applications for home-equity plans to consumers.

(4) Furthermore, certain requirements of § 226.57 apply to institutions of higher education.

(d) Organization. The regulation is divided into subparts and appendices as follows:

(1) Subpart A contains general information. It sets forth:

(i) The authority, purpose, coverage, and organization of the regulation;

(ii) The definitions of basic terms;

(iii) The transactions that are exempt from coverage; and

(iv) The method of determining the finance charge.

(2) Subpart B contains the rules for open-end credit. It requires that account-opening disclosures and periodic statements be provided, as well as additional disclosures for credit and charge card applications and solicitations and for home-equity plans subject to the requirements of § 226.5a and § 226.5b, respectively. It also describes special rules that apply to credit card transactions, treatment of payments and credit balances, procedures for resolving credit billing errors, annual percentage rate calculations, rescission requirements, and advertising.

(3) Subpart C relates to closed-end credit. It contains rules on disclosures, treatment of credit balances, annual percentages rate calculations, rescission requirements, and advertising.

(4) Subpart D contains rules on oral disclosures, disclosures in languages other than English, record retention, effect on state laws, state exemptions, and rate limitations.

(5) Subpart E contains special rules for certain mortgage transactions. Section 226.32 requires certain disclosures and provides limitations for loans that have rates and fees above specified amounts. Section 226.33 requires disclosures, including the total annual loan cost rate, for reverse mortgage transactions. Section 226.34 prohibits specific acts and practices in connection with mortgage transactions that are subject to § 226.32. Section 226.35 prohibits specific acts and practices in connection with higher-priced mortgage loans, as defined in § 226.35(a). Section 226.36 prohibits specific acts and practices in connection with credit secured by a consumer's principal dwelling.

(6) Subpart F relates to private education loans. It contains rules on disclosures, limitations on changes in terms after approval, the right to cancel the loan, and limitations on co-branding in the marketing of private education loans.

(7) Subpart G relates to credit card accounts under an open-end (not home-secured) consumer credit plan (except for § 226.57(c), which applies to all open-end credit plans). Section 226.51 contains rules on evaluation of a consumer's ability to make the required payments under the terms of an account. Section 226.52 limits the fees that a consumer can be required to pay with respect to an open-end (not home-secured) consumer credit plan during the first year after account opening. Section 226.53 contains rules on allocation of payments in excess of the minimum payment. Section 226.54 sets forth certain limitations on the imposition of finance charges as the result of a loss of a grace period. Section 226.55 contains limitations on increases in annual percentage rates, fees, and charges for credit card accounts. Section 226.56 prohibits the assessment of fees or charges for over-the-limit transactions unless the consumer affirmatively consents to the creditor's payment of over-the-limit transactions. Section 226.57 sets forth rules for reporting and marketing of college student open-end credit. Section 226.58 sets forth requirements for the Internet posting of credit card accounts under an open-end (not home-secured) consumer credit plan.

(8) Several appendices contain information such as the procedures for determinations about state laws, state exemptions and issuance of staff interpretations, special rules for certain kinds of credit plans, a list of enforcement agencies, and the rules for computing annual percentage rates in closed-end credit transactions and total-annual-loan-cost rates for reverse mortgage transactions.

(e) Enforcement and liability. Section 108 of the act contains the administrative enforcement provisions. Sections 112, 113, 130, 131, and 134 contain provisions relating to liability for failure to comply with the requirements of the act and the regulation. Section 1204 (c) of title XII of the Competitive Equality Banking Act of 1987, Public Law 100-86, *101 Stat. 552,* incorporates by reference administrative enforcement and civil liability provisions of sections 108 and 130 of the act.

FOOTNOTES:
(n3)Footnote 1. [Reserved].

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1B- Consumer Credit Law Manual § 226.2

§ **226.2 Definitions and rules of construction.**

(a) Definitions. For purposes of this regulation, the following definitions apply:

(1) Act means the Truth in Lending Act (*15 U.S.C. 1601 et seq.*).

(2) Advertisement means a commercial message in any medium that promotes, directly or indirectly, a credit transaction.

(3) [Reserved.] n2

(4) Billing cycle or cycle means the interval between the days or dates of regular periodic statements. These intervals shall be equal and no longer than a quarter of a year. An interval will be considered equal if the number of days in the cycle does not vary more than four days from the regular day or date of the periodic statement.

(5) Board means the Board of Governors of the Federal Reserve System.

(6) Business day means a day on which the creditor's offices are open to the public for carrying on substantially all of

its business functions. However, for purposes of rescission under §§ 226.15 and 226.23, and for purposes of §§ 226.19(a)(1)(ii), 226.19(a)(2), 226.31, and 226.46(d)(4), the term means all calendar days except Sundays and the legal public holidays specified in *5 U.S.C. 6103(a)*, such as New Year's Day, the Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day.

(7) Card issuer means a person that issues a credit card or that person's agent with respect to the card.

(8) Cardholder means a natural person to whom a credit card is issued for consumer credit purposes, or a natural person who has agreed with the card issuer to pay consumer credit obligations arising from the issuance of a credit card to another natural person. For purposes of § 226.12(a) and (b), the term includes any person to whom a credit card is issued for any purpose, including business, commercial or agricultural use, or a person who has agreed with the card issuer to pay obligations arising from the issuance of such a credit card to another person.

(9) Cash price means the price at which a creditor, in the ordinary course of business, offers to sell for cash property or service that is the subject of the transaction. At the creditor's option, the term may include the price of accessories, services related to the sale, service contracts and taxes and fees for license, title, and registration. The term does not include any finance charge.

(10) Closed-end-credit means consumer credit other than open-end-credit as defined in this section.

(11) Consumer means a cardholder or natural person to whom consumer credit is offered or extended. However, for purposes of rescission under §§ 226.15 and 226.23, the term also includes a natural person in whose principal dwelling a security interest is or will be retained or acquired, if that person's ownership interest in the dwelling is or will be subject to the security interest.

(12) Consumer credit means credit offered or extended to a consumer primarily for personal, family, or household purposes.

(13) Consummation means the time that a consumer becomes contractually obligated on a credit transaction.

(14) Credit means the right to defer payment of debt or to incur debt and defer its payment.

(15)

(i) Credit card means any card, plate, or other single credit device that may be used from time to time to obtain credit.

(ii) Credit card account under an open-end (not home-secured) consumer credit plan means any open-end credit account accessed by a credit card, except:

(A) A credit card that accesses a home-equity plan subject to the requirements of § 226.5b; or

(B) An overdraft line of credit accessed by a debit card.

(iii) Charge card means a credit card on an account for which no periodic rate is used to compute a finance charge.

(16) Credit sale means a sale in which the seller is a creditor. The term includes a bailment or lease (unless terminable without penalty at any time by the consumer) under which the consumer:

(i) Agrees to pay as compensation for use a sum substantially equivalent to, or in excess of, the total value of the property and service involved; and

(ii) Will become (or has the option to become), for no additional consideration or for nominal consideration, the owner of the property upon compliance with the agreement.

(17) Creditor means:

(i) A person who regularly extends consumer credit n3 that is subject to a finance charge or is payable by written agreement in more than four installments (not including a down payment), and to whom the obligation is initially payable, either on the face of the note or contract, or by agreement when there is no note or contract.

(ii) For purposes of §§ 226.4(c)(8) (Discounts), 226.9(d) (Finance charge imposed at time of transaction), and 226.12(e) (Prompt notification of returns and crediting of refunds), a person that honors a credit card.

(iii) For purposes of subpart B, any card issuer that extends either open-end credit or credit that is not subject to a finance charge and is not payable by written agreement in more than four installments.

(iv) For purposes of subpart B (except for the credit and charge card disclosures contained in §§ 226.5a and 226.9(e) and (f), the finance charge disclosures contained in § 226.6(a)(1) and (b)(3)(i) and § 226.7(a)(4) through (7) and (b)(4) through (6) and the right of rescission set forth in § 226.15) and subpart C, any card issuer that extends closed-end credit that is subject to a finance charge or is payable by written agreement in more than four installments.

(v) A person regularly extends consumer credit only if it extended credit (other than credit subject to the requirements of § 226.32) more than 25 times (or more than 5 times for transactions secured by a dwelling) in the preceding calendar year. If a person did not meet these numerical standards in the preceding calendar year, the numerical standards shall be applied to the current calendar year. A person regularly extends consumer credit if, in any 12-month period, the person originates more than one credit extension that is subject to the requirements of § 226.32 or one or more such credit extensions through a mortgage broker.

(18) Downpayment means an amount, including the value of property used as a trade-in, paid to a seller to reduce the cash price of goods or services purchased in a credit sale transaction. A deferred portion of a downpayment may be treated as part of the downpayment if it is payable not later than the due date of the second otherwise regularly scheduled payment and is not subject to a finance charge.

(19) Dwelling means a residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence.

(20) Open-end credit means consumer credit extended by a creditor under a plan in which:

(i) The creditor reasonably contemplates repeated transactions;

(ii) The creditor may impose a finance charge from time to time on an outstanding unpaid balance; and

(iii) The amount of credit that may be extended to the consumer during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid.

(21) Periodic rate means a rate of finance charge that is or may be imposed by a creditor on a balance for a day, week, month, or other subdivision of a year.

(22) Person means a natural person or an organization, including a corporation, partnership, proprietorship, association, cooperative, estate, trust, or government unit.

(23) Prepaid finance charge means any finance charge paid separately in cash or by check before or at consummation of a transaction, or withheld from the proceeds of the credit at any time.

(24) Residential mortgage transaction means a transaction in which a mortgage, deed of trust, purchase money security interest arising under an installment sales contract, or equivalent consensual security interest is created or retained in the consumer's principal dwelling to finance the acquisition or initial construction of that dwelling.

(25) Security interest means an interest in property that secures performance of a consumer credit obligation and that is recognized by state or federal law. It does not include incidental interests such as interests in proceeds, accessions, additions, fixtures, insurance proceeds (whether or not the creditor is a loss payee or beneficiary), premium rebates, or interests in after-acquired property. For purposes of disclosures under §§ 226.6 and 226.18, the term does not include an interest that arises solely by operation of law. However, for purposes of the right of rescission under §§ 226.15 and 226.23, the term does include interests that arise solely by operation of law.

(26) State means any state, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

(b) Rules of construction. For purposes of this regulation, the following rules of construction apply:

(1) Where appropriate, the singular form of a word includes the plural form and plural includes singular.

(2) Where the words obligation and transaction are used in the regulation, they refer to a consumer credit obligation or transaction, depending upon the context. Where the word credit is used in the regulation, it means consumer credit unless the context clearly indicates otherwise.

(3) Unless defined in this regulation, the words used have the meanings given to them by state law or contract.

(4) Footnotes have the same legal effect as the text of the regulation.

(5) Where the word amount is used in this regulation to describe disclosure requirements, it refers to a numerical amount.

FOOTNOTES:
(n4)Footnote 2. [Reserved].

(n5)Footnote 3. [Reserved].

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1B- Consumer Credit Law Manual § 226.3

§ **226.3 Exempt transactions.**

This regulation does not apply to the following: n4

(a) Business, commercial, agricultural, or organizational credit.

(1) An extension of credit primarily for a business, commercial or agricultural purpose.

(2) An extension of credit to other than a natural person, including credit to government agencies or instrumentalities.

(b) Credit over $25,000 not secured by real property or a dwelling. An extension of credit in which the amount financed exceeds $25,000 or in which there is an express written commitment to extend credit in excess of $25,000, unless the extension of credit is:

(1) Secured by real property, or by personal property used or expected to be used as the principal dwelling of the consumer; or

(2) A private education loan as defined in § 226.46(b)(5).

(c) Public utility credit. An extension of credit that involves public utility services provided through pipe, wire, other connected facilities, or radio or similar transmission (including extensions of such facilities), if the charges for service, delayed payment, or any discounts for prompt payment are filed with or regulated by any government unit. The financing of durable goods or home improvements by a public utility is not exempt.

(d) Securities or commodities accounts. Transactions in securities or commodities accounts in which credit is extended by a broker-dealer registered with the Securities and Exchange Commission or the Commodity Futures Trading Commission.

(e) Home fuel budget plans. An installment agreement for the purchase of home fuels in which no finance charge is imposed.

(f) Student Loan Programs. Loans made, insured, or guaranteed pursuant to a program authorized by title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*).

(g) Employer-sponsored retirement plans. An extension of credit to a participant in an employer-sponsored retirement plan qualified under *Section 401(a) of the Internal Revenue Code*, a tax-sheltered annuity under *Section 403(b) of the Internal Revenue Code*, or an eligible governmental deferred compensation plan under *Section 457(b) of the Internal Revenue Code* (*26 U.S.C. 401(a)*; *26 U.S.C. 403(b)*; *26 U.S.C. 457(b)*), provided that the extension of credit is comprised of fully vested funds from such participant's account and is made in compliance with the Internal Revenue Code (*26 U.S.C. 1 et seq.*).

FOOTNOTES:
(n6)Footnote 4. [Reserved].

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1B- Consumer Credit Law Manual § 226.4

§ **226.4 Finance charge.**

(a) Definition. The finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction.

(1) Charges by third parties. The finance charge includes fees and amounts charged by someone other than the creditor, unless otherwise excluded under this section, if the creditor:

(i) Requires the use of a third party as a condition of or an incident to the extension of credit, even if the consumer can choose the third party; or

(ii) Retains a portion of the third-party charge, to the extent of the portion retained.

(2) Special rule; closing agent charges. Fees charged by a third party that conducts the loan closing (such as a settlement agent, attorney, or escrow or title company) are finance charges only if the creditor:

(i) Requires the particular services for which the consumer is charged;

(ii) Requires the imposition of the charge; or

(iii) Retains a portion of the third-party charge, to the extent of the portion retained.

(3) Special rule; mortgage broker fees. Fees charged by a mortgage broker (including fees paid by the consumer directly to the broker or to the creditor for delivery to the broker) are finance charges even if the creditor does not require the consumer to use a mortgage broker and even if the creditor does not retain any portion of the charge.

(b) Examples of finance charges. The finance charge includes the following types of charges, except for charges specifically excluded by paragraphs (c) through (e) of this section:

(1) Interest, time price differential, and any amount payable under an add-on or discount system of additional charges.

(2) Service, transaction, activity, and carrying charges, including any charge imposed on a checking or other transaction account to the extent that the charge exceeds the charge for a similar account without a credit feature.

(3) Points, loan fees, assumption fees, finder's fees, and similar charges.

(4) Appraisal, investigation, and credit report fees.

(5) Premiums or other charges for any guarantee or insurance protecting the creditor against the consumer's default or other credit loss.

(6) Charges imposed on a creditor by another person for purchasing or accepting a consumer's obligation, if the consumer is required to pay the charges in cash, as an addition to the obligation, or as a deduction from the proceeds of the obligation.

(7) Premiums or other charges for credit life, accident, health, or loss-of-income insurance, written in connection with a credit transaction.

(8) Premiums or other charges for insurance against loss of or damage to property, or against liability arising out of the ownership or use of property, written in connection with a credit transaction.

(9) Discounts for the purpose of inducing payment by a means other than the use of credit.

(10) Charges or premiums paid for debt cancellation or debt suspension coverage written in connection with a credit transaction, whether or not the coverage is insurance under applicable law.

(c) Charges excluded from the finance charge. The following charges are not finance charges:

(1) Application fees charged to all applicants for credit, whether or not credit is actually extended.

(2) Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence.

(3) Charges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing.

(4) Fees charged for participation in a credit plan, whether assessed on an annual or other periodic basis.

(5) Seller's points.

(6) Interest forfeited as a result of an interest reduction required by law on a time deposit used as security for an extension of credit.

(7) Real-estate related fees. The following fees in a transaction secured by real property or in a residential mortgage transaction, if the fees are bona fide and reasonable in amount:

(i) Fees for title examination, abstract of title, title insurance, property survey, and similar purposes.

(ii) Fees for preparing loan-related documents, such as deeds, mortgages, and reconveyance or settlement documents.

(iii) Notary and credit-report fees.

(iv) Property appraisal fees or fees for inspections to assess the value or condition of the property if the service is performed prior to closing, including fees related to pest-infestation or flood-hazard determinations.

(v) Amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge.

(8) Discounts offered to induce payment for a purchase by cash, check, or other means, as provided in section 167(b) of the Act.

(d) Insurance and debt cancellation and debt suspension coverage.

(1) Voluntary credit insurance premiums. Premiums for credit life, accident, health, or loss-of-income insurance may be excluded from the finance charge if the following conditions are met:

(i) The insurance coverage is not required by the creditor, and this fact is disclosed in writing.

(ii) The premium for the initial term of insurance coverage is disclosed in writing. If the term of insurance is less than the term of the transaction, the term of insurance also shall be disclosed. The premium may be disclosed on a unit-cost basis only in open-end credit transactions, closed-end credit transactions by mail or telephone under § 226.17(g), and certain closed-end credit transactions involving an insurance plan that limits the total amount of indebtedness subject to coverage.

(iii) The consumer signs or initials an affirmative written request for the insurance after receiving the disclosures specified in this paragraph, except as provided in paragraph (d)(4) of this section. Any consumer in the transaction may sign or initial the request.

(2) Property insurance premiums. Premiums for insurance against loss of or damage to property, or against liability arising out of the ownership or use of property, including single interest insurance if the insurer waives all right of subrogation against the consumer, n5 may be excluded from the finance charge if the following conditions are met:

(i) The insurance coverage may be obtained from a person of the consumer's choice, n6 and this fact is disclosed. (A creditor may reserve the right to refuse to accept, for reasonable cause, an insurer offered by the consumer.)

(ii) If the coverage is obtained from or through the creditor, the premium for the initial term of insurance coverage shall be disclosed. If the term of insurance is less than the term of the transaction, the term of insurance shall also be disclosed. The premium may be disclosed on a unit-cost basis only in open-end credit transactions, closed-end credit transactions by mail or telephone under § 226.17(g), and certain closed-end credit transactions involving an insurance plan that limits the total amount of indebtedness subject to coverage.

(3) Voluntary debt cancellation or debt suspension fees. Charges or premiums paid for debt cancellation coverage for amounts exceeding the value of the collateral securing the obligation or for debt cancellation or debt suspension coverage in the event of the loss of life, health, or income or in case of accident may be excluded from the finance charge, whether or not the coverage is insurance, if the following conditions are met:

(i) The debt cancellation or debt suspension agreement or coverage is not required by the creditor, and this fact is disclosed in writing;

(ii) The fee or premium for the initial term of coverage is disclosed in writing. If the term of coverage is less than the term of the credit transaction, the term of coverage also shall be disclosed. The fee or premium may be disclosed on a unit-cost basis only in open-end credit transactions, closed-end credit transactions by mail or telephone under § 226.17(g), and certain closed-end credit transactions involving a debt cancellation agreement that limits the total amount of indebtedness subject to coverage;

(iii) The following are disclosed, as applicable, for debt suspension coverage: That the obligation to pay loan principal and interest is only suspended, and that interest will continue to accrue during the period of suspension.

(iv) The consumer signs or initials an affirmative written request for coverage after receiving the disclosures specified in this paragraph, except as provided in paragraph (d)(4) of this section. Any consumer in the transaction may sign or initial the request.

(4) Telephone purchases. If a consumer purchases credit insurance or debt cancellation or debt suspension coverage for an open-end (not home-secured) plan by telephone, the creditor must make the disclosures under paragraphs (d)(1)(i) and (ii) or (d)(3)(i) through (iii) of this section, as applicable, orally. In such a case, the creditor shall:

(i) Maintain evidence that the consumer, after being provided the disclosures orally, affirmatively elected to purchase the insurance or coverage; and

(ii) Mail the disclosures under paragraphs (d)(1)(i) and (ii) or (d)(3)(i) through (iii) of this section, as applicable, within three business days after the telephone purchase.

(e) Certain security interest charges. If itemized and disclosed, the following charges may be excluded from the finance charge:

(1) Taxes and fees prescribed by law that actually are or will be paid to public officials for determining the existence of or for perfecting, releasing, or satisfying a security interest.

(2) The premium for insurance in lieu of perfecting a security interest to the extent that the premium does not exceed the fees described in paragraph (e)(1) of this section that otherwise would be payable.

(3) Taxes on security instruments. Any tax levied on security instruments or on documents evidencing indebtedness if the payment of such taxes is a requirement for recording the instrument securing the evidence of indebtedness.

(f) Prohibited offsets. Interest, dividends, or other income received or to be received by the consumer on deposits or investments shall not be deducted in computing the finance charge.

FOOTNOTES:
(n7)Footnote 5. [Reserved].

(n8)Footnote 6. [Reserved].

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1B- Consumer Credit Law Manual § 226.5

§ **226.5 General disclosure requirements.**

(a) Forms of disclosures.

(1) General.

(i) The creditor shall make the disclosures required by this subpart clearly and conspicuously.

(ii) The creditor shall make the disclosures required by this subpart in writing, n7 in a form that the consumer may keep, n8 except that:

(A) The following disclosures need not be written: Disclosures under § 226.6(b)(3) of charges that are imposed as part of an open-end (not home-secured) plan that are not required to be disclosed under § 226.6(b)(2) and related disclosures of charges under § 226.9(c)(2)(iii)(B); disclosures under § 226.9(c)(2)(vi); disclosures under § 226.9(d) when a finance charge is imposed at the time of the transaction; and disclosures under § 226.56(b)(1)(i).

(B) The following disclosures need not be in a retainable form: Disclosures that need not be written under paragraph (a)(1)(ii)(A) of this section; disclosures for credit and charge card applications and solicitations under § 226.5a; home-equity disclosures under § 226.5b(d); the alternative summary billing-rights statement under § 226.9(a)(2); the credit and charge card renewal disclosures required under § 226.9(e); and the payment requirements

under § 226.10(b), except as provided in § 226.7(b)(13).

(iii) The disclosures required by this subpart may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (*15 U.S.C. 7001 et seq.*). The disclosures required by §§ 226.5a, 226.5b, and 226.16 may be provided to the consumer in electronic form without regard to the consumer consent or other provisions of the E-Sign Act in the circumstances set forth in those sections.

(2) Terminology.

(i) Terminology used in providing the disclosures required by this subpart shall be consistent.

(ii) For home-equity plans subject to § 226.5b, the terms finance charge and annual percentage rate, when required to be disclosed with a corresponding amount or percentage rate, shall be more conspicuous than any other required disclosure. n9 The terms need not be more conspicuous when used for periodic statement disclosures under § 226.7(a)(4) and for advertisements under § 226.16.

(iii) If disclosures are required to be presented in a tabular format pursuant to paragraph (a)(3) of this section, the term penalty APR shall be used, as applicable. The term penalty APR need not be used in reference to the annual percentage rate that applies with the loss of a promotional rate, assuming the annual percentage rate that applies is not greater than the annual percentage rate that would have applied at the end of the promotional period; or if the annual percentage rate that applies with the loss of a promotional rate is a variable rate, the annual percentage rate is calculated using the same index and margin as would have been used to calculate the annual percentage rate that would have applied at the end of the promotional period. If credit insurance or debt cancellation or debt suspension coverage is required as part of the plan, the term required shall be used and the program shall be identified by its name. If an annual percentage rate is required to be presented in a tabular format pursuant to paragraph (a)(3)(i) or (a)(3)(iii) of this section, the term fixed, or a similar term, may not be used to describe such rate unless the creditor also specifies a time period that the rate will be fixed and the rate will not increase during that period, or if no such time period is provided, the rate will not increase while the plan is open.

(3) Specific formats.

(i) Certain disclosures for credit and charge card applications and solicitations must be provided in a tabular format in accordance with the requirements of § 226.5a(a)(2).

(ii) Certain disclosures for home-equity plans must precede other disclosures and must be given in accordance with the requirements of § 226.5b(a).

(iii) Certain account-opening disclosures must be provided in a tabular format in accordance with the requirements of § 226.6(b)(1).

(iv) Certain disclosures provided on periodic statements must be grouped together in accordance with the requirements of § 226.7(b)(6) and (b)(13).

(v) Certain disclosures provided on periodic statements must be given in accordance with the requirements of § 226.7(b)(12).

(vi) Certain disclosures accompanying checks that access a credit card account must be provided in a tabular format in accordance with the requirements of § 226.9(b)(3).

(vii) Certain disclosures provided in a change-in-terms notice must be provided in a tabular format in accordance with the requirements of § 226.9(c)(2)(iv)(D).

(viii) Certain disclosures provided when a rate is increased due to delinquency, default or as a penalty must be provided in a tabular format in accordance with the requirements of § 226.9(g)(3)(ii).

(b) Time of disclosures.

(1) Account-opening disclosures.

(i) General rule. The creditor shall furnish account-opening disclosures required by § 226.6 before the first transaction is made under the plan.

(ii) Charges imposed as part of an open-end (not home-secured) plan. Charges that are imposed as part of an open-end (not home-secured) plan and are not required to be disclosed under § 226.6(b)(2) may be disclosed after account opening but before the consumer agrees to pay or becomes obligated to pay for the charge, provided they are disclosed at a time and in a manner that a consumer would be likely to notice them. This provision does not apply to

charges imposed as part of a home-equity plan subject to the requirements of § 226.5b.

(iii) Telephone purchases. Disclosures required by § 226.6 may be provided as soon as reasonably practicable after the first transaction if:

(A) The first transaction occurs when a consumer contacts a merchant by telephone to purchase goods and at the same time the consumer accepts an offer to finance the purchase by establishing an open-end plan with the merchant or third-party creditor;

(B) The merchant or third-party creditor permits consumers to return any goods financed under the plan and provides consumers with a sufficient time to reject the plan and return the goods free of cost after the merchant or third-party creditor has provided the written disclosures required by § 226.6; and

(C) The consumer's right to reject the plan and return the goods is disclosed to the consumer as a part of the offer to finance the purchase.

(iv)

(A) General. In general, a creditor may not collect any fee before account-opening disclosures are provided. A creditor may collect, or obtain the consumer's agreement to pay, membership fees, including application fees excludable from the finance charge under § 226.4(c)(1), before providing account-opening disclosures if, after receiving the disclosures, the consumer may reject the plan and have no obligation to pay these fees (including application fees) or any other fee or charge. A membership fee for purposes of this paragraph has the same meaning as a fee for the issuance or availability of credit described in § 226.5a(b)(2). If the consumer rejects the plan, the creditor must promptly refund the membership fee if it has been paid, or take other action necessary to ensure the consumer is not obligated to pay that fee or any other fee or charge.

(B) Home-equity plans. Creditors offering home-equity plans subject to the requirements of § 226.5b are not subject to the requirements of paragraph (b)(1)(iv)(A) of this section.

(v) Application fees. A creditor may collect an application fee excludable from the finance charge under § 226.4(c)(1) before providing account-opening disclosures. However, if a consumer rejects the plan after receiving account-opening disclosures, the consumer must have no obligation to pay such an application fee, or if the fee was paid, it must be refunded. See § 226.5(b)(1)(iv)(A).

(2) Periodic statements.

(i) Statement required. The creditor shall mail or deliver a periodic statement as required by § 226.7 for each billing cycle at the end of which an account has a debit or credit balance of more than $1 or on which a finance charge has been imposed. A periodic statement need not be sent for an account if the creditor deems it uncollectible, if delinquency collection proceedings have been instituted, if the creditor has charged off the account in accordance with loan-loss provisions and will not charge any additional fees or interest on the account, or if furnishing the statement would violate federal law.

(ii) Timing requirements.

(A) Payment due date. For credit card accounts under an open-end (not home-secured) consumer credit plan, a card issuer must adopt reasonable procedures designed to ensure that

(1) Periodic statements are mailed or delivered at least 21 days prior to the payment due date disclosed on the statement pursuant to § 226.7(b)(11)(i)(A); and

(2) The card issuer does not treat as late for any purpose a required minimum periodic payment received by the card issuer within 21 days after mailing or delivery of the periodic statement disclosing the due date for that payment.

(B) Grace period expiration date. For open-end consumer credit plans, a creditor must adopt reasonable procedures designed to ensure that:

(1) Periodic statements are mailed or delivered at least 21 days prior to the date on which any grace period expires; and

(2) The creditor does not impose finance charges as a result of the loss of a grace period if a payment that satisfies the terms of the grace period is received by the creditor within 21 days after mailing or delivery of the periodic statement.

(3) For purposes of paragraph (b)(2)(ii)(B) of this section, "grace period" means a period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate. n10

(3) Credit and charge card application and solicitation disclosures. The card issuer shall furnish the disclosures for credit and charge card applications and solicitations in accordance with the timing requirements of § 226.5a.

(4) Home-equity plans. Disclosures for home-equity plans shall be made in accordance with the timing requirements of § 226.5b(b).

(c) Basis of disclosures and use of estimates. Disclosures shall reflect the terms of the legal obligation between the parties. If any information necessary for accurate disclosure is unknown to the creditor, it shall make the disclosure based on the best information reasonably available and shall state clearly that the disclosure is an estimate.

(d) Multiple creditors; multiple consumers. If the credit plan involves more than one creditor, only one set of disclosures shall be given, and the creditors shall agree among themselves which creditor must comply with the requirements that this regulation imposes on any or all of them. If there is more than one consumer, the disclosures may be made to any consumer who is primarily liable on the account. If the right of rescission under § 226.15 is applicable, however, the disclosures required by §§ 226.6 and 226.15(b) shall be made to each consumer having the right to rescind.

(e) Effect of subsequent events. If a disclosure becomes inaccurate because of an event that occurs after the creditor mails or delivers the disclosures, the resulting inaccuracy is not a violation of this regulation, although new disclosures may be required under § 226.9(c).

FOOTNOTES:

(n9)Footnote 7. [Reserved].

(n10)Footnote 8. [Reserved].

(n11)Footnote 9. [Reserved].

(n12)Footnote 10. [Reserved].

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
12 C.F.R. Part 226 REGULATION Z--TRUTH IN LENDING
Subpart B Open End Credit

1B- Consumer Credit Law Manual § 226.5a

§ **226.5a Credit and charge card applications and solicitations.**

(a) General rules. The card issuer shall provide the disclosures required under this section on or with a solicitation or an application to open a credit or charge card account.

(1) Definition of solicitation. For purposes of this section, the term solicitation means an offer by the card issuer to open a credit or charge card account that does not require the consumer to complete an application. A "firm offer of credit" as defined in section 603(l) of the Fair Credit Reporting Act (*15 U.S.C. 1681a(l)*) for a credit or charge card is a solicitation for purposes of this section

(2) Form of disclosures; tabular format.

(i) The disclosures in paragraphs (b)(1) through (5) (except for (b)(1)(iv)(B)) and (b)(7) through (15) of this section made pursuant to paragraph (c), (d)(2), (e)(1) or (f) of this section generally shall be in the form of a table with headings, content, and format substantially similar to any of the applicable tables found in G-10 in appendix G to this part.

(ii) The table described in paragraph (a)(2)(i) of this section shall contain only the information required or permitted by this section. Other information may be presented on or with an application or solicitation, provided such information appears outside the required table.

(iii) Disclosures required by paragraphs (b)(1)(iv)(B) and (b)(6) of this section must be placed directly beneath the table.

(iv) When a tabular format is required, any annual percentage rate required to be disclosed pursuant to paragraph (b)(1) of this section, any introductory rate required to be disclosed pursuant to paragraph (b)(1)(ii) of this section, any rate that will apply after a premium initial rate expires required to be disclosed under paragraph (b)(1)(iii) of this section, and any fee or percentage amounts required to be disclosed pursuant to paragraphs (b)(2), (b)(4), (b)(8) through (b)(13) of this section must be disclosed in bold text. However, bold text shall not be used for: Any maximum limits on fee amounts disclosed in the table that do not relate to fees that vary by state; the amount of any periodic fee disclosed pursuant to paragraph (b)(2) of this section that is not an annualized amount; and other annual percentage rates or fee amounts disclosed in the table.

(v) For an application or a solicitation that is accessed by the consumer in electronic form, the disclosures required under this section may be provided to the consumer in electronic form on or with the application or solicitation.

(vi)

(A) Except as provided in paragraph (a)(2)(vi)(B) of this section, the table described in paragraph (a)(2)(i) of this section must be provided in a prominent location on or with an application or a solicitation.

(B) If the table described in paragraph (a)(2)(i) of this section is provided electronically, it must be provided in close proximity to the application or solicitation.

(3) Fees based on a percentage. If the amount of any fee required to be disclosed under this section is determined on the basis of a percentage of another amount, the percentage used and the identification of the amount against which the percentage is applied may be disclosed instead of the amount of the fee.

(4) Fees that vary by state. Card issuers that impose fees referred to in paragraphs (b)(8) through (12) of this section that vary by state may, at the issuer's option, disclose in the table required by paragraph (a)(2)(i) of this section: the specific fee applicable to the consumer's account; or the range of the fees, if the disclosure includes a statement that the amount of the fee varies by state and refers the consumer to a disclosure provided with the table where the amount of the fee applicable to the consumer's account is disclosed. A card issuer may not list fees for multiple states in the table.

(5) Exceptions. This section does not apply to:

(i) Home-equity plans accessible by a credit or charge card that are subject to the requirements of § 226.5b;

(ii) Overdraft lines of credit tied to asset accounts accessed by check-guarantee cards or by debit cards;

(iii) Lines of credit accessed by check-guarantee cards or by debit cards that can be used only at automated teller machines;

(iv) Lines of credit accessed solely by account numbers;

(v) Additions of a credit or charge card to an existing open-end plan;

(vi) General purpose applications unless the application, or material accompanying it, indicates that it can be used to open a credit or charge card account; or

(vii) Consumer-initiated requests for applications.

(b) Required disclosures. The card issuer shall disclose the items in this paragraph on or with an application or a solicitation in accordance with the requirements of paragraphs (c), (d), (e)(1) or (f) of this section. A credit card issuer shall disclose all applicable items in this paragraph except for paragraph (b)(7) of this section. A charge card issuer shall disclose the applicable items in paragraphs (b)(2), (4), (7) through (12), and (15) of this section.

(1) Annual percentage rate. Each periodic rate that may be used to compute the finance charge on an outstanding balance for purchases, a cash advance, or a balance transfer, expressed as an annual percentage rate (as determined by § 226.14(b)). When more than one rate applies for a category of transactions, the range of balances to which each rate is applicable shall also be disclosed. The annual percentage rate for purchases disclosed pursuant to this paragraph shall be in at least 16-point type, except for the following: Oral disclosures of the annual percentage rate for purchases; or a penalty rate that may apply upon the occurrence of one or more specific events.

(i) Variable rate information. If a rate disclosed under paragraph (b)(1) of this section is a variable rate, the card issuer shall also disclose the fact that the rate may vary and how the rate is determined. In describing how the applicable rate will be determined, the card issuer must identify the type of index or formula that is used in setting the rate. The value of the index and the amount of the margin that are used to calculate the variable rate shall not be disclosed in the table. A disclosure of any applicable limitations on rate increases or decreases shall not be included in the table.

(ii) Discounted initial rate. If the initial rate is an introductory rate, as that term is defined in § 226.16(g)(2)(ii), the card issuer must disclose in the table the introductory rate, the time period during which the introductory rate will remain in effect, and must use the term "introductory" or "intro" in immediate proximity to the introductory rate. The card issuer also must disclose the rate that would otherwise apply to the account pursuant to paragraph (b)(1) of this section. Where the rate is not tied to an index or formula, the card issuer must disclose the rate that will apply after the introductory rate expires. In a variable-rate account, the card issuer must disclose a rate based on the applicable index or formula in accordance with the accuracy requirements set forth in paragraphs (c)(2), (d)(3), or (e)(4) of this section, as applicable.

(iii) Premium initial rate. If the initial rate is temporary and is higher than the rate that will apply after the temporary rate expires, the card issuer must disclose the premium initial rate pursuant to paragraph (b)(1) of this section and the time period during which the premium initial rate will remain in effect. Consistent with paragraph (b)(1) of this section, the premium initial rate for purchases must be in at least 16-point type. The issuer must also disclose in the table the rate that will apply after the premium initial rate expires, in at least 16-point type.

(iv) Penalty rates.

(A) In general. Except as provided in paragraph (b)(1)(iv)(B) of this section, if a rate may increase as a penalty for one or more events specified in the account agreement, such as a late payment or an extension of credit that exceeds the credit limit, the card issuer must disclose pursuant to paragraph (b)(1) of this section the increased rate that may apply, a brief description of the event or events that may result in the increased rate, and a brief description of how long the increased rate will remain in effect.

(B) Introductory rates. If the issuer discloses an introductory rate, as that term is defined in § 226.16(g)(2)(ii), in the table or in any written or electronic promotional materials accompanying applications or solicitations subject to paragraph (c) or (e) of this section, the issuer must briefly disclose directly beneath the table the circumstances, if any, under which the introductory rate may be revoked, and the type of rate that will apply after the introductory rate is revoked.

(v) Rates that depend on consumer's creditworthiness. If a rate cannot be determined at the time disclosures are given because the rate depends, at least in part, on a later determination of the consumer's creditworthiness, the card issuer must disclose the specific rates or the range of rates that could apply and a statement that the rate for which the consumer may qualify at account opening will depend on the consumer's creditworthiness, and other factors if applicable. If the rate that depends, at least in part, on a later determination of the consumer's creditworthiness is a penalty rate, as described in paragraph (b)(1)(iv) of this section, the card issuer at its option may disclose the highest rate that could apply, instead of disclosing the specific rates or the range of rates that could apply.

(vi) APRs that vary by state. Issuers imposing annual percentage rates that vary by state may, at the issuer's option, disclose in the table: the specific annual percentage rate applicable to the consumer's account; or the range of the annual percentage rates, if the disclosure includes a statement that the annual percentage rate varies by state and refers the consumer to a disclosure provided with the table where the annual percentage rate applicable to the consumer's account is disclosed. A card issuer may not list annual percentage rates for multiple states in the table.

(2) Fees for issuance or availability.

(i) Any annual or other periodic fee that may be imposed for the issuance or availability of a credit or charge card, including any fee based on account activity or inactivity; how frequently it will be imposed; and the annualized amount of the fee.

(ii) Any non-periodic fee that relates to opening an account. A card issuer must disclose that the fee is a one-time fee.

(3) Fixed finance charge; minimum interest charge. Any fixed finance charge and a brief description of the charge. Any minimum interest charge if it exceeds $1.00 that could be imposed during a billing cycle, and a brief description of the charge. The $1.00 threshold amount shall be adjusted periodically by the Board to reflect changes in the Consumer Price Index. The Board shall calculate each year a price level adjusted minimum interest charge using the Consumer Price Index in effect on June 1 of that year. When the cumulative change in the adjusted minimum value derived from applying the annual Consumer Price level to the current minimum interest charge threshold has risen by a whole dollar, the minimum interest charge will be increased by $1.00. The issuer may, at its option, disclose in the table minimum interest charges below this threshold.

(4) Transaction charges. Any transaction charge imposed by the card issuer for the use of the card for purchases.

(5) Grace period. The date by which or the period within which any credit extended for purchases may be repaid without incurring a finance charge due to a periodic interest rate and any conditions on the availability of the grace period. If no grace period is provided, that fact must be disclosed. If the length of the grace period varies, the card issuer may disclose the range of days, the minimum number of days, or the average number of days in the grace period, if the disclosure is identified as a range, minimum, or average. In disclosing in the tabular format a grace period that applies to all types of purchases, the phrase "How to Avoid Paying Interest on Purchases" shall be used as the heading for the row describing the grace period. If a grace period is not offered on all types of purchases, in disclosing this fact in the tabular format, the phrase "Paying Interest" shall be used as the heading for the row describing this fact.

(6) Balance computation method. The name of the balance computation method listed in paragraph (g) of this section that is used to determine the balance for purchases on which the finance charge is computed, or an explanation of the

method used if it is not listed. In determining which balance computation method to disclose, the card issuer shall assume that credit extended for purchases will not be repaid within the grace period, if any.

(7) Statement on charge card payments. A statement that charges incurred by use of the charge card are due when the periodic statement is received.

(8) Cash advance fee. Any fee imposed for an extension of credit in the form of cash or its equivalent.

(9) Late payment fee. Any fee imposed for a late payment.

(10) Over-the-limit fee. Any fee imposed for exceeding a credit limit.

(11) Balance transfer fee. Any fee imposed to transfer an outstanding balance.

(12) Returned-payment fee. Any fee imposed by the card issuer for a returned payment.

(13) Required insurance, debt cancellation or debt suspension coverage.

(i) A fee for insurance described in § 226.4(b)(7) or debt cancellation or suspension coverage described in § 226.4(b)(10), if the insurance or debt cancellation or suspension coverage is required as part of the plan; and

(ii) A cross reference to any additional information provided about the insurance or coverage accompanying the application or solicitation, as applicable.

(14) Available credit. If a card issuer requires fees for the issuance or availability of credit described in paragraph (b)(2) of this section, or requires a security deposit for such credit, and the total amount of those required fees and/or security deposit that will be imposed and charged to the account when the account is opened is 15 percent or more of the minimum credit limit for the card, a card issuer must disclose the available credit remaining after these fees or security deposit are debited to the account, assuming that the consumer receives the minimum credit limit. In determining whether the 15 percent threshold test is met, the issuer must only consider fees for issuance or availability of credit, or a security deposit, that are required. If fees for issuance or availability are optional, these fees should not be considered in determining whether the disclosure must be given. Nonetheless, if the 15 percent threshold test is met, the

issuer in providing the disclosure must disclose the amount of available credit calculated by excluding those optional fees, and the available credit including those optional fees. This paragraph does not apply with respect to fees or security deposits that are not debited to the account.

(15) Web site reference. A reference to the Web site established by the Board and a statement that consumers may obtain on the Web site information about shopping for and using credit cards.

(c) Direct mail and electronic applications and solicitations.

(1) General. The card issuer shall disclose the applicable items in paragraph (b) of this section on or with an application or solicitation that is mailed to consumers or provided to consumers in electronic form.

(2) Accuracy.

(i) Disclosures in direct mail applications and solicitations must be accurate as of the time the disclosures are mailed. An accurate variable annual percentage rate is one in effect within 60 days before mailing.

(ii) Disclosures provided in electronic form must be accurate as of the time they are sent, in the case of disclosures sent to a consumer's e-mail address, or as of the time they are viewed by the public, in the case of disclosures made available at a location such as a card issuer's Web site. An accurate variable annual percentage rate provided in electronic form is one in effect within 30 days before it is sent to a consumer's e-mail address, or viewed by the public, as applicable.

(d) Telephone applications and solicitations.

(1) Oral disclosure. The card issuer shall disclose orally the information in paragraphs (b)(1) through (7) and (b)(14) of this section, to the extent applicable, in a telephone application or solicitation initiated by the card issuer.

(2) Alternative disclosure. The oral disclosure under paragraph (d)(1) of this section need not be given if the card issuer either:

(i)

(A) Does not impose a fee described in paragraph (b)(2) of this section; or

(B) Imposes such a fee but provides the consumer with a right to reject the plan consistent with § 226.5(b)(1)(iv); and

(ii) The card issuer discloses in writing within 30 days after the consumer requests the card (but in no event later than the delivery of the card) the following:

(A) The applicable information in paragraph (b) of this section; and

(B) As applicable, the fact that the consumer has the right to reject the plan and not be obligated to pay fees described in paragraph (b)(2) or any other fees or charges until the consumer has used the account or made a payment on the account after receiving a billing statement.

(3) Accuracy.

(i) The oral disclosures under paragraph (d)(1) of this section must be accurate as of the time they are given.

(ii) The alternative disclosures under paragraph (d)(2) of this section generally must be accurate as of the time they are mailed or delivered. A variable annual percentage rate is one that is accurate if it was:

(A) In effect at the time the disclosures are mailed or delivered; or

(B) In effect as of a specified date (which rate is then updated from time to time, but no less frequently than each calendar month).

(e) Applications and solicitations made available to general public. The card issuer shall provide disclosures, to the extent applicable, on or with an application or solicitation that is made available to the general public, including one contained in a catalog, magazine, or other generally available publication. The disclosures shall be provided in accordance with paragraph (e)(1) or (e)(2) of this section.

(1) Disclosure of required credit information. The card issuer may disclose in a prominent location on the application or solicitation the following:

(i) The applicable information in paragraph (b) of this section;

(ii) The date the required information was printed, including a statement that the required information was accurate as of that date and is subject to change after that date; and

(iii) A statement that the consumer should contact the card issuer for any change in the required information since it was printed, and a toll-free telephone number or a mailing address for that purpose.

(2) No disclosure of credit information. If none of the items in paragraph (b) of this section is provided on or with the application or solicitation, the card issuer may state in a prominent location on the application or solicitation the following:

(i) There are costs associated with the use of the card; and

(ii) The consumer may contact the card issuer to request specific information about the costs, along with a toll-free telephone number and a mailing address for that purpose.

(3) Prompt response to requests for information. Upon receiving a request for any of the information referred to in this paragraph, the card issuer shall promptly and fully disclose the information requested.

(4) Accuracy. The disclosures given pursuant to paragraph (e)(1) of this section must be accurate as of the date of printing. A variable annual percentage rate is accurate if it was in effect within 30 days before printing.

(f) In-person applications and solicitations. A card issuer shall disclose the information in paragraph (b) of this section, to the extent applicable, on or with an application or solicitation that is initiated by the card issuer and given to the consumer in person. A card issuer complies with the requirements of this paragraph if the issuer provides disclosures in accordance with paragraph (c)(1) or (e)(1) of this section.

(g) Balance computation methods defined. The following methods may be described by name. Methods that differ due to variations such as the allocation of payments, whether the finance charge begins to accrue on the transaction date or the date of posting the transaction, the existence or length of a grace period, and whether the balance is adjusted by charges such as late payment fees, annual fees and unpaid finance charges do not constitute separate balance computation methods.

(1)

(i) Average daily balance (including new purchases). This balance is figured by adding the outstanding balance (including new purchases and deducting payments and credits) for each day in the billing cycle, and then dividing by the number of days in the billing cycle.

(ii) Average daily balance (excluding new purchases). This balance is figured by adding the outstanding balance (excluding new purchases and deducting payments and credits) for each day in the billing cycle, and then dividing by the number of days in the billing cycle.

(2) Adjusted balance. This balance is figured by deducting payments and credits made during the billing cycle from the outstanding balance at the beginning of the billing cycle.

(3) Previous balance. This balance is the outstanding balance at the beginning of the billing cycle.

(4) Daily balance. For each day in the billing cycle, this balance is figured by taking the beginning balance each day, adding any new purchases, and subtracting any payment and credits.

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
12 C.F.R. Part 226 REGULATION Z--TRUTH IN LENDING
Subpart B Open End Credit

1B- Consumer Credit Law Manual § 226.5b

§ **226.5b Requirements for home equity plans.**

The requirements of this section apply to open-end credit plans secured by the consumer's dwelling. For purposes of this section, an annual percentage rate is the annual percentage rate corresponding to the periodic rate as determined under § 226.14(b).

(a) Form of disclosures.

(1) General. The disclosures required by paragraph (d) of this section shall be made clearly and conspicuously and shall be grouped together and segregated from all unrelated information. The disclosures may be provided on the application form or on a separate form. The disclosure described in paragraph (d)(4)(iii), the itemization of third-party fees described in paragraph (d)(8), and the variable-rate information described in paragraph (d)(12) of this section may be provided separately from the other required disclosures.

(2) Precedence of certain disclosures. The disclosures described in paragraph (d)(1) through (4)(ii) of this section shall precede the other required disclosures.

(3) For an application that is accessed by the consumer in electronic form, the disclosures required under this section may be provided to the consumer in electronic form on or with the application.

(b) Time of disclosures. The disclosures and brochure required by paragraphs (d) and (e) of this section shall be provided at the time an application is provided to the consumer.[10a]

(c) Duties of third parties. Persons other than the creditor who provide applications to consumers for home equity plans must provide the brochure required under paragraph (e) of this section at the time an application is provided. If such persons have the disclosures required under paragraph (d) of this section for a creditor's home equity plan, they also shall provide the disclosures at such time. n10a

(d) Content of disclosures. The creditor shall provide the following disclosures, as applicable:

(1) Retention of information. A statement that the consumer should make or otherwise retain a copy of the disclosures.

(2) Conditions for disclosed terms.

(i) A statement of the time by which the consumer must submit an application to obtain specific terms disclosed and an identification of any disclosed term that is subject to change prior to opening the plan.

(ii) A statement that, if a disclosed term changes (other than a change due to fluctuations in the index in a variable-rate plan) prior to opening the plan and the consumer therefore elects not to open the plan, the consumer may receive a refund of all fees paid in connection with the application.

(3) Security interest and risk to home. A statement that the creditor will acquire a security interest in the consumer's dwelling and that loss of the dwelling may occur in the event of default.

(4) Possible actions by creditor.

(i) A statement that, under certain conditions, the creditor may terminate the plan and require payment of the outstanding balance in full in a single payment and impose fees upon termination; prohibit additional extensions of credit or reduce the credit limit; and, as specified in the initial agreement, implement certain changes in the plan.

(ii) A statement that the consumer may receive, upon request, information about the conditions under which such

actions may occur.

(iii) In lieu of the disclosure required under paragraph (d)(4)(ii) of this section, a statement of such conditions.

(5) Payment terms. The payment terms of the plan, including:

(i) The length of the draw period and any repayment period.

(ii) An explanation of how the minimum periodic payment will be determined and the timing of the payments. If paying only the minimum periodic payments may not repay any of the principal or may repay less than the outstanding balance, a statement of this fact, as well as a statement that a balloon payment may result. n10b

(iii) An example, based on a $10,000 outstanding balance and a recent annual percentage rate, n10c showing the minimum periodic payment, any balloon payment, and the time it would take to repay the $10,000 outstanding balance if the consumer made only those payments and obtained no additional extensions of credit.

If different payment terms may apply to the draw and any repayment period, or if different payment terms may apply within either period, the disclosures shall reflect the different payment terms.

(6) Annual percentage rate. For fixed-rate plans, a recent annual percentage rate [10c] imposed under the plan and a statement that the rate does not include costs other than interest.

(7) Fees imposed by creditor. An itemization of any fees imposed by the creditor to open, use, or maintain the plan, stated as a dollar amount or percentage, and when such fees are payable.

(8) Fees imposed by third parties to open a plan. A good faith estimate, stated as a single dollar amount or range, of any fees that may be imposed by persons other than the creditor to open the plan, as well as a statement that the consumer may receive, upon request, a good faith itemization of such fees. In lieu of the statement, the itemization of such fees may be provided.

(9) Negative amortization. A statement that negative amortization may occur and that negative amortization increases the principal balance and reduces the consumer's equity in the dwelling.

(10) Transaction requirements. Any limitations on the number of extensions of credit and the amount of credit that may be obtained during any time period, as well as any minimum outstanding balance and minimum draw requirements, stated as dollar amounts or percentages.

(11) Tax implications. A statement that the consumer should consult a tax advisor regarding the deductibility of interest and charges under the plan.

(12) Disclosures for variable-rate plans. For a plan in which the annual percentage rate is variable, the following disclosures, as applicable:

(i) The fact that the annual percentage rate, payment, or term may change due to the variable-rate feature.

(ii) A statement that the annual percentage rate does not include costs other than interest.

(iii) The index used in making rate adjustments and a source of information about the index.

(iv) An explanation of how the annual percentage rate will be determined, including an explanation of how the index is adjusted, such as by the addition of a margin.

(v) A statement that the consumer should ask about the current index value, margin, discount or premium, and annual percentage rate.

(vi) A statement that the initial annual percentage rate is not based on the index and margin used to make later rate adjustments, and the period of time such initial rate will be in effect.

(vii) The frequency of changes in the annual percentage rate.

(viii) Any rules relating to changes in the index value and the annual percentage rate and resulting changes in the payment amount, including, for example, an explanation of payment limitations and rate carryover.

(ix) A statement of any annual or more frequent periodic limitations on changes in the annual percentage rate (or a statement that no annual limitation exists), as well as a statement of the maximum annual percentage rate that may be imposed under each payment option.

(x) The minimum periodic payment required when the maximum annual percentage rate for each payment option is in effect for a $10,000 outstanding balance, and a statement of the earliest date or time the maximum rate may be imposed.

(xi) An historical example, based on a $10,000 extension of credit, illustrating how annual percentage rates and payments would have been affected by index value changes implemented according to the terms of the plan. The historical example shall be based on the most recent 15 years of index values (selected for the same time period each year) and shall reflect all significant plan terms, such as negative amortization, rate carryover, rate discounts, and rate and payment limitations, that would have been affected by the index movement during the period.

(xii) A statement that rate information will be provided on or with each periodic statement.

(e) Brochure. The home equity brochure published by the Board or a suitable substitute shall be provided.

(f) Limitations on home equity plans. No creditor may, by contract or otherwise:

(1) Change the annual percentage rate unless:

(i) Such change is based on an index that is not under the creditor's control; and

(ii) Such index is available to the general public.

(2) Terminate a plan and demand repayment of the entire outstanding balance in advance of the original term (except for reverse mortgage transactions that are subject to paragraph (f)(4) of this section) unless:

(i) There is fraud or material misrepresentation by the consumer in connection with the plan;

(ii) The consumer fails to meet the repayment terms of the agreement for any outstanding balance;

(iii) Any action or inaction by the consumer adversely affects the creditor's security for the plan, or any right of the creditor in such security; or

(iv) Federal law dealing with credit extended by a depository institution to its executive officers specifically requires that as a condition of the plan the credit shall become due and payable on demand, provided that the creditor includes such a provision in the initial agreement.

(3) Change any term, except that a creditor may:

(i) Provide in the initial agreement that it may prohibit additional extensions of credit or reduce the credit limit during any period in which the maximum annual percentage rate is reached. A creditor also may provide in the initial agreement that specified changes will occur if a specified event takes place (for example, that the annual percentage rate will increase a specified amount if the consumer leaves the creditor's employment).

(ii) Change the index and margin used under the plan if the original index is no longer available, the new index has an historical movement substantially similar to that of the original index, and the new index and margin would have resulted in an annual percentage rate substantially similar to the rate in effect at the time the original index became unavailable.

(iii) Make a specified change if the consumer specifically agrees to it in writing at that time.

(iv) Make a change that will unequivocally benefit the consumer throughout the remainder of the plan.

(v) Make an insignificant change to terms.

(vi) Prohibit additional extensions of credit or reduce the credit limit applicable to an agreement during any period in which:

(A) The value of the dwelling that secures the plan declines significantly below the dwelling's appraised value for purposes of the plan;

(B) The creditor reasonably believes that the consumer will be unable to fulfill the repayment obligations under the plan because of a material change in the consumer's financial circumstances;

(C) The consumer is in default of any material obligation under the agreement;

(D) The creditor is precluded by government action from imposing the annual percentage rate provided for in the agreement;

(E) The priority of the creditor's security interest is adversely affected by government action to the extent that the value of the security interest is less than 120 percent of the credit line; or

(F) The creditor is notified by its regulatory agency that continued advances constitute an unsafe and unsound practice.

(4) For reverse mortgage transactions that are subject to § 226.33, terminate a plan and demand repayment of the entire outstanding balance in advance of the original term except:

(i) In the case of default;

(ii) If the consumer transfers title to the property securing the note;

(iii) If the consumer ceases using the property securing the note as the primary dwelling; or

(iv) Upon the consumer's death.

(g) Refund of fees. A creditor shall refund all fees paid by the consumer to anyone in connection with an application if any term required to be disclosed under paragraph (d) of this section changes (other than a change due to fluctuations in

the index in a variable-rate plan) before the plan is opened and, as a result, the consumer elects not to open the plan.

(h) Imposition of nonrefundable fees. Neither a creditor nor any other person may impose a nonrefundable fee in connection with an application until three business days after the consumer receives the disclosures and brochure required under this section. n10d

FOOTNOTES:

(n13)Footnote 10a. The disclosures and the brochure may be delivered or placed in the mail not later than three business days following receipt of a consumer's application in the case of applications contained in magazines or other publications, or when the application is received by telephone or through an intermediary agent or broker.

(n14)Footnote 10b. A balloon payment results if paying the minimum periodic payments does not fully amortize the outstanding balance by a specified date or time, and the consumer must repay the entire outstanding balance at such time.

(n15)Footnote 10c. For fixed-rate plans, a recent annual percentage rate is a rate that has been in effect under the plan within the twelve months preceding the date the disclosures are provided to the consumer. For variable-rate plans, a recent annual percentage rate is the most recent rate provided in the historical example described in paragraph (d)(12)(xi) of this section or a rate that has been in effect under the plan since the date of the most recent rate in the table.

(n16)Footnote 10d. If the disclosures and brochure are mailed to the consumer, the consumer is considered to have received them three business days after they are mailed.

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
12 C.F.R. Part 226 REGULATION Z--TRUTH IN LENDING
Subpart B Open End Credit

1B- Consumer Credit Law Manual § 226.6

§ **226.6 Account-opening disclosures.**

(a) Rules affecting home-equity plans. The requirements of this paragraph (a) apply only to home-equity plans subject to the requirements of § 226.5b. A creditor shall disclose the items in this section, to the extent applicable:

(1) Finance charge. The circumstances under which a finance charge will be imposed and an explanation of how it will be determined, as follows:

(i) A statement of when finance charges begin to accrue, including an explanation of whether or not any time period exists within which any credit extended may be repaid without incurring a finance charge. If such a time period is provided, a creditor may, at its option and without disclosure, impose no finance charge when payment is received after the time period's expiration.

(ii) A disclosure of each periodic rate that may be used to compute the finance charge, the range of balances to which it is applicable, n11 and the corresponding annual percentage rate. n12 If a creditor offers a variable-rate plan, the creditor shall also disclose: the circumstances under which the rate(s) may increase; any limitations on the increase; and the effect(s) of an increase. When different periodic rates apply to different types of transactions, the types of transactions to which the periodic rates shall apply shall also be disclosed. A creditor is not required to adjust the range of balances disclosure to reflect the balance below which only a minimum charge applies.

(iii) An explanation of the method used to determine the balance on which the finance charge may be computed.

(iv) An explanation of how the amount of any finance charge will be determined, n13 including a description of how any finance charge other than the periodic rate will be determined.

(2) Other charges. The amount of any charge other than a finance charge that may be imposed as part of the plan, or an explanation of how the charge will be determined.

(3) Home-equity plan information. The following disclosures described in § 226.5b(d), as applicable:

(i) A statement of the conditions under which the creditor may take certain action, as described in § 226.5b(d)(4)(i), such as terminating the plan or changing the terms.

(ii) The payment information described in § 226.5b(d)(5)(i) and (ii) for both the draw period and any repayment period.

(iii) A statement that negative amortization may occur as described in § 226.5b(d)(9).

(iv) A statement of any transaction requirements as described in § 226.5b(d)(10).

(v) A statement regarding the tax implications as described in § 226.5b(d)(11).

(vi) A statement that the annual percentage rate imposed under the plan does not include costs other than interest as described in § 226.5b(d)(6) and (d)(12)(ii).

(vii) The variable-rate disclosures described in § 226.5b(d)(12)(viii), (d)(12)(x), (d)(12)(xi), and (d)(12)(xii), as well as the disclosure described in § 226.5b(d)(5)(iii), unless the disclosures provided with the application were in a form the consumer could keep and included a representative payment example for the category of payment option chosen by the consumer.

(4) Security interests. The fact that the creditor has or will acquire a security interest in the property purchased under the plan, or in other property identified by item or type.

(5) Statement of billing rights. A statement that outlines the consumer's rights and the creditor's responsibilities under §§ 226.12(c) and 226.13 and that is substantially similar to the statement found in Model Form G-3 or, at the creditor's option, G-3(A), in appendix G to this part.

(b) Rules affecting open-end (not home-secured) plans. The requirements of paragraph (b) of this section apply to plans other than home-equity plans subject to the requirements of § 226.5b.

(1) Form of disclosures; tabular format for open-end (not home-secured) plans. Creditors must provide the account-opening disclosures specified in paragraph (b)(2)(i) through (b)(2)(v) (except for (b)(2)(i)(D)(2)) and (b)(2)(vii) through (b)(2)(xiv) of this section in the form of a table with the headings, content, and format substantially similar to any of the applicable tables in G-17 in appendix G.

(i) Highlighting. In the table, any annual percentage rate required to be disclosed pursuant to paragraph (b)(2)(i) of this section; any introductory rate permitted to be disclosed pursuant to paragraph (b)(2)(i)(B) or required to be disclosed under paragraph (b)(2)(i)(F) of this section, any rate that will apply after a premium initial rate expires permitted to be disclosed pursuant to paragraph (b)(2)(i)(C) or required to be disclosed pursuant to paragraph (b)(2)(i)(F), and any fee or percentage amounts required to be disclosed pursuant to paragraphs (b)(2)(ii), (b)(2)(iv), (b)(2)(vii) through (b)(2)(xii) of this section must be disclosed in bold text. However, bold text shall not be used for: Any maximum limits on fee amounts disclosed in the table that do not relate to fees that vary by state; the amount of any periodic fee disclosed pursuant to paragraph (b)(2) of this section that is not an annualized amount; and other annual percentage rates or fee amounts disclosed in the table.

(ii) Location. Only the information required or permitted by paragraphs (b)(2)(i) through (b)(2)(v) (except for (b)(2)(i)(D)(2)) and (b)(2)(vii) through (b)(2)(xiv) of this section shall be in the table. Disclosures required by paragraphs (b)(2)(i)(D)(2), (b)(2)(vi) and (b)(2)(xv) of this section shall be placed directly below the table. Disclosures required by paragraphs (b)(3) through (b)(5) of this section that are not otherwise required to be in the table and other information may be presented with the account agreement or account-opening disclosure statement, provided such information appears outside the required table.

(iii) Fees that vary by state. Creditors that impose fees referred to in paragraphs (b)(2)(vii) through (b)(2)(xi) of this section that vary by state and that provide the disclosures required by paragraph (b) of this section in person at the time the open-end (not home-secured) plan is established in connection with financing the purchase of goods or services may, at the creditor's option, disclose in the account-opening table the specific fee applicable to the consumer's account, or the range of the fees, if the disclosure includes a statement that the amount of the fee varies by state and refers the consumer to the account agreement or other disclosure provided with the account-opening table where the amount of the fee applicable to the consumer's account is disclosed. A creditor may not list fees for multiple states in the account-opening summary table.

(iv) Fees based on a percentage. If the amount of any fee required to be disclosed under this section is determined on the basis of a percentage of another amount, the percentage used and the identification of the amount against which the percentage is applied may be disclosed instead of the amount of the fee.

(2) Required disclosures for account-opening table for open-end (not home-secured) plans. A creditor shall disclose the items in this section, to the extent applicable:

(i) Annual percentage rate. Each periodic rate that may be used to compute the finance charge on an outstanding balance for purchases, a cash advance, or a balance transfer, expressed as an annual percentage rate (as determined by § 226.14(b)). When more than one rate applies for a category of transactions, the range of balances to which each rate is applicable shall also be disclosed. The annual percentage rate for purchases disclosed pursuant to this paragraph shall be in at least 16-point type, except for the following: A penalty rate that may apply upon the occurrence of one or more specific events.

(A) Variable-rate information. If a rate disclosed under paragraph (b)(2)(i) of this section is a variable rate, the creditor shall also disclose the fact that the rate may vary and how the rate is determined. In describing how the applicable rate will be determined, the creditor must identify the type of index or formula that is used in setting the rate. The value of the index and the amount of the margin that are used to calculate the variable rate shall not be disclosed in the table. A disclosure of any applicable limitations on rate increases or decreases shall not be included in the table.

(B) Discounted initial rates. If the initial rate is an introductory rate, as that term is defined in § 226.16(g)(2)(ii), the creditor must disclose the rate that would otherwise apply to the account pursuant to paragraph (b)(2)(i) of this section. Where the rate is not tied to an index or formula, the creditor must disclose the rate that will apply after the introductory rate expires. In a variable-rate account, the card issuer must disclose a rate based on the applicable index or formula in accordance with the accuracy requirements of paragraph (b)(4)(ii)(G) of this section. Except as provided in paragraph (b)(2)(i)(F) of this section, the creditor is not required to, but may disclose in the table the introductory rate along with the rate that would otherwise apply to the account if the creditor also discloses the time period during which the introductory rate will remain in effect, and uses the term "introductory" or "intro" in immediate proximity to the introductory rate.

(C) Premium initial rate. If the initial rate is temporary and is higher than the rate that will apply after the temporary rate expires, the creditor must disclose the premium initial rate pursuant to paragraph (b)(2)(i) of this section. Consistent with paragraph (b)(2)(i) of this section, the premium initial rate for purchases must be in at least 16-point type. Except as provided in paragraph (b)(2)(i)(F) of this section, the creditor is not required to, but may disclose in the table the rate that will apply after the premium initial rate expires if the creditor also discloses the time period during which the premium initial rate will remain in effect. If the creditor also discloses in the table the rate that will apply after the premium initial rate for purchases expires, that rate also must be in at least 16-point type.

(D) Penalty rates.

(1) In general. Except as provided in paragraph (b)(2)(i)(D)(2) of this section, if a rate may increase as a penalty for one or more events specified in the account agreement, such as a late payment or an extension of credit that exceeds the credit limit, the creditor must disclose pursuant to paragraph (b)(2)(i) of this section the increased rate that may apply, a brief description of the event or events that may result in the increased rate, and a brief description of how long the increased rate will remain in effect. If more than one penalty rate may apply, the creditor at its option may disclose the highest rate that could apply, instead of disclosing the specific rates or the range of rates that could apply.

(2) Introductory rates. If the creditor discloses in the table an introductory rate, as that term is defined in § 226.16(g)(2)(ii), creditors must briefly disclose directly beneath the table the circumstances under which the introductory rate may be revoked, and the rate that will apply after the introductory rate is revoked.

(E) Point of sale where APRs vary by state or based on creditworthiness. Creditors imposing annual percentage rates that vary by state or based on the consumer's creditworthiness and providing the disclosures required by paragraph (b) of this section in person at the time the open-end (not home-secured) plan is established in connection with financing the purchase of goods or services may, at the creditor's option, disclose pursuant to paragraph (b)(2)(i) of this section in the account-opening table:

(1) The specific annual percentage rate applicable to the consumer's account; or

(2) The range of the annual percentage rates, if the disclosure includes a statement that the annual percentage rate varies by state or will be determined based on the consumer's creditworthiness and refers the consumer to the account agreement or other disclosure provided with the account-opening table where the annual percentage rate applicable to the consumer's account is disclosed. A creditor may not list annual percentage rates for multiple states in the account-opening table.

(F) Credit card accounts under an open-end (not home-secured) consumer credit plan. Notwithstanding paragraphs (b)(2)(i)(B) and (b)(2)(i)(C) of this section, for credit card accounts under an open-end (not home-secured) plan, issuers must disclose in the table:

(1) Any introductory rate as that term is defined in § 226.16(g)(2)(ii) that would apply to the account, consistent with the requirements of paragraph (b)(2)(i)(B) of this section, and

(2) Any rate that would apply upon the expiration of a premium initial rate, consistent with the requirements of

paragraph (b)(2)(i)(C) of this section.

(ii) Fees for issuance or availability.

(A) Any annual or other periodic fee that may be imposed for the issuance or availability of an open-end plan, including any fee based on account activity or inactivity; how frequently it will be imposed; and the annualized amount of the fee.

(B) Any non-periodic fee that relates to opening the plan. A creditor must disclose that the fee is a one-time fee.

(iii) Fixed finance charge; minimum interest charge. Any fixed finance charge and a brief description of the charge. Any minimum interest charge if it exceeds $1.00 that could be imposed during a billing cycle, and a brief description of the charge. The $1.00 threshold amount shall be adjusted periodically by the Board to reflect changes in the Consumer Price Index. The Board shall calculate each year a price level adjusted minimum interest charge using the Consumer Price Index in effect on the June 1 of that year. When the cumulative change in the adjusted minimum value derived from applying the annual Consumer Price level to the current minimum interest charge threshold has risen by a whole dollar, the minimum interest charge will be increased by $1.00. The creditor may, at its option, disclose in the table minimum interest charges below this threshold.

(iv) Transaction charges. Any transaction charge imposed by the creditor for use of the open-end plan for purchases.

(v) Grace period. The date by which or the period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate and any conditions on the availability of the grace period. If no grace period is provided, that fact must be disclosed. If the length of the grace period varies, the creditor may disclose the range of days, the minimum number of days, or the average number of the days in the grace period, if the disclosure is identified as a range, minimum, or average. In disclosing in the tabular format a grace period that applies to all features on the account, the phrase "How to Avoid Paying Interest" shall be used as the heading for the row describing the grace period. If a grace period is not offered on all features of the account, in disclosing this fact in the tabular format, the phrase "Paying Interest" shall be used as the heading for the row describing this fact.

(vi) Balance computation method. The name of the balance computation method listed in § 226.5a(g) that is used to determine the balance on which the finance charge is computed for each feature, or an explanation of the method used if it is not listed, along with a statement that an explanation of the method(s) required by paragraph (b)(4)(i)(D) of this section is provided with the account-opening disclosures. In determining which balance computation method to disclose, the creditor shall assume that credit extended will not be repaid within any grace period, if any.

(vii) Cash advance fee. Any fee imposed for an extension of credit in the form of cash or its equivalent.

(viii) Late payment fee. Any fee imposed for a late payment.

(ix) Over-the-limit fee. Any fee imposed for exceeding a credit limit.

(x) Balance transfer fee. Any fee imposed to transfer an outstanding balance.

(xi) Returned-payment fee. Any fee imposed by the creditor for a returned payment.

(xii) Required insurance, debt cancellation or debt suspension coverage.

(A) A fee for insurance described in § 226.4(b)(7) or debt cancellation or suspension coverage described in § 226.4(b)(10), if the insurance, or debt cancellation or suspension coverage is required as part of the plan; and

(B) A cross reference to any additional information provided about the insurance or coverage, as applicable.

(xiii) Available credit. If a creditor requires fees for the issuance or availability of credit described in paragraph (b)(2)(ii) of this section, or requires a security deposit for such credit, and the total amount of those required fees and/or security deposit that will be imposed and charged to the account when the account is opened is 15 percent or more of the minimum credit limit for the plan, a creditor must disclose the available credit remaining after these fees or security deposit are debited to the account. The determination whether the 15 percent threshold is met must be based on the minimum credit limit for the plan. However, the disclosure provided under this paragraph must be based on the actual initial credit limit provided on the account. In determining whether the 15 percent threshold test is met, the creditor must only consider fees for issuance or availability of credit, or a security deposit, that are required. If fees for issuance or availability are optional, these fees should not be considered in determining whether the disclosure must be given. Nonetheless, if the 15 percent threshold test is met, the creditor in providing the disclosure must disclose the amount of available credit calculated by excluding those optional fees, and the available credit including those optional fees. The creditor shall also disclose that the consumer has the right to reject the plan and not be obligated to pay those fees or any other fee or charges until the consumer has used the account or made a payment on the account after receiving a periodic statement. This paragraph does not apply with respect to fees or security deposits that are not debited to the account.

(xiv) Web site reference. For issuers of credit cards that are not charge cards, a reference to the Web site established by the Board and a statement that consumers may obtain on the Web site information about shopping for and using credit cards.

(xv) Billing error rights reference. A statement that information about consumers' right to dispute transactions is included in the account-opening disclosures.

(3) Disclosure of charges imposed as part of open-end (not home-secured) plans. A creditor shall disclose, to the extent applicable:

(i) For charges imposed as part of an open-end (not home-secured) plan, the circumstances under which the charge may be imposed, including the amount of the charge or an explanation of how the charge is determined. For finance charges, a statement of when the charge begins to accrue and an explanation of whether or not any time period exists within which any credit that has been extended may be repaid without incurring the charge. If such a time period is provided, a creditor may, at its option and without disclosure, elect not to impose a finance charge when payment is received after the time period expires.

(ii) Charges imposed as part of the plan are:

(A) Finance charges identified under § 226.4(a) and § 226.4(b).

(B) Charges resulting from the consumer's failure to use the plan as agreed, except amounts payable for collection activity after default, attorney's fees whether or not automatically imposed, and post-judgment interest rates permitted by law.

(C) Taxes imposed on the credit transaction by a state or other governmental body, such as documentary stamp taxes on cash advances.

(D) Charges for which the payment, or nonpayment, affect the consumer's access to the plan, the duration of the plan, the amount of credit extended, the period for which credit is extended, or the timing or method of billing or payment.

(E) Charges imposed for terminating a plan.

(F) Charges for voluntary credit insurance, debt cancellation or debt suspension.

(iii) Charges that are not imposed as part of the plan include:

(A) Charges imposed on a cardholder by an institution other than the card issuer for the use of the other institution's ATM in a shared or interchange system.

(B) A charge for a package of services that includes an open-end credit feature, if the fee is required whether or not the open-end credit feature is included and the non-credit services are not merely incidental to the credit feature.

(C) Charges under § 226.4(e) disclosed as specified.

(4) Disclosure of rates for open-end (not home-secured) plans. A creditor shall disclose, to the extent applicable:

(i) For each periodic rate that may be used to calculate interest:

(A) Rates. The rate, expressed as a periodic rate and a corresponding annual percentage rate.

(B) Range of balances. The range of balances to which the rate is applicable; however, a creditor is not required to adjust the range of balances disclosure to reflect the balance below which only a minimum charge applies.

(C) Type of transaction. The type of transaction to which the rate applies, if different rates apply to different types of transactions.

(D) Balance computation method. An explanation of the method used to determine the balance to which the rate is applied.

(ii) Variable-rate accounts. For interest rate changes that are tied to increases in an index or formula (variable-rate

accounts) specifically set forth in the account agreement:

(A) The fact that the annual percentage rate may increase.

(B) How the rate is determined, including the margin.

(C) The circumstances under which the rate may increase.

(D) The frequency with which the rate may increase.

(E) Any limitation on the amount the rate may change.

(F) The effect(s) of an increase.

(G) Except as specified in paragraph (b)(4)(ii)(H) of this section, a rate is accurate if it is a rate as of a specified date and this rate was in effect within the last 30 days before the disclosures are provided.

(H) Creditors imposing annual percentage rates that vary according to an index that is not under the creditor's control that provide the disclosures required by paragraph (b) of this section in person at the time the open-end (not home-secured) plan is established in connection with financing the purchase of goods or services may disclose in the table a rate, or range of rates to the extent permitted by § 226.6(b)(2)(i)(E), that was in effect within the last 90 days before the disclosures are provided, along with a reference directing the consumer to the account agreement or other disclosure provided with the account-opening table where an annual percentage rate applicable to the consumer's account in effect within the last 30 days before the disclosures are provided is disclosed.

(iii) Rate changes not due to index or formula. For interest rate changes that are specifically set forth in the account agreement and not tied to increases in an index or formula:

(A) The initial rate (expressed as a periodic rate and a corresponding annual percentage rate) required under paragraph (b)(4)(i)(A) of this section.

(B) How long the initial rate will remain in effect and the specific events that cause the initial rate to change.

(C) The rate (expressed as a periodic rate and a corresponding annual percentage rate) that will apply when the initial rate is no longer in effect and any limitation on the time period the new rate will remain in effect.

(D) The balances to which the new rate will apply.

(E) The balances to which the current rate at the time of the change will apply.

(5) Additional disclosures for open-end (not home-secured) plans. A creditor shall disclose, to the extent applicable:

(i) Voluntary credit insurance, debt cancellation or debt suspension. The disclosures in §§ 226.4(d)(1)(i) and (d)(1)(ii) and (d)(3)(i) through (d)(3)(iii) if the creditor offers optional credit insurance or debt cancellation or debt suspension coverage that is identified in § 226.4(b)(7) or (b)(10).

(ii) Security interests. A statement that outlines the consumer's rights and the creditor's responsibilities under §§ 226.12(c) and 226.13 and that is substantially similar to the statement found in Model Form G-3(A) in appendix G to this part.

(iii) Statement of billing rights. The fact that the creditor has or will acquire a security interest in the property purchased under the plan, or in other property identified by item or type.

FOOTNOTES:
(n17)Footnote 11. [Reserved].

(n18)Footnote 12. [Reserved].

(n19)Footnote 13. [Reserved].

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
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1B- Consumer Credit Law Manual § 226.7

§ **226.7 Periodic statement.**

The creditor shall furnish the consumer with a periodic statement that discloses the following items, to the extent applicable:

(a) Rules affecting home-equity plans. The requirements of paragraph (a) of this section apply only to home-equity plans subject to the requirements of § 226.5b. Alternatively, a creditor subject to this paragraph may, at its option, comply with any of the requirements of paragraph (b) of this section; however, any creditor that chooses not to provide a disclosure under paragraph (a)(7) of this section must comply with paragraph (b)(6) of this section.

(1) Previous balance. The account balance outstanding at the beginning of the billing cycle.

(2) Identification of transactions. An identification of each credit transaction in accordance with § 226.8.

(3) Credits. Any credit to the account during the billing cycle, including the amount and the date of crediting. The date need not be provided if a delay in accounting does not result in any finance or other charge.

(4) Periodic rates.

(i) Except as provided in paragraph (a)(4)(ii) of this section, each periodic rate that may be used to compute the finance charge, the range of balances to which it is applicable, n14 and the corresponding annual percentage rate. n15 If no finance charge is imposed when the outstanding balance is less than a certain amount, the creditor is not required to disclose that fact, or the balance below which no finance charge will be imposed. If different periodic rates apply to different types of transactions, the types of transactions to which the periodic rates apply shall also be disclosed. For variable-rate plans, the fact that the periodic rate(s) may vary.

(ii) Exception. An annual percentage rate that differs from the rate that would otherwise apply and is offered only for a promotional period need not be disclosed except in periods in which the offered rate is actually applied.

(5) Balance on which finance charge computed. The amount of the balance to which a periodic rate was applied and an explanation of how that balance was determined. When a balance is determined without first deducting all credits and payments made during the billing cycle, the fact and the amount of the credits and payments shall be disclosed.

(6) Amount of finance charge and other charges. Creditors may comply with paragraphs (a)(6) of this section, or with paragraph (b)(6) of this section, at their option.

(i) Finance charges. The amount of any finance charge debited or added to the account during the billing cycle, using the term finance charge. The components of the finance charge shall be individually itemized and identified to show the amount(s) due to the application of any periodic rates and the amounts(s) of any other type of finance charge. If there is more than one periodic rate, the amount of the finance charge attributable to each rate need not be separately itemized and identified.

(ii) Other charges. The amounts, itemized and identified by type, of any charges other than finance charges debited to the account during the billing cycle.

(7) Annual percentage rate. At a creditor's option, when a finance charge is imposed during the billing cycle, the annual percentage rate(s) determined under § 226.14(c) using the term annual percentage rate.

(8) Grace period. The date by which or the time period within which the new balance or any portion of the new balance must be paid to avoid additional finance charges. If such a time period is provided, a creditor may, at its option and without disclosure, impose no finance charge if payment is received after the time period's expiration.

(9) Address for notice of billing errors. The address to be used for notice of billing errors. Alternatively, the address

may be provided on the billing rights statement permitted by § 226.9(a)(2).

(10) Closing date of billing cycle; new balance. The closing date of the billing cycle and the account balance outstanding on that date.

(b) Rules affecting open-end (not home-secured) plans. The requirements of paragraph (b) of this section apply only to plans other than home-equity plans subject to the requirements of § 226.5b.

(1) Previous balance. The account balance outstanding at the beginning of the billing cycle.

(2) Identification of transactions. An identification of each credit transaction in accordance with § 226.8.

(3) Credits. Any credit to the account during the billing cycle, including the amount and the date of crediting. The date need not be provided if a delay in crediting does not result in any finance or other charge.

(4) Periodic rates.

(i) Except as provided in paragraph (b)(4)(ii) of this section, each periodic rate that may be used to compute the interest charge expressed as an annual percentage rate and using the term Annual Percentage Rate, along with the range of balances to which it is applicable. If no interest charge is imposed when the outstanding balance is less than a certain amount, the creditor is not required to disclose that fact, or the balance below which no interest charge will be imposed. The types of transactions to which the periodic rates apply shall also be disclosed. For variable-rate plans, the fact that the annual percentage rate may vary.

(ii) Exception. A promotional rate, as that term is defined in § 226.16(g)(2)(i), is required to be disclosed only in periods in which the offered rate is actually applied.

(5) Balance on which finance charge computed. The amount of the balance to which a periodic rate was applied and an explanation of how that balance was determined, using the term Balance Subject to Interest Rate. When a balance is determined without first deducting all credits and payments made during the billing cycle, the fact and the amount of the credits and payments shall be disclosed. As an alternative to providing an explanation of how the balance was determined, a creditor that uses a balance computation method identified in § 226.5a(g) may, at the creditor's option, identify the name of the balance computation method and provide a toll-free telephone number where consumers may obtain from the creditor more information about the balance computation method and how resulting interest charges

were determined. If the method used is not identified in § 226.5a(g), the creditor shall provide a brief explanation of the method used.

(6) Charges imposed.

(i) The amounts of any charges imposed as part of a plan as stated in § 226.6(b)(3), grouped together, in proximity to transactions identified under paragraph (b)(2) of this section, substantially similar to Sample G-18(A) in appendix G to this part.

(ii) Interest. Finance charges attributable to periodic interest rates, using the term Interest Charge, must be grouped together under the heading Interest Charged, itemized and totaled by type of transaction, and a total of finance charges attributable to periodic interest rates, using the term Total Interest, must be disclosed for the statement period and calendar year to date, using a format substantially similar to Sample G-18(A) in appendix G to this part.

(iii) Fees. Charges imposed as part of the plan other than charges attributable to periodic interest rates must be grouped together under the heading Fees, identified consistent with the feature or type, and itemized, and a total of charges, using the term Fees, must be disclosed for the statement period and calendar year to date, using a format substantially similar to Sample G-18(A) in appendix G to this part.

(7) Change-in-terms and increased penalty rate summary for open-end (not home-secured) plans. Creditors that provide a change-in-terms notice required by § 226.9(c), or a rate increase notice required by § 226.9(g), on or with the periodic statement, must disclose the information in § 226.9(c)(2)(iv)(A) and (c)(2)(iv)(B) (if applicable) or § 226.9(g)(3)(i) on the periodic statement in accordance with the format requirements in § 226.9(c)(2)(iv)(D), and § 226.9(g)(3)(ii). See Forms G-18(F) and G-18(G) in appendix G to this part.

(8) Grace period. The date by which or the time period within which the new balance or any portion of the new balance must be paid to avoid additional finance charges. If such a time period is provided, a creditor may, at its option and without disclosure, impose no finance charge if payment is received after the time period's expiration.

(9) Address for notice of billing errors. The address to be used for notice of billing errors. Alternatively, the address may be provided on the billing rights statement permitted by § 226.9(a)(2).

(10) Closing date of billing cycle; new balance. The closing date of the billing cycle and the account balance outstanding on that date. The new balance must be disclosed in accordance with the format requirements of paragraph (b)(13) of this section.

(11) Due date; late payment costs.

(i) Except as provided in paragraph (b)(11)(ii) of this section and in accordance with the format requirements in paragraph (b)(13) of this section, for a credit card account under an open-end (not home-secured) consumer credit plan, a card issuer must provide on each periodic statement:

(A) The due date for a payment. The due date disclosed pursuant to this paragraph shall be the same day of the month for each billing cycle.

(B) The amount of any late payment fee and any increased periodic rate(s) (expressed as an annual percentage rate(s)) that may be imposed on the account as a result of a late payment. If a range of late payment fees may be assessed, the card issuer may state the range of fees, or the highest fee and at the issuer's option with the highest fee an indication that the fee imposed could be lower. If the rate may be increased for more than one feature or balance, the card issuer may state the range of rates or the highest rate that could apply and at the issuer's option an indication that the rate imposed could be lower.

(ii) Exception. The requirements of paragraph (b)(11)(i) of this section do not apply to the following:

(A) Periodic statements provided solely for charge card accounts; and

(B) Periodic statements provided for a charged-off account where payment of the entire account balance is due immediately.

(12) Repayment disclosures.

(i) In general. Except as provided in paragraphs (b)(12)(ii) and (b)(12)(v) of this section, for a credit card account under an open-end (not home-secured) consumer credit plan, a card issuer must provide the following disclosures on each periodic statement:

(A) The following statement with a bold heading: "Minimum Payment Warning: If you make only the minimum payment each period, you will pay more in interest and it will take you longer to pay off your balance;"

(B) The minimum payment repayment estimate, as described in Appendix M1 to this part. If the minimum payment repayment estimate is less than 2 years, the card issuer must disclose the estimate in months. Otherwise, the estimate must be disclosed in years and rounded to the nearest whole year;

(C) The minimum payment total cost estimate, as described in Appendix M1 to this part. The minimum payment total cost estimate must be rounded to the nearest whole dollar;

(D) A statement that the minimum payment repayment estimate and the minimum payment total cost estimate are based on the current outstanding balance shown on the periodic statement. A statement that the minimum payment repayment estimate and the minimum payment total cost estimate are based on the assumption that only minimum payments are made and no other amounts are added to the balance;

(E) A toll-free telephone number where the consumer may obtain from the card issuer information about credit counseling services consistent with paragraph (b)(12)(iv) of this section; and

(F)

(1) Except as provided in paragraph (b)(12)(i)(F)(2) of this section, the following disclosures:

(i) The estimated monthly payment for repayment in 36 months, as described in Appendix M1 to this part. The estimated monthly payment for repayment in 36 months must be rounded to the nearest whole dollar;

(ii) A statement that the card issuer estimates that the consumer will repay the outstanding balance shown on the periodic statement in 3 years if the consumer pays the estimated monthly payment each month for 3 years;

(iii) The total cost estimate for repayment in 36 months, as described in Appendix M1 to this part. The total cost estimate for repayment in 36 months must be rounded to the nearest whole dollar; and

(iv) The savings estimate for repayment in 36 months, as described in Appendix M1 to this part. The savings estimate for repayment in 36 months must be rounded to the nearest whole dollar.

(2) The requirements of paragraph (b)(12)(i)(F)(1) of this section do not apply to a periodic statement in any of

the following circumstances:

(i) The minimum payment repayment estimate that is disclosed on the periodic statement pursuant to paragraph (b)(12)(i)(B) of this section after rounding is three years or less;

(ii) The estimated monthly payment for repayment in 36 months, as described in Appendix M1 to this part, rounded to the nearest whole dollar that is calculated for a particular billing cycle is less than the minimum payment required for the plan for that billing cycle; and

(iii) A billing cycle where an account has both a balance in a revolving feature where the required minimum payments for this feature will not amortize that balance in a fixed amount of time specified in the account agreement and a balance in a fixed repayment feature where the required minimum payment for this fixed repayment feature will amortize that balance in a fixed amount of time specified in the account agreement which is less than 36 months.

(ii) Negative or no amortization. If negative or no amortization occurs when calculating the minimum payment repayment estimate as described in Appendix M1 of this part, a card issuer must provide the following disclosures on the periodic statement instead of the disclosures set forth in paragraph (b)(12)(i) of this section:

(A) The following statement: "Minimum Payment Warning: Even if you make no more charges using this card, if you make only the minimum payment each month we estimate you will never pay off the balance shown on this statement because your payment will be less than the interest charged each month";

(B) The following statement: "If you make more than the minimum payment each period, you will pay less in interest and pay off your balance sooner";

(C) The estimated monthly payment for repayment in 36 months, as described in Appendix M1 to this part. The estimated monthly payment for repayment in 36 months must be rounded to the nearest whole dollar;

(D) A statement that the card issuer estimates that the consumer will repay the outstanding balance shown on the periodic statement in 3 years if the consumer pays the estimated monthly payment each month for 3 years; and

(E) A toll-free telephone number where the consumer may obtain from the card issuer information about credit counseling services consistent with paragraph (b)(12)(iv) of this section.

(iii) Format requirements. A card issuer must provide the disclosures required by paragraph (b)(12)(i) or (b)(12)(ii) of this section in accordance with the format requirements of paragraph (b)(13) of this section, and in a format substantially similar to Samples G-18(C)(1), G-18(C)(2) and G-18(C)(3) in Appendix G to this part, as applicable.

(iv) Provision of information about credit counseling services.

(A) Required information. To the extent available from the United States Trustee or a bankruptcy administrator, a card issuer must provide through the toll-free telephone number disclosed pursuant to paragraphs (b)(12)(i) or (b)(12)(ii) of this section the name, street address, telephone number, and Web site address for at least three organizations that have been approved by the United States Trustee or a bankruptcy administrator pursuant to *11 U.S.C. 111(a)(1)* to provide credit counseling services in, at the card issuer's option, either the state in which the billing address for the account is located or the state specified by the consumer.

(B) Updating required information. At least annually, a card issuer must update the information provided pursuant to paragraph (b)(12)(iv)(A) of this section for consistency with the information available from the United States Trustee or a bankruptcy administrator.

(v) Exemptions. Paragraph (b)(12) of this section does not apply to:

(A) Charge card accounts that require payment of outstanding balances in full at the end of each billing cycle;

(B) A billing cycle immediately following two consecutive billing cycles in which the consumer paid the entire balance in full, had a zero outstanding balance or had a credit balance; and

(C) A billing cycle where paying the minimum payment due for that billing cycle will pay the entire outstanding balance on the account for that billing cycle.

(13) Format requirements. The due date required by paragraph (b)(11) of this section shall be disclosed on the front of the first page of the periodic statement. The amount of the late payment fee and the annual percentage rate(s) required by paragraph (b)(11) of this section shall be stated in close proximity to the due date. The ending balance required by paragraph (b)(10) of this section and the disclosures required by paragraph (b)(12) of this section shall be disclosed closely proximate to the minimum payment due. The due date, late payment fee and annual percentage rate, ending

balance, minimum payment due, and disclosures required by paragraph (b)(12) of this section shall be grouped together. Sample G-18(D) in Appendix G to this part sets forth an example of how these terms may be grouped.

(14) Deferred interest or similar transactions. For accounts with an outstanding balance subject to a deferred interest or similar program, the date by which that outstanding balance must be paid in full in order to avoid the obligation to pay finance charges on such balance must be disclosed on the front of each periodic statement issued during the deferred interest period beginning with the first periodic statement issued during the deferred interest period that reflects the deferred interest or similar transaction. The disclosure provided pursuant to this paragraph must be substantially similar to Sample G-18(H) in Appendix G to this part.

FOOTNOTES:
(n20)Footnote 14. [Reserved].

(n21)Footnote 15. [Reserved].

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
12 C.F.R. Part 226 REGULATION Z--TRUTH IN LENDING
Subpart B Open End Credit

1B- Consumer Credit Law Manual § 226.8

§ 226.8 Identifying transactions on periodic statements.

The creditor shall identify credit transactions on or with the first periodic statement that reflects the transaction by furnishing the following information, as applicable. n16

(a) Sale credit.

(1) Except as provided in paragraph (a)(2) of this section, for each credit transaction involving the sale of property or services, the creditor must disclose the amount and date of the transaction, and either:

(i) A brief identification n17 of the property or services purchased, for creditors and sellers that are the same or related; n18 or

(ii) The seller's name; and the city and state or foreign country where the transaction took place. n19 The creditor may omit the address or provide any suitable designation that helps the consumer to identify the transaction when the transaction took place at a location that is not fixed; took place in the consumer's home; or was a mail, Internet, or telephone order.

(2) Creditors need not comply with paragraph (a)(1) of this section if an actual copy of the receipt or other credit document is provided with the first periodic statement reflecting the transaction, and the amount of the transaction and

either the date of the transaction to the consumer's account or the date of debiting the transaction are disclosed on the copy or on the periodic statement.

(b) Nonsale credit. For each credit transaction not involving the sale of property or services, the creditor must disclose a brief identification of the transaction; n20 the amount of the transaction; and at least one of the following dates: The date of the transaction, the date the transaction was debited to the consumer's account, or, if the consumer signed the credit document, the date appearing on the document. If an actual copy of the receipt or other credit document is provided and that copy shows the amount and at least one of the specified dates, the brief identification may be omitted.

(c) Alternative creditor procedures; consumer inquiries for clarification or documentation. The following procedures apply to creditors that treat an inquiry for clarification or documentation as a notice of a billing error, including correcting the account in accordance with § 226.13(e):

(1) Failure to disclose the information required by paragraphs (a) and (b) of this section is not a failure to comply with the regulation, provided that the creditor also maintains procedures reasonably designed to obtain and provide the information. This applies to transactions that take place outside a state, as defined in § 226.2(a)(26), whether or not the creditor maintains procedures reasonably adapted to obtain the required information.

(2) As an alternative to the brief identification for sale or nonsale credit, the creditor may disclose a number or symbol that also appears on the receipt or other credit document given to the consumer, if the number or symbol reasonably identifies that transaction with that creditor.

FOOTNOTES:
(n22)Footnote 16. [Reserved].

(n23)Footnote 17. [Reserved].

(n24)Footnote 18. [Reserved].

(n25)Footnote 19. [Reserved].

(n26)Footnote 20. [Reserved].

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
12 C.F.R. Part 226 REGULATION Z--TRUTH IN LENDING
Subpart B Open End Credit

1B- Consumer Credit Law Manual § 226.9

§ **226.9 Subsequent disclosure requirements.**

(a) Furnishing statement of billing rights.

(1) Annual statement. The creditor shall mail or deliver the billing rights statement required by § 226.6(a)(5) and (b)(5)(iii) at least once per calendar year, at intervals of not less than 6 months nor more than 18 months, either to all consumers or to each consumer entitled to receive a periodic statement under § 226.5(b)(2) for any one billing cycle.

(2) Alternative summary statement. As an alternative to paragraph (a)(1) of this section, the creditor may mail or deliver, on or with each periodic statement, a statement substantially similar to Model Form G-4 or Model Form G-4(A) in appendix G to this part, as applicable. Creditors offering home-equity plans subject to the requirements of § 226.5b may use either Model Form, at their option.

(b) Disclosures for supplemental credit access devices and additional features.

(1) If a creditor, within 30 days after mailing or delivering the account-opening disclosures under § 226.6(a)(1) or (b)(3)(ii)(A), as applicable, adds a credit feature to the consumer's account or mails or delivers to the consumer a credit access device, including but not limited to checks that access a credit card account, for which the finance charge terms are the same as those previously disclosed, no additional disclosures are necessary. Except as provided in paragraph (b)(3) of this section, after 30 days, if the creditor adds a credit feature or furnishes a credit access device (other than as a renewal, resupply, or the original issuance of a credit card) on the same finance charge terms, the creditor shall disclose, before the consumer uses the feature or device for the first time, that it is for use in obtaining credit under the

terms previously disclosed.

(2) Except as provided in paragraph (b)(3) of this section, whenever a credit feature is added or a credit access device is mailed or delivered to the consumer, and the finance charge terms for the feature or device differ from disclosures previously given, the disclosures required by § 226.6(a)(1) or (b)(3)(ii)(A), as applicable, that are applicable to the added feature or device shall be given before the consumer uses the feature or device for the first time.

(3) Checks that access a credit card account.

(i) Disclosures. For open-end plans not subject to the requirements of § 226.5b, if checks that can be used to access a credit card account are provided more than 30 days after account-opening disclosures under § 226.6(b) are mailed or delivered, or are provided within 30 days of the account-opening disclosures and the finance charge terms for the checks differ from the finance charge terms previously disclosed, the creditor shall disclose on the front of the page containing the checks the following terms in the form of a table with the headings, content, and form substantially similar to Sample G-19 in appendix G to this part:

(A) If a promotional rate, as that term is defined in § 226.16(g)(2)(i) applies to the checks:

(1) The promotional rate and the time period during which the promotional rate will remain in effect;

(2) The type of rate that will apply (such as whether the purchase or cash advance rate applies) after the promotional rate expires, and the annual percentage rate that will apply after the promotional rate expires. For a variable-rate account, a creditor must disclose an annual percentage rate based on the applicable index or formula in accordance with the accuracy requirements set forth in paragraph (b)(3)(ii) of this section; and

(3) The date, if any, by which the consumer must use the checks in order to qualify for the promotional rate. If the creditor will honor checks used after such date but will apply an annual percentage rate other than the promotional rate, the creditor must disclose this fact and the type of annual percentage rate that will apply if the consumer uses the checks after such date.

(B) If no promotional rate applies to the checks:

(1) The type of rate that will apply to the checks and the applicable annual percentage rate. For a variable-rate account, a creditor must disclose an annual percentage rate based on the applicable index or formula in accordance with

the accuracy requirements set forth in paragraph (b)(3)(ii) of this section.

(2) [Reserved]

(C) Any transaction fees applicable to the checks disclosed under § 226.6(b)(2)(iv); and

(D) Whether or not a grace period is given within which any credit extended by use of the checks may be repaid without incurring a finance charge due to a periodic interest rate. When disclosing whether there is a grace period, the phrase "How to Avoid Paying Interest on Check Transactions" shall be used as the row heading when a grace period applies to credit extended by the use of the checks. When disclosing the fact that no grace period exists for credit extended by use of the checks, the phrase "Paying Interest" shall be used as the row heading.

(ii) Accuracy. The disclosures in paragraph (b)(3)(i) of this section must be accurate as of the time the disclosures are mailed or delivered. A variable annual percentage rate is accurate if it was in effect within 60 days of when the disclosures are mailed or delivered.

(c)

(1) Rules affecting home-equity plans.

(i) Written notice required. For home-equity plans subject to the requirements of § 226.5b, whenever any term required to be disclosed under § 226.6(a) is changed or the required minimum periodic payment is increased, the creditor shall mail or deliver written notice of the change to each consumer who may be affected. The notice shall be mailed or delivered at least 15 days prior to the effective date of the change. The 15-day timing requirement does not apply if the change has been agreed to by the consumer; the notice shall be given, however, before the effective date of the change.

(ii) Notice not required. For home-equity plans subject to the requirements of § 226.5b, a creditor is not required to provide notice under this section when the change involves a reduction of any component of a finance or other charge or when the change results from an agreement involving a court proceeding.

(iii) Notice to restrict credit. For home-equity plans subject to the requirements of § 226.5b, if the creditor prohibits additional extensions of credit or reduces the credit limit pursuant to § 226.5b(f)(3)(i) or (f)(3)(vi), the creditor shall mail or deliver written notice of the action to each consumer who will be affected. The notice must be provided not later than three business days after the action is taken and shall contain specific reasons for the action. If the creditor requires

the consumer to request reinstatement of credit privileges, the notice also shall state that fact.

(2) Rules affecting open-end (not home-secured) plans.

(i) Changes where written advance notice is required.

(A) General. For plans other than home-equity plans subject to the requirements of § 226.5b, except as provided in paragraphs (c)(2)(i)(B), (c)(2)(iii) and (c)(2)(v) of this section, when a significant change in account terms as described in paragraph (c)(2)(ii) of this section is made to a term required to be disclosed under § 226.6(b)(3), (b)(4) or (b)(5) or the required minimum periodic payment is increased, a creditor must provide a written notice of the change at least 45 days prior to the effective date of the change to each consumer who may be affected. The 45-day timing requirement does not apply if the consumer has agreed to a particular change; the notice shall be given, however, before the effective date of the change. Increases in the rate applicable to a consumer's account due to delinquency, default or as a penalty described in paragraph (g) of this section that are not due to a change in the contractual terms of the consumer's account must be disclosed pursuant to paragraph (g) of this section instead of paragraph (c)(2) of this section.

(B) Changes agreed to by the consumer. A notice of change in terms is required, but it may be mailed or delivered as late as the effective date of the change if the consumer agrees to the particular change. This paragraph (c)(2)(i)(B) applies only when a consumer substitutes collateral or when the creditor can advance additional credit only if a change relatively unique to that consumer is made, such as the consumer's providing additional security or paying an increased minimum payment amount. The following are not considered agreements between the consumer and the creditor for purposes of this paragraph (c)(2)(i)(B): The consumer's general acceptance of the creditor's contract reservation of the right to change terms; the consumer's use of the account (which might imply acceptance of its terms under state law); the consumer's acceptance of a unilateral term change that is not particular to that consumer, but rather is of general applicability to consumers with that type of account; and the consumer's request to reopen a closed account or to upgrade an existing account to another account offered by the creditor with different credit or other features.

(ii) Significant changes in account terms. For purposes of this section, a "significant change in account terms" means a change to a term required to be disclosed under § 226.6(b)(1) and (b)(2), an increase in the required minimum periodic payment, or the acquisition of a security interest.

(iii) Charges not covered by § 226.6(b)(1) and (b)(2). Except as provided in paragraph (c)(2)(vi) of this section, if a creditor increases any component of a charge, or introduces a new charge, required to be disclosed under § 226.6(b)(3) that is not a significant change in account terms as described in paragraph (c)(2)(ii) of this section, a creditor may either, at its option:

(A) Comply with the requirements of paragraph (c)(2)(i) of this section; or

(B) Provide notice of the amount of the charge before the consumer agrees to or becomes obligated to pay the charge, at a time and in a manner that a consumer would be likely to notice the disclosure of the charge. The notice may be provided orally or in writing.

(iv) Disclosure requirements.

(A) Significant changes in account terms. If a creditor makes a significant change in account terms as described in paragraph (c)(2)(ii) of this section, the notice provided pursuant to paragraph (c)(2)(i) of this section must provide the following information:

(1) A summary of the changes made to terms required by § 226.6(b)(1) and (b)(2), a description of any increase in the required minimum periodic payment, and a description of any security interest being acquired by the creditor;

(2) A statement that changes are being made to the account;

(3) For accounts other than credit card accounts under an open-end (not home-secured) consumer credit plan subject to § 226.9(c)(2)(iv)(B), a statement indicating the consumer has the right to opt out of these changes, if applicable, and a reference to additional information describing the opt-out right provided in the notice, if applicable;

(4) The date the changes will become effective;

(5) If applicable, a statement that the consumer may find additional information about the summarized changes, and other changes to the account, in the notice;

(6) If the creditor is changing a rate on the account, other than a penalty rate, a statement that if a penalty rate currently applies to the consumer's account, the new rate described in the notice will not apply to the consumer's account until the consumer's account balances are no longer subject to the penalty rate; and

(7) If the change in terms being disclosed is an increase in an annual percentage rate, the balances to which the increased rate will be applied. If applicable, a statement identifying the balances to which the current rate will continue to apply as of the effective date of the change in terms.

(B) Right to reject for credit card accounts under an open-end (not home-secured) consumer credit plan. In addition to the disclosures in paragraph (c)(2)(iv)(A) of this section, if a card issuer makes a significant change in account terms on a credit card account under an open-end (not home-secured) consumer credit plan, the creditor must generally provide the following information on the notice provided pursuant to paragraph (c)(2)(i) of this section. This information is not required to be provided in the case of an increase in the required minimum periodic payment, a change in an annual percentage rate applicable to a consumer's account, a change in the balance computation method applicable to consumer's account necessary to comply with § 226.54, or when the change results from the creditor not receiving the consumer's required minimum periodic payment within 60 days after the due date for that payment:

(1) A statement that the consumer has the right to reject the change or changes prior to the effective date of the changes, unless the consumer fails to make a required minimum periodic payment within 60 days after the due date for that payment;

(2) Instructions for rejecting the change or changes, and a toll-free telephone number that the consumer may use to notify the creditor of the rejection; and

(3) If applicable, a statement that if the consumer rejects the change or changes, the consumer's ability to use the account for further advances will be terminated or suspended.

(C) Changes resulting from failure to make minimum periodic payment within 60 days from due date for credit card accounts under an open-end (not home-secured) consumer credit plan. For a credit card account under an open-end (not home-secured) consumer credit plan, if the significant change required to be disclosed pursuant to paragraph (c)(2)(i) of this section is an increase in an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) based on the consumer's failure to make a minimum periodic payment within 60 days from the due date for that payment, the notice provided pursuant to paragraph (c)(2)(i) of this section must also contain the following information:

(1) A statement of the reason for the increase; and

(2) That the increase will cease to apply to transactions that occurred prior to or within 14 days of provision of the notice, if the creditor receives six consecutive required minimum periodic payments on or before the payment due date, beginning with the first payment due following the effective date of the increase.

(D) Format requirements.

(1) Tabular format. The summary of changes described in paragraph (c)(2)(iv)(A)(1) of this section must be in a tabular format (except for a summary of any increase in the required minimum periodic payment), with headings and format substantially similar to any of the account-opening tables found in G-17 in appendix G to this part. The table must disclose the changed term and information relevant to the change, if that relevant information is required by § 226.6(b)(1) and (b)(2). The new terms shall be described in the same level of detail as required when disclosing the terms under § 226.6(b)(2).

(2) Notice included with periodic statement. If a notice required by paragraph (c)(2)(i) of this section is included on or with a periodic statement, the information described in paragraph (c)(2)(iv)(A)(1) of this section must be disclosed on the front of any page of the statement. The summary of changes described in paragraph (c)(2)(iv)(A)(1) of this section must immediately follow the information described in paragraph (c)(2)(iv)(A)(2) through (c)(2)(iv)(A)(7) and, if applicable, paragraphs (c)(2)(iv)(B) and (c)(2)(iv)(C) of this section, and be substantially similar to the format shown in Sample G-20 or G-21 in appendix G to this part.

(3) Notice provided separately from periodic statement. If a notice required by paragraph (c)(2)(i) of this section is not included on or with a periodic statement, the information described in paragraph (c)(2)(iv)(A)(1) of this section must, at the creditor's option, be disclosed on the front of the first page of the notice or segregated on a separate page from other information given with the notice. The summary of changes required to be in a table pursuant to paragraph (c)(2)(iv)(A)(1) of this section may be on more than one page, and may use both the front and reverse sides, so long as the table begins on the front of the first page of the notice and there is a reference on the first page indicating that the table continues on the following page. The summary of changes described in paragraph (c)(2)(iv)(A)(1) of this section must immediately follow the information described in paragraph (c)(2)(iv)(A)(2) through (c)(2)(iv)(A)(7) and, if applicable, paragraphs (c)(2)(iv)(B) and (c)(2)(iv)(C), of this section, substantially similar to the format shown in Sample G-20 or G-21 in appendix G to this part.

(v) Notice not required. For open-end plans (other than home equity plans subject to the requirements of § 226.5b) a creditor is not required to provide notice under this section:

(A) When the change involves charges for documentary evidence; a reduction of any component of a finance or other charge; suspension of future credit privileges (except as provided in paragraph (c)(2)(vi) of this section) or termination of an account or plan; when the change results from an agreement involving a court proceeding; when the change is an extension of the grace period; or if the change is applicable only to checks that access a credit card account and the changed terms are disclosed on or with the checks in accordance with paragraph (b)(3) of this section;

(B) When the change is an increase in an annual percentage rate upon the expiration of a specified period of time, provided that:

(1) Prior to commencement of that period, the creditor disclosed in writing to the consumer, in a clear and conspicuous manner, the length of the period and the annual percentage rate that would apply after expiration of the period;

(2) The disclosure of the length of the period and the annual percentage rate that would apply after expiration of the period are set forth in close proximity and in equal prominence to the first listing of the disclosure of the rate that applies during the specified period of time; and

(3) The annual percentage rate that applies after that period does not exceed the rate disclosed pursuant to paragraph (c)(2)(v)(B)(1) of this paragraph or, if the rate disclosed pursuant to paragraph (c)(2)(v)(B)(1) of this section was a variable rate, the rate following any such increase is a variable rate determined by the same formula (index and margin) that was used to calculate the variable rate disclosed pursuant to paragraph (c)(2)(v)(B)(1);

(C) When the change is an increase in a variable annual percentage rate in accordance with a credit card agreement that provides for changes in the rate according to operation of an index that is not under the control of the creditor and is available to the general public; or

(D) When the change is an increase in an annual percentage rate, a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii), or the required minimum periodic payment due to the completion of a workout or temporary hardship arrangement by the consumer or the consumer's failure to comply with the terms of such an arrangement, provided that:

(1) The annual percentage rate or fee or charge applicable to a category of transactions or the required minimum periodic payment following any such increase does not exceed the rate or fee or charge or required minimum periodic payment that applied to that category of transactions prior to commencement of the arrangement or, if the rate that applied to a category of transactions prior to the commencement of the workout or temporary hardship arrangement was a variable rate, the rate following any such increase is a variable rate determined by the same formula (index and margin) that applied to the category of transactions prior to commencement of the workout or temporary hardship arrangement; and

(2) The creditor has provided the consumer, prior to the commencement of such arrangement, with a clear and conspicuous disclosure of the terms of the arrangement (including any increases due to such completion or failure). This disclosure must generally be provided in writing. However, a creditor may provide the disclosure of the terms of the arrangement orally by telephone, provided that the creditor mails or delivers a written disclosure of the terms of the arrangement to the consumer as soon as reasonably practicable after the oral disclosure is provided.

(vi) Reduction of the credit limit. For open-end plans that are not subject to the requirements of § 226.5b, if a

creditor decreases the credit limit on an account, advance notice of the decrease must be provided before an over-the-limit fee or a penalty rate can be imposed solely as a result of the consumer exceeding the newly decreased credit limit. Notice shall be provided in writing or orally at least 45 days prior to imposing the over-the-limit fee or penalty rate and shall state that the credit limit on the account has been or will be decreased.

(d) Finance charge imposed at time of transaction.

(1) Any person, other than the card issuer, who imposes a finance charge at the time of honoring a consumer's credit card, shall disclose the amount of that finance charge prior to its imposition.

(2) The card issuer, other than the person honoring the consumer's credit card, shall have no responsibility for the disclosure required by paragraph (d)(1) of this section, and shall not consider any such charge for the purposes of §§ 226.5a, 226.6 and 226.7.

(e) Disclosures upon renewal of credit or charge card.

(1) Notice prior to renewal. A card issuer that imposes any annual or other periodic fee to renew a credit or charge card account of the type subject to § 226.5a, including any fee based on account activity or inactivity or any card issuer that has changed or amended any term of a cardholder's account required to be disclosed under § 226.6(b)(1) and (b)(2) that has not previously been disclosed to the consumer, shall mail or deliver written notice of the renewal to the cardholder. If the card issuer imposes any annual or other periodic fee for renewal, the notice shall be provided at least 30 days or one billing cycle, whichever is less, before the mailing or the delivery of the periodic statement on which any renewal fee is initially charged to the account. If the card issuer has changed or amended any term required to be disclosed under § 226.6(b)(1) and (b)(2) and such changed or amended term has not previously been disclosed to the consumer, the notice shall be provided at least 30 days prior to the scheduled renewal date of the consumer's credit or charge card. The notice shall contain the following information:

(i) The disclosures contained in § 226.5a(b)(1) through (b)(7) that would apply if the account were renewed; n20a and

(ii) How and when the cardholder may terminate credit availability under the account to avoid paying the renewal fee, if applicable.

(2) Notification on periodic statements. The disclosures required by this paragraph may be made on or with a periodic statement. If any of the disclosures are provided on the back of a periodic statement, the card issuer shall include a

reference to those disclosures on the front of the statement.

(f) Change in credit card account insurance provider.

(1) Notice prior to change. If a credit card issuer plans to change the provider of insurance for repayment of all or part of the outstanding balance of an open-end credit card account of the type subject to § 226.5a, the card issuer shall mail or deliver to the cardholder written notice of the change not less than 30 days before the change in provider occurs. The notice shall also include the following items, to the extent applicable:

(i) Any increase in the rate that will result from the change;

(ii) Any substantial decrease in coverage that will result from the change; and

(iii) A statement that the cardholder may discontinue the insurance.

(2) Notice when change in provider occurs. If a change described in paragraph (f)(1) of this section occurs, the card issuer shall provide the cardholder with a written notice no later than 30 days after the change, including the following items, to the extent applicable:

(i) The name and address of the new insurance provider;

(ii) A copy of the new policy or group certificate containing the basic terms of the insurance, including the rate to be charged; and

(iii) A statement that the cardholder may discontinue the insurance.

(3) Substantial decrease in coverage. For purposes of this paragraph, a substantial decrease in coverage is a decrease in a significant term of coverage that might reasonably be expected to affect the cardholder's decision to continue the insurance. Significant terms of coverage include, for example, the following:

(i) Type of coverage provided;

(ii) Age at which coverage terminates or becomes more restrictive;

(iii) Maximum insurable loan balance, maximum periodic benefit payment, maximum number of payments, or other term affecting the dollar amount of coverage or benefits provided;

(iv) Eligibility requirements and number and identity of persons covered;

(v) Definition of a key term of coverage such as disability;

(vi) Exclusions from or limitations on coverage; and

(vii) Waiting periods and whether coverage is retroactive.

(4) Combined notification. The notices required by paragraph (f)(1) and (2) of this section may be combined provided the timing requirement of paragraph (f)(1) of this section is met. The notices may be provided on or with a periodic statement.

(g) Increase in rates due to delinquency or default or as a penalty.

(1) Increases subject to this section. For plans other than home-equity plans subject to the requirements of § 226.5b, except as provided in paragraph (g)(4) of this section, a creditor must provide a written notice to each consumer who may be affected when:

(i) A rate is increased due to the consumer's delinquency or default; or

(ii) A rate is increased as a penalty for one or more events specified in the account agreement, such as making a late payment or obtaining an extension of credit that exceeds the credit limit.

(2) Timing of written notice. Whenever any notice is required to be given pursuant to paragraph (g)(1) of this section, the creditor shall provide written notice of the increase in rates at least 45 days prior to the effective date of the increase. The notice must be provided after the occurrence of the events described in paragraphs (g)(1)(i) and (g)(1)(ii) of this section that trigger the imposition of the rate increase.

(3)

(i) Disclosure requirements for rate increases.

(A) General. If a creditor is increasing the rate due to delinquency or default or as a penalty, the creditor must provide the following information on the notice sent pursuant to paragraph (g)(1) of this section:

(1) A statement that the delinquency or default rate or penalty rate, as applicable, has been triggered;

(2) The date on which the delinquency or default rate or penalty rate will apply;

(3) The circumstances under which the delinquency or default rate or penalty rate, as applicable, will cease to apply to the consumer's account, or that the delinquency or default rate or penalty rate will remain in effect for a potentially indefinite time period;

(4) A statement indicating to which balances the delinquency or default rate or penalty rate will be applied; and

(5) If applicable, a description of any balances to which the current rate will continue to apply as of the effective date of the rate increase, unless a consumer fails to make a minimum periodic payment within 60 days from the due date for that payment.

(B) Rate increases resulting from failure to make minimum periodic payment within 60 days from due date. For a credit card account under an open-end (not home-secured) consumer credit plan, if the rate increase required to be disclosed pursuant to paragraph (g)(1) of this section is an increase pursuant to § 226.55(b)(4) based on the consumer's failure to make a minimum periodic payment within 60 days from the due date for that payment, the notice provided pursuant to paragraph (g)(1) of this section must also contain the following information:

(1) A statement of the reason for the increase; and

(2) That the increase will cease to apply to transactions that occurred prior to or within 14 days of provision of the notice, if the creditor receives six consecutive required minimum periodic payments on or before the payment due date, beginning with the first payment due following the effective date of the increase.

(ii) Format requirements.

(A) If a notice required by paragraph (g)(1) of this section is included on or with a periodic statement, the information described in paragraph (g)(3)(i) of this section must be in the form of a table and provided on the front of any page of the periodic statement, above the notice described in paragraph (c)(2)(iv) of this section if that notice is provided on the same statement.

(B) If a notice required by paragraph (g)(1) of this section is not included on or with a periodic statement, the information described in paragraph (g)(3)(i) of this section must be disclosed on the front of the first page of the notice. Only information related to the increase in the rate to a penalty rate may be included with the notice, except that this notice may be combined with a notice described in paragraph (c)(2)(iv) or (g)(4) of this section.

(4) Exception for decrease in credit limit. A creditor is not required to provide a notice pursuant to paragraph (g)(1) of this section prior to increasing the rate for obtaining an extension of credit that exceeds the credit limit, provided that:

(i) The creditor provides at least 45 days in advance of imposing the penalty rate a notice, in writing, that includes:

(A) A statement that the credit limit on the account has been or will be decreased.

(B) A statement indicating the date on which the penalty rate will apply, if the outstanding balance exceeds the credit limit as of that date;

(C) A statement that the penalty rate will not be imposed on the date specified in paragraph (g)(4)(i)(B) of this section, if the outstanding balance does not exceed the credit limit as of that date;

(D) The circumstances under which the penalty rate, if applied, will cease to apply to the account, or that the penalty rate, if applied, will remain in effect for a potentially indefinite time period;

(E) A statement indicating to which balances the penalty rate may be applied; and

(F) If applicable, a description of any balances to which the current rate will continue to apply as of the effective date of the rate increase, unless the consumer fails to make a minimum periodic payment within 60 days from the due date for that payment; and

(ii) The creditor does not increase the rate applicable to the consumer's account to the penalty rate if the outstanding balance does not exceed the credit limit on the date set forth in the notice and described in paragraph (g)(4)(i)(B) of this section.

(iii)

(A) If a notice provided pursuant to paragraph (g)(4)(i) of this section is included on or with a periodic statement, the information described in paragraph (g)(4)(i) of this section must be in the form of a table and provided on the front of any page of the periodic statement; or

(B) If a notice required by paragraph (g)(4)(i) of this section is not included on or with a periodic statement, the information described in paragraph (g)(4)(i) of this section must be disclosed on the front of the first page of the notice. Only information related to the reduction in credit limit may be included with the notice, except that this notice may be combined with a notice described in paragraph (c)(2)(iv) or (g)(1) of this section.

(h) Consumer rejection of certain significant changes in terms.

(1) Right to reject. If paragraph (c)(2)(iv)(B) of this section requires disclosure of the consumer's right to reject a significant change to an account term, the consumer may reject that change by notifying the creditor of the rejection before the effective date of the change.

(2) Effect of rejection. If a creditor is notified of a rejection of a significant change to an account term as provided in paragraph (h)(1) of this section, the creditor must not:

(i) Apply the change to the account;

(ii) Impose a fee or charge or treat the account as in default solely as a result of the rejection; or

(iii) Require repayment of the balance on the account using a method that is less beneficial to the consumer than one of the methods listed in § 226.55(c)(2).

(3) Exception. Section 226.9(h) does not apply when the creditor has not received the consumer's required minimum periodic payment within 60 days after the due date for that payment.

FOOTNOTES:
(n27)Footnote 20a. [Reserved].

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1B- Consumer Credit Law Manual § 226.10

§ **226.10 Payments.**

(a) General rule. A creditor shall credit a payment to the consumer's account as of the date of receipt, except when a delay in crediting does not result in a finance or other charge or except as provided in paragraph (b) of this section.

(b) Specific requirements for payments.

(1) General rule. A creditor may specify reasonable requirements for payments that enable most consumers to make conforming payments.

(2) Examples of reasonable requirements for payments. Reasonable requirements for making payment may include:

(i) Requiring that payments be accompanied by the account number or payment stub;

(ii) Setting reasonable cut-off times for payments to be received by mail, by electronic means, by telephone, and in person (except as provided in paragraph (b)(3) of this section), provided that such cut-off times shall be no earlier than 5 p.m. on the payment due date at the location specified by the creditor for the receipt of such payments;

(iii) Specifying that only checks or money orders should be sent by mail;

(iv) Specifying that payment is to be made in U.S. dollars; or

(v) Specifying one particular address for receiving payments, such as a post office box.

(3) In-person payments on credit card accounts.

(i) General. Notwithstanding § 226.10(b), payments on a credit card account under an open-end (not home-secured) consumer credit plan made in person at a branch or office of a card issuer that is a financial institution prior to the close of business of that branch or office shall be considered received on the date on which the consumer makes the payment. A card issuer that is a financial institution shall not impose a cut-off time earlier than the close of business for any such payments made in person at any branch or office of the card issuer at which such payments are accepted. Notwithstanding § 226.10(b)(2)(ii), a card issuer may impose a cut-off time earlier than 5 p.m. for such payments, if the close of business of the branch or office is earlier than 5 p.m.

(ii) Financial institution. For purposes of paragraph (b)(3) of this section, "financial institution" shall mean a bank, savings association, or credit union.

(4) Nonconforming payments. If a creditor specifies, on or with the periodic statement, requirements for the consumer to follow in making payments as permitted under this § 226.10, but accepts a payment that does not conform to the requirements, the creditor shall credit the payment within five days of receipt.

(c) Adjustment of account. If a creditor fails to credit a payment, as required by paragraphs (a) or (b) of this section, in time to avoid the imposition of finance or other charges, the creditor shall adjust the consumer's account so that the charges imposed are credited to the consumer's account during the next billing cycle.

(d) Crediting of payments when creditor does not receive or accept payments on due date.

(1) General. Except as provided in paragraph (d)(2) of this section, if a creditor does not receive or accept payments by mail on the due date for payments, the creditor may generally not treat a payment received the next business day as late for any purpose. For purposes of this paragraph (d), the "next business day" means the next day on which the creditor accepts or receives payments by mail.

(2) Payments accepted or received other than by mail. If a creditor accepts or receives payments made on the due date by a method other than mail, such as electronic or telephone payments, the creditor is not required to treat a payment made by that method on the next business day as timely, even if it does not accept mailed payments on the due date.

(e) Limitations on fees related to method of payment. For credit card accounts under an open-end (not home-secured) consumer credit plan, a creditor may not impose a separate fee to allow consumers to make a payment by any method, such as mail, electronic, or telephone payments, unless such payment method involves an expedited service by a customer service representative of the creditor.

(f) Changes by card issuer. If a card issuer makes a material change in the address for receiving payments or procedures for handling payments, and such change causes a material delay in the crediting of a payment to the consumer's account during the 60-day period following the date on which such change took effect, the card issuer may not impose any late fee or finance charge for a late payment on the credit card account during the 60-day period following the date on which the change took effect.

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1B- Consumer Credit Law Manual § 226.11

§ **226.11 Treatment of credit balances; account termination.**

(a) Credit balances. When a credit balance in excess of $1 is created on a credit account (through transmittal of funds to a creditor in excess of the total balance due on an account, through rebates of unearned finance charges or insurance premiums, or through amounts otherwise owed to or held for the benefit of the consumer), the creditor shall:

(1) Credit the amount of the credit balance to the consumer's account;

(2) Refund any part of the remaining credit balance within seven business days from receipt of a written request from the consumer;

(3) Make a good faith effort to refund to the consumer by cash, check, or money order, or credit to a deposit account of the consumer, any part of the credit balance remaining in the account for more than six months. No further action is required if the consumer's current location is not known to the creditor and cannot be traced through the consumer's last known address or telephone number.

(b) Account termination.

(1) A creditor shall not terminate an account prior to its expiration date solely because the consumer does not incur a finance charge.

(2) Nothing in paragraph (b)(1) of this section prohibits a creditor from terminating an account that is inactive for three or more consecutive months. An account is inactive for purposes of this paragraph if no credit has been extended (such as by purchase, cash advance or balance transfer) and if the account has no outstanding balance.

(c) Timely settlement of estate debts.

(1) General rule.

(i) Reasonable policies and procedures required. For credit card accounts under an open-end (not home-secured) consumer credit plan, card issuers must adopt reasonable written policies and procedures designed to ensure that an administrator of an estate of a deceased accountholder can determine the amount of and pay any balance on the account in a timely manner.

(ii) Application to joint accounts. Paragraph (c) of this section does not apply to the account of a deceased consumer if a joint accountholder remains on the account.

(2) Timely statement of balance.

(i) Requirement. Upon request by the administrator of an estate, a card issuer must provide the administrator with the amount of the balance on a deceased consumer's account in a timely manner.

(ii) Safe harbor. For purposes of paragraph (c)(2)(i) of this section, providing the amount of the balance on the account within 30 days of receiving the request is deemed to be timely.

(3) Limitations after receipt of request from administrator.

(i) Limitation on fees and increases in annual percentage rates. After receiving a request from the administrator of an estate for the amount of the balance on a deceased consumer's account, a card issuer must not impose any fees on the account (such as a late fee, annual fee, or over-the-limit fee) or increase any annual percentage rate, except as provided by § 226.55(b)(2).

(ii) Limitation on trailing or residual interest. A card issuer must waive or rebate any additional finance charge due to a periodic interest rate if payment in full of the balance disclosed pursuant to paragraph (c)(2) of this section is received within 30 days after disclosure.

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1B- Consumer Credit Law Manual § 226.12

§ **226.12 Special credit card provisions.**

(a) Issuance of credit cards. Regardless of the purpose for which a credit card is to be used, including business, commercial, or agricultural use, no credit card shall be issued to any person except:

(1) In response to an oral or written request or application for the card; or

(2) As a renewal of, or substitute for, an accepted credit card. n21

(b) Liability of cardholder for unauthorized use.

(1)

(i) Definition of unauthorized use. For purposes of this section, the term "unauthorized use" means the use of a credit card by a person, other than the cardholder, who does not have actual, implied, or apparent authority for such use, and from which the cardholder receives no benefit.

(ii) Limitation on amount. The liability of a cardholder for unauthorized use n22 of a credit card shall not exceed the lesser of $50 or the amount of money, property, labor, or services obtained by the unauthorized use before notification to the card issuer under paragraph (b)(3) of this section.

(2) Conditions of liability. A cardholder shall be liable for unauthorized use of a credit card only if:

(i) The credit card is an accepted credit card;

(ii) The card issuer has provided adequate notice n23 of the cardholder's maximum potential liability and of means by which the card issuer may be notified of loss or theft of the card. The notice shall state that the cardholder's liability shall not exceed $50 (or any lesser amount) and that the cardholder may give oral or written notification, and shall describe a means of notification (for example, a telephone number, an address, or both); and

(iii) The card issuer has provided a means to identify the cardholder on the account or the authorized user of the card.

(3) Notification to card issuer. Notification to a card issuer is given when steps have been taken as may be reasonably required in the ordinary course of business to provide the card issuer with the pertinent information about the loss, theft, or possible unauthorized use of a credit card, regardless of whether any particular officer, employee, or agent of the card issuer does, in fact, receive the information. Notification may be given, at the option of the person giving it, in person, by telephone, or in writing. Notification in writing is considered given at the time of receipt or, whether or not received, at the expiration of the time ordinarily required for transmission, whichever is earlier.

(4) Effect of other applicable law or agreement. If state law or an agreement between a cardholder and the card issuer imposes lesser liability than that provided in this paragraph, the lesser liability shall govern.

(5) Business use of credit cards. If 10 or more credit cards are issued by one card issuer for use by the employees of an organization, this section does not prohibit the card issuer and the organization from agreeing to liability for unauthorized use without regard to this section. However, liability for unauthorized use may be imposed on an employee of the organization, by either the card issuer or the organization, only in accordance with this section.

(c) Right of cardholder to assert claims or defenses against card issuer. n24

(1) General rule. When a person who honors a credit card fails to resolve satisfactorily a dispute as to property or services purchased with the credit card in a consumer credit transaction, the cardholder may assert against the card issuer all claims (other than tort claims) and defenses arising out of the transaction and relating to the failure to resolve the dispute. The cardholder may withhold payment up to the amount of credit outstanding for the property or services

that gave rise to the dispute and any finance or other charges imposed on that amount. n25

(2) Adverse credit reports prohibited. If, in accordance with paragraph (c)(1) of this section, the cardholder withholds payment of the amount of credit outstanding for the disputed transaction, the card issuer shall not report that amount as delinquent until the dispute is settled or judgment is rendered.

(3) Limitations.

(i) General. The rights stated in paragraphs (c)(1) and (c)(2) of this section apply only if:

(A) The cardholder has made a good faith attempt to resolve the dispute with the person honoring the credit card; and

(B) The amount of credit extended to obtain the property or services that result in the assertion of the claim or defense by the cardholder exceeds $50, and the disputed transaction occurred in the same state as the cardholder's current designated address or, if not within the same state, within 100 miles from that address. n26

(ii) Exclusion. The limitations stated in paragraph (c)(3)(i)(B) of this section shall not apply when the person honoring the credit card:

(A) Is the same person as the card issuer;

(B) Is controlled by the card issuer directly or indirectly;

(C) Is under the direct or indirect control of a third person that also directly or indirectly controls the card issuer;

(D) Controls the card issuer directly or indirectly;

(E) Is a franchised dealer in the card issuer's products or services; or

(F) Has obtained the order for the disputed transaction through a mail solicitation made or participated in by the card issuer.

(d) Offsets by card issuer prohibited.

(1) A card issuer may not take any action, either before or after termination of credit card privileges, to offset a cardholder's indebtedness arising from a consumer credit transaction under the relevant credit card plan against funds of the cardholder held on deposit with the card issuer.

(2) This paragraph does not alter or affect the right of a card issuer acting under state or federal law to do any of the following with regard to funds of a cardholder held on deposit with the card issuer if the same procedure is constitutionally available to creditors generally: Obtain or enforce a consensual security interest in the funds; attach or otherwise levy upon the funds; or obtain or enforce a court order relating to the funds.

(3) This paragraph does not prohibit a plan, if authorized in writing by the cardholder, under which the card issuer may periodically deduct all or part of the cardholder's credit card debt from a deposit account held with the card issuer (subject to the limitations in § 226.13(d)(1)).

(e) Prompt notification of returns and crediting of refunds.

(1) When a creditor other than the card issuer accepts the return of property or forgives a debt for services that is to be reflected as a credit to the consumer's credit card account, that creditor shall, within 7 business days from accepting the return or forgiving the debt, transmit a credit statement to the card issuer through the card issuer's normal channels for credit statements.

(2) The card issuer shall, within 3 business days from receipt of a credit statement, credit the consumer's account with the amount of the refund.

(3) If a creditor other than a card issuer routinely gives cash refunds to consumers paying in cash, the creditor shall also give credit or cash refunds to consumers using credit cards, unless it discloses at the time the transaction is consummated that credit or cash refunds for returns are not given. This section does not require refunds for returns nor does it prohibit refunds in kind.

(f) Discounts; tie-in arrangements. No card issuer may, by contract or otherwise:

(1) Prohibit any person who honors a credit card from offering a discount to a consumer to induce the consumer to pay by cash, check, or similar means rather than by use of a credit card or its underlying account for the purchase of property or services; or

(2) Require any person who honors the card issuer's credit card to open or maintain any account or obtain any other service not essential to the operation of the credit card plan from the card issuer or any other person, as a condition of participation in a credit card plan. If maintenance of an account for clearing purposes is determined to be essential to the operation of the credit card plan, it may be required only if no service charges or minimum balance requirements are imposed.

(g) Relation to Electronic Fund Transfer Act and Regulation E. For guidance on whether Regulation Z (12 CFR part 226) or Regulation E (12 CFR part 205) applies in instances involving both credit and electronic fund transfer aspects, refer to Regulation E, *12 CFR 205.12(a)* regarding issuance and liability for unauthorized use. On matters other than issuance and liability, this section applies to the credit aspects of combined credit/electronic fund transfer transactions, as applicable.

FOOTNOTES:
(n28)Footnote 21. [Reserved].

(n29)Footnote 22. [Reserved].

(n30)Footnote 23. [Reserved].

(n31)Footnote 24. [Reserved].

(n32)Footnote 25. [Reserved].

(n33)Footnote 26. 26

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1B- Consumer Credit Law Manual § 226.13

§ **226.13 Billing error resolution.n27**

(a) Definition of billing error. For purposes of this section, the term billing error means:

(1) A reflection on or with a periodic statement of an extension of credit that is not made to the consumer or to a person who has actual, implied, or apparent authority to use the consumer's credit card or open-end credit plan.

(2) A reflection on or with a periodic statement of an extension of credit that is not identified in accordance with the requirements of §§ 226.7(a)(2) or (b)(2), as applicable, and 226.8.

(3) A reflection on or with a periodic statement of an extension of credit for property or services not accepted by the consumer or the consumer's designee, or not delivered to the consumer or the consumer's designee as agreed.

(4) A reflection on a periodic statement of the creditor's failure to credit properly a payment or other credit issued to the consumer's account.

(5) A reflection on a periodic statement of a computational or similar error of an accounting nature that is made by the creditor.

(6) A reflection on a periodic statement of an extension of credit for which the consumer requests additional clarification, including documentary evidence.

(7) The creditor's failure to mail or deliver a periodic statement to the consumer's last known address if that address was received by the creditor, in writing, at least 20 days before the end of the billing cycle for which the statement was required.

(b) Billing error notice. n28 A billing error notice is a written notice n29 from a consumer that:

(1) Is received by a creditor at the address disclosed under § 226.7(a)(9) or (b)(9), as applicable, no later than 60 days after the creditor transmitted the first periodic statement that reflects the alleged billing error;

(2) Enables the creditor to identify the consumer's name and account number; and

(3) To the extent possible, indicates the consumer's belief and the reasons for the belief that a billing error exists, and the type, date, and amount of the error.

(c) Time for resolution; general procedures.

(1) The creditor shall mail or deliver written acknowledgment to the consumer within 30 days of receiving a billing error notice, unless the creditor has complied with the appropriate resolution procedures of paragraphs (e) and (f) of this section, as applicable, within the 30-day period; and

(2) The creditor shall comply with the appropriate resolution procedures of paragraphs (e) and (f) of this section, as applicable, within 2 complete billing cycles (but in no event later than 90 days) after receiving a billing error notice.

(d) Rules pending resolution. Until a billing error is resolved under paragraph (e) or (f) of this section, the following rules apply:

(1) Consumer's right to withhold disputed amount; collection action prohibited. The consumer need not pay (and the creditor may not try to collect) any portion of any required payment that the consumer believes is related to the disputed

amount (including related finance or other charges). n30 If the cardholder has enrolled in an automatic payment plan offered by the card issuer and has agreed to pay the credit card indebtedness by periodic deductions from the cardholder's deposit account, the card issuer shall not deduct any part of the disputed amount or related finance or other charges if a billing error notice is received any time up to 3 business days before the scheduled payment date.

(2) Adverse credit reports prohibited. The creditor or its agent shall not (directly or indirectly) make or threaten to make an adverse report to any person about the consumer's credit standing, or report that an amount or account is delinquent, because the consumer failed to pay the disputed amount or related finance or other charges.

(3) Acceleration of debt and restriction of account prohibited. A creditor shall not accelerate any part of the consumer's indebtedness or restrict or close a consumer's account solely because the consumer has exercised in good faith rights provided by this section. A creditor may be subject to the forfeiture penalty under *15 U.S.C. 1666(e)* for failure to comply with any of the requirements of this section.

(4) Permitted creditor actions. A creditor is not prohibited from taking action to collect any undisputed portion of the item or bill; from deducting any disputed amount and related finance or other charges from the consumer's credit limit on the account; or from reflecting a disputed amount and related finance or other charges on a periodic statement, provided that the creditor indicates on or with the periodic statement that payment of any disputed amount and related finance or other charges is not required pending the creditor's compliance with this section.

(e) Procedures if billing error occurred as asserted. If a creditor determines that a billing error occurred as asserted, it shall within the time limits in paragraph (c)(2) of this section:

(1) Correct the billing error and credit the consumer's account with any disputed amount and related finance or other charges, as applicable; and

(2) Mail or deliver a correction notice to the consumer.

(f) Procedures if different billing error or no billing error occurred. If, after conducting a reasonable investigation, n31 a creditor determines that no billing error occurred or that a different billing error occurred from that asserted, the creditor shall within the time limits in paragraph (c)(2) of this section:

(1) Mail or deliver to the consumer an explanation that sets forth the reasons for the creditor's belief that the billing error alleged by the consumer is incorrect in whole or in part;

(2) Furnish copies of documentary evidence of the consumer's indebtedness, if the consumer so requests; and

(3) If a different billing error occurred, correct the billing error and credit the consumer's account with any disputed amount and related finance or other charges, as applicable.

(g) Creditor's rights and duties after resolution. If a creditor, after complying with all of the requirements of this section, determines that a consumer owes all or part of the disputed amount and related finance or other charges, the creditor:

(1) Shall promptly notify the consumer in writing of the time when payment is due and the portion of the disputed amount and related finance or other charges that the consumer still owes;

(2) Shall allow any time period disclosed under § 226.6(a)(1) or (b)(2)(v), as applicable, and § 226.7(a)(8) or (b)(8), as applicable, during which the consumer can pay the amount due under paragraph (g)(1) of this section without incurring additional finance or other charges;

(3) May report an account or amount as delinquent because the amount due under paragraph (g)(1) of this section remains unpaid after the creditor has allowed any time period disclosed under § 226.6(a)(1) or (b)(2)(v), as applicable, and § 226.7(a)(8) or (b)(8), as applicable or 10 days (whichever is longer) during which the consumer can pay the amount; but

(4) May not report that an amount or account is delinquent because the amount due under paragraph (g)(1) of the section remains unpaid, if the creditor receives (within the time allowed for payment in paragraph (g)(3) of this section) further written notice from the consumer that any portion of the billing error is still in dispute, unless the creditor also:

(i) Promptly reports that the amount or account is in dispute;

(ii) Mails or delivers to the consumer (at the same time the report is made) a written notice of the name and address of each person to whom the creditor makes a report; and

(iii) Promptly reports any subsequent resolution of the reported delinquency to all persons to whom the creditor has made a report.

(h) Reassertion of billing error. A creditor that has fully complied with the requirements of this section has no further responsibilities under this section (other than as provided in paragraph (g)(4) of this section) if a consumer reasserts substantially the same billing error.

(i) Relation to Electronic Fund Transfer Act and Regulation E. If an extension of credit is incident to an electronic fund transfer, under an agreement between a consumer and a financial institution to extend credit when the consumer's account is overdrawn or to maintain a specified minimum balance in the consumer's account, the creditor shall comply with the requirements of Regulation E, *12 CFR 205.11* governing error resolution rather than those of paragraphs (a), (b), (c), (e), (f), and (h) of this section.

FOOTNOTES:
(n34)Footnote 27. [Reserved].

(n35)Footnote 28. [Reserved].

(n36)Footnote 29. [Reserved].

(n37)Footnote 30. [Reserved].

(n38)Footnote 31. [Reserved].

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1B- Consumer Credit Law Manual § 226.14

§ **226.14 Determination of annual percentage rate.**

(a) General rule. The annual percentage rate is a measure of the cost of credit, expressed as a yearly rate. An annual percentage rate shall be considered accurate if it is not more than 1/8th of 1 percentage point above or below the annual percentage rate determined in accordance with this section. n31a An error in disclosure of the annual percentage rate or finance charge shall not, in itself, be considered a violation of this regulation if:

(1) The error resulted from a corresponding error in a calculation tool used in good faith by the creditor; and

(2) Upon discovery of the error, the creditor promptly discontinues use of that calculation tool for disclosure purposes, and notifies the Board in writing of the error in the calculation tool.

(b) Annual percentage rate--in general. Where one or more periodic rates may be used to compute the finance charge, the annual percentage rate(s) to be disclosed for purposes of §§ 226.5a, 226.5b, 226.6, 226.7(a)(4) or (b)(4), 226.9, 226.15, 226.16, 226.26, 226.55, and 226.56 shall be computed by multiplying each periodic rate by the number of periods in a year.

(c) Optional effective annual percentage rate for periodic statements for creditors offering open-end plans subject to the requirements of § 226.5b. A creditor offering an open-end plan subject to the requirements of § 226.5b need not disclose an effective annual percentage rate. Such a creditor may, at its option, disclose an effective annual percentage rate(s) pursuant to § 226.7(a)(7) and compute the effective annual percentage rate as follows:

(1) Solely periodic rates imposed. If the finance charge is determined solely by applying one or more periodic rates, at the creditor's option, either:

(i) By multiplying each periodic rate by the number of periods in a year; or

(ii) By dividing the total finance charge for the billing cycle by the sum of the balances to which the periodic rates were applied and multiplying the quotient (expressed as a percentage) by the number of billing cycles in a year.

(2) Minimum or fixed charge, but not transaction charge, imposed. If the finance charge imposed during the billing cycle is or includes a minimum, fixed, or other charge not due to the application of a periodic rate, other than a charge with respect to any specific transaction during the billing cycle, by dividing the total finance charge for the billing cycle by the amount of the balance(s) to which it is applicable n32 and multiplying the quotient (expressed as a percentage) by the number of billing cycles in a year. n33 If there is no balance to which the finance charge is applicable, an annual percentage rate cannot be determined under this section. Where the finance charge imposed during the billing cycle is or includes a loan fee, points, or similar charge that relates to opening, renewing, or continuing an account, the amount of such charge shall not be included in the calculation of the annual percentage rate.

(3) Transaction charge imposed. If the finance charge imposed during the billing cycle is or includes a charge relating to a specific transaction during the billing cycle (even if the total finance charge also includes any other minimum, fixed, or other charge not due to the application of a periodic rate), by dividing the total finance charge imposed during the billing cycle by the total of all balances and other amounts on which a finance charge was imposed during the billing cycle without duplication, and multiplying the quotient (expressed as a percentage) by the number of billing cycles in a year, n34 except that the annual percentage rate shall not be less than the largest rate determined by multiplying each periodic rate imposed during the billing cycle by the number of periods in a year. n35 Where the finance charge imposed during the billing cycle is or includes a loan fee, points, or similar charge that relates to the opening, renewing, or continuing an account, the amount of such charge shall not be included in the calculation of the annual percentage rate. See appendix F to this part regarding determination of the denominator of the fraction under this paragraph.

(4) If the finance charge imposed during the billing cycle is or includes a minimum, fixed, or other charge not due to the application of a periodic rate and the total finance charge imposed during the billing cycle does not exceed 50 cents for a monthly or longer billing cycle, or the pro rata part of 50 cents for a billing cycle shorter than monthly, at the creditor's option, by multiplying each applicable periodic rate by the number of periods in a year, notwithstanding the provisions of paragraphs (c)(2) and (c)(3) of this section.

(d) Calculations where daily periodic rate applied. If the provisions of paragraph (c)(1)(ii) or (c)(2) of this section apply and all or a portion of the finance charge is determined by the application of one or more daily periodic rates, the annual

percentage rate may be determined either:

(1) By dividing the total finance charge by the average of the daily balances and multiplying the quotient by the number of billing cycles in a year; or

(2) By dividing the total finance charge by the sum of the daily balances and multiplying the quotient by 365.

FOOTNOTES:
(n39)Footnote 31a. [Reserved].

(n40)Footnote 32. [Reserved].

(n41)Footnote 33. [Reserved].

(n42)Footnote 34. [Reserved].

(n43)Footnote 35. [Reserved].

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1B- Consumer Credit Law Manual § 226.15

§ **226.15 Right of rescission.**

(a) *Consumer's right to rescind.*

(1)

(i) Except as provided in paragraph (a)(1)(ii) of this section, in a credit plan in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind: each credit extension made under the plan; the plan when the plan is opened; a security interest when added or increased to secure an existing plan; and the increase when a credit limit on the plan is increased.

(ii) As provided in section 125(e) of the Act, the consumer does not have the right to rescind each credit extension made under the plan if such extension is made in accordance with a previously established credit limit for the plan.

(2) To exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram, or other means of written communication. Notice is considered given when mailed, or when filed for telegraphic transmission, or, if sent by other means, when delivered to the creditor's designated place of business.

(3) The consumer may exercise the right to rescind until midnight of the third business day following the occurrence described in paragraph (a)(1) of this section that gave rise to the right of rescission, delivery of the notice required by paragraph (b) of this section, or delivery of all material disclosures, n36 whichever occurs last. If the required notice and

material disclosures are not delivered, the right to rescind shall expire 3 years after the occurrence giving rise to the right of rescission, or upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first. In the case of certain administrative proceedings, the rescission period shall be extended in accordance with section 125(f) of the Act.

(4) When more than one consumer has the right to rescind, the exercise of the right by one consumer shall be effective as to all consumers.

(b) *Notice of right to rescind*. In any transaction or occurrence subject to rescission, a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind (one copy to each if the notice is delivered in electronic form in accordance with the consumer consent and other applicable provisions of the E-Sign Act). The notice shall identify the transaction or occurrence and clearly and conspicuously disclose the following:

(1) The retention or acquisition of a security interest in the consumer's principal dwelling.

(2) The consumer's right to rescind, as described in paragraph (a)(1) of this section.

(3) How to exercise the right to rescind, with a form for that purpose, designating the address of the creditor's place of business.

(4) The effects of rescission, as described in paragraph (d) of this section.

(5) The date the rescission period expires.

(c) *Delay of creditor's performance*. Unless a consumer waives the right to rescind under paragraph (e) of this section, no money shall be disbursed other than in escrow, no services shall be performed, and no materials delivered until after the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded. A creditor does not violate this section if a third party with no knowledge of the event activating the rescission right does not delay in providing materials or services, as long as the debt incurred for those materials or services is not secured by the property subject to rescission.

(d) *Effects of rescission*.

(1) When a consumer rescinds a transaction, the security interest giving rise to the right of rescission becomes void, and the consumer shall not be liable for any amount, including any finance charge.

(2) Within 20 calendar days after receipt of a notice of rescission, the creditor shall return any money or property that has been given to anyone in connection with the transaction and shall take any action necessary to reflect the termination of the security interest.

(3) If the creditor has delivered any money or property, the consumer may retain possession until the creditor has met its obligation under paragraph (d)(2) of this section. When the creditor has complied with that paragraph, the consumer shall tender the money or property to the creditor or, where the latter would be impracticable or inequitable, tender its reasonable value. At the consumer's option, tender of property may be made at the location of the property or at the consumer's residence. Tender of money must be made at the creditor's designated place of business. If the creditor does not take possession of the money or property within 20 calendar days after the consumer's tender, the consumer may keep it without further obligation.

(4) The procedures outlined in paragraphs (d)(2) and (3) of this section may be modified by court order.

(e) *Consumer's waiver of right to rescind.*

(1) The consumer may modify or waive the right to rescind if the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency. To modify or waive the right, the consumer shall give the creditor a dated written statement that describes the emergency, specifically modifies or waives the right to rescind, and bears the signature of all the consumers entitled to rescind. Printed forms for this purpose are prohibited, except as provided in paragraph (e)(2) of this section.

(2) The need of the consumer to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during June through September 1993, pursuant to *42 U.S.C. 5170*, to be a major disaster area because of severe storms and flooding in the Midwest. n36a In this instance, creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(3) The consumer's need to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during June through September 1994 to be a major disaster area, pursuant to *42 U.S.C. 5170*, because of severe storms and flooding in the South. n36b In this instance, creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(4) The consumer's need to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during October 1994 to be a major disaster area, pursuant to *42 U.S.C. 5170*, because of severe storms and flooding in Texas. n36c In this instance, creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(f) *Exempt transactions*. The right to rescind does not apply to the following:

(1) A residential mortgage transaction.

(2) A credit plan in which a state agency is a creditor.

FOOTNOTES:

(n44)Footnote 36. The term "material disclosures" means the information that must be provided to satisfy the requirements in section 226.6 with regard to the method of determining the finance charge and the balance upon which a finance charge will be imposed, the annual percentage rate, the amount or method of determining the amount of any membership or participation fee that may be imposed as part of the plan, and the payment information described in § 226.5b(d)(5)(i) and (ii) that is required under § 226.6(e)(2).

(n45)Footnote 36a. A list of the affected areas will be maintained by the Board.

(n46)Footnote 36b. A list of the affected areas will be maintained and published by the Board. Such areas now include parts of Alabama, Florida, and Georgia.

(n47)Footnote 36c. A list of the affected areas will be maintained and published by the Board. Such areas now include the following counties in Texas: Angelina, Austin, Bastrop, Brazos, Brazoria, Burleson, Chambers, Fayette, Fort Bend, Galveston, Grimes, Hardin, Harris, Houston, Jackson, Jasper, Jefferson, Lee, Liberty, Madison, Matagorda, Montgomery, Nacagdoches, Orange, Polk, San Augustine, San Jacinto, Shelby, Trinity, Victoria, Washington, Waller, Walker, and Wharton.

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1B- Consumer Credit Law Manual § 226.16

§ **226.16 Advertising.**

(a) Actually available terms. If an advertisement for credit states specific credit terms, it shall state only those terms that actually are or will be arranged or offered by the creditor.

(b) Advertisement of terms that require additional disclosures.

(1) Any term required to be disclosed under § 226.6(b)(3) set forth affirmatively or negatively in an advertisement for an open-end (not home-secured) credit plan triggers additional disclosures under this section. Any term required to be disclosed under § 226.6(a)(1) or (a)(2) set forth affirmatively or negatively in an advertisement for a home-equity plan subject to the requirements of § 226.5b triggers additional disclosures under this section. If any of the terms that trigger additional disclosures under this paragraph is set forth in an advertisement, the advertisement shall also clearly and conspicuously set forth the following: n36d

(i) Any minimum, fixed, transaction, activity or similar charge that is a finance charge under § 226.4 that could be imposed.

(ii) Any periodic rate that may be applied expressed as an annual percentage rate as determined under § 226.14(b). If the plan provides for a variable periodic rate, that fact shall be disclosed.

(iii) Any membership or participation fee that could be imposed.

(2) If an advertisement for credit to finance the purchase of goods or services specified in the advertisement states a periodic payment amount, the advertisement shall also state the total of payments and the time period to repay the obligation, assuming that the consumer pays only the periodic payment amount advertised. The disclosure of the total of payments and the time period to repay the obligation must be equally prominent to the statement of the periodic payment amount.

(c) Catalogs or other multiple-page advertisements; electronic advertisements.

(1) If a catalog or other multiple-page advertisement, or an electronic advertisement (such as an advertisement appearing on an Internet Web site), gives information in a table or schedule in sufficient detail to permit determination of the disclosures required by paragraph (b) of this section, it shall be considered a single advertisement if:

(i) The table or schedule is clearly and conspicuously set forth; and

(ii) Any statement of terms set forth in § 226.6 appearing anywhere else in the catalog or advertisement clearly refers to the page or location where the table or schedule begins.

(2) A catalog or other multiple-page advertisement or an electronic advertisement (such as an advertisement appearing on an Internet Web site) complies with this paragraph if the table or schedule of terms includes all appropriate disclosures for a representative scale of amounts up to the level of the more commonly sold higher-priced property or services offered.

(d) Additional requirements for home-equity plans.

(1) Advertisement of terms that require additional disclosures. If any of the terms required to be disclosed under § 226.6(a)(1) or (a)(2) or the payment terms of the plan are set forth, affirmatively or negatively, in an advertisement for a home-equity plan subject to the requirements of § 226.5b, the advertisement also shall clearly and conspicuously set forth the following:

(i) Any loan fee that is a percentage of the credit limit under the plan and an estimate of any other fees imposed for opening the plan, stated as a single dollar amount or a reasonable range.

(ii) Any periodic rate used to compute the finance charge, expressed as an annual percentage rate as determined under § 226.14(b).

(iii) The maximum annual percentage rate that may be imposed in a variable-rate plan.

(2) Discounted and premium rates. If an advertisement states an initial annual percentage rate that is not based on the index and margin used to make later rate adjustments in a variable-rate plan, the advertisement also shall state with equal prominence and in close proximity to the initial rate:

(i) The period of time such initial rate will be in effect; and

(ii) A reasonably current annual percentage rate that would have been in effect using the index and margin.

(3) Balloon payment. If an advertisement contains a statement of any minimum periodic payment and a balloon payment may result if only the minimum periodic payments are made, even if such a payment is uncertain or unlikely, the advertisement also shall state with equal prominence and in close proximity to the minimum periodic payment statement that a balloon payment may result, if applicable. n36e A balloon payment results if paying the minimum periodic payments does not fully amortize the outstanding balance by a specified date or time, and the consumer is required to repay the entire outstanding balance at such time. If a balloon payment will occur when the consumer makes only the minimum payments required under the plan, an advertisement for such a program which contains any statement of any minimum periodic payment shall also state with equal prominence and in close proximity to the minimum periodic payment statement:

(i) That a balloon payment will result; and

(ii) The amount and timing of the balloon payment that will result if the consumer makes only the minimum payments for the maximum period of time that the consumer is permitted to make such payments.

(4) Tax implications. An advertisement that states that any interest expense incurred under the home-equity plan is or may be tax deductible may not be misleading in this regard. If an advertisement distributed in paper form or through the Internet (rather than by radio or television) is for a home-equity plan secured by the consumer's principal dwelling, and the advertisement states that the advertised extension of credit may exceed the fair market value of the dwelling, the advertisement shall clearly and conspicuously state that:

(i) The interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes; and

(ii) The consumer should consult a tax adviser for further information regarding the deductibility of interest and charges.

(5) Misleading terms. An advertisement may not refer to a home-equity plan as "free money" or contain a similarly misleading term.

(6) Promotional rates and payments.

(i) Definitions. The following definitions apply for purposes of paragraph (d)(6) of this section:

(A) Promotional rate. The term "promotional rate" means, in a variable-rate plan, any annual percentage rate that is not based on the index and margin that will be used to make rate adjustments under the plan, if that rate is less than a reasonably current annual percentage rate that would be in effect under the index and margin that will be used to make rate adjustments under the plan.

(B) Promotional payment. The term "promotional payment" means:

(1) For a variable-rate plan, any minimum payment applicable for a promotional period that:

(i) Is not derived by applying the index and margin to the outstanding balance when such index and margin will be used to determine other minimum payments under the plan; and

(ii) Is less than other minimum payments under the plan derived by applying a reasonably current index and margin that will be used to determine the amount of such payments, given an assumed balance.

(2) For a plan other than a variable-rate plan, any minimum payment applicable for a promotional period if that payment is less than other payments required under the plan given an assumed balance.

(C) Promotional period. A "promotional period" means a period of time, less than the full term of the loan, that the promotional rate or promotional payment may be applicable.

(ii) Stating the promotional period and post-promotional rate or payments. If any annual percentage rate that may be applied to a plan is a promotional rate, or if any payment applicable to a plan is a promotional payment, the following must be disclosed in any advertisement, other than television or radio advertisements, in a clear and conspicuous manner with equal prominence and in close proximity to each listing of the promotional rate or payment:

(A) The period of time during which the promotional rate or promotional payment will apply;

(B) In the case of a promotional rate, any annual percentage rate that will apply under the plan. If such rate is variable, the annual percentage rate must be disclosed in accordance with the accuracy standards in §§ 226.5b or 226.16(b)(1)(ii) as applicable; and

(C) In the case of a promotional payment, the amounts and time periods of any payments that will apply under the plan. In variable-rate transactions, payments that will be determined based on application of an index and margin shall be disclosed based on a reasonably current index and margin.

(iii) Envelope excluded. The requirements in paragraph (d)(6)(ii) of this section do not apply to an envelope in which an application or solicitation is mailed, or to a banner advertisement or pop-up advertisement linked to an application or solicitation provided electronically.

(e) Alternative disclosures--television or radio advertisements. An advertisement made through television or radio stating any of the terms requiring additional disclosures under paragraphs (b)(1) or (d)(1) of this section may alternatively comply with paragraphs (b)(1) or (d)(1) of this section by stating the information required by paragraphs (b)(1)(ii) or (d)(1)(ii) of this section, as applicable, and listing a toll-free telephone number, or any telephone number that allows a consumer to reverse the phone charges when calling for information, along with a reference that such number may be used by consumers to obtain the additional cost information.

(f) Misleading terms. An advertisement may not refer to an annual percentage rate as "fixed," or use a similar term, unless the advertisement also specifies a time period that the rate will be fixed and the rate will not increase during that period, or if no such time period is provided, the rate will not increase while the plan is open.

(g) Promotional rates.

(1) Scope. The requirements of this paragraph apply to any advertisement of an open-end (not home-secured) plan, including promotional materials accompanying applications or solicitations subject to § 226.5a(c) or accompanying applications or solicitations subject to § 226.5a(e).

(2) Definitions.

(i) Promotional rate means any annual percentage rate applicable to one or more balances or transactions on an open-end (not home-secured) plan for a specified period of time that is lower than the annual percentage rate that will be in effect at the end of that period on such balances or transactions.

(ii) Introductory rate means a promotional rate offered in connection with the opening of an account.

(iii) Promotional period means the maximum time period for which the promotional rate may be applicable.

(3) Stating the term "introductory". If any annual percentage rate that may be applied to the account is an introductory rate, the term introductory or intro must be in immediate proximity to each listing of the introductory rate in a written or electronic advertisement.

(4) Stating the promotional period and post-promotional rate. If any annual percentage rate that may be applied to the account is a promotional rate under paragraph (g)(2)(i) of this section, the information in paragraphs (g)(4)(i) and (g)(4)(ii) of this section must be stated in a clear and conspicuous manner in the advertisement. If the rate is stated in a written or electronic advertisement, the information in paragraphs (g)(4)(i) and (g)(4)(ii) of this section must also be stated in a prominent location closely proximate to the first listing of the promotional rate.

(i) When the promotional rate will end; and

(ii) The annual percentage rate that will apply after the end of the promotional period. If such rate is variable, the annual percentage rate must comply with the accuracy standards in §§ 226.5a(c)(2), 226.5a(d)(3), 226.5a(e)(4), or 226.16(b)(1)(ii), as applicable. If such rate cannot be determined at the time disclosures are given because the rate depends at least in part on a later determination of the consumer's creditworthiness, the advertisement must disclose the specific rates or the range of rates that might apply.

(5) Envelope excluded. The requirements in paragraph (g)(4) of this section do not apply to an envelope or other enclosure in which an application or solicitation is mailed, or to a banner advertisement or pop-up advertisement, linked to an application or solicitation provided electronically.

(h) Deferred interest or similar offers.

(1) Scope. The requirements of this paragraph apply to any advertisement of an open-end credit plan not subject to § 226.5b, including promotional materials accompanying applications or solicitations subject to § 226.5a(c) or accompanying applications or solicitations subject to § 226.5a(e).

(2) Definitions. "Deferred interest" means finance charges, accrued on balances or transactions, that a consumer is not obligated to pay or that will be waived or refunded to a consumer if those balances or transactions are paid in full by a specified date. The maximum period from the date the consumer becomes obligated for the balance or transaction until the specified date by which the consumer must pay the balance or transaction in full in order to avoid finance charges, or receive a waiver or refund of finance charges, is the "deferred interest period." "Deferred interest" does not include any finance charges the consumer avoids paying in connection with any recurring grace period.

(3) Stating the deferred interest period. If a deferred interest offer is advertised, the deferred interest period must be stated in a clear and conspicuous manner in the advertisement. If the phrase "no interest" or similar term regarding the possible avoidance of interest obligations under the deferred interest program is stated, the term "if paid in full" must also be stated in a clear and conspicuous manner preceding the disclosure of the deferred interest period in the advertisement. If the deferred interest offer is included in a written or electronic advertisement, the deferred interest period and, if applicable, the term "if paid in full" must also be stated in immediate proximity to each statement of "no interest," "no payments," "deferred interest," "same as cash," or similar term regarding interest or payments during the deferred interest period.

(4) Stating the terms of the deferred interest or similar offer. If any deferred interest offer is advertised, the information in paragraphs (h)(4)(i) and (h)(4)(ii) of this section must be stated in the advertisement, in language similar to Sample G-24 in Appendix G to this part. If the deferred interest offer is included in a written or electronic advertisement, the information in paragraphs (h)(4)(i) and (h)(4)(ii) of this section must also be stated in a prominent location closely proximate to the first statement of "no interest," "no payments," "deferred interest," "same as cash," or similar term regarding interest or payments during the deferred interest period.

(i) A statement that interest will be charged from the date the consumer becomes obligated for the balance or transaction subject to the deferred interest offer if the balance or transaction is not paid in full within the deferred interest period; and

(ii) A statement, if applicable, that interest will be charged from the date the consumer incurs the balance or transaction subject to the deferred interest offer if the account is in default before the end of the deferred interest period.

(5) Envelope excluded. The requirements in paragraph (h)(4) of this section do not apply to an envelope or other enclosure in which an application or solicitation is mailed, or to a banner advertisement or pop-up advertisement linked to an application or solicitation provided electronically.

FOOTNOTES:
(n48)Footnote 36d. [Reserved].

(n49)Footnote 36e. [Reserved].

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1B- Consumer Credit Law Manual § 226.17

§ **226.17 General disclosure requirements.**

(a) *Form of disclosures*.

(1) The creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep. The disclosures required by this subpart may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (*15 U.S.C. 7001 et seq.*). The disclosures required by §§ 226.17(g), 226.19(b), and 226.24 may be provided to the consumer in electronic form without regard to the consumer consent or other provisions of the E-Sign Act in the circumstances set forth in those sections. The disclosures shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related n37 to the disclosures required under § 226.18. n38 The itemization of the amount financed under § 226.18(c)(1) must be separate from the other disclosures under that section.

(2) The terms "finance charge" and "annual percentage rate," when required to be disclosed under § 226.18 (d) and (e) together with a corresponding amount or percentage rate, shall be more conspicuous than any other disclosure, except the creditor's identity under § 226.18(a).

(b) *Time of disclosures*. The creditor shall make disclosures before consummation of the transaction. In certain mortgage transactions, special timing requirements are set forth in § 226.19(a). In certain variable-rate transactions, special timing requirements for variable-rate disclosures are set forth in § 226.19(b) and § 226.20(c). In certain transactions involving mail or telephone orders or a series of sales, the timing of the disclosures may be delayed in accordance with paragraphs (g) and (h) of this section.

(c) *Basis of disclosures and use of estimates.*

(1) The disclosures shall reflect the terms of the legal obligation between the parties.

(2)

(i) If any information necessary for an accurate disclosure is unknown to the creditor, the creditor shall make the disclosure based on the best information reasonably available at the time the disclosure is provided to the consumer, and shall state clearly that the disclosure is an estimate.

(ii) For a transaction in which a portion of the interest is determined on a per-diem basis and collected at consummation, any disclosure affected by the per-diem interest shall be considered accurate if the disclosure is based on the information known to the creditor at the time that the disclosure documents are prepared for consummation of the transaction.

(3) The creditor may disregard the effects of the following in making calculations and disclosures.

(i) The payments must be collected in whole cents.

(ii) That dates of scheduled payments and advances may be changed because the scheduled date is not a business day.

(iii) That months have different numbers of days.

(iv) The occurrence of leap year.

(4) In making calculations and disclosures, the creditor may disregard any irregularity in the first period that falls within the limits described below and any payment schedule irregularity that results from the irregular first period:

(i) For transactions in which the term is less than 1 year, a first period not more than 6 days shorter or 13 days

longer than a regular period;

(ii) For transactions in which the term is at least 1 year and less than 10 years, a first period not more than 11 days shorter or 21 days longer than a regular period; and

(iii) For transactions in which the term is at least 10 years, a first period shorter than or not more than 32 days longer than a regular period.

(5) If an obligation is payable on demand, the creditor shall make the disclosures based on an assumed maturity of 1 year. If an alternate maturity date is stated in the legal obligation between the parties, the disclosures shall be based on that date.

(6)

(i) A series of advances under an agreement to extend credit up to a certain amount may be considered as one transaction.

(ii) When a multiple-advance loan to finance the construction of a dwelling may be permanently financed by the same creditor, the construction phase and the permanent phase may be treated as either one transaction or more than one transaction.

(d) *Multiple creditors; multiple consumers*. If a transaction involves more than one creditor, only one set of disclosures shall be given and the creditors shall agree among themselves which creditor must comply with the requirements that this regulation imposes on any or all of them. If there is more than one consumer, the disclosures may be made to any consumer who is primarily liable on the obligation. If the transaction is rescindable under § 226.23, however, the disclosures shall be made to each consumer who has the right to rescind.

(e) *Effect of subsequent events*. If a disclosure becomes inaccurate because of an event that occurs after the creditor delivers the required disclosures, the inaccuracy is not a violation of this regulation, although new disclosures may be required under paragraph (f) of this section, § 226.19, or § 226.20.

(f) *Early disclosures*. If disclosures required by this subpart are given before the date of consummation of a transaction and a subsequent event makes them inaccurate, the creditor shall disclose before consummation (subject to the provisions of § 226.19(a)(2) and § 226.19(a)(5)(iii)): n39

(1) Any changed term unless the term was based on an estimate in accordance with § 226.17(c)(2) and was labelled an estimate;

(2) All changed terms, if the annual percentage rate at the time of consummation varies from the annual percentage rate disclosed earlier by more than 1/8 of 1 percentage point in a regular transaction, or more than 1/4 of 1 percentage point in an irregular transaction, as defined in § 226.22(a).

(g) *Mail or telephone orders--delay in disclosures*. If a creditor receives a purchase order or a request for an extension of credit by mail, telephone, or facsimile machine without face-to-face or direct telephone solicitation, the creditor may delay the disclosures until the due date of the first payment, if the following information for representative amounts or ranges of credit is made available in written form or in electronic form to the consumer or to the public before the actual purchase order or request:

(1) The cash price or the principal loan amount.

(2) The total sale price.

(3) The finance charge.

(4) The annual percentage rate, and if the rate may increase after consummation, the following disclosures:

(i) The circumstances under which the rate may increase.

(ii) Any limitations on the increase.

(iii) The effect of an increase.

(5) The terms of repayment.

(h) *Series of sales--delay in disclosures*. If a credit sale is one of a series made under an agreement providing that subsequent sales may be added to an outstanding balance, the creditor may delay the required disclosures until the due date of the first payment for the current sale, if the following two conditions are met:

(1) The consumer has approved in writing the annual percentage rate or rates, the range of balances to which they apply, and the method of treating any unearned finance charge on an existing balance.

(2) The creditor retains no security interest in any property after the creditor has received payments equal to the cash price and any finance charge attributable to the sale of that property. For purposes of this provision, in the case of items purchased on different dates, the first purchased is deemed the first item paid for; in the case of items purchased on the same date, the lowest priced is deemed the first item paid for.

(i) *Interim student credit extensions*. For each transaction involving an interim credit extension under a student credit program, the creditor need not make the following disclosures: the finance charge under § 226.18(d), the payment schedule under § 226.18(g), the total of payments under § 226.18(h), or the total sale price under § 226.18(j).

FOOTNOTES:

(n50)Footnote 37. The disclosures may include an acknowledgment of receipt, the date of the transaction, and the consumer's name, address, and account number.

(n51)Footnote 38. The following disclosures may be made together with or separately from other required disclosures: the creditor's identity under § 226.18(a), the variable rate example under § 226.18(f)(1)(iv), insurance or debt cancellation under § 226.18(n), and certain security interest charges under § 226.18(o).

(n52)Footnote 39. [Reserved.]

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1B- Consumer Credit Law Manual § 226.18

§ **226.18 Content of disclosures.**

For each transaction, the creditor shall disclose the following information as applicable:

(a) *Creditor*. The identity of the creditor making the disclosures.

(b) *Amount financed*. The "amount financed," using that term, and a brief description such as "the amount of credit provided to you or on your behalf." The amount financed is calculated by:

(1) Determining the principal loan amount or the cash price (subtracting any downpayment);

(2) Adding any other amounts that are financed by the creditor and are not part of the finance charge; and

(3) Subtracting any prepaid finance charge.

(c) *Itemization of amount financed*.

(1) A separate written itemization of the amount financed, including: n40

(i) The amount of any proceeds distributed directly to the consumer.

(ii) The amount credited to the consumer's account with the creditor.

(iii) Any amounts paid to other persons by the creditor on the consumer's behalf. The creditor shall identify those persons. n41

(iv) The prepaid finance charge.

(2) The creditor need not comply with paragraph (c)(1) of this section if the creditor provides a statement that the consumer has the right to receive a written itemization of the amount financed, together with a space for the consumer to indicate whether it is desired, and the consumer does not request it.

(d) *Finance charge*. The *finance charge*, using that term, and a brief description such as "the dollar amount the credit will cost you."

(1) *Mortgage loans*. In a transaction secured by real property or a dwelling, the disclosed finance charge and other disclosures affected by the disclosed finance charge (including the amount financed and the annual percentage rate) shall be treated as accurate if the amount disclosed as the finance charge:

(i) is understated by no more than $100; or

(ii) is greater than the amount required to be disclosed.

(2) *Other credit*. In any other transaction, the amount disclosed as the finance charge shall be treated as accurate if, in a transaction involving an amount financed of $1,000 or less, it is not more than $5 above or below the amount required to be disclosed; or, in a transaction involving an amount financed of more than $1,000, it is not more than $10 above or below the amount required to be disclosed.

(e) *Annual percentage rate*. The "annual percentage rate," using that term, and a brief description such as "the cost of your credit as a yearly rate." n42

(f) *Variable rate*.

(1) If the annual percentage rate may increase after consummation in a transaction not secured by the consumer's principal dwelling or in a transaction secured by the consumer's principal dwelling with a term of one year or less, the following disclosures: n43

(i) The circumstances under which the rate may increase.

(ii) Any limitations on the increase.

(iii) The effect of an increase.

(iv) An example of the payment terms that would result from an increase.

(2) If the annual percentage rate may increase after consummation in a transaction secured by the consumer's principal dwelling with a term greater than one year, the following disclosures:

(i) The fact that the transaction contains a variable-rate feature.

(ii) A statement that variable-rate disclosures have been provided earlier.

(g) *Payment schedule*. The number, amounts, and timing of payments scheduled to repay the obligation.

(1) In a demand obligation with no alternate maturity date, the creditor may comply with this paragraph by disclosing the due dates or payment periods of any scheduled interest payments for the first year.

(2) In a transaction in which a series of payments varies because a finance charge is applied to the unpaid principal balance, the creditor may comply with this paragraph by disclosing the following information:

(i) The dollar amounts of the largest and smallest payments in the series.

(ii) A reference to the variations in the other payments in the series.

(h) *Total of payments*. The "total of payments," using that term, and a descriptive explanation such as "the amount you will have paid when you have made all scheduled payments." n44

(i) *Demand feature*. If the obligation has a demand feature, that fact shall be disclosed. When the disclosures are based on an assumed maturity of 1 year as provided in § 226.17(c)(5), that fact shall also be disclosed.

(j) *Total sale price*. In a credit sale, the "total sale price," using that term, and a descriptive explanation (including the amount of any downpayment) such as "the total price of your purchase on credit, including your downpayment of $_____." The total sale price is the sum of the cash price, the items described in paragraph (b)(2), and the finance charge disclosed under paragraph (d) of this section.

(k) *Prepayment*.

(1) When an obligation includes a finance charge computed from time to time by application of a rate to the unpaid principal balance, a statement indicating whether or not a penalty may be imposed if the obligation is prepaid in full.

(2) When an obligation includes a finance charge other than the finance charge described in paragraph (k)(1) of this section, a statement indicating whether or not the consumer is entitled to a rebate of any finance charge if the obligation is prepaid in full.

(l) *Late payment*. Any dollar or percentage charge that may be imposed before maturity due to a late payment, other than a deferral or extension charge.

(m) *Security interest*. The fact that the creditor has or will acquire a security interest in the property purchased as part of the transaction, or in other property identified by item or type.

(n) *Insurance and debt cancellation*. The items required by § 226.4(d) in order to exclude certain insurance premiums and debt cancellation fees from the finance charge.

(o) *Certain security interest charges*. The disclosures required by § 226.4(e) in order to exclude from the finance charge certain fees prescribed by law or certain premiums for insurance in lieu of perfecting a security interest.

(p) *Contract reference*. A statement that the consumer should refer to the appropriate contract document for information about nonpayment, default, the right to accelerate the maturity of the obligation, and prepayment rebates and penalties. At the creditor's option, the statement may also include a reference to the contract for further information about security interests and, in a residential mortgage transaction, about the creditor's policy regarding assumption of the obligation.

(q) *Assumption policy*. In a residential mortgage transaction, a statement whether or not a subsequent purchaser of the dwelling from the consumer may be permitted to assume the remaining obligation on its original terms.

(r) *Required deposit*. If the creditor requires the consumer to maintain a deposit as a condition of the specific transaction, a statement that the annual percentage rate does not reflect the effect of the required deposit. n45

FOOTNOTES:

(n53)Footnote 40. Good faith estimates of settlement costs provided for transactions subject to the Real Estate Settlement Procedures Act (*12 U.S.C. 2601 et seq.*) may be substituted for the disclosures required by paragraph (c) of this section.

(n54)Footnote 41. The following payees may be described using generic or other general terms and need not be further identified: public officials or government agencies, credit reporting agencies, appraisers, and insurance companies.

(n55)Footnote 42. For any transaction involving a finance charge of $5 or less on an amount financed of $75 or less, or a finance charge of $7.50 or less on an amount financed of more than $75, the creditor need not disclose the annual percentage rate.

(n56)Footnote 43. Information provided in accordance with §§ 226.18(f)(2) and 226.19(b) may be substituted for the disclosures required by paragraph (f)(1) of this section.

(n57)Footnote 44. In any transaction involving a single payment, the creditor need not disclose the total of payments.

(n58)Footnote 45. A required deposit need not include, for example: (1) an escrow account for items such as taxes, insurance or repairs; (2) a deposit that earns not less than 5 percent per year; or (3) payments under a Morris Plan.

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1B- Consumer Credit Law Manual § 226.19

§ 226.19 Certain mortgage and variable-rate transactions. [Effective Oct. 1, 2009.]

(a) Mortgage transactions subject to RESPA--

(1)

(i) Time of disclosures. In a mortgage transaction subject to the Real Estate Settlement Procedures Act (*12 U.S.C. 2601 et seq.*) that is secured by the consumer's dwelling, other than a home equity line of credit subject to § 226.5b or mortgage transaction subject to paragraph (a)(5) of this section, the creditor shall make good faith estimates of the disclosures required by § 226.18 and shall deliver or place them in the mail not later than the third business day after the creditor receives the consumer's written application.

(ii) Imposition of fees. Except as provided in paragraph (a)(1)(iii) of this section, neither a creditor nor any other person may impose a fee on a consumer in connection with the consumer's application for a mortgage transaction subject to paragraph (a)(1)(i) of this section before the consumer has received the disclosures required by paragraph (a)(1)(i) of this section. If the disclosures are mailed to the consumer, the consumer is considered to have received them three business days after they are mailed.

(iii) Exception to fee restriction. A creditor or other person may impose a fee for obtaining the consumer's credit history before the consumer has received the disclosures required by paragraph (a)(1)(i) of this section, provided the fee is bona fide and reasonable in amount.

(2) Waiting periods for early disclosures and corrected disclosures.

(i) The creditor shall deliver or place in the mail the good faith estimates required by paragraph (a)(1)(i) of this section not later than the seventh business day before consummation of the transaction.

(ii) If the annual percentage rate disclosed under paragraph (a)(1)(i) of this section becomes inaccurate, as defined in § 226.22, the creditor shall provide corrected disclosures with all changed terms. The consumer must receive the corrected disclosures no later than three business days before consummation. If the corrected disclosures are mailed to the consumer or delivered to the consumer by means other than delivery in person, the consumer is deemed to have received the corrected disclosures three business days after they are mailed or delivered.

(3) Consumer's waiver of waiting period before consummation. If the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency, the consumer may modify or waive the seven-business-day waiting period or the three-business-day waiting period required by paragraph (a)(2) of this section, after receiving the disclosures required by § 226.18. To modify or waive a waiting period, the consumer shall give the creditor a dated written statement that describes the emergency, specifically modifies or waives the waiting period, and bears the signature of all the consumers who are primarily liable on the legal obligation. Printed forms for this purpose are prohibited.

(4) Notice. Disclosures made pursuant to paragraph (a)(1) or paragraph (a)(2) of this section shall contain the following statement: "You are not required to complete this agreement merely because you have received these disclosures or signed a loan application." The disclosure required by this paragraph shall be grouped together with the disclosures required by paragraphs (a)(1) or (a)(2) of this section.

(5) Timeshare plans. In a mortgage transaction subject to the Real Estate Settlement Procedures Act (*12 U.S.C. 2601 et seq.*) that is secured by a consumer's interest in a timeshare plan described in *11 U.S.C. 101*(53(D)):

(i) The requirements of paragraphs (a)(1) through (a)(4) of this section do not apply;

(ii) The creditor shall make good faith estimates of the disclosures required by § 226.18 before consummation, or shall deliver or place them in the mail not later than three business days after the creditor receives the consumer's written application, whichever is earlier; and

(iii) If the annual percentage rate at the time of consummation varies from the annual percentage rate disclosed under paragraph (a)(5)(ii) of this section by more than 1/8 of 1 percentage point in a regular transaction or more than 1/4

of 1 percentage point in an irregular transaction, as defined in § 226.22, the creditor shall disclose all the changed terms no later than consummation or settlement.

(b) Certain variable-rate transactions. n45a If the annual percentage rate may increase after consummation in a transaction secured by the consumer's principal dwelling with a term greater than one year, the following disclosures must be provided at the time an application form is provided or before the consumer pays a non-refundable fee, whichever is earlier: n45b

(1) The booklet titled Consumer Handbook on Adjustable Rate Mortgages published by the Board and the Federal Home Loan Bank Board, or a suitable substitute.

(2) A loan program disclosure for each variable-rate program in which the consumer expresses an interest. The following disclosures, as applicable, shall be provided:

(i) The fact that the interest rate, payment, or term of the loan can change.

(ii) The index or formula used in making adjustments, and a source of information about the index or formula.

(iii) An explanation of how the interest rate and payment will be determined, including an explanation of how the index is adjusted, such as by the addition of a margin.

(iv) A statement that the consumer should ask about the current margin value and current interest rate.

(v) The fact that the interest rate will be discounted, and a statement that the consumer should ask about the amount of the interest rate discount.

(vi) The frequency of interest rate and payment changes.

(vii) Any rules relating to changes in the index, interest rate, payment amount, and outstanding loan balance including, for example, an explanation of interest rate or payment limitations, negative amortization, and interest rate carryover.

(viii) At the option of the creditor, either of the following:

(A) A historical example, based on a $10,000 loan amount, illustrating how payments and the loan balance would have been affected by interest rate changes implemented according to the terms of the loan program disclosure. The example shall reflect the most recent 15 years of index values. The example shall reflect all significant loan program terms, such as negative amortization, interest rate carryover, interest rate discounts, and interest rate and payment limitations, that would have been affected by the index movement during the period.

(B) The maximum interest rate and payment for a $10,000 loan originated at the initial interest rate (index value plus margin, adjusted by the amount of any discount or premium) in effect as of an identified month and year for the loan program disclosure assuming the maximum periodic increases in rates and payments under the program; and the initial interest rate and payment for that loan and a statement that the periodic payment may increase or decrease substantially depending on changes in the rate.

(ix) An explanation of how the consumer may calculate the payments for the loan amount to be borrowed based on either:

(A) The most recent payment shown in the historical example in paragraph (b)(2)(viii)(A) of this section; or

(B) The initial interest rate used to calculate the maximum interest rate and payment in paragraph (b)(2)(viii)(B) of this section.

(x) The fact that the loan program contains a demand feature.

(xi) The type of information that will be provided in notices of adjustments and the timing of such notices.

(xii) A statement that disclosure forms are available for the creditor's other variable-rate loan programs.

(c) Electronic disclosures. For an application that is accessed by the consumer in electronic form, the disclosures required by paragraph (b) of this section may be provided to the consumer in electronic form on or with the application.

FOOTNOTES:

(n59)Footnote 45a. Information provided in accordance with variable-rate regulations of other federal agencies may be substituted for the disclosures required by paragraph (b) of this section.

(n60)Footnote 45b. Disclosures may be delivered or placed in the mail not later than three business days following receipt of a consumer's application when the application reaches the creditor by telephone, or through an intermediary agent or broker.

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1B- Consumer Credit Law Manual § 226.20

§ 226.20 Subsequent disclosure requirements.

(a) *Refinancings*. A refinancing occurs when an existing obligation that was subject to this subpart is satisfied and replaced by a new obligation undertaken by the same consumer. A refinancing is a new transaction requiring new disclosures to the consumer. The new finance charge shall include any unearned portion of the old finance charge that is not credited to the existing obligation. The following shall not be treated as a refinancing:

(1) A renewal of a single payment obligation with no change in the original terms.

(2) A reduction in the annual percentage rate with a corresponding change in the payment schedule.

(3) An agreement involving a court proceeding.

(4) A change in the payment schedule or a change in collateral requirements as a result of the consumer's default or delinquency, unless the rate is increased, or the new amount financed exceeds the unpaid balance plus earned finance charge and premiums for continuation of insurance of the types described in § 226.4(d).

(5) The renewal of optional insurance purchased by the consumer and added to an existing transaction, if disclosures relating to the initial purchase were provided as required by this subpart.

(b) *Assumptions*. An assumption occurs when a creditor expressly agrees in writing with a subsequent consumer to accept that consumer as a primary obligor on an existing residential mortgage transaction. Before the assumption occurs, the creditor shall make new disclosures to the subsequent consumer, based on the remaining obligation. If the finance charge originally imposed on the existing obligation was an add-on or discount finance charge, the creditor need only disclose:

(1) The unpaid balance of the obligation assumed.

(2) The total charges imposed by the creditor in connection with the assumption.

(3) The information required to be disclosed under § 226.18(k), (l), (m), and (n).

(4) The annual percentage rate originally imposed on the obligation.

(5) The payment schedule under § 226.18(g) and the total of payments under § 226.18(h) based on the remaining obligation.

(c) *Variable-rate adjustments*. n45c An adjustment to the interest rate with or without a corresponding adjustment to the payment in a variable-rate transaction subject to § 226.19(b) is an event requiring new disclosures to the consumer. At least once each year during which an interest rate adjustment is implemented without an accompanying payment change, and at least 25, but no more than 120, calendar days before a payment at a new level is due, the following disclosures, as applicable, must be delivered or placed in the mail:

(1) The current and prior interest rates.

(2) The index values upon which the current and prior interest rates are based.

(3) The extent to which the creditor has foregone any increase in the interest rate.

(4) The contractual effects of the adjustment, including the payment due after the adjustment is made, and a statement

of the loan balance.

(5) The payment, if different from that referred to in paragraph (c)(4) of this section, that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term.

FOOTNOTES:
(n61)Footnote 45c. Information provided in accordance with variable-rate subsequent disclosure regulations of other federal agencies may be substituted for the disclosure required by paragraph (c) of this section.

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1B- Consumer Credit Law Manual § 226.21

§ **226.21 Treatment of credit balances.**

When a credit balance in excess of $1 is created in connection with a transaction (through transmittal of funds to a creditor in excess of the total balance due on an account, through rebates of unearned finance charges or insurance premiums, or through amounts otherwise owed to or held for the benefit of a consumer), the creditor shall:

(a) Credit the amount of the credit balance to the consumer's account;

(b) Refund any part of the remaining credit balance, upon the written request of the consumer; and

(c) Make a good faith effort to refund to the consumer by cash, check, or money order, or credit to a deposit account of the consumer, any part of the credit balance remaining in the account for more than 6 months, except that no further action is required if the consumer's current location is not known to the creditor and cannot be traced through the consumer's last known address or telephone number.

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1B- Consumer Credit Law Manual § 226.22

§ **226.22 Determination of annual percentage rate.**

(a) *Accuracy of annual percentage rate*.

(1) The annual percentage rate is a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the consumer to the amount and timing of payments made. The annual percentage rate shall be determined in accordance with either the actuarial method or the United States Rule method. Explanations, equations and instructions for determining the annual percentage rate in accordance with the actuarial method are set forth in Appendix J to this regulation. n45d

(2) As a general rule, the annual percentage rate shall be considered accurate if it is not more than 1/8 of 1 percentage point above or below the annual percentage rate determined in accordance with paragraph (a)(1) of this section.

(3) In an irregular transaction, the annual percentage rate shall be considered accurate if it is not more than 1/4 of 1 percentage point above or below the annual percentage rate determined in accordance with paragraph (a)(1) of this section. n46

(4) *Mortgage loans*. If the annual percentage rate disclosed in a transaction secured by real property or a dwelling varies from the actual rate determined in accordance with paragraph (a)(1) of this section, in addition to the tolerances applicable under paragraphs (a)(2) and (3) of this section, the disclosed annual percentage rate shall also be considered accurate if:

(i) The rate results from the disclosed finance charge; and

(ii)

(A) The disclosed finance charge would be considered accurate under § 226.18(d)(1); or

(B) For purposes of rescission, if the disclosed finance charge would be considered accurate under § 226.23(g) or (h), whichever applies.

(5) *Additional tolerance for mortgage loans*. In a transaction secured by real property or a dwelling, in addition to the tolerances applicable under paragraphs (a)(2) and (3) of this section, if the disclosed finance charge is calculated incorrectly but is considered accurate under § 226.18(d)(1) or § 226.23(g) or (h), the disclosed annual percentage rate shall be considered accurate:

(i) If the disclosed finance charge is understated, and the disclosed annual percentage rate is also understated but it is closer to the actual annual percentage rate than the rate that would be considered accurate under paragraph (a)(4) of this section;

(ii) If the disclosed finance charge is overstated, and the disclosed annual percentage rate is also overstated but it is closer to the actual annual percentage rate than the rate that would be considered accurate under paragraph (a)(4) of this section.

(b) *Computation tools*.

(1) The Regulation Z Annual Percentage Rate Tables produced by the Board may be used to determine the annual percentage rate, and any rate determined from those tables in accordance with the accompanying instructions complies with the requirements of this section. Volume I of the tables applies to single advance transactions involving up to 480 monthly payments or 104 weekly payments. It may be used for regular transactions and for transactions with any of the following irregularities: an irregular first period, an irregular first payment, and an irregular final payment. Volume II of the tables applies to transactions involving multiple advances and any type of payment or period irregularity.

(2) Creditors may use any other computation tool in determining the annual percentage rate if the rate so determined equals the rate determined in accordance with Appendix J, within the degree of accuracy set forth in paragraph (a) of

this section.

(c) *Single add-on rate transactions*. If a single add-on rate is applied to all transactions with maturities up to 60 months and if all payments are equal in amount and period, a single annual percentage rate may be disclosed for all those transactions, so long as it is the highest annual percentage rate for any such transaction.

(d) *Certain transactions involving ranges of balances*. For purposes of disclosing the annual percentage rate referred to in § 226.17(g)(4) (Mail or telephone orders--delay in disclosures) and (h) (Series of sales--delay in disclosures), if the same finance charge is imposed on all balances within a specified range of balances, the annual percentage rate computed for the median balance may be disclosed for all the balances. However, if the annual percentage rate computed for the median balance understates the annual percentage rate computed for the lowest balance by more than 8 percent of the latter rate, the annual percentage rate shall be computed on whatever lower balance will produce an annual percentage rate that does not result in an understatement of more than 8 percent of the rate determined on the lowest balance.

FOOTNOTES:
(n62)Footnote 45d. An error in disclosure of the annual percentage rate or finance charge shall not, in itself, be considered a violation of this regulation if: (1) The error resulted from a corresponding error in a calculation tool used in good faith by the creditor; and (2) upon discovery of the error, the creditor promptly discontinues use of that calculation tool for disclosure purposes and notifies the Board in writing of the error in the calculation tool.

(n63)Footnote 46. For purposes of paragraph (a)(3) of this section, an irregular transaction is one that includes one or more of the following features: multiple advances, irregular payment periods, or irregular payment amounts (other than an irregular first period or an irregular first or final payment).

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1B- Consumer Credit Law Manual § 226.23

§ **226.23 Right of rescission.**

(a) *Consumer's right to rescind.*

(1) In a credit transaction in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind the transaction, except for transactions described in paragraph (f) of this section. n47

(2) To exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication. Notice is considered given when mailed, when filed for telegraphic transmission or, if sent by other means, when delivered to the creditor's designated place of business.

(3) The consumer may exercise the right to rescind until midnight of the third business day following consummation, delivery of the notice required by paragraph (b) of this section, or delivery of all material disclosures, n48 whichever occurs last. If the required notice or material disclosures are not delivered, the right to rescind shall expire 3 years after consummation, upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first. In the case of certain administrative proceedings, the rescission period shall be extended in accordance with section 125(f) of the Act.

(4) When more than one consumer in a transaction has the right to rescind, the exercise of the right by one consumer shall be effective as to all consumers.

(b)

(1) *Notice of right to rescind.* In a transaction subject to rescission, a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind (one copy to each if the notice is delivered in electronic form in accordance with the consumer consent and other applicable provisions of the E-Sign Act). The notice shall be on a separate document that identifies the transaction and shall clearly and conspicuously disclose the following:

(i) The retention or acquisition of a security interest in the consumer's principal dwelling.

(ii) The consumer's right to rescind the transaction.

(iii) How to exercise the right to rescind, with a form for that purpose, designating the address of the creditor's place of business.

(iv) The effects of rescission, as described in paragraph (d) of this section.

(v) The date the rescission period expires.

(2) *Proper form of notice.* To satisfy the disclosure requirements of paragraph (b)(1) of this section, the creditor shall provide the appropriate model form in Appendix H of this part or a substantially similar notice.

(c) *Delay of creditor's performance.* Unless a consumer waives the right of rescission under paragraph (e) of this section, no money shall be disbursed other than in escrow, no services shall be performed and no materials delivered until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded.

(d) *Effects of rescission.*

(1) When a consumer rescinds a transaction, the security interest giving rise to the right of rescission becomes void and the consumer shall not be liable for any amount, including any finance charge.

(2) Within 20 calendar days after receipt of a notice of rescission, the creditor shall return any money or property that has been given to anyone in connection with the transaction and shall take any action necessary to reflect the termination of the security interest.

(3) If the creditor has delivered any money or property, the consumer may retain possession until the creditor has met its obligation under paragraph (d)(2) of this section. When the creditor has complied with that paragraph, the consumer shall tender the money or property to the creditor or, where the latter would be impracticable or inequitable, tender its reasonable value. At the consumer's option, tender of property may be made at the location of the property or at the consumer's residence. Tender of money must be made at the creditor's designated place of business. If the creditor does not take possession of the money or property within 20 calendar days after the consumer's tender, the consumer may keep it without further obligation.

(4) The procedures outlined in paragraphs (d)(2) and (3) of this section may be modified by court order.

(e) *Consumer's waiver of right to rescind.*

(1) The consumer may modify or waive the right to rescind if the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency. To modify or waive the right, the consumer shall give the creditor a dated written statement that describes the emergency, specifically modifies or waives the right to rescind, and bears the signature of all the consumers entitled to rescind. Printed forms for this purpose are prohibited, except as provided in paragraph (e)(2) of this section.

(2) The need of the consumer to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during June through September 1993, pursuant to *42 U.S.C. 5170*, to be a major disaster area because of severe storms and flooding in the Midwest. n48a In this instance, creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(3) The consumer's need to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during June through September 1994 to be a major disaster area, pursuant to *42 U.S.C. 5170*, because of severe storms and flooding in the South. n48b In this instance, creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(4) The consumer's need to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during October 1994 to be a major disaster area, pursuant to *42 U.S.C. 5170*, because of severe storms and flooding in Texas. n48c In this instance,

creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(f) *Exempt transactions*. The right to rescind does not apply to the following:

(1) A residential mortgage transaction.

(2) A refinancing or consolidation by the same creditor of an extension of credit already secured by the consumer's principal dwelling. The right of rescission shall apply, however, to the extent the new amount financed exceeds the unpaid principal balance, any earned unpaid finance charge on the existing debt, and amounts attributed solely to the costs of the refinancing or consolidation.

(3) A transaction in which a state agency is a creditor.

(4) An advance, other than an initial advance, in a series of advances or in a series of single-payment obligations that is treated as a single transaction under § 226.17(c)(6), if the notice required by paragraph (b) of this section and all material disclosures have been given to the consumer.

(5) A renewal of optional insurance premiums that is not considered a refinancing under § 226.20(a)(5).

(g) *Tolerances for accuracy*.

(1) *One-half of 1 percent tolerance*. Except as provided in paragraphs (g)(2) and (h)(2) of this section, the finance charge and other disclosures affected by the finance charge (such as the amount financed and the annual percentage rate) shall be considered accurate for purposes of this section if the disclosed finance charge:

(i) is understated by no more than 1/2 of 1 percent of the face amount of the note or $100, whichever is greater; or

(ii) is greater than the amount required to be disclosed.

(2) *One percent tolerance*. In a refinancing of a residential mortgage transaction with a new creditor (other than a transaction covered by § 226.32), if there is no new advance and no consolidation of existing loans, the finance charge and other disclosures affected by the finance charge (such as the amount financed and the annual percentage rate) shall be considered accurate for purposes of this section if the disclosed finance charge:

(i) is understated by no more than 1 percent of the face amount of the note or $100, whichever is greater; or

(ii) is greater than the amount required to be disclosed.

(h) *Special rules for foreclosures*.

(1) *Right to rescind*. After the initiation of foreclosure on the consumer's principal dwelling that secures the credit obligation, the consumer shall have the right to rescind the transaction if:

(i) A mortgage broker fee that should have been included in the finance charge was not included; or

(ii) The creditor did not provide the properly completed appropriate model form in Appendix H of this part, or a substantially similar notice of rescission.

(2) *Tolerance for disclosures*. After the initiation of foreclosure on the consumer's principal dwelling that secures the credit obligation, the finance charge and other disclosures affected by the finance charge (such as the amount financed and the annual percentage rate) shall be considered accurate for purposes of this section if the disclosed finance charge:

(i) is understated by no more than $35; or

(ii) is greater than the amount required to be disclosed.

FOOTNOTES:

(n64)Footnote 47. For purposes of this section, the addition to an existing obligation of a security interest in a consumer's principal dwelling is a transaction. The right of rescission applies only to the addition of the security interest and not the existing obligation. The creditor shall deliver the notice required by paragraph (b) of this section but need not deliver new material disclosures. Delivery of the required notice shall begin the rescission period.

(n65)Footnote 48. The term "material disclosures" means the required disclosures of the annual percentage rate,

the finance charge, the amount financed, the total of payments, the payment schedule, and the disclosures and limitations referred to in §§ 226.32(c) and (d) and 226.35(b)(2).

(n66)Footnote 48a. A list of the affected areas will be maintained by the Board.

(n67)Footnote 48b. A list of the affected areas will be maintained and published by the Board. Such areas now include parts of Alabama, Florida, and Georgia.

(n68)Footnote 48c. A list of the affected areas will be maintained and published by the Board. Such areas now include the following counties in Texas: Angelina, Austin, Bastrop, Brazos, Brazoria, Burleson, Chambers, Fayette, Fort Bend, Galveston, Grimes, Hardin, Harris, Houston, Jackson, Jasper, Jefferson, Lee, Liberty, Madison, Matagorda, Montgomery, Nacagdoches, Orange, Polk, San Augustine, San Jacinto, Shelby, Trinity, Victoria, Washington, Waller, Walker, and Wharton.

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1B- Consumer Credit Law Manual § 226.24

§ **226.24 Advertising.**

(a) Actually available terms. If an advertisement for credit states specific credit terms, it shall state only those terms that actually are or will be arranged or offered by the creditor.

(b) Clear and conspicuous standard. Disclosures required by this section shall be made clearly and conspicuously.

(c) Advertisement of rate of finance charge. If an advertisement states a rate of finance charge, it shall state the rate as an "annual percentage rate," using that term. If the annual percentage rate may be increased after consummation, the advertisement shall state that fact. If an advertisement is for credit not secured by a dwelling, the advertisement shall not state any other rate, except that a simple annual rate or periodic rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the annual percentage rate. If an advertisement is for credit secured by a dwelling, the advertisement shall not state any other rate, except that a simple annual rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the annual percentage rate.

(d) Advertisement of terms that require additional disclosures--

(1) Triggering terms. If any of the following terms is set forth in an advertisement, the advertisement shall meet the requirements of paragraph (d)(2) of this section:

(i) The amount or percentage of any downpayment.

(ii) The number of payments or period of repayment.

(iii) The amount of any payment.

(iv) The amount of any finance charge.

(2) Additional terms. An advertisement stating any of the terms in paragraph (d)(1) of this section shall state the following terms, n49 as applicable (an example of one or more typical extensions of credit with a statement of all the terms applicable to each may be used):

(i) The amount or percentage of the downpayment.

(ii) The terms of repayment, which reflect the repayment obligations over the full term of the loan, including any balloon payment.

(iii) The "annual percentage rate," using that term, and, if the rate may be increased after consummation, that fact.

(e) Catalogs or other multiple-page advertisements; electronic advertisements--

(1) If a catalog or other multiple-page advertisement, or an electronic advertisement (such as an advertisement appearing on an Internet Web site), gives information in a table or schedule in sufficient detail to permit determination of the disclosures required by paragraph (d)(2) of this section, it shall be considered a single advertisement if--

(i) The table or schedule is clearly and conspicuously set forth; and

(ii) Any statement of the credit terms in paragraph (d)(1) of this section appearing anywhere else in the catalog or advertisement clearly refers to the page or location where the table or schedule begins.

(2) A catalog or other multiple-page advertisement or an electronic advertisement (such as an advertisement appearing on an Internet Web site) complies with paragraph (d)(2) of this section if the table or schedule of terms includes all appropriate disclosures for a representative scale of amounts up to the level of the more commonly sold higher-priced property or services offered.

(f) Disclosure of Rates and Payments in Advertisements for Credit Secured by a Dwelling.

(1) Scope. The requirements of this paragraph apply to any advertisement for credit secured by a dwelling, other than television or radio advertisements, including promotional materials accompanying applications.

(2) Disclosure of rates--

(i) In general. If an advertisement for credit secured by a dwelling states a simple annual rate of interest and more than one simple annual rate of interest will apply over the term of the advertised loan, the advertisement shall disclose in a clear and conspicuous manner:

(A) Each simple annual rate of interest that will apply. In variable-rate transactions, a rate determined by adding an index and margin shall be disclosed based on a reasonably current index and margin;

(B) The period of time during which each simple annual rate of interest will apply; and

(C) The annual percentage rate for the loan. If such rate is variable, the annual percentage rate shall comply with the accuracy standards in §§ 226.17(c) and 226.22.

(ii) Clear and conspicuous requirement. For purposes of paragraph (f)(2)(i) of this section, clearly and conspicuously disclosed means that the required information in paragraphs (f)(2)(i)(A) through (C) shall be disclosed with equal prominence and in close proximity to any advertised rate that triggered the required disclosures. The required information in paragraph (f)(2)(i)(C) may be disclosed with greater prominence than the other information.

(3) Disclosure of payments--

(i) In general. In addition to the requirements of paragraph (c) of this section, if an advertisement for credit secured by a dwelling states the amount of any payment, the advertisement shall disclose in a clear and conspicuous manner:

(A) The amount of each payment that will apply over the term of the loan, including any balloon payment. In variable-rate transactions, payments that will be determined based on the application of the sum of an index and margin shall be disclosed based on a reasonably current index and margin;

(B) The period of time during which each payment will apply; and

(C) In an advertisement for credit secured by a first lien on a dwelling, the fact that the payments do not include amounts for taxes and insurance premiums, if applicable, and that the actual payment obligation will be greater.

(ii) Clear and conspicuous requirement. For purposes of paragraph (f)(3)(i) of this section, a clear and conspicuous disclosure means that the required information in paragraphs (f)(3)(i)(A) and (B) shall be disclosed with equal prominence and in close proximity to any advertised payment that triggered the required disclosures, and that the required information in paragraph (f)(3)(i)(C) shall be disclosed with prominence and in close proximity to the advertised payments.

(4) Envelope excluded. The requirements in paragraphs (f)(2) and (f)(3) of this section do not apply to an envelope in which an application or solicitation is mailed, or to a banner advertisement or pop-up advertisement linked to an application or solicitation provided electronically.

(g) Alternative disclosures--television or radio advertisements. An advertisement made through television or radio stating any of the terms requiring additional disclosures under paragraph (d)(2) of this section may comply with paragraph (d)(2) of this section either by:

(1) Stating clearly and conspicuously each of the additional disclosures required under paragraph (d)(2) of this section; or

(2) Stating clearly and conspicuously the information required by paragraph (d)(2)(iii) of this section and listing a toll-free telephone number, or any telephone number that allows a consumer to reverse the phone charges when calling for information, along with a reference that such number may be used by consumers to obtain additional cost information.

(h) Tax implications. If an advertisement distributed in paper form or through the Internet (rather than by radio or television) is for a loan secured by the consumer's principal dwelling, and the advertisement states that the advertised extension of credit may exceed the fair market value of the dwelling, the advertisement shall clearly and conspicuously state that:

(1) The interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes; and

(2) The consumer should consult a tax adviser for further information regarding the deductibility of interest and charges.

(i) Prohibited acts or practices in advertisements for credit secured by a dwelling. The following acts or practices are prohibited in advertisements for credit secured by a dwelling:

(1) Misleading advertising of "fixed" rates and payments. *Using the word "fixed" to refer to rates, payments, or the credit transaction in an advertisement for variable-rate transactions or other transactions where the payment will increase, unless:*

(i) In the case of an advertisement solely for one or more variable-rate transactions,

(A) The phrase "Adjustable-Rate Mortgage," "Variable-Rate Mortgage," or "ARM" appears in the advertisement before the first use of the word "fixed" and is at least as conspicuous as any use of the word "fixed" in the advertisement; and

(B) Each use of the word "fixed" to refer to a rate or payment is accompanied by an equally prominent and closely proximate statement of the time period for which the rate or payment is fixed, and the fact that the rate may vary or the payment may increase after that period;

(ii) In the case of an advertisement solely for non-variable-rate transactions where the payment will increase (e.g., a stepped-rate mortgage transaction with an initial lower payment), each use of the word "fixed" to refer to the payment is accompanied by an equally prominent and closely proximate statement of the time period for which the payment is fixed, and the fact that the payment will increase after that period; or

(iii) In the case of an advertisement for both variable-rate transactions and non-variable-rate transactions,

(A) The phrase "Adjustable-Rate Mortgage," "Variable-Rate Mortgage," or "ARM" appears in the advertisement with equal prominence as any use of the term "fixed," "Fixed-Rate Mortgage," or similar terms; and

(B) Each use of the word "fixed" to refer to a rate, payment, or the credit transaction either refers solely to the transactions for which rates are fixed and complies with paragraph (i)(1)(ii) of this section, if applicable, or, if it refers to the variable-rate transactions, is accompanied by an equally prominent and closely proximate statement of the time period for which the rate or payment is fixed, and the fact that the rate may vary or the payment may increase after that period.

(2) Misleading comparisons in advertisements. Making any comparison in an advertisement between actual or hypothetical credit payments or rates and any payment or simple annual rate that will be available under the advertised product for a period less than the full term of the loan, unless:

(i) In general. The advertisement includes a clear and conspicuous comparison to the information required to be disclosed under sections 226.24(f)(2) and (3); and

(ii) Application to variable-rate transactions. If the advertisement is for a variable-rate transaction, and the advertised payment or simple annual rate is based on the index and margin that will be used to make subsequent rate or payment adjustments over the term of the loan, the advertisement includes an equally prominent statement in close proximity to the payment or rate that the payment or rate is subject to adjustment and the time period when the first adjustment will occur.

(3) Misrepresentations about government endorsement. Making any statement in an advertisement that the product offered is a "government loan program", "government-supported loan", or is otherwise endorsed or sponsored by any federal, state, or local government entity, unless the advertisement is for an FHA loan, VA loan, or similar loan program that is, in fact, endorsed or sponsored by a federal, state, or local government entity.

(4) Misleading use of the current lender's name. Using the name of the consumer's current lender in an advertisement that is not sent by or on behalf of the consumer's current lender, unless the advertisement:

(i) Discloses with equal prominence the name of the person or creditor making the advertisement; and

(ii) Includes a clear and conspicuous statement that the person making the advertisement is not associated with, or acting on behalf of, the consumer's current lender.

(5) Misleading claims of debt elimination. Making any misleading claim in an advertisement that the mortgage product offered will eliminate debt or result in a waiver or forgiveness of a consumer's existing loan terms with, or obligations to, another creditor.

(6) Misleading use of the term "counselor". Using the term "counselor" in an advertisement to refer to a for-profit mortgage broker or mortgage creditor, its employees, or persons working for the broker or creditor that are involved in offering, originating or selling mortgages.

(7) Misleading foreign-language advertisements. Providing information about some trigger terms or required disclosures, such as an initial rate or payment, only in a foreign language in an advertisement, but providing information about other trigger terms or required disclosures, such as information about the fully-indexed rate or fully amortizing payment, only in English in the same advertisement.

FOOTNOTES:
(n69)Footnote 49. An example of one or more typical extensions of credit with a statement of all the terms applicable to each may be used.

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1B- Consumer Credit Law Manual § 226.25

§ **226.25 Record retention.**

(a) *General rule*. A creditor shall retain evidence of compliance with this regulation (other than advertising requirements under §§ 226.16 and 226.24) for 2 years after the date disclosures are required to be made or action is required to be taken. The administrative agencies responsible for enforcing the regulation may require creditors under their jurisdictions to retain records for a longer period if necessary to carry out their enforcement responsibilities under section 108 of the act.

(b) *Inspection of records*. A creditor shall permit the agency responsible for enforcing this regulation with respect to that creditor to inspect its relevant records for compliance.

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1B- Consumer Credit Law Manual § 226.26

§ **226.26 Use of annual percentage rate in oral disclosures.**

(a) *Open-end credit*. In an oral response to a consumer's inquiry about the cost of open-end credit, only the annual percentage rate or rates shall be stated, except that the periodic rate or rates also may be stated. If the annual percentage rate cannot be determined in advance because there are finance charges other than a periodic rate, the corresponding annual percentage rate shall be stated, and other cost information may be given.

(b) *Closed-end credit*. In an oral response to a consumer's inquiry about the cost of closed-end credit, only the annual percentage rate shall be stated, except that a simple annual rate or periodic rate also may be stated if it is applied to an unpaid balance. If the annual percentage rate cannot be determined in advance, the annual percentage rate for a sample transaction shall be stated, and other cost information for the consumer's specific transaction may be given.

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1B- Consumer Credit Law Manual § 226.27

§ **226.27 Language of disclosures.**

Disclosures required by this regulation may be made in a language other than English, provided that the disclosures are made available in English upon the consumer's request. This requirement for providing English disclosures on request does not apply to advertisements subject to §§ 226.16 and 226.24.

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1B- Consumer Credit Law Manual § 226.28

§ **226.28 Effect on State laws.**

(a) *Inconsistent disclosure requirements.*

(1) Except as provided in paragraph (d) of this section, state law requirements that are inconsistent with the requirements contained in chapter 1 (General Provisions), chapter 2 (Credit Transactions), or chapter 3 (Credit Advertising) of the act and the implementing provisions of this regulation are preempted to the extent of the inconsistency. A State law is inconsistent if it requires a creditor to make disclosures or take actions that contradict the requirements of the Federal law. A State law is contradictory if it requires the use of the same term to represent a different amount or a different meaning than the Federal law, or if it requires the use of a term different from that required in the Federal law to describe the same item. A creditor, state, or other interested party may request the Board to determine whether a State law requirement is inconsistent. After the Board determines that a state law is inconsistent, a creditor may not make disclosures using the inconsistent term or form.

(2)

(i) State law requirements are inconsistent with the requirements contained in sections 161 (Correction of billing errors) or 162 (Regulation of credit reports) of the Act and the implementing provisions of this regulation and are preempted if they provide rights, responsibilities, or procedures for consumers or creditors that are different from those required by the Federal law. However, a State law that allows a consumer to inquire about an open-end credit account and imposes on the creditor an obligation to respond to such inquiry after the time allowed in the Federal law for the consumer to submit written notice of a billing error shall not be preempted in any situation where the time period for making written notice under this regulation has expired. If a creditor gives written notice of a consumer's rights under such State law, the notice shall state that reliance on the longer time period available under state law may result in the loss of important rights that could be preserved by acting more promptly under Federal law; it shall also explain that the state law provisions apply only after expiration of the time period for submitting a proper written notice of a billing

error under the Federal law. If the state disclosures are made on the same side of a page as the required Federal disclosures, the state disclosures shall appear under a demarcation line below the Federal disclosures, and the Federal disclosures shall be identified by a heading indicating that they are made in compliance with Federal law.

(ii) State law requirements are inconsistent with the requirements contained in chapter 4 (Credit billing) of the Act (other than section 161 or 162) and the implementing provisions of this regulation and are preempted if the creditor cannot comply with State law without violating Federal law.

(iii) A State may request the Board to determine whether its law is inconsistent with chapter 4 of the Act and its implementing provisions.

(b) *Equivalent disclosure requirements*. If the Board determines that a disclosure required by state law (other than a requirement relating to the finance charge, annual percentage rate, or the disclosures required under § 226.32) is substantially the same in meaning as a disclosure required under the act or this regulation, creditors in that state may make the state disclosure in lieu of the federal disclosure. A creditor, State, or other interested party may request the Board to determine whether a State disclosure is substantially the same in meaning as a Federal disclosure.

(c) *Request for determination*. The procedures under which a request for a determination may be made under this section are set forth in Appendix A.

(d) *Special rule for credit and charge cards*. State law requirements relating to the disclosure of credit information in any credit or charge card application or solicitation that is subject to the requirements of section 127(c) of chapter 2 of the act (§ 226.5a of the regulation) or in any renewal notice for a credit or charge card that is subject to the requirements of section 127(d) of chapter 2 of the act (§ 226.9(e) of the regulation) are preempted. State laws relating to the enforcement of section 127 (c) and (d) of the act are not preempted.

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1B- Consumer Credit Law Manual § 226.29

§ **226.29 State exemptions.**

(a) *General rule*. Any State may apply to the Board to exempt a class of transactions within the State from the requirements of chapter 2 (Credit transactions) or chapter 4 (Credit billing) of the Act and the corresponding provisions of this regulation. The Board shall grant an exemption if it determines that:

(1) The State law is substantially similar to the Federal law or, in the case of chapter 4, affords the consumer greater protection than the Federal law; and

(2) There is adequate provision for enforcement.

(b) *Civil liability*.

(1) No exemptions granted under this section shall extend to the civil liability provisions of sections 130 and 131 of the Act.

(2) If an exemption has been granted, the disclosures required by the applicable State law (except any additional requirements not imposed by Federal law) shall constitute the disclosures required by this Act.

(c) *Applications*. The procedures under which a State may apply for an exemption under this section are set forth in Appendix B.

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1B- Consumer Credit Law Manual § 226.30

§ **226.30 Limitation on rates.**

A creditor shall include in any consumer credit contract secured by a dwelling and subject to the act and this regulation the maximum interest rate that may be imposed during the term of the obligation n50 when:

(a) In the case of closed-end credit, the annual percentage rate may increase after consummation, or

(b) In the case of open-end credit, the annual percentage rate may increase during the plan.

FOOTNOTES:
(n70)Footnote 50. [Reserved].

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1B- Consumer Credit Law Manual § 226.31

§ **226.31 General rules.**

(a) *Relation to other subparts in this part*. The requirements and limitations of this subpart are in addition to and not in lieu of those contained in other subparts of this part.

(b) *Form of disclosures*. The creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep. The disclosures required by this subpart may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (*15 U.S.C. § 7001 et seq.*).

(c) *Timing of disclosure*.

(1) *Disclosures for certain closed-end home mortgages*. The creditor shall furnish the disclosures required by § 226.32 at least three business days prior to consummation of a mortgage transaction covered by § 226.32.

(i) *Change in terms*. After complying with paragraph (c)(1) of this section and prior to consummation, if the creditor changes any term that makes the disclosures inaccurate, new disclosures shall be provided in accordance with the requirements of this subpart.

(ii) *Telephone disclosures*. A creditor may provide new disclosures by telephone if the consumer initiates the

change and if, at consummation:

(A) The creditor provides new written disclosures; and

(B) The consumer and creditor sign a statement that the new disclosures were provided by telephone at least three days prior to consummation.

(iii) *Consumer's waiver of waiting period before consummation*. The consumer may, after receiving the disclosures required by paragraph (c)(1) of this section, modify or waive the three-day waiting period between delivery of those disclosures and consummation if the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency. To modify or waive the right, the consumer shall give the creditor a dated written statement that describes the emergency, specifically modifies or waives the waiting period, and bears the signature of all the consumers entitled to the waiting period. Printed forms for this purpose are prohibited, except when creditors are permitted to use printed forms pursuant to § 226.23(e)(2).

(2) *Disclosures for reverse mortgages*. The creditor shall furnish the disclosures required by § 226.33 at least three business days prior to:

(i) Consummation of a closed-end credit transaction; or

(ii) The first transaction under an open-end credit plan.

(d) *Basis of disclosures and use of estimates*.

(1) *Legal Obligation*. Disclosures shall reflect the terms of the legal obligation between the parties.

(2) *Estimates*. If any information necessary for an accurate disclosure is unknown to the creditor, the creditor shall make the disclosure based on the best information reasonably available at the time the disclosure is provided, and shall state clearly that the disclosure is an estimate.

(3) *Per-diem interest*. For a transaction in which a portion of the interest is determined on a per-diem basis and collected at consummation, any disclosure affected by the per-diem interest shall be considered accurate if the

disclosure is based on the information known to the creditor at the time that the disclosure documents are prepared.

(e) *Multiple creditors; multiple consumers*. If a transaction involves more than one creditor, only one set of disclosures shall be given and the creditors shall agree among themselves which creditor must comply with the requirements that this part imposes on any or all of them. If there is more than one consumer, the disclosures may be made to any consumer who is primarily liable on the obligation. If the transaction is rescindable under § 226.15 or § 226.23, however, the disclosures shall be made to each consumer who has the right to rescind.

(f) *Effect of subsequent events*. If a disclosure becomes inaccurate because of an event that occurs after the creditor delivers the required disclosures, the inaccuracy is not a violation of Regulation Z (12 CFR part 226), although new disclosures may be required for mortgages covered by § 226.32 under paragraph (c) of this section, § 226.9(c), § 226.19, or § 226.20.

(g) *Accuracy of annual percentage rate*. For purposes of § 226.32, the annual percentage rate shall be considered accurate, and may be used in determining whether a transaction is covered by § 226.32, if it is accurate according to the requirements and within the tolerances under § 226.22. The finance charge tolerances for rescission under § 226.23(g) or (h) shall not apply for this purpose.

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1B- Consumer Credit Law Manual § 226.32

§ 226.32 Requirements for certain closed-end home mortgages.

(a) *Coverage*.

(1) Except as provided in paragraph (a)(2) of this section, the requirements of this section apply to a consumer credit transaction that is secured by the consumer's principal dwelling, and in which either:

(i) The annual percentage rate at consummation will exceed by more than 10 percentage points the yield on Treasury securities having comparable periods of maturity to the loan maturity as of the fifteenth day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor; or

(ii) The total points and fees payable by the consumer at or before loan closing will exceed the greater of 8 percent of the total loan amount, or $400; the $400 figure shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index that was reported on the preceding June 1.

(2) This section does not apply to the following:

(i) A residential mortgage transaction.

(ii) A reverse mortgage transaction subject to § 226.33.

(iii) An open-end credit plan subject to subpart B of this part.

(b) *Definitions*. For purposes of this subpart, the following definitions apply:

(1) For purposes of paragraph (a)(1)(ii) of this section, *points and fees* means:

(i) All items required to be disclosed under § 226.4(a) and 226.4(b), except interest or the time-price differential;

(ii) All compensation paid to mortgage brokers;

(iii) All items listed in § 226.4(c)(7) (other than amounts held for future payment of taxes) unless the charge is reasonable, the creditor receives no direct or indirect compensation in connection with the charge, and the charge is not paid to an affiliate of the creditor; and

(iv) Premiums or other charges for credit life, accident, health, or loss-of-income insurance, or debt-cancellation coverage (whether or not the debt-cancellation coverage is insurance under applicable law) that provides for cancellation of all or part of the consumer's liability in the event of the loss of life, health, or income or in the case of accident, written in connection with the credit transaction.

(2) *Affiliate* means any company that controls, is controlled by, or is under common control with another company, as set forth in the Bank Holding Company Act of 1956 (*12 U.S.C. 1841 et seq.*).

(c) *Disclosures*. In addition to other disclosures required by this part, in a mortgage subject to this section the creditor shall disclose the following:

(1) *Notices*. The following statement: "You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application. If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan."

(2) *Annual percentage rate*. The annual percentage rate.

(3) *Regular payment; balloon payment*. The amount of the regular monthly (or other periodic) payment and the amount of any balloon payment. The regular payment disclosed under this paragraph shall be treated as accurate if it is based on an amount borrowed that is deemed accurate and is disclosed under paragraph (c)(5) of this section.

(4) *Variable-rate*. For variable-rate transactions, a statement that the interest rate and monthly payment may increase, and the amount of the single maximum monthly payment, based on the maximum interest rate required to be disclosed under § 226.30.

(5) *Amount borrowed*. For a mortgage refinancing, the total amount the consumer will borrow, as reflected by the face amount of the note; and where the amount borrowed includes premiums or other charges for optional credit insurance or debt-cancellation coverage, that fact shall be stated, grouped together with the disclosure of the amount borrowed. The disclosure of the amount borrowed shall be treated as accurate if it is not more than $100 above or below the amount required to be disclosed.

(d) *Limitations*. A mortgage transaction subject to this section may not provide for the following terms:

(1)

(i) *Balloon payment*. For a loan with a term of less than five years, a payment schedule with regular periodic payments that when aggregated do not fully amortize the outstanding principal balance.

(ii) *Exception*. The limitations in paragraph (d)(1)(i) of this section do not apply to loans with maturities of less than one year, if the purpose of the loan is a "bridge" loan connected with the acquisition or construction of a dwelling intended to become the consumer's principal dwelling.

(2) *Negative amortization*. A payment schedule with regular periodic payments that cause the principal balance to increase.

(3) *Advance payments*. A payment schedule that consolidates more than two periodic payments and pays them in advance from the proceeds.

(4) *Increased interest rate*. An increase in the interest rate after default.

(5) *Rebates*. A refund calculated by a method less favorable than the actuarial method (as defined by section 933(d) of the Housing and Community Development Act of 1992, *15 U.S.C. 1615(d)*), for rebates of interest arising from a loan acceleration due to default.

(6) *Prepayment penalties*. Except as allowed under paragraph (d)(7) of this section, a penalty for paying all or part of the principal before the date on which the principal is due. A prepayment penalty includes computing a refund of unearned interest by a method that is less favorable to the consumer than the actuarial method, as defined by section 933(d) of the Housing and Community Development Act of 1992, *15 U.S.C. 1615(d)*.

(7) *Prepayment penalty exception*. A mortgage transaction subject to this section may provide for a prepayment penalty (including a refund calculated according to the rule of 78s) otherwise permitted by law if, under the terms of the loan:

(i) The penalty will not apply after the two-year period following consummation;

(ii) The penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or an affiliate of the creditor;

(iii) At consummation, the consumer's total monthly debt payments (including amounts owed under the mortgage) do not exceed 50 percent of the consumer's monthly gross income, as verified in accordance with § 226.34(a)(4)(ii); and

(iv) The amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation.

(8) *Due-on-demand clause*. A demand feature that permits the creditor to terminate the loan in advance of the original maturity date and to demand repayment of the entire outstanding balance, except in the following circumstances:

(i) There is fraud or material misrepresentation by the consumer in connection with the loan;

(ii) The consumer fails to meet the repayment terms of the agreement for any outstanding balance; or

(iii) There is any action or inaction by the consumer that adversely affects the creditor's security for the loan, or any right of the creditor in such security.

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1B- Consumer Credit Law Manual § 226.33

§ **226.33 Requirements for reverse mortgages.**

(a) *Definition*. For purposes of this subpart, reverse mortgage transaction means a nonrecourse consumer credit obligation in which:

(1) A mortgage, deed of trust, or equivalent consensual security interest securing one or more advances is created in the consumer's principal dwelling; and

(2) Any principal, interest, or shared appreciation or equity is due and payable (other than in the case of default) only after:

(i) The consumer dies;

(ii) The dwelling is transferred; or

(iii) The consumer ceases to occupy the dwelling as a principal dwelling.

(b) *Content of disclosures*. In addition to other disclosures required by this part, in a reverse mortgage transaction the

creditor shall provide the following disclosures in a form substantially similar to the model form found in paragraph (d) of Appendix K of this part:

(1) *Notice*. A statement that the consumer is not obligated to complete the reverse mortgage transaction merely because the consumer has received the disclosures required by this section or has signed an application for a reverse mortgage loan.

(2) *Total annual loan cost rates*. A good-faith projection of the total cost of the credit, determined in accordance with paragraph (c) of this section and expressed as a table of "total annual loan cost rates," using that term, in accordance with Appendix K of this part.

(3) *Itemization of pertinent information*. An itemization of loan terms, charges, the age of the youngest borrower and the appraised property value.

(4) *Explanation of table*. An explanation of the table of total annual loan cost rates as provided in the model form found in paragraph (d) of Appendix K of this part.

(c) *Projected total cost of credit*. The projected total cost of credit shall reflect the following factors, as applicable:

(1) *Costs to consumer*. All costs and charges to the consumer, including the costs of any annuity the consumer purchases as part of the reverse mortgage transaction.

(2) *Payments to consumer*. All advances to and for the benefit of the consumer, including annuity payments that the consumer will receive from an annuity that the consumer purchases as part of the reverse mortgage transaction.

(3) *Additional creditor compensation*. Any shared appreciation or equity in the dwelling that the creditor is entitled by contract to receive.

(4) *Limitations on consumer liability*. Any limitation on the consumer's liability (such as nonrecourse limits and equity conservation agreements).

(5) *Assumed annual appreciation rates*. Each of the following assumed annual appreciation rates for the dwelling:

(i) 0 percent.

(ii) 4 percent.

(iii) 8 percent.

(6) *Assumed loan period.*

(i) Each of the following assumed loan periods, as provided in Appendix L of this part:

(A) Two years.

(B) The actuarial life expectancy of the consumer to become obligated on the reverse mortgage transaction (as of that consumer's most recent birthday). In the case of multiple consumers, the period shall be the actuarial life expectancy of the youngest consumer (as of that consumer's most recent birthday).

(C) The actuarial life expectancy specified by paragraph (c)(6)(i)(B) of this section, multiplied by a factor of 1.4 and rounded to the nearest full year.

(ii) At the creditor's option, the actuarial life expectancy specified by paragraph (c)(6)(i)(B) of this section, multiplied by a factor of .5 and rounded to the nearest full year.

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1B- Consumer Credit Law Manual § 226.34

§ 226.34 Prohibited acts or practices in connection with credit subject to § 226.32.

(a) Prohibited acts or practices for loans subject to § 226.32. A creditor extending mortgage credit subject to § 226.32 shall not--

(1) Home improvement contracts. Pay a contractor under a home improvement contract from the proceeds of a mortgage covered by § 226.32, other than:

(i) By an instrument payable to the consumer or jointly to the consumer and the contractor; or

(ii) At the election of the consumer, through a third-party escrow agent in accordance with terms established in a written agreement signed by the consumer, the creditor, and the contractor prior to the disbursement.

(2) Notice to assignee. Sell or otherwise assign a mortgage subject to § 226.32 without furnishing the following statement to the purchaser or assignee: "Notice: This is a mortgage subject to special rules under the federal Truth in Lending Act. Purchasers or assignees of this mortgage could be liable for all claims and defenses with respect to the mortgage that the borrower could assert against the creditor."

(3) Refinancings within one-year period. Within one year of having extended credit subject to § 226.32, refinance any loan subject to § 226.32 to the same borrower into another loan subject to § 226.32, unless the refinancing is in the

borrower's interest. An assignee holding or servicing an extension of mortgage credit subject to § 226.32, shall not, for the remainder of the one-year period following the date of origination of the credit, refinance any loan subject to § 226.32 to the same borrower into another loan subject to § 226.32, unless the refinancing is in the borrower's interest. A creditor (or assignee) is prohibited from engaging in acts or practices to evade this provision, including a pattern or practice of arranging for the refinancing of its own loans by affiliated or unaffiliated creditors, or modifying a loan agreement (whether or not the existing loan is satisfied and replaced by the new loan) and charging a fee.

(4) Repayment ability. *Extend credit subject to § 226.32 to a consumer based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation, including the consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and mortgage-related obligations.*

(i) Mortgage-related obligations. For purposes of this paragraph (a)(4), mortgage-related obligations are expected property taxes, premiums for mortgage-related insurance required by the creditor as set forth in § 226.35(b)(3)(i), and similar expenses.

(ii) Verification of repayment ability. Under this paragraph (a)(4) a creditor must verify the consumer's repayment ability as follows:

(A) A creditor must verify amounts of income or assets that it relies on to determine repayment ability, including expected income or assets, by the consumer's Internal Revenue Service Form W-2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets.

(B) Notwithstanding paragraph (a)(4)(ii)(A), a creditor has not violated paragraph (a)(4)(ii) if the amounts of income and assets that the creditor relied upon in determining repayment ability are not materially greater than the amounts of the consumer's income or assets that the creditor could have verified pursuant to paragraph (a)(4)(ii)(A) at the time the loan was consummated.

(C) A creditor must verify the consumer's current obligations.

(iii) Presumption of compliance. A creditor is presumed to have complied with this paragraph (a)(4) with respect to a transaction if the creditor:

(A) Verifies the consumer's repayment ability as provided in paragraph (a)(4)(ii);

(B) Determines the consumer's repayment ability using the largest payment of principal and interest scheduled in the first seven years following consummation and taking into account current obligations and mortgage-related obligations as defined in paragraph (a)(4)(i); and

(C) Assesses the consumer's repayment ability taking into account at least one of the following: The ratio of total debt obligations to income, or the income the consumer will have after paying debt obligations.

(iv) Exclusions from presumption of compliance. Notwithstanding the previous paragraph, no presumption of compliance is available for a transaction for which:

(A) The regular periodic payments for the first seven years would cause the principal balance to increase; or

(B) The term of the loan is less than seven years and the regular periodic payments when aggregated do not fully amortize the outstanding principal balance.

(v) Exemption. This paragraph (a)(4) does not apply to temporary or "bridge" loans with terms of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months.

(b) Prohibited acts or practices for dwelling-secured loans; open-end credit. In connection with credit secured by the consumer's dwelling that does not meet the definition in § 226.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of § 226.32.

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1B- Consumer Credit Law Manual § 226.35

§ 226.35 Prohibited acts or practices in connection with higher-priced mortgage loans. [§ 226.35(b)(3)) effective on April 1, 2010.]

(a) Higher-priced mortgage loans

(1) For purposes of this section, a higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for loans secured by a first lien on a dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling.

(2) "Average prime offer rate" means an annual percentage rate that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Board publishes average prime offer rates for a broad range of types of transactions in a table updated at least weekly as well as the methodology the Board uses to derive these rates.

(3) Notwithstanding paragraph (a)(1) of this section, the term "higher-priced mortgage loan" does not include a transaction to finance the initial construction of a dwelling, a temporary or "bridge" loan with a term of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months, a reverse-mortgage transaction subject to § 226.33, or a home equity line of credit subject to § 226.5b.

(b) Rules for higher-priced mortgage loans. Higher-priced mortgage loans are subject to the following restrictions:

(1) Repayment ability. A creditor shall not extend credit based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation as provided in § 226.34(a)(4).

(2) Prepayment penalties. A loan may not include a penalty described by § 226.32(d)(6) unless:

(i) The penalty is otherwise permitted by law, including § 226.32(d)(7) if the loan is a mortgage transaction described in § 226.32(a); and

(ii) Under the terms of the loan --

(A) The penalty will not apply after the two-year period following consummation;

(B) The penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or an affiliate of the creditor; and

(C) The amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation.

(3) [Effective April 1, 2010.] Escrows --

(i) Failure to escrow for property taxes and insurance. Except as provided in paragraph (b)(3)(ii) of this section, a creditor may not extend a loan secured by a first lien on a principal dwelling unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor, such as insurance against loss of or damage to property, or against liability arising out of the ownership or use of the property, or insurance protecting the creditor against the consumer's default or other credit loss.

(ii) Exemptions for loans secured by shares in a cooperative and for certain condominium units --

(A) Escrow accounts need not be established for loans secured by shares in a cooperative; and

(B) Insurance premiums described in paragraph (b)(3)(i) of this section need not be included in escrow accounts for loans secured by condominium units, where the condominium association has an obligation to the condominium unit owners to maintain a master policy insuring condominium units.

(iii) Cancellation. A creditor or servicer may permit a consumer to cancel the escrow account required in paragraph (b)(3)(i) of this section only in response to a consumer's dated written request to cancel the escrow account that is received no earlier than 365 days after consummation.

(iv) Definition of escrow account. For purposes of this section, "escrow account" shall have the same meaning as in *24 CFR 3500.17(b)* as amended.

(4) Evasion; open-end credit. In connection with credit secured by a consumer's principal dwelling that does not meet the definition of open-end credit in § 226.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of this section.

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1B- Consumer Credit Law Manual § 226.36

§ 226.36 Prohibited acts or practices in connection with credit secured by a consumer's principal dwelling.

(a) Mortgage broker defined. For purposes of this section, the term "mortgage broker" means a person, other than an employee of a creditor, who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person. The term includes a person meeting this definition, even if the consumer credit obligation is initially payable to such person, unless the person provides the funds for the transaction at consummation out of the person's own resources, out of deposits held by the person, or by drawing on a bona fide warehouse line of credit.

(b) Misrepresentation of value of consumer's dwelling--

(1) Coercion of appraiser. In connection with a consumer credit transaction secured by a consumer's principal dwelling, no creditor or mortgage broker, and no affiliate of a creditor or mortgage broker shall directly or indirectly coerce, influence, or otherwise encourage an appraiser to misstate or misrepresent the value of such dwelling.

(i) Examples of actions that violate this paragraph (b)(1) include:

(A) Implying to an appraiser that current or future retention of the appraiser depends on the amount at which the appraiser values a consumer's principal dwelling;

(B) Excluding an appraiser from consideration for future engagement because the appraiser reports a value of a consumer's principal dwelling that does not meet or exceed a minimum threshold;

(C) Telling an appraiser a minimum reported value of a consumer's principal dwelling that is needed to approve the loan;

(D) Failing to compensate an appraiser because the appraiser does not value a consumer's principal dwelling at or above a certain amount; and

(E) Conditioning an appraiser's compensation on loan consummation.

(ii) Examples of actions that do not violate this paragraph (b)(1) include:

(A) Asking an appraiser to consider additional information about a consumer's principal dwelling or about comparable properties;

(B) Requesting that an appraiser provide additional information about the basis for a valuation;

(C) Requesting that an appraiser correct factual errors in a valuation;

(D) Obtaining multiple appraisals of a consumer's principal dwelling, so long as the creditor adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value;

(E) Withholding compensation from an appraiser for breach of contract or substandard performance of services as provided by contract; and

(F) Taking action permitted or required by applicable federal or state statute, regulation, or agency guidance.

(2) When extension of credit prohibited. In connection with a consumer credit transaction secured by a consumer's principal dwelling, a creditor who knows, at or before loan consummation, of a violation of paragraph (b)(1) of this

section in connection with an appraisal shall not extend credit based on such appraisal unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling.

(3) Appraiser defined. As used in this paragraph (b), an appraiser is a person who engages in the business of providing assessments of the value of dwellings. The term "appraiser" includes persons that employ, refer, or manage appraisers and affiliates of such persons.

(c) Servicing practices.

(1) In connection with a consumer credit transaction secured by a consumer's principal dwelling, no servicer shall--

(i) Fail to credit a payment to the consumer's loan account as of the date of receipt, except when a delay in crediting does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency, or except as provided in paragraph (c)(2) of this section;

(ii) Impose on the consumer any late fee or delinquency charge in connection with a payment, when the only delinquency is attributable to late fees or delinquency charges assessed on an earlier payment, and the payment is otherwise a full payment for the applicable period and is paid on its due date or within any applicable grace period; or

(iii) Fail to provide, within a reasonable time after receiving a request from the consumer or any person acting on behalf of the consumer, an accurate statement of the total outstanding balance that would be required to satisfy the consumer's obligation in full as of a specified date.

(2) If a servicer specifies in writing requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer shall credit the payment as of 5 days after receipt.

(3) For purposes of this paragraph (c), the terms "servicer" and "servicing" have the same meanings as provided in *24 CFR 3500.2(b)*, as amended.

(d) This section does not apply to a home equity line of credit subject to § 226.5b.

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1B- Consumer Credit Law Manual § 226.37-226.38

§ **226.37 [Reserved]**

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1B- Consumer Credit Law Manual § 226.39

§ **226.39 Mortgage transfer disclosures.**

(a) Scope. The disclosure requirements of this section apply to any covered person except as otherwise provided in this section. For purposes of this section:

(1) A "covered person "means any person, as defined in § 226.2(a)(22), that becomes the owner of an existing mortgage loan by acquiring legal title to the debt obligation, whether through a purchase, assignment, or other transfer, and who acquires more than one mortgage loan in any twelve-month period. For purposes of this section, a servicer of a mortgage loan shall not be treated as the owner of the obligation if the servicer holds title to the loan or it is assigned to the servicer solely for the administrative convenience of the servicer in servicing the obligation.

(2) A "mortgage loan "means any consumer credit transaction that is secured by the principal dwelling of a consumer.

(b) Disclosure required. Except as provided in paragraph (c) of this section, any person that becomes a covered person as defined in this section shall mail or deliver the disclosures required by this section to the consumer on or before the 30th calendar day following the acquisition date. If there is more than one covered person, only one disclosure shall be given and the covered persons shall agree among themselves which covered person shall comply with the requirements that this section imposes on any or all of them.

(1) Acquisition date. For purposes of this section, the date that the covered person acquired the mortgage loan shall be the date of acquisition recognized in the books and records of the acquiring party.

(2) Multiple consumers. If there is more than one consumer liable on the obligation, a covered person may mail or deliver the disclosures to any consumer who is primarily liable.

(c) Exceptions. Notwithstanding paragraph (b) of this section, a covered person is not subject to the requirements of this section with respect to a particular mortgage loan if:

(1) The covered person sells or otherwise transfers or assigns legal title to the mortgage loan on or before the 30th calendar day following the date that the covered person acquired the mortgage loan; or

(2) The mortgage loan is transferred to the covered person in connection with a repurchase agreement and the transferor that is obligated to repurchase the loan continues to recognize the loan as an asset on its own books and records. However, if the transferor does not repurchase the mortgage loan, the acquiring party must make the disclosures required by § 226.39 within 30 days after the date that the transaction is recognized as an acquisition in its books and records.

(d) Content of required disclosures. The disclosures required by this section shall identify the loan that was acquired or transferred and state the following:

(1) The identity, address, and telephone number of the covered person who owns the mortgage loan. If there is more than one covered person, the information required by this paragraph shall be provided for each of them.

(2) The acquisition date recognized by the covered person.

(3) How to reach an agent or party having authority to act on behalf of the covered person (or persons), which shall identify a person (or persons) authorized to receive legal notices on behalf of the covered person and resolve issues concerning the consumer's payments on the loan. However, no information is required to be provided under this paragraph if the consumer can use the information provided under paragraph (d)(1) of this section for these purposes. If multiple persons are identified under this paragraph, the disclosure shall provide contact information for each and indicate the extent to which the authority of each agent differs. For purposes of this paragraph (d)(3), it is sufficient if the covered person provides only a telephone number provided that the consumer can use the telephone number to obtain the address for the agent or other person identified.

(4) The location where transfer of ownership of the debt to the covered person is recorded. However, if the transfer of

ownership has not been recorded in public records at the time the disclosure is provided, the covered person complies with this paragraph by stating this fact.

(e) Optional disclosures. In addition to the information required to be disclosed under paragraph (d) of this section, a covered person may, at its option, provide any other information regarding the transaction.

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1B- Consumer Credit Law Manual § 226.40-226.45

§ **226.40 [Reserved]**

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1B- Consumer Credit Law Manual § 226.46

§ **226.46 Special disclosure requirements for private education loans.**

(a) Coverage. The requirements of this subpart apply to private education loans as defined in § 226.46(b)(5). A creditor may, at its option, comply with the requirements of this subpart for an extension of credit subject to §§ 226.17 and 226.18 that is extended to a consumer for expenses incurred after graduation from a law, medical, dental, veterinary, or other graduate school and related to relocation, study for a bar or other examination, participation in an internship or residency program, or similar purposes.

(1) Relation to other subparts in this part. Except as otherwise specifically provided, the requirements and limitations of this subpart are in addition to and not in lieu of those contained in other subparts of this Part.

(b) Definitions. For purposes of this subpart, the following definitions apply:

(1) Covered educational institution means:

(i) An educational institution that meets the definition of an institution of higher education, as defined in paragraph (b)(2) of this section, without regard to the institution's accreditation status; and

(ii) Includes an agent, officer, or employee of the institution of higher education. An agent means an institution-affiliated organization as defined by section 151 of the Higher Education Act of 1965 (*20 U.S.C. 1019*) or an

officer or employee of an institution-affiliated organization.

(2) Institution of higher education has the same meaning as in sections 101 and 102 of the Higher Education Act of 1965 (*20 U.S.C. 1001-1002*) and the implementing regulations published by the U.S. Department of Education.

(3) Postsecondary educational expenses means any of the expenses that are listed as part of the cost of attendance, as defined under section 472 of the Higher Education Act of 1965 (*20 U.S.C. 1087ll*), of a student at a covered educational institution. These expenses include tuition and fees, books, supplies, miscellaneous personal expenses, room and board, and an allowance for any loan fee, origination fee, or insurance premium charged to a student or parent for a loan incurred to cover the cost of the student's attendance.

(4) Preferred lender arrangement has the same meaning as in section 151 of the Higher Education Act of 1965 (*20 U.S.C. 1019*).

(5) Private education loan means an extension of credit that:

(i) Is not made, insured, or guaranteed under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*);

(ii) Is extended to a consumer expressly, in whole or in part, for postsecondary educational expenses, regardless of whether the loan is provided by the educational institution that the student attends;

(iii) Does not include open-end credit any loan that is secured by real property or a dwelling; and

(iv) Does not include an extension of credit in which the covered educational institution is the creditor if:

(A) The term of the extension of credit is 90 days or less; or

(B) an interest rate will not be applied to the credit balance and the term of the extension of credit is one year or less, even if the credit is payable in more than four installments.

(c) Form of disclosures.

(1) Clear and conspicuous. The disclosures required by this subpart shall be made clearly and conspicuously.

(2) Transaction disclosures.

(i) The disclosures required under §§ 226.47(b) and (c) shall be made in writing, in a form that the consumer may keep. The disclosures shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related to the disclosures required under §§ 226.47(b) and (c), which include the disclosures required under § 226.18.

(ii) The disclosures may include an acknowledgement of receipt, the date of the transaction, and the consumer's name, address, and account number. The following disclosures may be made together with or separately from other required disclosures: the creditor's identity under § 226.18(a), insurance or debt cancellation under § 226.18(n), and certain security interest charges under § 226.18(o).

(iii) The term "finance charge" and corresponding amount, when required to be disclosed under § 226.18(d), and the interest rate required to be disclosed under §§ 226.47(b)(1)(i) and (c)(1), shall be more conspicuous than any other disclosure, except the creditor's identity under § 228.18(a).

(3) Electronic disclosures. The disclosures required under §§ 226.47(b) and (c) may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (*15 U.S.C. 7001 et seq.*). The disclosures required by § 226.47(a) may be provided to the consumer in electronic form on or with an application or solicitation that is accessed by the consumer in electronic form without regard to the consumer consent or other provisions of the E-Sign Act. The form required to be received under § 226.48(e) may be accepted by the creditor in electronic form as provided for in that section.

(d) Timing of disclosures.

(1) Application or solicitation disclosures.

(i) The disclosures required by § 226.47(a) shall be provided on or with any application or solicitation. For purposes of this subpart, the term solicitation means an offer of credit that does not require the consumer to complete an

application. A "firm offer of credit" as defined in section 603(l) of the Fair Credit Reporting Act (*15 U.S.C. 1681a(l)*) is a solicitation for purposes of this section.

(ii) The creditor may, at its option, disclose orally the information in § 226.47(a) in a telephone application or solicitation. Alternatively, if the creditor does not disclose orally the information in § 226.47(a), the creditor must provide the disclosures or place them in the mail no later than three business days after the consumer has applied for the credit, except that, if the creditor either denies the consumer's application or provides or places in the mail the disclosures in § 226.47(b) no later than three business days after the consumer requests the credit, the creditor need not also provide the § 226.47(a) disclosures.

(iii) Notwithstanding paragraph (d)(1)(i), for a loan that the consumer may use for multiple purposes including, but not limited to, postsecondary educational expenses, the creditor need not provide the disclosures required by § 226.47(a).

(2) Approval disclosures. The creditor shall provide the disclosures required by § 226.47(b) before consummation on or with any notice of approval provided to the consumer. If the creditor mails notice of approval, the disclosures must be mailed with the notice. If the creditor communicates notice of approval by telephone, the creditor must mail the disclosures within three business days of providing the notice of approval. If the creditor communicates notice of approval electronically, the creditor may provide the disclosures in electronic form in accordance with § 226.46(d)(3); otherwise the creditor must mail the disclosures within three business days of communicating the notice of approval. If the creditor communicates approval in person, the creditor must provide the disclosures to the consumer at that time.

(3) Final disclosures. The disclosures required by § 226.47(c) shall be provided after the consumer accepts the loan in accordance with § 226.48(c)(1).

(4) Receipt of mailed disclosures. If the disclosures under paragraphs (d)(1), (d)(2) or (d)(3), are mailed to the consumer, the consumer is considered to have received them three business days after they are mailed.

(e) Basis of disclosures and use of estimates

(1) Legal obligation. Disclosures shall reflect the terms of the legal obligation between the parties.

(2) Estimates. If any information necessary for an accurate disclosure is unknown to the creditor, the creditor shall make the disclosure based on the best information reasonably available at the time the disclosure is provided, and shall state clearly that the disclosure is an estimate.

(f) Multiple creditors; multiple consumers. If a transaction involves more than one creditor, only one set of disclosures shall be given and the creditors shall agree among themselves which creditor will comply with the requirements that this part imposes on any or all of them. If there is more than one consumer, the disclosures may be made to any consumer who is primarily liable on the obligation.

(g) Effect of subsequent events.

(1) Approval disclosures. If a disclosure under § 226.47(b) becomes inaccurate because of an event that occurs after the creditor delivers the required disclosures, the inaccuracy is not a violation of Regulation Z (12 CFR part 226), although new disclosures may be required under § 226.48(c).

(2) Final disclosures. If a disclosure under § 226.47(c) becomes inaccurate because of an event that occurs after the creditor delivers the required disclosures, the inaccuracy is not a violation of Regulation Z (12 CFR part 226).

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1B- Consumer Credit Law Manual § 226.47

§ **226.47 Content of disclosures.**

(a) Application or solicitation disclosures. A creditor shall provide the disclosures required under paragraph (a) of this section on or with a solicitation or an application for a private education loan.

(1) Interest Rates.

(i) The interest rate or range of interest rates applicable to the loan and actually offered by the creditor at the time of application or solicitation. If the rate will depend, in part, on a later determination of the consumer's creditworthiness or other factors, a statement that the rate for which the consumer may qualify will depend on the consumer's creditworthiness and other factors, if applicable.

(ii) Whether the interest rates applicable to the loan are fixed or variable.

(iii) If the interest rate may increase after consummation of the transaction, any limitations on the interest rate adjustments, or lack thereof; a statement that the consumer's actual rate could be higher or lower than the rates disclosed under paragraph (a)(1)(i) of this section, if applicable; and, if the limitation is determined by applicable law, that fact.

(iv) Whether the applicable interest rates typically will be higher if the loan is not co-signed or guaranteed.

(2) Fees and default or late payment costs.

(i) An itemization of the fees or range of fees required to obtain the private education loan.

(ii) Any fees, changes to the interest rate, and adjustments to principal based on the consumer's defaults or late payments.

(3) Repayment terms.

(i) The term of the loan, which is the period during which regularly scheduled payments of principal and interest will be due.

(ii) A description of any payment deferral options, or, if the consumer does not have the option to defer payments, that fact.

(iii) For each payment deferral option applicable while the student is enrolled at a covered educational institution:

(A) Whether interest will accrue during the deferral period; and

(B) If interest accrues, whether payment of interest may be deferred and added to the principal balance.

(iv) A statement that if the consumer files for bankruptcy, the consumer may still be required to pay back the loan.

(4) Cost estimates. An example of the total cost of the loan calculated as the total of payments over the term of the loan:

(i) Using the highest rate of interest disclosed under paragraph (a)(1) of this section and including all finance charges applicable to loans at that rate;

(ii) Using an amount financed of $10,000, or $5000 if the creditor only offers loans of this type for less than $10,000; and

(iii) Calculated for each payment option.

(5) Eligibility. Any age or school enrollment eligibility requirements relating to the consumer or co-signer.

(6) Alternatives to private education loans.

(i) A statement that the consumer may qualify for Federal student financial assistance through a program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*).

(ii) The interest rates available under each program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*) and whether the rates are fixed or variable.

(iii) A statement that the consumer may obtain additional information concerning Federal student financial assistance from the institution of higher education that the student attends, or at the Web site of the U.S. Department of Education, including an appropriate Web site address.

(iv) A statement that a covered educational institution may have school-specific education loan benefits and terms not detailed on the disclosure form.

(7) Rights of the consumer. A statement that if the loan is approved, the terms of the loan will be available and will not change for 30 days except as a result of adjustments to the interest rate and other changes permitted by law.

(8) Self-certification information. A statement that, before the loan may be consummated, the consumer must complete the self-certification form and that the form may be obtained from the institution of higher education that the student attends.

(b) Approval disclosures. On or with any notice of approval provided to the consumer, the creditor shall disclose the

information required under § 226.18 and the following information:

(1) Interest rate.

(i) The interest rate applicable to the loan.

(ii) Whether the interest rate is fixed or variable.

(iii) If the interest rate may increase after consummation of the transaction, any limitations on the rate adjustments, or lack thereof.

(2) Fees and default or late payment costs.

(i) An itemization of the fees or range of fees required to obtain the private education loan.

(ii) Any fees, changes to the interest rate, and adjustments to principal based on the consumer's defaults or late payments.

(3) Repayment terms.

(i) The principal amount of the loan for which the consumer has been approved.

(ii) The term of the loan, which is the period during which regularly scheduled payments of principal and interest will be due.

(iii) A description of the payment deferral option chosen by the consumer, if applicable, and any other payment deferral options that the consumer may elect at a later time.

(iv) Any payments required while the student is enrolled at a covered educational institution, based on the deferral option chosen by the consumer.

(v) The amount of any unpaid interest that will accrue while the student is enrolled at a covered educational institution, based on the deferral option chosen by the consumer.

(vi) A statement that if the consumer files for bankruptcy, the consumer may still be required to pay back the loan.

(vii) An estimate of the total amount of payments calculated based on:

(A) The interest rate applicable to the loan. Compliance with § 226.18(h) constitutes compliance with this requirement.

(B) The maximum possible rate of interest for the loan or, if a maximum rate cannot be determined, a rate of 25%.

(C) If a maximum rate cannot be determined, the estimate of the total amount for repayment must include a statement that there is no maximum rate and that the total amount for repayment disclosed under paragraph (b)(3)(vii)(B) of this section is an estimate and will be higher if the applicable interest rate increases.

(viii) The maximum monthly payment based on the maximum rate of interest for the loan or, if a maximum rate cannot be determined, a rate of 25%. If a maximum cannot be determined, a statement that there is no maximum rate and that the monthly payment amount disclosed is an estimate and will be higher if the applicable interest rate increases.

(4) Alternatives to private education loans.

(i) A statement that the consumer may qualify for Federal student financial assistance through a program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*).

(ii) The interest rates available under each program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*), and whether the rates are fixed or variable.

(iii) A statement that the consumer may obtain additional information concerning Federal student financial assistance from the institution of higher education that the student attends, or at the Web site of the U.S. Department of Education, including an appropriate Web site address.

(5) Rights of the consumer.

(i) A statement that the consumer may accept the terms of the loan until the acceptance period under § 226.48(c)(1) has expired. The statement must include the specific date on which the acceptance period expires, based on the date upon which the consumer receives the disclosures required under this subsection for the loan. The disclosure must also specify the method or methods by which the consumer may communicate acceptance.

(ii) A statement that, except for changes to the interest rate and other changes permitted by law, the rates and terms of the loan may not be changed by the creditor during the period described in paragraph (b)(5)(i) of this section.

(c) Final disclosures. After the consumer has accepted the loan in accordance with § 226.48(c)(1), the creditor shall disclose to the consumer the information required by § 226.18 and the following information:

(1) Interest rate. Information required to be disclosed under §§ 226.47(b)(1).

(2) Fees and default or late payment costs. Information required to be disclosed under § 226.47(b)(2).

(3) Repayment terms. Information required to be disclosed under § 226.47(b)(3).

(4) Cancellation right. A statement that:

(i) the consumer has the right to cancel the loan, without penalty, at any time before the cancellation period under § 226.48(d) expires, and

(ii) loan proceeds will not be disbursed until after the cancellation period under § 226.48(d) expires. The statement must include the specific date on which the cancellation period expires and state that the consumer may cancel by that date. The statement must also specify the method or methods by which the consumer may cancel. If the creditor permits

cancellation by mail, the statement must specify that the consumer's mailed request will be deemed timely if placed in the mail not later than the cancellation date specified on the disclosure. The disclosures required by this paragraph (c)(4) must be made more conspicuous than any other disclosure required under this section, except for the finance charge, the interest rate, and the creditor's identity, which must be disclosed in accordance with the requirements of § 226.46(c)(2)(iii).

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1B- Consumer Credit Law Manual § 226.48

§ **226.48 Limitations on private education loans.**

(a) Co-branding prohibited.

(1) Except as provided in paragraph (b) of this section, a creditor, other than the covered educational institution itself, shall not use the name, emblem, mascot, or logo of a covered educational institution, or other words, pictures, or symbols identified with a covered educational institution, in the marketing of private education loans in a way that implies that the covered education institution endorses the creditor's loans.

(2) A creditor's marketing of private education loans does not imply that the covered education institution endorses the creditor's loans if the marketing includes a clear and conspicuous disclosure that is equally prominent and closely proximate to the reference to the covered educational institution that the covered educational institution does not endorse the creditor's loans and that the creditor is not affiliated with the covered educational institution.

(b) Endorsed lender arrangements. If a creditor and a covered educational institution have entered into an arrangement where the covered educational institution agrees to endorse the creditor's private education loans, and such arrangement is not prohibited by other applicable law or regulation, paragraph (a)(1) of this section does not apply if the private education loan marketing includes a clear and conspicuous disclosure that is equally prominent and closely proximate to the reference to the covered educational institution that the creditor's loans are not offered or made by the covered educational institution, but are made by the creditor.

(c) Consumer's right to accept.

(1) The consumer has the right to accept the terms of a private education loan at any time within 30 calendar days following the date on which the consumer receives the disclosures required under § 226.47(b).

(2) Except for changes permitted under paragraphs (c)(3) and (c)(4), the rate and terms of the private education loan that are required to be disclosed under §§ 226.47(b) and (c) may not be changed by the creditor prior to the earlier of:

(i) The date of disbursement of the loan; or

(ii) The expiration of the 30 calendar day period described in paragraph (c)(1) of this section if the consumer has not accepted the loan within that time.

(3) Exceptions not requiring re-disclosure.

(i) Notwithstanding paragraph (c)(2) of this section, nothing in this section prevents the creditor from:

(A) Withdrawing an offer before consummation of the transaction if the extension of credit would be prohibited by law or if the creditor has reason to believe that the consumer has committed fraud in connection with the loan application;

(B) Changing the interest rate based on adjustments to the index used for a loan;

(C) Changing the interest rate and terms if the change will unequivocally benefit the consumer; or

(D) Reducing the loan amount based upon a certification or other information received from the covered educational institution, or from the consumer, indicating that the student's cost of attendance has decreased or the consumer's other financial aid has increased. A creditor may make corresponding changes to the rate and other terms only to the extent that the consumer would have received the terms if the consumer had applied for the reduced loan amount.

(ii) If the creditor changes the rate or terms of the loan under this paragraph (c)(3), the creditor need not provide the

disclosures required under § 228.47(b) for the new loan terms, nor need the creditor provide an additional 30-day period to the consumer to accept the new terms of the loan under paragraph (c)(1) of this section.

(4) Exceptions requiring re-disclosure. (i) Notwithstanding paragraphs (c)(2) or (c)(3) of this section, nothing in this section prevents the creditor, at its option, from changing the rate or terms of the loan to accommodate a specific request by the consumer. For example, if the consumer requests a different repayment option, the creditor may, but need not, offer to provide the requested repayment option and make any other changes to the rate and terms.

(ii) If the creditor changes the rate or terms of the loan under this paragraph (c)(4), the creditor shall provide the disclosures required under § 228.47(b) and shall provide the consumer the 30-day period to accept the loan under paragraph (c)(1) of this section. The creditor shall not make further changes to the rates and terms of the loan, except as specified in paragraphs (c)(3) and (4) of this section. Except as permitted under § 226.48(c)(3), unless the consumer accepts the loan offered by the creditor in response to the consumer's request, the creditor may not withdraw or change the rates or terms of the loan for which the consumer was approved prior to the consumer's request for a change in loan terms.

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Subpart G Special Rules Applicable to Credit Card Accounts and Open-End Credit Offered to College Students

1B- Consumer Credit Law Manual § 226.51

§ **226.51 Ability to Pay.**

(a) **General rule.**

(1)

(i) Consideration of ability to pay. A card issuer must not open a credit card account for a consumer under an open-end (not home-secured) consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required minimum periodic payments under the terms of the account based on the consumer's income or assets and current obligations.

(ii) Reasonable policies and procedures. Card issuers must establish and maintain reasonable written policies and procedures to consider a consumer's income or assets and current obligations. Reasonable policies and procedures to consider a consumer's ability to make the required payments include a consideration of at least one of the following: The ratio of debt obligations to income; the ratio of debt obligations to assets; or the income the consumer will have after paying debt obligations. It would be unreasonable for a card issuer to not review any information about a consumer's income, assets, or current obligations, or to issue a credit card to a consumer who does not have any income or assets.

(2) Minimum periodic payments.

(i) Reasonable method. For purposes of paragraph (a)(1) of this section, a card issuer must use a reasonable method

for estimating the minimum periodic payments the consumer would be required to pay under the terms of the account.

(ii) Safe harbor. A card issuer complies with paragraph (a)(2)(i) of this section if it estimates required minimum periodic payments using the following method:

(A) The card issuer assumes utilization, from the first day of the billing cycle, of the full credit line that the issuer is considering offering to the consumer; and

(B) The card issuer uses a minimum payment formula employed by the issuer for the product the issuer is considering offering to the consumer or, in the case of an existing account, the minimum payment formula that currently applies to that account, provided that:

(1) If the applicable minimum payment formula includes interest charges, the card issuer estimates those charges using an interest rate that the issuer is considering offering to the consumer for purchases or, in the case of an existing account, the interest rate that currently applies to purchases; and

(2) If the applicable minimum payment formula includes mandatory fees, the card issuer must assume that such fees have been charged to the account.

(b) Rules affecting young consumers.

(1) Applications from young consumers. A card issuer may not open a credit card account under an open-end (not home-secured) consumer credit plan for a consumer less than 21 years old, unless the consumer has submitted a written application and the card issuer has:

(i) Financial information indicating the consumer has an independent ability to make the required minimum periodic payments on the proposed extension of credit in connection with the account, consistent with paragraph (a) of this section; or

(ii)

(A) A signed agreement of a cosigner, guarantor, or joint applicant who is at least 21 years old to be either secondarily liable for any debt on the account incurred by the consumer before the consumer has attained the age of 21 or jointly liable with the consumer for any debt on the account, and

(B) Financial information indicating such cosigner, guarantor, or joint applicant has the ability to make the required minimum periodic payments on such debts, consistent with paragraph (a) of this section.

(2) Credit line increases for young consumers. If a credit card account has been opened pursuant to paragraph (b)(1)(ii) of this section, no increase in the credit limit may be made on such account before the consumer attains the age of 21 unless the cosigner, guarantor, or joint accountholder who assumed liability at account opening agrees in writing to assume liability on the increase.

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1B- Consumer Credit Law Manual § 226.52

§ **226.52 Limitations on fees.**

(a) Limitations during first year after account opening.

(1) General rule. Except as provided in paragraph (a)(2) of this section, if a card issuer charges any fees to a credit card account under an open-end (not home-secured) consumer credit plan during the first year after the account is opened, the total amount of fees the consumer is required to pay with respect to the account during that year must not exceed 25 percent of the credit limit in effect when the account is opened.

(2) Fees not subject to limitations. Paragraph (a) of this section does not apply to:

(i) Late payment fees, over-the-limit fees, and returned-payment fees; or

(ii) Fees that the consumer is not required to pay with respect to the account.

(3) Rule of construction. This paragraph (a) does not authorize the imposition or payment of fees or charges otherwise prohibited by law.

(b) [Reserved].

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1B- Consumer Credit Law Manual § 226.53

§ 226.53 Allocation of payments.

(a) General rule. Except as provided in paragraph (b) of this section, when a consumer makes a payment in excess of the required minimum periodic payment for a credit card account under an open-end (not home-secured) consumer credit plan, the card issuer must allocate the excess amount first to the balance with the highest annual percentage rate and any remaining portion to the other balances in descending order based on the applicable annual percentage rate.

(b) Special rule for accounts with balances subject to deferred interest or similar programs. When a balance on a credit card account under an open-end (not home-secured) consumer credit plan is subject to a deferred interest or similar program that provides that a consumer will not be obligated to pay interest that accrues on the balance if the balance is paid in full prior to the expiration of a specified period of time:

(1) Last two billing cycles. The card issuer must allocate any amount paid by the consumer in excess of the required minimum periodic payment consistent with paragraph (a) of this section, except that, during the two billing cycles immediately preceding expiration of the specified period, the excess amount must be allocated first to the balance subject to the deferred interest or similar program and any remaining portion allocated to any other balances consistent with paragraph (a) of this section; or

(2) Consumer request. The card issuer may at its option allocate any amount paid by the consumer in excess of the required minimum periodic payment among the balances on the account in the manner requested by the consumer.

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1B- Consumer Credit Law Manual § 226.54

§ **226.54 Limitations on the imposition of finance charges.**

(a) Limitations on imposing finance charges as a result of the loss of a grace period.

(1) General rule. Except as provided in paragraph (b) of this section, a card issuer must not impose finance charges as a result of the loss of a grace period on a credit card account under an open-end (not home-secured) consumer credit plan if those finance charges are based on:

(i) Balances for days in billing cycles that precede the most recent billing cycle; or

(ii) Any portion of a balance subject to a grace period that was repaid prior to the expiration of the grace period.

(2) Definition of grace period. For purposes of paragraph (a)(1) of this section, "grace period" has the same meaning as in § 226.5(b)(2)(ii)(B)(3).

(b) Exceptions. Paragraph (a) of this section does not apply to:

(1) Adjustments to finance charges as a result of the resolution of a dispute under § 226.12 or § 226.13; or

(2) Adjustments to finance charges as a result of the return of a payment.

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1B- Consumer Credit Law Manual § 226.55

§ 226.55 Limitations on increasing annual percentage rates, fees, and charges.

(a) General rule. Except as provided in paragraph (b) of this section, a card issuer must not increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) on a credit card account under an open-end (not home-secured) consumer credit plan.

(b) Exceptions. A card issuer may increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) pursuant to an exception set forth in this paragraph even if that increase would not be permitted under a different exception.

(1) Temporary rate exception. A card issuer may increase an annual percentage rate upon the expiration of a specified period of six months or longer, provided that:

(i) Prior to the commencement of that period, the card issuer disclosed in writing to the consumer, in a clear and conspicuous manner, the length of the period and the annual percentage rate that would apply after expiration of the period; and

(ii) Upon expiration of the specified period:

(A) The card issuer must not apply an annual percentage rate to transactions that occurred prior to the period that

exceeds the annual percentage rate that applied to those transactions prior to the period;

(B) If the disclosures required by paragraph (b)(1)(i) of this section are provided pursuant to § 226.9(c), the card issuer must not apply an annual percentage rate to transactions that occurred within 14 days after provision of the notice that exceeds the annual percentage rate that applied to that category of transactions prior to provision of the notice; and

(C) The card issuer must not apply an annual percentage rate to transactions that occurred during the period that exceeds the increased annual percentage rate disclosed pursuant to paragraph (b)(1)(i) of this section.

(2) Variable rate exception. A card issuer may increase an annual percentage rate when:

(i) The annual percentage rate varies according to an index that is not under the card issuer's control and is available to the general public; and

(ii) The increase in the annual percentage rate is due to an increase in the index.

(3) Advance notice exception. A card issuer may increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) after complying with the applicable notice requirements in § 226.9(b), (c), or (g), provided that:

(i) If a card issuer discloses an increased annual percentage rate, fee, or charge pursuant to § 226.9(b), the card issuer must not apply that rate, fee, or charge to transactions that occurred prior to provision of the notice;

(ii) If a card issuer discloses an increased annual percentage rate, fee, or charge pursuant to § 226.9(c) or (g), the card issuer must not apply that rate, fee, or charge to transactions that occurred prior to or within 14 days after provision of the notice; and

(iii) This exception does not permit a card issuer to increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) during the first year after the account is opened.

(4) Delinquency exception. A card issuer may increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) due to the card issuer not receiving the consumer's required

minimum periodic payment within 60 days after the due date for that payment, provided that:

(i) The card issuer must disclose in a clear and conspicuous manner in the notice of the increase pursuant to § 226.9(c) or (g):

(A) A statement of the reason for the increase; and

(B) That the increased annual percentage rate, fee, or charge will cease to apply if the card issuer receives six consecutive required minimum periodic payments on or before the payment due date beginning with the first payment due following the effective date of the increase; and

(ii) If the card issuer receives six consecutive required minimum periodic payments on or before the payment due date beginning with the first payment due following the effective date of the increase, the card issuer must reduce any annual percentage rate, fee, or charge increased pursuant to this exception to the annual percentage rate, fee, or charge that applied prior to the increase with respect to transactions that occurred prior to or within 14 days after provision of the § 226.9(c) or (g) notice.

(5) Workout and temporary hardship arrangement exception. A card issuer may increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) due to the consumer's completion of a workout or temporary hardship arrangement or the consumer's failure to comply with the terms of such an arrangement, provided that:

(i) Prior to commencement of the arrangement (except as provided in § 226.9(c)(2)(v)(D)), the card issuer has provided the consumer with a clear and conspicuous written disclosure of the terms of the arrangement (including any increases due to the completion or failure of the arrangement); and

(ii) Upon the completion or failure of the arrangement, the card issuer must not apply to any transactions that occurred prior to commencement of the arrangement an annual percentage rate, fee, or charge that exceeds the annual percentage rate, fee, or charge that applied to those transactions prior to commencement of the arrangement.

(6) Servicemembers Civil Relief Act exception. If an annual percentage rate has been decreased pursuant to *50 U.S.C. app. 527*, a card issuer may increase that annual percentage rate once *50 U.S.C. app. 527* no longer applies, provided that the card issuer must not apply to any transactions that occurred prior to the decrease an annual percentage rate that exceeds the annual percentage rate that applied to those transactions prior to the decrease.

(c) Treatment of protected balances.

(1) Definition of protected balance. For purposes of this paragraph, "protected balance" means the amount owed for a category of transactions to which an increased annual percentage rate or an increased fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) cannot be applied after the annual percentage rate, fee, or charge for that category of transactions has been increased pursuant to paragraph (b)(3) of this section.

(2) Repayment of protected balance. The card issuer must not require repayment of the protected balance using a method that is less beneficial to the consumer than one of the following methods:

(i) The method of repayment for the account before the effective date of the increase;

(ii) An amortization period of not less than five years, beginning no earlier than the effective date of the increase; or

(iii) A required minimum periodic payment that includes a percentage of the balance that is equal to no more than twice the percentage required before the effective date of the increase.

(d) Continuing application. This section continues to apply to a balance on a credit card account under an open-end (not home-secured) consumer credit plan after:

(1) The account is closed or acquired by another creditor; or

(2) The balance is transferred from a credit card account under an open-end (not home-secured) consumer credit plan issued by a creditor to another credit account issued by the same creditor or its affiliate or subsidiary (unless the account to which the balance is transferred is subject to § 226.5b).

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1B- Consumer Credit Law Manual § 226.56

§ **226.56 Requirements for over-the-limit transactions.**

(a) Definition. For purposes of this section, the term "over-the-limit transaction" means any extension of credit by a card issuer to complete a transaction that causes a consumer's credit card account balance to exceed the credit limit.

(b) Opt-in requirement.

(1) General. A card issuer shall not assess a fee or charge on a consumer's credit card account under an open-end (not home-secured) consumer credit plan for an over-the-limit transaction unless the card issuer:

(i) Provides the consumer with an oral, written or electronic notice, segregated from all other information, describing the consumer's right to affirmatively consent, or opt in, to the card issuer's payment of an over-the-limit transaction;

(ii) Provides a reasonable opportunity for the consumer to affirmatively consent, or opt in, to the card issuer's payment of over-the-limit transactions;

(iii) Obtains the consumer's affirmative consent, or opt-in, to the card issuer's payment of such transactions;

(iv) Provides the consumer with confirmation of the consumer's consent in writing, or if the consumer agrees, electronically; and

(v) Provides the consumer notice in writing of the right to revoke that consent following the assessment of an over-the-limit fee or charge.

(2) Completion of over-the-limit transactions without consumer consent. Notwithstanding the absence of a consumer's affirmative consent under paragraph (b)(1)(iii) of this section, a card issuer may pay any over-the-limit transaction on a consumer's account provided that the card issuer does not impose any fee or charge on the account for paying that over-the-limit transaction.

(c) Method of election. A card issuer may permit a consumer to consent to the card issuer's payment of any over-the-limit transaction in writing, orally, or electronically, at the card issuer's option. The card issuer must also permit the consumer to revoke his or her consent using the same methods available to the consumer for providing consent.

(d) Timing and placement of notices.

(1) Initial notice.

(i) General. The notice required by paragraph (b)(1)(i) of this section shall be provided prior to the assessment of any over-the-limit fee or charge on a consumer's account.

(ii) Oral or electronic consent. If a consumer consents to the card issuer's payment of any over-the-limit transaction by oral or electronic means, the card issuer must provide the notice required by paragraph (b)(1)(i) of this section immediately prior to obtaining that consent.

(2) Confirmation of opt-in. The notice required by paragraph (b)(1)(iv) of this section may be provided no later than the first periodic statement sent after the consumer has consented to the card issuer's payment of over-the-limit transactions.

(3) Notice of right of revocation. The notice required by paragraph (b)(1)(v) of this section shall be provided on the front of any page of each periodic statement that reflects the assessment of an over-the-limit fee or charge on a

consumer's account.

(e) Content.

(1) Initial notice. The notice required by paragraph (b)(1)(i) of this section shall include all applicable items in this paragraph (e)(1) and may not contain any information not specified in or otherwise permitted by this paragraph.

(i) Fees. The dollar amount of any fees or charges assessed by the card issuer on a consumer's account for an over-the-limit transaction;

(ii) APRs. Any increased periodic rate(s) (expressed as an annual percentage rate(s)) that may be imposed on the account as a result of an over-the-limit transaction; and

(iii) Disclosure of opt-in right. An explanation of the consumer's right to affirmatively consent to the card issuer's payment of over-the-limit transactions, including the method(s) by which the consumer may consent.

(2) Subsequent notice. The notice required by paragraph (b)(1)(v) of this section shall describe the consumer's right to revoke any consent provided under paragraph (b)(1)(iii) of this section, including the method(s) by which the consumer may revoke.

(3) Safe harbor. Use of Model Forms G-25(A) or G-25(B) of Appendix G to this part, or substantially similar notices, constitutes compliance with the notice content requirements of paragraph (e) of this section.

(f) Joint relationships. If two or more consumers are jointly liable on a credit card account under an open-end (not home-secured) consumer credit plan, the card issuer shall treat the affirmative consent of any of the joint consumers as affirmative consent for that account. Similarly, the card issuer shall treat a revocation of consent by any of the joint consumers as revocation of consent for that account.

(g) Continuing right to opt in or revoke opt-in. A consumer may affirmatively consent to the card issuer's payment of over-the-limit transactions at any time in the manner described in the notice required by paragraph (b)(1)(i) of this section. Similarly, the consumer may revoke the consent at any time in the manner described in the notice required by paragraph (b)(1)(v) of this section.

(h) Duration of opt-in. A consumer's affirmative consent to the card issuer's payment of over-the-limit transactions is effective until revoked by the consumer, or until the card issuer decides for any reason to cease paying over-the-limit transactions for the consumer.

(i) Time to comply with revocation request. A card issuer must comply with a consumer's revocation request as soon as reasonably practicable after the card issuer receives it.

(j) Prohibited practices. Notwithstanding a consumer's affirmative consent to a card issuer's payment of over-the-limit transactions, a card issuer is prohibited from engaging in the following practices:

(1) Fees or charges imposed per cycle.

(i) General rule. A card issuer may not impose more than one over-the-limit fee or charge on a consumer's credit card account per billing cycle, and, in any event, only if the credit limit was exceeded during the billing cycle. In addition, except as provided in paragraph (j)(1)(ii) of this section, a card issuer may not impose an over-the-limit fee or charge on the consumer's credit card account for more than three billing cycles for the same over-the-limit transaction where the consumer has not reduced the account balance below the credit limit by the payment due date for either of the last two billing cycles.

(ii) Exception. The prohibition in paragraph (j)(1)(i) of this section on imposing an over-the-limit fee or charge in more than three billing cycles for the same over-the-limit transaction(s) does not apply if another over-the-limit transaction occurs during either of the last two billing cycles.

(2) Failure to promptly replenish. A card issuer may not impose an over-the-limit fee or charge solely because of the card issuer's failure to promptly replenish the consumer's available credit following the crediting of the consumer's payment under § 226.10.

(3) Conditioning. A card issuer may not condition the amount of a consumer's credit limit on the consumer affirmatively consenting to the card issuer's payment of over-the-limit transactions if the card issuer assesses a fee or charge for such service.

(4) Over-the-limit fees attributed to fees or interest. A card issuer may not impose an over-the-limit fee or charge for a billing cycle if a consumer exceeds a credit limit solely because of fees or interest charged by the card issuer to the consumer's account during that billing cycle. For purposes of this paragraph (j)(4), the relevant fees or interest charges

are charges imposed as part of the plan under § 226.6(b)(3).

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1B- Consumer Credit Law Manual § 226.57

§ **226.57 Reporting and marketing rules for college student open-end credit.**

(a) Definitions:

(1) College student credit card. The term "college student credit card" as used in this section means a credit card issued under a credit card account under an open-end (not home-secured) consumer credit plan to any college student.

(2) College student. The term "college student" as used in this section means a consumer who is a full-time or part-time student of an institution of higher education.

(3) Institution of higher education. The term "institution of higher education" as used in this section has the same meaning as in sections 101 and 102 of the Higher Education Act of 1965 (*20 U.S.C. 1001* and *1002*).

(4) Affiliated organization. The term "affiliated organization" as used in this section means an alumni organization or foundation affiliated with or related to an institution of higher education.

(5) College credit card agreement. The term "college credit card agreement" as used in this section means any business, marketing or promotional agreement between a card issuer and an institution of higher education or an affiliated organization in connection with which college student credit cards are issued to college students currently enrolled at that institution.

(b) Public disclosure of agreements. An institution of higher education shall publicly disclose any contract or other agreement made with a card issuer or creditor for the purpose of marketing a credit card.

(c) Prohibited inducements. No card issuer or creditor may offer a college student any tangible item to induce such student to apply for or open an open-end consumer credit plan offered by such card issuer or creditor, if such offer is made:

(1) On the campus of an institution of higher education;

(2) Near the campus of an institution of higher education; or

(3) At an event sponsored by or related to an institution of higher education.

(d) Annual report to the Board.

(1) Requirement to report. Any card issuer that was a party to one or more college credit card agreements in effect at any time during a calendar year must submit to the Board an annual report regarding those agreements in the form and manner prescribed by the Board.

(2) Contents of report. The annual report to the Board must include the following:

(i) Identifying information about the card issuer and the agreements submitted, including the issuer's name, address, and identifying number (such as an RSSD ID number or tax identification number);

(ii) A copy of any college credit card agreement to which the card issuer was a party that was in effect at any time during the period covered by the report;

(iii) A copy of any memorandum of understanding in effect at any time during the period covered by the report between the card issuer and an institution of higher education or affiliated organization that directly or indirectly relates to the college credit card agreement or that controls or directs any obligations or distribution of benefits between any

such entities;

(iv) The total dollar amount of any payments pursuant to a college credit card agreement from the card issuer to an institution of higher education or affiliated organization during the period covered by the report, and the method or formula used to determine such amounts;

(v) The total number of credit card accounts opened pursuant to any college credit card agreement during the period covered by the report; and

(vi) The total number of credit card accounts opened pursuant to any such agreement that were open at the end of the period covered by the report.

(3) Timing of reports. Except for the initial report described in this § 226.57(d)(3), a card issuer must submit its annual report for each calendar year to the Board by the first business day on or after March 31 of the following calendar year. Card issuers must submit the first report following the effective date of this section, providing information for the 2009 calendar year, to the Board by February 22, 2010.

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1B- Consumer Credit Law Manual § 226.58

§ 226.58 Internet posting of credit card agreements.

(a) Applicability. The requirements of this section apply to any card issuer that issues credit cards under a credit card account under an open-end (not home-secured) consumer credit plan.

(b) Definitions.

(1) Agreement. For purposes of this section, "agreement" or "credit card agreement" means the written document or documents evidencing the terms of the legal obligation, or the prospective legal obligation, between a card issuer and a consumer for a credit card account under an open-end (not home-secured) consumer credit plan. "Agreement" or "credit card agreement" also includes the pricing information, as defined in § 226.58(b)(6).

(2) Amends. For purposes of this section, an issuer "amends" an agreement if it makes a substantive change (an "amendment") to the agreement. A change is substantive if it alters the rights or obligations of the card issuer or the consumer under the agreement. Any change in the pricing information, as defined in § 226.58(b)(6), is deemed to be substantive.

(3) Business day. For purposes of this section, "business day" means a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions.

(4) Offers. For purposes of this section, an issuer "offers" or "offers to the public" an agreement if the issuer is soliciting or accepting applications for accounts that would be subject to that agreement.

(5) Open account. For purposes of this section, an account is an "open account" or "open credit card account" if it is a credit card account under an open-end (not home-secured) consumer credit plan and either:

(i) The cardholder can obtain extensions of credit on the account; or

(ii) There is an outstanding balance on the account that has not been charged off. An account that has been suspended temporarily (for example, due to a report by the cardholder of unauthorized use of the card) is considered an "open account" or "open credit card account."

(6) Pricing information. For purposes of this section, "pricing information" means the information listed in § 226.6(b)(2)(i) through (b)(2)(xii) and (b)(4). Pricing information does not include temporary or promotional rates and terms or rates and terms that apply only to protected balances.

(7) Private label credit card account and private label credit card plan. For purposes of this section:

(i) "private label credit card account" means a credit card account under an open-end (not home-secured) consumer credit plan with a credit card that can be used to make purchases only at a single merchant or an affiliated group of merchants; and

(ii) "private label credit card plan" means all of the private label credit card accounts issued by a particular issuer with credit cards usable at the same single merchant or affiliated group of merchants.

(c) Submission of agreements to Board.

(1) Quarterly submissions. A card issuer must make quarterly submissions to the Board, in the form and manner specified by the Board, that contain:

(i) Identifying information about the card issuer and the agreements submitted, including the issuer's name, address, and identifying number (such as an RSSD ID number or tax identification number);

(ii) The credit card agreements that the card issuer offered to the public as of the last business day of the preceding calendar quarter that the card issuer has not previously submitted to the Board;

(iii) Any credit card agreement previously submitted to the Board that was amended during the preceding calendar quarter, as described in § 226.58(c)(3); and

(iv) Notification regarding any credit card agreement previously submitted to the Board that the issuer is withdrawing, as described in § 226.58(c)(4) and (c)(5).

(2) Timing of first two submissions. The first submission following the effective date of this section must be sent to the Board no later than February 22, 2010, and must contain the credit card agreements that the card issuer offered to the public as of December 31, 2009. The next submission must be sent to the Board no later than August 2, 2010, and must contain:

(i) Any credit card agreement that the card issuer offered to the public as of June 30, 2010, that the card issuer has not previously submitted to the Board;

(ii) Any credit card agreement previously submitted to the Board that was amended after December 31, 2009, and on or before June 30, 2010, as described in § 226.58(c)(3); and

(iii) Notification regarding any credit card agreement previously submitted to the Board that the issuer is withdrawing as of June 30, 2010, as described in § 226.58(c)(4) and (c)(5).

(3) Amended agreements. If a credit card agreement has been submitted to the Board, the agreement has not been amended and the card issuer continues to offer the agreement to the public, no additional submission regarding that agreement is required. If a credit card agreement that previously has been submitted to the Board is amended, the card issuer must submit the entire amended agreement to the Board, in the form and manner specified by the Board, by the first quarterly submission deadline after the last day of the calendar quarter in which the change became effective.

(4) Withdrawal of agreements. If a card issuer no longer offers to the public a credit card agreement that previously has been submitted to the Board, the card issuer must notify the Board, in the form and manner specified by the Board, by the first quarterly submission deadline after the last day of the calendar quarter in which the issuer ceased to offer the agreement.

(5) De minimis exception.

(i) A card issuer is not required to submit any credit card agreements to the Board if the card issuer had fewer than 10,000 open credit card accounts as of the last business day of the calendar quarter.

(ii) If an issuer that previously qualified for the de minimis exception ceases to qualify, the card issuer must begin making quarterly submissions to the Board no later than the first quarterly submission deadline after the date as of which the issuer ceased to qualify.

(iii) If a card issuer that did not previously qualify for the de minimis exception qualifies for the de minimis exception, the card issuer must continue to make quarterly submissions to the Board until the issuer notifies the Board that the card issuer is withdrawing all agreements it previously submitted to the Board.

(6) Private label credit card exception.

(i) A card issuer is not required to submit to the Board a credit card agreement if, as of the last business day of the calendar quarter, the agreement:

(A) is offered for accounts under one or more private label credit card plans each of which has fewer than 10,000 open accounts; and

(B) is not offered to the public other than for accounts under such a plan.

(ii) If an agreement that previously qualified for the private label credit card exception ceases to qualify, the card issuer must submit the agreement to the Board no later than the first quarterly submission deadline after the date as of which the agreement ceased to qualify.

(iii) If an agreement that did not previously qualify for the private label credit card exception qualifies for the exception, the card issuer must continue to make quarterly submissions to the Board with respect to that agreement until the issuer notifies the Board that the agreement is being withdrawn.

(7) Product testing exception.

(i) A card issuer is not required to submit to the Board a credit card agreement if, as of the last business day of the calendar quarter, the agreement:

(A) is offered as part of a product test offered to only a limited group of consumers for a limited period of time;

(B) is used for fewer than 10,000 open accounts; and

(C) is not offered to the public other than in connection with such a product test.

(ii) If an agreement that previously qualified for the product testing exception ceases to qualify, the card issuer must submit the agreement to the Board no later than the first quarterly submission deadline after the date as of which the agreement ceased to qualify.

(iii) If an agreement that did not previously qualify for the product testing exception qualifies for the exception, the card issuer must continue to make quarterly submissions to the Board with respect to that agreement until the issuer notifies the Board that the agreement is being withdrawn.

(8) Form and content of agreements submitted to the Board.

(i) Form and content generally.

(A) Each agreement must contain the provisions of the agreement and the pricing information in effect as of the last business day of the preceding calendar quarter.

(B) Agreements must not include any personally identifiable information relating to any cardholder, such as name, address, telephone number, or account number.

(C) The following are not deemed to be part of the agreement for purposes of § 226.58, and therefore are not required to be included in submissions to the Board:

(1) disclosures required by state or federal law, such as affiliate marketing notices, privacy policies, or disclosures under the E-Sign Act;

(2) solicitation materials;

(3) periodic statements;

(4) ancillary agreements between the issuer and the consumer, such as debt cancellation contracts or debt suspension agreements;

(5) offers for credit insurance or other optional products and other similar advertisements; and

(6) documents that may be sent to the consumer along with the credit card or credit card agreement such as a cover letter, a validation sticker on the card, or other information about card security.

(D) Agreements must be presented in a clear and legible font.

(ii) Pricing information.

(A) Pricing information must be set forth in a single addendum to the agreement that contains only the pricing information.

(B) Pricing information that may vary from one cardholder to another depending on the cardholder's creditworthiness or state of residence or other factors must be disclosed either by setting forth all the possible variations (such as purchase APRs of 13 percent, 15 percent, 17 percent, and 19 percent) or by providing a range of possible variations (such as purchase APRs ranging from 13 percent to 19 percent).

(C) If a rate included in the pricing information is a variable rate, the issuer must identify the index or formula used in setting the rate and the margin. Rates that may vary from one cardholder to another must be disclosed by providing the index and the possible margins (such as the prime rate plus 5 percent, 8 percent, 10 percent, or 12 percent) or range of margins (such as the prime rate plus from 5 to 12 percent). The value of the rate and the value of the index are not required to be disclosed.

(iii) Optional variable terms addendum. Provisions of the agreement other than the pricing information that may vary from one cardholder to another depending on the cardholder's creditworthiness or state of residence or other factors may be set forth in a single addendum to the agreement separate from the pricing information addendum.

(iv) Integrated agreement. Issuers may not provide provisions of the agreement or pricing information in the form of change-in-terms notices or riders (other than the pricing information addendum and the optional variable terms addendum). Changes in provisions or pricing information must be integrated into the text of the agreement, the pricing information addendum or the optional variable terms addendum, as appropriate.

(d) Posting of agreements offered to the public.

(1) Except as provided below, a card issuer must post and maintain on its publicly available Web site the credit card agreements that the issuer is required to submit to the Board under § 226.58(c). With respect to an agreement offered solely for accounts under one or more private label credit card plans, an issuer may fulfill this requirement by posting and maintaining the agreement in accordance with the requirements of this section on the publicly available Web site of at least one of the merchants at which credit cards issued under each private label credit card plan with 10,000 or more open accounts may be used.

(2) Except as provided in § 226.58(d), agreements posted pursuant to § 226.58(d) must conform to the form and content requirements for agreements submitted to the Board specified in § 226.58(c)(8).

(3) Agreements posted pursuant to § 226.58(d) may be posted in any electronic format that is readily usable by the general public. Agreements must be placed in a location that is prominent and readily accessible by the public and must be accessible without submission of personally identifiable information.

(4) The card issuer must update the agreements posted on its Web site pursuant to § 226.58(d) at least as frequently as the quarterly schedule required for submission of agreements to the Board under § 226.58(c). If the issuer chooses to update the agreements on its Web site more frequently, the agreements posted on the issuer's Web site may contain the provisions of the agreement and the pricing information in effect as of a date other than the last business day of the preceding calendar quarter.

(e) Agreements for all open accounts.

(1) Availability of individual cardholder's agreement. With respect to any open credit card account, a card issuer must either:

(i) Post and maintain the cardholder's agreement on its Web site; or

(ii) Promptly provide a copy of the cardholder's agreement to the cardholder upon the cardholder's request. If the card issuer makes an agreement available upon request, the issuer must provide the cardholder with the ability to request a copy of the agreement both by using the issuer's Web site (such as by clicking on a clearly identified box to make the request) and by calling a readily available telephone line the number for which is displayed on the issuer's Web site and clearly identified as to purpose. The card issuer must send to the cardholder or otherwise make available to the cardholder a copy of the cardholder's agreement in electronic or paper form no later than 30 days after the issuer receives the cardholder's request.

(2) Special rule for issuers without interactive Web sites. An issuer that does not maintain a Web site from which cardholders can access specific information about their individual accounts, instead of complying with § 226.58(e)(1), may make agreements available upon request by providing the cardholder with the ability to request a copy of the agreement by calling a readily available telephone line, the number for which is displayed on the issuer's Web site and clearly identified as to purpose or included on each periodic statement sent to the cardholder and clearly identified as to purpose. The issuer must send to the cardholder or otherwise make available to the cardholder a copy of the cardholder's agreement in electronic or paper form no later than 30 days after the issuer receives the cardholder's request.

(3) Form and content of agreements.

(i) Except as provided in § 226.58(e), agreements posted on the card issuer's Web site pursuant to § 226.58(e)(1)(i) or made available upon the cardholder's request pursuant to § 226.58(e)(1)(ii) or (e)(2) must conform to the form and content requirements for agreements submitted to the Board specified in § 226.58(c)(8).

(ii) If the card issuer posts an agreement on its Web site or otherwise provides an agreement to a cardholder electronically under § 226.58(e), the agreement may be posted or provided in any electronic format that is readily usable by the general public and must be placed in a location that is prominent and readily accessible to the cardholder.

(iii) Agreements posted or otherwise provided pursuant to § 226.58(e) may contain personally identifiable information relating to the cardholder, such as name, address, telephone number, or account number, provided that the issuer takes appropriate measures to make the agreement accessible only to the cardholder or other authorized persons.

(iv) Agreements posted or otherwise provided pursuant to § 226.58(e) must set forth the specific provisions and pricing information applicable to the particular cardholder. Provisions and pricing information must be complete and accurate as of a date no more than 60 days prior to: (1) the date on which the agreement is posted on the card issuer's Web site under § 226.58(e)(1)(i); or (2) the date the cardholder's request is received under § 226.58(e)(1)(ii) or (e)(2).

(v) Agreements provided upon cardholder request pursuant to § 226.58(e)(1)(ii) or (e)(2) may be provided by the issuer in either electronic or paper form, regardless of the form of the cardholder's request.

(f) E-Sign Act requirements. Card issuers may provide credit card agreements in electronic form under § 226.58(d) and (e) without regard to the consumer notice and consent requirements of section 101(c) of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (*15 U.S.C. 7001 et seq.*).

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Appendix A to Part 226 Effect on State Laws

1B Consumer Credit Law Manual Appendix A to Part 226

Appendix A to Part 226 Effect on State Laws

Request for Determination

A request for a determination that a State law is inconsistent or that a State law is substantially the same as the Act and regulation shall be in writing and addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. The request shall be made pursuant to the procedures herein and the Board's Rules of Procedure (12 CFR Part 262).

Supporting Documents

A request for a determination shall include the following items:

(1) The text of the State statute, regulation, or other document that is the subject of the request.

(2) Any other statute, regulation, or judicial or administrative opinion that implements, interprets, or applies the relevant provision.

(3) A comparison of the State law with the corresponding provision of the Federal law, including a full discussion of the basis for the requesting party's belief that the State provision is either inconsistent or substantially the same.

(4) Any other information that the requesting party believes may assist the Board in its determination.

Public Notice of Determination

Notice that the Board intends to make a determination (either on request or on its own motion) will be published in the Federal Register, with an opportunity for public comment, unless the Board finds that notice and opportunity for comment would be impracticable, unnecessary, or contrary to the public interest and publishes its reasons for such decision.

Subject to the Board's Rules Regarding Availability of Information (12 CFR Part 261), all requests made, including any documents and other material submitted in support of the requests, will be made available for public inspection and copying.

Notice After Determination

Notice of a final determination will be published in the Federal Register, and the Board will furnish a copy of such notice to the party who made the request and to the appropriate State official.

Reversal of Determination

The Board reserves the right to reverse a determination for any reason bearing on the coverage or effect of State or Federal law.

Notice of reversal of a determination will be published in the Federal Register and a copy furnished to the appropriate State official.
[*46 FR 20892* , Apr. 7, 1981; *46 FR 29246* , June 1, 1981]

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Appendix B to Part 226 State Exemptions

1B Consumer Credit Law Manual Appendix B to Part 226

Appendix B to Part 226 State Exemptions

Application

Any State may apply to the Board for a determination that a class of transactions subject to State law is exempt from the requirements of the Act and this regulation. An application shall be in writing and addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, and shall be signed by the appropriate State official. The application shall be made pursuant to the procedures herein and the Board's Rules of Procedure (12 CFR Part 262).

Supporting Documents

An application shall be accompanied by:

(1) The text of the State statute or regulation that is the subject of the application, and any other statute, regulation, or judicial or administrative opinion that implements, interprets, or applies it.

(2) A comparison of the State law with the corresponding provisions of the Federal law.

(3) The text of the State statute or regulation that provides for civil and criminal liability and administrative enforcement of the State law.

(4) A statement of the provisions for enforcement, including an identification of the State office that administers the relevant law, information on the funding and the number and qualifications of personnel engaged in enforcement, and a description of the enforcement procedures to be followed, including information on examination procedures, practices, and policies. If an exemption application extends to federally chartered institutions, the applicant must furnish evidence that arrangements have been made with the appropriate Federal agencies to ensure adequate enforcement of State law in regard to such creditors.

(5) A statement of reasons to support the applicant's claim that an exemption should be granted.

Public Notice of Application

Notice of an application will be published, with an opportunity for public comment, in the Federal Register, unless the Board finds that notice and opportunity for comment would be impracticable, unnecessary, or contrary to the public interest and publishes its reasons for such decision.

Subject to the Board's Rules Regarding Availability of Information (12 CFR Part 261), all applications made, including any documents and other material submitted in support of the applications, will be made available for public inspection and copying. A copy of the application also will be made available at the Federal Reserve Bank of each district in which the applicant is situated.

Favorable Determination

If the Board determines on the basis of the information before it that an exemption should be granted, notice of the exemption will be published in the Federal Register, and a copy furnished to the applicant and to each Federal official responsible for administrative enforcement.

The appropriate State official shall inform the Board within 30 days of any change in its relevant law or regulations. The official shall file with the Board such periodic reports as the Board may require.

The Board will inform the appropriate State official of any subsequent amendments to the Federal law, regulation, interpretations, or enforcement policies that might require an amendment to State law, regulation, interpretations, or enforcement procedures.

Adverse Determination

If the Board makes an initial determination that an exemption should not be granted, the Board will afford the applicant a reasonable opportunity to demonstrate further that an exemption is proper. If the Board ultimately finds that an exemption should not be granted, notice of an adverse determination will be published in the Federal Register and a copy furnished to the applicant.

Revocation of Exemption

The Board reserves the right to revoke an exemption if at any time it determines that the standards required for an exemption are not met.

Before taking such action, the Board will notify the appropriate State official of its intent, and will afford the official such opportunity as it deems appropriate in the circumstances to demonstrate that revocation is improper. If the Board ultimately finds that revocation is proper, notice of the Board's intention to revoke such exemption will be published in the Federal Register with a reasonable period of time for interested persons to comment.

Notice of revocation of an exemption will be published in the Federal Register. A copy of such notice will be furnished to the appropriate State official and to the Federal officials responsible for enforcement. Upon revocation of an exemption, creditors in that State shall then be subject to the requirements of the Federal law.

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Appendix C to Part 226 Issuance of Staff Interpretations

1B Consumer Credit Law Manual Appendix C to Part 226

Appendix C to Part 226 Issuance of Staff Interpretations

Official Staff Interpretations

Officials in the Board's Division of Consumer and Community Affairs are authorized to issue official staff interpretations of this regulation. These interpretations provide the protection afforded under section 130(f) of the Act. Except in unusual circumstances, such interpretations will not be issued separately but will be incorporated in an official commentary to the regulation which will be amended periodically.

Requests for Issuance of Official Staff Interpretations

A request for an official staff interpretation shall be in writing and addressed to the Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. The request shall contain a complete statement of all relevant facts concerning the issue, including copies of all pertinent documents.

Scope of Interpretations

No staff interpretations will be issued approving creditors' forms, statements, or calculation tools or methods. This restriction does not apply to forms, statements, tools, or methods whose use is required or sanctioned by a government agency.

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Appendix D to Part 226 Multiple Advance Construction Loans

1B Consumer Credit Law Manual Appendix D to Part 226

Appendix D to Part 226 Multiple Advance Construction Loans

Section 226.17(c)(6) permits creditors to treat multiple advance loans to finance construction of a dwelling that may be permanently financed by the same creditor either as a single transaction or as more than one transaction. If the actual schedule of advances is not known, the following methods may be used to estimate the interest portion of the finance charge and the annual percentage rate and to make disclosures. If the creditor chooses to disclose the construction phase separately, whether interest is payable periodically or at the end of construction, Part I may be used. If the creditor chooses to disclose the construction and the permanent financing as one transaction, Part II may be used.

Part I--Construction period disclosed separately

A. If interest is payable only on the amount actually advanced for the time it is outstanding:

1. Estimated interest--Assume that one-half of the commitment amount is outstanding at the contract interest rate for the entire construction period.

2. Estimated annual percentage rate--Assume a single payment loan that matures at the end of the construction period. The finance charge is the sum of the estimated interest and any prepaid finance charge. The amount financed for computation purposes is determined by subtracting any prepaid finance charge from one-half of the commitment amount.

3. Repayment schedule--The number and amounts of any interest payments may be omitted in disclosing the payment schedule under § 226.18(g). The fact that interest payments are required and the timing of such payments shall be disclosed.

4. Amount financed--The amount financed for disclosure purposes is the entire commitment amount less any prepaid finance charge.

B. If interest is payable on the entire commitment amount without regard to the dates or amounts of actual disbursement:

1. Estimated interest--Assume that the entire commitment amount is outstanding at the contract interest rate for the entire construction period.

2. Estimated annual percentage rate--Assume a single payment loan that matures at the end of the construction period. The finance charge is the sum of the estimated interest and any prepaid finance charge. The amount financed for computation purposes is determined by subtracting any prepaid finance charge from one-half of the commitment amount.

3. Repayment schedule--Interest payments shall be disclosed in making the repayment schedule disclosure under § 226.18(g).

4. Amount financed--The amount financed for disclosure purposes is the entire commitment amount less any prepaid finance charge.

Example:

Assume a $50,000 loan commitment at 10.5% interest with a five-month construction period and a prepaid finance charge of two points.

(A)	*(B)*
Estimated interest:	
$25,000 x .105 / 12 x 5 = $1,093.75	$50,000 x .105 / 12 x 5 = $2,187.50
Estimated APR:	
[(1,093.75 + 1,000) x 100] / (25,000 - 1,000) / 5 x 12 = 20.94%	[(2,187.50 + 1,000) x 100] / (25,000 - 1,000) / 5 x 12 = 31.88%

Disclosures	
Amount financed $49,000	$49,000
Prepaid finance charge 1,000	1,000
FINANCE CHARGE (estimate)	
2,093.75	3,187.50
ANNUAL PERCENTAGE RATE (estimate)	
20.94%	31.88%
Repayment:	
One payment of principal of $50,000 on 12-12-80. Interest on the amount of credit outstanding will be paid monthly.	4 monthly payments of $437.50, beginning 8-12-80, and a final payment of $50,437.50 on 12-12-80.
Total of payments (estimate)	
$51,093.75	$52,187.50

Part II--Construction and permanent financing disclosed as one transaction.

A. The creditor shall estimate the interest payable during the construction period to be included in the total finance charge as follows:

1. If interest is payable only on the amount actually advanced for the time it is outstanding, assume that one-half of the commitment amount is outstanding at the contract interest rate for the entire construction period.

2. If interest is payable on the entire commitment amount without regard to the dates or amounts of actual disbursement, assume that the entire commitment amount is outstanding at the contract rate for the entire construction period.

B. The creditor shall compute the estimated annual percentage rate as follows:

1. Estimated interest payable during the construction period shall be treated for computation purposes as a prepaid finance charge (although it shall not be treated as a prepaid finance charge for disclosure purposes).

2. The number of payments shall not include any payments of interest only that are made during the construction period.

3. The first payment period shall consist of one-half of the construction period plus the period between the end of the construction period and the first amortization payment.

C. The creditor shall disclose the repayment schedule as follows:

1. For loans under paragraph A.1. of part II, without reflecting the number or amounts of payments of interest only that are made during the construction period. The fact that interest payments must be made and the timing of such payments shall be disclosed.

2. For loans under paragraph A.2. of part II, including any payments of interest only that are made during the construction period.

D. The creditor shall disclose the amount financed as the entire commitment amount less any prepaid finance charge.

Example:

Assume a $50,000 loan commitment at 10.5% interest with a five-month construction period and a prepaid finance charge of two points, followed by 30-year permanent financing at the same rate with monthly amortization payments of $457.37.

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Appendix E to Part 226 Rules for Card Issuers That Bill on a Transaction-by-Transaction Basis

1B Consumer Credit Law Manual Appendix E to Part 226

Appendix E to Part 226 Rules for Card Issuers That Bill on a Transaction-by-Transaction Basis

The following provisions of Subpart B apply if credit cards are issued and the card issuer and the seller are the same or related persons; no finance charge is imposed; consumers are billed in full for each use of the card on a transaction-by-transaction basis, by means of an invoice or other statement reflecting each use of the card; and no cumulative account is maintained which reflects the transactions by each consumer during a period of time, such as a month. The term "related person" refers to, for example, a franchised or licensed seller of a creditor's product or service or a seller who assigns or sells sales accounts to a creditor or arranges for credit under a plan that allows the consumer to use the credit only in transactions with that seller. A seller is not related to the creditor merely because the seller and the creditor have an agreement authorizing the seller to honor the creditor's credit card.

1. Section 226.6(a)(5) or § 226.6(b)(5)(iii).

2. Section 226.6(a)(2) or § 226.6(b)(3)(ii)(B), as applicable. The disclosure required by § 226.6(a)(2) or § 226.6(b)(3)(ii)(B) shall be limited to those charges that are or may be imposed as a result of the deferral of payment by use of the card, such as late payment or delinquency charges. A tabular format is not required.

3. Section 226.6(a)(4) or § 226.6(b)(5)(ii).

4. Section 226.7(a)(2) or § 226.7(b)(2), as applicable; § 226.7(a)(9) or § 226.7(b)(9), as applicable. Creditors may comply by placing the required disclosures on the invoice or statement sent to the consumer for each transaction.

5. Section 226.9(a). Creditors may comply by mailing or delivering the statement required by § 226.6(a)(5) or § 226.6(b)(5)(iii) (see -3 and G-3(A) to this part) to each consumer receiving a transaction invoice during a one-month period chosen by the card issuer or by sending either the statement prescribed by § 226.6(a)(5) or § 226.6(b)(5)(iii), or an alternative billing error rights statement substantially similar to that in -4 and G-4(A) to this part, with each invoice sent to a consumer.

6. Section 226.9(c). A tabular format is not required.

7. Section 226.10.

8. Section 226.11(a). This section applies when a card issuer receives a payment or other credit that exceeds by more than $1 the amount due, as shown on the transaction invoice. The requirement to credit amounts to an account may be complied with by other reasonable means, such as by a credit memorandum. Since no periodic statement is provided, a notice of the credit balance shall be sent to the consumer within a reasonable period of time following its occurrence unless a refund of the credit balance is mailed or delivered to the consumer within seven business days of its receipt by the card issuer.

9. Section 226.12 including § 226.12(c) and (d), as applicable. Section 226.12(e) is inapplicable.

10. Section 226.13, as applicable. All references to "periodic statement" shall be read to indicate the invoice or other statement for the relevant transaction. All actions with regard to correcting and adjusting a consumer's account may be taken by issuing a refund or a new invoice, or by other appropriate means consistent with the purposes of the section.

11. Section 226.15, as applicable.

[Reg. Z, *46 FR 20892,* Apr. 7, 1981, as amended at *46 FR 61090,* Dec. 9, 1981; *74 FR 5244,* Jan. 29, 2009, withdrawn at *75 FR 7925,* Feb. 22, 2010; *75 FR 7658,* Feb. 22, 2010]

[Reg. Z, *46 FR 20892* , Apr. 7, 1981; *74 FR 5244,* Jan. 29, 2009, withdrawn at *75 FR 7925,* Feb. 22, 2010; *75 FR 7658,* Feb. 22, 2010]

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Appendix F to Part 226 Optional Annual Percentage Rate Computations for Creditors Offering Open-End Plans Subject to the Requirements of § 226.5b

1B Consumer Credit Law Manual Appendix F to Part 226

Appendix F to Part 226 Optional Annual Percentage Rate Computations for Creditors Offering Open-End Plans Subject to the Requirements of § 226.5b

In determining the denominator of the fraction under § 226.14(c)(3), no amount will be used more than once when adding the sum of the balances n1 subject to periodic rates to the sum of the amounts subject to specific transaction charges. (Where a portion of the finance charge is determined by application of one or more daily periodic rates, the phrase "sum of the balances" shall also mean the "average of daily balances.") In every case, the full amount of transactions subject to specific transaction charges shall be included in the denominator. Other balances or parts of balances shall be included according to the manner of determining the balance subject to a periodic rate, as illustrated in the following examples of accounts on monthly billing cycles:

1. Previous balance--none. A specific transaction of $100 occurs on the first day of the billing cycle. The average daily balance is $100. A specific transaction charge of 3 percent is applicable to the specific transaction. The periodic rate is 1 1/2 percent applicable to the average daily balance. The numerator is the amount of the finance charge, which is $4.50. The denominator is the amount of the transaction (which is $100), plus the amount by which the balance subject to the periodic rate exceeds the amount of the specific transactions (such excess in this case is 0), totaling $100.The annual percentage rate is the quotient (which is 4 1/2 percent) multiplied by 12 (the number of months in a year), i.e., 54 percent.

2. Previous balance--$100. A specific transaction of $100 occurs at the midpoint of the billing cycle. The average daily balance is $150. A specific transaction charge of 3 percent is applicable to the specific transaction. The periodic rate is 1 1/2 percent applicable to the average daily balance. The numerator is the amount of the finance charge which is $5.25. The denominator is the amount of the transaction (which is $100), plus the amount by which the balance subject to the periodic rate exceeds the amount of the specific transaction (such excess in this case is $50), totaling $150. As

explained in example 1, the annual percentage rate is 3 1/2 percent x 12 = 42 percent.

3. If, in example 2, the periodic rate applies only to the previous balance, the numerator is $4.50 and the denominator is $200 (the amount of the transaction, $100, plus the balance subject only to the periodic rate, the $100 previous balance). As explained in example 1, the annual percentage rate is 2 1/4 percent x 12 = 27 percent.

4. If, in example 2, the periodic rate applies only to an adjusted balance (previous balance less payments and credits) and the consumer made a payment of $50 at the midpoint of the billing cycle, the numerator is $3.75 and the denominator is $150 (the amount of the transaction, $100, plus the balance subject to the periodic rate, the $50 adjusted balance). As explained in example 1, the annual percentage rate is 2 1/2 percent x 12 = 30 percent.

5. Previous balance--$100.

A specific transaction (check) of $100 occurs at the midpoint of the billing cycle. The average daily balance is $150. The specific transaction charge is $.25 per check. The periodic rate is 1 1/2 percent applied to the average daily balance. The numerator is the amount of the finance charge, which is $2.50 and includes the $.25 check charge and the $2.25 resulting from the application of the periodic rate. The denominator is the full amount of the specific transaction (which is $100) plus the amount by which the average daily balance exceeds the amount of the specific transaction (which in this case is $50), totaling $150. As explained in example 1, the annual percentage rate would be 1 2/3 percent x 12 = 20 percent.

6. Previous balance--none. A specific transaction of $100 occurs at the midpoint of the billing cycle. The average daily balance is $50. The specific transaction charge is 3 percent of the transaction amount or $3.00. The periodic rate is 1 1/2 percent per month applied to the average daily balance. The numerator is the amount of the finance charge, which is $3.75, including the $3.00 transaction charge and $.75 resulting from application of the periodic rate. The denominator is the full amount of the specific transaction ($100) plus the amount by which the balance subject to the periodic rate exceeds the amount of the transaction ($0). Where the specific transaction amount exceeds the balance subject to the periodic rate, the resulting number is considered to be zero rather than a negative number ($50-$100 = -$50). The denominator, in this case, is $100. As explained in example 1, the annual percentage rate is 3 3/4 percent x 12 = 45 percent.

FOOTNOTES:
(n71)Footnote 1. [Reserved].

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Appendix G to Part 226 Open-End Model Forms and Clauses

[Reg. Z, *46 FR 20892,* Apr. 7, 1981, as amended at *46 FR 60191,* Dec. 9, 1981; *54 FR 13868* , Apr. 6, 1989; *54 FR 24689* , June 9, 1989; *55 FR 38312* , Sept. 18, 1990; *65 FR 58903, 58908* , Oct. 3, 2000; *74 FR 5244,* Jan. 29, 2009, withdrawn at *75 FR 7925,* Feb. 22, 2010; *75 FR 7658,* Feb. 22, 2010]

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§ G-1 Balance Computation Methods Model Clauses (Home-Equity Plans)

(a) Adjusted balance method

We figure [a portion of] the finance charge on your account by applying the periodic rate to the "adjusted balance" of your account. We get the "adjusted balance" by taking the balance you owed at the end of the previous billing cycle and subtracting [any unpaid finance charges and] any payments and credits received during the present billing cycle.

(b) Previous balance method

We figure [a portion of the finance charge on your account by applying the periodic rate to the amount you owe at the beginning of each billing cycle [minus any unpaid finance charges. We do not subtract any payments or credits received during the billing cycle. [The amount of payments and credits to your account this billing cycle was $.

(c) Average daily balance method (excluding current transactions)

We figure [a portion of] the finance charge on your account by applying the periodic rate to the "average daily balance" of your account (excluding current transactions). To get the "average daily balance" we take the beginning balance of your account each day and subtract any payments or credits [and any unpaid finance charges]. We do not add in any new [purchases/advances/loans]. This gives us the daily balance. Then, we add all the daily balances for the billing cycle together and divide the total by the number of days in the billing cycle. This gives us the "average daily balance."

(d) Average daily balance method (including current transactions)

We figure [a portion of] the finance charge on your account by applying the periodic rate to the "average daily balance" of your account (including current transactions). To get the "average daily balance" we take the beginning balance of your account each day, add any new [purchases/advances/loans], and subtract any payments or credits, [and unpaid finance charges]. This gives us the daily balance. Then, we add up all the daily balances for the billing cycle and divide the total by the number of days in the billing cycle. This gives us the "average daily balance."

(e) Ending balance method

We figure [a portion of] the finance charge on your account by applying the periodic rate to the amount you owe at the end of each billing cycle (including new purchases and deducting payments and credits made during the billing cycle).

(f) Daily balance method (including current transactions)

Daily balance method (including current transactions)We figure [a portion of] the finance charge on your account by applying the periodic rate to the "daily balance" of your account for each day in the billing cycle. To get the "daily balance" we take the beginning balance of your account each day, add any new [purchases/advances/fees], and subtract [any unpaid finance charges and] any payments or credits. This gives us the daily balance.

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1B- Consumer Credit Law Manual G-1(A)

§ G-1(A) Balance Computation Methods Model Clauses (Plans Other Than Home-Equity Plans)

(a) Adjusted balance method

We figure the interest charge on your account by applying the periodic rate to the "adjusted balance" of your account. We get the "adjusted balance" by taking the balance you owed at the end of the previous billing cycle and subtracting [any unpaid interest or other finance charges and] any payments and credits received during the present billing cycle.

(b) Previous balance method

We figure the interest charge on your account by applying the periodic rate to the amount you owe at the beginning of each billing cycle. We do not subtract any payments or credits received during the billing cycle.

(c) Average daily balance method (excluding current transactions)

We figure the interest charge on your account by applying the periodic rate to the "average daily balance" of your account. To get the "average daily balance" we take the beginning balance of your account each day and subtract [any unpaid interest or other finance charges and] any payments or credits. We do not add in any new [purchases/advances/fees]. This gives us the daily balance. Then, we add all the daily balances for the billing cycle together and divide the total by the number of days in the billing cycle. This gives us the "average daily balance."

(d) Average daily balance method (including current transactions)

We figure the interest charge on your account by applying the periodic rate to the "average daily balance" of your account. To get the "average daily balance" we take the beginning balance of your account each day, add any new [purchases/advances/fees], and subtract [any unpaid interest or other finance charges and] any payments or credits. This gives us the daily balance. Then, we add up all the daily balances for the billing cycle and divide the total by the number of days in the billing cycle. This gives us the "average daily balance."

(e) Ending balance method

We figure the interest charge on your account by applying the periodic rate to the amount you owe at the end of each billing cycle (including new [purchases/advances/fees] and deducting payments and credits made during the billing cycle).

(f) Daily balance method (including current transactions)

We figure the interest charge on your account by applying the periodic rate to the "daily balance" of your account for each day in the billing cycle. To get the "daily balance" we take the beginning balance of your account each day, add any new [purchases/advances/fees], and subtract [any unpaid interest or other finance charges and] any payments or credits. This gives us the daily balance.

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1B- Consumer Credit Law Manual G-2

§ G-2 Liability for Unauthorized Use Model Clause (Home-Equity Plans)

You may be liable for the unauthorized use of your credit card [or other term that describes the credit card. You will not be liable for unauthorized use that occurs after you notify [name of card issuer or its designee at [address, orally or in writing, of the loss, theft, or possible unauthorized use. [You may also contact us on the Web: [Creditor Web or email address In any case, your liability will not exceed [insert $50 or any lesser amount under agreement with the cardholder.

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1B- Consumer Credit Law Manual G-2(A)

§ G-2(A) Liability for Unauthorized Use Model Clause (Plans Other Than Home-Equity Plans)

If you notice the loss or theft of your credit card or a possible unauthorized use of your card, you should write to us immediately at: [address] [address listed on your bill],
or call us at [telephone number].

[You may also contact us on the Web: [Creditor Web or email address
You will not be liable for any unauthorized use that occurs after you notify us. You may, however, be liable for unauthorized use that occurs before your notice to us. In any case, your liability will not exceed [insert $50 or any lesser amount under agreement with the cardholder].

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1B- Consumer Credit Law Manual G-3

§ G-3 Long-Form Billing-Error Rights Model Form (Home-Equity Plans)

YOUR BILLING RIGHTS

KEEP THIS NOTICE FOR FUTURE USE

This notice contains important information about your rights and our responsibilities under the Fair Credit Billing Act.

Notify Us in Case of Errors or Questions About Your Bill

If you think your bill is wrong, or if you need more information about a transaction on your bill, write us [on a separate sheet at [address [the address listed on your bill. Write to us as soon as possible. We must hear from you no later than 60 days after we sent you the first bill on which the error or problem appeared. [You may also contact us on the Web: [Creditor Web or email address You can telephone us, but doing so will not preserve your rights.

In your letter, give us the following information:

- Your name and account number.
- The dollar amount of the suspected error.
- Describe the error and explain, if you can, why you believe there is an error. If you need more information, describe the item you are not sure about.

If you have authorized us to pay your credit card bill automatically from your savings or checking account, you can stop

the payment on any amount you think is wrong. To stop the payment your letter must reach us three business days before the automatic payment is scheduled to occur.

Your Rights and Our Responsibilities After We Receive Your Written Notice

We must acknowledge your letter within 30 days, unless we have corrected the error by then. Within 90 days, we must either correct the error or explain why we believe the bill was correct.

After we receive your letter, we cannot try to collect any amount you question, or report you as delinquent. We can continue to bill you for the amount you question, including finance charges, and we can apply any unpaid amount against your credit limit. You do not have to pay any questioned amount while we are investigating, but you are still obligated to pay the parts of your bill that are not in question.

If we find that we made a mistake on your bill, you will not have to pay any finance charges related to any questioned amount. If we didn't make a mistake, you may have to pay finance charges, and you will have to make up any missed payments on the questioned amount. In either case, we will send you a statement of the amount you owe and the date that it is due.

If you fail to pay the amount that we think you owe, we may report you as delinquent. However, if our explanation does not satisfy you and you write to us within ten days telling us that you still refuse to pay, we must tell anyone we report you to that you have a question about your bill. And, we must tell you the name of anyone we reported you to. We must tell anyone we report you to that the matter has been settled between us when it finally is.

If we don't follow these rules, we can't collect the first $50 of the questioned amount, even if your bill was correct.

Special Rule for Credit Card Purchases

If you have a problem with the quality of property or services that you purchased with a credit card, and you have tried in good faith to correct the problem with the merchant, you may have the right not to pay the remaining amount due on the property or services.

There are two limitations on this right:

(a) You must have made the purchase in your home state or, if not within your home state within 100 miles of your current mailing address; and

(b) The purchase price must have been more than $50.

These limitations do not apply if we own or operate the merchant, or if we mailed you the advertisement for the property or services.

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§ G-3(A) Long-Form Billing-Error Rights Model Form (Plans Other Than Home-Equity Plans)

Your Billing Rights: Keep This Document For Future Use

This notice tells you about your rights and our responsibilities under the Fair Credit Billing Act.

What To Do If You Find A Mistake On Your Statement

If you think there is an error on your statement, write to us at:

[Creditor Name]
[Creditor Address]

[You may also contact us on the Web: [Creditor Web or email address

In your letter, give us the following information:

- Account information: Your name and account number.
- Dollar amount: The dollar amount of the suspected error.
- Description of problem: If you think there is an error on your bill, describe what you believe is wrong and why you believe it is a mistake.

You must contact us:

- Within 60 days after the error appeared on your statement.

- At least 3 business days before an automated payment is scheduled, if you want to stop payment on the amount you think is wrong.

You must notify us of any potential errors in writing [or electronically]. You may call us, but if you do we are not required to investigate any potential errors and you may have to pay the amount in question.

What Will Happen After We Receive Your Letter

When we receive your letter, we must do two things:

1. Within 30 days of receiving your letter, we must tell you that we received your letter. We will also tell you if we have already corrected the error.

2. Within 90 days of receiving your letter, we must either correct the error or explain to you why we believe the bill is correct.

While we investigate whether or not there has been an error:

- We cannot try to collect the amount in question, or report you as delinquent on that amount.

- The charge in question may remain on your statement, and we may continue to charge you interest on that amount.

- While you do not have to pay the amount in question, you are responsible for the remainder of your balance.

- We can apply any unpaid amount against your credit limit.

After we finish our investigation, one of two things will happen:

- If we made a mistake: You will not have to pay the amount in question or any interest or other fees related to that amount.

- If we do not believe there was a mistake: You will have to pay the amount in question, along with applicable interest and fees. We will send you a statement of the amount you owe and the date payment is due. We may then report you as delinquent if you do not pay the amount we think you owe.

If you receive our explanation but still believe your bill is wrong, you must write to us within 10 days telling us that you still refuse to pay. If you do so, we cannot report you as delinquent without also reporting that you are questioning your bill. We must tell you the name of anyone to whom we reported you as delinquent, and we must let those organizations know when the matter has been settled between us.

If we do not follow all of the rules above, you do not have to pay the first $50 of the amount you question even if your bill is correct.

Your Rights If You Are Dissatisfied With Your Credit Card Purchases

If you are dissatisfied with the goods or services that you have purchased with your credit card, and you have tried in good faith to correct the problem with the merchant, you may have the right not to pay the remaining amount due on the purchase.

To use this right, all of the following must be true:

1. The purchase must have been made in your home state or within 100 miles of your current mailing address, and the purchase price must have been more than $50. (Note: Neither of these are necessary if your purchase was based on an advertisement we mailed to you, or if we own the company that sold you the goods or services.)

2. You must have used your credit card for the purchase. Purchases made with cash advances from an ATM or with a check that accesses your credit card account do not qualify.

3. You must not yet have fully paid for the purchase.

If all of the criteria above are met and you are still dissatisfied with the purchase, contact us in writing [or electronically] at:

[Creditor Name]
[Creditor Address]

[Creditor Web or e-mail address]

While we investigate, the same rules apply to the disputed amount as discussed above. After we finish our investigation, we will tell you our decision. At that point, if we think you owe an amount and you do not pay, we may report you as delinquent.

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§ G-4 Alternative Billing-Error Rights Model Form (Home-Equity Plans)

BILLING RIGHTS SUMMARY

In Case of Errors or Questions About Your Bill

If you think your bill is wrong, or if you need more information about a transaction on your bill, write us [on a separate sheet at [address [the address shown on your bill as soon as possible. [You may also contact us on the Web: [Creditor Web or e-mail address We must hear from you no later than 60 days after we sent you the first bill on which the error or problem appeared. You can telephone us, but doing so will not preserve your rights.

In your letter, give us the following information:

- Your name and account number.
- The dollar amount of the suspected error.
- Describe the error and explain, if you can, why you believe there is an error. If you need more information, describe the item you are unsure about.

You do not have to pay any amount in question while we are investigating, but you are still obligated to pay the parts of your bill that are not in question. While we investigate your question, we cannot report you as delinquent or take any action to collect the amount you question.You do not have to pay any amount in question while we are investigating, but you are still obligated to pay the parts of your bill that are not in question. While we investigate your question, we cannot report you as delinquent or take any action to collect the amount you question.

Special Rule for Credit Card Purchases

If you have a problem with the quality of goods or services that you purchased with a credit card, and you have tried in good faith to correct the problem with the merchant, you may not have to pay the remaining amount due on the goods or services. You have this protection only when the purchase price was more than $50 and the purchase was made in your home state or within 100 miles of your mailing address. (If we own or operate the merchant, or if we mailed you the advertisement for the property or services, all purchases are covered regardless of amount or location of purchase.)

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§ G-4(A) Alternative Billing-Error Rights Model Form (Plans Other Than Home-Equity Plans)

What To Do If You Think You Find A Mistake On Your Statement

If you think there is an error on your statement, write to us at:

[Creditor Name]
[Creditor Address]

[You may also contact us on the Web: [Creditor Web or e-mail address

In your letter, give us the following information:

- Account information: Your name and account number.
- Dollar amount: The dollar amount of the suspected error.
- Description of Problem: If you think there is an error on your bill, describe what you believe is wrong and why you believe it is a mistake.

You must contact us within 60 days after the error appeared on your statement.

You must notify us of any potential errors in writing [or electronically]. You may call us, but if you do we are not required to investigate any potential errors and you may have to pay the amount in question.

While we investigate whether or not there has been an error, the following are true:

- We cannot try to collect the amount in question, or report you as delinquent on that amount.

- The charge in question may remain on your statement, and we may continue to charge you interest on that amount. But, if we determine that we made a mistake, you will not have to pay the amount in question or any interest or other fees related to that amount.

- While you do not have to pay the amount in question, you are responsible for the remainder of your balance.

- We can apply any unpaid amount against your credit limit.

Your Rights If You Are Dissatisfied With Your Credit Card Purchases

If you are dissatisfied with the goods or services that you have purchased with your credit card, and you have tried in good faith to correct the problem with the merchant, you may have the right not to pay the remaining amount due on the purchase.

To use this right, all of the following must be true:

1. The purchase must have been made in your home state or within 100 miles of your current mailing address, and the purchase price must have been more than $50. (Note: Neither of these are necessary if your purchase was based on an advertisement we mailed to you, or if we own the company that sold you the goods or services.)

2. You must have used your credit card for the purchase. Purchases made with cash advances from an ATM or with a check that accesses your credit card account do not qualify.

3. You must not yet have fully paid for the purchase.

If all of the criteria above are met and you are still dissatisfied with the purchase, contact us in writing [or electronically] at:

[Creditor Name]
[Creditor Address]
[Creditor Web Address]

While we investigate, the same rules apply to the disputed amount as discussed above. After we finish our investigation, we will tell you our decision. At that point, if we think you owe an amount and you do not pay we may report you as delinquent.

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§ **G-5** ***Rescission Model Form (When Opening An Account)***

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§ **G-6** ***Rescission Model Form (For Each Transaction)***

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§ **G-7** ***Rescission Model Form (When Increasing the Credit Limit)***

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§ **G-8** ***Rescission Model Form (When Adding a Security Interest)***

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§ **G-9** ***Rescission Model Form (When Increasing the Security)***

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1B- Consumer Credit Law Manual G-10(A)

§ **G-10A** ***Applications and Solicitations Model Forms (Credit Cards) (§ 226.5a(b))***

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§ **G-10B** ***Applications and Solicitations Sample (Credit Card) (§ 226.5a(b))***

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1B- Consumer Credit Law Manual G-10(C)

§ **G-10C** ***Applications and Solicitations Model Form (Charge Cards)***

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1B- Consumer Credit Law Manual G-10(D)

§ **G-10D** ***Applications and Solicitations Model Form (Charge CARDS) (§ 226.5a(b))***

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§ **G-10E** ***Applications and Solicitations Sample (Charge Cards) (§ 226.5a(b))***

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§ G-11 Applications and Solicitations Made Available to the General Public Model Clauses

(a) Disclosure of Required Credit Information The information about the costs of the card described in this [application]/[solicitation] is accurate as of (month/year). This information may have changed after that date. To find out what may have changed, [call us at (telephone number)] [write to us at (address)].

(b) No Disclosure of Credit Information There are costs associated with the use of this card. To obtain information about these costs, call us at (telephone number) or write to us at (address).

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§ **G-12 [Reserved]**

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§ **G-13A Change in Insurance Provider Model Form (Combined Notice)**

The credit card account you have with us is insured. This is to notify you that we plan to replace your current coverage with insurance coverage from a different insurer. If we obtain insurance for your account from a different insurer, you may cancel the insurance.

[Your premium rate will increase to $ per _____.]

[Your coverage will be affected by the following:

[] The elimination of a type of coverage previously provided to you. [(explanation)] [See of the attached policy for details.]

[] A lowering of the age at which your coverage will terminate or will become more restrictive. [(explanation)] [See of the attached policy or certificate for details.]

[] A decrease in your maximum insurable loan balance, maximum periodic benefit payment, maximum number of payments, or any other decrease in the dollar amount of your coverage or benefits. [(explanation)] [See _____of the attached policy or certificate for details.]

[] A restriction on the eligibility for benefits for you or others. [(explanation)] [See of the attached policy or certificate for details.]

[] A restriction in the definition of "disability" or other key term of coverage. [(explanation)] [See of the attached policy or certificate for details.]

[] The addition of exclusions or limitations that are broader or other than those under the current coverage. [(explanation)] [See of the attached policy or certificate for details.]

[] An increase in the elimination (waiting) period or a change to nonretroactive coverage. [(explanation)]
[See of the attached policy or certificate for details).]

[The name and mailing address of the new insurer providing the coverage for your account is (name and address).]

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§ G-13B Change in Insurance Provider Model Form

We have changed the insurer providing the coverage for your account. The new insurer's name and address are (name and address). A copy of the new policy or certificate is attached.

You may cancel the insurance for your account.

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1B- Consumer Credit Law Manual G-14A

§ G-14A Home Equity Sample

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§ G-14B Home Equity Sample

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1B- Consumer Credit Law Manual G-15

§ G-15 Home Equity Model Clause

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1B- Consumer Credit Law Manual G-16(A)

§ **G-16A Debt Suspension Model Clause**

Please enroll me in the optional [insert name of program], and bill my account the fee of [how cost is determined]. I understand that enrollment is not required to obtain credit. I also understand that depending on the event, the protection may only temporarily suspend my duty to make minimum payments, not reduce the balance I owe. I understand that my balance will actually grow during the suspension period as interest continues to accumulate.

[To Enroll, Sign Here]/[To Enroll, Initial Here]. X _____

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1B- Consumer Credit Law Manual G-16(B)

§ **G-16B Debt Suspension Sample**

Please enroll me in the optional [name of program], and bill my account the fee of $.83 per $100 of my month-end account balance. I understand that enrollment is not required to obtain credit. I also understand that depending on the event, the protection may only temporarily suspend my duty to make minimum payments, not reduce the balance I owe. I understand that my balance will actually grow during the suspension period as interest continues to accumulate.

To Enroll, Initial Here. X _____

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§ G17A Account-Opening Model Form

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§ G17B Account-Opening Model Sample

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§ G17C Account-Opening Model Sample

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§ **G17D Account-Opening Model Sample (Line of Credit)**

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1B- Consumer Credit Law Manual G-18(A)

§ G-18A Transactions; Interest Charges; Fees Sample (§ 226.7(b))

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1B- Consumer Credit Law Manual G-18(B)

§ **G-18B Late Payment Fee Sample**

Late Payment Warning: If we do not receive your minimum payment by the date listed above, you may have to pay a $35 late fee and your APRs may be increased up to the Penalty APR of 28.99%.

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1B- Consumer Credit Law Manual G-18(C)(1)

§ G-18C1 Minimum Payment Warning (When Amortization Occurs and the 36-Month Disclosures Are Required)

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1B- Consumer Credit Law Manual G-18(C)(2)

§ G-18C2 Minimum Payment Warning (When Amortization Occurs and the 36-Month Disclosures Are Not Required)

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§ **G-18C3 Minimum Payment Warning (When Negative or No Amortization Occurs)**

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1B- Consumer Credit Law Manual G-18(D)

§ G-18D New Balance, Due Date, Late Payment and Minimum Payment Sample (Credit cards) (§ 226.7(b))

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§ **G-18E [Reserved]**

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§ **G-18F Periodic Statement Form**

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§ **G-18G Periodic Statement Form**

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1B- Consumer Credit Law Manual G-18(H)

§ **G-18H Deferred Interest Periodic Statement Clause**

[You must pay your promotional balance in full by [date] to avoid paying accrued interest charges.]

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§ G-19 Checks Accessing a Credit Card Account Sample (§ 226.9(b)(3))

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§ **G-20 Change-in-Terms Sample (Increase in Annual Percentage Rate)**

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§ **G-20 Change-in-Terms Sample (Increase in Fees)**

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§ **G-22 Penalty Rate Increase Sample (Payment 60 or Fewer Days Late)**

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§ G-23 Penalty Rate Increase Sample (Payment More Than 60 Days Late)

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1B- Consumer Credit Law Manual G-24

§ G-24 Deferred Interest Offer Clauses

(a) For Credit Card Accounts Under an Open-End (Not Home-Secured) Consumer Credit Plan

[Interest will be charged to your account from the purchase date if the purchase balance is not paid in full within the/by [deferred interest period/date] or if you make a late payment.]

(b) For Other Open-End Plans

[Interest will be charged to your account from the purchase date if the purchase balance is not paid in full within the/by [deferred interest period/date] or if your account is otherwise in default.]

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1B- Consumer Credit Law Manual G-25(A)

§ **G-25A Consent Form for Over-the-Credit Limit Transactions**

Your choice regarding over-the-credit limit coverage

Unless you tell us otherwise, we will decline any transaction that causes you to go over your credit limit. If you want us to authorize these transactions, you can request over-the-credit limit coverage.

If you have over-the-credit limit coverage and you go over your credit limit, we will charge you a fee of X and may increase your APRs to the Penalty APR of XX.XX%. You will only pay one fee per billing cycle, even if you go over your limit multiple times in the same cycle.

Even if you request over-the-credit limit coverage, in some cases we may still decline a transaction that would cause you to go over your limit, such as if you are past due or significantly over your credit limit.

If you want over-the-limit coverage and to allow us to authorize transactions that go over your credit limit, please:

-- Call us at [telephone number];

-- Visit or [Web site];

-- Check or initial the box below, and return the form to us at [address].

[]I want over-the-limit coverage. I understand that if I go over my credit limit, I will be charged a fee of $] and my APRs may be increased. [I have the right to cancel this coverage at any time.]

[] I do not want over-the-limit coverage. I understand that transactions that exceed my credit limit will not be authorized.]

Printed Name:----------

Date:----------

[Account Number]:-----

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1B- Consumer Credit Law Manual G-25(B)

§ G-25B Revocation Notice for Periodic Statement Regarding Over-the-Credit Limit Transactions

You currently have over-the-credit limit coverage on your account, which means that we pay transactions that cause you go to over your credit limit. If you do go over your credit limit, we will charge you a fee of X and your APRs may be increased. To remove over-the-credit-limit coverage from your account, call us at 1-800-xxxxxxx or visit [insert Web site]. [You may also write us at: [insert address].]

[You may also check or initial the box below and return this form to us at: [insert address].]

[] I want to cancel over-the-limit coverage for my account.

Printed Name:----------

Date:----------

[Account Number]:-----

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1B- Consumer Credit Law Manual H-1

§ H-1 Credit Sale Model Form

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§ H-2 Loan Model Form

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1B- Consumer Credit Law Manual H-3

§ H-3 Amount Financed Itemization Model Form

Itemization of the Amount Financed of $

$ Amount given to you directly

$ Amount paid on your account

Amount paid to others on your behalf

$ to [public officials] [credit bureau] [appraiser] [insurance company]

$ to (name of another creditor)

$ to (other)

$ Prepaid finance charge

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1B- Consumer Credit Law Manual H-4(A)

§ **H-4A Variable Rate Model Clauses**

The annual percentage rate may increase during the term of this transaction if:

[the prime interest rate of (creditor) increases.]

[the balance in your deposit account falls below $_____.]

[you terminate your employment with (employer) _____.]

[The interest rate will not increase above _____%.]

[The maximum interest rate increase at one time will be _____%.]

[The rate will not increase more than once every (time period).]

Any increase will take the form of:

[higher payment amounts.]

[more payments of the same account.]

[a larger amount due at maturity.]

Example based on the specific transaction

[If the interest rate increases by _____% in (time period),

[your regular payments will increase to $_____.]

[you will have to make additional payments.]

[your final payment will increase to $_____.]

Example based on a typical transaction

[If your loan were for $ at _____% for (term) and the rate increased to _____% in (time period),

[your regular payments would increase by $_____.]

[you would have to make additional payments.]

[your final payment would increase by $_____.]

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1B- Consumer Credit Law Manual H-4(B)

§ **H-4B Variable-Rate Model Clauses**

Your loan contains a variable-rate feature. Disclosures about the variable-rate feature have been provided to you earlier.

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1B- Consumer Credit Law Manual H-4(C)

§ **H-4C Variable-Rate Model Clauses**

This disclosure describes the features of the Adjustable Rate Mortgage (ARM) program you are considering. Information on other ARM programs is available upon request.

How Your Interest Rate and Payment are Determined

- Your interest rate will be based on [an index plus a margin] [a formula].
- Your payment will be based on the interest rate, loan balance, and loan term.

-- [The interest rate will be based on (identification of index) plus our margin. Ask for our current interest rate and margin.]

-- [The interest rate will be based on (identification of formula). Ask us for our current interest rate.]

-- information about the index [formula for rate adjustments] is published [can be found] _____.

-- [The initial interest rate is not based on the (index) (formula) used to make later adjustments. Ask us for the amount of current interest rate discounts.]

How Your Interest Rate Can Change

- Your interest rate can change (frequency).
- [Your interest rate cannot increase or decrease more than percentage points at each adjustment.]

- Your interest rate cannot increase [or decrease] more than percentage points over the term of the loan.

How Your Payment Can Change

- Your payment can change (frequency) based on changes in the interest rate.

- [Your payment cannot increase more than (amount or percentage) at each adjustment.]

- You will be notified in writing days before the due date of a payment at a new level. This notice will contain information about your interest rates, payment amount, and loan balance.

- [You will be notified once each year during which interest rate adjustments, but no payment adjustments, have been made to your loan. This notice will contain information about your interest rates, payment amount, and loan balance.]

- [For example, on a $10,000 [term] loan with an initial interest rate of [(the rate shown in the interest rate column below for the year 19 _____)] [(in effect (month) (year)], the maximum amount that the interest rate can rise under this program is percentage points, to %, and the monthly payment can rise from a first-year payment of $ to a maximum of $ in the year. To see what your payments would be, divide your mortgage amount by $10,000; then multiply the monthly payment by that amount. (For example, the monthly payment for a mortgage amount of $60,000 would be: $60,000 / $10,000 = 6; 6 x = $ per month.)]

Example

The example below shows how your payments would have changed under this ARM program based on actual changes in the index from 1982 to 1996. This does not necessarily indicate how your index will change in the future.

The example is based on the following assumptions:

Amount of loan.....	$10,000
Term.....	_____
Change date.....	_____
Payment adjustment.....	(frequency)
Interest adjustment.....	(frequency)
[Margin] n*	_____
Caps _____[periodic interest rate cap]	
_____ lifetime interest rate cap	
_____ [payment cap]	
[Interest rate carryover]--	
[Negative amortization]	
[Interest rate discount] n**	
Index.....	(identification of in-

dex or formula)

Year	Index (%)	Margin (Percentage points)	Interest Rate (%)	Monthly Payment (]	Remaining Balance (]
1982					
1983					
1984					
1985					
1986					
1987					
1988					
1989					
1990					
1991					
1992					
1993					
1994					
1995					
1996					

Note:

To see what your payments would have been during that period, divide your mortgage amount by $10,000; then multiply the monthly payments by that amount (For example, in 1996 the monthly payment for a mortgage amount of $60,000 taken out in 1982 would be:

$60,000 / $10,000 = 6; 6 x _____= $ per month.)

FOOTNOTES:

(n72)Footnote *. This is a margin we have used recently; your margin may be different.

(n73)Footnote **. This is the amount of a discount we have provided recently; your loan may be discounted by a different amount.

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1B- Consumer Credit Law Manual H-4(D)

§ **H-4D Variable-Rate Model Clauses**

Your new interest rate will be _____%, which is based on an index value of _____%.

Your previous interest rate was _____%, which was based on an index value of _____%.

[The new interest rate does not reflect a change of percentage points in the index value which was not added because of _____.]

[The new payment will be $_____.]

[Your new loan balance is $_____.]

[Your (new) (existing) payment will not be sufficient to cover the interest due and the difference will be added to the loan amount. The payment amount needed to pay your loan in full by the end of the term at the new interest rate is $_____.]

[The following interest rate adjustments have been implemented this year without changing your payment: _____.

These interest rates were based on the following index values: _____.]

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1B- Consumer Credit Law Manual H-5

§ H-5 Demand Feature Model Clauses

This obligation [is payable on demand.]

[has a demand feature.]

[All disclosures are based on an assumed maturity of one year.]

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1B- Consumer Credit Law Manual H-6

§ **H-6 Assumption Policy Model Clause**

Assumption: Someone buying your house [may, subject to conditions, be allowed to] [cannot] assume the remainder of the mortgage on the original terms.

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§ H-7 Required Deposit Model Clause

The annual percentage rate does not take into account your required deposit.

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§ **H-8 Rescission Model Form (General)**

NOTICE OF RIGHT TO CANCEL

Your Right to Cancel

You are entering into a transaction that will result in a [mortgage/lien/security interest] [on/in] your home. You have a legal right under federal law to cancel this transaction, without cost, within three business days from whichever of the following events occurs last:

(1) the date of the transaction, which is _____; or

(2) the date you received your Truth-in-Lending disclosures; or

(3) the date you received this notice of your right to cancel.

If you cancel the transaction, the [mortgage/lien/security interest] is also cancelled. Within 20 calendar days after we receive your notice, we must take the steps necessary to reflect the fact that the [mortgage/lien/security interest] [on/in] your home has been cancelled, and we must return to you any money or property you have given to us or to anyone else in connection with this transaction.

You may keep any money or property we have given you until we have done the things mentioned above, but you must then offer to return the money or property. If it is impractical or unfair for you to return the property, you must offer its reasonable value. You may offer to return the property at your home or at the location of the property. Money must be returned to the address below. If we do not take possession of the money or property within 20 calendar days of your

offer, you may keep it without further obligation.

How to Cancel

If you decide to cancel this transaction, you may do so by notifying us in writing, at

(creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of (date) (or midnight of the third business day following the latest of the three events listed above). If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL.

_____
Consumer's Signature

_____
Date

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§ H-9 Rescission Model Form (Refinancing With Original Creditor)

NOTICE OF RIGHT TO CANCEL.

Your Right to Cancel

You are entering into a new transaction to increase the amount of credit provided to you. Your home is the security for this new transaction. You have a legal right under federal law to cancel this new transaction, without cost, within three business days from whichever of the following events occurs last:

(1) the date of this new transaction, which is _____; or

(2) the date you received your new Truth in Lending disclosures; or

(3) the date you received this notice of your right to cancel.

If you cancel this new transaction, it will not affect any amount that you presently owe. Your home is the security for that amount. Within 20 calendar days after we receive your notice of cancellation of this new transaction, we must take the steps necessary to reflect the fact that your home does not secure the increase of credit. We must also return any money you have given to us or anyone else in connection with this new transaction.

You may keep any money we have given you in this new transaction until we have done the things mentioned above, but you must then offer to return the money at the address below.

If we do not take possession of the money within 20 calendar days of your offer, you may keep it without further

obligation.

How to Cancel

If you decide to cancel this new transaction, you may do so by notifying us in writing, at

(Creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of

(Date)

(or midnight of the third business day following the latest of the three events listed above).

If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL.

_____
Consumer's Signature

_____
Date

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§ H-10 Credit Sale Sample

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§ H-11 Installment Loan Sample

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§ H-12 Refinancing Sample

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§ H-13 Mortgage with Demand Feature Sample

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§ H-14 Variable-Rate Mortgage Sample

This disclosure describes the features of the Adjustable Rate Mortgage [ARM] program you are considering. Information on other ARM programs is available upon request.

How Your Interest Rate and Payment are Determined

- Your interest rate will be based on an index rate plus a margin.
- Your payment will be based on the interest rate, loan balance, and loan term.

  -- The interest rate will be based on the weekly average yield on United Treasury securities adjusted to a constant maturity of 1 year (your index), plus our margin. Ask us for our current interest rate and margin.

  -- Information about the index rate is published weekly in the *Wall Street Journal*.

- Your interest rate will equal the index rate plus our margin unless interest rate "caps" limit the amount of change in the interest rate.

How Your Interest Rate Can Change

- Your interest rate can change yearly.
- Your interest rate cannot increase or decrease more than two percentage points per year.
- Your interest rate cannot increase or decrease more than five percentage points over the term of the

loan.

How Your Monthly Payment Can Change

- Your monthly payment can change yearly based on changes in the interest rate.

- [For example, on a $10,000, 30-year loan with an initial interest rate of 12.41 percent in effect in July 1996, the maximum amount that the interest rate can rise under this program is 5 percentage points, to 17.41 percent, and the monthly payment can rise from a first-year payment of $106.03 to a maximum of $145.34 in the fourth year. To see what your payment is, divide your mortgage amount by $10,000; then multiply the monthly payment by that amount. (For example, the monthly payment for a mortgage amount of $60,000 would be: $60,000 / $10,000=6; 6x106.03=$636.18 per month.)

- You will be notified in writing 25 days before the annual payment adjustment may be made. This notice will contain information about your interest rates, payment amount, and loan balance.]

Example

The example below shows how your payments would have changed under this ARM program based on actual changes in the index from 1982 to 1996. This does not necessarily indicate how your index will change in the future. The example is based on the following assumptions:

Amount.....	$10,000
Term.....	30 years
Payment adjustment.....	1 year
Interest adjustment.....	1 year
Margin.....	3 percentage points
Caps.....	2 percentage points annual interest rate 5 percentage points lifetime interest rate
Index.....	Weekly average yield on U.S. Treasury securities adjusted to a constant maturity of one year.

Year (as of 1st week ending in July)	Index (%)	Margin n*(percentage points)	Interest Rate (%)	Monthly Payment (]	Remaining Balance (]
1982.....	14.41	3	17.41	145.90	9,989.37
1983.....	9.78	3	15.41 n**	129.81	9,969.66
1984.....	12.17	3	15.17	127.91	9,945.51
1985.....	7.66	3	13.17[**]	112.43	9,903.70
1986.....	6.36	3	12.41 n***	106.73	9,848.94
1987.....	6.71	3	12.41[***]	106.73	9,786.98

1988.....	7.52	3	12.41[***]	106.73	9,716.88
1989.....	7.97	3	12.41[***]	106.73	9,637.56
1990.....	8.06	3	12.41[***]	106.73	9,547.83
1991.....	6.40	3	12.41[***]	106.73	9,446.29
1992.....	3.96	3	12.41[***]	106.73	9,331.56
1993.....	3.42	3	12.41[***]	106.73	9,201.61
1994.....	5.47	3	12.41[***]	106.73	9,054.72
1995.....	5.53	3	12.41[***]	106.73	8,888.52
1996.....	5.82	3	12.41[***]	106.73	8,700.37

Note:

To see what your payments would have been during that period, divide your mortgage amount by $10,000; then multiply the monthly payments by that amount (for example, in 1996 the monthly payment for a mortgage amount of $60,000 taken out in 1982 would be:
$60,000 / $10,000 = 6; 6 x $106.73 = $640.38).

- You will be notified in writing 25 days before the annual payment adjustment may be made. This notice will contain information about your interest rates, payment amount and loan balance.]

FOOTNOTES:

(n74)Footnote *. This is a margin we have used recently; your margin may be different.

(n75)Footnote **. This interest rate reflects a 2 percentage point annual interest rate cap.

(n76)Footnote ***. This interest rate reflects a 5 percentage point lifetime interest rate cap.

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§ H-15 Graduated-Payment Mortgage Sample

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§ H-16 Mortgage Sample

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§ **H-17A Debt Suspension Model Clause**

Please enroll me in the optional [insert name of program], and bill my account the fee of [insert charge for the initial term of coverage]. I understand that enrollment is not required to obtain credit. I also understand that depending on the event, the protection may only temporarily suspend my duty to make minimum payments, not reduce the balance I owe. I understand that my balance will actually grow during the suspension period as interest continues to accumulate.

[To Enroll, Sign Here]/[To Enroll, Initial Here]. X_____

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§ **H-17B Debt Suspension Sample**

Please enroll me in the optional [name of program], and bill my account the fee of $200.00. I understand that enrollment is not required to obtain credit. I also understand that depending on the event, the protection may only temporarily suspend my duty to make minimum payments, not reduce the balance I owe. I understand that my balance will actually grow during the suspension period as interest continues to accumulate.

To Enroll, Initial Here. X _____

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§ H-18 Private Education Loan Application and Solicitation Model Form

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§ H-19 Private Education Loan Approval Model Form

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§ H-20 Private Education Loan Final Model Form

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§ H-21 Private Education Loan Application and Solicitation Sample

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§ H-22 Private Education Loan Approval Sample

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§ H-23 Private Education Loan Final Sample

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Appendix I to Part 226 Federal Enforcement Agencies

The following list indicates which federal agency enforces Regulation Z for particular classes of businesses. Any questions concerning compliance by a particular business should be directed to the appropriate enforcement agency. Terms that are not defined in the Federal Deposit Insurance Act (*12 U.S.C. 1813(s)*) shall have the meaning given to them in the International Banking Act of 1978 (*12 U.S.C. 3101*).

National banks and federal branches and federal agencies of foreign banks

District office of the Office of the Comptroller of the Currency for the district in which the institution is located.

State member banks, branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act

Federal Reserve Bank serving the district in which the institution is located.

Non-member insured banks and insured state branches of foreign banks

Federal Deposit Insurance Corporation Regional director for the region in which the institution is located.

Savings institutions insured under the Savings Association Insurance Fund of the FDIC and federally chartered savings banks insured under the Bank Insurance Fund of the FDIC (but not including state-chartered savings banks insured under the Bank Insurance Fund).

Office of Thrift Supervision Regional Director for the region in which the institution is located.

Federal Credit Unions

Regional office of the National Credit Union Administration serving the area in which the Federal credit union is located.

Air Carriers

Assistant General Counsel for Aviation Enforcement and Proceedings, Department of Transportation, 400 Seventh Street, SW., Washington, D.C. 20590.

Creditors Subject to Packers and Stockyards Act

Nearest Packers and Stockyards Administration area supervisor.

Federal Land Banks, Federal Land Bank Associations, Federal Intermediate Credit Banks and Production Credit Associations

Farm Credit Administration, 490 L'Enfant Plaza, SW., Washington, D.C. 20578.

Retail, Department Stores, Consumer Finance Companies, All Other Creditors, and All Nonbank Credit Card Issuers (Creditors operating on a local or regional basis should use the address of the FTC Regional Office in which they operate.)

Division of Credit Practices, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C. 20580.

[Reg. Z, *46 FR 20892,* Apr. 7, 1981, as amended at *50 FR 8708,* Mar. 5, 1985; *54 FR 53539,* Dec. 29, 1989; *56 FR 51322* , Oct. 11, 1991; *57 FR 20400* , May 13, 1992]

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Appendix J to Part 226 Annual Percentage Rate Computations for Closed-End Credit Transactions

(a) *Introduction*.

(1) Section 226.22(a) of Regulation Z provides that the annual percentage rate for other than open end credit transactions shall be determined in accordance with either the actuarial method or the United States Rule method. This appendix contains an explanation of the actuarial method as well as equations, instructions and examples of how this method applies to single advance and multiple advance transactions.

(2) Under the actuarial method, at the end of each unit-period (or fractional unit-period) the unpaid balance of the amount financed is increased by the finance charge earned during that period and is decreased by the total payment (if any) made at the end of that period. The determination of unit-periods and fractional unit-periods shall be consistent with the definitions and rules in paragraphs (b)(3), (4) and (5) of this section and the general equation of paragraph (b)(8) of this section.

(3) In contrast, under the United States Rule method, at the end of each payment period, the unpaid balance of the amount financed is increased by the finance charge earned during that payment period and is decreased by the payment made at the end of that payment period. If the payment is less than the finance charge earned, the adjustment of the unpaid balance of the amount financed is postponed until the end of the next payment period. If at that time the sum of

the two payments is still less than the total earned finance charge for the two payment periods, the adjustment of the unpaid balance of the amount financed is postponed still another payment period, and so forth.

(b) *Instructions and equations for the actuarial method.*

(1) *General rule.* The annual percentage rate shall be the nominal annual percentage rate determined by multiplying the unit-period rate by the number of unit-periods in a year.

(2) *Term of the transaction.* The term of the transaction begins on the date of its consummation, except that if the finance charge or any portion of it is earned beginning on a later date, the term begins on the later date. The term ends on the date the last payment is due, except that if an advance is scheduled after that date, the term ends on the later date. For computation purposes, the length of the term shall be equal to the time interval between any point in time on the beginning date to the same point in time on the ending date.

(3) *Definitions of time intervals.*

(i) A period is the interval of time between advances or between payments and includes the interval of time between the date the finance charge begins to be earned and the date of the first advance thereafter or the date of the first payment thereafter, as applicable.

(ii) A common period is any period that occurs more than once in a transaction.

(iii) A standard interval of time is a day, week, semimonth, month, or a multiple of a week or a month up to, but not exceeding, one year.

(iv) All months shall be considered equal. Full months shall be measured from any point in time on a given date of a given month to the same point in time on the same date of another month. If a series of payments (or advances) is scheduled for the last day of each month, months shall be measured from the last day of the given month to the last day of another month. If payments (or advances) are scheduled for the 29th or 30th of each month, the last day of February shall be used when applicable.

(4) *Unit-period.*

(i) In all transactions other than a single advance, single payment transaction, the unit-period shall be that common period, not to exceed one year, that occurs most frequently in the transaction, except that

(A) If two or more common periods occur with equal frequency, the smaller of such common periods shall be the unit-period; or

(B) If there is no common period in the transaction, the unit-period shall be that period which is the average of all periods rounded to the nearest whole standard interval of time. If the average is equally near two standard intervals of time, the lower shall be the unit-period.

(ii) In a single advance, single payment transaction, the unit-period shall be the term of the transaction, but shall not exceed one year.

(5) *Number of unit-periods between two given dates.*

(i) The number of days between two dates shall be the number of 24-hour intervals between any point in time on the first date to the same point in time on the second date.

(ii) If the unit-period is a month, the number of full unit-periods between two dates shall be the number of months measured back from the later date. The remaining fraction of a unit-period shall be the number of days measured forward from the earlier date to the beginning of the first full unit-period, divided by 30. If the unit-period is a month, there are 12 unit-periods per year.

(iii) If the unit-period is a semimonth or a multiple of a month not exceeding 11 months, the number of days between two dates shall be 30 times the number of full months measured back from the later date, plus the number of remaining days. The number of full unit-periods and the remaining fraction of a unit-period shall be determined by dividing such number of days by 15 in the case of a semimonthly unit-period or by the appropriate multiple of 30 in the case of a multimonthly unit-period. If the unit-period is a semimonth, the number of unit-periods per year shall be 24. If the number of unit-periods is a multiple of a month, the number of unit-periods per year shall be 12 divided by the number of months per unit-period.

(iv) If the unit-period is a day, a week, or a multiple of a week, the number of full unit-periods and the remaining fractions of a unit-period shall be determined by dividing the number of days between the two given dates by the number of days per unit-period. If the unit-period is a day, the number of unit-periods per year shall be 365. If the

unit-period is a week or a multiple of a week, the number of unit-periods per year shall be 52 divided by the number of weeks per unit-period.

(v) If the unit-period is a year, the number of full unit-periods between two dates shall be the number of full years (each equal to 12 months) measured back from the later date. The remaining fraction of a unit-period shall be

(A) The remaining number of months divided by 12 if the remaining interval is equal to a whole number of months, or

(B) The remaining number of days divided by 365 if the remaining interval is *not* equal to a whole number of months.

(vi) In a single advance, single payment transaction in which the term is less than a year and is equal to a whole number of months, the number of unit-periods in the term shall be one, and the number of unit-periods per year shall be 12 divided by the number of months in the term or 365 divided by the number of days in the term.

(vii) In a single advance, single payment transaction in which the term is less than a year and is *not* equal to a whole number of months, the number of unit-periods in the term shall be 1, and the number of unit-periods per year shall be 365 divided by the number of days in the term.

(6) *Percentage rate for a fraction of a unit-period*. The percentage rate of finance charge for a fraction (less than one) of a unit-period shall be equal to such fraction multiplied by the percentage rate of finance charge per unit-period.

(7) *Symbols*. The symbols used to express the terms of a transaction in the equation set forth in paragraph (b)(8) of this section are defined as follows:

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[Reg. Z, *46 FR 20892,* Apr. 7, 1981, as amended at *46 FR 29246,* June 1, 1981]

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Appendix K to Part 226 Total Annual Loan Cost Rate Computations for Reverse Mortgage Transactions

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Appendix K to Part 226 Total Annual Loan Cost Rate Computations for Reverse Mortgage Transactions

(a) *Introduction*. Creditors are required to disclose a series of total annual loan cost rates for each reverse mortgage transaction. This appendix contains the equations creditors must use in computing the total annual loan cost rate for various transactions, as well as instructions, explanations, and examples for various transactions. This appendix is modeled after Appendix J of this part (Annual Percentage Rates Computations for Closed-end Credit Transactions); creditors should consult Appendix J of this part for additional guidance in using the formulas for reverse mortgages.

(b) *Instructions and equations for the total annual loan cost rate*.

(1) *General rule*. The total annual loan cost rate shall be the nominal total annual loan cost rate determined by multiplying the unit-period rate by the number of unit-periods in a year.

(2) *Term of the transaction*. For purposes of total annual loan cost disclosures, the term of a reverse mortgage transaction is assumed to begin on the first of the month in which consummation is expected to occur. If a loan cost or any portion of a loan cost is initially incurred beginning on a date later than consummation, the term of the transaction is assumed to begin on the first of the month in which that loan cost is incurred. For purposes of total annual loan cost disclosures, the term ends on each of the assumed loan periods specified in § 226.33(c)(6).

(3) *Definitions of time intervals.*

(i) A *period* is the interval of time between advances.

(ii) A *common period* is any period that occurs more than once in a transaction.

(iii) A *standard interval of time* is a day, week, semimonth, month, or a multiple of a week or a month up to, but not exceeding, 1 year.

(iv) All months shall be considered to have an equal number of days.

(4) *Unit-period.*

(i) In all transactions other than single-advance, single-payment transactions, the unit-period shall be that common period, not to exceed one year, that occurs most frequently in the transaction, except that:

(A) If two or more common periods occur with equal frequency, the smaller of such common periods shall be the unit-period; or

(B) If there is no common period in the transaction, the unit-period shall be that period which is the average of all periods rounded to the nearest whole standard interval of time. If the average is equally near two standard intervals of time, the lower shall be the unit-period.

(ii) In a single-advance, single-payment transaction, the unit-period shall be the term of the transaction, but shall not exceed one year.

(5) *Number of unit-periods between two given dates.*

(i) The number of days between two dates shall be the number of 24-hour intervals between any point in time on the

first date to the same point in time on the second date.

(ii) If the unit-period is a month, the number of full unit-periods between two dates shall be the number of months. If the unit-period is a month, the number of unit-periods per year shall be 12.

(iii) If the unit-period is a semimonth or a multiple of a month not exceeding 11 months, the number of days between two dates shall be 30 times the number of full months. The number of full unit-periods shall be determined by dividing the number of days by 15 in the case of a semimonthly unit-period or by the appropriate multiple of 30 in the case of a multimonthly unit-period. If the unit-period is a semimonth, the number of unit-periods per year shall be 24. If the number of unit-periods is a multiple of a month, the number of unit-periods per year shall be 12 divided by the number of months per unit-period.

(iv) If the unit-period is a day, a week, or a multiple of a week, the number of full unit-periods shall be determined by dividing the number of days between the two given dates by the number of days per unit-period. If the unit-period is a day, the number of unit-periods per year shall be 365. If the unit-period is a week or a multiple of a week, the number of unit-periods per year shall be 52 divided by the number of weeks per unit-period.

(v) If the unit-period is a year, the number of full unit-periods between two dates shall be the number of full years (each equal to 12 months).

(6) *Symbols*. The symbols used to express the terms of a transaction in the equation set forth in paragraph (b)(8) of this appendix are defined as follows:

A[j]=The amount of each periodic or lump-sum advance to the consumer under the reverse mortgage transaction.

i=Percentage rate of the total annual loan cost per unit-period, expressed as a decimal equivalent.

j=The number of unit-periods until the jth advance.

n=The number of unit-periods between consummation and repayment of the debt.

P[n]=Min (Bal[n], Val[n]). This is the maximum amount that the creditor can be repaid at the specified loan term.

Bal[n]=Loan balance at time of repayment, including all costs and fees incurred by the consumer (including any shared appreciation or shared equity amount) compounded to time n at the creditor's contract rate of interest.

Val[n]=Val[0] (1 + 0)y, where Val[0] is the property value at consummation, s is the assumed annual rate of appreciation for the dwelling, and o is the number of years in the assumed term. Valn must be reduced by the amount of any equity reserved for the consumer by agreement between the parties, or by 7 percent (or the amount or percentage specified in the credit agreement), if the amount required to be repaid is limited to the net proceeds of sale.

E=The summation operator.

Symbols used in the examples shown in this appendix are defined as follows: FV[x-1]i = The future value of 1 per unit period for x unit periods, first advance due immediately (at time = 0, which is consummation).

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w=The number of unit-periods per year.

I=wi x 100=the nominal total annual loan cost rate.

(7) *General equation*. The total annual loan cost rate for a reverse mortgage transaction must be determined by first solving the following formula, which sets forth the relationship between the advances to the consumer and the amount owed to the creditor under the terms of the reverse mortgage agreement for the loan cost rate per unit-period (the loan cost rate per unit-period is then multiplied by the number of unit-periods per year to obtain the total annual loan cost rate I; that is, I = wi):

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(8) *Solution of general equation by iteration process*.

(i) The general equation in paragraph (b)(7) of this appendix, when applied to a simple transaction for a reverse mortgage loan of equal monthly advances of $350 each, and with a total amount owed of $14,313.08 at an assumed repayment period of two years, takes the special form:

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Using the iteration procedures found in steps 1 through 4 of (b)(9)(i) of Appendix J of this part, the total annual loan cost rate, correct to two decimals, is 48.53%.

(ii) In using these iteration procedures, it is expected that calculators or computers will be programmed to carry all available decimals throughout the calculation and that enough iterations will be performed to make virtually certain that the total annual loan cost rate obtained, when rounded to two decimals, is correct. Total annual loan cost rates in the examples below were obtained by using a 10-digit programmable calculator and the iteration procedure described in Appendix J of this part.

(9) *Assumption for discretionary cash advances*. If the consumer controls the timing of advances made after consummation (such as in a credit line arrangement), the creditor must use the general formula in paragraph (b)(7) of this appendix. The total annual loan cost rate shall be based on the assumption that 50 percent of the principal loan amount is advanced at closing, or in the case of an open-end transaction, at the time the consumer becomes obligated under the plan. Creditors shall assume the advances are made at the interest rate then in effect and that no further advances are made to, or repayments made by, the consumer during the term of the transaction or plan.

(10) *Assumption for variable-rate reverse mortgage transactions*. If the interest rate for a reverse mortgage transaction may increase during the loan term and the amount or timing is not known at consummation, creditors shall base the disclosures on the initial interest rate in effect at the time the disclosures are provided.

(11) *Assumption for closing costs*. In calculating the total annual loan cost rate, creditors shall assume all closing and other consumer costs are financed by the creditor.

(c) *Examples of total annual loan cost rate computations*.

(1) *Lump-sum advance at consummation*.

Lump-sum advance to consumer at consummation: $30,000

Total of consumer's loan costs financed at consummation: $4,500

Contract interest rate: 11.60%

Estimated time of repayment (based on life expectancy of a consumer at age 78): 10 years

Appraised value of dwelling at consummation: $100,000

Assumed annual dwelling appreciation rate: 4%

P[10] = Min (103,385.84, 137,662.72)

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i =.1317069438

Total annual loan cost rate (100(.1317069438 x 1)) = 13.17%

(2) *Monthly advance beginning at consummation*.

Monthly advance to consumer, beginning at consummation: $492.51

Total of consumer's loan costs financed at consummation: $4,500

Contract interest rate: 9.00%

Estimated time of repayment (based on life expectancy of a consumer at age 78): 10 years

Appraised value of dwelling at consummation: $100,000

Assumed annual dwelling appreciation rate: 8%

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Total annual loan cost rate (100(.009061140 x 12))=10.87%

(3) *Lump sum advance at consummation and monthly advances thereafter.*

Lump sum advance to consumer at consummation: $10,000

Monthly advance to consumer, beginning at consummation: $725

Total of consumer's loan costs financed at consummation: $4,500

Contract rate of interest: 8.5%

Estimated time of repayment (based on life expectancy of a consumer at age 75): 12 years

Appraised value of dwelling at consummation: $100,000

Assumed annual dwelling appreciation rate: 8%

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Total annual loan cost rate (100(.007708844 x 12)) = 9.25%

(d) *Reverse mortgage model form and sample form.*

(1) *Model form.*

Total Annual Loan Cost Rate

Loan Terms

Age of youngest borrower:

Appraised property value:

Interest rate:

Monthly advance:

Initial draw:

Line of credit:

Initial Loan Charges

Closing costs:

Mortgage insurance premium:

Annuity cost:

Monthly Loan Charges

Servicing fee:

Other Charges:

Mortgage insurance:

Shared Appreciation:

Repayment Limits

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The cost of any reverse mortgage loan depends on how long you keep the loan and how much your house appreciates in value. Generally, the longer you keep a reverse mortgage, the lower the total annual loan cost rate will be.

This table shows the estimated cost of your reverse mortgage loan, expressed as an annual rate. It illustrates the cost for three [four] loan terms: 2 years, [half of life expectancy for someone your age,] that life expectancy, and 1.4 times that life expectancy. The table also shows the cost of the loan, assuming the value of your home appreciates at three different rates: 0%, 4% and 8%.

The total annual loan cost rates in this table are based on the total charges associated with this loan. These charges typically include principal, interest, closing costs, mortgage insurance premiums, annuity costs, and servicing costs (but not costs when you sell the home).

The rates in this table are estimates. Your actual cost may differ if, for example, the amount of your loan advances varies or the interest rate on your mortgage changes.

Signing an Application or Receiving These Disclosures Does Not Require You To Complete This Loan

(2) Sample Form.

Total Annual Loan Cost Rate

Loan Terms

Age of youngest borrower: 75

Appraised property value: $100,000

Interest rate: 9%

Monthly advance: $301.80

Initial draw: $1,000

Line of credit: $4,000

Initial Loan Charges

Closing costs: $5,000

Mortgage insurance premium: None

Annuity cost: None

Monthly Loan Charges

Servicing fee: None

Other Charges

Mortgage insurance: None

Shared Appreciation: None

Repayment Limits

Net proceeds estimated at 93% of projected home sale

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The cost of any reverse mortgage loan depends on how long you keep the loan and how much your house appreciates in value. Generally, the longer you keep a reverse mortgage, the lower the total annual loan cost rate will be.

This table shows the estimated cost of your reverse mortgage loan, expressed as an annual rate. It illustrates the cost for three [four] loan terms: 2 years, [half of life expectancy for someone your age,] that life expectancy, and 1.4 times that life expectancy. The table also shows the cost of the loan, assuming the value of your home appreciates at three different rates: 0%,4% and 8%.

The total annual loan cost rates in this table are based on the total charges associated with this loan. These charges typically include principal, interest, closing costs, mortgage insurance premiums, annuity costs, and servicing costs (but not disposition costs--costs when you sell the home).

The rates in this table are estimates. Your actual cost may differ if, for example, the amount of your loan advances varies or the interest rate on your mortgage changes.

Signing an Application or Receiving These Disclosures Does Not Require You To Complete This Loan
[*60 FR 15474* , Mar. 24, 1995; *60 FR 50400* , Sept. 29, 1995]

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Appendix L to Part 226 Assumed Loan Periods for Computations of Total Annual Loan Cost Rates

(a) *Required tables*. In calculating the total annual loan cost rates in accordance with Appendix K of this part, creditors shall assume three loan periods, as determined by the following table.

(b) *Loan periods*.

(1) Loan Period 1 is a two-year loan period.

(2) Loan Period 2 is the life expectancy in years of the youngest borrower to become obligated on the reverse mortgage loan, as shown in the U.S. Decennial Life Tables for 1979-1981 for females, rounded to the nearest whole year.

(3) Loan Period 3 is the life expectancy figure in Loan Period 3, multiplied by 1.4 and rounded to the nearest full year (life expectancy figures at.5 have been rounded up to 1).

(4) At the creditor's option, an additional period may be included, which is the life expectancy figure in Loan Period 2, multiplied by.5 and rounded to the nearest full year (life expectancy figures at.5 have been rounded up to 1).

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[*60 FR 15476* , Mar. 24, 1995]

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Appendix M1 to Part 226 Repayment Disclosures

(a) Definitions.

(1) "Promotional terms" means terms of a cardholder's account that will expire in a fixed period of time, as set forth by the card issuer.

(2) "Deferred interest or similar plan" means a plan where a consumer will not be obligated to pay interest that accrues on balances or transactions if those balances or transactions are paid in full prior to the expiration of a specified period of time.

(b) Calculating minimum payment repayment estimates.

(1) Minimum payment formulas. When calculating the minimum payment repayment estimate, card issuers must use the minimum payment formula(s) that apply to a cardholder's account. If more than one minimum payment formula applies to an account, the issuer must apply each minimum payment formula to the portion of the balance to which the formula applies. In this case, the issuer must disclose the longest repayment period calculated. For example, assume that an issuer uses one minimum payment formula to calculate the minimum payment amount for a general revolving

feature, and another minimum payment formula to calculate the minimum payment amount for special purchases, such as a "club plan purchase." Also, assume that based on a consumer's balances in these features and the annual percentage rates that apply to such features, the repayment period calculated pursuant to this Appendix for the general revolving feature is 5 years, while the repayment period calculated for the special purchase feature is 3 years. This issuer must disclose 5 years as the repayment period for the entire balance to the consumer. If any promotional terms related to payments apply to a cardholder's account, such as a deferred billing plan where minimum payments are not required for 12 months, card issuers may assume no promotional terms apply to the account. For example, assume that a promotional minimum payment of $10 applies to an account for six months, and then after the promotional period expires, the minimum payment is calculated as 2 percent of the outstanding balance on the account or $20 whichever is greater. An issuer may assume during the promotional period that the $10 promotional minimum payment does not apply, and instead calculate the minimum payment disclosures based on the minimum payment formula of 2 percent of the outstanding balance or $20, whichever is greater. Alternatively, during the promotional period, an issuer in calculating the minimum payment repayment estimate may apply the promotional minimum payment until it expires and then apply the minimum payment formula that applies after the promotional minimum payment expires. In the above example, an issuer could calculate the minimum payment repayment estimate during the promotional period by applying the $10 promotional minimum payment for the first six months and then applying the 2 percent or $20 (whichever is greater) minimum payment formula after the promotional minimum payment expires. In calculating the minimum payment repayment estimate during a promotional period, an issuer may not assume that the promotional minimum payment will apply until the outstanding balance is paid off by making only minimum payments (assuming the repayment estimate is longer than the promotional period). In the above example, the issuer may not calculate the minimum payment repayment estimate during the promotional period by assuming that the $10 promotional minimum payment will apply beyond the six months until the outstanding balance is repaid.

(2) Annual percentage rate. When calculating the minimum payment repayment estimate, a card issuer must use the annual percentage rates that apply to a cardholder's account, based on the portion of the balance to which the rate applies. If any promotional terms related to annual percentage rates apply to a cardholder's account, other than deferred interest or similar plans, a card issuer in calculating the minimum payment repayment estimate during the promotional period must apply the promotional annual percentage rate(s) until it expires and then must apply the rate that applies after the promotional rate(s) expires. If the rate that applies after the promotional rate(s) expires is a variable rate, a card issuer must calculate that rate based on the applicable index or formula. This variable rate is accurate if it was in effect within the last 30 days before the minimum payment repayment estimate is provided. For deferred interest plans or similar plans, if minimum payments under the deferred interest or similar plan will repay the balances or transactions in full prior to the expiration of the specified period of time, a card issuer must assume that the consumer will not be obligated to pay the accrued interest. This means, in calculating the minimum payment repayment estimate, the card issuer must apply a zero percent annual percentage rate to the balance subject to the deferred interest or similar plan. If, however, minimum payments under the deferred interest plan or similar plan may not repay the balances or transactions in full prior to the expiration of the specified period of time, a card issuer must assume that a consumer will not repay the balances or transactions in full prior to the expiration of the specified period of time and thus the consumer will be obligated to pay the accrued interest. This means, in calculating the minimum payment repayment estimate, the card issuer must apply the annual percentage rate at which interest is accruing to the balance subject to the deferred interest or similar plan.

(3) Beginning balance. When calculating the minimum payment repayment estimate, a card issuer must use as the beginning balance the outstanding balance on a consumer's account as of the closing date of the last billing cycle. When calculating the minimum payment repayment estimate, a card issuer may round the beginning balance as described above to the nearest whole dollar.

(4) Assumptions. When calculating the minimum payment repayment estimate, a card issuer for each of the terms below, may either make the following assumption about that term, or use the account term that applies to a consumer's account.

(i) Only minimum monthly payments are made each month. In addition, minimum monthly payments are made each month--for example, a debt cancellation or suspension agreement, or skip payment feature does not apply to the account.

(ii) No additional extensions of credit are obtained, such as new purchases, transactions, fees, charges or other activity. No refunds or rebates are given.

(iii) The annual percentage rate or rates that apply to a cardholder's account will not change, through either the operation of a variable rate or the change to a rate, except as provided in paragraph (b)(2) of this Appendix. For example, if a penalty annual percentage rate currently applies to a consumer's account, a card issuer may assume that the penalty annual percentage rate will apply to the consumer's account indefinitely, even if the consumer may potentially return to a non-penalty annual percentage rate in the future under the account agreement.

(iv) There is no grace period.

(v) The final payment pays the account in full (i.e., there is no residual finance charge after the final month in a series of payments).

(vi) The average daily balance method is used to calculate the balance.

(vii) All months are the same length and leap year is ignored. A monthly or daily periodic rate may be assumed. If a daily periodic rate is assumed, the issuer may either assume (1) a year is 365 days long, and all months are 30.41667 days long, or (2) a year is 360 days long, and all months are 30 days long.

(viii) Payments are credited either on the last day of the month or the last day of the billing cycle.

(ix) Payments are allocated to lower annual percentage rate balances before higher annual percentage rate balances.

(x) The account is not past due and the account balance does not exceed the credit limit.

(xi) When calculating the minimum payment repayment estimate, the assumed payments, current balance and interest charges for each month may be rounded to the nearest cent, as shown in Appendix M2 to this part.

(5) Tolerance. A minimum payment repayment estimate shall be considered accurate if it is not more than 2 months above or below the minimum payment repayment estimate determined in accordance with the guidance in this Appendix (prior to rounding described in § 226.7(b)(12)(i)(B) and without use of the assumptions listed in paragraph (b)(4) of this Appendix to the extent a card issuer chooses instead to use the account terms that apply to a consumer's account). For example, assume the minimum payment repayment estimate calculated using the guidance in this Appendix is 28 months (2 years, 4 months), and the minimum payment repayment estimate calculated by the issuer is 30 months (2 years, 6 months). The minimum payment repayment estimate should be disclosed as 2 years, due to the rounding rule set forth in § 226.7(b)(12)(i)(B). Nonetheless, based on the 30-month estimate, the issuer disclosed 3 years, based on that rounding rule. The issuer would be in compliance with this guidance by disclosing 3 years, instead of 2 years, because the issuer's estimate is within the 2 months' tolerance, prior to rounding. In addition, even if an issuer's estimate is more than 2 months above or below the minimum payment repayment estimate calculated using the guidance in this Appendix, so long as the issuer discloses the correct number of years to the consumer based on the rounding rule set forth in § 226.7(b)(12)(i)(B), the issuer would be in compliance with this guidance. For example, assume the minimum payment repayment estimate calculated using the guidance in this Appendix is 32 months (2 years, 8 months), and the minimum payment repayment estimate calculated by the issuer is 38 months (3 years, 2 months). Under the rounding rule set forth in § 226.7(b)(12)(i)(B), both of these estimates would be rounded and disclosed to the consumer as 3 years. Thus, if the issuer disclosed 3 years to the consumer, the issuer would be in compliance with this guidance even though the minimum payment repayment estimate calculated by the issuer is outside the 2 months' tolerance amount.

(c) Calculating the minimum payment total cost estimate. When calculating the minimum payment total cost estimate, a card issuer must total the dollar amount of the interest and principal that the consumer would pay if he or she made minimum payments for the length of time calculated as the minimum payment repayment estimate under paragraph (b) of this Appendix. The minimum payment total cost estimate is deemed to be accurate if it is based on a minimum payment repayment estimate that is within the tolerance guidance set forth in paragraph (b)(5) of this Appendix. For example, assume the minimum payment repayment estimate calculated using the guidance in this Appendix is 28 months (2 years, 4 months), and the minimum payment repayment estimate calculated by the issuer is 30 months (2 years, 6 months). The minimum payment total cost estimate will be deemed accurate even if it is based on the 30 month estimate for length of repayment, because the issuer's minimum payment repayment estimate is within the 2 months' tolerance, prior to rounding. In addition, assume the minimum payment repayment estimate calculated under this Appendix is 32 months (2 years, 8 months), and the minimum payment repayment estimate calculated by the issuer is 38 months (3 years, 2 months). Under the rounding rule set forth in § 226.7(b)(12)(i)(B), both of these estimates would be rounded and disclosed to the consumer as 3 years. If the issuer based the minimum payment total cost estimate on 38 months (or any other minimum payment repayment estimate that would be rounded to 3 years), the minimum payment total cost estimate would be deemed to be accurate.

(d) Calculating the estimated monthly payment for repayment in 36 months.

(1) In general. When calculating the estimated monthly payment for repayment in 36 months, a card issuer must calculate the estimated monthly payment amount that would be required to pay off the outstanding balance shown on the statement within 36 months, assuming the consumer paid the same amount each month for 36 months.

(2) Weighted annual percentage rate. In calculating the estimated monthly payment for repayment in 36 months, an issuer may use a weighted annual percentage rate that is based on the annual percentage rates that apply to a cardholder's account and the portion of the balance to which the rate applies, as shown in Appendix M2 to this part. If a card issuer uses a weighted annual percentage rate and any promotional terms related to annual percentage rates apply to a cardholder's account, other than deferred interest plans or similar plans, in calculating the weighted annual percentage rate, the issuer must calculate a weighted average of the promotional rate and the rate that will apply after the promotional rate expires based on the percentage of 36 months each rate will apply, as shown in Appendix M2 to this part. For deferred interest plans or similar plans, if minimum payments under the deferred interest or similar plan will repay the balances or transactions in full prior to the expiration of the specified period of time, if a card issuer uses a weighted annual percentage rate, the card issuer must assume that the consumer will not be obligated to pay the accrued interest. This means, in calculating the weighted annual percentage rate, the card issuer must apply a zero percent annual percentage rate to the balance subject to the deferred interest or similar plan. If, however, minimum payments under the deferred interest plan or similar plan may not repay the balances or transactions in full prior to the expiration of the specified period of time, a card issuer in calculating the weighted annual percentage rate must assume that a consumer will not repay the balances or transactions in full prior to the expiration of the specified period of time and thus the consumer will be obligated to pay the accrued interest. This means, in calculating the weighted annual percentage rate, the card issuer must apply the annual percentage rate at which interest is accruing to the balance subject to the deferred interest or similar plan. A card issuer may use a method of calculating the estimated monthly payment for repayment in 36 months other than a weighted annual percentage rate, so long as the calculation results in the same payment amount each month and so long as the total of the payments would pay off the outstanding balance shown on the periodic statement within 36 months.

(3) Assumptions. In calculating the estimated monthly payment for repayment in 36 months, a card issuer must use the same terms described in paragraph (b) of this Appendix, as appropriate.

(4) Tolerance. An estimated monthly payment for repayment in 36 months shall be considered accurate if it is not more than 10 percent above or below the estimated monthly payment for repayment in 36 months determined in accordance with the guidance in this Appendix (after rounding described in § 226.7(b)(12)(i)(F)(1)(i)).

(e) Calculating the total cost estimate for repayment in 36 months. When calculating the total cost estimate for repayment in 36 months, a card issuer must total the dollar amount of the interest and principal that the consumer would pay if he or she made the estimated monthly payment calculated under paragraph (d) of this Appendix each month for 36 months. The total cost estimate for repayment in 36 months shall be considered accurate if it is based on the estimated monthly payment for repayment in 36 months that is calculated in accordance with paragraph (d) of this Appendix.

(f) Calculating the savings estimate for repayment in 36 months. When calculating the saving estimate for repayment in 36 months, a card issuer must subtract the total cost estimate for repayment in 36 months calculated under paragraph (e) of this Appendix (rounded to the nearest whole dollar as set forth in § 226.7(b)(12)(i)(F)(1)(iii)) from the minimum payment total cost estimate calculated under paragraph (c) of this Appendix (rounded to the nearest whole dollar as set forth in § 226.7(b)(12)(i)(C)). The savings estimate for repayment in 36 months shall be considered accurate if it is based on the total cost estimate for repayment in 36 months that is calculated in accordance with paragraph (e) of this Appendix and the minimum payment total cost estimate calculated under paragraph (c) of this Appendix.
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Appendix M2 to Part 226 Sample Calculations of Repayment Disclosures

The following is an example of how to calculate the minimum payment repayment estimate, the minimum payment total cost estimate, the estimated monthly payment for repayment in 36 months, the total cost estimate for repayment in 36 months, and the savings estimate for repayment in 36 months using the guidance in Appendix M1 to this part where three annual percentage rates apply (where one of the rates is a promotional APR), the total outstanding balance is $1000, and the minimum payment formula is 2 percent of the outstanding balance or $20, whichever is greater. The following calculation is written in SAS code.

```
data one;

/*
Note: pmt01 = estimated monthly payment to repay balance in 36 months sumpmts36 = sum of payments for repayment in 36 months

month = number of months to repay total balance if making only minimum payments
pmt = minimum monthly payment
fc = monthly finance charge
sumpmts = sum of payments for minimum payments
*/

* inputs;

* annual percentage rates; apr1=0.0; apr2=0.17; apr3=0.21; * insert in ascending order;

* outstanding balances; cbal1=500; cbal2=250; cbal3=250;

* dollar minimum payment; dmin=20;
```

```
* percent minimum payment; pmin=0.02; * (0.02+perrate);

* promotional rate information;

* last month for promotional rate; expm=6; * = 0 if no promotional rate;

* regular rate; rrate=.17; * = 0 if no promotional rate;
array apr(3); array perrate(3);
days=365/12; * calculate days in month;

* calculate estimated monthly payment to pay off balances in 36 months, and total cost of repaying balance in 36
months;
array xperrate(3);
do I=1 to 3;
xperrate(I)=(apr(I)/365)*days; * calculate periodic rate;
 end;
if expm gt 0 then xperrate1a=(expm/36)*xperrate1+(1-(expm/36))*(rrate/365)*days; else xperrate1a=xperrate1;
tbal=cbal1+cbal2+cbal3;
perrate36=(cbal1*xperrate1a+ cbal2*xperrate2+cbal3*xperrate3)/ (cbal1+cbal2+cbal3);

* months to repay; dmonths=36;

* initialize counters for sum of payments for repayment in 36 months; Sumpmts36=0;
pvaf=(1-(1+perrate36)**-dmonths)/perrate36; * calculate present value of annuity factor;
pmt01und(tbal/pvaf,0.01); * calculate monthly payment for designated number of months;
sumpmts36 = pmt01 * 36;

* calculate time to repay and total cost of making minimum payments each month;

* initialize counter for months, and sum of payments;
month=0;
sumpmts=0;
do I=1 to 3;
perrate(I)=(apr(I)/365)*days; * calculate periodic rate;
end;
put perrate1=perrate2=perrate3=;
eins:
month=month+1; * increment month counter;
pmtund(pmin*tbal,0.01); * calculate payment as percentage of balance;
if month ge expm and expm ne 0 then perrate1=(rrate/365)*days;
if pmt lt dmin then pmt=dmin; * set dollar minimum payment;
array xxxbal(3); array cbal(3);
do I=1 to 3;
xxxbal(I)und(cbal(I)*(1+perrate(I)),0.01);
end;
fc=xxxbal1+xxxbal2+xxxbal3-tbal;
if pmt gt (tbal+fc) then do;
do I=1 to 3;
if cbal(I) gt 0 then pmtund(cbal(I)*(1+perrate(I)),0.01); * set final payment amount;
end;
end;
```

```
if pmt le xxxbal1 then do;
cbal1=xxxbal1-pmt;
cbal2=xxxbal2;
cbal3=xxxbal3;
end;
if pmt gt xxxbal1 and xxxbal2 gt 0 and pmt le (xxxbal1+xxxbal2) then do;
cbal2=xxxbal2-(pmt-xxxbal1);
cbal1=0;
cbal3=xxxbal3;
end;
if pmt gt xxxbal2 and xxxbal3 gt 0 then do;
cbal3=xxxbal3-(pmt-xxxbal1-xxxbal2);
cbal2=0;
end;
sumpmts=sumpmts+pmt; * increment sum of payments;
tbal=cbal1+cbal2+cbal3; * calculate new total balance;

* print month, balance, payment amount, and finance charge;
put month=tbal=cbal1=cbal2=cbal3=pmt= fc=;
if tbal gt 0 then go to eins; * go to next month if balance is greater than zero;

* initialize total cost savings;
savtot=0;
savtot= round(sumpmts,1)--round (sumpmts36,1);

* print number of months to repay debt if minimum payments made, final balance (zero), total cost if minimum
payments made, estimated monthly payment for repayment in 36 months, total cost for repayment in 36 months, and
total savings if repaid in 36 months;
put title=' ';
put title='number of months to repay debt if minimum payment made, final balance, total cost if minimum payments
made, estimated monthly payment for repayment in 36 months, total cost for repayment in 36 months, and total savings
if repaid in 36 months';
put month=tbal=sumpmts=pmt01= sumpmts36=savtot=;
put title=' ';
run;
```

[*74 FR 5244* , 5441, Jan. 29, 2009, withdrawn at *75 FR 7925,* Feb. 22, 2010; *75 FR 7658,* Feb. 22, 2010]

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Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
12 C.F.R. Part 226 REGULATION Z--TRUTH IN LENDING
Supp I to Part 226 Official Staff Interpretations (Part I of III)

1B- Consumer Credit Law Manual CFR

§ CFR OFFICIAL STAFF INTERPRETATIONS

Introduction

1. Official status. This commentary is the vehicle by which the staff of the Division of Consumer and Community Affairs of the Federal Reserve Board issues official staff interpretations of Regulation Z. Good faith compliance with this commentary affords protection from liability under 130(f) of the Truth in Lending Act. Section 130(f) (*15 U.S.C. 1640*) protects creditors from civil liability for any act done or omitted in good faith in conformity with any interpretation issued by a duly authorized official or employee of the Federal Reserve System.

2. Procedure for requesting interpretations. Under appendix C of the regulation, anyone may request an official staff interpretation. Interpretations that are adopted will be incorporated in this commentary following publication in the Federal Register. No official staff interpretations are expected to be issued other than by means of this commentary.

3. Rules of construction.

(a) Lists that appear in the commentary may be exhaustive or illustrative; the appropriate construction should be clear from the context. In most cases, illustrative lists are introduced by phrases such as "including, but not limited to," "among other things," "for example," or "such as."

(b) Throughout the commentary, reference to "this section" or "this paragraph" means the section or paragraph in the regulation that is the subject of the comment.

4. Comment designations. Each comment in the commentary is identified by a number and the regulatory section or paragraph which it interprets. The comments are designated with as much specificity as possible according to the particular regulatory provision addressed. For example, some of the comments to § 226.18(b) are further divided by subparagraph, such as comment 18(b)(1)-1 and comment 18(b)(2)-1. In other cases, comments have more general application and are designated, for example, as comment 18-1 or comment 18(b)-1. This introduction may be cited as comments I-1 through I-4. Comments to the appendices may be cited, for example, as comment app. A-1.

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1B- Consumer Credit Law Manual Subpart A

§ **A General**

Section 226.1 Authority, Purpose, Coverage, Organization, Enforcement and Liability

1(c) Coverage.

1. Foreign applicability. Regulation Z applies to all persons (including branches of foreign banks and sellers located in the United States) that extend consumer credit to residents (including resident aliens) of any state as defined in § 226.2. If an account is located in the United States and credit is extended to a U.S. resident, the transaction is subject to the regulation. This will be the case whether or not a particular advance or purchase on the account takes place in the United States and whether or not the extender of credit is chartered or based in the United States or a foreign country. For example, if a U.S. resident has a credit card account located in the consumer's state issued by a bank (whether U.S. or foreign-based), the account is covered by the regulation, including extensions of credit under the account that occur outside the United States. In contrast, if a U.S. resident residing or visiting abroad, or a foreign national abroad, opens a credit card account issued by a foreign branch of a U.S. bank, the account is not covered by the regulation.

1(d) Organization.

Paragraph 1(d)(1).

1. [Reserved].

Paragraph 1(d)(2).

1. [Reserved].

Paragraph 1(d)(3).

1. Effective date. The Board's amendments to Regulation Z published on May 19, 2009 apply to covered loans (including refinance loans and assumptions considered new transactions under § 226.20) for which the creditor receives an application on or after July 30, 2009.

Paragraph 1(d)(4).

1. [Reserved].

Paragraph 1(d)(5).

1. Effective dates. The Board's revisions published on July 30, 2008 (the "final rules") apply to covered loans (including refinance loans and assumptions considered new transactions under § 226.20) for which the creditor receives an application on or after October 1, 2009, except for the final rules on advertising, escrows, and loan servicing. But see comment 1(d)(3)-1. The final rules on escrow in § 226.35(b)(3) are effective for covered loans (including refinancings and assumptions in § 226.20) for which the creditor receives an application on or after April 1, 2010; but for such loans secured by manufactured housing on or after October 1, 2010. The final rules applicable to servicers in § 226.36(c) apply to all covered loans serviced on or after October 1, 2009. The final rules on advertising apply to advertisements occurring on or after October 1, 2009. For example, a radio ad occurs on the date it is first broadcast; a solicitation occurs on the date it is mailed to the consumer. The following examples illustrate the application of the effective dates for the final rules.

i. General. A refinancing or assumption as defined in § 226.20(a) or (b) is a new transaction and is covered by a provision of the final rules if the creditor receives an application for the transaction on or after that provision's effective date. For example, if a creditor receives an application for a refinance loan covered by § 226.35(a) on or after October 1, 2009, and the refinance loan is consummated on October 15, 2009, the provision restricting prepayment penalties in § 226.35(b)(2) applies. However, if the transaction were a modification of an existing obligation's terms that does not constitute a refinance loan under § 226.20(a), the final rules, including for example the restriction on prepayment penalties, would not apply.

ii. Escrows. Assume a consumer applies for a refinance loan to be secured by a dwelling (that is not a manufactured home) on March 15, 2010, and the loan is consummated on April 2, 2010. The escrow rule in § 226.35(b)(3) does not apply.

iii. Servicing. Assume that a consumer applies for a new loan on August 1, 2009. The loan is consummated on September 1, 2009. The servicing rules in § 226.36(c) apply to the servicing of that loan as of October 1, 2009.

Paragraph 1(d)(6).

1. Mandatory compliance dates. Compliance with the Board's revisions to Regulation Z published on August 14, 2009 is mandatory for private education loans for which the creditor receives an application on or after February 14, 2010. Compliance with the final rules on co-branding in §§ 226.48(a) and (b) is mandatory for marketing occurring on or after February 14, 2010. Compliance with the final rules is optional for private education loan transactions for which an application was received prior to February 14, 2010, even if consummated after the mandatory compliance date.

2. Optional compliance. A creditor may, at its option, provide the approval and final disclosures required under §§ 226.47(b) or (c) for private education loans where an application was received prior to the mandatory compliance date. If the creditor opts to provide the disclosures, the creditor must also comply with the applicable timing and other rules in §§ 226.46 and 226.48 (including providing the consumer with the 30-day acceptance period under § 226.48(c), and the right to cancel under § 226.48(d)). For example if the creditor receives an application on January 25, 2010 and approves the consumer's application on or after February 14, 2010, the creditor may, at its option, provide the approval disclosures under § 226.47(b), the final disclosures under § 226.47(c) and comply with the applicable requirements §§ 226.46 and 226.48. The creditor must also obtain the self-certification form as required in § 226.48(e), if applicable. Or, for example, if the creditor receives an application on January 25, 2010 and approves the consumer's application before February 14, 2010, the creditor may, at its option, provide the final disclosure under § 226.47(c) and comply with the applicable timing and other requirements of §§ 226.46 and 226.48, including providing the consumer with the right to cancel under § 226.48(d). The creditor must also obtain the self-certification form as required in § 226.48(e), if applicable.

Paragraph 1(d)(7).

1. [Reserved].

Section 226.2 Definitions and Rules of Construction

2(a)(2) Advertisement.

1. Coverage. Only commercial messages that promote consumer credit transactions requiring disclosures are advertisements. Messages inviting, offering, or otherwise announcing generally to prospective customers the availability of credit transactions, whether in visual, oral, or print media, are covered by Regulation Z (12 CFR part 226).

i. Examples include:

A. Messages in a newspaper, magazine, leaflet, promotional flyer, or catalog.

B. Announcements on radio, television, or public address system.

C. Electronic advertisements, such as on the Internet.

D. Direct mail literature or other printed material on any exterior or interior sign.

E. Point of sale displays.

F. Telephone solicitations.

G. Price tags that contain credit information.

H. Letters sent to customers or potential customers as part of an organized solicitation of business.

I. Messages on checking account statements offering auto loans at a stated annual percentage rate.

J. Communications promoting a new open-end plan or closed-end transaction.

ii. The term does not include:

A. Direct personal contacts, such as follow-up letters, cost estimates for individual consumers, or oral or written communication relating to the negotiation of a specific transaction.

B. Informational material, for example, interest-rate and loan-term memos, distributed only to business entities.

C. Notices required by federal or state law, if the law mandates that specific information be displayed and only the information so mandated is included in the notice.

D. News articles the use of which is controlled by the news medium.

E. Market-research or educational materials that do not solicit business.

F. Communications about an existing credit account (for example, a promotion encouraging additional or different uses of an existing credit card account).

2. Persons covered. All persons must comply with the advertising provisions in §§ 226.16 and 226.24, not just those that meet the definition of creditor in § 226.2(a)(17). Thus, home builders, merchants, and others who are not themselves creditors must comply with the advertising provisions of the regulation if they advertise consumer credit transactions. However, under section 145 of the act, the owner and the personnel of the medium in which an advertisement appears, or through which it is disseminated, are not subject to civil liability for violations.

2(a)(3) [Reserved].

2(a)(4) Billing cycle or cycle.

1. Intervals. In open-end credit plans, the billing cycle determines the intervals for which periodic disclosure statements are required; these intervals are also used as measuring points for other duties of the creditor. Typically, billing cycles are monthly, but they may be more frequent or less frequent (but not less frequent than quarterly).

2. Creditors that do not bill. The term cycle is interchangeable with billing cycle for definitional purposes, since some creditors' cycles do not involve the sending of bills in the traditional sense but only statements of account activity. This is commonly the case with financial institutions when periodic payments are made through payroll deduction or through automatic debit of the consumer's asset account.

3. Equal cycles. Although cycles must be equal, there is a permissible variance to account for weekends, holidays, and differences in the number of days in months. If the actual date of each statement does not vary by more than four days from a fixed "day" (for example, the third Thursday of each month) or "date" (for example, the 15th of each month) that the creditor regularly uses, the intervals between statements are considered equal. The requirement that cycles be equal applies even if the creditor applies a daily periodic rate to determine the finance charge. The requirement that intervals be equal does not apply to the first billing cycle on an open-end account (i.e., the time period between account opening and the generation of the first periodic statement) or to a transitional billing cycle that can occur if the creditor occasionally changes its billing cycles so as to establish a new statement day or date. (See comments 9(c)(1)-3 and 9(c)(2)-3.)

4. Payment reminder. The sending of a regular payment reminder (rather than a late payment notice) establishes a cycle for which the creditor must send periodic statements.

2(a)(6) Business day.

1. Business function test. Activities that indicate that the creditor is open for substantially all of its business functions include the availability of personnel to make loan disbursements, to open new accounts, and to handle credit transaction inquiries. Activities that indicate that the creditor is not open for substantially all of its business functions include a retailer's merely accepting credit cards for purchases or a bank's having its customer-service windows open only for limited purposes such as deposits and withdrawals, bill paying, and related services.

2. Rule for rescission, disclosures for certain mortgage transactions, and private education loans. A more precise rule for what is a business day (all calendar days except Sundays and the Federal legal holidays specified in *5 U.S.C. 6103(a)*) applies when the right of rescission, the receipt of disclosures for certain dwelling-secured mortgage transactions under §§ 226.19(a)(1)(ii), 226.19(a)(2), 226.31(c), or the receipt of disclosures for private education loans under § 226.46(d)(4) is involved. Four Federal legal holidays are identified in *5 U.S.C. 6103(a)* by a specific date: New Year's Day, January 1; Independence Day, July 4; Veterans Day, November 11; and Christmas Day, December 25. When one of these holidays (July 4, for example) falls on a Saturday, Federal offices and other entities might observe the holiday on the preceding Friday (July 3). In cases where the more precise rule applies, the observed holiday (in the example, July 3) is a business day.

2(a)(7) Card issuer.

1. Agent. An agent of a card issuer is considered a card issuer. Because agency relationships are traditionally defined by contract and by state or other applicable law, the regulation does not define agent. Merely providing services relating to the production of credit cards or data processing for others, however, does not make one the agent of the card issuer. In contrast, a financial institution may become the agent of the card issuer if an agreement between the institution and the card issuer provides that the cardholder may use a line of credit with the financial institution to pay

obligations incurred by use of the credit card.

2(a)(8) Cardholder.

1. General rule. A cardholder is a natural person at whose request a card is issued for consumer credit purposes or who is a co-obligor or guarantor for such a card issued to another. The second category does not include an employee who is a co-obligor or guarantor on a card issued to the employer for business purposes, nor does it include a person who is merely the authorized user of a card issued to another.

2. Limited application of regulation. For the limited purposes of the rules on issuance of credit cards and liability for unauthorized use, a cardholder includes any person, including an organization, to whom a card is issued for any purpose--including a business, agricultural, or commercial purpose.

3. Issuance. See the commentary to § 226.12(a).

4. Dual-purpose cards and dual-card systems. Some card issuers offer dual-purpose cards that are for business as well as consumer purposes. If a card is issued to an individual for consumer purposes, the fact that an organization has guaranteed to pay the debt does not make it business credit. On the other hand, if a card is issued for business purposes, the fact that an individual sometimes uses it for consumer purchases does not subject the card issuer to the provisions on periodic statements, billing-error resolution, and other protections afforded to consumer credit. Some card issuers offer dual-card systems--that is, they issue two cards to the same individual, one intended for business use, the other for consumer or personal use. With such a system, the same person may be a cardholder for general purposes when using the card issued for consumer use, and a cardholder only for the limited purposes of the restrictions on issuance and liability when using the card issued for business purposes.

2(a)(9) Cash price.

1. Components. This amount is a starting point in computing the amount financed and the total sale price under § 226.18 for credit sales. Any charges imposed equally in cash and credit transactions may be included in the cash price, or they may be treated as other amounts financed under § 226.18(b)(2).

2. Service contracts. Service contracts include contracts for the repair or the servicing of goods, such as mechanical breakdown coverage, even if such a contract is characterized as insurance under state law.

3. Rebates. The creditor has complete flexibility in the way it treats rebates for purposes of disclosure and calculation. (See the commentary to § 226.18(b).)

2(a)(10) Closed-end credit.

1. General. The coverage of this term is defined by exclusion. That is, it includes any credit arrangement that does not fall within the definition of open-end credit. Subpart C contains the disclosure rules for closed-end credit when the obligation is subject to a finance charge or is payable by written agreement in more than four installments.

2(a)(11) Consumer.

1. Scope. Guarantors, endorsers, and sureties are not generally consumers for purposes of the regulation, but they may be entitled to rescind under certain circumstances and they may have certain rights if they are obligated on credit card plans.

2. Rescission rules. For purposes of rescission under §§ 226.15 and 226.23, a consumer includes any natural person whose ownership interest in his or her principal dwelling is subject to the risk of loss. Thus, if a security interest is taken in A's ownership interest in a house and that house is A's principal dwelling, A is a consumer for purposes of rescission, even if A is not liable, either primarily or secondarily, on the underlying consumer credit transaction. An ownership interest does not include, for example, leaseholds or inchoate rights, such as dower.

3. Land trusts. Credit extended to land trusts, as described in the commentary to § 226.3(a), is considered to be extended to a natural person for purposes of the definition of consumer.

2(a)(12) Consumer credit.

1. Primary purpose. There is no precise test for what constitutes credit offered or extended for personal, family, or household purposes, nor for what constitutes the primary purpose. (See, however, the discussion of business purposes in the commentary to § 226.3(a).)

2(a)(13) Consummation.

1. State law governs. When a contractual obligation on the consumer's part is created is a matter to be determined under applicable law; Regulation Z does not make this determination. A contractual commitment agreement, for example, that under applicable law binds the consumer to the credit terms would be consummation. Consummation, however, does not occur merely because the consumer has made some financial investment in the transaction (for example, by paying a nonrefundable fee) unless, of course, applicable law holds otherwise.

2. Credit v. sale. Consummation does not occur when the consumer becomes contractually committed to a sale transaction, unless the consumer also becomes legally obligated to accept a particular credit arrangement. For example, when a consumer pays a nonrefundable deposit to purchase an automobile, a purchase contract may be created, but consummation for purposes of the regulation does not occur unless the consumer also contracts for financing at that time.

2(a)(14) Credit.

1. Exclusions. The following situations are not considered credit for purposes of the regulation:

i. Layaway plans, unless the consumer is contractually obligated to continue making payments. Whether the consumer is so obligated is a matter to be determined under applicable law. The fact that the consumer is not entitled to a refund of any amounts paid towards the cash price of the merchandise does not bring layaways within the definition of credit.

ii. Tax liens, tax assessments, court judgments, and court approvals of reaffirmation of debts in bankruptcy. However, third-party financing of such obligations (for example, a bank loan obtained to pay off a tax lien) is credit for purposes of the regulation.

iii. Insurance premium plans that involve payment in installments with each installment representing the payment for insurance coverage for a certain future period of time, unless the consumer is contractually obligated to continue making payments.

iv. Home improvement transactions that involve progress payments, if the consumer pays, as the work progresses, only for work completed and has no contractual obligation to continue making payments.

v. Borrowing against the accrued cash value of an insurance policy or a pension account, if there is no independent obligation to repay.

vi. Letters of credit.

vii. The execution of option contracts. However, there may be an extension of credit when the option is exercised, if there is an agreement at that time to defer payment of a debt.

viii. Investment plans in which the party extending capital to the consumer risks the loss of the capital advanced. This includes, for example, an arrangement with a home purchaser in which the investor pays a portion of the downpayment and of the periodic mortgage payments in return for an ownership interest in the property, and shares in any gain or loss of property value.

ix. Mortgage assistance plans administered by a government agency in which a portion of the consumer's monthly payment amount is paid by the agency. No finance charge is imposed on the subsidy amount, and that amount is due in a lump-sum payment on a set date or upon the occurrence of certain events. (If payment is not made when due, a new note imposing a finance charge may be written, which may then be subject to the regulation.)

2. Payday loans; deferred presentment. Credit includes a transaction in which a cash advance is made to a consumer in exchange for the consumer's personal check, or in exchange for the consumer's authorization to debit the consumer's deposit account, and where the parties agree either that the check will not be cashed or deposited, or that the consumer's deposit account will not be debited, until a designated future date. This type of transaction is often referred to as a "payday loan" or "payday advance" or "deferred-presentment loan." A fee charged in connection with such a transaction may be a finance charge for purposes of § 226.4, regardless of how the fee is characterized under state law. Where the fee charged constitutes a finance charge under § 226.4 and the person advancing funds regularly extends consumer credit, that person is a creditor and is required to provide disclosures consistent with the requirements of Regulation Z. (See § 226.2(a)(17).)

2(a)(15) Credit card.

1. Usable from time to time. A credit card must be usable from time to time. Since this involves the possibility of repeated use of a single device, checks and similar instruments that can be used only once to obtain a single credit extension are not credit cards.

2. Examples.

i. Examples of credit cards include:

A. A card that guarantees checks or similar instruments, if the asset account is also tied to an overdraft line or if the instrument directly accesses a line of credit.

B. A card that accesses both a credit and an asset account (that is, a debit-credit card).

C. An identification card that permits the consumer to defer payment on a purchase.

D. An identification card indicating loan approval that is presented to a merchant or to a lender, whether or not the consumer signs a separate promissory note for each credit extension.

E. A card or device that can be activated upon receipt to access credit, even if the card has a substantive use other than credit, such as a purchase-price discount card. Such a card or device is a credit card notwithstanding the fact that the recipient must first contact the card issuer to access or activate the credit feature.

ii. In contrast, credit card does not include, for example:

A. A check-guarantee or debit card with no credit feature or agreement, even if the creditor occasionally honors an inadvertent overdraft.

B. Any card, key, plate, or other device that is used in order to obtain petroleum products for business purposes from a wholesale distribution facility or to gain access to that facility, and that is required to be used without regard to payment terms.

3. Charge card. Generally, charge cards are cards used in connection with an account on which outstanding balances cannot be carried from one billing cycle to another and are payable when a periodic statement is received. Under the regulation, a reference to credit cards generally includes charge cards. The term charge card is, however, distinguished from credit card in §§ 226.5a, 226.7(b)(11), 226.7(b)(12), 226.9(e), 226.9(f) and 226.28(d), and appendices G-10 through G-13. When the term credit card is used in those provisions, it refers to credit cards other than charge cards.

2(a)(16) Credit sale.

1. Special disclosure. If the seller is a creditor in the transaction, the transaction is a credit sale and the special credit sale disclosures (that is, the disclosures under § 226.18(j)) must be given. This applies even if there is more than one creditor in the transaction and the creditor making the disclosures is not the seller. (See the commentary to § 226.17(d).)

2. Sellers who arrange credit If the seller of the property or services involved arranged for financing but is not a creditor as to that sale, the transaction is not a credit sale. Thus, if a seller assists the consumer in obtaining a direct loan from a financial institution and the consumer's note is payable to the financial institution, the transaction is a loan and only the financial institution is a creditor.

3. Refinancings. Generally, when a credit sale is refinanced within the meaning of § 226.20(a), loan disclosures should be made. However, if a new sale of goods or services is also involved, the transaction is a credit sale.

4. Incidental sales. Some lenders sell a product or service--such as credit, property, or health insurance--as part of a loan transaction. Section 226.4 contains the rules on whether the cost of credit life, disability or property insurance is part of the finance charge. If the insurance is financed, it may be disclosed as a separate credit-sale transaction or disclosed as part of the primary transaction; if the latter approach is taken, either loan or credit-sale disclosures may be made. (See the commentary to § 226.17(c)(1) for further discussion of this point.)

5. Credit extensions for educational purposes. A credit extension for educational purposes in which an educational institution is the creditor may be treated as either a credit sale or a loan, regardless of whether the funds are given directly to the student, credited to the student's account, or disbursed to other persons on the student's behalf. The disclosure of the total sale price need not be given if the transaction is treated as a loan.

2(a)(17) Creditor.

1. General. The definition contains four independent tests. If any one of the tests is met, the person is a creditor for purposes of that particular test.

Paragraph 2(a)(17)(i).

1. Prerequisites. This test is composed of two requirements, both of which must be met in order for a particular credit extension to be subject to the regulation and for the credit extension to count towards satisfaction of the numerical tests mentioned in § 226.2(a)(17)(v).

i. First, there must be either or both of the following:

A. A written (rather than oral) agreement to pay in more than four installments. A letter that merely confirms an oral agreement does not constitute a written agreement for purposes of the definition.

B. A finance charge imposed for the credit. The obligation to pay the finance charge need not be in writing.

ii. Second, the obligation must be payable to the person in order for that person to be considered a creditor. If an obligation is made payable to bearer, the creditor is the one who initially accepts the obligation.

2. Assignees. If an obligation is initially payable to one person, that person is the creditor even if the obligation by its terms is simultaneously assigned to another person. For example:

i. An auto dealer and a bank have a business relationship in which the bank supplies the dealer with credit sale contracts that are initially made payable to the dealer and provide for the immediate assignment of the obligation to the bank. The dealer and purchaser execute the contract only after the bank approves the creditworthiness of the purchaser. Because the obligation is initially payable on its face to the dealer, the dealer is the only creditor in the transaction.

3. Numerical tests. The examples below illustrate how the numerical tests of § 226.2(a)(17)(v) are applied. The examples assume that consumer credit with a finance charge or written agreement for more than 4 installments was extended in the years in question and that the person did not extend such credit in 2006.

4. Counting transactions. For purposes of closed-end credit, the creditor counts each credit transaction. For open-end credit, transactions means accounts, so that outstanding accounts are counted instead of individual credit extensions. Normally the number of transactions is measured by the preceding calendar year; if the requisite number is met, then the person is a creditor for all transactions in the current year. However, if the person did not meet the test in the preceding year, the number of transactions is measured by the current calendar year. For example, if the person extends consumer credit 26 times in 2007, it is a creditor for purposes of the regulation for the last extension of credit in 2007 and for all extensions of consumer credit in 2008. On the other hand, if a business begins in 2007 and extends consumer credit 20 times, it is not a creditor for purposes of the regulation in 2007. If it extends consumer credit 75 times in 2008, however, it becomes a creditor for purposes of the regulation (and must begin making disclosures) after the 25th extension of credit in that year and is a creditor for all extensions of consumer credit in 2009.

5. Relationship between consumer credit in general and credit secured by a dwelling. Extensions of credit secured by a dwelling are counted towards the 25-extensions test. For example, if in 2007 a person extends unsecured consumer credit 23 times and consumer credit secured by a dwelling twice, it becomes a creditor for the succeeding extensions of credit, whether or not they are secured by a dwelling. On the other hand, extensions of consumer credit

not secured by a dwelling are not counted towards the number of credit extensions secured by a dwelling. For example, if in 2007 a person extends credit not secured by a dwelling 8 times and credit secured by a dwelling 3 times, it is not a creditor.

6. Effect of satisfying one test. Once one of the numerical tests is satisfied, the person is also a creditor for the other type of credit. For example, in 2007 a person extends consumer credit secured by a dwelling 5 times. That person is a creditor for all succeeding credit extensions, whether they involve credit secured by a dwelling or not.

7. Trusts. In the case of credit extended by trusts, each individual trust is considered a separate entity for purposes of applying the criteria. For example:

i. A bank is the trustee for three trusts. Trust A makes 15 extensions of consumer credit annually; Trust B makes 10 extensions of consumer credit annually; and Trust C makes 30 extensions of consumer credit annually. Only Trust C is a creditor for purposes of the regulation.

Paragraph 2(a)(17)(ii). [Reserved].

Paragraph 2(a)(17)(iii).

1. Card issuers subject to Subpart B. Section 226.2(a)(17)(iii) makes certain card issuers creditors for purposes of the open-end credit provisions of the regulation. This includes, for example, the issuers of so-called travel and entertainment cards that expect repayment at the first billing and do not impose a finance charge. Since all disclosures are to be made only as applicable, such card issuers would omit finance charge disclosures. Other provisions of the regulation regarding such areas as scope, definitions, determination of which charges are finance charges, Spanish language disclosures, record retention, and use of model forms, also apply to such card issuers.

Paragraph 2(a)(17)(iv).

1. Card issuers subject to Subparts B and C. Section 226.2(a)(17)(iv) includes as creditors card issuers extending closed-end credit in which there is a finance charge or an agreement to pay in more than four installments. These card issuers are subject to the appropriate provisions of Subparts B and C, as well as to the general provisions.

2(a)(18) Downpayment.

1. Allocation. If a consumer makes a lump-sum payment, partially to reduce the cash price and partially to pay prepaid finance charges, only the portion attributable to reducing the cash price is part of the downpayment. (See the commentary to § 226.2(a)(23).)

2. Pick-up payments.

i. Creditors may treat the deferred portion of the downpayment, often referred to as pick-up payments, in a number of ways. If the pick-up payment is treated as part of the downpayment:

A. It is subtracted in arriving at the amount financed under § 226.18(b).

B. It may, but need not, be reflected in the payment schedule under § 226.18(g).

ii. If the pick-up payment does not meet the definition (for example, if it is payable after the second regularly scheduled payment) or if the creditor chooses not to treat it as part of the downpayment:

A. It must be included in the amount financed.

B. It must be shown in the payment schedule.

iii. Whichever way the pick-up payment is treated, the total of payments under § 226.18(h) must equal the sum of the payments disclosed under § 226.18(g).

3. Effect of existing liens.

i. No cash payment. In a credit sale, the "downpayment" may only be used to reduce the cash price. For example, when a trade-in is used as the downpayment and the existing lien on an automobile to be traded in exceeds the value of the automobile, creditors must disclose a zero on the downpayment line rather than a negative number. To illustrate, assume a consumer owes $10,000 on an existing automobile loan and that the trade-in value of the automobile is only $8,000, leaving a $2,000 deficit. The creditor should disclose a downpayment of $0, not -$2,000.

ii. Cash payment. If the consumer makes a cash payment, creditors may, at their option, disclose the entire cash payment as the downpayment, or apply the cash payment first to any excess lien amount and disclose any remaining cash as the downpayment. In the above example:

A. If the downpayment disclosed is equal to the cash payment, the $2,000 deficit must be reflected as an additional amount financed under § 226.18(b)(2).

B. If the consumer provides $1,500 in cash (which does not extinguish the $2,000 deficit), the creditor may disclose a downpayment of $1,500 or of $0.

C. If the consumer provides $3,000 in cash, the creditor may disclose a downpayment of $3,000 or of $1,000.

2(a)(19) Dwelling.

1. Scope. A dwelling need not be the consumer's principal residence to fit the definition, and thus a vacation or second home could be a dwelling. However, for purposes of the definition of residential mortgage transaction and the right to rescind, a dwelling must be the principal residence of the consumer. (See the commentary to §§ 226.2(a)(24), 226.15, and 226.23.)

2. Use as a residence. Mobile homes, boats, and trailers are dwellings if they are in fact used as residences, just as are condominium and cooperative units. Recreational vehicles, campers, and the like not used as residences are not dwellings.

3. Relation to exemptions. Any transaction involving a security interest in a consumer's principal dwelling (as well as in any real property) remains subject to the regulation despite the general exemption in § 226.3(b) for credit extensions over $25,000.

2(a)(20) Open-end credit.

1. General. This definition describes the characteristics of open-end credit (for which the applicable disclosure and other rules are contained in Subpart B), as distinct from closed-end credit. Open-end credit is consumer credit that is extended under a plan and meets all 3 criteria set forth in the definition.

2. Existence of a plan. The definition requires that there be a plan, which connotes a contractual arrangement between the creditor and the consumer. Some creditors offer programs containing a number of different credit features. The consumer has a single account with the institution that can be accessed repeatedly via a number of sub-accounts

established for the different program features and rate structures. Some features of the program might be used repeatedly (for example, an overdraft line) while others might be used infrequently (such as the part of the credit line available for secured credit). If the program as a whole is subject to prescribed terms and otherwise meets the definition of open-end credit, such a program would be considered a single, multifeatured plan.

3. Repeated transactions. Under this criterion, the creditor must reasonably contemplate repeated transactions. This means that the credit plan must be usable from time to time and the creditor must legitimately expect that there will be repeat business rather than a one-time credit extension. The creditor must expect repeated dealings with consumers under the credit plan as a whole and need not believe a consumer will reuse a particular feature of the plan. The determination of whether a creditor can reasonably contemplate repeated transactions requires an objective analysis. Information that much of the creditor's customer base with accounts under the plan make repeated transactions over some period of time is relevant to the determination, particularly when the plan is opened primarily for the financing of infrequently purchased products or services. A standard based on reasonable belief by a creditor necessarily includes some margin for judgmental error. The fact that particular consumers do not return for further credit extensions does not prevent a plan from having been properly characterized as open-end. For example, if much of the customer base of a clothing store makes repeat purchases, the fact that some consumers use the plan only once would not affect the characterization of the store's plan as open-end credit. The criterion regarding repeated transactions is a question of fact to be decided in the context of the creditor's type of business and the creditor's relationship with its customers. For example, it would be more reasonable for a bank or depository institution to contemplate repeated transactions with a customer than for a seller of aluminum siding to make the same assumption about its customers.

4. Finance charge on an outstanding balance. The requirement that a finance charge may be computed and imposed from time to time on the outstanding balance means that there is no specific amount financed for the plan for which the finance charge, total of payments, and payment schedule can be calculated. A plan may meet the definition of open-end credit even though a finance charge is not normally imposed, provided the creditor has the right, under the plan, to impose a finance charge from time to time on the outstanding balance. For example, in some plans, a finance charge is not imposed if the consumer pays all or a specified portion of the outstanding balance within a given time period. Such a plan could meet the finance charge criterion, if the creditor has the right to impose a finance charge, even though the consumer actually pays no finance charges during the existence of the plan because the consumer takes advantage of the option to pay the balance (either in full or in installments) within the time necessary to avoid finance charges.

5. Reusable line. The total amount of credit that may be extended during the existence of an open-end plan is unlimited because available credit is generally replenished as earlier advances are repaid. A line of credit is self-replenishing even though the plan itself has a fixed expiration date, as long as during the plan's existence the consumer may use the line, repay, and reuse the credit. The creditor may occasionally or routinely verify credit information such as the consumer's continued income and employment status or information for security purposes but, to meet the definition of open-end credit, such verification of credit information may not be done as a condition of granting a consumer's request for a particular advance under the plan. In general, a credit line is self-replenishing if the consumer can take further advances as outstanding balances are repaid without being required to separately apply for those additional advances. A credit card account where the plan as a whole replenishes meets the self-replenishing criterion, notwithstanding the fact that a credit card issuer may verify credit information from time to time in connection with specific transactions. This criterion of unlimited credit distinguishes open-end credit from a series of advances made pursuant to a closed-end credit loan commitment. For example:

i. Under a closed-end commitment, the creditor might agree to lend a total of $10,000 in a series of advances as needed by the consumer. When a consumer has borrowed the full $10,000, no more is advanced under that particular agreement, even if there has been repayment of a portion of the debt. (See § 226.2(a)(17)(iv) for disclosure requirements when a credit card is used to obtain the advances.)

ii. This criterion does not mean that the creditor must establish a specific credit limit for the line of credit or that the line of credit must always be replenished to its original amount. The creditor may reduce a credit limit or refuse to extend new credit in a particular case due to changes in the creditor's financial condition or the consumer's creditworthiness. (The rules in § 226.5b(f), however, limit the ability of a creditor to suspend credit advances for home equity plans.) While consumers should have a reasonable expectation of obtaining credit as long as they remain current and within any preset credit limits, further extensions of credit need not be an absolute right in order for the plan to meet the self-replenishing criterion.

6. Verifications of collateral value. Creditors that otherwise meet the requirements of § 226.2(a)(20) extend open-end credit notwithstanding the fact that the creditor must verify collateral values to comply with federal, state, or other applicable law or verifies the value of collateral in connection with a particular advance under the plan.

7. Open-end real estate mortgages. Some credit plans call for negotiated advances under so-called open-end real estate mortgages. Each such plan must be independently measured against the definition of open-end credit, regardless of the terminology used in the industry to describe the plan. The fact that a particular plan is called an open-end real estate mortgage, for example, does not, by itself, mean that it is open-end credit under the regulation.

2(a)(21) Periodic rate.

1. Basis. The periodic rate may be stated as a percentage (for example, 1 1/2% per month) or as a decimal equivalent (for example, .015 monthly). It may be based on any portion of a year the creditor chooses. Some creditors use 1/360 of an annual rate as their periodic rate. These creditors:

i. May disclose a 1/360 rate as a daily periodic rate, without further explanation, if it is in fact only applied 360 days per year. But if the creditor applies that rate for 365 days, the creditor must note that fact and, of course, disclose the true annual percentage rate.

ii. Would have to apply the rate to the balance to disclose the annual percentage rate with the degree of accuracy required in the regulation (that is, within 1/8th of 1 percentage point of the rate based on the actual 365 days in the year).

2. Transaction charges. Periodic rate does not include initial one-time transaction charges, even if the charge is computed as a percentage of the transaction amount.

2(a)(22) Person.

1. Joint ventures. A joint venture is an organization and is therefore a person.

2. Attorneys. An attorney and his or her client are considered to be the same person for purposes of this regulation when the attorney is acting within the scope of the attorney-client relationship with regard to a particular transaction.

3. Trusts. A trust and its trustee are considered to be the same person for purposes of this regulation.

2(a)(23) Prepaid finance charge.

1. General. Prepaid finance charges must be taken into account under § 226.18(b) in computing the disclosed amount financed, and must be disclosed if the creditor provides an itemization of the amount financed under § 226.18(c).

2. Examples.

i. Common examples of prepaid finance charges include:

A. Buyer's points.

B. Service fees.

C. Loan fees.

D. Finder's fees.

E. Loan-guarantee insurance.

F. Credit-investigation fees.

ii. However, in order for these or any other finance charges to be considered prepaid, they must be either paid separately in cash or check or withheld from the proceeds. Prepaid finance charges include any portion of the finance charge paid prior to or at closing or settlement.

3. Exclusions. Add-on and discount finance charges are not prepaid finance charges for purposes of this regulation. Finance charges are not prepaid merely because they are precomputed, whether or not a portion of the charge will be rebated to the consumer upon prepayment. (See the commentary to § 226.18(b).)

4. Allocation of lump-sum payments. In a credit sale transaction involving a lump-sum payment by the consumer and a discount or other item that is a finance charge under § 226.4, the discount or other item is a prepaid finance charge to the extent the lump-sum payment is not applied to the cash price. For example, a seller sells property to a consumer for $10,000, requires the consumer to pay $3,000 at the time of the purchase, and finances the remainder as a closed-end credit transaction. The cash price of the property is $9,000. The seller is the creditor in the transaction and therefore the $1,000 difference between the credit and cash prices (the discount) is a finance charge. (See the commentary to § 226.4(b)(9) and (c)(5).) If the creditor applies the entire $3,000 to the cash price and adds the $1,000 finance charge to the interest on the $6,000 to arrive at the total finance charge, all of the $3,000 lump-sum payment is a downpayment and the discount is not a prepaid finance charge. However, if the creditor only applies $2,000 of the lump-sum payment to the cash price, then $2,000 of the $3,000 is a downpayment and the $1,000 discount is a prepaid finance charge.

2(a)(24) Residential mortgage transaction.

1. Relation to other sections. This term is important in five provisions in the regulation:

i. Section 226.4(c)(7)--exclusions from the finance charge.

ii. Section 226.15(f)--exemption from the right of rescission.

iii. Section 226.18(q)--whether or not the obligation is assumable.

iv. Section 226.20(b)--disclosure requirements for assumptions.

v. Section 226.23(f)--exemption from the right of rescission.

2. Lien status. The definition is not limited to first lien transactions. For example, a consumer might assume a paid-down first mortgage (or borrow part of the purchase price) and borrow the balance of the purchase price from a creditor who takes a second mortgage. The second mortgage transaction is a residential mortgage transaction if the dwelling purchased is the consumer's principal residence.

3. Principal dwelling. A consumer can have only one principal dwelling at a time. Thus, a vacation or other second home would not be a principal dwelling. However, if a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within a year or upon the completion of construction, the new dwelling is considered the principal dwelling for purposes of applying this definition to a particular transaction. (See the commentary to §§ 226.15(a) and 226.23(a).)

4. Construction financing. If a transaction meets the definition of a residential mortgage transaction and the creditor chooses to disclose it as several transactions under § 226.17(c)(6), each one is considered to be a residential mortgage transaction, even if different creditors are involved. For example:

i. The creditor makes a construction loan to finance the initial construction of the consumer's principal dwelling, and the loan will be disbursed in five advances. The creditor gives six sets of disclosures (five for the construction phase and one for the permanent phase). Each one is a residential mortgage transaction.

ii. One creditor finances the initial construction of the consumer's principal dwelling and another creditor makes a loan to satisfy the construction loan and provide permanent financing. Both transactions are residential mortgage transactions.

5. Acquisition.

i. A residential mortgage transaction finances the acquisition of a consumer's principal dwelling. The term does

not include a transaction involving a consumer's principal dwelling if the consumer had previously purchased and acquired some interest to the dwelling, even though the consumer had not acquired full legal title.

ii. Examples of new transactions involving a previously acquired dwelling include the financing of a balloon payment due under a land sale contract and an extension of credit made to a joint owner of property to buy out the other joint owner's interest. In these instances, disclosures are not required under § 226.18(q) (assumability policies). However, the rescission rules of §§ 226.15 and 226.23 do apply to these new transactions.

iii. In other cases, the disclosure and rescission rules do not apply. For example, where a buyer enters into a written agreement with the creditor holding the seller's mortgage, allowing the buyer to assume the mortgage, if the buyer had previously purchased the property and agreed with the seller to make the mortgage payments, § 226.20(b) does not apply (assumptions involving residential mortgages).

6. Multiple purpose transactions. A transaction meets the definition of this section if any part of the loan proceeds will be used to finance the acquisition or initial construction of the consumer's principal dwelling. For example, a transaction to finance the initial construction of the consumer's principal dwelling is a residential mortgage transaction even if a portion of the funds will be disbursed directly to the consumer or used to satisfy a loan for the purchase of the land on which the dwelling will be built.

7. Construction on previously acquired vacant land. A residential mortgage transaction includes a loan to finance the construction of a consumer's principal dwelling on a vacant lot previously acquired by the consumer.

2(a)(25) Security interest.

1. Threshold test. The threshold test is whether a particular interest in property is recognized as a security interest under applicable law. The regulation does not determine whether a particular interest is a security interest under applicable law. If the creditor is unsure whether a particular interest is a security interest under applicable law (for example, if statutes and case law are either silent or inconclusive on the issue), the creditor may at its option consider such interests as security interests for Truth in Lending purposes. However, the regulation and the commentary do exclude specific interests, such as after-acquired property and accessories, from the scope of the definition regardless of their categorization under applicable law, and these named exclusions may not be disclosed as security interests under the regulation. (But see the discussion of exclusions elsewhere in the commentary to § 226.2(a)(25).)

2. Exclusions. The general definition of security interest excludes three groups of interests: incidental interests, interests in after-acquired property, and interests that arise solely by operation of law. These interests may not be disclosed with the disclosures required under § 226.18, but the creditor is not precluded from preserving these rights elsewhere in the contract documents, or invoking and enforcing such rights, if it is otherwise lawful to do so. If the

creditor is unsure whether a particular interest is one of the excluded interests, the creditor may, at its option, consider such interests as security interests for Truth in Lending purposes.

3. Incidental interests.

i. Incidental interests in property that are not security interests include, among other things:

A. Assignment of rents.

B. Right to condemnation proceeds.

C. Interests in accessories and replacements.

D. Interests in escrow accounts, such as for taxes and insurance.

E. Waiver of homestead or personal property rights.

ii. The notion of an incidental interest does not encompass an explicit security interest in an insurance policy if that policy is the primary collateral for the transaction--for example, in an insurance premium financing transaction.

4. Operation of law. Interests that arise solely by operation of law are excluded from the general definition. Also excluded are interests arising by operation of law that are merely repeated or referred to in the contract. However, if the creditor has an interest that arises by operation of law, such as a vendor's lien, and takes an independent security interest in the same property, such as a UCC security interest, the latter interest is a disclosable security interest unless otherwise provided.

5. Rescission rules. Security interests that arise solely by operation of law are security interests for purposes of rescission. Examples of such interests are mechanics' and materialmen's liens.

6. Specificity of disclosure. A creditor need not separately disclose multiple security interests that it may hold in the

same collateral. The creditor need only disclose that the transaction is secured by the collateral, even when security interests from prior transactions remain of record and a new security interest is taken in connection with the transaction. In disclosing the fact that the transaction is secured by the collateral, the creditor also need not disclose how the security interest arose. For example, in a closed-end credit transaction, a rescission notice need not specifically state that a new security interest is "acquired" or an existing security interest is "retained" in the transaction. The acquisition or retention of a security interest in the consumer's principal dwelling instead may be disclosed in a rescission notice with a general statement such as the following: "Your home is the security for the new transaction."

2(b) Rules of construction.

1. Footnotes. Footnotes are used extensively in the regulation to provide special exceptions and more detailed explanations and examples. Material that appears in a footnote has the same legal weight as material in the body of the regulation.

2. Amount. The numerical amount must be a dollar amount unless otherwise indicated. For example, in a closed-end transaction (Subpart C), the amount financed and the amount of any payment must be expressed as a dollar amount. In some cases, an amount should be expressed as a percentage. For example, in disclosures provided before the first transaction under an open-end plan (Subpart B), creditors are permitted to explain how the amount of any finance charge will be determined; where a cash-advance fee (which is a finance charge) is a percentage of each cash advance, the amount of the finance charge for that fee is expressed as a percentage.

Section 226.3 Exempt Transactions

1. Relationship to § 226.12. The provisions in § 226.12(a) and (b) governing the issuance of credit cards and the limitations on liability for their unauthorized use apply to all credit cards, even if the credit cards are issued for use in connection with extensions of credit that otherwise are exempt under this section.

3(a) Business, commercial, agricultural, or organizational credit.

1. Primary purposes. A creditor must determine in each case if the transaction is primarily for an exempt purpose. If some question exists as to the primary purpose for a credit extension, the creditor is, of course, free to make the disclosures, and the fact that disclosures are made under such circumstances is not controlling on the question of whether the transaction was exempt. (See comment 3(a)-2, however, with respect to credit cards.)

2. Business purpose purchases.

i. Business-purpose credit cards--extensions of credit for consumer purposes. If a business-purpose credit card is issued to a person, the provisions of the regulation do not apply, other than as provided in §§ 226.12(a) and 226.12(b), even if extensions of credit for consumer purposes are occasionally made using that business-purpose credit card. For example, the billing error provisions set forth in § 226.13 do not apply to consumer-purpose extensions of credit using a business-purpose credit card.

ii. Consumer-purpose credit cards--extensions of credit for business purposes. If a consumer-purpose credit card is issued to a person, the provisions of the regulation apply, even to occasional extensions of credit for business purposes made using that consumer-purpose credit card. For example, a consumer may assert a billing error with respect to any extension of credit using a consumer-purpose credit card, even if the specific extension of credit on such credit card or open-end credit plan that is the subject of the dispute was made for business purposes.

3. Factors. In determining whether credit to finance an acquisition--such as securities, antiques, or art--is primarily for business or commercial purposes (as opposed to a consumer purpose), the following factors should be considered:

i. General.

A. The relationship of the borrower's primary occupation to the acquisition. The more closely related, the more likely it is to be business purpose.

B. The degree to which the borrower will personally manage the acquisition. The more personal involvement there is, the more likely it is to be business purpose.

C. The ratio of income from the acquisition to the total income of the borrower. The higher the ratio, the more likely it is to be business purpose.

D. The size of the transaction. The larger the transaction, the more likely it is to be business purpose.

E. The borrower's statement of purpose for the loan.

ii. Business-purpose examples. Examples of business-purpose credit include:

A. A loan to expand a business, even if it is secured by the borrower's residence or personal property.

B. A loan to improve a principal residence by putting in a business office.

C. A business account used occasionally for consumer purposes.

iii. Consumer-purpose examples. Examples of consumer-purpose credit include:

A. Credit extensions by a company to its employees or agents if the loans are used for personal purposes.

B. A loan secured by a mechanic's tools to pay a child's tuition.

C. A personal account used occasionally for business purposes.

4. Non-owner-occupied rental property. Credit extended to acquire, improve, or maintain rental property (regardless of the number of housing units) that is not owner-occupied is deemed to be for business purposes. This includes, for example, the acquisition of a warehouse that will be leased or a single-family house that will be rented to another person to live in. If the owner expects to occupy the property for more than 14 days during the coming year, the property cannot be considered non-owner-occupied and this special rule will not apply. For example, a beach house that the owner will occupy for a month in the coming summer and rent out the rest of the year is owner occupied and is not governed by this special rule. (See comment 3(a)-5, however, for rules relating to owner-occupied rental property.)

5. Owner-occupied rental property. If credit is extended to acquire, improve, or maintain rental property that is or will be owner-occupied within the coming year, different rules apply:

i. Credit extended to acquire the rental property is deemed to be for business purposes if it contains more than 2 housing units.

ii. Credit extended to improve or maintain the rental property is deemed to be for business purposes if it contains more than 4 housing units. Since the amended statute defines dwelling to include 1 to 4 housing units, this rule

preserves the right of rescission for credit extended for purposes other than acquisition. Neither of these rules means that an extension of credit for property containing fewer than the requisite number of units is necessarily consumer credit. In such cases, the determination of whether it is business or consumer credit should be made by considering the factors listed in comment 3(a)-3.

6. Business credit later refinanced. Business-purpose credit that is exempt from the regulation may later be rewritten for consumer purposes. Such a transaction is consumer credit requiring disclosures only if the existing obligation is satisfied and replaced by a new obligation made for consumer purposes undertaken by the same obligor.

7. Credit card renewal. A consumer-purpose credit card that is subject to the regulation may be converted into a business-purpose credit card at the time of its renewal, and the resulting business-purpose credit card would be exempt from the regulation. Conversely, a business-purpose credit card that is exempt from the regulation may be converted into a consumer-purpose credit card at the time of its renewal, and the resulting consumer-purpose credit card would be subject to the regulation.

8. Agricultural purpose. An agricultural purpose includes the planting, propagating, nurturing, harvesting, catching, storing, exhibiting, marketing, transporting, processing, or manufacturing of food, beverages (including alcoholic beverages), flowers, trees, livestock, poultry, bees, wildlife, fish, or shellfish by a natural person engaged in farming, fishing, or growing crops, flowers, trees, livestock, poultry, bees, or wildlife. The exemption also applies to a transaction involving real property that includes a dwelling (for example, the purchase of a farm with a homestead) if the transaction is primarily for agricultural purposes.

9. Organizational credit. The exemption for transactions in which the borrower is not a natural person applies, for example, to loans to corporations, partnerships, associations, churches, unions, and fraternal organizations. The exemption applies regardless of the purpose of the credit extension and regardless of the fact that a natural person may guarantee or provide security for the credit.

10. Land trusts. Credit extended for consumer purposes to a land trust is considered to be credit extended to a natural person rather than credit extended to an organization. In some jurisdictions, a financial institution financing a residential real estate transaction for an individual uses a land trust mechanism. Title to the property is conveyed to the land trust for which the financial institution itself is trustee. The underlying installment note is executed by the financial institution in its capacity as trustee and payment is secured by a trust deed, reflecting title in the financial institution as trustee. In some instances, the consumer executes a personal guaranty of the indebtedness. The note provides that it is payable only out of the property specifically described in the trust deed and that the trustee has no personal liability on the note. Assuming the transactions are for personal, family, or household purposes, these transactions are subject to the regulation since in substance (if not form) consumer credit is being extended.

3(b) Credit over $25,000 not secured by real property or a dwelling.

1. Coverage. Since a mobile home can be a dwelling under § 226.2(a)(19), this exemption does not apply to a credit extension secured by a mobile home used or expected to be used as the principal dwelling of the consumer, even if the credit exceeds $25,000. A loan commitment for closed-end credit in excess of $25,000 is exempt even though the amounts actually drawn never actually reach $25,000.

2. Open-end credit.

i. An open-end credit plan is exempt under § 226.3(b) (unless secured by real property or personal property used or expected to be used as the consumer's principal dwelling) if either of the following conditions is met:

A. The creditor makes a firm commitment to lend over $25,000 with no requirement of additional credit information for any advances (except as permitted from time to time pursuant to § 226.2(a)(20)).

B. The initial extension of credit on the line exceeds $25,000.

ii. If a security interest is taken at a later time in any real property, or in personal property used or expected to be used as the consumer's principal dwelling, the plan would no longer be exempt. The creditor must comply with all of the requirements of the regulation including, for example, providing the consumer with an initial disclosure statement. If the security interest being added is in the consumer's principal dwelling, the creditor must also give the consumer the right to rescind the security interest. (See the commentary to § 226.15 concerning the right of rescission.)

3. Closed-end credit--subsequent changes. A closed-end loan for over $25,000 may later be rewritten for $25,000 or less, or a security interest in real property or in personal property used or expected to be used as the consumer's principal dwelling may be added to an extension of credit for over $25,000. Such a transaction is consumer credit requiring disclosures only if the existing obligation is satisfied and replaced by a new obligation made for consumer purposes undertaken by the same obligor. (See the commentary to § 226.23(a)(1) regarding the right of rescission when a security interest in a consumer's principal dwelling is added to a previously exempt transaction.)

3(c) Public utility credit.

1. Examples. Examples of public utility services include:

i. General.

A. Gas, water, or electrical services.

B. Cable television services.

C. Installation of new sewer lines, water lines, conduits, telephone poles, or metering equipment in an area not already serviced by the utility.

ii. Extensions of credit not covered. The exemption does not apply to extensions of credit, for example:

A. To purchase appliances such as gas or electric ranges, grills, or telephones.

B. To finance home improvements such as new heating or air conditioning systems.

3(d) Securities or commodities accounts.

1. Coverage. This exemption does not apply to a transaction with a broker registered solely with the state, or to a separate credit extension in which the proceeds are used to purchase securities.

3(e) Home fuel budget plans.

1. Definition. Under a typical home fuel budget plan, the fuel dealer estimates the total cost of fuel for the season, bills the customer for an average monthly payment, and makes an adjustment in the final payment for any difference between the estimated and the actual cost of the fuel. Fuel is delivered as needed, no finance charge is assessed, and the customer may withdraw from the plan at any time. Under these circumstances, the arrangement is exempt from the regulation, even if a charge to cover the billing costs is imposed.

3(f) Student loan programs.

1. Coverage. This exemption applies to loans made, insured, or guaranteed under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq*.). This exemption does not apply to private education loans as defined by § 226.46(b)(5).

Section 226.4 Finance Charge

4(a) Definition.

1. Charges in comparable cash transactions. Charges imposed uniformly in cash and credit transactions are not finance charges. In determining whether an item is a finance charge, the creditor should compare the credit transaction in question with a similar cash transaction. A creditor financing the sale of property or services may compare charges with those payable in a similar cash transaction by the seller of the property or service.

i. For example, the following items are not finance charges:

A. Taxes, license fees, or registration fees paid by both cash and credit customers.

B. Discounts that are available to cash and credit customers, such as quantity discounts.

C. Discounts available to a particular group of consumers because they meet certain criteria, such as being members of an organization or having accounts at a particular financial institution. This is the case even if an individual must pay cash to obtain the discount, provided that credit customers who are members of the group and do not qualify for the discount pay no more than the nonmember cash customers.

D. Charges for a service policy, auto club membership, or policy of insurance against latent defects offered to or required of both cash and credit customers for the same price.

ii. In contrast, the following items are finance charges:

A. Inspection and handling fees for the staged disbursement of construction-loan proceeds.

B. Fees for preparing a Truth in Lending disclosure statement, if permitted by law (for example, the Real Estate Settlement Procedures Act prohibits such charges in certain transactions secured by real property).

C. Charges for a required maintenance or service contract imposed only in a credit transaction.

iii. If the charge in a credit transaction exceeds the charge imposed in a comparable cash transaction, only the difference is a finance charge. For example:

A. If an escrow agent is used in both cash and credit sales of real estate and the agent's charge is $100 in a cash transaction and $150 in a credit transaction, only $50 is a finance charge.

2. Costs of doing business. Charges absorbed by the creditor as a cost of doing business are not finance charges, even though the creditor may take such costs into consideration in determining the interest rate to be charged or the cash price of the property or service sold. However, if the creditor separately imposes a charge on the consumer to cover certain costs, the charge is a finance charge if it otherwise meets the definition. For example:

i. A discount imposed on a credit obligation when it is assigned by a seller-creditor to another party is not a finance charge as long as the discount is not separately imposed on the consumer. (See § 226.4(b)(6).)

ii. A tax imposed by a state or other governmental body on a creditor is not a finance charge if the creditor absorbs the tax as a cost of doing business and does not separately impose the tax on the consumer. (For additional discussion of the treatment of taxes, see other commentary to § 226.4(a).)

3. Forfeitures of interest. If the creditor reduces the interest rate it pays or stops paying interest on the consumer's deposit account or any portion of it for the term of a credit transaction (including, for example, an overdraft on a checking account or a loan secured by a certificate of deposit), the interest lost is a finance charge. (See the commentary to § 226.4(c)(6).) For example:

A. A consumer borrows $5,000 for 90 days and secures it with a $10,000 certificate of deposit paying 15% interest. The creditor charges the consumer an interest rate of 6% on the loan and stops paying interest on $5,000 of the $10,000 certificate for the term of the loan. The interest lost is a finance charge and must be reflected in the annual percentage rate on the loan.

B. However, the consumer must be entitled to the interest that is not paid in order for the lost interest to be a finance charge. For example:

iii. A consumer wishes to buy from a financial institution a $10,000 certificate of deposit paying 15% interest but has only $4,000. The financial institution offers to lend the consumer $6,000 at an interest rate of 6% but will pay the 15% interest only on the amount of the consumer's deposit, $4,000. The creditor's failure to pay interest on the $6,000 does not result in an additional finance charge on the extension of credit, provided the consumer is entitled by the deposit agreement with the financial institution to interest only on the amount of the consumer's deposit.

iv. A consumer enters into a combined time deposit/credit agreement with a financial institution that establishes a time deposit account and an open-end line of credit. The line of credit may be used to borrow against the funds in the time deposit. The agreement provides for an interest rate on any credit extension of, for example, 1%. In addition, the agreement states that the creditor will pay 0% interest on the amount of the time deposit that corresponds to the amount of the credit extension(s). The interest that is not paid on the time deposit by the financial institution is not a finance charge (and therefore does not affect the annual percentage rate computation).

4. Treatment of transaction fees on credit card plans. Any transaction charge imposed on a cardholder by a card issuer is a finance charge, regardless of whether the issuer imposes the same, greater, or lesser charge on withdrawals of funds from an asset account such as a checking or savings account. For example:

i. Any charge imposed on a credit cardholder by a card issuer for the use of an automated teller machine (ATM) to obtain a cash advance (whether in a proprietary, shared, interchange, or other system) is a finance charge regardless of whether the card issuer imposes a charge on its debit cardholders for using the ATM to withdraw cash from a consumer asset account, such as a checking or savings account.

ii. Any charge imposed on a credit cardholder for making a purchase or obtaining a cash advance outside the United States, with a foreign merchant, or in a foreign currency is a finance charge, regardless of whether a charge is imposed on debit cardholders for such transactions. The following principles apply in determining what is a foreign transaction fee and the amount of the fee:

A. Included are (1) fees imposed when transactions are made in a foreign currency and converted to U.S. dollars; (2) fees imposed when transactions are made in U.S. dollars outside the U.S.; and (3) fees imposed when transactions are made (whether in a foreign currency or in U.S. dollars) with a foreign merchant, such as via a merchant's Web site. For example, a consumer may use a credit card to make a purchase in Bermuda, in U.S. dollars, and the card issuer may impose a fee because the transaction took place outside the United States.

B. Included are fees imposed by the card issuer and fees imposed by a third party that performs the conversion, such as a credit card network or the card issuer's corporate parent. (For example, in a transaction processed through a credit card network, the network may impose a 1 percent charge and the card-issuing bank may impose an additional 2 percent charge, for a total of a 3 percentage point foreign transaction fee being imposed on the consumer.)

C. Fees imposed by a third party are included only if they are directly passed on to the consumer. For example, if a credit card network imposes a 1 percent fee on the card issuer, but the card issuer absorbs the fee as a cost of doing business (and only passes it on to consumers in the general sense that the interest and fees are imposed on all its customers to recover its costs), then the fee is not a foreign transaction fee and need not be disclosed. In another example, if the credit card network imposes a 1 percent fee for a foreign transaction on the card issuer, and the card issuer imposes this same fee on the consumer who engaged in the foreign transaction, then the fee is a foreign transaction fee and a finance charge.

D. A card issuer is not required to disclose a fee imposed by a merchant. For example, if the merchant itself performs the currency conversion and adds a fee, this fee need not be disclosed by the card issuer. Under § 226.9(d), a card issuer is not obligated to disclose finance charges imposed by a party honoring a credit card, such as a merchant, although the merchant is required to disclose such a finance charge if the merchant is subject to the Truth in Lending Act and Regulation Z.

E. The foreign transaction fee is determined by first calculating the dollar amount of the transaction by using a currency conversion rate outside the card issuer's and third party's control. Any amount in excess of that dollar amount is a foreign transaction fee. Conversion rates outside the card issuer's and third party's control include, for example, a rate selected from the range of rates available in the wholesale currency exchange markets, an average of the highest and lowest rates available in such markets, or a government-mandated or government-managed exchange rate (or a rate selected from a range of such rates).

F. The rate used for a particular transaction need not be the same rate that the card issuer (or third party) itself obtains in its currency conversion operations. In addition, the rate used for a particular transaction need not be the rate in effect on the date of the transaction (purchase or cash advance).

5. Taxes.

i. Generally, a tax imposed by a state or other governmental body solely on a creditor is a finance charge if the creditor separately imposes the charge on the consumer.

ii. In contrast, a tax is not a finance charge (even if it is collected by the creditor) if applicable law imposes the tax:

A. Solely on the consumer;

B. On the creditor and the consumer jointly;

C. On the credit transaction, without indicating which party is liable for the tax; or

D. On the creditor, if applicable law directs or authorizes the creditor to pass the tax on to the consumer. (For purposes of this section, if applicable law is silent as to passing on the tax, the law is deemed not to authorize passing it on.)

iii. For example, a stamp tax, property tax, intangible tax, or any other state or local tax imposed on the consumer, or on the credit transaction, is not a finance charge even if the tax is collected by the creditor.

iv. In addition, a tax is not a finance charge if it is excluded from the finance charge by another provision of the regulation or commentary (for example, if the tax is imposed uniformly in cash and credit transactions).

4(a)(1) Charges by third parties.

1. Choosing the provider of a required service. An example of a third-party charge included in the finance charge is the cost of required mortgage insurance, even if the consumer is allowed to choose the insurer.

2. Annuities associated with reverse mortgages. Some creditors offer annuities in connection with a reverse-mortgage transaction. The amount of the premium is a finance charge if the creditor requires the purchase of the annuity incident to the credit. Examples include the following:

i. The credit documents reflect the purchase of an annuity from a specific provider or providers.

ii. The creditor assesses an additional charge on consumers who do not purchase an annuity from a specific provider.

iii. The annuity is intended to replace in whole or in part the creditor's payments to the consumer either immediately or at some future date.

4(a)(2) Special rule; closing agent charges.

1. General. This rule applies to charges by a third party serving as the closing agent for the particular loan. An example of a closing agent charge included in the finance charge is a courier fee where the creditor requires the use of a courier.

2. Required closing agent. If the creditor requires the use of a closing agent, fees charged by the closing agent are included in the finance charge only if the creditor requires the particular service, requires the imposition of the charge, or retains a portion of the charge. Fees charged by a third-party closing agent may be otherwise excluded from the finance charge under § 226.4. For example, a fee that would be paid in a comparable cash transaction may be excluded under § 226.4(a). A charge for conducting or attending a closing is a finance charge and may be excluded only if the charge is included in and is incidental to a lump-sum fee excluded under § 226.4(c)(7).

4(a)(3) Special rule; mortgage broker fees.

1. General. A fee charged by a mortgage broker is excluded from the finance charge if it is the type of fee that is also excluded when charged by the creditor. For example, to exclude an application fee from the finance charge under § 226.4(c)(1), a mortgage broker must charge the fee to all applicants for credit, whether or not credit is extended.

2. Coverage. This rule applies to charges paid by consumers to a mortgage broker in connection with a consumer credit transaction secured by real property or a dwelling.

3. Compensation by lender. The rule requires all mortgage broker fees to be included in the finance charge. Creditors sometimes compensate mortgage brokers under a separate arrangement with those parties. Creditors may draw on amounts paid by the consumer, such as points or closing costs, to fund their payment to the broker. Compensation paid by a creditor to a mortgage broker under an agreement is not included as a separate component of a consumer's total finance charge (although this compensation may be reflected in the finance charge if it comes from amounts paid by the consumer to the creditor that are finance charges, such as points and interest).

4(b) Examples of finance charges.

1. Relationship to other provisions. Charges or fees shown as examples of finance charges in § 226.4(b) may be excludable under § 226.4(c), (d), or (e). For example:

i. Premiums for credit life insurance, shown as an example of a finance charge under § 226.4(b)(7), may be excluded if the requirements of § 226.4(d)(1) are met.

ii. Appraisal fees mentioned in § 226.4(b)(4) are excluded for real property or residential mortgage transactions under § 226.4(c)(7).

Paragraph 4(b)(2).

1. Checking account charges. A checking or transaction account charge imposed in connection with a credit feature is a finance charge under § 226.4(b)(2) to the extent the charge exceeds the charge for a similar account without a credit feature. If a charge for an account with a credit feature does not exceed the charge for an account without a credit feature, the charge is not a finance charge under § 226.4(b)(2). To illustrate:

i. A $5 service charge is imposed on an account with an overdraft line of credit (where the institution has agreed in writing to pay an overdraft), while a $3 service charge is imposed on an account without a credit feature; the $2 difference is a finance charge. (If the difference is not related to account activity, however, it may be excludable as a participation fee. See the commentary to § 226.4(c)(4).)

ii. A $5 service charge is imposed for each item that results in an overdraft on an account with an overdraft line of credit, while a $25 service charge is imposed for paying or returning each item on a similar account without a credit feature; the $5 charge is not a finance charge.

Paragraph 4(b)(3).

1. Assumption fees. The assumption fees mentioned in § 226.4(b)(3) are finance charges only when the assumption occurs and the fee is imposed on the new buyer. The assumption fee is a finance charge in the new buyer's transaction.

Paragraph 4(b)(5).

1. Credit loss insurance. Common examples of the insurance against credit loss mentioned in § 226.4(b)(5) are mortgage guaranty insurance, holder in due course insurance, and repossession insurance. Such premiums must be included in the finance charge only for the period that the creditor requires the insurance to be maintained.

2. Residual value insurance. Where a creditor requires a consumer to maintain residual value insurance or where the creditor is a beneficiary of a residual value insurance policy written in connection with an extension of credit (as is the case in some forms of automobile balloon-payment financing, for example), the premiums for the insurance must be included in the finance charge for the period that the insurance is to be maintained. If a creditor pays for residual-value insurance and absorbs the payment as a cost of doing business, such costs are not considered finance charges. (See comment 4(a)-2.)

Paragraphs 4(b)(7) and (b)(8).

1. Pre-existing insurance policy. The insurance discussed in § 226.4(b)(7) and (b)(8) does not include an insurance policy (such as a life or an automobile collision insurance policy) that is already owned by the consumer, even if the policy is assigned to or otherwise made payable to the creditor to satisfy an insurance requirement. Such a policy is not "written in connection with" the transaction, as long as the insurance was not purchased for use in that credit extension, since it was previously owned by the consumer.

2. Insurance written in connection with a transaction. Credit insurance sold before or after an open-end (not home-secured) plan is opened is considered "written in connection with a credit transaction." Insurance sold after consummation in closed-end credit transactions or after the opening of a home-equity plan subject to the requirements of § 226.5b is not considered "written in connection with" the credit transaction if the insurance is written because of the consumer's default (for example, by failing to obtain or maintain required property insurance) or because the consumer requests insurance after consummation or the opening of a home-equity plan subject to the requirements of § 226.5b (although credit-sale disclosures may be required for the insurance sold after consummation if it is financed).

3. Substitution of life insurance. The premium for a life insurance policy purchased and assigned to satisfy a credit life insurance requirement must be included in the finance charge, but only to the extent of the cost of the credit life insurance if purchased from the creditor or the actual cost of the policy (if that is less than the cost of the insurance available from the creditor). If the creditor does not offer the required insurance, the premium to be included in the finance charge is the cost of a policy of insurance of the type, amount, and term required by the creditor.

4. Other insurance. Fees for required insurance not of the types described in § 226.4(b)(7) and (b)(8) are finance charges and are not excludable. For example:

i. The premium for a hospitalization insurance policy, if it is required to be purchased only in a credit transaction, is a finance charge.

Paragraph 4(b)(9).

1. Discounts for payment by other than credit. The discounts to induce payment by other than credit mentioned in § 226.4(b)(9) include, for example, the following situation:

i. The seller of land offers individual tracts for $10,000 each. If the purchaser pays cash, the price is $9,000, but if the purchaser finances the tract with the seller the price is $10,000. The $1,000 difference is a finance charge for those who buy the tracts on credit.

2. Exception for cash discounts.

i. Creditors may exclude from the finance charge discounts offered to consumers for using cash or another means of payment instead of using a credit card or an open-end plan. The discount may be in whatever amount the seller desires, either as a percentage of the regular price (as defined in section 103(z) of the act, as amended) or a dollar amount. Pursuant to section 167(b) of the act, this provision applies only to transactions involving an open-end credit plan or a credit card (whether open-end or closed-end credit is extended on the card). The merchant must offer the discount to prospective buyers whether or not they are cardholders or members of the open-end credit plan. The merchant may, however, make other distinctions. For example:

A. The merchant may limit the discount to payment by cash and not offer it for payment by check or by use of a debit card.

B. The merchant may establish a discount plan that allows a 15% discount for payment by cash, a 10% discount for payment by check, and a 5% discount for payment by a particular credit card. None of these discounts is a finance charge.

ii. Pursuant to section 171(c) of the act, discounts excluded from the finance charge under this paragraph are also excluded from treatment as a finance charge or other charge for credit under any state usury or disclosure laws.

3. Determination of the regular price.

i. The regular price is critical in determining whether the difference between the price charged to cash customers and credit customers is a discount or a surcharge, as these terms are defined in amended section 103 of the act. The regular price is defined in section 103 of the act as--

* * * the tag or posted price charged for the property or service if a single price is tagged or posted, or the price charged for the property or service when payment is made by use of an open-end credit account or a credit card if either (1) no price is tagged or posted, or (2) two prices are tagged or posted. * * *

ii. For example, in the sale of motor vehicle fuel, the tagged or posted price is the price displayed at the pump. As a result, the higher price (the open-end credit or credit card price) must be displayed at the pump, either alone or along with the cash price. Service station operators may designate separate pumps or separate islands as being for either cash or credit purchases and display only the appropriate prices at the various pumps. If a pump is capable of displaying on its meter either a cash or a credit price depending upon the consumer's means of payment, both the cash price and the credit price must be displayed at the pump. A service station operator may display the cash price of fuel by itself on a curb sign, as long as the sign clearly indicates that the price is limited to cash purchases.

4(b)(10) Debt cancellation and debt suspension fees.

1. Definition. Debt cancellation coverage provides for payment or satisfaction of all or part of a debt when a specified event occurs. The term "debt cancellation coverage" includes guaranteed automobile protection, or "GAP," agreements, which pay or satisfy the remaining debt after property insurance benefits are exhausted. Debt suspension coverage provides for suspension of the obligation to make one or more payments on the date(s) otherwise required by the credit agreement, when a specified event occurs. The term "debt suspension" does not include loan payment deferral arrangements in which the triggering event is the bank's unilateral decision to allow a deferral of payment and the borrower's unilateral election to do so, such as by skipping or reducing one or more payments ("skip payments").

2. Coverage written in connection with a transaction. Coverage sold after consummation in closed-end credit transactions or after the opening of a home-equity plan subject to the requirements of § 226.5b is not "written in connection with" the credit transaction if the coverage is written because the consumer requests coverage after consummation or the opening of a home-equity plan subject to the requirements of § 226.5b (although credit-sale disclosures may be required for the coverage sold after consummation if it is financed). Coverage sold before or after an open-end (not home-secured) plan is opened is considered "written in connection with a credit transaction."

4(c) Charges excluded from the finance charge.

Paragraph 4(c)(1).

1. Application fees. An application fee that is excluded from the finance charge is a charge to recover the costs associated with processing applications for credit. The fee may cover the costs of services such as credit reports, credit investigations, and appraisals. The creditor is free to impose the fee in only certain of its loan programs, such as mortgage loans. However, if the fee is to be excluded from the finance charge under § 226.4(c)(1), it must be charged to all applicants, not just to applicants who are approved or who actually receive credit.

Paragraph 4(c)(2).

1. Late payment charges.

i. Late payment charges can be excluded from the finance charge under § 226.4(c)(2) whether or not the person imposing the charge continues to extend credit on the account or continues to provide property or services to the consumer. In determining whether a charge is for actual unanticipated late payment on a 30-day account, for example, factors to be considered include:

A. The terms of the account. For example, is the consumer required by the account terms to pay the account balance in full each month? If not, the charge may be a finance charge.

B. The practices of the creditor in handling the accounts. For example, regardless of the terms of the account, does the creditor allow consumers to pay the accounts over a period of time without demanding payment in full or taking other action to collect? If no effort is made to collect the full amount due, the charge may be a finance charge.

ii. Section 226.4(c)(2) applies to late payment charges imposed for failure to make payments as agreed, as well as failure to pay an account in full when due.

2. Other excluded charges. Charges for "delinquency, default, or a similar occurrence" include, for example, charges for reinstatement of credit privileges or for submitting as payment a check that is later returned unpaid.

Paragraph 4(c)(3).

1. Assessing interest on an overdraft balance. A charge on an overdraft balance computed by applying a rate of interest to the amount of the overdraft is not a finance charge, even though the consumer agrees to the charge in the account agreement, unless the financial institution agrees in writing that it will pay such items.

Paragraph 4(c)(4).

1. Participation fees--periodic basis. The participation fees described in § 226.4(c)(4) do not necessarily have to be formal membership fees, nor are they limited to credit card plans. The provision applies to any credit plan in which payment of a fee is a condition of access to the plan itself, but it does not apply to fees imposed separately on individual closed-end transactions. The fee may be charged on a monthly, annual, or other periodic basis; a one-time, non-recurring fee imposed at the time an account is opened is not a fee that is charged on a periodic basis, and may not be treated as a participation fee.

2. Participation fees--exclusions. Minimum monthly charges, charges for non-use of a credit card, and other

charges based on either account activity or the amount of credit available under the plan are not excluded from the finance charge by § 226.4(c)(4). Thus, for example, a fee that is charged and then refunded to the consumer based on the extent to which the consumer uses the credit available would be a finance charge. (See the commentary to § 226.4(b)(2). Also, see comment 14(c)-2 for treatment of certain types of fees excluded in determining the annual percentage rate for the periodic statement.)

Paragraph 4(c)(5).

1. Seller's points. The seller's points mentioned in § 226.4(c)(5) include any charges imposed by the creditor upon the noncreditor seller of property for providing credit to the buyer or for providing credit on certain terms. These charges are excluded from the finance charge even if they are passed on to the buyer, for example, in the form of a higher sales price. Seller's points are frequently involved in real estate transactions guaranteed or insured by governmental agencies. A commitment fee paid by a noncreditor seller (such as a real estate developer) to the creditor should be treated as seller's points. Buyer's points (that is, points charged to the buyer by the creditor), however, are finance charges.

2. Other seller-paid amounts. Mortgage insurance premiums and other finance charges are sometimes paid at or before consummation or settlement on the borrower's behalf by a noncreditor seller. The creditor should treat the payment made by the seller as seller's points and exclude it from the finance charge if, based on the seller's payment, the consumer is not legally bound to the creditor for the charge. A creditor who gives disclosures before the payment has been made should base them on the best information reasonably available.

Paragraph 4(c)(6).

1. Lost interest. Certain federal and state laws mandate a percentage differential between the interest rate paid on a deposit and the rate charged on a loan secured by that deposit. In some situations, because of usury limits the creditor must reduce the interest rate paid on the deposit and, as a result, the consumer loses some of the interest that would otherwise have been earned. Under § 226.4(c)(6), such "lost interest" need not be included in the finance charge. This rule applies only to an interest reduction imposed because a rate differential is required by law and a usury limit precludes compliance by any other means. If the creditor imposes a differential that exceeds that required, only the lost interest attributable to the excess amount is a finance charge. (See the commentary to § 226.4(a).)

Paragraph 4(c)(7).

1. Real estate or residential mortgage transaction charges. The list of charges in § 226.4(c)(7) applies both to residential mortgage transactions (which may include, for example, the purchase of a mobile home) and to other transactions secured by real estate. The fees are excluded from the finance charge even if the services for which the fees are imposed are performed by the creditor's employees rather than by a third party. In addition, the cost of verifying or confirming information connected to the item is also excluded. For example, credit-report fees cover not only the cost of the report but also the cost of verifying information in the report. In all cases, charges excluded under § 226.4(c)(7) must be bona fide and reasonable.

2. Lump-sum charges. If a lump sum charged for several services includes a charge that is not excludable, a portion of the total should be allocated to that service and included in the finance charge. However, a lump sum charged for conducting or attending a closing (for example, by a lawyer or a title company) is excluded from the finance charge if the charge is primarily for services related to items listed in § 226.4(c)(7) (for example, reviewing or completing documents), even if other incidental services such as explaining various documents or disbursing funds for the parties are performed. The entire charge is excluded even if a fee for the incidental services would be a finance charge if it were imposed separately.

3. Charges assessed during the loan term. Real estate or residential mortgage transaction charges excluded under § 226.4(c)(7) are those charges imposed solely in connection with the initial decision to grant credit. This would include, for example, a fee to search for tax liens on the property or to determine if flood insurance is required. The exclusion does not apply to fees for services to be performed periodically during the loan term, regardless of when the fee is collected. For example, a fee for one or more determinations during the loan term of the current tax-lien status or flood-insurance requirements is a finance charge, regardless of whether the fee is imposed at closing, or when the service is performed. If a creditor is uncertain about what portion of a fee to be paid at consummation or loan closing is related to the initial decision to grant credit, the entire fee may be treated as a finance charge.

4(d) Insurance and debt cancellation and debt suspension coverage.

1. General. Section 226.4(d) permits insurance premiums and charges and debt cancellation and debt suspension charges to be excluded from the finance charge. The required disclosures must be made in writing, except as provided in § 226.4(d)(4). The rules on location of insurance and debt cancellation and debt suspension disclosures for closed-end transactions are in § 226.17(a). For purposes of § 226.4(d), all references to insurance also include debt cancellation and debt suspension coverage unless the context indicates otherwise.

2. Timing of disclosures. If disclosures are given early, for example under § 226.17(f) or § 226.19(a), the creditor need not redisclose if the actual premium is different at the time of consummation. If insurance disclosures are not given at the time of early disclosure and insurance is in fact written in connection with the transaction, the disclosures under § 226.4(d) must be made in order to exclude the premiums from the finance charge.

3. Premium rate increases. The creditor should disclose the premium amount based on the rates currently in effect and need not designate it as an estimate even if the premium rates may increase. An increase in insurance rates after consummation of a closed-end credit transaction or during the life of an open-end credit plan does not require redisclosure in order to exclude the additional premium from treatment as a finance charge.

4. Unit-cost disclosures.

i. Open-end credit. The premium or fee for insurance or debt cancellation or debt suspension for the initial term of coverage may be disclosed on a unit-cost basis in open-end credit transactions. The cost per unit should be based on the initial term of coverage, unless one of the options under comment 4(d)-12 is available.

ii. Closed-end credit. One of the transactions for which unit-cost disclosures (such as 50 cents per year for each $100 of the amount financed) may be used in place of the total insurance premium involves a particular kind of insurance plan. For example, a consumer with a current indebtedness of $8,000 is covered by a plan of credit life insurance coverage with a maximum of $10,000. The consumer requests an additional $4,000 loan to be covered by the same insurance plan. Since the $4,000 loan exceeds, in part, the maximum amount of indebtedness that can be covered by the plan, the creditor may properly give the insurance-cost disclosures on the $4,000 loan on a unit-cost basis.

5. Required credit life insurance; debt cancellation or suspension coverage. Credit life, accident, health, or loss-of-income insurance, and debt cancellation and suspension coverage described in § 226.4(b)(10), must be voluntary in order for the premium or charges to be excluded from the finance charge. Whether the insurance or coverage is in fact required or optional is a factual question. If the insurance or coverage is required, the premiums must be included in the finance charge, whether the insurance or coverage is purchased from the creditor or from a third party. If the consumer is required to elect one of several options--such as to purchase credit life insurance, or to assign an existing life insurance policy, or to pledge security such as a certificate of deposit--and the consumer purchases the credit life insurance policy, the premium must be included in the finance charge. (If the consumer assigns a preexisting policy or pledges security instead, no premium is included in the finance charge. The security interest would be disclosed under § 226.6(a)(4), § 226.6(b)(5)(ii), or § 226.18(m). See the commentary to § 226.4(b)(7) and (b)(8).)

6. Other types of voluntary insurance. Insurance is not credit life, accident, health, or loss-of-income insurance if the creditor or the credit account of the consumer is not the beneficiary of the insurance coverage. If the premium for such insurance is not imposed by the creditor as an incident to or a condition of credit, it is not covered by § 226.4.

7. Signatures. If the creditor offers a number of insurance options under § 226.4(d), the creditor may provide a means for the consumer to sign or initial for each option, or it may provide for a single authorizing signature or initial with the options selected designated by some other means, such as a check mark. The insurance authorization may be signed or initialed by any consumer, as defined in § 226.2(a)(11), or by an authorized user on a credit card account.

8. Property insurance. To exclude property insurance premiums or charges from the finance charge, the creditor must allow the consumer to choose the insurer and disclose that fact. This disclosure must be made whether or not the property insurance is available from or through the creditor. The requirement that an option be given does not require that the insurance be readily available from other sources. The premium or charge must be disclosed only if the consumer elects to purchase the insurance from the creditor; in such a case, the creditor must also disclose the term of the property insurance coverage if it is less than the term of the obligation.

9. Single-interest insurance. Blanket and specific single-interest coverage are treated the same for purposes of the regulation. A charge for either type of single-interest insurance may be excluded from the finance charge if:

i. The insurer waives any right of subrogation.

ii. The other requirements of § 226.4(d)(2) are met. This includes, of course, giving the consumer the option of obtaining the insurance from a person of the consumer's choice. The creditor need not ascertain whether the consumer is able to purchase the insurance from someone else.

10. Single-interest insurance defined. The term single-interest insurance as used in the regulation refers only to the types of coverage traditionally included in the term vendor's single-interest insurance (or VSI), that is, protection of tangible property against normal property damage, concealment, confiscation, conversion, embezzlement, and skip. Some comprehensive insurance policies may include a variety of additional coverages, such as repossession insurance and holder-in-due-course insurance. These types of coverage do not constitute single-interest insurance for purposes of the regulation, and premiums for them do not qualify for exclusion from the finance charge under § 226.4(d). If a policy that is primarily VSI also provides coverages that are not VSI or other property insurance, a portion of the premiums must be allocated to the nonexcludable coverages and included in the finance charge. However, such allocation is not required if the total premium in fact attributable to all of the non-VSI coverages included in the policy is $1.00 or less (or $5.00 or less in the case of a multiyear policy).

11. Initial term.

i. The initial term of insurance or debt cancellation or debt suspension coverage determines the period for which a premium amount must be disclosed, unless one of the options discussed under comment 4(d)-12 is available. For purposes of § 226.4(d), the initial term is the period for which the insurer or creditor is obligated to provide coverage, even though the consumer may be allowed to cancel the coverage or coverage may end due to nonpayment before that term expires.

ii. For example:

A. The initial term of a property insurance policy on an automobile that is written for one year is one year even though premiums are paid monthly and the term of the credit transaction is four years.

B. The initial term of an insurance policy is the full term of the credit transaction if the consumer pays or finances a single premium in advance.

12. Initial term; alternative.

i. General. A creditor has the option of providing cost disclosures on the basis of one year of insurance or debt cancellation or debt suspension coverage instead of a longer initial term (provided the premium or fee is clearly labeled as being for one year) if:

A. The initial term is indefinite or not clear, or

B. The consumer has agreed to pay a premium or fee that is assessed periodically but the consumer is under no obligation to continue the coverage, whether or not the consumer has made an initial payment.

ii. Open-end plans. For open-end plans, a creditor also has the option of providing unit-cost disclosure on the basis of a period that is less than one year if the consumer has agreed to pay a premium or fee that is assessed periodically, for example monthly, but the consumer is under no obligation to continue the coverage.

iii. Examples. To illustrate:

A. A credit life insurance policy providing coverage for a 30-year mortgage loan has an initial term of 30 years, even though premiums are paid monthly and the consumer is not required to continue the coverage. Disclosures may be based on the initial term, but the creditor also has the option of making disclosures on the basis of coverage for an assumed initial term of one year.

13. Loss-of-income insurance. The loss-of-income insurance mentioned in § 226.4(d) includes involuntary unemployment insurance, which provides that some or all of the consumer's payments will be made if the consumer becomes unemployed involuntarily.

4(d)(3) Voluntary debt cancellation or debt suspension fees.

1. General. Fees charged for the specialized form of debt cancellation agreement known as guaranteed automobile protection ("GAP") agreements must be disclosed according to § 226.4(d)(3) rather than according to § 226.4(d)(2) for property insurance.

2. Disclosures. Creditors can comply with § 226.4(d)(3) by providing a disclosure that refers to debt cancellation or debt suspension coverage whether or not the coverage is considered insurance. Creditors may use the model credit insurance disclosures only if the debt cancellation or debt suspension coverage constitutes insurance under state law. (See Model Clauses and Samples at G-16 and H-17 in appendix G and appendix H to part 226 for guidance on how to provide the disclosure required by § 226.4(d)(3)(iii) for debt suspension products.)

3. Multiple events. If debt cancellation or debt suspension coverage for two or more events is provided at a single charge, the entire charge may be excluded from the finance charge if at least one of the events is accident or loss of life, health, or income and the conditions specified in § 226.4(d)(3) or, as applicable, § 226.4(d)(4), are satisfied.

4. Disclosures in programs combining debt cancellation and debt suspension features. If the consumer's debt can be cancelled under certain circumstances, the disclosure may be modified to reflect that fact. The disclosure could, for example, state (in addition to the language required by § 226.4(d)(3)(iii)) that "In some circumstances, my debt may be cancelled." However, the disclosure would not be permitted to list the specific events that would result in debt cancellation.

4(d)(4) Telephone purchases.

1. Affirmative request. A creditor would not satisfy the requirement to obtain a consumer's affirmative request if the "request" was a response to a script that uses leading questions or negative consent. A question asking whether the consumer wishes to enroll in the credit insurance or debt cancellation or suspension plan and seeking a yes-or-no response (such as "Do you want to enroll in this optional debt cancellation plan?") would not be considered leading.

4(e) Certain security interest charges.

1. Examples.

i. Excludable charges. Sums must be actually paid to public officials to be excluded from the finance charge under § 226.4(e)(1) and (e)(3). Examples are charges or other fees required for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents, as well as intangible property or other taxes even when the charges or fees are imposed by the state solely on the creditor and charged to the consumer (if the tax must be paid to record a security agreement). (See comment 4(a)-5 regarding the treatment of taxes, generally.)

ii. Charges not excludable. If the obligation is between the creditor and a third party (an assignee, for example), charges or other fees for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents relating to that obligation are not excludable from the finance charge under this section.

2. Itemization. The various charges described in § 226.4(e)(1) and (e)(3) may be totaled and disclosed as an aggregate sum, or they may be itemized by the specific fees and taxes imposed. If an aggregate sum is disclosed, a general term such as security interest fees or filing fees may be used.

3. Notary fees. In order for a notary fee to be excluded under § 226.4(e)(1), all of the following conditions must be met:

i. The document to be notarized is one used to perfect, release, or continue a security interest.

ii. The document is required by law to be notarized.

iii. A notary is considered a public official under applicable law.

iv. The amount of the fee is set or authorized by law.

4. Nonfiling insurance. The exclusion in § 226.4(e)(2) is available only if nonfiling insurance is purchased. If the creditor collects and simply retains a fee as a sort of "self-insurance" against nonfiling, it may not be excluded from the finance charge. If the nonfiling insurance premium exceeds the amount of the fees excludable from the finance charge under § 226.4(e)(1), only the excess is a finance charge. For example:

i. The fee for perfecting a security interest is $5.00 and the fee for releasing the security interest is $3.00. The creditor charges $10.00 for nonfiling insurance. Only $8.00 of the $10.00 is excludable from the finance charge.

4(f) Prohibited offsets.

1. Earnings on deposits or investments. The rule that the creditor shall not deduct any earnings by the consumer on deposits or investments applies whether or not the creditor has a security interest in the property.

Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
12 C.F.R. Part 226 REGULATION Z--TRUTH IN LENDING
Supp I to Part 226 Official Staff Interpretations (Part I of III)

1B- Consumer Credit Law Manual Subpart B

§ **B Open-End Credit**

Section 226.5 General Disclosure Requirements

5(a) Form of disclosures.

5(a)(1) General.

1. Clear and conspicuous standard. The "clear and conspicuous" standard generally requires that disclosures be in a reasonably understandable form. Disclosures for credit card applications and solicitations under § 226.5a, highlighted account-opening disclosures under § 226.6(b)(1), highlighted disclosure on checks that access a credit card under § 226.9(b)(3), highlighted change-in-terms disclosures under § 226.9(c)(2)(iv)(D), and highlighted disclosures when a rate is increased due to delinquency, default or for a penalty under § 226.9(g)(3)(ii) must also be readily noticeable to the consumer.

2. Clear and conspicuous--reasonably understandable form. Except where otherwise provided, the reasonably understandable form standard does not require that disclosures be segregated from other material or located in any particular place on the disclosure statement, or that numerical amounts or percentages be in any particular type size. For disclosures that are given orally, the standard requires that they be given at a speed and volume sufficient for a consumer to hear and comprehend them. (See comment 5(b)(1)(ii)-1.) Except where otherwise provided, the standard does not prohibit:

i. Pluralizing required terminology ("finance charge" and "annual percentage rate").

ii. Adding to the required disclosures such items as contractual provisions, explanations of contract terms, state disclosures, and translations.

iii. Sending promotional material with the required disclosures.

iv. Using commonly accepted or readily understandable abbreviations (such as "mo." for "month" or "Tx." for "Texas") in making any required disclosures.

v. Using codes or symbols such as "APR" (for annual percentage rate), "FC" (for finance charge), or "Cr" (for credit balance), so long as a legend or description of the code or symbol is provided on the disclosure statement.

3. Clear and conspicuous--readily noticeable standard. To meet the readily noticeable standard, disclosures for credit card applications and solicitations under § 226.5a, highlighted account-opening disclosures under § 226.6(b)(1), highlighted disclosures on checks that access a credit card account under § 226.9(b)(3), highlighted change-in-terms disclosures under § 226.9(c)(2)(iv)(D), and highlighted disclosures when a rate is increased due to delinquency, default or penalty pricing under § 226.9(g)(3)(ii) must be given in a minimum of 10-point font. (See special rule for font size requirements for the annual percentage rate for purchases under §§ 226.5a(b)(1) and 226.6(b)(2)(i).)

4. Integrated document. The creditor may make both the account-opening disclosures (§ 226.6) and the periodic-statement disclosures (§ 226.7) on more than one page, and use both the front and the reverse sides, except where otherwise indicated, so long as the pages constitute an integrated document. An integrated document would not include disclosure pages provided to the consumer at different times or disclosures interspersed on the same page with promotional material. An integrated document would include, for example:

i. Multiple pages provided in the same envelope that cover related material and are folded together, numbered consecutively, or clearly labeled to show that they relate to one another; or

ii. A brochure that contains disclosures and explanatory material about a range of services the creditor offers, such as credit, checking account, and electronic fund transfer features.

5. Disclosures covered. Disclosures that must meet the "clear and conspicuous" standard include all required communications under this subpart. Therefore, disclosures made by a person other than the card issuer, such as disclosures of finance charges imposed at the time of honoring a consumer's credit card under § 226.9(d), and notices, such as the correction notice required to be sent to the consumer under § 226.13(e), must also be clear and conspicuous.

Paragraph 5(a)(1)(ii)(A).

1. Electronic disclosures. Disclosures that need not be provided in writing under § 226.5(a)(1)(ii)(A) may be provided in writing, orally, or in electronic form. If the consumer requests the service in electronic form, such as on the creditor's Web site, the specified disclosures may be provided in electronic form without regard to the consumer consent or other provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (*15 U.S.C. 7001 et seq.*).

Paragraph 5(a)(1)(iii).

1. Disclosures not subject to E-Sign Act. See the commentary to § 226.5(a)(1)(ii)(A) regarding disclosures (in addition to those specified under § 226.5(a)(1)(iii)) that may be provided in electronic form without regard to the consumer consent or other provisions of the E-Sign Act.

5(a)(2) Terminology.

1. When disclosures must be more conspicuous. For home-equity plans subject to § 226.5b, the terms finance charge and annual percentage rate, when required to be used with a number, must be disclosed more conspicuously than other required disclosures, except in the cases provided in § 226.5(a)(2)(ii). At the creditor's option, finance charge and annual percentage rate may also be disclosed more conspicuously than the other required disclosures even when the regulation does not so require. The following examples illustrate these rules:

i. In disclosing the annual percentage rate as required by § 226.6(a)(1)(ii), the term annual percentage rate is subject to the more conspicuous rule.

ii. In disclosing the amount of the finance charge, required by § 226.7(a)(6)(i), the term finance charge is subject to the more conspicuous rule.

iii. Although neither finance charge nor annual percentage rate need be emphasized when used as part of general informational material or in textual descriptions of other terms, emphasis is permissible in such cases. For example, when the terms appear as part of the explanations required under § 226.6(a)(1)(iii) and (a)(1)(iv), they may be equally conspicuous as the disclosures required under §§ 226.6(a)(1)(ii) and 226.7(a)(7).

2. Making disclosures more conspicuous. In disclosing the terms finance charge and annual percentage rate more conspicuously for home-equity plans subject to § 226.5b, only the words finance charge and annual percentage rate should be accentuated. For example, if the term total finance charge is used, only finance charge should be emphasized. The disclosures may be made more conspicuous by, for example:

i. Capitalizing the words when other disclosures are printed in lower case.

ii. Putting them in bold print or a contrasting color.

iii. Underlining them.

iv. Setting them off with asterisks.

v. Printing them in larger type.

3. Disclosure of figures--exception to more conspicuous rule. For home-equity plans subject to § 226.5b, the terms annual percentage rate and finance charge need not be more conspicuous than figures (including, for example, numbers, percentages, and dollar signs).

4. Consistent terminology. Language used in disclosures required in this subpart must be close enough in meaning to enable the consumer to relate the different disclosures; however, the language need not be identical.

5(b) Time of disclosures.

5(b)(1) Account-opening disclosures.

5(b)(1)(i) General rule.

1. Disclosure before the first transaction. When disclosures must be furnished "before the first transaction," account-opening disclosures must be delivered before the consumer becomes obligated on the plan. Examples include:

i. Purchases. The consumer makes the first purchase, such as when a consumer opens a credit plan and makes purchases contemporaneously at a retail store, except when the consumer places a telephone call to make the purchase and opens the plan contemporaneously. (See commentary to § 226.5(b)(1)(iii) below.)

ii. Advances. The consumer receives the first advance. If the consumer receives a cash advance check at the same time the account-opening disclosures are provided, disclosures are still timely if the consumer can, after receiving the disclosures, return the cash advance check to the creditor without obligation (for example, without paying finance charges).

2. Reactivation of suspended account. If an account is temporarily suspended (for example, because the consumer has exceeded a credit limit, or because a credit card is reported lost or stolen) and then is reactivated, no new account-opening disclosures are required.

3. Reopening closed account. If an account has been closed (for example, due to inactivity, cancellation, or expiration) and then is reopened, new account-opening disclosures are required. No new account-opening disclosures are required, however, when the account is closed merely to assign it a new number (for example, when a credit card is reported lost or stolen) and the "new" account then continues on the same terms.

4. Converting closed-end to open-end credit. If a closed-end credit transaction is converted to an open-end credit account under a written agreement with the consumer, account-opening disclosures under § 226.6 must be given before the consumer becomes obligated on the open-end credit plan. (See the commentary to § 226.17 on converting open-end credit to closed-end credit.)

5. Balance transfers. A creditor that solicits the transfer by a consumer of outstanding balances from an existing account to a new open-end plan must furnish the disclosures required by § 226.6 so that the consumer has an opportunity, after receiving the disclosures, to contact the creditor before the balance is transferred and decline the transfer. For example, assume a consumer responds to a card issuer's solicitation for a credit card account subject to § 226.5a that offers a range of balance transfer annual percentage rates, based on the consumer's creditworthiness. If the creditor opens an account for the consumer, the creditor would comply with the timing rules of this section by providing the consumer with the annual percentage rate (along with the fees and other required disclosures) that would apply to the balance transfer in time for the consumer to contact the creditor and withdraw the request. A creditor that permits consumers to withdraw the request by telephone has met this timing standard if the creditor does not effect the balance transfer until 10 days after the creditor has sent account-opening disclosures to the consumer, assuming the consumer has not contacted the creditor to withdraw the request. Card issuers that are subject to the requirements of § 226.5a may establish procedures that comply with both §§ 226.5a and 226.6 in a single disclosure statement.

6. Substitution or replacement of credit card accounts.

i. Generally. When a card issuer substitutes or replaces an existing credit card account with another credit card account, the card issuer must either provide notice of the terms of the new account consistent with § 226.6(b) or provide notice of the changes in the terms of the existing account consistent with § 226.9(c)(2). Whether a substitution or replacement results in the opening of a new account or a change in the terms of an existing account for purposes of the disclosure requirements in §§ 226.6(b) and 226.9(c)(2) is determined in light of all the relevant facts and circumstances. For additional requirements and limitations related to the substitution or replacement of credit card accounts, see *§§ 226.12*(a) and 226.55(d) and comments 12(a)(1)-1 through -8, 12(a)(2)-1 through -9, 55(b)(3)-3, and 55(d)-1 through -3.

ii. Relevant facts and circumstances. Listed below are facts and circumstances that are relevant to whether a substitution or replacement results in the opening of a new account or a change in the terms of an existing account for purposes of the disclosure requirements in §§ 226.6(b) and 226.9(c)(2). When most of the facts and circumstances listed below are present, the substitution or replacement likely constitutes the opening of a new account for which § 226.6(b) disclosures are appropriate. When few of the facts and circumstances listed below are present, the substitution or replacement likely constitutes a change in the terms of an existing account for which § 226.9(c)(2) disclosures are appropriate.

A. Whether the card issuer provides the consumer with a new credit card;

B. Whether the card issuer provides the consumer with a new account number;

C. Whether the account provides new features or benefits after the substitution or replacement (such as rewards on purchases);

D. Whether the account can be used to conduct transactions at a greater or lesser number of merchants after the substitution or replacement (such as when a retail card is replaced with a cobranded general purpose credit card that can be used at a wider number of merchants);

E. Whether the card issuer implemented the substitution or replacement on an individualized basis (such as in response to a consumer's request); and

F. Whether the account becomes a different type of open-end plan after the substitution or replacement (such

as when a charge card is replaced by a credit card).

iii. Replacement as a result of theft or unauthorized use. Notwithstanding paragraphs i. and ii. above, a card issuer that replaces a credit card or provides a new account number because the consumer has reported the card stolen or because the account appears to have been used for unauthorized transactions is not required to provide a notice under §§ 226.6(b) or 226.9(c)(2) unless the card issuer has changed a term of the account that is subject to §§ 226.6(b) or 226.9(c)(2).

5(b)(1)(ii) Charges imposed as part of an open-end (not home-secured) plan.

1. Disclosing charges before the fee is imposed. Creditors may disclose charges imposed as part of an open-end (not home-secured) plan orally or in writing at any time before a consumer agrees to pay the fee or becomes obligated for the charge, unless the charge is specified under § 226.6(b)(2). (Charges imposed as part of an open-end (not home-secured plan) that are not specified under § 226.6(b)(2) may alternatively be disclosed in electronic form; see the commentary to § 226.5(a)(1)(ii)(A).) Creditors must provide such disclosures at a time and in a manner that a consumer would be likely to notice them. For example, if a consumer telephones a card issuer to discuss a particular service, a creditor would meet the standard if the creditor clearly and conspicuously discloses the fee associated with the service that is the topic of the telephone call orally to the consumer. Similarly, a creditor providing marketing materials in writing to a consumer about a particular service would meet the standard if the creditor provided a clear and conspicuous written disclosure of the fee for that service in those same materials. A creditor that provides written materials to a consumer about a particular service but provides a fee disclosure for another service not promoted in such materials would not meet the standard. For example, if a creditor provided marketing materials promoting payment by Internet, but included the fee for a replacement card on such materials with no explanation, the creditor would not be disclosing the fee at a time and in a manner that the consumer would be likely to notice the fee.

5(b)(1)(iii) Telephone purchases.

1. Return policies. In order for creditors to provide disclosures in accordance with the timing requirements of this paragraph, consumers must be permitted to return merchandise purchased at the time the plan was established without paying mailing or return-shipment costs. Creditors may impose costs to return subsequent purchases of merchandise under the plan, or to return merchandise purchased by other means such as a credit card issued by another creditor. A reasonable return policy would be of sufficient duration that the consumer is likely to have received the disclosures and had sufficient time to make a decision about the financing plan before his or her right to return the goods expires. Return policies need not provide a right to return goods if the consumer consumes or damages the goods, or for installed appliances or fixtures, provided there is a reasonable repair or replacement policy to cover defective goods or installations. If the consumer chooses to reject the financing plan, creditors comply with the requirements of this paragraph by permitting the consumer to pay for the goods with another reasonable form of payment acceptable to the merchant and keep the goods although the creditor cannot require the consumer to do so.

5(b)(1)(iv) Membership fees.

1. Membership fees. See § 226.5a(b)(2) and related commentary for guidance on fees for issuance or availability of a credit or charge card.

2. Rejecting the plan. If a consumer has paid or promised to pay a membership fee including an application fee excludable from the finance charge under § 226.4(c)(1) before receiving account-opening disclosures, the consumer may, after receiving the disclosures, reject the plan and not be obligated for the membership fee, application fee, or any other fee or charge. A consumer who has received the disclosures and uses the account, or makes a payment on the account after receiving a billing statement, is deemed not to have rejected the plan.

3. Using the account. A consumer uses an account by obtaining an extension of credit after receiving the account-opening disclosures, such as by making a purchase or obtaining an advance. A consumer does not "use" the account by activating the account. A consumer also does not "use" the account when the creditor assesses fees on the account (such as start-up fees or fees associated with credit insurance or debt cancellation or suspension programs agreed to as a part of the application and before the consumer receives account-opening disclosures). For example, the consumer does not "use" the account when a creditor sends a billing statement with start-up fees, there is no other activity on the account, the consumer does not pay the fees, and the creditor subsequently assesses a late fee or interest on the unpaid fee balances. A consumer also does not "use" the account by paying an application fee excludable from the finance charge under § 226.4(c)(1) prior to receiving the account-opening disclosures.

4. Home-equity plans. Creditors offering home-equity plans subject to the requirements of § 226.5b are subject to the requirements of § 226.5b(h) regarding the collection of fees.

5(b)(2) Periodic statements.

Paragraph 5(b)(2)(i).

1. Periodic statements not required. Periodic statements need not be sent in the following cases:

i. If the creditor adjusts an account balance so that at the end of the cycle the balance is less than $1--so long as no finance charge has been imposed on the account for that cycle.

ii. If a statement was returned as undeliverable. If a new address is provided, however, within a reasonable time before the creditor must send a statement, the creditor must resume sending statements. Receiving the address at least 20 days before the end of a cycle would be a reasonable amount of time to prepare the statement for that cycle. For

example, if an address is received 22 days before the end of the June cycle, the creditor must send the periodic statement for the June cycle. (See *§ 226.13*(a)(7).)

2. Termination of draw privileges. When a consumer's ability to draw on an open-end account is terminated without being converted to closed-end credit under a written agreement, the creditor must continue to provide periodic statements to those consumers entitled to receive them under § 226.5(b)(2)(i), for example, when the draw period of an open-end credit plan ends and consumers are paying off outstanding balances according to the account agreement or under the terms of a workout agreement that is not converted to a closed-end transaction. In addition, creditors must continue to follow all of the other open-end credit requirements and procedures in subpart B.

3. Uncollectible accounts. An account is deemed uncollectible for purposes of § 226.5(b)(2)(i) when a creditor has ceased collection efforts, either directly or through a third party.

4. Instituting collection proceedings. Creditors institute a delinquency collection proceeding by filing a court action or initiating an adjudicatory process with a third party. Assigning a debt to a debt collector or other third party would not constitute instituting a collection proceeding.

Paragraph 5(b)(2)(ii).

1. Mailing or delivery of periodic statements. A creditor is not required to determine the specific date on which a periodic statement is mailed or delivered to an individual consumer for purposes of § 226.5(b)(2)(ii). A creditor complies with § 226.5(b)(2)(ii) if it has adopted reasonable procedures designed to ensure that periodic statements are mailed or delivered to consumers no later than a certain number of days after the closing date of the billing cycle and adds that number of days to the 21-day period required by § 226.5(b)(2)(ii) when determining the payment due date and the date on which any grace period expires for purposes of § 226.5(b)(2)(ii)(A)(1) and (b)(2)(ii)(B)(1). For example, if a creditor has adopted reasonable procedures designed to ensure that periodic statements are mailed or delivered to consumers no later than three days after the closing date of the billing cycle, the payment due date and the date on which any grace period expires must be no less than 24 days after the closing date of the billing cycle. Similarly, in these circumstances, the limitations in § 226.5(b)(2)(ii)(A)(2) and (b)(2)(ii)(B)(2) on treating a payment as late and imposing finance charges apply for 24 days after the closing date of the billing cycle.

2. Treating a payment as late for any purpose. Treating a payment as late for any purpose includes increasing the annual percentage rate as a penalty, reporting the consumer as delinquent to a credit reporting agency, assessing a late fee or any other fee, initiating collection activities, or terminating benefits (such as rewards on purchases) based on the consumer's failure to make a payment within a specified amount of time or by a specified date. The prohibition in § 226.5(b)(2)(ii)(A)(2) on treating a payment as late for any purpose applies only during the 21-day period following mailing or delivery of the periodic statement stating the due date for that payment and only if the required minimum periodic payment is received within that period. For example:

i. Assume that a periodic statement mailed on April 4 states that a required minimum periodic payment of $50 is due on April 25. If the card issuer does not receive any payment on or before April 25, § 226.5(b)(2)(ii)(A)(2) does not prohibit the card issuer from treating the required minimum periodic payment as late.

ii. Same facts as in paragraph i. above. On April 20, the card issuer receives a payment of $30 and no additional payment is received on or before April 25. Section 226.5(b)(2)(ii)(A)(2) does not prohibit the card issuer from treating the required minimum periodic payment as late.

iii. Same facts as in paragraph i. above. On May 4, the card issuer has not received the $50 required minimum periodic payment that was due on April 25. The periodic statement mailed on May 4 states that a required minimum periodic payment of $150 is due on May 25. Section 226.5(b)(2)(ii)(A)(2) does not permit the card issuer to treat the $150 required minimum periodic payment as late until April 26. However, the card issuer may continue to treat the $50 required minimum periodic payment as late during this period.

3. Grace periods.

i. Definition of grace period. For purposes of § 226.5(b)(2)(ii)(B), "grace period" means a period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate. A deferred interest or similar promotional program under which the consumer is not obligated to pay interest that accrues on a balance if that balance is paid in full prior to the expiration of a specified period of time is not a grace period for purposes of § 226.5(b)(2)(ii)(B). Similarly, a period following the payment due date during which a late payment fee will not be imposed is not a grace period for purposes of § 226.5(b)(2)(ii)(B). See comments 7(b)(11)-1, 7(b)(11)-2, and 54(a)(1)-2.

ii. Applicability of § 226.5(b)(2)(ii)(B). Section 226.5(b)(2)(ii)(B) applies if an account is eligible for a grace period when the periodic statement is mailed or delivered. Section 226.5(b)(2)(ii)(B) does not require the creditor to provide a grace period or prohibit the creditor from placing limitations and conditions on a grace period to the extent consistent with § 226.5(b)(2)(ii)(B) and § 226.54. See comment 54(a)(1)-1. Furthermore, the prohibition in § 226.5(b)(2)(ii)(B)(2) applies only during the 21-day period following mailing or delivery of the periodic statement and applies only when the creditor receives a payment within that 21-day period that satisfies the terms of the grace period.

iii. Example. Assume that the billing cycles for an account begin on the first day of the month and end on the last day of the month and that the payment due date for the account is the twenty-fifth of the month. Assume also that, under the terms of the account, the balance at the end of a billing cycle must be paid in full by the following payment due date in order for the account to remain eligible for the grace period. At the end of the April billing cycle, the balance on the account is $500. The grace period applies to the $500 balance because the balance for the March billing cycle was paid in full on April 25. Accordingly, § 226.5(b)(2)(ii)(B)(1) requires the creditor to have reasonable procedures designed to ensure that the periodic statement reflecting the $500 balance is mailed or delivered on or before May 4. Furthermore, § 226.5(b)(2)(ii)(B)(2) requires the creditor to have reasonable procedures designed to ensure that the creditor does not impose finance charges as a result of the loss of the grace period if a $500 payment is received on or

before May 25. However, if the creditor receives a payment of $300 on April 25, § 226.5(b)(2)(ii)(B)(2) would not prohibit the creditor from imposing finance charges as a result of the loss of the grace period (to the extent permitted by § 226.54).

4. Application of § 226.5(b)(2)(ii) to charge card and charged-off accounts.

i. Charge card accounts. For purposes of § 226.5(b)(2)(ii)(A)(1), the payment due date is the date the card issuer is required to disclose on the periodic statement pursuant to § 226.7(b)(11)(i)(A). Because § 226.7(b)(11)(ii) provides that § 226.7(b)(11)(i) does not apply to periodic statements provided solely for charge card accounts, § 226.5(b)(2)(ii)(A)(1) also does not apply to the mailing or delivery of periodic statements provided solely for such accounts. However, in these circumstances, § 226.5(b)(2)(ii)(A)(2) requires the card issuer to have reasonable procedures designed to ensure that a payment is not treated as late for any purpose during the 21-day period following mailing or delivery of the statement. Section 226.5(b)(2)(ii)(B) does not apply to charge card accounts because, for purposes of § 226.5(b)(2)(ii)(B), a grace period is a period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate and, consistent with § 226.2(a)(15)(iii), charge card accounts do not impose a finance charge based on a periodic rate.

ii. Charged-off accounts. For purposes of § 226.5(b)(2)(ii)(A)(1), the payment due date is the date the card issuer is required to disclose on the periodic statement pursuant to § 226.7(b)(11)(i)(A). Because § 226.7(b)(11)(ii) provides that § 226.7(b)(11)(i) does not apply to periodic statements provided for charged-off accounts where full payment of the entire account balance is due immediately, § 226.5(b)(2)(ii)(A)(1) also does not apply to the mailing or delivery of periodic statements provided solely for such accounts. Furthermore, although § 226.5(b)(2)(ii)(A)(2) requires the card issuer to have reasonable procedures designed to ensure that a payment is not treated as late for any purpose during the 21-day period following mailing or delivery of the statement, § 226.5(b)(2)(ii)(A)(2) does not prohibit a card issuer from continuing to treat prior payments as late during that period. See comment 5(b)(2)(ii)-2. Section 226.5(b)(2)(ii)(B) does not apply to charged-off accounts where full payment of the entire account balance is due immediately because such accounts do not provide a grace period.

5. Consumer request to pick up periodic statements. When a consumer initiates a request, the creditor may permit, but may not require, the consumer to pick up periodic statements. If the consumer wishes to pick up a statement, the statement must be made available in accordance with § 226.5(b)(2)(ii).

6. Deferred interest and similar promotional programs. See comment 7(b)-1.iv.

Paragraph 5(b)(2)(iii).

1. Computer malfunction. The exceptions identified in § 226.5(b)(2)(iii) of this section do not extend to the failure to provide a periodic statement because of computer malfunction.

5(c) Basis of disclosures and use of estimates.

1. Legal obligation. The disclosures should reflect the credit terms to which the parties are legally bound at the time of giving the disclosures.

i. The legal obligation is determined by applicable state or other law.

ii. The fact that a term or contract may later be deemed unenforceable by a court on the basis of equity or other grounds does not, by itself, mean that disclosures based on that term or contract did not reflect the legal obligation.

iii. The legal obligation normally is presumed to be contained in the contract that evidences the agreement. But this may be rebutted if another agreement between the parties legally modifies that contract.

2. Estimates--obtaining information. Disclosures may be estimated when the exact information is unknown at the time disclosures are made. Information is unknown if it is not reasonably available to the creditor at the time disclosures are made. The reasonably available standard requires that the creditor, acting in good faith, exercise due diligence in obtaining information. In using estimates, the creditor is not required to disclose the basis for the estimated figures, but may include such explanations as additional information. The creditor normally may rely on the representations of other parties in obtaining information. For example, the creditor might look to insurance companies for the cost of insurance.

3. Estimates--redisclosure. If the creditor makes estimated disclosures, redisclosure is not required for that consumer, even though more accurate information becomes available before the first transaction. For example, in an open-end plan to be secured by real estate, the creditor may estimate the appraisal fees to be charged; such an estimate might reasonably be based on the prevailing market rates for similar appraisals. If the exact appraisal fee is determinable after the estimate is furnished but before the consumer receives the first advance under the plan, no new disclosure is necessary.

5(d) Multiple creditors; multiple consumers.

1. Multiple creditors. Under § 226.5(d):

i. Creditors must choose which of them will make the disclosures.

ii. A single, complete set of disclosures must be provided, rather than partial disclosures from several creditors.

iii. All disclosures for the open-end credit plan must be given, even if the disclosing creditor would not otherwise have been obligated to make a particular disclosure.

2. Multiple consumers. Disclosures may be made to either obligor on a joint account. Disclosure responsibilities are not satisfied by giving disclosures to only a surety or guarantor for a principal obligor or to an authorized user. In rescindable transactions, however, separate disclosures must be given to each consumer who has the right to rescind under § 226.15.

3. Card issuer and person extending credit not the same person. Section 127(c)(4)(D) of the Truth in Lending Act (*15 U.S.C. 1637(c)(4)(D)*) contains rules pertaining to charge card issuers with plans that allow access to an open-end credit plan that is maintained by a person other than the charge card issuer. These rules are not implemented in Regulation Z (although they were formerly implemented in § 226.5a(f)). However, the statutory provisions remain in effect and may be used by charge card issuers with plans meeting the specified criteria.

5(e) Effect of subsequent events.

1. Events causing inaccuracies. Inaccuracies in disclosures are not violations if attributable to events occurring after disclosures are made. For example, when the consumer fails to fulfill a prior commitment to keep the collateral insured and the creditor then provides the coverage and charges the consumer for it, such a change does not make the original disclosures inaccurate. The creditor may, however, be required to provide a new disclosure(s) under § 226.9(c).

2. Use of inserts. When changes in a creditor's plan affect required disclosures, the creditor may use inserts with outdated disclosure forms. Any insert:

i. Should clearly refer to the disclosure provision it replaces.

ii. Need not be physically attached or affixed to the basic disclosure statement.

iii. May be used only until the supply of outdated forms is exhausted.

Section 226.5a --Credit and Charge Card Applications and Solicitations

1. General. Section 226.5a generally requires that credit disclosures be contained in application forms and solicitations initiated by a card issuer to open a credit or charge card account. (See § 226.5a(a)(5) and (e)(2) for exceptions; see § 226.5a(a)(1) and accompanying commentary for the definition of solicitation; see also § 226.2(a)(15) and accompanying commentary for the definition of charge card.)

2. Substitution of account-opening summary table for the disclosures required by § 226.5a. In complying with § 226.5a(c), (e)(1) or (f), a card issuer may provide the account-opening summary table described in § 226.6(b)(1) in lieu of the disclosures required by § 226.5a, if the issuer provides the disclosures required by § 226.6 on or with the application or solicitation.

3. Clear and conspicuous standard. See comment 5(a)(1)-1 for the clear and conspicuous standard applicable to § 226.5a disclosures.

5a(a) General rules.

5a(a)(1) Definition of solicitation.

1. Invitations to apply. A card issuer may contact a consumer who has not been preapproved for a card account about opening an account (whether by direct mail, telephone, or other means) and invite the consumer to complete an application. Such a contact does not meet the definition of solicitation, nor is it covered by this section, unless the contact itself includes an application form in a direct mailing, electronic communication or "take-one"; an oral application in a telephone contact initiated by the card issuer; or an application in an in-person contact initiated by the card issuer.

5a(a)(2) Form of disclosures; tabular format.

1. Location of table.

i. General. Except for disclosures given electronically, disclosures in § 226.5a(b) that are required to be provided in a table must be prominently located on or with the application or solicitation. Disclosures are deemed to be

prominently located, for example, if the disclosures are on the same page as an application or solicitation reply form. If the disclosures appear elsewhere, they are deemed to be prominently located if the application or solicitation reply form contains a clear and conspicuous reference to the location of the disclosures and indicates that they contain rate, fee, and other cost information, as applicable.

ii. Electronic disclosures. If the table is provided electronically, the table must be provided in close proximity to the application or solicitation. Card issuers have flexibility in satisfying this requirement. Methods card issuers could use to satisfy the requirement include, but are not limited to, the following examples:

A. The disclosures could automatically appear on the screen when the application or reply form appears;

B. The disclosures could be located on the same Web page as the application or reply form (whether or not they appear on the initial screen), if the application or reply form contains a clear and conspicuous reference to the location of the disclosures and indicates that the disclosures contain rate, fee, and other cost information, as applicable;

C. Card issuers could provide a link to the electronic disclosures on or with the application (or reply form) as long as consumers cannot bypass the disclosures before submitting the application or reply form. The link would take the consumer to the disclosures, but the consumer need not be required to scroll completely through the disclosures; or

D. The disclosures could be located on the same Web page as the application or reply form without necessarily appearing on the initial screen, immediately preceding the button that the consumer will click to submit the application or reply.

Whatever method is used, a card issuer need not confirm that the consumer has read the disclosures.

2. Multiple accounts. If a tabular format is required to be used, card issuers offering several types of accounts may disclose the various terms for the accounts in a single table or may provide a separate table for each account.

3. Information permitted in the table. See the commentary to § 226.5a(b), (d), and (e)(1) for guidance on additional information permitted in the table.

4. Deletion of inapplicable disclosures. Generally, disclosures need only be given as applicable. Card issuers may, therefore, omit inapplicable headings and their corresponding boxes in the table. For example, if no foreign transaction fee is imposed on the account, the heading Foreign transaction and disclosure may be deleted from the table or the disclosure form may contain the heading Foreign transaction and a disclosure showing none. There is an exception for the grace period disclosure; even if no grace period exists, that fact must be stated.

5. Highlighting of annual percentage rates and fee amounts.

i. In general. See Samples G-10(B) and G-10(C) for guidance on providing the disclosures described in § 226.5a(a)(2)(iv) in bold text. Other annual percentage rates or fee amounts disclosed in the table may not be in bold text. Samples G-10(B) and G-10(C) also provide guidance to issuers on how to disclose the rates and fees described in § 226.5a(a)(2)(iv) in a clear and conspicuous manner, by including these rates and fees generally as the first text in the applicable rows of the table so that the highlighted rates and fees generally are aligned vertically in the table.

ii. Maximum limits on fees. Section 226.5a(a)(2)(iv) provides that any maximum limits on fee amounts unrelated to fees that vary by state may not be disclosed in bold text. For example, assume an issuer will charge a cash advance fee of $5 or 3 percent of the cash advance transaction amount, whichever is greater, but the fee will not exceed $100. The maximum limit of $100 for the cash advance fee must not be highlighted in bold. Nonetheless, assume that the amount of the late fee varies by state, and the range of amount of late fees disclosed is $15-$25. In this case, the maximum limit of $25 on the late fee amounts must be highlighted in bold. In both cases, the minimum fee amount (e.g. $5 or $15) must be disclosed in bold text.

iii. Periodic fees. Section 226.5a(a)(2)(iv) provides that any periodic fee disclosed pursuant to § 226.5a(b)(2) that is not an annualized amount must not be disclosed in bold. For example, if an issuer imposes a $10 monthly maintenance fee for a card account, the issuer must disclose in the table that there is a $10 monthly maintenance fee, and that the fee is $120 on an annual basis. In this example, the $10 fee disclosure would not be disclosed in bold, but the $120 annualized amount must be disclosed in bold. In addition, if an issuer must disclose any annual fee in the table, the amount of the annual fee must be disclosed in bold.

6. Form of disclosures. Whether disclosures must be in electronic form depends upon the following:

i. If a consumer accesses a credit card application or solicitation electronically (other than as described under ii. below), such as on-line at a home computer, the card issuer must provide the disclosures in electronic form (such as with the application or solicitation on its Web site) in order to meet the requirement to provide disclosures in a timely manner on or with the application or solicitation. If the issuer instead mailed paper disclosures to the consumer, this requirement would not be met.

ii. In contrast, if a consumer is physically present in the card issuer's office, and accesses a credit card application or solicitation electronically, such as via a terminal or kiosk (or if the consumer uses a terminal or kiosk located on the premises of an affiliate or third party that has arranged with the card issuer to provide applications or solicitations to consumers), the issuer may provide disclosures in either electronic or paper form, provided the issuer complies with the timing and delivery ("on or with") requirements of the regulation.

7. Terminology. Section 226.5a(a)(2)(i) generally requires that the headings, content and format of the tabular disclosures be substantially similar, but need not be identical, to the applicable tables in appendix G-10 to part 226; but See § 226.5(a)(2) for terminology requirements applicable to § 226.5a disclosures.

5a(a)(4) Fees that vary by state.

1. Manner of disclosing range. If the card issuer discloses a range of fees instead of disclosing the amount of the specific fee applicable to the consumer's account, the range may be stated as the lowest authorized fee (zero, if there are one or more states where no fee applies) to the highest authorized fee.

5a(a)(5) Exceptions.

1. Noncoverage of consumer-initiated requests. Applications provided to a consumer upon request are not covered by § 226.5a, even if the request is made in response to the card issuer's invitation to apply for a card account. To illustrate, if a card issuer invites consumers to call a toll-free number or to return a response card to obtain an application, the application sent in response to the consumer's request need not contain the disclosures required under § 226.5a. Similarly, if the card issuer invites consumers to call and make an oral application on the telephone, § 226.5a does not apply to the application made by the consumer. If, however, the card issuer calls a consumer or initiates a telephone discussion with a consumer about opening a card account and contemporaneously takes an oral application, such applications are subject to § 226.5a, specifically § 226.5a(d). Likewise, if the card issuer initiates an in-person discussion with a consumer about opening a card account and contemporaneously takes an application, such applications are subject to § 226.5a, specifically § 226.5a(f).

5a(b) Required disclosures.

1. Tabular format. Provisions in § 226.5a(b) and its commentary provide that certain information must appear or is permitted to appear in a table. The tabular format is required for § 226.5a(b) disclosures given pursuant to § 226.5a(c), (d)(2), (e)(1) and (f). The tabular format does not apply to oral disclosures given pursuant to § 226.5a(d)(1). (See § 226.5a(a)(2).)

2. Accuracy. Rules concerning accuracy of the disclosures required by § 226.5a(b), including variable rate disclosures, are stated in § 226.5a(c)(2), (d)(3), and (e)(4), as applicable.

5a(b)(1) Annual percentage rate.

1. Variable-rate accounts--definition. For purposes of § 226.5a(b)(1), a variable-rate account exists when rate changes are part of the plan and are tied to an index or formula. (See the commentary to § 226.6(b)(4)(ii) for examples of variable-rate plans.)

2. Variable-rate accounts--fact that rate varies and how the rate will be determined. In describing how the applicable rate will be determined, the card issuer must identify in the table the type of index or formula used, such as the prime rate. In describing the index, the issuer may not include in the table details about the index. For example, if the issuer uses a prime rate, the issuer must disclose the rate as a "prime rate" and may not disclose in the table other details about the prime rate, such as the fact that it is the highest prime rate published in the Wall Street Journal two business days before the closing date of the statement for each billing period. The issuer may not disclose in the table the current value of the index (such as that the prime rate is currently 7.5 percent) or the amount of the margin or spread added to the index or formula in setting the applicable rate. A card issuer may not disclose any applicable limitations on rate increases or decreases in the table, such as describing that the rate will not go below a certain rate or higher than a certain rate. (See Samples G-10(B) and G-10(C) for guidance on how to disclose the fact that the applicable rate varies and how it is determined.)

3. Discounted initial rates.

i. Immediate proximity. If the term "introductory" is in the same phrase as the introductory rate, as that term is defined in § 226.16(g)(2)(ii), it will be deemed to be in immediate proximity of the listing. For example, an issuer that uses the phrase "introductory balance transfer APR X percent" has used the word "introductory" within the same phrase as the rate. (See Sample G-10(C) for guidance on how to disclose clearly and conspicuously the expiration date of the introductory rate and the rate that will apply after the introductory rate expires, if an introductory rate is disclosed in the table.)

ii. Subsequent changes in terms. The fact that an issuer may reserve the right to change a rate subsequent to account opening, pursuant to the notice requirements of § 226.9(c) and the limitations in § 226.55, does not, by itself, make that rate an introductory rate. For example, assume an issuer discloses an annual percentage rate for purchases of 12.99% but does not specify a time period during which that rate will be in effect. Even if that issuer subsequently increases the annual percentage rate for purchases to 15.99%, pursuant to a change-in-terms notice provided under § 226.9(c), the 12.99% is not an introductory rate.

iii. More than one introductory rate. If more than one introductory rate may apply to a particular balance in succeeding periods, the term "introductory" need only be used to describe the first introductory rate. For example, if an issuer offers a rate of 8.99% on purchases for six months, 10.99% on purchases for the following six months, and 14.99% on purchases after the first year, the term "introductory" need only be used to describe the 8.99% rate.

4. Premium initial rates--subsequent changes in terms. The fact that an issuer may reserve the right to change a rate subsequent to account opening, pursuant to the notice requirements of § 226.9(c) and the limitations in § 226.55 (as applicable), does not, by itself, make that rate a premium initial rate. For example, assume an issuer discloses an annual percentage rate for purchases of 18.99% but does not specify a time period during which that rate will be in effect. Even if that issuer subsequently reduces the annual percentage rate for purchases to 15.99%, the 18.99% is not a premium initial rate. If the rate decrease is the result of a change from a non-variable rate to a variable rate or from a variable rate to a non-variable rate, see comments 9(c)(2)(v)-3 and 9(c)(2)(v)-4 for guidance on the notice requirements under § 226.9(c).

5. Increased penalty rates.

i. In general. For rates that are not introductory rates, if a rate may increase as a penalty for one or more events specified in the account agreement, such as a late payment or an extension of credit that exceeds the credit limit, the card issuer must disclose the increased rate that would apply, a brief description of the event or events that may result in the increased rate, and a brief description of how long the increased rate will remain in effect. The description of the specific event or events that may result in an increased rate should be brief. For example, if an issuer may increase a rate to the penalty rate because the consumer does not make the minimum payment by 5 p.m., Eastern Time, on its payment due date, the issuer should describe this circumstance in the table as "make a late payment." Similarly, if an issuer may increase a rate that applies to a particular balance because the account is more than 60 days late, the issuer should describe this circumstance in the table as "make a late payment." An issuer may not distinguish between the events that may result in an increased rate for existing balances and the events that may result in an increased rate for new transactions. (See Samples G-10(B) and G-10(C) (in the row labeled "Penalty APR and When it Applies") for additional guidance on the level of detail in which the specific event or events should be described.) The description of how long the increased rate will remain in effect also should be brief. If a card issuer reserves the right to apply the increased rate indefinitely, that fact should be stated. (See Samples G-10(B) and G-10(C) (in the row labeled "Penalty APR and When it Applies") for additional guidance on the level of detail which the issuer should use to describe how long the increased rate will remain in effect.) A card issuer will be deemed to meet the standard to clearly and conspicuously disclose the information required by § 226.5a(b)(1)(iv)(A) if the issuer uses the format shown in Samples G-10(B) and G-10(C) (in the row labeled "Penalty APR and When it Applies") to disclose this information.

ii. Introductory rates--general. An issuer is required to disclose directly beneath the table the circumstances under which an introductory rate, as that term is defined in § 226.16(g)(2)(ii), may be revoked, and the rate that will apply after the revocation. This information about revocation of an introductory rate and the rate that will apply after revocation must be provided even if the rate that will apply after the introductory rate is revoked is the rate that would have applied at the end of the promotional period. In a variable-rate account, the rate that would have applied at the end of the promotional period is a rate based on the applicable index or formula in accordance with the accuracy requirements set forth in § 226.5a(c)(2) or (e)(4). In describing the rate that will apply after revocation of the introductory rate, if the rate that will apply after revocation of the introductory rate is already disclosed in the table, the issuer is not required to repeat the rate, but may refer to that rate in a clear and conspicuous manner. For example, if the rate that will apply after revocation of an introductory rate is the standard rate that applies to that type of transaction (such as a purchase or balance transfer transaction), and the standard rates are labeled in the table as "standard APRs," the issuer may refer to the "standard APR" when describing the rate that will apply after revocation of an introductory

rate. (See Sample G-10(C) in the disclosure labeled "Loss of Introductory APR" directly beneath the table.) The description of the circumstances in which an introductory rate could be revoked should be brief. For example, if an issuer may increase an introductory rate because the account is more than 60 days late, the issuer should describe this circumstance in the table as "make a late payment." In addition, if the circumstances in which an introductory rate could be revoked are already listed elsewhere in the table, the issuer is not required to repeat the circumstances again, but may refer to those circumstances in a clear and conspicuous manner. For example, if the circumstances in which an introductory rate could be revoked are the same as the event or events that may trigger a "penalty rate" as described in § 226.5a(b)(1)(iv)(A), the issuer may refer to the actions listed in the Penalty APR row, in describing the circumstances in which the introductory rate could be revoked. (See Sample G-10(C) in the disclosure labeled "Loss of Introductory APR" directly beneath the table for additional guidance on the level of detail in which to describe the circumstances in which an introductory rate could be revoked.) A card issuer will be deemed to meet the standard to clearly and conspicuously disclose the information required by § 226.5a(b)(1)(iv)(B) if the issuer uses the format shown in Sample G-10(C) to disclose this information.

iii. Introductory rates--limitations on revocation. Issuers that are disclosing an introductory rate are prohibited by § 226.55 from increasing or revoking the introductory rate before it expires unless the consumer fails to make a required minimum periodic payment within 60 days after the due date for the payment. In making the required disclosure pursuant to § 226.5a(b)(1)(iv)(B), issuers should describe this circumstance directly beneath the table as "make a late payment."

6. Rates that depend on consumer's creditworthiness.

i. In general. The card issuer, at its option, may disclose the possible rates that may apply as either specific rates, or a range of rates. For example, if there are three possible rates that may apply (9.99, 12.99 or 17.99 percent), an issuer may disclose specific rates (9.99, 12.99 or 17.99 percent) or a range of rates (9.99 to 17.99 percent). The card issuer may not disclose only the lowest, highest or median rate that could apply. (See Samples G-10(B) and G-10(C) for guidance on how to disclose a range of rates.)

ii. Penalty rates. If the rate is a penalty rate, as described in § 226.5a(b)(1)(iv), the card issuer at its option may disclose the highest rate that could apply, instead of disclosing the specific rates or the range of rates that could apply. For example, if the penalty rate could be up to 28.99 percent, but the issuer may impose a penalty rate that is less than that rate depending on factors at the time the penalty rate is imposed, the issuer may disclose the penalty rate as "up to" 28.99 percent. The issuer also must include a statement that the penalty rate for which the consumer may qualify will depend on the consumer's creditworthiness, and other factors if applicable.

iii. Other factors. Section 226.5a(b)(1)(v) applies even if other factors are used in combination with a consumer's creditworthiness to determine the rate for which a consumer may qualify at account opening. For example, § 226.5a(b)(1)(v) would apply if the issuer considers the type of purchase the consumer is making at the time the consumer opens the account, in combination with the consumer's creditworthiness, to determine the rate for which the consumer may qualify at account opening. If other factors are considered, the issuer should amend the statement about creditworthiness, to indicate that the rate for which the consumer may qualify at account opening will depend on the

consumer's creditworthiness and other factors. Nonetheless, § 226.5a(b)(1)(v) does not apply if a consumer's creditworthiness is not one of the factors that will determine the rate for which the consumer may qualify at account opening (for example, if the rate is based solely on the type of purchase that the consumer is making at the time the consumer opens the account, or is based solely on whether the consumer has other banking relationships with the card issuer).

7. Rate based on another rate on the account. In some cases, one rate may be based on another rate on the account. For example, assume that a penalty rate as described in § 226.5a(b)(1)(iv)(A) is determined by adding 5 percentage points to the current purchase rate, which is 10 percent. In this example, the card issuer in disclosing the penalty rate must disclose 15 percent as the current penalty rate. If the purchase rate is a variable rate, then the penalty rate also is a variable rate. In that case, the card issuer also must disclose the fact that the penalty rate may vary and how the rate is determined, such as "This APR may vary with the market based on the Prime Rate." In describing the penalty rate, the issuer shall not disclose in the table the amount of the margin or spread added to the current purchase rate to determine the penalty rate, such as describing that the penalty rate is determined by adding 5 percentage points to the purchase rate. (See § 226.5a(b)(1)(i) and comment 5a(b)(1)-2 for further guidance on describing a variable rate.)

8. Rates. The only rates that shall be disclosed in the table are annual percentage rates determined under § 226.14(b). Periodic rates shall not be disclosed in the table.

9. Deferred interest or similar transactions. An issuer offering a deferred interest or similar plan, such as a promotional program that provides that a consumer will not be obligated to pay interest that accrues on a balance if that balance is paid in full prior to the expiration of a specified period of time, may not disclose a 0% rate as the rate applicable to deferred interest or similar transactions if there are any circumstances under which the consumer will be obligated for interest on such transactions for the deferred interest or similar period.

5a(b)(2) Fees for issuance or availability.

1. Membership fees. Membership fees for opening an account must be disclosed under this paragraph. A membership fee to join an organization that provides a credit or charge card as a privilege of membership must be disclosed only if the card is issued automatically upon membership. Such a fee shall not be disclosed in the table if membership results merely in eligibility to apply for an account.

2. Enhancements. Fees for optional services in addition to basic membership privileges in a credit or charge card account (for example, travel insurance or card-registration services) shall not be disclosed in the table if the basic account may be opened without paying such fees. Issuing a card to each primary cardholder (not authorized users) is considered a basic membership privilege and fees for additional cards, beyond the first card on the account, must be disclosed as a fee for issuance or availability. Thus, a fee to obtain an additional card on the account beyond the first card (so that each cardholder would have his or her own card) must be disclosed in the table as a fee for issuance or availability under § 226.5a(b)(2). This fee must be disclosed even if the fee is optional; that is, if the fee is charged only

if the cardholder requests one or more additional cards. (See the available credit disclosure in § 226.5a(b)(14).)

3. One-time fees. Disclosure of non-periodic fees is limited to fees related to opening the account, such as one-time membership or participation fees, or an application fee that is excludable from the finance charge under § 226.4(c)(1). The following are examples of fees that shall not be disclosed in the table:

i. Fees for reissuing a lost or stolen card.

ii. Statement reproduction fees.

4. Waived or reduced fees. If fees required to be disclosed are waived or reduced for a limited time, the introductory fees or the fact of fee waivers may be provided in the table in addition to the required fees if the card issuer also discloses how long the reduced fees or waivers will remain in effect.

5. Periodic fees and one-time fees. A card issuer disclosing a periodic fee must disclose the amount of the fee, how frequently it will be imposed, and the annualized amount of the fee. A card issuer disclosing a non-periodic fee must disclose that the fee is a one-time fee. (See Sample G-10(C) for guidance on how to meet these requirements.)

5a(b)(3) Fixed finance charge; minimum interest charge.

1. Example of brief statement. See Samples G-10(B) and G-10(C) for guidance on how to provide a brief description of a minimum interest charge.

2. Adjustment of $1.00 threshold amount. Consistent with § 226.5a(b)(3), the Board will publish adjustments to the $1.00 threshold amount, as appropriate.

5a(b)(4) Transaction charges.

1. Charges imposed by person other than card issuer. Charges imposed by a third party, such as a seller of goods, shall not be disclosed in the table under this section; the third party would be responsible for disclosing the charge under § 226.9(d)(1).

2. Foreign transaction fees. A transaction charge imposed by the card issuer for the use of the card for purchases includes any fee imposed by the issuer for purchases in a foreign currency or that take place outside the United States or with a foreign merchant. (See comment 4(a)-4 for guidance on when a foreign transaction fee is considered charged by the card issuer.) If an issuer charges the same foreign transaction fee for purchases and cash advances in a foreign currency, or that take place outside the United States or with a foreign merchant, the issuer may disclose this foreign transaction fee as shown in Samples G-10(B) and G-10(C). Otherwise, the issuer must revise the foreign transaction fee language shown in Samples G-10(B) and G-10(C) to disclose clearly and conspicuously the amount of the foreign transaction fee that applies to purchases and the amount of the foreign transaction fee that applies to cash advances.

5a(b)(5) Grace period.

1. How grace period disclosure is made. The card issuer must state any conditions on the applicability of the grace period. An issuer that offers a grace period on all purchases and conditions the grace period on the consumer paying his or her outstanding balance in full by the due date each billing cycle, or on the consumer paying the outstanding balance in full by the due date in the previous and/or the current billing cycle(s) will be deemed to meet these requirements by providing the following disclosure, as applicable: "Your due date is [at least days after the close of each billing cycle. We will not charge you any interest on purchases if you pay your entire balance by the due date each month."

2. No grace period. The issuer may use the following language to describe that no grace period on any purchases is offered, as applicable: "We will begin charging interest on purchases on the transaction date."

3. Grace period on some purchases. If the issuer provides a grace period on some types of purchases but no grace period on others, the issuer may combine and revise the language in comments 5a(b)(5)-1 and -2 as appropriate to describe to which types of purchases a grace period applies and to which types of purchases no grace period is offered.

4. Limitations on the imposition of finance charges in § 226.54. Section 226.5a(b)(5) does not require a card issuer to disclose the limitations on the imposition of finance charges in § 226.54.

5a(b)(6) Balance computation method.

1. Form of disclosure. In cases where the card issuer uses a balance computation method that is identified by name in the regulation, the card issuer must disclose below the table only the name of the method. In cases where the card issuer uses a balance computation method that is not identified by name in the regulation, the disclosure below the table must clearly explain the method in as much detail as set forth in the descriptions of balance methods in § 226.5a(g). The explanation need not be as detailed as that required for the disclosures under § 226.6(b)(4)(i)(D). (See the commentary

to § 226.5a(g) for guidance on particular methods.)

2. Determining the method. In determining which balance computation method to disclose for purchases, the card issuer must assume that a purchase balance will exist at the end of any grace period. Thus, for example, if the average daily balance method will include new purchases only if purchase balances are not paid within the grace period, the card issuer would disclose the name of the average daily balance method that includes new purchases. The card issuer must not assume the existence of a purchase balance, however, in making other disclosures under § 226.5a(b).

5a(b)(7) Statement on charge card payments.

1. Applicability and content. The disclosure that charges are payable upon receipt of the periodic statement is applicable only to charge card accounts. In making this disclosure, the card issuer may make such modifications as are necessary to more accurately reflect the circumstances of repayment under the account. For example, the disclosure might read, "Charges are due and payable upon receipt of the periodic statement and must be paid no later than 15 days after receipt of such statement."

5a(b)(8) Cash advance fee.

1. Content. See Samples G-10(B) and G-10(C) for guidance on how to disclose clearly and conspicuously the cash advance fee.

2. Foreign cash advances. Cash advance fees required to be disclosed under § 226.5a(b)(8) include any charge imposed by the card issuer for cash advances in a foreign currency or that take place outside the United States or with a foreign merchant. (See comment 4(a)-4 for guidance on when a foreign transaction fee is considered charged by the card issuer.) If an issuer charges the same foreign transaction fee for purchases and cash advances in a foreign currency or that take place outside the United States or with a foreign merchant, the issuer may disclose this foreign transaction fee as shown in Samples G-10(B) and (C). Otherwise, the issuer must revise the foreign transaction fee language shown in Samples G-10(B) and (C) to disclose clearly and conspicuously the amount of the foreign transaction fee that applies to purchases and the amount of the foreign transaction fee that applies to cash advances.

3. ATM fees. An issuer is not required to disclose pursuant to § 226.5a(b)(8) any charges imposed on a cardholder by an institution other than the card issuer for the use of the other institution's ATM in a shared or interchange system.

5a(b)(9) Late payment fee.

1. Applicability. The disclosure of the fee for a late payment includes only those fees that will be imposed for actual, unanticipated late payments. (See the commentary to § 226.4(c)(2) for additional guidance on late payment fees. See Samples G-10(B) and G-10(C) for guidance on how to disclose clearly and conspicuously the late payment fee.)

5a(b)(10) Over-the-limit fee.

1. Applicability. The disclosure of fees for exceeding a credit limit does not include fees for other types of default or for services related to exceeding the limit. For example, no disclosure is required of fees for reinstating credit privileges or fees for the dishonor of checks on an account that, if paid, would cause the credit limit to be exceeded. (See Samples G-10(B) and G-10(C) for guidance on how to disclose clearly and conspicuously the over-the-limit fee.)

Required insurance, debt cancellation, or debt suspension coverage.

1. Content. See Sample G-10(B) for guidance on how to comply with the requirements in § 226.5a(b)(13).

5a(b)(14) Available credit.

1. Calculating available credit. If the 15 percent threshold test is met, the issuer must disclose the available credit excluding optional fees, and the available credit including optional fees. In calculating the available credit to disclose in the table, the issuer must consider all fees for the issuance or availability of credit described in § 226.5a(b)(2), and any security deposit, that will be imposed and charged to the account when the account is opened, such as one-time issuance and set-up fees. For example, in calculating the available credit, issuers must consider the first year's annual fee and the first month's maintenance fee (as applicable) if they are charged to the account on the first billing statement. In calculating the amount of the available credit including optional fees, if optional fees could be charged multiple times, the issuer shall assume that the optional fee is only imposed once. For example, if an issuer charges a fee for each additional card issued on the account, the issuer in calculating the amount of the available credit including optional fees may assume that the cardholder requests only one additional card. In disclosing the available credit, the issuer shall round down the available credit amount to the nearest whole dollar.

2. Content. See Sample G-10(C) for guidance on how to provide the disclosure required by § 226.5a(b)(14) clearly and conspicuously.

5a(b)(15) Web site reference.

1. Content. See Samples G-10(B) and G-10(C) for guidance on disclosing a reference to the Web site established

by the Board and a statement that consumers may obtain on the Web site information about shopping for and using credit card accounts.

5a(c) Direct mail and electronic applications and solicitations.

1. Mailed publications. Applications or solicitations contained in generally available publications mailed to consumers (such as subscription magazines) are subject to the requirements applicable to take-ones in § 226.5a(e), rather than the direct mail requirements of § 226.5a(c). However, if a primary purpose of a card issuer's mailing is to offer credit or charge card accounts--for example, where a card issuer "prescreens" a list of potential cardholders using credit criteria, and then mails to the targeted group its catalog containing an application or a solicitation for a card account--the direct mail rules apply. In addition, a card issuer may use a single application form as a take-one (in racks in public locations, for example) and for direct mailings, if the card issuer complies with the requirements of § 226.5a(c) even when the form is used as a take-one --that is, by presenting the required § 226.5a disclosures in a tabular format. When used in a direct mailing, the credit term disclosures must be accurate as of the mailing date whether or not the § 226.5a(e)(1)(ii) and (e)(1)(iii) disclosures are included; when used in a take-one, the disclosures must be accurate for as long as the take-one forms remain available to the public if the § 226.5a(e)(1)(ii) and (e)(1)(iii) disclosures are omitted. (If those disclosures are included in the take-one, the credit term disclosures need only be accurate as of the printing date.)

5a(d) Telephone applications and solicitations.

1. Coverage.

i. This paragraph applies if:

A. A telephone conversation between a card issuer and consumer may result in the issuance of a card as a consequence of an issuer-initiated offer to open an account for which the issuer does not require any application (that is, a prescreened telephone solicitation).

B. The card issuer initiates the contact and at the same time takes application information over the telephone.

ii. This paragraph does not apply to:

A. Telephone applications initiated by the consumer.

B. Situations where no card will be issued--because, for example, the consumer indicates that he or she does not want the card, or the card issuer decides either during the telephone conversation or later not to issue the card.

2. Right to reject the plan. The right to reject the plan referenced in this paragraph is the same as the right to reject the plan described in § 226.5(b)(1)(iv). If an issuer substitutes the account-opening summary table described in § 226.6(b)(1) in lieu of the disclosures specified in § 226.5a(d)(2)(ii), the disclosure specified in § 226.5a(d)(2)(ii)(B) must appear in the table, if the issuer is required to do so pursuant to § 226.6(b)(2)(xiii). Otherwise, the disclosure specified in § 226.5a(d)(2)(ii)(B) may appear either in or outside the table containing the required credit disclosures.

3. Substituting account-opening table for alternative written disclosures. An issuer may substitute the account-opening summary table described in § 226.6(b)(1) in lieu of the disclosures specified in § 226.5a(d)(2)(ii).

Applications and solicitations made available to general public.

1. Coverage. Applications and solicitations made available to the general public include what are commonly referred to as take-one applications typically found at counters in banks and retail establishments, as well as applications contained in catalogs, magazines and other generally available publications. In the case of credit unions, this paragraph applies to applications and solicitations to open card accounts made available to those in the general field of membership.

2. In-person applications and solicitations. In-person applications and solicitations initiated by a card issuer are subject to § 226.5a(f), not § 226.5a(e). (See § 226.5a(f) and accompanying commentary for rules relating to in-person applications and solicitations.)

3. Toll-free telephone number. If a card issuer, in complying with any of the disclosure options of § 226.5a(e), provides a telephone number for consumers to call to obtain credit information, the number must be toll-free for nonlocal calls made from an area code other than the one used in the card issuer's dialing area. Alternatively, a card issuer may provide any telephone number that allows a consumer to call for information and reverse the telephone charges.

Disclosure of required credit information.

1. Date of printing. Disclosure of the month and year fulfills the requirement to disclose the date an application was printed.

2. Form of disclosures. The disclosures specified in § 226.5a(e)(1)(ii) and (e)(1)(iii) may appear either in or

outside the table containing the required credit disclosures.

No disclosure of credit information.

1. When disclosure option available. A card issuer may use this option only if the issuer does not include on or with the application or solicitation any statement that refers to the credit disclosures required by § 226.5a(b). Statements such as no annual fee, low interest rate, favorable rates, and low costs are deemed to refer to the required credit disclosures and, therefore, may not be included on or with the solicitation or application, if the card issuer chooses to use this option.

5a(e)(3) Prompt response to requests for information.

1. Prompt disclosure. Information is promptly disclosed if it is given within 30 days of a consumer's request for information but in no event later than delivery of the credit or charge card.

2. Information disclosed. When a consumer requests credit information, card issuers need not provide all the required credit disclosures in all instances. For example, if disclosures have been provided in accordance with § 226.5a(e)(1) and a consumer calls or writes a card issuer to obtain information about changes in the disclosures, the issuer need only provide the items of information that have changed from those previously disclosed on or with the application or solicitation. If a consumer requests information about particular items, the card issuer need only provide the requested information. If, however, the card issuer has made disclosures in accordance with the option in § 226.5a(e)(2) and a consumer calls or writes the card issuer requesting information about costs, all the required disclosure information must be given.

3. Manner of response. A card issuer's response to a consumer's request for credit information may be provided orally or in writing, regardless of the manner in which the consumer's request is received by the issuer. Furthermore, the card issuer must provide the information listed in § 226.5a(e)(1). Information provided in writing need not be in a tabular format.

5a(f) In-person applications and solicitations.

1. Coverage.

i. This paragraph applies if:

A. An in-person conversation between a card issuer and a consumer may result in the issuance of a card as a consequence of an issuer-initiated offer to open an account for which the issuer does not require any application (that is, a preapproved in-person solicitation).

B. The card issuer initiates the contact and at the same time takes application information in person. For example, the following are covered:

1. A consumer applies in person for a car loan at a financial institution and the loan officer invites the consumer to apply for a credit or charge card account; the consumer accepts the invitation and submits an application.

2. An employee of a retail establishment, in the course of processing a sales transaction using a bank credit card, asks a customer if he or she would like to apply for the retailer's credit or charge card; the customer responds affirmatively and submits an application.

ii. This paragraph does not apply to:

A. In-person applications initiated by the consumer.

B. Situations where no card will be issued--because, for example, the consumer indicates that he or she does not want the card, or the card issuer decides during the in-person conversation not to issue the card.

226.5b Requirements for Home Equity Plans

1. Coverage. This section applies to all open-end credit plans secured by the consumer's dwelling, as defined in § 226.2(a)(19), and is not limited to plans secured by the consumer's principal dwelling. (See the commentary to § 226.3(a), which discusses whether transactions are consumer or business-purpose credit, for guidance on whether a home equity plan is subject to Regulation Z.)

2. Changes to home equity plans entered into on or after November 7, 1989. Section 226.9(c) applies if, by written agreement under § 226.5b(f)(3)(iii), a creditor changes the terms of a home equity plan--entered into on or after November 7, 1989--at or before its scheduled expiration, for example, by renewing a plan on different terms. A new plan results, however, if the plan is renewed (with or without changes to the terms) after the scheduled expiration. The new plan is subject to all open-end credit rules, including §§ 226.5b, 226.6, and 226.15.

3. Transition rules and renewals of preexisting plans. The requirements of this section do not apply to home equity plans entered into before November 7, 1989. The requirements of this section also do not apply if the original consumer, on or after November 7, 1989, renews a plan entered into prior to that date (with or without changes to the terms). If, on or after November 7, 1989, a security interest in the consumer's dwelling is added to a line of credit entered into before that date, the substantive restrictions of this section apply for the remainder of the plan, but no new disclosures are required under this section.

4. Disclosure of repayment phase--applicability of requirements. Some plans provide in the initial agreement for a period during which no further draws may be taken and repayment of the amount borrowed is made. All of the applicable disclosures in this section must be given for the repayment phase. Thus, for example, a creditor must provide payment information about the repayment phase as well as about the draw period, as required by § 226.5b(d)(5). If the rate that will apply during the repayment phase is fixed at a known amount, the creditor must provide an annual percentage rate under § 226.5b(d)(6) for that phase. If, however, a creditor uses an index to determine the rate that will apply at the time of conversion to the repayment phase--even if the rate will thereafter be fixed--the creditor must provide the information in § 226.5b(d)(12), as applicable.

5. Payment terms--applicability of closed-end provisions and substantive rules. All payment terms that are provided for in the initial agreement are subject to the requirements of subpart B and not subpart C of the regulation. Payment terms that are subsequently added to the agreement may be subject to subpart B or to subpart C, depending on the circumstances. The following examples apply these general rules to different situations:

- If the initial agreement provides for a repayment phase or for other payment terms such as options permitting conversion of part or all of the balance to a fixed rate during the draw period, these terms must be disclosed pursuant to §§ 226.5b and 226.6, and not under subpart C. Furthermore, the creditor must continue to provide periodic statements under § 226.7 and comply with other provisions of subpart B (such as the substantive requirements of § 226.5b(f)) throughout the plan, including the repayment phase.

- If the consumer and the creditor enter into an agreement during the draw period to repay all or part of the principal balance on different terms (for example, with a fixed rate of interest) and the amount of available credit will be replenished as the principal balance is repaid, the creditor must continue to comply with subpart B. For example, the creditor must continue to provide periodic statements and comply with the substantive requirements of § 226.5b(f) throughout the plan.

- If the consumer and creditor enter into an agreement during the draw period to repay all or part of the principal balance and the amount of available credit will not be replenished as the principal balance is repaid, the creditor must give closed-end credit disclosures pursuant to subpart C for that new agreement. In such cases, subpart B, including the substantive rules, does not apply to the closed-end credit transaction, although it will continue to apply to any remaining open-end credit available under the plan.

6. Spreader clause. When a creditor holds a mortgage or deed of trust on the consumer's dwelling and that mortgage or deed of trust contains a spreader clause (also known as a dragnet or cross-collateralization clause), subsequent

occurrences such as the opening of an open-end plan are subject to the rules applicable to home equity plans to the same degree as if a security interest were taken directly to secure the plan, unless the creditor effectively waives its security interest under the spreader clause with respect to the subsequent open-end credit extensions.

5b(a) Form of Disclosure

5b(a)(1) General

1. Written disclosures. The disclosures required under this section must be clear and conspicuous and in writing, but need not be in a form the consumer can keep. (See the commentary to § 226.6(a)(3) for special rules when disclosures required under § 226.5b(d) are given in a retainable form.)

2. Disclosure of annual percentage rate--more conspicuous requirement. As provided in § 226.5(a)(2), when the term annual percentage rate is required to be disclosed with a number, it must be more conspicuous than other required disclosures.

3. Segregation of disclosures. While most of the disclosures must be grouped together and segregated from all unrelated information, the creditor is permitted to include information that explains or expands on the required disclosures, including, for example:

- Any prepayment penalty
- How a substitute index may be chosen
- Actions the creditor may take short of terminating and accelerating an outstanding balance
- Renewal terms
- Rebate of fees

An example of information that does not explain or expand on the required disclosures and thus cannot be included is the creditor's underwriting criteria, although the creditor could provide such information separately from the required disclosures.

4. Method of providing disclosures. A creditor may provide a single disclosure form for all of its home equity plans, as long as the disclosure describes all aspects of the plans. For example, if the creditor offers several payment options, all such options must be disclosed. (See, however, the commentary to § 226.5b(d)(5)(iii) and (d)(12)(x) and (xi) for disclosure requirements relating to these provisions.) If any aspects of a plan are linked together, the creditor must disclose clearly the relationship of the terms to each other. For example, if the consumer can only obtain a particular payment option in conjunction with a certain variable-rate feature, this fact must be disclosed. A creditor has the option

of providing separate disclosure forms for multiple options or variations in features. For example, a creditor that offers different payment options for the draw period may prepare separate disclosure forms for the two payment options. A creditor using this alternative, however, must include a statement on each disclosure form that the consumer should ask about the creditor's other home equity programs. (This disclosure is required only for those programs available generally to the public. Thus, if the only other programs available are employee preferred-rate plans, for example, the creditor would not have to provide this statement.) A creditor that receives a request for information about other available programs must provide the additional disclosures as soon as reasonably possible.

5. Form of electronic disclosures provided on or with electronic applications. Creditors must provide the disclosures required by this section (including the brochure) on or with a blank application that is made available to the consumer in electronic form, such as on a creditor's Internet Web site. Creditors have flexibility in satisfying this requirement. Methods creditors could use to satisfy the requirement include, but are not limited to, the following examples:

i. The disclosures could automatically appear on the screen when the application appears;

ii. The disclosures could be located on the same web page as the application (whether or not they appear on the initial screen), if the application contains a clear and conspicuous reference to the location of the disclosures and indicates that the disclosures contain rate, fee, and other cost information, as applicable;

iii. Creditors could provide a link to the electronic disclosures on or with the application as long as consumers cannot bypass the disclosures before submitting the application. The link would take the consumer to the disclosures, but the consumer need not be required to scroll completely through the disclosures; or

iv. The disclosures could be located on the same web page as the application without necessarily appearing on the initial screen, immediately preceding the button that the consumer will click to submit the application.

Whatever method is used, a creditor need not confirm that the consumer has read the disclosures.

5b(a)(2) Precedence of Certain Disclosures

1. Precedence rule. The list of conditions provided at the creditor's option under § 226.5b(d)(4)(iii) need not precede the other disclosures.

Paragraph 5b(a)(3)

1. Form of disclosures. Whether disclosures must be in electronic form depends upon the following:

i. If a consumer accesses a home equity credit line application electronically (other than as described under ii. below), such as online at a home computer, the creditor must provide the disclosures in electronic form (such as with the application form on its Web site) in order to meet the requirement to provide disclosures in a timely manner on or with the application. If the creditor instead mailed paper disclosures to the consumer, this requirement would not be met.

ii. In contrast, if a consumer is physically present in the creditor's office, and accesses a home equity credit line application electronically, such as via a terminal or kiosk (or if the consumer uses a terminal or kiosk located on the premises of an affiliate or third party that has arranged with the creditor to provide applications to consumers), the creditor may provide disclosures in either electronic or paper form, provided the creditor complies with the timing, delivery, and retainability requirements of the regulation.

5b(b) Time of Disclosures

1. Mail and telephone applications. If the creditor sends applications through the mail, the disclosures and a brochure must accompany the application. If an application is taken over the telephone, the disclosures and brochure may be delivered or mailed within three business days of taking the application. If an application is mailed to the consumer following a telephone request, however, the creditor also must send the disclosures and a brochure along with the application.

2. General purpose applications. The disclosures and a brochure need not be provided when a general purpose application is given to a consumer unless (1) the application or materials accompanying it indicate that it can be used to apply for a home equity plan or (2) the application is provided in response to a consumer's specific inquiry about a home equity plan. On the other hand, if a general purpose application is provided in response to a consumer's specific inquiry only about credit other than a home equity plan, the disclosures and brochure need not be provided even if the application indicates it can be used for a home equity plan, unless it is accompanied by promotional information about home equity plans.

3. Publicly-available applications. Some creditors make applications for home equity plans, such as take-ones, available without the need for a consumer to request them. These applications must be accompanied by the disclosures and a brochure, such as by attaching the disclosures and brochure to the application form.

4. Response cards. A creditor may solicit consumers for its home equity plan by mailing a response card which the consumer returns to the creditor to indicate interest in the plan. If the only action taken by the creditor upon receipt of the response card is to send the consumer an application form or to telephone the consumer to discuss the plan, the

creditor need not send the disclosures and brochure with the response card.

5. Denial or withdrawal of application. In situations where footnote 10a permits the creditor a three-day delay in providing disclosures and the brochure, if the creditor determines within that period that an application will not be approved, the creditor need not provide the consumer with the disclosures or brochure. Similarly, if the consumer withdraws the application within this three-day period, the creditor need not provide the disclosures or brochure.

6. Intermediary agent or broker. In determining whether or not an application involves an intermediary agent or broker as discussed in footnote 10a, creditors should consult the provisions in comment 19(b)-3.

5b(c) Duties of Third Parties

1. Intermediary agent or broker. Although third parties who give applications to consumers for home equity plans must provide the brochure required under § 226.5b(e) in all cases, such persons need provide the disclosures required under § 226.5b(d) only in certain instances. A third party has no duty to obtain disclosures about a creditor's home equity plan or to create a set of disclosures based on what it knows about a creditor's plan. If, however, a creditor provides the third party with disclosures along with its application form, the third party must give the disclosures to the consumer with the application form. The duties under this section are those of the third party; the creditor is not responsible for ensuring that a third party complies with those obligations. If an intermediary agent or broker takes an application over the telephone or receives an application contained in a magazine or other publication, footnote 10a permits that person to mail the disclosures and brochure within three business days of receipt of the application. (See the commentary to § 226.5b(h) about imposition of non-refundable fees.)

5b(d) Content of Disclosures

1. Disclosures given as applicable. The disclosures required under this section need be made only as applicable. Thus, for example, if negative amortization cannot occur in a home equity plan, a reference to it need not be made.

2. Duty to respond to requests for information. If the consumer, prior to the opening of a plan, requests information as suggested in the disclosures (such as the current index value or margin), the creditor must provide this information as soon as reasonably possible after the request.

5b(d)(1) Retention of Information

1. When disclosure not required. The creditor need not disclose that the consumer should make or otherwise retain a copy of the disclosures if they are retainable--for example, if the disclosures are not part of an application that must be returned to the creditor to apply for the plan.

5b(d)(2) Conditions for Disclosed Terms

Paragraph 5b(d)(2)(i)

1. Guaranteed terms. The requirement that the creditor disclose the time by which an application must be submitted to obtain the disclosed terms does not require the creditor to guarantee any terms. If a creditor chooses not to guarantee any terms, it must disclose that all of the terms are subject to change prior to opening the plan. The creditor also is permitted to guarantee some terms and not others, but must indicate which terms are subject to change.

2. Date for obtaining disclosed terms. The creditor may disclose either a specific date or a time period for obtaining the disclosed terms. If the creditor discloses a time period, the consumer must be able to determine from the disclosure the specific date by which an application must be submitted to obtain any guaranteed terms. For example, the disclosure might read, "To obtain the following terms, you must submit your application within 60 days after the date appearing on this disclosure," provided the disclosure form also shows the date.

Paragraph 5b(d)(2)(ii)

1. Relation to other provisions. Creditors should consult the rules in § 226.5b(g) regarding refund of fees.

5b(d)(4) Possible Actions by Creditor

Paragraph 5b(d)(4)(i)

1. Fees imposed upon termination. This disclosure applies only to fees (such as penalty or prepayment fees) that the creditor imposes if it terminates the plan prior to normal expiration. The disclosure does not apply to fees that are imposed either when the plan expires in accordance with the agreement or if the consumer terminates the plan prior to its scheduled maturity. In addition, the disclosure does not apply to fees associated with collection of the debt, such as attorneys fees and court costs, or to increases in the annual percentage rate linked to the consumer's failure to make payments. The actual amount of the fee need not be disclosed.

2. Changes specified in the initial agreement. If changes may occur pursuant to § 226.5b(f)(3)(i), a creditor must state that certain changes will be implemented as specified in the initial agreement.

Paragraph 5b(d)(4)(iii)

1. Disclosure of conditions. In making this disclosure, the creditor may provide a high-lighted copy of the document that contains such information, such as the contract or security agreement. The relevant items must be distinguished from the other information contained in the document. For example, the creditor may provide a cover sheet that specifically points out which contract provisions contain the information, or may mark the relevant items on the document itself. As an alternative to disclosing the conditions in this manner, the creditor may simply describe the conditions using the language in §§ 226.5b(f)(2)(i)-(iii), 226.5b(f)(3)(i) (regarding freezing the line when the maximum annual percentage rate is reached), and 226.5b(f)(3)(vi) or language that is substantially similar. The condition contained in § 226.5b(f)(2)(iv) need not be stated. In describing specified changes that may be implemented during the plan, the creditor may provide a disclosure such as "Our agreement permits us to make certain changes to the terms of the line at specified times or upon the occurrence of specified events."

2. Form of disclosure. The list of conditions under § 226.5b(d)(4)(iii) may appear with the segregated disclosures or apart from them. If the creditor elects to provide the list of conditions with the segregated disclosures, the list need not comply with the precedence rule in § 226.5b(a)(2).

5b(d)(5) Payment Terms

Paragraph 5b(d)(5)(i)

1. Length of the plan. The combined length of the draw period and any repayment period need not be stated. If the length of the repayment phase cannot be determined because, for example, it depends on the balance outstanding at the beginning of the repayment period, the creditor must state that the length is determined by the size of the balance. If the length of the plan is indefinite (for example, because there is no time limit on the period during which the consumer can take advances), the creditor must state that fact.

2. Renewal provisions. If, under the credit agreement, a creditor retains the right to review a line at the end of the specified draw period and determine whether to renew or extend the draw period of the plan, the possibility of renewal or extension--regardless of its likelihood--should be ignored for purposes of the disclosures. For example, if an agreement provides that the draw period is five years and that the creditor may renew the draw period for an additional five years, the possibility of renewal should be ignored and the draw period should be considered five years. (See the commentary accompanying § 226.9(c)(1) dealing with change in terms requirements.)

Paragraph 5b(d)(5)(ii)

1. Determination of the minimum periodic payment. This disclosure must reflect how the minimum periodic payment is determined, but need only describe the principal and interest components of the payment. Other charges that may be part of the payment (as well as the balance computation method) may, but need not, be described under this provision.

2. Fixed rate and term payment options during draw period. If the home equity plan permits the consumer to repay all or part of the balance during the draw period at a fixed rate (rather than a variable rate) and over a specified time period, this feature must be disclosed. To illustrate, a variable-rate plan may permit a consumer to elect during a ten-year draw period to repay all or a portion of the balance over a three-year period at a fixed rate. The creditor must disclose the rules relating to this feature including the period during which the option can be selected, the length of time over which repayment can occur, any fees imposed for such a feature, and the specific rate or a description of the index and margin that will apply upon exercise of this choice. For example, the index and margin disclosure might state, "If you choose to convert any portion of your balance to a fixed rate, the rate will be the highest prime rate published in the "Wall Street Journal" that is in effect at the date of conversion plus a margin." If the fixed rate is to be determined according to an index, it must be one that is outside the creditor's control and is publicly available in accordance with § 226.5b(f)(1). The effect of exercising the option should not be reflected elsewhere in the disclosures, such as in the historical example required in § 226.5b(d)(12)(xi).

3. Balloon payments. In programs where the occurrence of a balloon payment is possible, the creditor must disclose the possibility of a balloon payment even if such a payment is uncertain or unlikely. In such cases, the disclosure might read, "Your minimum payments may not be sufficient to fully repay the principal that is outstanding on your line. If they are not, you will be required to pay the entire outstanding balance in a single payment." In programs where a balloon payment will occur, such as programs with interest-only payments during the draw period and no repayment period, the disclosures must state that fact. For example, the disclosure might read, "Your minimum payments will not repay the principal that is outstanding on your line. You will be required to pay the entire outstanding balance in a single payment." In making this disclosure, the creditor is not required to use the term "balloon payment." The creditor is also not required to disclose the amount of the balloon payment. (See, however, the requirement under § 226.5b(d)(5)(iii).) The balloon payment disclosure does not apply in cases where repayment of the entire outstanding balance would occur only as a result of termination and acceleration. The creditor also need not make a disclosure about balloon payments if the final payment could not be more than twice the amount of other minimum payments under the plan.

Paragraph 5b(d)(5)(iii)

1. Minimum periodic payment example. In disclosing the payment example, the creditor may assume that the credit limit as well as the outstanding balance is $10,000 if such an assumption is relevant to calculating payments. (If the creditor only offers lines of credit for less than $10,000, the creditor may assume an outstanding balance of $5,000 instead of $10,000 in making this disclosure.) The example should reflect the payment comprised only of principal and interest. Creditors may provide an additional example reflecting other charges that may be included in the payment, such as credit insurance premiums. Creditors may assume that all months have an equal number of days, that payments are collected in whole cents, and that payments will fall on a business day even though they may be due on a non-business day. For variable-rate plans, the example must be based on the last rate in the historical example required in § 226.5b(d)(12)(xi), or a more recent rate. In cases where the last rate shown in the historical example is different from the index value and margin (for example, due to a rate cap), creditors should calculate the rate by using the index value and margin. A discounted rate may not be considered a more recent rate in calculating this payment example for either variable- or fixed-rate plans.

2. Representative examples. In plans with multiple payment options within the draw period or within any

repayment period, the creditor may provide representative examples as an alternative to providing examples for each payment option. The creditor may elect to provide representative payment examples based on three categories of payment options. The first category consists of plans that permit minimum payment of only accrued finance charges (interest only plans). The second category includes plans in which a fixed percentage or a fixed fraction of the outstanding balance or credit limit (for example, 2% of the balance or 1/180th of the balance) is used to determine the minimum payment. The third category includes all other types of minimum payment options, such as a specified dollar amount plus any accrued finance charges. Creditors may classify their minimum payment arrangements within one of these three categories even if other features exist, such as varying lengths of a draw or repayment period, required payment of past due amounts, late charges, and minimum dollar amounts. The creditor may use a single example within each category to represent the payment options in that category. For example, if a creditor permits minimum payments of 1%, 2%, 3% or 4% of the outstanding balance, it may pick one of these four options and provide the example required under § 226.5b(d)(5)(iii) for that option alone.

The example used to represent a category must be an option commonly chosen by consumers, or a typical or representative example. (See the commentary to § 226.5b(d)(12)(x) and (xi) for a discussion of the use of representative examples for making those disclosures. Creditors using a representative example within each category must use the same example for purposes of the disclosures under § 226.5b (d)(5)(iii) and (d)(12)(x) and (xi).) Creditors may use representative examples under § 226.5b(d)(5) only with respect to the payment example required under paragraph (d)(5)(iii). Creditors must provide a full narrative description of all payment options under § 226.5b(d)(5)(i) and (ii).

3. Examples for draw and repayment periods. Separate examples must be given for the draw and repayment periods unless the payments are determined the same way during both periods. In setting forth payment examples for any repayment period under this section (and the historical example under § 226.5b(d)(12)(xi)), creditors should assume a $10,000 advance is taken at the beginning of the draw period and is reduced according to the terms of the plan. Creditors should not assume an additional advance is taken at any time, including at the beginning of any repayment period.

4. Reverse mortgages. Reverse mortgages, also known as reverse annuity or home equity conversion mortgages, in addition to permitting the consumer to obtain advances, may involve the disbursement of monthly advances to the consumer for a fixed period or until the occurrence of an event such as the consumer's death. Repayment of the reverse mortgage (generally a single payment of principal and accrued interest) may be required to be made at the end of the disbursements or, for example, upon the death of the consumer. In disclosing these plans, creditors must apply the following rules, as applicable:

- If the reverse mortgage has a specified period for advances and disbursements but repayment is due only upon occurrence of a future event such as the death of the consumer, the creditor must assume that disbursements will be made until they are scheduled to end. The creditor must assume repayment will occur when disbursements end (or within a period following the final disbursement which is not longer than the regular interval between disbursements). This assumption should be used even though repayment may occur before or after the disbursements are scheduled to end. In such cases, the creditor may include a statement such as "The disclosures assume that you will repay the line at the time the draw period and our payments to you end. As provided in your agreement, your repayment may be rquired at a different time." The single payment should be considered the "minimum periodic payment" and consequently would not be treated as a balloon payment. The example of the minimum payment under § 226.5b(d)(5)(iii) should assume a single $10,000 draw.

- If the reverse mortgage has neither a specified period for advances or disbursements nor a specified repayment date and these terms will be determined solely by reference to future events, including the consumer's death, the creditor may assume that the draws and disbursements will end upon the consumer's death (estimated by using actuarial tables, for example) and that repayment will be required at the same time (or within a period following the date of the final disbursement which is not longer than the regular interval for disbursements). Alternatively, the creditor may base the disclosures upon another future event it estimates will be most likely to occur first. (If terms will be determined by reference to future events which do not include the consumer's death, the creditor must base the disclosures upon the occurrence of the event estimated to be most likely to occur first.)

- In making the disclosures, the creditor must assume that all draws and disbursements and accrued interest will be paid by the consumer. For example, if the note has a non-recourse provision providing that the consumer is not obligated for an amount greater than the value of the house, the creditor must nonetheless assume that the full amount to be drawn or disbursed will be repaid. In this case, however, the creditor may include a statement such as "The disclosures assume full repayment of the amount advanced plus accrued interest, although the amount you may be required to pay is limited by your agreement."

- Some reverse mortgages provide that some or all of the appreciation in the value of the property will be shared between the consumer and the creditor. The creditor must disclose the appreciation feature, including describing how the creditor's share will be determined, any limitations, and when the feature may be exercised.

5b(d)(6) Annual Percentage Rate

1. Preferred-rate plans. If a creditor offers a preferential fixed-rate plan in which the rate will increase a specified amount upon the occurrence of a specified event, the creditor must disclose the specific amount the rate will increase.

5b(d)(7) Fees Imposed by Creditor

1. Applicability. The fees referred to in § 226.5b(d)(7) include items such as application fees, points, annual fees, transaction fees, fees to obtain checks to access the plan, and fees imposed for converting to a repayment phase that is provided for in the original agreement. This disclosure includes any fees that are imposed by the creditor to use or maintain the plan, whether the fees are kept by the creditor or a third party. For example, if a creditor requires an annual credit report on the consumer and requires the consumer to pay this fee to the creditor or directly to the third party, the fee must be specifically stated. Third party fees to open the plan that are initially paid by the consumer to the creditor may be included in this disclosure or in the disclosure under § 226.5b(d)(8).

2. Manner of describing fees. Charges may be stated as an estimated dollar amount for each fee, or as a percentage of a typical or representative amount of credit. The creditor may provide a stepped fee schedule in which a fee will increase a specified amount at a specified date. (See the discussion contained in the commentary to § 226.5b(f)(3)(i).)

3. Fees not required to be disclosed. Fees that are not imposed to open, use, or maintain a plan, such as fees for researching an account, photocopying, paying late, stopping payment, having a check returned, exceeding the credit limit, or closing out an account do not have to be disclosed under this section. Credit report and appraisal fees imposed to investigate whether a condition permitting a freeze continues to exist--as discussed in the commentary to § 226.5b(f)(3)(vi)--are not required to be disclosed under this section or § 226.5b(d)(8).

4. Rebates of closing costs. If closing costs are imposed they must be disclosed, regardless of whether such costs may be rebated later (for example, rebated to the extent of any interest paid during the first year of the plan).

5. Terms used in disclosure. Creditors need not use the terms finance charge or other charge in describing the fees imposed by the creditor under this section or those imposed by third parties under § 226.5b(d)(8).

5b(d)(8) Fees Imposed by Third Parties to Open a Plan

1. Applicability. Section 226.5b(d)(8) applies only to fees imposed by third parties to open the plan. Thus, for example, this section does not require disclosure of a fee imposed by a government agency at the end of a plan to release a security interest. Fees to be disclosed include appraisal, credit report, government agency, and attorneys fees. In cases where property insurance is required by the creditor, the creditor either may disclose the amount of the premium or may state that property insurance is required. For example, the disclosure might state, "You must carry insurance on the property that secures this plan."

2. Itemization of third-party fees. In all cases creditors must state the total of third-party fees as a single dollar amount or a range except that the total need not include costs for property insurance if the creditor discloses that such insurance is required. A creditor has two options with regard to providing the more detailed information about third party fees. Creditors may provide a statement that the consumer may request more specific cost information about third party fees from the creditor. As an alternative to including this statement, creditors may provide an itemization of such fees (by type and amount) with the early disclosures. Any itemization provided upon the consumer's request need not include a disclosure about property insurance.

3. Manner of describing fees. A good faith estimate of the amount of fees must be provided. Creditors may provide, based on a typical or representative amount of credit, a range for such fees or state the dollar amount of such fees. Fees may be expressed on a unit cost basis, for example, $5 per $1,000 of credit.

4. Rebates of third party fees. Even if fees imposed by third parties may be rebated, they must be disclosed. (See the commentary to § 226.5b(d)(7).)

5b(d)(9) Negative Amortization

1. Disclosure required. In transactions where the minimum payment will not or may not be sufficient to cover the interest that accrues on the outstanding balance, the creditor must disclose that negative amortization will or may occur. This disclosure is required whether or not the unpaid interest is added to the outstanding balance upon which interest is computed. A disclosure is not required merely because a loan calls for non-amortizing or partially amortizing payments.

5b(d)(10) Transaction Requirements

1. Applicability. A limitation on automated teller machine usage need not be disclosed under this paragraph unless that is the only means by which the consumer can obtain funds.

5b(d)(12) Disclosures for Variable-Rate Plans

1. Variable-rate provisions. Sample forms in appendix G-14 provide illustrative guidance on the variable-rate rules.

Paragraph 5b(d)(12)(iv)

1. Determination of annual percentage rate. If the creditor adjusts its index through the addition of a margin, the disclosure might read, "Your annual percentage rate is based on the index plus a margin." The creditor is not required to disclose a specific value for the margin.

Paragraph 5b(d)(12)(viii)

1. Preferred-rate provisions. This paragraph requires disclosure of preferred-rate provisions, where the rate will increase upon the occurrence of some event, such as the borrower-employee leaving the creditor's employ or the consumer closing an existing deposit account with the creditor.

2. Provisions on conversion to fixed rates. The commentary to § 226.5b(d)(5)(ii) discusses the disclosure requirements for options permitting the consumer to convert from a variable rate to a fixed rate.

Paragraph 5b(d)(12)(ix)

1. Periodic limitations on increases in rates. The creditor must disclose any annual limitations on increases in the annual percentage rate. If the creditor bases its rate limitation on 12 monthly billing cycles, such a limitation should be treated as an annual cap. Rate limitations imposed on less than an annual basis must be stated in terms of a specific amount of time. For example, if the creditor imposes rate limitations on only a semiannual basis, this must be expressed as a rate limitation for a six-month time period. If the creditor does not impose periodic limitations (annual or shorter) on rate increases, the fact that there are no annual rate limitations must be stated.

2. Maximum limitations on increases in rates. The maximum annual percentage rate that may be imposed under each payment option over the term of the plan (including the draw period and any repayment period provided for in the initial agreement) must be provided. The creditor may disclose this rate as a specific number (for example, 18%) or as a specific amount above the initial rate. For example, this disclosure might read, "The maximum annual percentage rate that can apply to your line will be 5 percentage points above your initial rate." If the creditor states the maximum rate as a specific amount above the initial rate, the creditor must include a statement that the consumer should inquire about the rate limitations that are currently available. If an initial discount is not taken into account in applying maximum rate limitations, that fact must be disclosed. If separate overall limitations apply to rate increases resulting from events such as the exercise of a fixed-rate conversion option or leaving the creditor's employ, those limitations also must be stated. Limitations do not include legal limits in the nature of usury or rate ceilings under state or federal statutes or regulations.

3. Form of disclosures. The creditor need not disclose each periodic or maximum rate limitation that is currently available. Instead, the creditor may disclose the range of the lowest and highest periodic and maximum rate limitations that may be applicable to the creditor's home equity plans. Creditors using this alternative must include a statement that the consumer should inquire about the rate limitations that are currently available.

Paragraph 5b(d)(12)(x)

1. Maximum rate payment example. In calculating the payment creditors should assume the maximum rate is in effect. Any discounted or premium initial rates or periodic rate limitations should be ignored for purposes of this disclosure. If a range is used to disclose the maximum cap under § 226.5b(d)(12)(ix), the highest rate in the range must be used for the disclosure under this paragraph. As an alternative to making disclosures based on each payment option, the creditor may choose a representative example within the three categories of payment options upon which to base this disclosure. (See the commentary to § 226.5b(d)(5).) However, separate examples must be provided for the draw period and for any repayment period unless the payment is determined the same way in both periods. Creditors should calculate the example for the repayment period based on an assumed $10,000 balance. (See the commentary to § 226.5b(d)(5) for a discussion of the circumstances in which a creditor may use a lower outstanding balance.)

2. Time the maximum rate could be reached. In stating the date or time when the maximum rate could be reached, creditors should assume the rate increases as rapidly as possible under the plan. In calculating the date or time, creditors should factor in any discounted or premium initial rates and periodic rate limitations. This disclosure must be provided for the draw phase and any repayment phase. Creditors should assume the index and margin shown in the last year of the historical example (or a more recent rate) is in effect at the beginning of each phase.

Paragraph 5b(d)(12)(xi)

1. Index movement. Index values and annual percentage rates must be shown for the entire 15 years of the historical example and must be based on the most recent 15 years. The example must be updated annually to reflect the most recent 15 years of index values as soon as reasonably possible after the new index value becomes available. If the values for an index have not been available for 15 years, a creditor need only go back as far as the values have been available and may start the historical example at the year for which values are first available.

2. Selection of index values. The historical example must reflect the method of choosing index values for the plan. For example, if an average of index values is used in the plan, averages must be used in the example, but if an index value as of a particular date is used, a single index value must be shown. The creditor is required to assume one date (or one period, if an average is used) within a year on which to base the history of index values. The creditor may choose to use index values as of any date or period as long as the index value as of this date or period is used for each year in the example. Only one index value per year need be shown, even if the plan provides for adjustments to the annual percentage rate or payment more than once in a year. In such cases, the creditor can assume that the index rate remained constant for the full year for the purpose of calculating the annual percentage rate and payment.

3. Selection of margin. A value for the margin must be assumed in order to prepare the example. A creditor may select a representative margin that it has used with the index during the six months preceding preparation of the disclosures and state that the margin is one that it has used recently. The margin selected may be used until the creditor annually updates the disclosure form to reflect the most recent 15 years of index values.

4. Amount of discount or premium. In reflecting any discounted or premium initial rate, the creditor may select a discount or premium that it has used during the six months preceding preparation of the disclosures, and should disclose that the discount or premium is one that the creditor has used recently. The discount or premium should be reflected in the example for as long as it is in effect. The creditor may assume that a discount or premium that would have been in effect for any part of a year was in effect for the full year for purposes of reflecting it in the historical example.

5. Rate limitations. Limitations on both periodic and maximum rates must be reflected in the historical example. If ranges of rate limitations are provided under § 226.5b(d)(12)(ix), the highest rates provided in those ranges must be used in the example. Rate limitations that may apply more often than annually should be treated as if they were annual limitations. For example, if a creditor imposes a 1% cap every six months, this should be reflected in the example as if it were a 2% annual cap.

6. Assumed advances. The creditor should assume that the $10,000 balance is an advance taken at the beginning of the first billing cycle and is reduced according to the terms of the plan, and that the consumer takes no subsequent draws. As discussed in the commentary to § 226.5b(d)(5), creditors should not assume an additional advance is taken at the beginning of any repayment period. If applicable, the creditor may assume the $10,000 is both the advance and the credit limit. (See the commentary to § 226.5b(d)(5) for a discussion of the circumstances in which a creditor may use a

lower outstanding balance.)

7. Representative payment options. The creditor need not provide an historical example for all of its various payment options, but may select a representative payment option within each of the three categories of payments upon which to base its disclosure. (See the commentary to § 226.5b(d)(5).)

8. Payment information. The payment figures in the historical example must reflect all significant program terms. For example, features such as rate and payment caps, a discounted initial rate, negative amortization, and rate carryover must be taken into account in calculating the payment figures if these would have applied to the plan. The historical example should include payments for as much of the length of the plan as would occur during a 15-year period. For example:

- If the draw period is 10 years and the repayment period is 15 years, the example should illustrate the entire 10-year draw period and the first 5 years of the repayment period.

- If the length of the draw period is 15 years and there is a 15-year repayment phase, the historical example must reflect the payments for the 15-year draw period and would not show any of the repayment period. No additional historical example would be required to reflect payments for the repayment period.

- If the length of the plan is less than 15 years, payments in the historical example need only be shown for the number of years in the term. In such cases, however, the creditor must show the index values, margin and annual percentage rates and continue to reflect all significant plan terms such as rate limitations for the entire 15 years.

A creditor need show only a single payment per year in the example, even though payments may vary during a year. The calculations should be based on the actual payment computation formula, although the creditor may assume that all months have an equal number of days. The creditor may assume that payments are made on the last day of the billing cycle, the billing date or the payment due date, but must be consistent in the manner in which the period used to illustrate payment information is selected. Information about balloon payments and remaining balance may, but need not, be reflected in the example.

9. Disclosures for repayment period. The historical example must reflect all features of the repayment period, including the appropriate index values, margin, rate limitations, length of the repayment period, and payments. For example, if different indices are used during the draw and repayment periods, the index values for that portion of the 15 years that reflect the repayment period must be the values for the appropriate index.

10. Reverse mortgages. The historical example for reverse mortgages should reflect 15 years of index values and annual percentage rates, but the payment column should be blank until the year that the single payment will be made, assuming that payment is estimated to occur within 15 years. (See the commentary to § 226.5b(d)(5) for a discussion of reverse mortgages.)

5b(e) Brochure

1. Substitutes. A brochure is a suitable substitute for the Board's home equity brochure if it is, at a minimum, comparable to the Board's brochure in substance and comprehensiveness. Creditors are permitted to provide more detailed information than is contained in the Board's brochure.

2. Effect of third party delivery of brochure. If a creditor determines that a third party has provided a consumer with the required brochure pursuant to § 226.5b(c), the creditor need not give the consumer a second brochure.

5b(f) Limitations on Home-equity Plans

1. Coverage. Section 226.5b(f) limits both actions that may be taken and language that may be included in contracts, and applies to any assignee or holder as well as to the original creditor. The limitations apply to the draw period and any repayment period, and to any renewal or modification of the original agreement.

Paragraph 5b(f)(1)

1. External index. A creditor may change the annual percentage rate for a plan only if the change is based on an index outside the creditor's control. Thus, a creditor may not make rate changes based on its own prime rate or cost of funds and may not reserve a contractual right to change rates at its discretion. A creditor is permitted, however, to use a published prime rate, such as that in the Wall Street Journal, even if the bank's own prime rate is one of several rates used to establish the published rate.

2. Publicly available. The index must be available to the public. A publicly available index need not be published in a newspaper, but it must be one the consumer can independently obtain (by telephone, for example) and use to verify rates imposed under the plan.

3. Provisions not prohibited. This paragraph does not prohibit rate changes that are specifically set forth in the agreement. For example, stepped-rate plans, in which specified rates are imposed for specified periods, are permissible. In addition, preferred-rate provisions, in which the rate increases by a specified amount upon the occurrence of a specified event, also are permissible.

Paragraph 5b(f)(2)

1. Limitations on termination and acceleration. In general, creditors are prohibited from terminating and accelerating payment of the outstanding balance before the scheduled expiration of a plan. However, creditors may take these actions

in the four circumstances specified in § 226.5b(f)(2). Creditors are not permitted to specify in their contracts any other events that allow termination and acceleration beyond those permitted by the regulation. Thus, for example, an agreement may not provide that the balance is payable on demand nor may it provide that the account will be terminated and the balance accelerated if the rate cap is reached.

2. Other actions permitted. If an event permitting termination and acceleration occurs, a creditor may instead take actions short of terminating and accelerating. For example, a creditor could temporarily or permanently suspend further advances, reduce the credit limit, change the payment terms, or require the consumer to pay a fee. A creditor also may provide in its agreement that a higher rate or higher fees will apply in circumstances under which it would otherwise be permitted to terminate the plan and accelerate the balance. A creditor that does not immediately terminate an account and accelerate payment or take another permitted action may take such action at a later time, provided one of the conditions permitting termination and acceleration exists at that time.

Paragraph 5b(f)(2)(i)

1. Fraud or material misrepresentation. A creditor may terminate a plan and accelerate the balance if there has been fraud or material misrepresentation by the consumer in connection with the plan. This exception includes fraud or misrepresentation at any time, either during the application process or during the draw period and any repayment period. What constitutes fraud or misrepresentation is determined by applicable state law and may include acts of omission as well as overt acts, as long as any necessary intent on the part of the consumer exists.

Paragraph 5b(f)(2)(ii)

1. Failure to meet repayment terms. A creditor may terminate a plan and accelerate the balance when the consumer fails to meet the repayment terms provided for in the agreement. However, a creditor may terminate and accelerate under this provision only if the consumer actually fails to make payments. For example, a creditor may not terminate and accelerate if the consumer, in error, sends a payment to the wrong location, such as a branch rather than the main office of the creditor. If a consumer files for or is placed in bankruptcy, the creditor may terminate and accelerate under this provision if the consumer fails to meet the repayment terms of the agreement. This section does not override any state or other law that requires a right-to-cure notice, or otherwise places a duty on the creditor before it can terminate a plan and accelerate the balance.

Paragraph 5b(f)(2)(iii)

1. Impairment of security. A creditor may terminate a plan and accelerate the balance if the consumer's action or inaction adversely affects the creditor's security for the plan, or any right of the creditor in that security. Action or inaction by third parties does not, in itself, permit the creditor to terminate and accelerate.

2. Examples. A creditor may terminate and accelerate, for example, if:

- The consumer transfers title to the property or sells theproperty without the permission of the

creditor

- The consumer fails to maintain required insurance on the dwelling
- The consumer fails to pay taxes on the property
- The consumer permits the filing of a lien senior to that held by the creditor
- The sole consumer obligated on the plan dies
- The property is taken through eminent domain
- A prior lienholder forecloses

By contrast, the filing of a judgment against the consumer would permit termination and acceleration only if the amount of the judgment and collateral subject to the judgment is such that the creditor's security is adversely affected. If the consumer commits waste or otherwise destructively uses or fails to maintain the property such that the action adversely affects the security, the plan may be terminated and the balance accelerated. Illegal use of the property by the consumer would permit termination and acceleration if it subjects the property to seizure. If one of two consumers obligated on a plan dies the creditor may terminate the plan and accelerate the balance if the security is adversely affected. If the consumer moves out of the dwelling that secures the plan and that action adversely affects the security, the creditor may terminate a plan and accelerate the balance.

Paragraph 5b(f)(3)

1. Scope of provision. In general, a creditor may not change the terms of a plan after it is opened. For example, a creditor may not increase any fee or impose a new fee once the plan has been opened, even if the fee is charged by a third party, such as a credit reporting agency, for a service. The change of terms prohibition applies to all features of a plan, not only those required to be disclosed under this section. For example, this provision applies to charges imposed for late payment, although this fee is not required to be disclosed under § 226.5b(d)(7).

2. Charges not covered. There are three charges not covered by this provision. A creditor may pass on increases in taxes since such charges are imposed by a governmental body and are beyond the control of the creditor. In addition, a creditor may pass on increases in premiums for property insurance that are excluded from the finance charge under § 226.4(d)(2), since such insurance provides a benefit to the consumer independent of the use of the line and is often maintained notwithstanding the line. A creditor also may pass on increases in premiums for credit insurance that are excluded from the finance charge under § 226.4(d)(1), since the insurance is voluntary and provides a benefit to the consumer.

Paragraph 5b(f)(3)(i)

1. Changes provided for in agreement. A creditor may provide in the initial agreement that further advances will be prohibited or the credit line reduced during any period in which the maximum annual percentage rate is reached. A creditor also may provide for other specific changes to take place upon the occurrence of specific events. Both the triggering event and the resulting modification must be stated with specificity. For example, in home equity plans for employees, the agreement could provide that a specified higher rate or margin will apply if the borrower's employment

with the creditor ends. A contract could contain a stepped-rate or stepped-fee schedule providing for specified changes in the rate or the fees on certain dates or after a specified period of time. A creditor also may provide in the initial agreement that it will be entitled to a share of the appreciation in the value of the property as long as the specific appreciation share and the specific circumstances which require the payment of it are set forth. A contract may permit a consumer to switch among minimum payment options during the plan.

2. Prohibited provisions. A creditor may not include a general provision in its agreement permitting changes to any or all of the terms of the plan. For example, creditors may not include "boilerplate" language in the agreement stating that they reserve the right to change the fees imposed under the plan. In addition, a creditor may not include any "triggering events" or responses that the regulation expressly addresses in a manner different from that provided in the regulation. For example, an agreement may not provide that the margin in a variable-rate plan will increase if there is a material change in the consumer's financial circumstances, because the regulation specifies that temporarily freezing the line or lowering the credit limit is the permissible response to a material change in the consumer's financial circumstances. Similarly a contract cannot contain a provision allowing the creditor to freeze a line due to an insignificant decline in property value since the regulation allows that response only for a significant decline.

Paragraph 5b(f)(3)(ii)

1. Substitution of index. A creditor may change the index and margin used under the plan if the original index becomes unavailable, as long as historical fluctuations in the original and replacement indices were substantially similar, and as long as the replacement index and margin will produce a rate similar to the rate that was in effect at the time the original index became unavailable. If the replacement index is newly established and therefore does not have any rate history, it may be used if it produces a rate substantially similar to the rate in effect when the original index became unavailable.

Paragraph 5b(f)(3)(iii)

1. Changes by written agreement. A creditor may change the terms of a plan if the consumer expressly agrees in writing to the change at the time it is made. For example, a consumer and a creditor could agree in writing to change the repayment terms from interest-only payments to payments that reduce the principal balance. The provisions of any such agreement are governed by the limitations in § 226.5b(f). For example, a mutual agreement could not provide for future annual percentage rate changes based on the movement of an index controlled by the creditor or for termination and acceleration under circumstances other than those specified in the regulation. By contrast, a consumer could agree to a new credit limit for the plan, although the agreement could not permit the creditor to later change the credit limit except by a subsequent written agreement or in the circumstances described in § 226.5b(f)(3)(vi).

2. Written agreement. The change must be agreed to in writing by the consumer. Creditors are not permitted to assume consent because the consumer uses an account, even if use of an account would otherwise constitute acceptance of a proposed change under state law.

Paragraph 5b(f)(3)(iv)

1. Beneficial changes. After a plan is opened, a creditor may make changes that unequivocally benefit the consumer. Under this provision, a creditor may offer more options to consumers, as long as existing options remain. For example, a creditor may offer the consumer the option of making lower monthly payments or could increase the credit limit. Similarly, a creditor wishing to extend the length of the plan on the same terms may do so. Creditors are permitted to temporarily reduce the rate or fees charged during the plan (though a change in terms notice may be required under § 226.9(c) when the rate or fees are returned to their original level). Creditors also may offer an additional means of access to the line, even if fees are associated with using the device, provided the consumer retains the ability to use prior access devices on the original terms.

Paragraph 5b(f)(3)(v)

1. Insignificant changes. A creditor is permitted to make insignificant changes after a plan is opened. This rule accommodates operational and similar problems, such as changing the address of the creditor for purposes of sending payments. It does not permit a creditor to change a term such as a fee charged for late payments.

2. Examples of insignificant changes. Creditors may make minor changes to features such as the billing cycle date, the payment due date (as long as the consumer does not have a diminished grace period if one is provided), and the day of the month on which index values are measured to determine changes to the rate for variable-rate plans. A creditor also may change its rounding practice in accordance with the tolerance rules set forth in § 226.14 (for example, stating an exact APR of 14.3333 percent as 14.3 percent, even if it had previously been stated as 14.33 percent). A creditor may change the balance computation method it uses only if the change produces an insignificant difference in the finance charge paid by the consumer. For example, a creditor may switch from using the average daily balance method (including new transactions) to the daily balance method (including new transactions).

Paragraph 5b(f)(3)(vi)

1. Suspension of credit privileges or reduction of credit limit. A creditor may prohibit additional extensions of credit or reduce the credit limit in the circumstances specified in this section of the regulation. In addition, as discussed under § 226.5b(f)(3)(i), a creditor may contractually reserve the right to take such actions when the maximum annual percentage rate is reached. A creditor may not take these actions under other circumstances, unless the creditor would be permitted to terminate the line and accelerate the balance as described in § 226.5b(f)(2). The creditor's right to reduce the credit limit does not permit reducing the limit below the amount of the outstanding balance if this would require the consumer to make a higher payment.

2. Temporary nature of suspension or reduction. Creditors are permitted to prohibit additional extensions of credit or reduce the credit limit only while one of the designated circumstances exists. When the circumstance justifying the creditor's action ceases to exist, credit privileges must be reinstated, assuming that no other circumstance permitting such action exists at that time.

3. Imposition of fees. If not prohibited by state law, a creditor may collect only bona fide and reasonable appraisal

and credit report fees if such fees are actually incurred in investigating whether the condition permitting the freeze continues to exist. A creditor may not, in any circumstances, impose a fee to reinstate a credit line once the condition has been determined not to exist.

4. Reinstatement of credit privileges. Creditors are responsible for ensuring that credit privileges are restored as soon as reasonably possible after the condition that permitted the creditor's action ceases to exist. One way a creditor can meet this responsibility is to monitor the line on an ongoing basis to determine when the condition ceases to exist. The creditor must investigate the condition frequently enough to assure itself that the condition permitting the freeze continues to exist. The frequency with which the creditor must investigate to determine whether a condition continues to exist depends upon the specific condition permitting the freeze. As an alternative to such monitoring, the creditor may shift the duty to the consumer to request reinstatement of credit privileges by providing a notice in accordance with § 226.9(c)(1)(iii). A creditor may require a reinstatement request to be in writing if it notifies the consumer of this requirement on the notice provided under § 226.9(c)(1)(iii). Once the consumer requests reinstatement, the creditor must promptly investigate to determine whether the condition allowing the freeze continues to exist. Under this alternative, the creditor has a duty to investigate only upon the consumer's request.

5. Suspension of credit privileges following request by consumer. A creditor may honor a specific request by a consumer to suspend credit privileges. If the consumer later requests that the creditor reinstate credit privileges, the creditor must do so provided no other circumstance justifying a suspension exists at that time. If two or more consumers are obligated under a plan and each has the ability to take advances, the agreement may permit any of the consumers to direct the creditor not to make further advances. A creditor may require that all persons obligated under a plan request reinstatement.

6. Significant decline defined. What constitutes a significant decline for purposes of § 226.5b(f)(3)(vi)(A) will vary according to individual circumstances. In any event, if the value of the dwelling declines such that the initial difference between the credit limit and the available equity (based on the property's appraised value for purposes of the plan) is reduced by fifty percent, this constitutes a significant decline in the value of the dwelling for purposes of § 226.5b(f)(3)(vi)(A). For example, assume that a house with a first mortgage of $50,000 is appraised at $100,000 and the credit limit is $30,000. The difference between the credit limit and the available equity is $20,000, half of which is $10,000. The creditor could prohibit further advances or reduce the credit limit if the value of the property declines from $100,000 to $90,000. This provision does not require a creditor to obtain an appraisal before suspending credit privileges although a significant decline must occur before suspension can occur.

7. Material change in financial circumstances. Two conditions must be met for § 226.5b(f)(3)(vi)(B) to apply. First, there must be a "material change" in the consumer's financial circumstances, such as a significant decrease in the consumer's income. Second, as a result of this change, the creditor must have a reasonable belief that the consumer will be unable to fulfill the payment obligations of the plan. A creditor may, but does not have to, rely on specific evidence (such as the failure to pay other debts) in concluding that the second part of the test has been met. A creditor may prohibit further advances or reduce the credit limit under this section if a consumer files for or is placed in bankruptcy.

8. Default of a material obligation. Creditors may specify events that would qualify as a default of a material

obligation under § 226.5b(f)(3)(vi)(C). For example, a creditor may provide that default of a material obligation will exist if the consumer moves out of the dwelling or permits an intervening lien to be filed that would take priority over future advances made by the creditor.

9. Government limits on the annual percentage rate. Under § 226.5b(f)(3)(vi)(D), a creditor may prohibit further advances or reduce the credit limit if, for example, a state usury law is enacted which prohibits a creditor from imposing the agreed-upon annual percentage rate.

5b(g) Refund of Fees

1. Refund of fees required. If any disclosed term, including any term provided upon request pursuant to § 226.5b(d), changes between the time the early disclosures are provided to the consumer and the time the plan is opened, and the consumer as a result decides to not enter into the plan, a creditor must refund all fees paid by the consumer in connection with the application. All fees, including credit report fees and appraisal fees, must be refunded whether such fees are paid to the creditor or directly to third parties. A consumer is entitled to a refund of fees under these circumstances whether or not terms are guaranteed by the creditor under § 226.5b(d)(2)(i).

2. Variable-rate plans. The right to a refund of fees does not apply to changes in the annual percentage rate resulting from fluctuations in the index value in a variable-rate plan. Also, if the maximum annual percentage rate is expressed as an amount over the initial rate, the right to refund of fees would not apply to changes in the cap resulting from fluctuations in the index value.

3. Changes in terms. If a term, such as the maximum rate, is stated as a range in the early disclosures, and the term ultimately applicable to the plan falls within that range, a change does not occur for purposes of this section. If, however, no range is used and the term is changed (for example, a rate cap of 6 rather than 5 percentage points over the initial rate), the change would permit the consumer to obtain a refund of fees. If a fee imposed by the creditor is stated in the early disclosures as an estimate and the fee changes, the consumer could elect to not enter into the agreement and would be entitled to a refund of fees. On the other hand, if fees imposed by third parties are disclosed as estimates and those fees change, the consumer is not entitled to a refund of fees paid in connection with the application. Creditors must, however, use the best information reasonably available in providing disclosures about such fees.

4. Timing of refunds and relation to other provisions. The refund of fees must be made as soon as reasonably possible after the creditor is notified that the consumer is not entering into the plan because of the changed term, or that the consumer wants a refund of fees. The fact that an application fee may be refunded to some applicants under this provision does not render such fees finance charges under § 226.4(c)(1) of the regulation.

5b(h) Imposition of Nonrefundable Fees

1. Collection of fees after consumer receives disclosures. A fee may be collected after the consumer receives the disclosures and brochure and before the expiration of three days, although the fee must be refunded if, within three days of receiving the required information, the consumer decides to not enter into the agreement. In such a case, the consumer must be notified that the fee is refundable for three days. The notice must be clear and conspicuous and in writing, and may be included with the disclosures required under § 226.5b(d) or as an attachment to them. If disclosures and brochure are mailed to the consumer, footnote 10d of the regulation provides that a nonrefundable fee may not be imposed until six business days after the mailing.

2. Collection of fees before consumer receives disclosures. An application fee may be collected before the consumer receives the disclosures and brochure (for example, when an application contained in a magazine is mailed in with an application fee) provided that it remains refundable until three business days after the consumer receives the § 226.5b disclosures. No other fees except a refundable membership fee may be collected until after the consumer receives the disclosures required under § 226.5b.

3. Relation to other provisions. A fee collected before disclosures are provided may become nonrefundable except that, under § 226.5b(g), it must be refunded if the consumer elects to not enter into the plan because of a change in terms. (Of course, all fees must be refunded if the consumer later rescinds under § 226.15.)

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Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual Section 226.6

§ **226.6 Account-Opening Disclosures**

6(a) Rules affecting home-equity plans.

6(a)(1) Finance charge.

Paragraph 6(a)(1)(i).

1. When finance charges accrue. Creditors are not required to disclose a specific date when finance charges will begin to accrue. Creditors may provide a general explanation such as that the consumer has 30 days from the closing date to pay the new balance before finance charges will accrue on the account.

2. Grace periods. In disclosing whether or not a grace period exists, the creditor need not use "free period," "free-ride period," "grace period" or any other particular descriptive phrase or term. For example, a statement that "the finance charge begins on the date the transaction is posted to your account" adequately discloses that no grace period exists. In the same fashion, a statement that "finance charges will be imposed on any new purchases only if they are not paid in full within 25 days after the close of the billing cycle" indicates that a grace period exists in the interim.

Paragraph 6(a)(1)(ii).

1. Range of balances. The range of balances disclosure is inapplicable:

i. If only one periodic rate may be applied to the entire account balance.

ii. If only one periodic rate may be applied to the entire balance for a feature (for example, cash advances), even though the balance for another feature (purchases) may be subject to two rates (a 1.5% monthly periodic rate on purchase balances of $0-$500, and a 1% monthly periodic rate for balances above $500). In this example, the creditor must give a range of balances disclosure for the purchase feature.

2. Variable-rate disclosures--coverage.

i. Examples. This section covers open-end credit plans under which rate changes are specifically set forth in the account agreement and are tied to an index or formula. A creditor would use variable-rate disclosures for plans involving rate changes such as the following:

A. Rate changes that are tied to the rate the creditor pays on its six-month certificates of deposit.

B. Rate changes that are tied to Treasury bill rates.

C. Rate changes that are tied to changes in the creditor's commercial lending rate.

ii. An open-end credit plan in which the employee receives a lower rate contingent upon employment (that is, with the rate to be increased upon termination of employment) is not a variable-rate plan.

3. Variable-rate plan--rate(s) in effect. In disclosing the rate(s) in effect at the time of the account-opening disclosures (as is required by § 226.6(a)(1)(ii)), the creditor may use an insert showing the current rate; may give the rate as of a specified date and then update the disclosure from time to time, for example, each calendar month; or may disclose an estimated rate under § 226.5(c).

4. Variable-rate plan--additional disclosures required. In addition to disclosing the rates in effect at the time of the account-opening disclosures, the disclosures under § 226.6(a)(1)(ii) also must be made.

5. Variable-rate plan--index. The index to be used must be clearly identified; the creditor need not give, however, an explanation of how the index is determined or provide instructions for obtaining it.

6. Variable-rate plan--circumstances for increase.

i. Circumstances under which the rate(s) may increase include, for example:

A. An increase in the Treasury bill rate.

B. An increase in the Federal Reserve discount rate.

ii. The creditor must disclose when the increase will take effect; for example:

A. "An increase will take effect on the day that the Treasury bill rate increases," or

B. "An increase in the Federal Reserve discount rate will take effect on the first day of the creditor's billing cycle."

7. Variable-rate plan--limitations on increase. In disclosing any limitations on rate increases, limitations such as the maximum increase per year or the maximum increase over the duration of the plan must be disclosed. When there are no limitations, the creditor may, but need not, disclose that fact. (A maximum interest rate must be included in dwelling-secured open-end credit plans under which the interest rate may be changed. See§ 226.30and the commentary to that section.) Legal limits such as usury or rate ceilings under state or federal statutes or regulations need not be disclosed. Examples of limitations that must be disclosed include:

i. "The rate on the plan will not exceed 25% annual percentage rate."

ii. "Not more than 1/2% increase in the annual percentage rate per year will occur."

8. Variable-rate plan--effects of increase. Examples of effects of rate increases that must be disclosed include:

i. Any requirement for additional collateral if the annual percentage rate increases beyond a specified rate.

ii. Any increase in the scheduled minimum periodic payment amount.

9. Variable-rate plan--change-in-terms notice not required. No notice of a change in terms is required for a rate increase under a variable-rate plan as defined in comment 6(a)(1)(ii)-2.

10. Discounted variable-rate plans. In some variable-rate plans, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate is lower than the rate would be if it were calculated using the index or formula.

i. For example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the current Treasury bill rate is 10 percent, the creditor may forgo the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent, or the creditor may disregard the index or formula and set the initial rate at 9 percent.

ii. When creditors use an initial rate that is not calculated using the index or formula for later rate adjustments, the account-opening disclosure statement should reflect:

A. The initial rate (expressed as a periodic rate and a corresponding annual percentage rate), together with a statement of how long the initial rate will remain in effect;

B. The current rate that would have been applied using the index or formula (also expressed as a periodic rate and a corresponding annual percentage rate); and

C. The other variable-rate information required in § 226.6(a)(1)(ii).

iii. In disclosing the current periodic and annual percentage rates that would be applied using the index or formula, the creditor may use any of the disclosure options described in comment 6(a)(1)(ii)-3.

11. Increased penalty rates. If the initial rate may increase upon the occurrence of one or more specific events, such as a late payment or an extension of credit that exceeds the credit limit, the creditor must disclose the initial rate and the increased penalty rate that may apply. If the penalty rate is based on an index and an increased margin, the issuer must disclose the index and the margin. The creditor must also disclose the specific event or events that may result in the

increased rate, such as "22% APR, if 60 days late." If the penalty rate cannot be determined at the time disclosures are given, the creditor must provide an explanation of the specific event or events that may result in the increased rate. At the creditor's option, the creditor may disclose the period for which the increased rate will remain in effect, such as "until you make three timely payments." The creditor need not disclose an increased rate that is imposed when credit privileges are permanently terminated.

Paragraph 6(a)(1)(iii).

1. Explanation of balance computation method. A shorthand phrase such as "previous balance method" does not suffice in explaining the balance computation method. (See Model Clauses G-1 and G-1(A) to part 226.)

2. Allocation of payments. Creditors may, but need not, explain how payments and other credits are allocated to outstanding balances. For example, the creditor need not disclose that payments are applied to late charges, overdue balances, and finance charges before being applied to the principal balance; or in a multifeatured plan, that payments are applied first to finance charges, then to purchases, and then to cash advances. (See comment 7-1 for definition of multifeatured plan.)

Paragraph 6(a)(1)(iv).

1. Finance charges. In addition to disclosing the periodic rate(s) under § 226.6(a)(1)(ii), creditors must disclose any other type of finance charge that may be imposed, such as minimum, fixed, transaction, and activity charges; required insurance; or appraisal or credit report fees (unless excluded from the finance charge under § 226.4(c)(7)). Creditors are not required to disclose the fact that no finance charge is imposed when the outstanding balance is less than a certain amount or the balance below which no finance charge will be imposed.

6(a)(2) Other charges.

1. General; examples of other charges. Under § 226.6(a)(2), significant charges related to the plan (that are not finance charges) must also be disclosed. For example:

i. Late-payment and over-the-credit-limit charges.

ii. Fees for providing documentary evidence of transactions requested under § 226.13 (billing error resolution).

iii. Charges imposed in connection with residential mortgage transactions or real estate transactions such as title, appraisal, and credit-report fees (see § 226.4(c)(7)).

iv. A tax imposed on the credit transaction by a state or other governmental body, such as a documentary stamp tax on cash advances. (See the commentary to § 226.4(a)).

v. A membership or participation fee for a package of services that includes an open-end credit feature, unless the fee is required whether or not the open-end credit feature is included. For example, a membership fee to join a credit union is not an "other charge," even if membership is required to apply for credit. For example, if the primary benefit of membership in an organization is the opportunity to apply for a credit card, and the other benefits offered (such as a newsletter or a member information hotline) are merely incidental to the credit feature, the membership fee would be disclosed as an "other charge."

vi. Charges imposed for the termination of an open-end credit plan.

2. Exclusions. The following are examples of charges that are not "other charges"

i. Fees charged for documentary evidence of transactions for income tax purposes.

ii. Amounts payable by a consumer for collection activity after default; attorney's fees, whether or not automatically imposed; foreclosure costs; post-judgment interest rates imposed by law; and reinstatement or reissuance fees.

iii. Premiums for voluntary credit life or disability insurance, or for property insurance, that are not part of the finance charge.

iv. Application fees under § 226.4(c)(1).

v. A monthly service charge for a checking account with overdraft protection that is applied to all checking accounts, whether or not a credit feature is attached.

vi. Charges for submitting as payment a check that is later returned unpaid (See commentary to § 226.4(c)(2)).

vii. Charges imposed on a cardholder by an institution other than the card issuer for the use of the other institution's

ATM in a shared or interchange system. (See also comment 7(a)(2)-2.)

viii. Taxes and filing or notary fees excluded from the finance charge under § 226.4(e).

ix. A fee to expedite delivery of a credit card, either at account opening or during the life of the account, provided delivery of the card is also available by standard mail service (or other means at least as fast) without paying a fee for delivery.

x. A fee charged for arranging a single payment on the credit account, upon the consumer's request (regardless of how frequently the consumer requests the service), if the credit plan provides that the consumer may make payments on the account by another reasonable means, such as by standard mail service, without paying a fee to the creditor.

6(a)(3) Home-equity plan information.

1. Additional disclosures required. For home-equity plans, creditors must provide several of the disclosures set forth in § 226.5b(d) along with the disclosures required under § 226.6. Creditors also must disclose a list of the conditions that permit the creditor to terminate the plan, freeze or reduce the credit limit, and implement specified modifications to the original terms. (See comment 5b(d)(4)(iii)-1.)

2. Form of disclosures. The home-equity disclosures provided under this section must be in a form the consumer can keep, and are governed by § 226.5(a)(1). The segregation standard set forth in § 226.5b(a) does not apply to home-equity disclosures provided under § 226.6.

3. Disclosure of payment and variable-rate examples.

i. The payment-example disclosure in § 226.5b(d)(5)(iii) and the variable-rate information in § 226.5b(d)(12)(viii), (d)(12)(x), (d)(12)(xi), and (d)(12)(xii) need not be provided with the disclosures under § 226.6 if the disclosures under § 226.5b(d) were provided in a form the consumer could keep; and the disclosures of the payment example under § 226.5b(d)(5)(iii), the maximum-payment example under § 226.5b(d)(12)(x) and the historical table under § 226.5b(d)(12)(xi) included a representative payment example for the category of payment options the consumer has chosen.

ii. For example, if a creditor offers three payment options (one for each of the categories described in the commentary to § 226.5b(d)(5)), describes all three options in its early disclosures, and provides all of the disclosures in a retainable form, that creditor need not provide the § 226.5b(d)(5)(iii) or (d)(12) disclosures again when the account is

opened. If the creditor showed only one of the three options in the early disclosures (which would be the case with a separate disclosure form rather than a combined form, as discussed under § 226.5b(a)), the disclosures under § 226.5b(d)(5)(iii), (d)(12)(viii), (d)(12)(x), (d)(12)(xi) and (d)(12)(xii) must be given to any consumer who chooses one of the other two options. If the § 226.5b(d)(5)(iii) and (d)(12) disclosures are provided with the second set of disclosures, they need not be transaction-specific, but may be based on a representative example of the category of payment option chosen.

4. Disclosures for the repayment period. The creditor must provide disclosures about both the draw and repayment phases when giving the disclosures under § 226.6. Specifically, the creditor must make the disclosures in § 226.6(a)(3), state the corresponding annual percentage rate, and provide the variable-rate information required in § 226.6(a)(1)(ii) for the repayment phase. To the extent the corresponding annual percentage rate, the information in § 226.6(a)(1)(ii), and any other required disclosures are the same for the draw and repayment phase, the creditor need not repeat such information, as long as it is clear that the information applies to both phases.

6(a)(4) Security interests.

1. General. Creditors are not required to use specific terms to describe a security interest, or to explain the type of security or the creditor's rights with respect to the collateral.

2. Identification of property. Creditors sufficiently identify collateral by type by stating, for example, motor vehicle or household appliances. (Creditors should be aware, however, that the federal credit practices rules, as well as some state laws, prohibit certain security interests in household goods.) The creditor may, at its option, provide a more specific identification (for example, a model and serial number.)

3. Spreader clause. If collateral for preexisting credit with the creditor will secure the plan being opened, the creditor must disclose that fact. (Such security interests may be known as "spreader" or "dragnet" clauses, or as "cross-collateralization" clauses.) The creditor need not specifically identify the collateral; a reminder such as "collateral securing other loans with us may also secure this loan" is sufficient. At the creditor's option, a more specific description of the property involved may be given.

4. Additional collateral. If collateral is required when advances reach a certain amount, the creditor should disclose the information available at the time of the account-opening disclosures. For example, if the creditor knows that a security interest will be taken in household goods if the consumer's balance exceeds $1,000, the creditor should disclose accordingly. If the creditor knows that security will be required if the consumer's balance exceeds $1,000, but the creditor does not know what security will be required, the creditor must disclose on the initial disclosure statement that security will be required if the balance exceeds $1,000, and the creditor must provide a change-in- terms notice under § 226.9(c) at the time the security is taken. (See comment 6(a)(4)-2.)

5. Collateral from third party. Security interests taken in connection with the plan must be disclosed, whether the

collateral is owned by the consumer or a third party.

6(a)(5) Statement of billing rights.

1. See the commentary to Model Forms G-3, G-3(A), G-4, and G-4(A).

6(b) Rules affecting open-end (not home-secured) plans.

6(b)(1) Form of disclosures; tabular format for open-end (not home-secured) plans.

1. Relation to tabular summary for applications and solicitations. See commentary to § 226.5a(a), (b), and (c) regarding format and content requirements, except for the following:

i. Creditors must use the accuracy standard for annual percentage rates in § 226.6(b)(4)(ii)(G).

ii. Generally, creditors must disclose the specific rate for each feature that applies to the account. If the rates on an open-end (not home-secured) plan vary by state and the creditor is providing the account-opening table in person at the time the plan is established in connection with financing the purchase of goods or services the creditor may, at its option, disclose in the account-opening table (A) the rate applicable to the consumer's account, or (B) the range of rates, if the disclosure includes a statement that the rate varies by state and refers the consumer to the account agreement or other disclosure provided with the account-opening table where the rate applicable to the consumer's account is disclosed.

iii. Creditors must explain whether or not a grace period exists for all features on the account. The row heading "Paying Interest" must be used if any one feature on the account does not have a grace period.

iv. Creditors must name the balance computation method used for each feature of the account and state that an explanation of the balance computation method(s) is provided in the account-opening disclosures.

v. Creditors must state that consumers' billing rights are provided in the account-opening disclosures.

vi. If fees on an open-end (not home-secured) plan vary by state and the creditor is providing the account-opening table in person at the time the plan is established in connection with financing the purchase of goods or services the creditor may, at its option, disclose in the account-opening table (A) the specific fee applicable to the consumer's account, or (B) the range of fees, if the disclosure includes a statement that the amount of the fee varies by state and

refers the consumer to the account agreement or other disclosure provided with the account-opening table where the fee applicable to the consumer's account is disclosed.

vii. Creditors that must disclose the amount of available credit must state the initial credit limit provided on the account.

viii. Creditors must disclose directly beneath the table the circumstances under which an introductory rate may be revoked and the rate that will apply after the introductory rate is revoked. Issuers of credit card accounts under an open-end (not home-secured) consumer credit plan are subject to limitations on the circumstances under which an introductory rate may be revoked. (See comment 5a(b)(1)-5 for guidance on how a card issuer may disclose the circumstances under which an introductory rate may be revoked.)

ix. The applicable forms providing safe harbors for account-opening tables are under appendix G-17 to part 226.

2. Clear and conspicuous standard. See comment 5(a)(1)-1 for the clear and conspicuous standard applicable to § 226.6 disclosures.

3. Terminology. Section 226.6(b)(1) generally requires that the headings, content, and format of the tabular disclosures be substantially similar, but need not be identical, to the tables in appendix G to part 226; but see § 226.5(a)(2) for terminology requirements applicable to § 226.6(b).

6(b)(2) Required disclosures for account-opening table for open-end (not home-secured) plans.

6(b)(2)(iii) Fixed finance charge; minimum interest charge.

1. Example of brief statement. See Samples G-17(B), G-17(C), and G-17(D) for guidance on how to provide a brief description of a minimum interest charge.

6(b)(2)(v) Grace period.

1. Grace period. Creditors must state any conditions on the applicability of the grace period. A creditor that offers a grace period on all types of transactions for the account and conditions the grace period on the consumer paying his or her outstanding balance in full by the due date each billing cycle, or on the consumer paying the outstanding balance in full by the due date in the previous and/or the current billing cycle(s) will be deemed to meet these requirements by providing the following disclosure, as applicable: "Your due date is [at least]] days after the close of each billing cycle. We will not charge you any interest on your account if you pay your entire balance by the due date each month."

2. No grace period. Creditors may use the following language to describe that no grace period is offered, as applicable: "We will begin charging interest on [applicable transactions] on the transaction date."

3. Grace period on some features. See Samples G-17(B) and G-17(C) for guidance on complying with § 226.6(b)(2)(v) when a creditor offers a grace period for purchases but no grace period on balance transfers and cash advances.

4. Limitations on the imposition of finance charges in § 226.54. Section 226.6(b)(2)(v) does not require a card issuer to disclose the limitations on the imposition of finance charges in § 226.54.

6(b)(2)(vi) Balance computation method.

1. Content. See Samples G-17(B) and G-17(C) for guidance on how to disclose the balance computation method where the same method is used for all features on the account.

6(b)(2)(xiii) Available credit.

1. RRight to reject the plan. Creditors may use the following language to describe consumers' right to reject a plan after receiving account-opening disclosures: "You may still reject this plan, provided that you have not yet used the account or paid a fee after receiving a billing statement. If you do reject the plan, you are not responsible for any fees or charges."

6(b)(3) Disclosure of charges imposed as part of open-end (not home-secured) plans.

1. When finance charges accrue. Creditors are not required to disclose a specific date when a cost that is a finance charge under § 226.4 will begin to accrue.

2. Grace periods. In disclosing in the account agreement or disclosure statement whether or not a grace period exists, the creditor need not use any particular descriptive phrase or term. However, the descriptive phrase or term must be sufficiently similar to the disclosures provided pursuant to §§ 226.5a(b)(5) and 226.6(b)(2)(v) to satisfy a creditor's duty to provide consistent terminology under § 226.5(a)(2).

3. No finance charge imposed below certain balance. Creditors are not required to disclose the fact that no finance charge is imposed when the outstanding balance is less than a certain amount or the balance below which no finance charge will be imposed.

Paragraph 6(b)(3)(ii).

1. Failure to use the plan as agreed. Late payment fees, over-the-limit fees, and fees for payments returned unpaid are examples of charges resulting from consumers' failure to use the plan as agreed.

2. Examples of fees that affect the plan. Examples of charges the payment, or nonpayment, of which affects the consumer's account are:

i. Access to the plan. Fees for using the card at the creditor's ATM to obtain a cash advance, fees to obtain additional cards including replacements for lost or stolen cards, fees to expedite delivery of cards or other credit devices, application and membership fees, and annual or other participation fees identified in § 226.4(c)(4).

ii. Amount of credit extended. Fees for increasing the credit limit on the account, whether at the consumer's request or unilaterally by the creditor.

iii. Timing or method of billing or payment. Fees to pay by telephone or via the Internet.

3. Threshold test. If the creditor is unsure whether a particular charge is a cost imposed as part of the plan, the creditor may at its option consider such charges as a cost imposed as part of the plan for purposes of the Truth in Lending Act.

Paragraph 6(b)(3)(iii)(B).

1. Fees for package of services. A fee to join a credit union is an example of a fee for a package of services that is not imposed as part of the plan, even if the consumer must join the credit union to apply for credit. In contrast, a membership fee is an example of a fee for a package of services that is considered to be imposed as part of a plan where the primary benefit of membership in the organization is the opportunity to apply for a credit card, and the other benefits offered (such as a newsletter or a member information hotline) are merely incidental to the credit feature.

6(b)(4) Disclosure of rates for open-end (not home-secured) plans.

Paragraph 6(b)(4)(i)(B).

1. Range of balances. Creditors are not required to disclose the range of balances:

i. If only one periodic interest rate may be applied to the entire account balance.

ii. If only one periodic interest rate may be applied to the entire balance for a feature (for example, cash advances), even though the balance for another feature (purchases) may be subject to two rates (a 1.5% monthly periodic interest rate on purchase balances of $0-$500, and a 1% periodic interest rate for balances above $500). In this example, the creditor must give a range of balances disclosure for the purchase feature.

Paragraph 6(b)(4)(i)(D).

1. Explanation of balance computation method. Creditors do not provide a sufficient explanation of a balance computation method by using a shorthand phrase such as "previous balance method" or the name of a balance computation method listed in § 226.5a(g). (See Model Clauses G-1(A) in appendix G to part 226. See § 226.6(b)(2)(vi) regarding balance computation descriptions in the account-opening summary.)

2. Allocation of payments. Creditors may, but need not, explain how payments and other credits are allocated to outstanding balances.

6(b)(4)(ii) Variable-rate accounts.

1. Variable-rate disclosures--coverage.

i. Examples. Examples of open-end plans that permit the rate to change and are considered variable-rate plans include:

A. Rate changes that are tied to the rate the creditor pays on its six-month certificates of deposit.

B. Rate changes that are tied to Treasury bill rates.

C. Rate changes that are tied to changes in the creditor's commercial lending rate.

ii. Examples of open-end plans that permit the rate to change and are not considered variable-rate include:

A. Rate changes that are invoked under a creditor's contract reservation to increase the rate without reference to such an index or formula (for example, a plan that simply provides that the creditor reserves the right to raise its rates).

B. Rate changes that are triggered by a specific event such as an open-end credit plan in which the employee receives a lower rate contingent upon employment, and the rate increases upon termination of employment.

2. Variable-rate plan--circumstances for increase.

i. The following are examples that comply with the requirement to disclose circumstances under which the rate(s) may increase:

A. "The Treasury bill rate increases."

B. "The Federal Reserve discount rate increases."

ii. Disclosing the frequency with which the rate may increase includes disclosing when the increase will take effect; for example:

A. "An increase will take effect on the day that the Treasury bill rate increases."

B. "An increase in the Federal Reserve discount rate will take effect on the first day of the creditor's billing cycle."

3. Variable-rate plan--limitations on increase. In disclosing any limitations on rate increases, limitations such as the maximum increase per year or the maximum increase over the duration of the plan must be disclosed. When there are no limitations, the creditor may, but need not, disclose that fact. Legal limits such as usury or rate ceilings under state or federal statutes or regulations need not be disclosed. Examples of limitations that must be disclosed include:

i. "The rate on the plan will not exceed 25% annual percentage rate."

ii. "Not more than 1/2 of 1% increase in the annual percentage rate per year will occur."

4. Variable-rate plan--effects of increase. Examples of effects of rate increases that must be disclosed include:

i. Any requirement for additional collateral if the annual percentage rate increases beyond a specified rate.

ii. Any increase in the scheduled minimum periodic payment amount.

5. Discounted variable-rate plans. In some variable-rate plans, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate is lower than the rate would be if it were calculated using the index or formula.

i. For example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the current Treasury bill rate is 10 percent, the creditor may forgo the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent, or the creditor may disregard the index or formula and set the initial rate at 9 percent.

ii. When creditors disclose in the account-opening disclosures an initial rate that is not calculated using the index or formula for later rate adjustments, the disclosure should reflect:

A. The initial rate (expressed as a periodic rate and a corresponding annual percentage rate), together with a statement of how long the initial rate will remain in effect;

B. The current rate that would have been applied using the index or formula (also expressed as a periodic rate and a corresponding annual percentage rate); and

C. The other variable-rate information required by § 226.6(b)(4)(ii).

6(b)(4)(iii) Rate changes not due to index or formula.

1. Events that cause the initial rate to change.

i. Changes based on expiration of time period. If the initial rate will change at the expiration of a time period, creditors that disclose the initial rate in the account-opening disclosure must identify the expiration date and the fact that the initial rate will end at that time.

ii. Changes based on specified contract terms. If the account agreement provides that the creditor may change the initial rate upon the occurrence of a specified event or events, the creditor must identify the events or events. Examples include the consumer not making the required minimum payment when due, or the termination of an employee preferred rate when the employment relationship is terminated.

2. Rate that will apply after initial rate changes.

i. Increased margins. If the initial rate is based on an index and the rate may increase due to a change in the margin applied to the index, the creditor must disclose the increased margin. If more than one margin could apply, the creditor may disclose the highest margin.

ii. Risk-based pricing. In some plans, the amount of the rate change depends on how the creditor weighs the occurrence of events specified in the account agreement that authorize the creditor to change rates, as well as other factors. Creditors must state the increased rate that may apply. At the creditor's option, the creditor may state the possible rates as a range, or by stating only the highest rate that could be assessed. The creditor must disclose the period for which the increased rate will remain in effect, such as "until you make three timely payments," or if there is no limitation, the fact that the increased rate may remain indefinitely.

3. Effect of rate change on balances. Creditors must disclose information to consumers about the balance to which the new rate will apply and the balance to which the current rate at the time of the change will apply. Card issuers subject to § 226.55 may be subject to certain restrictions on the application of increased rates to certain balances.

6(b)(5) Additional disclosures for open-end (not home-secured) plans.

6(b)(5)(i) Voluntary credit insurance, debt cancellation or debt suspension.

1. Timing. Under § 226.4(d), disclosures required to exclude the cost of voluntary credit insurance or debt cancellation or debt suspension coverage from the finance charge must be provided before the consumer agrees to the purchase of the insurance or coverage. Creditors comply with § 226.6(b)(5)(i) if they provide those disclosures in accordance with § 226.4(d). For example, if the disclosures required by § 226.4(d) are provided at application, creditors need not repeat those disclosures at account opening.

6(b)(5)(ii) Security interests.

1. General. Creditors are not required to use specific terms to describe a security interest, or to explain the type of security or the creditor's rights with respect to the collateral.

2. Identification of property. Creditors sufficiently identify collateral by type by stating, for example, motor vehicle or household appliances. (Creditors should be aware, however, that the federal credit practices rules, as well as some state laws, prohibit certain security interests in household goods.) The creditor may, at its option, provide a more specific identification (for example, a model and serial number.)

3. Spreader clause. If collateral for preexisting credit with the creditor will secure the plan being opened, the creditor must disclose that fact. (Such security interests may be known as "spreader" or "dragnet" clauses, or as "cross-collateralization" clauses.) The creditor need not specifically identify the collateral; a reminder such as "collateral securing other loans with us may also secure this loan" is sufficient. At the creditor's option, a more specific description of the property involved may be given.

4. Additional collateral. If collateral is required when advances reach a certain amount, the creditor should disclose the information available at the time of the account-opening disclosures. For example, if the creditor knows that a security interest will be taken in household goods if the consumer's balance exceeds $1,000, the creditor should disclose accordingly. If the creditor knows that security will be required if the consumer's balance exceeds $1,000, but the creditor does not know what security will be required, the creditor must disclose on the initial disclosure statement that security will be required if the balance exceeds $1,000, and the creditor must provide a change-in-terms notice under § 226.9(c) at the time the security is taken. (See comment 6(b)(5)(ii)-2.)

5. Collateral from third party. Security interests taken in connection with the plan must be disclosed, whether the collateral is owned by the consumer or a third party.

6(b)(5)(iii) Statement of billing rights.

1. See the commentary to Model Forms G-3(A) and G-4(A).

Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual Section 226.7

§ **226.7 Periodic Statement**

1. Multifeatured plans. Some plans involve a number of different features, such as purchases, cash advances, or overdraft checking. Groups of transactions subject to different finance charge terms because of the dates on which the transactions took place are treated like different features for purposes of disclosures on the periodic statements. The commentary includes additional guidance for multifeatured plans.

7(a) Rules affecting home-equity plans.

7(a)(1) Previous balance.

1. Credit balances. If the previous balance is a credit balance, it must be disclosed in such a way so as to inform the consumer that it is a credit balance, rather than a debit balance.

2. Multifeatured plans. In a multifeatured plan, the previous balance may be disclosed either as an aggregate balance for the account or as separate balances for each feature (for example, a previous balance for purchases and a previous balance for cash advances). If separate balances are disclosed, a total previous balance is optional.

3. Accrued finance charges allocated from payments. Some open-end credit plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and reflected as an increase in the obligation. In such a plan, the previous balance need not reflect finance charges accrued since the last payment.

7(a)(2) Identification of transactions.

1. Multifeatured plans. In identifying transactions under § 226.7(a)(2) for multifeatured plans, creditors may, for example, choose to arrange transactions by feature (such as disclosing sale transactions separately from cash advance transactions) or in some other clear manner, such as by arranging the transactions in general chronological order.

2. Automated teller machine (ATM) charges imposed by other institutions in shared or interchange systems. A charge imposed on the cardholder by an institution other than the card issuer for the use of the other institution's ATM in a shared or interchange system and included by the terminal-operating institution in the amount of the transaction need not be separately disclosed on the periodic statement.

7(a)(3) Credits.

1. Identification--sufficiency. The creditor need not describe each credit by type (returned merchandise, rebate of finance charge, etc.)--"credit" would suffice--except if the creditor is using the periodic statement to satisfy the billing-error correction notice requirement. (See the commentary to § 226.13(e) and (f).)

2. Format. A creditor may list credits relating to credit extensions (payments, rebates, etc.) together with other types of credits (such as deposits to a checking account), as long as the entries are identified so as to inform the consumer which type of credit each entry represents.

3. Date. If only one date is disclosed (that is, the crediting date as required by the regulation), no further identification of that date is necessary. More than one date may be disclosed for a single entry, as long as it is clear which date represents the date on which credit was given.

4. Totals. A total of amounts credited during the billing cycle is not required.

7(a)(4) Periodic rates.

1. Disclosure of periodic rates--whether or not actually applied. Except as provided in § 226.7(a)(4)(ii), any periodic rate that may be used to compute finance charges (and its corresponding annual percentage rate) must be disclosed whether or not it is applied during the billing cycle. For example:

i. If the consumer's account has both a purchase feature and a cash advance feature, the creditor must disclose the rate for each, even if the consumer only makes purchases on the account during the billing cycle.

ii. If the rate varies (such as when it is tied to a particular index), the creditor must disclose each rate in effect

during the cycle for which the statement was issued.

2. Disclosure of periodic rates required only if imposition possible. With regard to the periodic rate disclosure (and its corresponding annual percentage rate), only rates that could have been imposed during the billing cycle reflected on the periodic statement need to be disclosed. For example:

i. If the creditor is changing rates effective during the next billing cycle (because of a variable-rate plan), the rates required to be disclosed under § 226.7(a)(4) are only those in effect during the billing cycle reflected on the periodic statement. For example, if the monthly rate applied during May was 1.5%, but the creditor will increase the rate to 1.8% effective June 1, 1.5% (and its corresponding annual percentage rate) is the only required disclosure under § 226.7(a)(4) for the periodic statement reflecting the May account activity.

ii. If rates applicable to a particular type of transaction changed after a certain date and the old rate is only being applied to transactions that took place prior to that date, the creditor need not continue to disclose the old rate for those consumers that have no outstanding balances to which that rate could be applied.

3. Multiple rates--same transaction. If two or more periodic rates are applied to the same balance for the same type of transaction (for example, if the finance charge consists of a monthly periodic rate of 1.5% applied to the outstanding balance and a required credit life insurance component calculated at 0.1% per month on the same outstanding balance), the creditor may do either of the following:

i. Disclose each periodic rate, the range of balances to which it is applicable, and the corresponding annual percentage rate for each. (For example, 1.5% monthly, 18% annual percentage rate; 0.1% monthly, 1.2% annual percentage rate.)

ii. Disclose one composite periodic rate (that is, 1.6% per month) along with the applicable range of balances and the corresponding annual percentage rate.

4. Corresponding annual percentage rate. In disclosing the annual percentage rate that corresponds to each periodic rate, the creditor may use "corresponding annual percentage rate," "nominal annual percentage rate," "corresponding nominal annual percentage rate," or similar phrases.

5. Rate same as actual annual percentage rate. When the corresponding rate is the same as the annual percentage rate disclosed under § 226.7(a)(7), the creditor need disclose only one annual percentage rate, but must use the phrase "annual percentage rate."

6. Range of balances. See comment 6(a)(1)(ii)-1. A creditor is not required to adjust the range of balances disclosure to reflect the balance below which only a minimum charge applies.

7(a)(5) Balance on which finance charge computed.

1. Limitation to periodic rates. Section 226.7(a)(5) only requires disclosure of the balance(s) to which a periodic rate was applied and does not apply to balances on which other kinds of finance charges (such as transaction charges) were imposed. For example, if a consumer obtains a $1,500 cash advance subject to both a 1% transaction fee and a 1% monthly periodic rate, the creditor need only disclose the balance subject to the monthly rate (which might include portions of earlier cash advances not paid off in previous cycles).

2. Split rates applied to balance ranges. If split rates were applied to a balance because different portions of the balance fall within two or more balance ranges, the creditor need not separately disclose the portions of the balance subject to such different rates since the range of balances to which the rates apply has been separately disclosed. For example, a creditor could disclose a balance of $700 for purchases even though a monthly periodic rate of 1.5% applied to the first $500, and a monthly periodic rate of 1% to the remainder. This option to disclose a combined balance does not apply when the finance charge is computed by applying the split rates to each day's balance (in contrast, for example, to applying the rates to the average daily balance). In that case, the balances must be disclosed using any of the options that are available if two or more daily rates are imposed. (See comment 7(a)(5)-5.)

3. Monthly rate on average daily balance. Creditors may apply a monthly periodic rate to an average daily balance.

4. Multifeatured plans. In a multifeatured plan, the creditor must disclose a separate balance (or balances, as applicable) to which a periodic rate was applied for each feature or group of features subject to different periodic rates or different balance computation methods. Separate balances are not required, however, merely because a grace period is available for some features but not others. A total balance for the entire plan is optional. This does not affect how many balances the creditor must disclose--or may disclose--within each feature. (See, for example, comment 7(a)(5)-5.)

5. Daily rate on daily balances.

i. If the finance charge is computed on the balance each day by application of one or more daily periodic rates, the balance on which the finance charge was computed may be disclosed in any of the following ways for each feature:

ii. If a single daily periodic rate is imposed, the balance to which it is applicable may be stated as:

A. A balance for each day in the billing cycle.

B. A balance for each day in the billing cycle on which the balance in the account changes.

C. The sum of the daily balances during the billing cycle.

D. The average daily balance during the billing cycle, in which case the creditor shall explain that the average daily balance is or can be multiplied by the number of days in the billing cycle and the periodic rate applied to the product to determine the amount of the finance charge.

iii. If two or more daily periodic rates may be imposed, the balances to which the rates are applicable may be stated as:

A. A balance for each day in the billing cycle.

B. A balance for each day in the billing cycle on which the balance in the account changes.

C. Two or more average daily balances, each applicable to the daily periodic rates imposed for the time that those rates were in effect, as long as the creditor explains that the finance charge is or may be determined by (1) multiplying each of the average balances by the number of days in the billing cycle (or if the daily rate varied during the cycle, by multiplying by the number of days the applicable rate was in effect), (2) multiplying each of the results by the applicable daily periodic rate, and (3) adding these products together.

6. Explanation of balance computation method. See the commentary to 6(a)(1)(iii).

7. Information to compute balance. In connection with disclosing the finance charge balance, the creditor need not give the consumer all of the information necessary to compute the balance if that information is not otherwise required to be disclosed. For example, if current purchases are included from the date they are posted to the account, the posting date need not be disclosed.

8. Non-deduction of credits. The creditor need not specifically identify the total dollar amount of credits not deducted

in computing the finance charge balance. Disclosure of the amount of credits not deducted is accomplished by listing the credits (§ 226.7(a)(3)) and indicating which credits will not be deducted in determining the balance (for example, "credits after the 15th of the month are not deducted in computing the finance charge.").

9. Use of one balance computation method explanation when multiple balances disclosed. Sometimes the creditor will disclose more than one balance to which a periodic rate was applied, even though each balance was computed using the same balance computation method. For example, if a plan involves purchases and cash advances that are subject to different rates, more than one balance must be disclosed, even though the same computation method is used for determining the balance for each feature. In these cases, one explanation of the balance computation method is sufficient. Sometimes the creditor separately discloses the portions of the balance that are subject to different rates because different portions of the balance fall within two or more balance ranges, even when a combined balance disclosure would be permitted under comment 7(a)(5)-2. In these cases, one explanation of the balance computation method is also sufficient (assuming, of course, that all portions of the balance were computed using the same method).

7(a)(6) Amount of finance charge and other charges.

Paragraph 7(a)(6)(i).

1. Total. A total finance charge amount for the plan is not required.

2. Itemization--types of finance charges. Each type of finance charge (such as periodic rates, transaction charges, and minimum charges) imposed during the cycle must be separately itemized; for example, disclosure of only a combined finance charge attributable to both a minimum charge and transaction charges would not be permissible. Finance charges of the same type may be disclosed, however, individually or as a total. For example, five transaction charges of $1 may be listed separately or as $5.

3. Itemization--different periodic rates. Whether different periodic rates are applicable to different types of transactions or to different balance ranges, the creditor may give the finance charge attributable to each rate or may give a total finance charge amount. For example, if a creditor charges 1.5% per month on the first $500 of a balance and 1% per month on amounts over $500, the creditor may itemize the two components ($7.50 and $1.00) of the $8.50 charge, or may disclose $8.50.

4. Multifeatured plans. In a multifeatured plan, in disclosing the amount of the finance charge attributable to the application of periodic rates no total periodic rate disclosure for the entire plan need be given.

5. Finance charges not added to account. A finance charge that is not included in the new balance because it is payable to a third party (such as required life insurance) must still be shown on the periodic statement as a finance charge.

6. Finance charges other than periodic rates. See comment 6(a)(1)(iv)-1 for examples.

7. Accrued finance charges allocated from payments. Some plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and therefore reflected as an increase in the obligation. In such a plan, no disclosure is required of finance charges that have accrued since the last payment.

8. Start-up fees. Points, loan fees, and similar finance charges relating to the opening of the account that are paid prior to the issuance of the first periodic statement need not be disclosed on the periodic statement. If, however, these charges are financed as part of the plan, including charges that are paid out of the first advance, the charges must be disclosed as part of the finance charge on the first periodic statement. However, they need not be factored into the annual percentage rate. (See§ 226.14(c)(3).)

Paragraph 7(a)(6)(ii).

1. Identification. In identifying any other charges actually imposed during the billing cycle, the type is adequately described as late charge or membership fee, for example. Similarly, closing costs or settlement costs, for example, may be used to describe charges imposed in connection with real estate transactions that are excluded from the finance charge under § 226.4(c)(7), if the same term (such as closing costs) was used in the initial disclosures and if the creditor chose to itemize and individually disclose the costs included in that term. Even though the taxes and filing or notary fees excluded from the finance charge under § 226.4(e) are not required to be disclosed as other charges under § 226.6(a)(2), these charges may be included in the amount shown as closing costs or settlement costs on the periodic statement, if the charges were itemized and disclosed as part of the closing costs or See comment 6(a)(2)-1 for examples of other charges.)

2. Date. The date of imposing or debiting other charges need not be disclosed.

3. Total. Disclosure of the total amount of other charges is optional.

4. Itemization--types of other charges. Each type of other charge (such as late-payment charges, over-the-credit-limit charges, and membership fees) imposed during the cycle must be separately itemized; for example, disclosure of only a total of other charges attributable to both an over-the-credit-limit charge and a late-payment charge would not be permissible. Other charges of the same type may be disclosed, however, individually or as a total. For example, three fees of $3 for providing copies related to the resolution of a billing error could be listed separately or as $9.

7(a)(7) Annual percentage rate.

1. Plans subject to the requirements of § 226.5b. For home-equity plans subject to the requirements of § 226.5b, creditors are not required to disclose an effective annual percentage rate. Creditors that state an annualized rate in addition to the corresponding annual percentage rate required by § 226.7(a)(4) must calculate that rate in accordance with § 226.14(c).

2. Labels. Creditors that choose to disclose an annual percentage rate calculated under § 226.14(c) and label the figure as "annual percentage rate" must label the periodic rate expressed as an annualized rate as the "corresponding APR," "nominal APR," or a similar phrase as provided in comment 7(a)(4)-4. Creditors also comply with the label requirement if the rate calculated under § 226.14(c) is described as the "effective APR" or something similar. For those creditors, the periodic rate expressed as an annualized rate could be labeled "annual percentage rate," consistent with the requirement under § 226.7(b)(4). If the two rates represent different values, creditors must label the rates differently to meet the clear and conspicuous standard under § 226.5(a)(1).

7(a)(8) Grace period.

1. Terminology. Although the creditor is required to indicate any time period the consumer may have to pay the balance outstanding without incurring additional finance charges, no specific wording is required, so long as the language used is consistent with that used on the account-opening disclosure statement. For example, "To avoid additional finance charges, pay the new balance before "would suffice.

7(a)(9) Address for notice of billing errors.

1. Terminology. The periodic statement should indicate the general purpose for the address for billing-error inquiries, although a detailed explanation or particular wording is not required.

2. Telephone number. A telephone number, e-mail address, or Web site location may be included, but the mailing address for billing-error inquiries, which is the required disclosure, must be clear and conspicuous. The address is deemed to be clear and conspicuous if a precautionary instruction is included that telephoning or notifying the creditor by e-mail or Web site will not preserve the consumer's billing rights, unless the creditor has agreed to treat billing error notices provided by electronic means as written notices, in which case the precautionary instruction is required only for telephoning.

7(a)(10) Closing date of billing cycle; new balance.

1. Credit balances. See comment 7(a)(1)-1.

2. Multifeatured plans. In a multifeatured plan, the new balance may be disclosed for each feature or for the plan as a whole. If separate new balances are disclosed, a total new balance is optional.

3. Accrued finance charges allocated from payments. Some plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and therefore reflected as an increase in the obligation. In such a plan, the new balance need not reflect finance charges accrued since the last payment.

7(b) Rules affecting open-end (not home-secured) plans.

1. Deferred interest or similar transactions. Creditors offer a variety of payment plans for purchases that permit consumers to avoid interest charges if the purchase balance is paid in full by a certain date. "Deferred interest" has the same meaning as in § 226.16(h)(2) and associated commentary. The following provides guidance for a deferred interest or similar plan where, for example, no interest charge is imposed on a $500 purchase made in January if the $500 balance is paid by July 31.

i. Annual percentage rates. Under § 226.7(b)(4), creditors must disclose each annual percentage rate that may be used to compute the interest charge. Under some plans with a deferred interest or similar feature, if the deferred interest balance is not paid by a certain date, July 31 in this example, interest charges applicable to the billing cycles between the date of purchase in January and July 31 may be imposed. Annual percentage rates that may apply to the deferred interest balance ($500 in this example) if the balance is not paid in full by July 31 must appear on periodic statements for the billing cycles between the date of purchase and July 31. However, if the consumer does not pay the deferred interest balance by July 31, the creditor is not required to identify, on the periodic statement disclosing the interest charge for the deferred interest balance, annual percentage rates that have been disclosed in previous billing cycles between the date of purchase and July 31.

ii. Balances subject to periodic rates. Under § 226.7(b)(5), creditors must disclose the balances subject to interest during a billing cycle. The deferred interest balance ($500 in this example) is not subject to interest for billing cycles between the date of purchase and July 31 in this example. Periodic statements sent for those billing cycles should not include the deferred interest balance in the balance disclosed under § 226.7(b)(5). This amount must be separately disclosed on periodic statements and identified by a term other than the term used to identify the balance disclosed under § 226.7(b)(5) (such as "deferred interest balance"). During any billing cycle in which an interest charge on the deferred interest balance is debited to the account, the balance disclosed under § 226.7(b)(5) should include the deferred interest balance for that billing cycle.

iii. Amount of interest charge. Under § 226.7(b)(6)(ii), creditors must disclose interest charges imposed during a billing cycle. For some deferred interest purchases, the creditor may impose interest from the date of purchase if the deferred interest balance ($500 in this example) is not paid in full by July 31 in this example, but otherwise will not impose interest for billing cycles between the date of purchase and July 31. Periodic statements for billing cycles preceding July 31 in this example should not include in the interest charge disclosed under § 226.7(b)(6)(ii) the amounts a consumer may owe if the deferred interest balance is not paid in full by July 31. In this example, the February periodic statement should not identify as interest charges interest attributable to the $500 January purchase. This amount must be separately disclosed on periodic statements and identified by a term other than "interest charge" (such as "contingent interest charge" or "deferred interest charge"). The interest charge on a deferred interest balance should be reflected on the periodic statement under § 226.7(b)(6)(ii) for the billing cycle in which the interest charge is debited to the account.

iv. Due date to avoid obligation for finance charges under a deferred interest or similar program. Section 226.7(b)(14) requires disclosure on periodic statements of the date by which any outstanding balance subject to a deferred interest or similar program must be paid in full in order to avoid the obligation for finance charges on such balance. This disclosure must appear on the front of each periodic statement issued during the deferred interest period beginning with the first periodic statement issued during the deferred interest period that reflects the deferred interest or similar transaction.

7(b)(1) Previous balance.

1. Credit balances. If the previous balance is a credit balance, it must be disclosed in such a way so as to inform the consumer that it is a credit balance, rather than a debit balance.

2. Multifeatured plans. In a multifeatured plan, the previous balance may be disclosed either as an aggregate balance for the account or as separate balances for each feature (for example, a previous balance for purchases and a previous balance for cash advances). If separate balances are disclosed, a total previous balance is optional.

3. Accrued finance charges allocated from payments. Some open-end credit plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and reflected as an increase in the obligation. In such a plan, the previous balance need not reflect finance charges accrued since the last payment.

7(b)(2) Identification of transactions.

1. Multifeatured plans. Creditors may, but are not required to, arrange transactions by feature (such as disclosing purchase transactions separately from cash advance transactions). Pursuant to § 226.7(b)(6), however, creditors must group all fees and all interest separately from transactions and may not disclose any fees or interest charges with transactions.

2. Automated teller machine (ATM) charges imposed by other institutions in shared or interchange systems. A charge imposed on the cardholder by an institution other than the card issuer for the use of the other institution's ATM in a shared or interchange system and included by the terminal-operating institution in the amount of the transaction need not be separately disclosed on the periodic statement.

7(b)(3) Credits.

1. Identification--sufficiency. The creditor need not describe each credit by type (returned merchandise, rebate of finance charge, etc.)--"credit" would suffice--except if the creditor is using the periodic statement to satisfy the billing-error correction notice requirement. (See the commentary to § 226.13(e) and (f).) Credits may be distinguished

from transactions in any way that is clear and conspicuous, for example, by use of debit and credit columns or by use of plus signs and/or minus signs.

2. Date. If only one date is disclosed (that is, the crediting date as required by the regulation), no further identification of that date is necessary. More than one date may be disclosed for a single entry, as long as it is clear which date represents the date on which credit was given.

3. Totals. A total of amounts credited during the billing cycle is not required.

7(b)(4) Periodic rates.

1. Disclosure of periodic interest rates--whether or not actually applied. Except as provided in § 226.7(b)(4)(ii), any periodic interest rate that may be used to compute finance charges, expressed as and labeled "Annual Percentage Rate," must be disclosed whether or not it is applied during the billing cycle. For example:

i. If the consumer's account has both a purchase feature and a cash advance feature, the creditor must disclose the annual percentage rate for each, even if the consumer only makes purchases on the account during the billing cycle.

ii. If the annual percentage rate varies (such as when it is tied to a particular index), the creditor must disclose each annual percentage rate in effect during the cycle for which the statement was issued.

2. Disclosure of periodic interest rates required only if imposition possible. With regard to the periodic interest rate disclosure (and its corresponding annual percentage rate), only rates that could have been imposed during the billing cycle reflected on the periodic statement need to be disclosed. For example:

i. If the creditor is changing annual percentage rates effective during the next billing cycle (either because it is changing terms or because of a variable-rate plan), the annual percentage rates required to be disclosed under § 226.7(b)(4) are only those in effect during the billing cycle reflected on the periodic statement. For example, if the annual percentage rate applied during May was 18%, but the creditor will increase the rate to 21% effective June 1, 18% is the only required disclosure under § 226.7(b)(4) for the periodic statement reflecting the May account activity.

ii. If the consumer has an overdraft line that might later be expanded upon the consumer's request to include secured advances, the rates for the secured advance feature need not be given until such time as the consumer has requested and received access to the additional feature.

iii. If annual percentage rates applicable to a particular type of transaction changed after a certain date and the old rate is only being applied to transactions that took place prior to that date, the creditor need not continue to disclose the old rate for those consumers that have no outstanding balances to which that rate could be applied.

3. Multiple rates--same transaction. If two or more periodic rates are applied to the same balance for the same type of transaction (for example, if the interest charge consists of a monthly periodic interest rate of 1.5% applied to the outstanding balance and a required credit life insurance component calculated at 0.1% per month on the same outstanding balance), creditors must disclose the periodic interest rate, expressed as an 18% annual percentage rate and the range of balances to which it is applicable. Costs attributable to the credit life insurance component must be disclosed as a fee under § 226.7(b)(6)(iii).

4. Fees. Creditors that identify fees in accordance with § 226.7(b)(6)(iii) need not identify the periodic rate at which a fee would accrue if the fee remains unpaid. For example, assume a fee is imposed for a late payment in the previous cycle and that the fee, unpaid, would be included in the purchases balance and accrue interest at the rate for purchases. The creditor need not separately disclose that the purchase rate applies to the portion of the purchases balance attributable to the unpaid fee.

5. Ranges of balances. See comment 6(b)(4)(i)(B)-1. A creditor is not required to adjust the range of balances disclosure to reflect the balance below which only a minimum charge applies.

6. Deferred interest transactions. See comment 7(b)-1.i.

7(b)(5) Balance on which finance charge computed.

1. Split rates applied to balance ranges. If split rates were applied to a balance because different portions of the balance fall within two or more balance ranges, the creditor need not separately disclose the portions of the balance subject to such different rates since the range of balances to which the rates apply has been separately disclosed. For example, a creditor could disclose a balance of $700 for purchases even though a monthly periodic rate of 1.5% applied to the first $500, and a monthly periodic rate of 1% to the remainder. This option to disclose a combined balance does not apply when the interest charge is computed by applying the split rates to each day's balance (in contrast, for example, to applying the rates to the average daily balance). In that case, the balances must be disclosed using any of the options that are available if two or more daily rates are imposed. (See comment 7(b)(5)-4.)

2. Monthly rate on average daily balance. Creditors may apply a monthly periodic rate to an average daily balance.

3. Multifeatured plans. In a multifeatured plan, the creditor must disclose a separate balance (or balances, as

applicable) to which a periodic rate was applied for each feature. Separate balances are not required, however, merely because a grace period is available for some features but not others. A total balance for the entire plan is optional. This does not affect how many balances the creditor must disclose--or may disclose--within each feature. (See, for example, comments 7(b)(5)-4 and 7(b)(4)-5.)

4. Daily rate on daily balance.

i. If a finance charge is computed on the balance each day by application of one or more daily periodic interest rates, the balance on which the interest charge was computed may be disclosed in any of the following ways for each feature:

ii. If a single daily periodic interest rate is imposed, the balance to which it is applicable may be stated as:

A. A balance for each day in the billing cycle.

B. A balance for each day in the billing cycle on which the balance in the account changes.

C. The sum of the daily balances during the billing cycle.

D. The average daily balance during the billing cycle, in which case the creditor may, at its option, explain that the average daily balance is or can be multiplied by the number of days in the billing cycle and the periodic rate applied to the product to determine the amount of interest.

iii. If two or more daily periodic interest rates may be imposed, the balances to which the rates are applicable may be stated as:

A. A balance for each day in the billing cycle.

B. A balance for each day in the billing cycle on which the balance in the account changes.

C. Two or more average daily balances, each applicable to the daily periodic interest rates imposed for the time that those rates were in effect. The creditor may, at its option, explain that interest is or may be determined by (1) multiplying each of the average balances by the number of days in the billing cycle (or if the daily rate varied during the cycle, by multiplying by the number of days the applicable rate was in effect), (2) multiplying each of the results by the applicable daily periodic rate, and (3) adding these products together.

5. Information to compute balance. In connection with disclosing the interest charge balance, the creditor need not give the consumer all of the information necessary to compute the balance if that information is not otherwise required to be disclosed. For example, if current purchases are included from the date they are posted to the account, the posting date need not be disclosed.

6. Non-deduction of credits. The creditor need not specifically identify the total dollar amount of credits not deducted in computing the finance charge balance. Disclosure of the amount of credits not deducted is accomplished by listing the credits (§ 226.7(b)(3)) and indicating which credits will not be deducted in determining the balance (for example, "credits after the 15th of the month are not deducted in computing the interest charge.").

7. Use of one balance computation method explanation when multiple balances disclosed. Sometimes the creditor will disclose more than one balance to which a periodic rate was applied, even though each balance was computed using the same balance computation method. For example, if a plan involves purchases and cash advances that are subject to different rates, more than one balance must be disclosed, even though the same computation method is used for determining the balance for each feature. In these cases, one explanation or a single identification of the name of the balance computation method is sufficient. Sometimes the creditor separately discloses the portions of the balance that are subject to different rates because different portions of the balance fall within two or more balance ranges, even when a combined balance disclosure would be permitted under comment 7(b)(5)-1. In these cases, one explanation or a single identification of the name of the balance computation method is also sufficient (assuming, of course, that all portions of the balance were computed using the same method).

8. Deferred interest transactions. See comment 7(b)-1.ii.

7(b)(6) Charges imposed.

1. Examples of charges. See commentary to § 226.6(b)(3).

2. Fees. Costs attributable to periodic rates other than interest charges shall be disclosed as a fee. For example, if a consumer obtains credit life insurance that is calculated at 0.1% per month on an outstanding balance and a monthly interest rate of 1.5% applies to the same balance, the creditor must disclose the dollar cost attributable to interest as an "interest charge" and the credit insurance cost as a "fee."

3. Total fees for calendar year to date.

i. Monthly statements. Some creditors send monthly statements but the statement periods do not coincide with the calendar month. For creditors sending monthly statements, the following comply with the requirement to provide calendar year-to-date totals.

A. A creditor may disclose a calendar-year-to-date total at the end of the calendar year by aggregating fees for 12 monthly cycles, starting with the period that begins during January and finishing with the period that begins during December. For example, if statement periods begin on the 10th day of each month, the statement covering December 10, 2011 through January 9, 2012, may disclose the year-to-date total for fees imposed from January 10, 2011, through January 9, 2012. Alternatively, the creditor could provide a statement for the cycle ending January 9, 2012, showing the year-to-date total for fees imposed January 1, 2011, through December 31, 2011.

B. A creditor may disclose a calendar-year-to-date total at the end of the calendar year by aggregating fees for 12 monthly cycles, starting with the period that begins during December and finishing with the period that begins during November. For example, if statement periods begin on the 10th day of each month, the statement covering November 10, 2011 through December 9, 2011, may disclose the year-to-date total for fees imposed from December 10, 2010, through December 9, 2011.

ii. Quarterly statements. Creditors issuing quarterly statements may apply the guidance set forth for monthly statements to comply with the requirement to provide calendar year-to-date totals on quarterly statements.

4. Minimum charge in lieu of interest. A minimum charge imposed if a charge would otherwise have been determined by applying a periodic rate to a balance except for the fact that such charge is smaller than the minimum must be disclosed as a fee. For example, assume a creditor imposes a minimum charge of $1.50 in lieu of interest if the calculated interest for a billing period is less than that minimum charge. If the interest calculated on a consumer's account for a particular billing period is 50 cents, the minimum charge of $1.50 would apply. In this case, the entire $1.50 would be disclosed as a fee; the periodic statement would reflect the $1.50 as a fee, and $0 in interest.

5. Adjustments to year-to-date totals. In some cases, a creditor may provide a statement for the current period reflecting that fees or interest charges imposed during a previous period were waived or reversed and credited to the account. Creditors may, but are not required to, reflect the adjustment in the year-to-date totals, nor, if an adjustment is made, to provide an explanation about the reason for the adjustment. Such adjustments should not affect the total fees or interest charges imposed for the current statement period.

6. Acquired accounts. An institution that acquires an account or plan must include, as applicable, fees and charges

imposed on the account or plan prior to the acquisition in the aggregate disclosures provided under § 226.7(b)(6) for the acquired account or plan. Alternatively, the institution may provide separate totals reflecting activity prior and subsequent to the account or plan acquisition. For example, a creditor that acquires an account or plan on August 12 of a given calendar year may provide one total for the period from January 1 to August 11 and a separate total for the period beginning on August 12.

7. Account upgrades. A creditor that upgrades, or otherwise changes, a consumer's plan to a different open-end credit plan must include, as applicable, fees and charges imposed for that portion of the calendar year prior to the upgrade or change in the consumer's plan in the aggregate disclosures provided pursuant to § 226.7(b)(6) for the new plan. For example, assume a consumer has incurred $125 in fees for the calendar year to date for a retail credit card account, which is then replaced by a cobranded credit card account also issued by the creditor. In this case, the creditor must reflect the $125 in fees incurred prior to the replacement of the retail credit card account in the calendar year-to-date totals provided for the cobranded credit card account. Alternatively, the institution may provide two separate totals reflecting activity prior and subsequent to the plan upgrade or change.

7(b)(7) Change-in-terms and increased penalty rate summary for open-end (not home-secured) plans.

1. Location of summary tables. If a change-in-terms notice required by § 226.9(c)(2) is provided on or with a periodic statement, a tabular summary of key changes must appear on the front of the statement. Similarly, if a notice of a rate increase due to delinquency or default or as a penalty required by § 226.9(g)(1) is provided on or with a periodic statement, information required to be provided about the increase, presented in a table, must appear on the front of the statement.

7(b)(8) Grace period.

1. Terminology. In describing the grace period, the language used must be consistent with that used on the account-opening disclosure statement. (See § 226.5(a)(2)(i).)

2. Deferred interest transactions. See comment 7(b)-1.iv.

3. Limitations on the imposition of finance charges in § 226.54. Section 226.7(b)(8) does not require a card issuer to disclose the limitations on the imposition of finance charges in § 226.54.

7(b)(9) Address for notice of billing errors.

1. Terminology. The periodic statement should indicate the general purpose for the address for billing-error inquiries, although a detailed explanation or particular wording is not required.

2. Telephone number. A telephone number, e-mail address, or Web site location may be included, but the mailing address for billing-error inquiries, which is the required disclosure, must be clear and conspicuous. The address is deemed to be clear and conspicuous if a precautionary instruction is included that telephoning or notifying the creditor by e-mail or Web site will not preserve the consumer's billing rights, unless the creditor has agreed to treat billing error notices provided by electronic means as written notices, in which case the precautionary instruction is required only for telephoning.

7(b)(10) Closing date of billing cycle; new balance.

1. Credit balances. See comment 7(b)(1)-1.

2. Multifeatured plans. In a multifeatured plan, the new balance may be disclosed for each feature or for the plan as a whole. If separate new balances are disclosed, a total new balance is optional.

3. Accrued finance charges allocated from payments. Some plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and therefore reflected as an increase in the obligation. In such a plan, the new balance need not reflect finance charges accrued since the last payment.

7(b)(11) Due date; late payment costs.

1. Informal periods affecting late payments. Although the terms of the account agreement may provide that a card issuer may assess a late payment fee if a payment is not received by a certain date, the card issuer may have an informal policy or practice that delays the assessment of the late payment fee for payments received a brief period of time after the date upon which a card issuer has the contractual right to impose the fee. A card issuer must disclose the due date according to the legal obligation between the parties, and need not consider the end of an informal "courtesy period" as the due date under § 226.7(b)(11).

2. Assessment of late payment fees. Some state or other laws require that a certain number of days must elapse following a due date before a late payment fee may be imposed. In addition, a card issuer may be restricted by the terms of the account agreement from imposing a late payment fee until a payment is late for a certain number of days following a due date. For example, assume a payment is due on March 10 and the account agreement or state law provides that a late payment fee cannot be assessed before March 21. A card issuer must disclose the due date under the terms of the legal obligation (March 10 in this example), and not a date different than the due date, such as when the card issuer is restricted by the account agreement or state or other law from imposing a late payment fee unless a payment is late for a certain number of days following the due date (March 21 in this example). Consumers' rights under state law to avoid the imposition of late payment fees during a specified period following a due date are unaffected by the disclosure requirement. In this example, the card issuer would disclose March 10 as the due date for purposes of § 226.7(b)(11), but could not, under state law, assess a late payment fee before March 21.

3. Fee or rate triggered by multiple events. If a late payment fee or penalty rate is triggered after multiple events, such as two late payments in six months, the card issuer may, but is not required to, disclose the late payment and penalty rate disclosure each month. The disclosures must be included on any periodic statement for which a late payment could trigger the late payment fee or penalty rate, such as after the consumer made one late payment in this example. For example, if a cardholder has already made one late payment, the disclosure must be on each statement for the following five billing cycles.

4. Range of late fees or penalty rates. A card issuer that imposes a range of late payment fees or rates on a credit card account under an open-end (not home-secured) consumer credit plan may state the highest fee or rate along with an indication lower fees or rates could be imposed. For example, a phrase indicating the late payment fee could be "up to $29" complies with this requirement.

5. Penalty rate in effect. If the highest penalty rate has previously been triggered on an account, the card issuer may, but is not required to, delete the amount of the penalty rate and the warning that the rate may be imposed for an untimely payment, as not applicable. Alternatively, the card issuer may, but is not required to, modify the language to indicate that the penalty rate has been increased due to previous late payments (if applicable).

6. Same day each month. The requirement that the due date be the same day each month means that the due date must generally be the same numerical date. For example, a consumer's due date could be the 25th of every month. In contrast, a due date that is the same relative date but not numerical date each month, such as the third Tuesday of the month, generally would not comply with this requirement. However, a consumer's due date may be the last day of each month, even though that date will not be the same numerical date. For example, if a consumer's due date is the last day of each month, it will fall on February 28th (or February 29th in a leap year) and on August 31st.

7. Change in due date. A creditor may adjust a consumer's due date from time to time provided that the new due date will be the same numerical date each month on an ongoing basis. For example, a creditor may choose to honor a consumer's request to change from a due date that is the 20th of each month to the 5th of each month, or may choose to change a consumer's due date from time to time for operational reasons. See comment 2(a)(4)-3 for guidance on transitional billing cycles.

8. Billing cycles longer than one month. The requirement that the due date be the same day each month does not prohibit billing cycles that are two or three months, provided that the due date for each billing cycle is on the same numerical date of the month. For example, a creditor that establishes two-month billing cycles could send a consumer periodic statements disclosing due dates of January 25, March 25, and May 25.

9. Payment due date when the creditor does not accept or receive payments by mail. If the due date in a given month falls on a day on which the creditor does not receive or accept payments by mail and the creditor is required to treat a payment received the next business day as timely pursuant to § 226.10(d), the creditor must disclose the due date

according to the legal obligation between the parties, not the date as of which the creditor is permitted to treat the payment as late. For example, assume that the consumer's due date is the 4th of every month and the creditor does not accept or receive payments by mail on Thursday, July 4. Pursuant to § 226.10(d), the creditor may not treat a mailed payment received on the following business day, Friday, July 5, as late for any purpose. The creditor must nonetheless disclose July 4 as the due date on the periodic statement and may not disclose a July 5 due date.

7(b)(12) Repayment disclosures.

Paragraph 7(b)(12)(i)(F)

1. Minimum payment repayment estimate disclosed on the periodic statement is three years or less. Section 226.7(b)(12)(i)(F)(2)(i) provides that a credit card issuer is not required to provide the disclosures related to repayment in 36 months if the minimum payment repayment estimate disclosed under § 226.7(b)(12)(i)(B) after rounding is 3 years or less. For example, if the minimum payment repayment estimate is 2 years 6 months to 3 years 5 months, issuers would be required under § 226.7(b)(12)(i)(B) to disclose that it would take 3 years to pay off the balance in full if making only the minimum payment. In these cases, an issuer would not be required to disclose the 36-month disclosures on the periodic statement because the minimum payment repayment estimate disclosed to the consumer on the periodic statement (after rounding) is 3 years or less.

7(b)(12)(iv) Provision of information about credit counseling services.

1. Approved organizations. Section 226.7(b)(12)(iv)(A) requires card issuers to provide information regarding at least three organizations that have been approved by the United States Trustee or a bankruptcy administrator pursuant to*11 U.S.C. 111*(a)(1)to provide credit counseling services in, at the card issuer's option, either the state in which the billing address for the account is located or the state specified by the consumer. A card issuer does not satisfy the requirements in § 226.7(b)(12)(iv)(A) by providing information regarding providers that have been approved pursuant to*11 U.S.C. 111*(a)(2)to offer personal financial management courses.

2. Information regarding approved organizations.

i. Provision of information obtained from United States Trustee or bankruptcy administrator. A card issuer complies with the requirements of § 226.7(b)(12)(iv)(A) if, through the toll-free number disclosed pursuant to § 226.7(b)(12)(i) or (b)(12)(ii), it provides the consumer with information obtained from the United States Trustee or a bankruptcy administrator, such as information obtained from the Web site operated by the United States Trustee. Section 226.7(b)(12)(iv)(A) does not require a card issuer to provide information that is not available from the United States Trustee or a bankruptcy administrator. If, for example, the Web site address for an organization approved by the United States Trustee is not available from the Web site operated by the United States Trustee, a card issuer is not required to provide a Web site address for that organization. However, § 226.7(b)(12)(iv)(B) requires the card issuer to, at least annually, update the information it provides for consistency with the information provided by the United States Trustee or a bankruptcy administrator.

ii. Provision of information consistent with request of approved organization. If requested by an approved organization, a card issuer may at its option provide, in addition to the name of the organization obtained from the United States Trustee or a bankruptcy administrator, another name used by that organization through the toll-free number disclosed pursuant to § 226.7(b)(12)(i) or (b)(12)(ii). In addition, if requested by an approved organization, a card issuer may at its option provide through the toll-free number disclosed pursuant to § 226.7(b)(12)(i) or (b)(12)(ii) a street address, telephone number, or Web site address for the organization that is different than the street address, telephone number, or Web site address obtained from the United States Trustee or a bankruptcy administrator. However, if requested by an approved organization, a card issuer must not provide information regarding that organization through the toll-free number disclosed pursuant to § 226.7(b)(12)(i) or (b)(12)(ii).

iii. Information regarding approved organizations that provide credit counseling services in a language other than English. A card issuer may at its option provide through the toll-free number disclosed pursuant to § 226.7(b)(12)(i) or (b)(12)(ii) information regarding approved organizations that provide credit counseling services in languages other than English. In the alternative, a card issuer may at its option state that such information is available from the Web site operated by the United States Trustee. Disclosing this Web site address does not by itself constitute a statement that organizations have been approved by the United States Trustee for purposes of comment 7(b)(12)(iv)-2.iv.

iv. For purposes of identifying transactions, the term same or related persons refers to, for example:

A. The United States Trustee or a bankruptcy administrator has determined that the organizations meet the minimum requirements for nonprofit pre-bankruptcy budget and credit counseling;

B. The organizations may provide other credit counseling services that have not been reviewed by the United States Trustee or a bankruptcy administrator; and

C. The United States Trustee or the bankruptcy administrator does not endorse or recommend any particular organization.

3. Automated response systems or devices. At their option, card issuers may use toll-free telephone numbers that connect consumers to automated systems, such as an interactive voice response system, through which consumers may obtain the information required by § 226.7(b)(12)(iv) by inputting information using a touch-tone telephone or similar device.

4. Toll-free telephone number. A card issuer may provide a toll-free telephone number that is designed to handle customer service calls generally, so long as the option to receive the information required by § 226.7(b)(12)(iv) is prominently disclosed to the consumer. For automated systems, the option to receive the information required by § 226.7(b)(12)(iv) is prominently disclosed to the consumer if it is listed as one of the options in the first menu of options

given to the consumer, such as "Press or say 3' if you would like information about credit counseling services." If the automated system permits callers to select the language in which the call is conducted and in which information is provided, the menu to select the language may precede the menu with the option to receive information about accessing credit counseling services.

5. Third parties. At their option, card issuers may use a third party to establish and maintain a toll-free telephone number for use by the issuer to provide the information required by § 226.7(b)(12)(iv).

6. Web site address. When making the repayment disclosures on the periodic statement pursuant to § 226.7(b)(12), a card issuer at its option may also include a reference to a Web site address (in addition to the toll-free telephone number) where its customers may obtain the information required by § 226.7(b)(12)(iv), so long as the information provided on the Web site complies with § 226.7(b)(12)(iv). The Web site address disclosed must take consumers directly to the Web page where information about accessing credit counseling may be obtained. In the alternative, the card issuer may disclose the Web site address for the Web page operated by the United States Trustee where consumers may obtain information about approved credit counseling organizations. Disclosing this Web site address does not by itself constitute a statement that organizations have been approved by the United States Trustee for purposes of comment 7(b)(12)(iv)-2.iv.

7. Advertising or marketing information. If a consumer requests information about credit counseling services, the card issuer may not provide advertisements or marketing materials to the consumer (except for providing the name of the issuer) prior to providing the information required by § 226.7(b)(12)(iv). Educational materials that do not solicit business are not considered advertisements or marketing materials for this purpose. Examples:

i. Toll-free telephone number. As described in comment 7(b)(12)(iv)-4, an issuer may provide a toll-free telephone number that is designed to handle customer service calls generally, so long as the option to receive the information required by § 226.7(b)(12)(iv) through that toll-free telephone number is prominently disclosed to the consumer. Once the consumer selects the option to receive the information required by § 226.7(b)(12)(iv), the issuer may not provide advertisements or marketing materials to the consumer (except for providing the name of the issuer) prior to providing the required information.

ii. Web page. If the issuer discloses a link to a Web site address as part of the disclosures pursuant to comment 7(b)(12)(iv)-6, the issuer may not provide advertisements or marketing materials (except for providing the name of the issuer) on the Web page accessed by the address prior to providing the information required by § 226.7(b)(12)(iv).

7(b)(12)(v) Exemptions.

1. Billing cycle where paying the minimum payment due for that billing cycle will pay the outstanding balance on the account for that billing cycle. Under § 226.7(b)(12)(v)(C), a card issuer is exempt from the repayment disclosure requirements set forth in § 226.7(b)(12) for a particular billing cycle where paying the minimum payment due for that

billing cycle will pay the outstanding balance on the account for that billing cycle. For example, if the entire outstanding balance on an account for a particular billing cycle is $20 and the minimum payment is $20, an issuer would not need to comply with the repayment disclosure requirements for that particular billing cycle. In addition, this exemption would apply to a charged-off account where payment of the entire account balance is due immediately.

7(b)(13) Format requirements.

1. Combined deposit account and credit account statements. Some financial institutions provide information about deposit account and open-end credit account activity on one periodic statement. For purposes of providing disclosures on the front of the first page of the periodic statement pursuant to § 226.7(b)(13), the first page of such a combined statement shall be the page on which credit transactions first appear.

Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual Section 226.8

§ 226.8 Identifying Transactions on Periodic Statements

8(a) Sale credit.

1. Sale credit. The term "sale credit" refers to a purchase in which the consumer uses a credit card or otherwise directly accesses an open-end line of credit (see comment 8(b)-1 if access is by means of a check) to obtain goods or services from a merchant, whether or not the merchant is the card issuer or creditor. "Sale credit" includes:

i. The purchase of funds-transfer services (such as a wire transfer) from an intermediary.

ii. The purchase of services from the card issuer or creditor. For the purchase of services that are costs imposed as part of the plan under § 226.6(b)(3), card issuers and creditors comply with the requirements for identifying transactions under this section by disclosing the fees in accordance with the requirements of § 226.7(b)(6). For the purchases of services that are not costs imposed as part of the plan, card issuers and creditors may, at their option, identify transactions under this section or in accordance with the requirements of § 226.7(b)(6).

2. Amount--transactions not billed in full. If sale transactions are not billed in full on any single statement, but are billed periodically in precomputed installments, the first periodic statement reflecting the transaction must show either the full amount of the transaction together with the date the transaction actually took place; or the amount of the first installment that was debited to the account together with the date of the transaction or the date on which the first installment was debited to the account. In any event, subsequent periodic statements should reflect each installment due, together with either any other identifying information required by § 226.8(a) (such as the seller's name and address in a three-party situation) or other appropriate identifying information relating the transaction to the first billing. The

debiting date for the particular installment, or the date the transaction took place, may be used as the date of the transaction on these subsequent statements.

3. Date--when a transaction takes place.

i. If the consumer conducts the transaction in person, the date of the transaction is the calendar date on which the consumer made the purchase or order, or secured the advance.

ii. For transactions billed to the account on an ongoing basis (other than installments to pay a precomputed amount), the date of the transaction is the date on which the amount is debited to the account. This might include, for example, monthly insurance premiums.

iii. For mail, Internet, or telephone orders, a creditor may disclose as the transaction date either the invoice date, the debiting date, or the date the order was placed by telephone or via the Internet.

iv. In a foreign transaction, the debiting date may be considered the transaction date.

4. Date--sufficiency of description.

i. If the creditor discloses only the date of the transaction, the creditor need not identify it as the "transaction date." If the creditor discloses more than one date (for example, the transaction date and the posting date), the creditor must identify each.

ii. The month and day sufficiently identify the transaction date, unless the posting of the transaction is delayed so long that the year is needed for a clear disclosure to the consumer.

5. Same or related persons.

i. For purposes of identifying transactions, the term same or related persons refers to, for example:

A. Franchised or licensed sellers of a creditor's product or service.

B. Sellers who assign or sell open-end sales accounts to a creditor or arrange for such credit under a plan that allows the consumer to use the credit only in transactions with that seller.

ii. A seller is not related to the creditor merely because the seller and the creditor have an agreement authorizing the seller to honor the creditor's credit card.

6. Brief identification--sufficiency of description. The "brief identification" provision in § 226.8(a)(1)(i) requires a designation that will enable the consumer to reconcile the periodic statement with the consumer's own records. In determining the sufficiency of the description, the following rules apply:

i. While item-by-item descriptions are not necessary, reasonable precision is required. For example, "merchandise," "miscellaneous," "second-hand goods," or "promotional items" would not suffice.

ii. A reference to a department in a sales establishment that accurately conveys the identification of the types of property or services available in the department is sufficient--for example, "jewelry," or "sporting goods."

iii. A number or symbol that is related to an identification list printed elsewhere on the statement that reasonably identifies the transaction with the creditor is sufficient.

7. Seller's name--sufficiency of description. The requirement contemplates that the seller's name will appear on the periodic statement in essentially the same form as it appears on transaction documents provided to the consumer at the time of the sale. The seller's name may also be disclosed as, for example:

i. A more complete spelling of the name that was alphabetically abbreviated on the receipt or other credit document.

ii. An alphabetical abbreviation of the name on the periodic statement even if the name appears in a more complete spelling on the receipt or other credit document. Terms that merely indicate the form of a business entity, such as "Inc.," "Co.," or "Ltd.," may always be omitted.

8. Location of transaction.

i. If the seller has multiple stores or branches within a city, the creditor need not identify the specific branch at which the sale occurred.

ii. When no meaningful address is available because the consumer did not make the purchase at any fixed location of the seller, the creditor may omit the address, or may provide some other identifying designation, such as "aboard plane," "ABC Airways Flight," "customer's home," "telephone order," "Internet order" or "mail order."

8(b) Nonsale credit.

1. Nonsale credit. The term "nonsale credit" refers to any form of loan credit including, for example:

i. A cash advance.

ii. An advance on a credit plan that is accessed by overdrafts on a checking account.

iii. The use of a "supplemental credit device" in the form of a check or draft or the use of the overdraft credit plan accessed by a debit card, even if such use is in connection with a purchase of goods or services.

iv. Miscellaneous debits to remedy mispostings, returned checks, and similar entries.

2. Amount--overdraft credit plans. If credit is extended under an overdraft credit plan tied to a checking account or by means of a debit card tied to an overdraft credit plan:

i. The amount to be disclosed is that of the credit extension, not the face amount of the check or the total amount of the debit/credit transaction.

ii. The creditor may disclose the amount of the credit extensions on a cumulative daily basis, rather than the amount attributable to each check or each use of the debit card that accesses the credit plan.

3. Date of transaction. See comment 8(a)-4.

4. Nonsale transaction--sufficiency of identification. The creditor sufficiently identifies a nonsale transaction by describing the type of advance it represents, such as cash advance, loan, overdraft loan, or any readily understandable trade name for the credit program.

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Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual Section 226.9

§ **226.9 Subsequent Disclosure Requirements**

9(a) Furnishing statement of billing rights.

9(a)(1) Annual statement.

1. General. The creditor may provide the annual billing rights statement:

i. By sending it in one billing period per year to each consumer that gets a periodic statement for that period; or

ii. By sending a copy to all of its accountholders sometime during the calendar year but not necessarily all in one billing period (for example, sending the annual notice in connection with renewal cards or when imposing annual membership fees).

2. Substantially similar. See the commentary to Model Forms G-3 and G-3(A) in appendix G to part 226.

9(a)(2) Alternative summary statement.

1. Changing from long-form to short form statement and vice versa. If the creditor has been sending the long-form annual statement, and subsequently decides to use the alternative summary statement, the first summary statement must be sent no later than 12 months after the last long-form statement was sent. Conversely, if the creditor wants to switch

to the long-form, the first long-form statement must be sent no later than 12 months after the last summary statement.

2. Substantially similar. See the commentary to Model Forms G-4 and G-4(A) in appendix G to part 226.

9(b) Disclosures for supplemental credit access devices and additional features.

1. Credit access device--examples. Credit access device includes, for example, a blank check, payee-designated check, blank draft or order, or authorization form for issuance of a check; it does not include a check issued payable to a consumer representing loan proceeds or the disbursement of a cash advance.

2. Credit account feature--examples. A new credit account feature would include, for example:

i. The addition of overdraft checking to an existing account (although the regular checks that could trigger the overdraft feature are not themselves "devices").

ii. The option to use an existing credit card to secure cash advances, when previously the card could only be used for purchases.

Paragraph 9(b)(2).

1. Different finance charge terms. Except as provided in § 226.9(b)(3) for checks that access a credit card account, if the finance charge terms are different from those previously disclosed, the creditor may satisfy the requirement to give the finance charge terms either by giving a complete set of new account-opening disclosures reflecting the terms of the added device or feature or by giving only the finance charge disclosures for the added device or feature.

9(b)(3) Checks that access a credit card account.

9(b)(3)(i) Disclosures.

1. Front of the page containing the checks. The following would comply with the requirement that the tabular disclosures provided pursuant to § 226.9(b)(3) appear on the front of the page containing the checks:

i. Providing the tabular disclosure on the front of the first page on which checks appear, for an offer where checks are provided on multiple pages;

ii. Providing the tabular disclosure on the front of a mini-book or accordion booklet containing the checks; or

iii. Providing the tabular disclosure on the front of the solicitation letter, when the checks are printed on the front of the same page as the solicitation letter even if the checks can be separated by the consumer from the solicitation letter using perforations.

Paragraph 9(b)(3)(i)(D).

1. Grace period. Creditors may use the following language to describe a grace period on check transactions: "Your due date is [at least days after the close of each billing cycle. We will not charge you interest on check transactions if you pay your entire balance by the due date each month." Creditors may use the following language to describe that no grace period on check transactions is offered, as applicable: "We will begin charging interest on these checks on the transaction date."

9(c) Change in terms.

9(c)(1) Rules affecting home-equity plans.

1. Changes initially disclosed. No notice of a change in terms need be given if the specific change is set forth initially, such as: rate increases under a properly disclosed variable-rate plan, a rate increase that occurs when an employee has been under a preferential rate agreement and terminates employment, or an increase that occurs when the consumer has been under an agreement to maintain a certain balance in a savings account in order to keep a particular rate and the account balance falls below the specified minimum. The rules in § 226.5b(f) relating to home-equity plans limit the ability of a creditor to change the terms of such plans.

2. State law issues. Examples of issues not addressed by § 226.9(c) because they are controlled by state or other applicable law include:

i. The types of changes a creditor may make. (But see § 226.5b(f))

ii. How changed terms affect existing balances, such as when a periodic rate is changed and the consumer does not pay off the entire existing balance before the new rate takes effect.

3. Change in billing cycle. Whenever the creditor changes the consumer's billing cycle, it must give a change-in-terms notice if the change either affects any of the terms required to be disclosed under § 226.6(a) or increases the minimum payment, unless an exception under § 226.9(c)(1)(ii) applies; for example, the creditor must

give advance notice if the creditor initially disclosed a 25-day grace period on purchases and the consumer will have fewer days during the billing cycle change.

9(c)(1)(i) Written notice required.

1. Affected consumers. Change-in-terms notices need only go to those consumers who may be affected by the change. For example, a change in the periodic rate for check overdraft credit need not be disclosed to consumers who do not have that feature on their accounts.

2. Timing--effective date of change. The rule that the notice of the change in terms be provided at least 15 days before the change takes effect permits mid-cycle changes when there is clearly no retroactive effect, such as the imposition of a transaction fee. Any change in the balance computation method, in contrast, would need to be disclosed at least 15 days prior to the billing cycle in which the change is to be implemented.

3. Timing--advance notice not required. Advance notice of 15 days is not necessary--that is, a notice of change in terms is required, but it may be mailed or delivered as late as the effective date of the change--in two circumstances:

i. If there is an increased periodic rate or any other finance charge attributable to the consumer's delinquency or default.

ii. If the consumer agrees to the particular change. This provision is intended for use in the unusual instance when a consumer substitutes collateral or when the creditor can advance additional credit only if a change relatively unique to that consumer is made, such as the consumer's providing additional security or paying an increased minimum payment amount. Therefore, the following are not "agreements" between the consumer and the creditor for purposes of § 226.9(c)(1)(i): The consumer's general acceptance of the creditor's contract reservation of the right to change terms; the consumer's use of the account (which might imply acceptance of its terms under state law); and the consumer's acceptance of a unilateral term change that is not particular to that consumer, but rather is of general applicability to consumers with that type of account.

4. Form of change-in-terms notice. A complete new set of the initial disclosures containing the changed term complies with § 226.9(c)(1)(i) if the change is highlighted in some way on the disclosure statement, or if the disclosure statement is accompanied by a letter or some other insert that indicates or draws attention to the term change.

5. Security interest change--form of notice. A copy of the security agreement that describes the collateral securing the consumer's account may be used as the notice, when the term change is the addition of a security interest or the addition or substitution of collateral.

6. Changes to home-equity plans entered into on or after November 7, 1989. Section 226.9(c)(1) applies when, by written agreement under § 226.5b(f)(3)(iii), a creditor changes the terms of a home-equity plan--entered into on or after November 7, 1989--at or before its scheduled expiration, for example, by renewing a plan on terms different from those of the original plan. In disclosing the change:

i. If the index is changed, the maximum annual percentage rate is increased (to the limited extent permitted by § 226.30), or a variable-rate feature is added to a fixed-rate plan, the creditor must include the disclosures required by § 226.5b(d)(12)(x) and (d)(12)(xi), unless these disclosures are unchanged from those given earlier.

ii. If the minimum payment requirement is changed, the creditor must include the disclosures required by § 226.5b(d)(5)(iii) (and, in variable-rate plans, the disclosures required by § 226.5b(d)(12)(x) and (d)(12)(xi)) unless the disclosures given earlier contained representative examples covering the new minimum payment requirement. (See the commentary to § 226.5b(d)(5)(iii), (d)(12)(x) and (d)(12)(xi) for a discussion of representative examples.)

iii. When the terms are changed pursuant to a written agreement as described in § 226.5b(f)(3)(iii), the advance-notice requirement does not apply.

9(c)(1)(ii) Notice not required.

1. Changes not requiring notice. The following are examples of changes that do not require a change-in-terms notice:

i. A change in the consumer's credit limit.

ii. A change in the name of the credit card or credit card plan.

iii. The substitution of one insurer for another.

iv. A termination or suspension of credit privileges. (But see § 226.5b(f).)

v. Changes arising merely by operation of law; for example, if the creditor's security interest in a consumer's car automatically extends to the proceeds when the consumer sells the car.

2. Skip features. If a credit program allows consumers to skip or reduce one or more payments during the year, or involves temporary reductions in finance charges, no notice of the change in terms is required either prior to the reduction or upon resumption of the higher rates or payments if these features are explained on the initial disclosure statement (including an explanation of the terms upon resumption). For example, a merchant may allow consumers to skip the December payment to encourage holiday shopping, or a teachers' credit union may not require payments during summer vacation. Otherwise, the creditor must give notice prior to resuming the original schedule or rate, even though no notice is required prior to the reduction. The change-in-terms notice may be combined with the notice offering the reduction. For example, the periodic statement reflecting the reduction or skip feature may also be used to notify the consumer of the resumption of the original schedule or rate, either by stating explicitly when the higher payment or charges resume, or by indicating the duration of the skip option. Language such as "You may skip your October payment," or "We will waive your finance charges for January," may serve as the change-in-terms notice.

9(c)(1)(iii) Notice to restrict credit.

1. Written request for reinstatement. If a creditor requires the request for reinstatement of credit privileges to be in writing, the notice under § 226.9(c)(1)(iii) must state that fact.

2. Notice not required. A creditor need not provide a notice under this paragraph if, pursuant to the commentary to § 226.5b(f)(2), a creditor freezes a line or reduces a credit line rather than terminating a plan and accelerating the balance.

9(c)(2) Rules affecting open-end (not home-secured) plans.

1. Changes initially disclosed. Except as provided in § 226.9(g)(1), no notice of a change in terms need be given if the specific change is set forth initially, such as rate increases under a properly disclosed variable-rate plan in accordance with § 226.9(c)(2)(v)(C). In contrast, notice must be given if the contract allows the creditor to increase the rate at its discretion.

2. State law issues. Some issues are not addressed by § 226.9(c)(2) because they are controlled by state or other applicable laws. These issues include the types of changes a creditor may make, to the extent otherwise permitted by this regulation.

3. Change in billing cycle. Whenever the creditor changes the consumer's billing cycle, it must give a change-in-terms notice if the change affects any of the terms described in § 226.9(c)(2)(i), unless an exception under § 226.9(c)(2)(v) applies; for example, the creditor must give advance notice if the creditor initially disclosed a 28-day grace period on purchases and the consumer will have fewer days during the billing cycle change. See also § 226.7(b)(11)(i)(A) regarding the general requirement that the payment due date for a credit card account under an open-end (not home-secured) consumer credit plan must be the same day each month.

4. Relationship to § 226.9(b). If a creditor adds a feature to the account on the type of terms otherwise required to be disclosed under § 226.6, the creditor must satisfy: the requirement to provide the finance charge disclosures for the added feature under § 226.9(b); and any applicable requirement to provide a change-in-terms notice under § 226.9(c), including any advance notice that must be provided. For example, if a creditor adds a balance transfer feature to an account more than 30 days after account-opening disclosures are provided, it must give the finance charge disclosures for the balance transfer feature under § 226.9(b) as well as comply with the change-in-terms notice requirements under § 226.9(c), including providing notice of the change at least 45 days prior to the effective date of the change. Similarly, if a creditor makes a balance transfer offer on finance charge terms that are higher than those previously disclosed for balance transfers, it would also generally be required to provide a change-in-terms notice at least 45 days in advance of the effective date of the change. A creditor may provide a single notice under § 226.9(c) to satisfy the notice requirements of both paragraphs (b) and (c) of § 226.9. For checks that access a credit card account subject to the disclosure requirements in § 226.9(b)(3), a creditor is not subject to the notice requirements under § 226.9(c) even if the applicable rate or fee is higher than those previously disclosed for such checks. Thus, for example, the creditor need not wait 45 days before applying the new rate or fee for transactions made using such checks, but the creditor must make the required disclosures on or with the checks in accordance with § 226.9(b)(3).

9(c)(2)(i) Changes where written advance notice is required.

1. Affected consumers. Change-in-terms notices need only go to those consumers who may be affected by the change. For example, a change in the periodic rate for check overdraft credit need not be disclosed to consumers who do not have that feature on their accounts. If a single credit account involves multiple consumers that may be affected by the change, the creditor should refer to § 226.5(d) to determine the number of notices that must be given.

2. Timing--effective date of change. The rule that the notice of the change in terms be provided at least 45 days before the change takes effect permits mid-cycle changes when there is clearly no retroactive effect, such as the imposition of a transaction fee. Any change in the balance computation method, in contrast, would need to be disclosed at least 45 days prior to the billing cycle in which the change is to be implemented.

3. Changes agreed to by the consumer. See also comment 5(b)(1)(i)-6.

4. Form of change-in-terms notice. Except if § 226.9(c)(2)(iv) applies, a complete new set of the initial disclosures containing the changed term complies with § 226.9(c)(2)(i) if the change is highlighted on the disclosure statement, or if the disclosure statement is accompanied by a letter or some other insert that indicates or draws attention to the term being changed.

5. Security interest change--form of notice. A creditor must provide a description of any security interest it is acquiring under § 226.9(c)(2)(iv). A copy of the security agreement that describes the collateral securing the consumer's account may also be used as the notice, when the term change is the addition of a security interest or the addition or substitution of collateral.

6. Examples. See comment 55(a)-1 and 55(b)-3 for examples of how a card issuer that is subject to § 226.55 may comply with the timing requirements for notices required by § 226.9(c)(2)(i).

9(c)(2)(iii) Charges not covered by § 226.6(b)(1) and (b)(2).

1. Applicability. Generally, if a creditor increases any component of a charge, or introduces a new charge, that is imposed as part of the plan under § 226.6(b)(3) but is not required to be disclosed as part of the account-opening summary table under § 226.6(b)(1) and (b)(2), the creditor may either, at its option (i) provide at least 45 days' written advance notice before the change becomes effective to comply with the requirements of § 226.9(c)(2)(i), or (ii) provide notice orally or in writing, or electronically if the consumer requests the service electronically, of the amount of the charge to an affected consumer before the consumer agrees to or becomes obligated to pay the charge, at a time and in a manner that a consumer would be likely to notice the disclosure. (See the commentary under § 226.5(a)(1)(iii) regarding disclosure of such changes in electronic form.) For example, a fee for expedited delivery of a credit card is a charge imposed as part of the plan under § 226.6(b)(3) but is not required to be disclosed in the account-opening summary table under § 226.6(b)(1) and (b)(2). If a creditor changes the amount of that expedited delivery fee, the creditor may provide written advance notice of the change to affected consumers at least 45 days before the change becomes effective. Alternatively, the creditor may provide oral or written notice, or electronic notice if the consumer requests the service electronically, of the amount of the charge to an affected consumer before the consumer agrees to or becomes obligated to pay the charge, at a time and in a manner that the consumer would be likely to notice the disclosure. (See comment 5(b)(1)(ii)-1 for examples of disclosures given at a time and in a manner that the consumer would be likely to notice them.)

9(c)(2)(iv) Disclosure requirements.

9(c)(2)(iv) Significant changes in account terms.

1. Changing margin for calculating a variable rate. If a creditor is changing a margin used to calculate a variable rate, the creditor must disclose the amount of the new rate (as calculated using the new margin) in the table described in § 226.9(c)(2)(iv), and include a reminder that the rate is a variable rate. For example, if a creditor is changing the margin for a variable rate that uses the prime rate as an index, the creditor must disclose in the table the new rate (as calculated using the new margin) and indicate that the rate varies with the market based on the prime rate.

2. Changing index for calculating a variable rate. If a creditor is changing the index used to calculate a variable rate, the creditor must disclose the amount of the new rate (as calculated using the new index) and indicate that the rate varies and the how the rate is determined, as explained in § 226.6(b)(2)(i)(A). For example, if a creditor is changing from using a prime rate to using the LIBOR in calculating a variable rate, the creditor would disclose in the table the new rate (using the new index) and indicate that the rate varies with the market based on the LIBOR.

3. Changing from a variable rate to a non-variable rate. If a creditor is changing from a variable rate to a non-variable rate, the creditor must disclose the amount of the new rate (that is, the non-variable rate) in the table.

4. Changing from a non-variable rate to a variable rate. If a creditor is changing from a non-variable rate to a variable rate, the creditor must disclose the amount of the new rate (the variable rate using the index and margin), and indicate that the rate varies with the market based on the index used, such as the prime rate or the LIBOR.

5. Changes in the penalty rate, the triggers for the penalty rate, or how long the penalty rate applies. If a creditor is changing the amount of the penalty rate, the creditor must also redisclose the triggers for the penalty rate and the information about how long the penalty rate applies even if those terms are not changing. Likewise, if a creditor is changing the triggers for the penalty rate, the creditor must redisclose the amount of the penalty rate and information about how long the penalty rate applies. If a creditor is changing how long the penalty rate applies, the creditor must redisclose the amount of the penalty rate and the triggers for the penalty rate, even if they are not changing.

6. Changes in fees. If a creditor is changing part of how a fee that is disclosed in a tabular format under § 226.6(b)(1) and (b)(2) is determined, the creditor must redisclose all relevant information related to that fee regardless of whether this other information is changing. For example, if a creditor currently charges a cash advance fee of "Either $5 or 3% of the transaction amount, whichever is greater. (Max: $100)," and the creditor is only changing the minimum dollar amount from $5 to $10, the issuer must redisclose the other information related to how the fee is determined. For example, the creditor in this example would disclose the following: "Either $10 or 3% of the transaction amount, whichever is greater. (Max: $100)."

7. Combining a notice described in § 226.9(c)(2)(iv) with a notice described in § 226.9(g)(3). If a creditor is required to provide a notice described in § 226.9(c)(2)(iv) and a notice described in § 226.9(g)(3) to a consumer, the creditor may combine the two notices. This would occur if penalty pricing has been triggered, and other terms are changing on the consumer's account at the same time.

8. Content. Sample G-20 contains an example of how to comply with the requirements in § 226.9(c)(2)(iv) when a variable rate is being changed to a non-variable rate on a credit card account. The sample explains when the new rate will apply to new transactions and to which balances the current rate will continue to apply. Sample G-21 contains an example of how to comply with the requirements in § 226.9(c)(2)(iv) when (i) the late payment fee on a credit card account is being increased in accordance with a formula that depends on the outstanding balance on the account, and (ii) the returned payment fee is also being increased. The sample discloses the consumer's right to reject the changes in accordance with § 226.9(h).

9. Clear and conspicuous standard. See comment 5(a)(1)-1 for the clear and conspicuous standard applicable to disclosures required under § 226.9(c)(2)(iv)(A)(1).

10. Terminology. See § 226.5(a)(2) for terminology requirements applicable to disclosures required under § 226.9(c)(2)(iv)(A)(1).

9(c)(2)(v) Notice not required.

1. Changes not requiring notice. The following are examples of changes that do not require a change-in-terms notice:

i. A change in the consumer's credit limit except as otherwise required by § 226.9(c)(2)(vi).

ii. A change in the name of the credit card or credit card plan.

iii. The substitution of one insurer for another.

iv. A termination or suspension of credit privileges.

v. Changes arising merely by operation of law; for example, if the creditor's security interest in a consumer's car automatically extends to the proceeds when the consumer sells the car.

. 2. Skip features.

i. General. If a credit program allows consumers to skip or reduce one or more payments during the year, or involves temporary reductions in finance charges other than reductions in an interest rate (except if § 226.9(c)(2)(v)(B) or (c)(2)(v)(D) applies), no notice of the change in terms is required either prior to the reduction or upon resumption of the higher finance charges or payments if these features are explained on the account-opening disclosure statement (including an explanation of the terms upon resumption). For example, a merchant may allow consumers to skip the December payment to encourage holiday shopping, or a teacher's credit union may not require payments during summer vacation. Otherwise, the creditor must give notice prior to resuming the original schedule or finance charge, even though no notice is required prior to the reduction. The change-in-terms notice may be combined with the notice offering the reduction. For example, the periodic statement reflecting the reduction or skip feature may also be used to notify the consumer of the resumption of the original schedule or finance charge, either by stating explicitly when the higher payment or charges resume or by indicating the duration of the skip option. Language such as "You may skip your October payment" may serve as the change-in-terms notice.

ii. Temporary reductions in interest rates. If a credit program involves temporary reductions in an interest rate, no notice of the change in terms is required either prior to the reduction or upon resumption of the original rate if these features are disclosed in advance in accordance with the requirements of § 226.9(c)(2)(v)(B). Otherwise, the creditor

must give notice prior to resuming the original rate, even though no notice is required prior to the reduction. The notice provided prior to resuming the original rate must comply with the timing requirements of § 226.9(c)(2)(i) and the content and format requirements of § 226.9(c)(2)(iv)(A), (B) (if applicable), (C) (if applicable), and (D). See comment 55(b)-3 for guidance regarding the application of § 226.55 in these circumstances.lan.

3. Changing from a variable rate to a non-variable rate. If a creditor is changing a rate applicable to a consumer's account from a variable rate to a non-variable rate, the creditor must provide a notice as otherwise required under § 226.9(c) even if the variable rate at the time of the change is higher than the non-variable rate. (See comment 9(c)(2)(iv)(A)-3.)

4. Changing from a non-variable rate to a variable rate. If a creditor is changing a rate applicable to a consumer's account from a non-variable rate to a variable rate, the creditor must provide a notice as otherwise required under § 226.9(c) even if the non-variable rate is higher than the variable rate at the time of the change. (See comment 9(c)(2)(iv)(A)-4.)

5. Temporary rate reductions offered by telephone. The timing requirements of § 226.9(c)(2)(v)(B) are deemed to have been met, and written disclosures required by § 226.9(c)(2)(v)(B) may be provided as soon as reasonably practicable after the first transaction subject to a rate that will be in effect for a specified period of time (a temporary rate) if:

i. The consumer accepts the offer of the temporary rate by telephone;

ii. The creditor permits the consumer to reject the temporary rate offer and have the rate or rates that previously applied to the consumer's balances reinstated for 45 days after the creditor mails or delivers the written disclosures required by § 226.9(c)(2)(v)(B); and

iii. The disclosures required by § 226.9(c)(2)(v)(B) and the consumer's right to reject the temporary rate offer and have the rate or rates that previously applied to the consumer's account reinstated are disclosed to the consumer as part of the temporary rate offer.

6. First listing. The disclosures required by § 226.9(c)(2)(v)(B)(1) are only required to be provided in close proximity and in equal prominence to the first listing of the temporary rate in the disclosure provided to the consumer. For purposes of § 226.9(c)(2)(v)(B), the first statement of the temporary rate is the most prominent listing on the front side of the first page of the disclosure. If the temporary rate does not appear on the front side of the first page of the disclosure, then the first listing of the temporary rate is the most prominent listing of the temporary rate on the subsequent pages of the disclosure. For advertising requirements for promotional rates, see§ 226.16(g).

7. Close proximity--point of sale. Creditors providing the disclosures required by § 226.9(c)(2)(v)(B) of this section in person in connection with financing the purchase of goods or services may, at the creditor's option, disclose the annual percentage rate that would apply after expiration of the period on a separate page or document from the temporary rate and the length of the period, provided that the disclosure of the annual percentage rate that would apply after the expiration of the period is equally prominent to, and is provided at the same time as, the disclosure of the temporary rate and length of the period.

8. Disclosure of annual percentage rates. If a rate disclosed pursuant to § 226.9(c)(2)(v)(B) or (c)(2)(v)(D) is a variable rate, the creditor must disclose the fact that the rate may vary and how the rate is determined. For example, a creditor could state "After October 1, 2009, your APR will be 14.99%. This APR will vary with the market based on the Prime Rate."

9. Deferred interest or similar programs. If the applicable conditions are met, the exception in § 226.9(c)(2)(v)(B) applies to deferred interest or similar promotional programs under which the consumer is not obligated to pay interest that accrues on a balance if that balance is paid in full prior to the expiration of a specified period of time. For purposes of this comment and § 226.9(c)(2)(v)(B), "deferred interest" has the same meaning as in § 226.16(h)(2) and associated commentary. For such programs, a creditor must disclose pursuant to § 226.9(c)(2)(v)(B)(1) the length of the deferred interest period and the rate that will apply to the balance subject to the deferred interest program if that balance is not paid in full prior to expiration of the deferred interest period. Examples of language that a creditor may use to make the required disclosures under § 226.9(c)(2)(v)(B)(1) include:

i. "No interest if paid in full in 6 months. If the balance is not paid in full in 6 months, interest will be imposed from the date of purchase at a rate of 15.99%."

ii. "No interest if paid in full by December 31, 2010. If the balance is not paid in full by that date, interest will be imposed from the transaction date at a rate of 15%."

10. Disclosure of the terms of a workout or temporary hardship arrangement. In order for the exception in § 226.9(c)(2)(v)(D) to apply, the disclosure provided to the consumer pursuant to § 226.9(c)(2)(v)(D)(2) must set forth:

i. The annual percentage rate that will apply to balances subject to the workout or temporary hardship arrangement;

ii. The annual percentage rate that will apply to such balances if the consumer completes or fails to comply with the terms of, the workout or temporary hardship arrangement;

iii. Any reduced fee or charge of a type required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) that will apply to balances subject to the workout or temporary hardship arrangement, as well as the fee or charge that will apply if the consumer completes or fails to comply with the terms of the workout or temporary hardship arrangement;

iv. Any reduced minimum periodic payment that will apply to balances subject to the workout or temporary hardship arrangement, as well as the minimum periodic payment that will apply if the consumer completes or fails to comply with the terms of the workout or temporary hardship arrangement; and

v. If applicable, that the consumer must make timely minimum payments in order to remain eligible for the workout or temporary hardship arrangement.

11. Index not under creditor's control. See comment 55(b)(2)-2 for guidance on when an index is deemed to be under the card issuer's control.

9(d) Finance charge imposed at time of transaction.

1. Disclosure prior to imposition. A person imposing a finance charge at the time of honoring a consumer's credit card must disclose the amount of the charge, or an explanation of how the charge will be determined, prior to its imposition. This must be disclosed before the consumer becomes obligated for property or services that may be paid for by use of a credit card. For example, disclosure must be given before the consumer has dinner at a restaurant, stays overnight at a hotel, or makes a deposit guaranteeing the purchase of property or services.

9(e) Disclosures upon renewal of credit or charge card.

1. Coverage. This paragraph applies to credit and charge card accounts of the type subject to § 226.5a. (See § 226.5a(a)(5) and the accompanying commentary for discussion of the types of accounts subject to § 226.5a.) The disclosure requirements are triggered when a card issuer imposes any annual or other periodic fee on such an account or if the card issuer has changed or amended any term of a cardholder's account required to be disclosed under § 226.6(b)(1) and (b)(2) that has not previously been disclosed to the consumer, whether or not the card issuer originally was required to provide the application and solicitation disclosures described in § 226.5a.

2. Form. The disclosures under this paragraph must be clear and conspicuous, but need not appear in a tabular format or in a prominent location. The disclosures need not be in a form the cardholder can retain.

3. Terms at renewal. Renewal notices must reflect the terms actually in effect at the time of renewal. For example, a card issuer that offers a preferential annual percentage rate to employees during their employment must send a renewal notice to employees disclosing the lower rate actually charged to employees (although the card issuer also may show the rate charged to the general public).

4. Variable rate. If the card issuer cannot determine the rate that will be in effect if the cardholder chooses to renew a variable-rate account, the card issuer may disclose the rate in effect at the time of mailing or delivery of the renewal notice. Alternatively, the card issuer may use the rate as of a specified date within the last 30 days before the disclosure is provided.

5. Renewals more frequent than annual. If a renewal fee is billed more often than annually, the renewal notice should be provided each time the fee is billed. In this instance, the fee need not be disclosed as an annualized amount. Alternatively, the card issuer may provide the notice no less than once every 12 months if the notice explains the amount and frequency of the fee that will be billed during the time period covered by the disclosure, and also discloses the fee as an annualized amount. The notice under this alternative also must state the consequences of a cardholder's decision to terminate the account after the renewal-notice period has expired. For example, if a $2 fee is billed monthly but the notice is given annually, the notice must inform the cardholder that the monthly charge is $2, the annualized fee is $24, and $2 will be billed to the account each month for the coming year unless the cardholder notifies the card issuer. If the cardholder is obligated to pay an amount equal to the remaining unpaid monthly charges if the cardholder terminates the account during the coming year but after the first month, the notice must disclose the fact.

6. Terminating credit availability. Card issuers have some flexibility in determining the procedures for how and when an account may be terminated. However, the card issuer must clearly disclose the time by which the cardholder must act to terminate the account to avoid paying a renewal fee, if applicable. State and other applicable law govern whether the card issuer may impose requirements such as specifying that the cardholder's response be in writing or that the outstanding balance be repaid in full upon termination.

7. Timing of termination by cardholder. When a card issuer provides notice under § 226.9(e)(1), a cardholder must be given at least 30 days or one billing cycle, whichever is less, from the date the notice is mailed or delivered to make a decision whether to terminate an account.

8. Timing of notices. A renewal notice is deemed to be provided when mailed or delivered. Similarly, notice of termination is deemed to be given when mailed or delivered.

9. Prompt reversal of renewal fee upon termination. In a situation where a cardholder has provided timely notice of termination and a renewal fee has been billed to a cardholder's account, the card issuer must reverse or otherwise withdraw the fee promptly. Once a cardholder has terminated an account, no additional action by the cardholder may be required.

10. Disclosure of changes in terms not required to be disclosed pursuant to § 226.6(b)(1) and (b)(2). Clear and conspicuous disclosure of a changed term on a periodic statement provided to a consumer prior to renewal of the consumer's account constitutes prior disclosure of that term for purposes of § 226.9(e)(1). Card issuers should refer to § 226.9(c)(2) for additional timing, content, and formatting requirements that apply to certain changes in terms under that paragraph.

9(e)(2) Notification on periodic statements.

1. Combined disclosures. If a single disclosure is used to comply with both §§ 226.9(e) and 226.7, the periodic statement must comply with the rules in §§ 226.5a and 226.7. For example, a description substantially similar to the heading describing the grace period required by § 226.5a(b)(5) must be used and the name of the balance-calculation method must be identified (if listed in § 226.5a(g)) to comply with the requirements of § 226.5a. A card issuer may include some of the renewal disclosures on a periodic statement and others on a separate document so long as there is some reference indicating that the disclosures relate to one another. All renewal disclosures must be provided to a cardholder at the same time.

2. Preprinted notices on periodic statements. A card issuer may preprint the required information on its periodic statements. A card issuer that does so, however, must make clear on the periodic statement when the preprinted renewal disclosures are applicable. For example, the card issuer could include a special notice (not preprinted) at the appropriate time that the renewal fee will be billed in the following billing cycle, or could show the renewal date as a regular (preprinted) entry on all periodic statements.

9(f) Change in credit card account insurance provider.

1. Coverage. This paragraph applies to credit card accounts of the type subject to § 226.5a if credit insurance (typically life, disability, and unemployment insurance) is offered on the outstanding balance of such an account. (Credit card accounts subject to § 226.9(f) are the same as those subject to § 226.9(e); See comment 9(e)-1.) Charge card accounts are not covered by this paragraph. In addition, the disclosure requirements of this paragraph apply only where the card issuer initiates the change in insurance provider. For example, if the card issuer's current insurance provider is merged into or acquired by another company, these disclosures would not be required. Disclosures also need not be given in cases where card issuers pay for credit insurance themselves and do not separately charge the cardholder.

2. No increase in rate or decrease in coverage. The requirement to provide the disclosure arises when the card issuer changes the provider of insurance, even if there will be no increase in the premium rate charged to the consumer and no decrease in coverage under the insurance policy.

3. Form of notice. If a substantial decrease in coverage will result from the change in provider, the card issuer either must explain the decrease or refer to an accompanying copy of the policy or group certificate for details of the new

terms of coverage. (See the commentary to appendix G-13 to part 226.)

4. Discontinuation of insurance. In addition to stating that the cardholder may cancel the insurance, the card issuer may explain the effect the cancellation would have on the consumer's credit card plan.

5. Mailing by third party. Although the card issuer is responsible for the disclosures, the insurance provider or another third party may furnish the disclosures on the card issuer's behalf.

9(f)(3) Substantial decrease in coverage.

1. Determination. Whether a substantial decrease in coverage will result from the change in provider is determined by the two-part test in § 226.9(f)(3): First, whether the decrease is in a significant term of coverage; and second, whether the decrease might reasonably be expected to affect a cardholder's decision to continue the insurance. If both conditions are met, the decrease must be disclosed in the notice.

9(g) Increase in rates due to delinquency or default or as a penalty.

1. Relationship between § 226.9(c) and (g) and § 226.55--examples. Card issuers subject to § 226.55 are prohibited from increasing the annual percentage rate for a category of transactions on any consumer credit card account unless specifically permitted by one of the exceptions in § 226.55(b). See comments 55(a)-1 and 55(b)-3 and the commentary to § 226.55(b)(4) for examples that illustrate the relationship between the notice requirements of § 226.9(c) and (g) and § 226.55.

2. Affected consumers. If a single credit account involves multiple consumers that may be affected by the change, the creditor should refer to § 226.5(d) to determine the number of notices that must be given.

3. Combining a notice described in § 226.9(g)(3) with a notice described in § 226.9(c)(2)(iv). If a creditor is required to provide notices pursuant to both § 226.9(c)(2)(iv) and (g)(3) to a consumer, the creditor may combine the two notices. This would occur when penalty pricing has been triggered, and other terms are changing on the consumer's account at the same time.

4. Content. Sample G-22 contains an example of how to comply with the requirements in § 226.9(g)(3)(i) when the rate on a consumer's credit card account is being increased to a penalty rate as described in § 226.9(g)(1)(ii), based on a late payment that is not more than 60 days late. Sample G-23 contains an example of how to comply with the requirements in § 226.9(g)(3)(i) when the rate increase is triggered by a delinquency of more than 60 days.

5. Clear and conspicuous standard. See comment 5(a)(1)-1 for the clear and conspicuous standard applicable to disclosures required under § 226.9(g).

6. Terminology. See § 226.5(a)(2) for terminology requirements applicable to disclosures required under § 226.9(g).

9(g)(4) Exceptions.9(g)(4) Exception for decrease in credit limit.

1. The following illustrates the requirements of § 226.9(g)(4). Assume that a creditor decreased the credit limit applicable to a consumer's account and sent a notice pursuant to § 226.9(g)(4) on January 1, stating among other things that the penalty rate would apply if the consumer's balance exceeded the new credit limit as of February 16. If the consumer's balance exceeded the credit limit on February 16, the creditor could impose the penalty rate on that date. However, a creditor could not apply the penalty rate if the consumer's balance did not exceed the new credit limit on February 16, even if the consumer's balance had exceeded the new credit limit on several dates between January 1 and February 15. If the consumer's balance did not exceed the new credit limit on February 16 but the consumer conducted a transaction on February 17 that caused the balance to exceed the new credit limit, the general rule in § 226.9(g)(1)(ii) would apply and the creditor would be required to give an additional 45 days' notice prior to imposition of the penalty rate (but under these circumstances the consumer would have no ability to cure the over-the-limit balance in order to avoid penalty pricing).

9(h) Consumer rejection of certain significant changes in terms.

1. Circumstances in which § 226.9(h) does not apply. Section 226.9(h) applies when § 226.9(c)(2)(iv)(B) requires disclosure of the consumer's right to reject a significant change to an account term. Thus, for example, § 226.9(h) does not apply to changes to the terms of home equity plans subject to the requirements of § 226.5b that are accessible by a credit or charge card because § 226.9(c)(2) does not apply to such plans. Similarly, § 226.9(h) does not apply in the following circumstances because § 226.9(c)(2)(iv)(B) does not require disclosure of the right to reject in those circumstances: (i) An increase in the required minimum periodic payment; (ii) a change in an annual percentage rate applicable to a consumer's account (such as changing the margin or index for calculating a variable rate, changing from a variable rate to a non-variable rate, or changing from a non-variable rate to a variable rate); (iii) a change in the balance computation method necessary to comply with § 226.54; and (iv) when the change results from the creditor not receiving the consumer's required minimum periodic payment within 60 days after the due date for that payment.

9(h)(1) Right to reject.

1. Reasonable requirements for submission of rejections. A creditor may establish reasonable requirements for the submission of rejections pursuant to § 226.9(h)(1). For example:

i. It would be reasonable for a creditor to require that rejections be made by the primary account holder and that the consumer identify the account number.

ii. It would be reasonable for a creditor to require that rejections be made only using the toll-free telephone number disclosed pursuant to § 226.9(c). It would also be reasonable for a creditor to designate additional channels for the submission of rejections (such as an address for rejections submitted by mail) so long as the creditor does not require that rejections be submitted through such additional channels.

iii. It would be reasonable for a creditor to require that rejections be received before the effective date disclosed pursuant to § 226.9(c) and to treat the account as not subject to § 226.9(h) if a rejection is received on or after that date. It would not, however, be reasonable to require that rejections be submitted earlier than the day before the effective date. If a creditor is unable to process all rejections received before the effective date, the creditor may delay implementation of the change in terms until all rejections have been processed. In the alternative, the creditor could implement the change on the effective date and then, on any account for which a timely rejection was received, reverse the change and remove or credit any interest charges or fees imposed as a result of the change. For example, if the effective date for a change in terms is June 15 and the creditor cannot process all rejections received by telephone on June 14 until June 16, the creditor may delay imposition of the change until June 17. Alternatively, the creditor could implement the change for all affected accounts on June 15 and then, once all rejections have been processed, return any account for which a timely rejection was received to the prior terms and ensure that the account is not assessed any additional interest or fees as a result of the change or that the account is credited for such interest or fees.

2. Use of account following provision of notice. A consumer does not waive or forfeit the right to reject a significant change in terms by using the account for transactions prior to the effective date of the change. Similarly, a consumer does not revoke a rejection by using the account for transactions after the rejection is received.

9(h)(2)(ii) Prohibition on penalties.

1. Termination or suspension of credit availability. Section 226.9(h)(2)(ii) does not prohibit a creditor from terminating or suspending credit availability as a result of the consumer's rejection of a significant change in terms.

2. Solely as a result of rejection. A creditor is prohibited from imposing a fee or charge or treating an account as in default solely as a result of the consumer's rejection of a significant change in terms. For example, if credit availability is terminated or suspended as a result of the consumer's rejection of a significant change in terms, a creditor is prohibited from imposing a periodic fee that was not charged before the consumer rejected the change (such as a closed account fee). See also comment 55(d)-1. However, regardless of whether credit availability is terminated or suspended as a result of the consumer's rejection, a creditor is not prohibited from continuing to charge a periodic fee that was charged before the rejection. Similarly, a creditor that charged a fee for late payment before a change was rejected is not prohibited from charging that fee after rejection of the change.

9(h)(2)(iii) Repayment of outstanding balance.

1. Relevant date for repayment methods. Once a consumer has rejected a significant change in terms, §

226.9(h)(2)(iii) prohibits the creditor from requiring repayment of the balance on the account using a method that is less beneficial to the consumer than one of the methods listed in § 226.55(c)(2). When applying the methods listed in § 226.55(c)(2) pursuant to § 226.9(h)(2)(iii), a creditor may utilize the date on which the creditor was notified of the rejection or a later date (such as the date on which the change would have gone into effect but for the rejection). For example, assume that on April 16 a creditor provides a notice pursuant to § 226.9(c) informing the consumer that the monthly maintenance fee for the account will increase effective June 1. The notice also states that the consumer may reject the increase by calling a specified toll-free telephone number before June 1 but that, if the consumer does so, credit availability for the account will be terminated. On May 5, the consumer calls the toll-free number and exercises the right to reject. If the creditor chooses to establish a five-year amortization period for the balance on the account consistent with § 226.55(c)(2)(ii), that period may begin no earlier than the date on which the creditor was notified of the rejection (May 5). However, the creditor may also begin the amortization period on the date on which the change would have gone into effect but for the rejection (June 1).

2. Balance on the account.

i. In general. When applying the methods listed in § 226.55(c)(2) pursuant to § 226.9(h)(2)(iii), the provisions in § 226.55(c)(2) and the guidance in the commentary to § 226.55(c)(2) regarding protected balances also apply to a balance on the account subject to § 226.9(h)(2)(iii). If a creditor terminates or suspends credit availability based on a consumer's rejection of a significant change in terms, the balance on the account that is subject to § 226.9(h)(2)(iii) is the balance at the end of the day on which credit availability is terminated or suspended. However, if a creditor does not terminate or suspend credit availability based on the consumer's rejection, the balance on the account subject to § 226.9(h)(2)(iii) is the balance at the end of the day on which the creditor was notified of the rejection or, at the creditor's option, a later date.

ii. Example. Assume that on June 16 a creditor provides a notice pursuant to § 226.9(c) informing the consumer that the annual fee for the account will increase effective August 1. The notice also states that the consumer may reject the increase by calling a specified toll-free telephone number before August 1 but that, if the consumer does so, credit availability for the account will be terminated. On July 20, the account has a purchase balance of $1,000 and the consumer calls the toll-free number and exercises the right to reject. On July 22, a $200 purchase is charged to the account. If the creditor terminates credit availability on July 25 as a result of the rejection, the balance subject to the repayment limitations in § 226.9(h)(2)(iii) is the $1,200 purchase balance at the end of the day on July 25. However, if the creditor does not terminate credit availability as a result of the rejection, the balance subject to the repayment limitations in § 226.9(h)(2)(iii) is the $1,000 purchase balance at the end of the day on the date the creditor was notified of the rejection (July 20), although the creditor may, at its option, treat the $200 purchase as part of the balance subject to § 226.9(h)(2)(iii).

9(h)(3) Exception.

1. Examples. Section 226.9(h)(3) provides that § 226.9(h) does not apply when the creditor has not received the consumer's required minimum periodic payment within 60 days after the due date for that payment. The following examples illustrate the application of this exception:

i. Account becomes more than 60 days delinquent before notice provided. Assume that a credit card account is opened on January 1 of year one and that the payment due date for the account is the fifteenth day of the month. On June 20 of year two, the creditor has not received the required minimum periodic payments due on April 15, May 15, and June 15. On June 20, the creditor provides a notice pursuant to § 226.9(c) informing the consumer that a monthly maintenance fee of $10 will be charged beginning on August 4. However, § 226.9(c)(2)(iv)(B) does not require the creditor to notify the consumer of the right to reject because the creditor has not received the April 15 minimum payment within 60 days after the due date. Furthermore, the exception in § 226.9(h)(3) applies and the consumer may not reject the fee.

ii. Account becomes more than 60 days delinquent after rejection. Assume that a credit card account is opened on January 1 of year one and that the payment due date for the account is the fifteenth day of the month. On April 20 of year two, the creditor has not received the required minimum periodic payment due on April 15. On April 20, the creditor provides a notice pursuant to § 226.9(c) informing the consumer that an annual fee of $100 will be charged beginning on June 4. The notice further states that the consumer may reject the fee by calling a specified toll-free telephone number before June 4 but that, if the consumer does so, credit availability for the account will be terminated. On May 5, the consumer calls the toll-free telephone number and rejects the fee. Section 226.9(h)(2)(i) prohibits the creditor from charging the $100 fee to the account. If, however, the creditor does not receive the minimum payments due on April 15 and May 15 by June 15, § 226.9(h)(3) permits the creditor to charge the $100 fee. The creditor must provide a second notice of the fee pursuant to § 226.9(c), but § 226.9(c)(2)(iv)(B) does not require the creditor to disclose the right to reject and § 226.9(h)(3) does not allow the consumer to reject the fee. Similarly, the restrictions in § 226.9(h)(2)(ii) and (iii) no longer apply.

Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual Section 226.10

§ **226.10 Payments**

10(a) General rule.

1. Crediting date. Section 226.10(a) does not require the creditor to post the payment to the consumer's account on a particular date; the creditor is only required to credit the payment as of the date of receipt.

2. Date of receipt. The "date of receipt" is the date that the payment instrument or other means of completing the payment reaches the creditor. For example:

i. Payment by check is received when the creditor gets it, not when the funds are collected.

ii. In a payroll deduction plan in which funds are deposited to an asset account held by the creditor, and from which payments are made periodically to an open-end credit account, payment is received on the date when it is debited to the asset account (rather than on the date of the deposit), provided the payroll deduction method is voluntary and the consumer retains use of the funds until the contractual payment date.

iii. If the consumer elects to have payment made by a third party payor such as a financial institution, through a preauthorized payment or telephone bill-payment arrangement, payment is received when the creditor gets the third party payor's check or other transfer medium, such as an electronic fund transfer, as long as the payment meets the creditor's requirements as specified under § 226.10(b).

iv. Payment made via the creditor's Web site is received on the date on which the consumer authorizes the creditor to effect the payment, even if the consumer gives the instruction authorizing that payment in advance of the date on which the creditor is authorized to effect the payment. If the consumer authorizes the creditor to effect the payment immediately, but the consumer's instruction is received after 5 p.m. or any later cut-off time specified by the creditor, the date on which the consumer authorizes the creditor to effect the payment is deemed to be the next business day.

10(b) Specific requirements for payments.

1. Payment by electronic fund transfer. A creditor may be prohibited from specifying payment by preauthorized electronic fund transfer. (See section 913 of the Electronic Fund Transfer Act.)

2. Payment via creditor's Web site. If a creditor promotes electronic payment via its Web site (such as by disclosing on the Web site itself that payments may be made via the Web site), any payments made via the creditor's Web site prior to the creditor's specified cut-off time, if any, would generally be conforming payments for purposes of § 226.10(b).

3. Acceptance of nonconforming payments. If the creditor accepts a nonconforming payment (for example, payment mailed to a branch office, when the creditor had specified that payment be sent to a different location), finance charges may accrue for the period between receipt and crediting of payments.

4. Acceptance of nonconforming payments. If the creditor accepts a nonconforming payment (for example, payment mailed to a branch office, when the creditor had specified that payment be sent to a different location), finance charges may accrue for the period between receipt and crediting of payments.

i. Payments may be made at any location where the creditor conducts business.

ii. Payments may be made any time during the creditor's normal business hours.Payments may be made any time during the creditor's normal business hours.

iii. Payment may be by cash, money order, draft, or other similar instrument in properly negotiable form, or by electronic fund transfer if the creditor and consumer have so agreed.

5. Payments made at point of sale. If a card issuer that is a financial institution issues a credit card under an open-end

(not home-secured) consumer credit plan that can be used only for transactions with a particular merchant or merchants or a credit card that is cobranded with the name of a particular merchant or merchants, and a consumer is able to make a payment on that credit card account at a retail location maintained by such a merchant, that retail location is not considered to be a branch or office of the card issuer for purposes of § 226.10(b)(3).

6. In-person payments on credit card accounts. For purposes of § 226.10(b)(3), payments made in person at a branch or office of a financial institution include payments made with the direct assistance of, or to, a branch or office employee, for example a teller at a bank branch. A payment made at the bank branch without the direct assistance of a branch or office employee, for example a payment placed in a branch or office mail slot, is not a payment made in person for purposes of § 226.10(b)(3).

7. In-person payments at affiliate of card issuer. If an affiliate of a card issuer that is a financial institution shares a name with the card issuer, such as "ABC," and accepts in-person payments on the card issuer's credit card accounts, those payments are subject to the requirements of § 226.10(b)(3).

10(d) Crediting of payments when creditor does not receive or accept payments on due date.

1. Example. A day on which the creditor does not receive or accept payments by mail may occur, for example, if the U.S. Postal Service does not deliver mail on that date.

2. Treating a payment as late for any purpose. See comment 5(b)(2)(ii)-2 for guidance on treating a payment as late for any purpose. When an account is not eligible for a grace period, imposing a finance charge due to a periodic interest rate does not constitute treating a payment as late.

10(e) Limitations on fees related to method of payment.

1. Separate fee to allow consumers to make a payment. For purposes of § 226.10(e), the term "separate fee" means a fee imposed on a consumer for making a payment to the consumer's account. A fee or other charge imposed if payment is made after the due date, such as a late fee or finance charge, is not a separate fee to allow consumers to make a payment for purposes of § 226.10(e).

2. Expedited. For purposes of § 226.10(e), the term "expedited" means crediting a payment the same day or, if the payment is received after any cut-off time established by the creditor, the next business day.

3. Service by a customer service representative. Service by a customer service representative of a creditor means any payment made to the consumer's account with the assistance of a live representative or agent of the creditor, including those made in person, on the telephone, or by electronic means. A customer service representative does not include

automated means of making payment that do not involve a live representative or agent of the creditor, such as a voice response unit or interactive voice response system. Service by a customer service representative includes any payment transaction which involves the assistance of a live representative or agent of the creditor, even if an automated system is required for a portion of the transaction.

10(f) Changes by card issuer.

1. Address for receiving payment. For purposes of § 226.10(f), "address for receiving payment" means a mailing address for receiving payment, such as a post office box, or the address of a branch or office at which payments on credit card accounts are accepted.

2. Materiality. For purposes of § 226.10(f), a "material change" means any change in the address for receiving payment or procedures for handling cardholder payments which causes a material delay in the crediting of a payment. "Material delay" means any delay in crediting payment to a consumer's account which would result in a late payment and the imposition of a late fee or finance charge. A delay in crediting a payment which does not result in a late fee or finance charge would be immaterial.

3. Safe harbor.

i. General. A card issuer may elect not to impose a late fee or finance charge on a consumer's account for the 60-day period following a change in address for receiving payment or procedures for handling cardholder payments which could reasonably be expected to cause a material delay in crediting of a payment to the consumer's account. For purposes of § 226.10(f), a late fee or finance charge is not imposed if the fee or charge is waived or removed, or an amount equal to the fee or charge is credited to the account.

ii. Retail location. For a material change in the address of a retail location or procedures for handling cardholder payments at a retail location, a card issuer may impose a late fee or finance charge on a consumer's account for a late payment during the 60-day period following the date on which the change took effect. However, if a consumer is notified by a consumer no later than 60 days after the card issuer transmitted the first periodic statement that reflects the late fee or finance charge for a late payment that the late payment was caused by such change, the card issuer must waive or remove any late fee or finance charge, or credit an amount equal to any late fee or finance charge, imposed on the account during the 60-day period following the date on which the change took effect.

4. Examples.

i. A card issuer changes the mailing address for receiving payments by mail from a five-digit postal zip code to a nine-digit postal zip code. A consumer mails a payment using the five-digit postal zip code. The change in mailing

address is immaterial and it does not cause a delay. Therefore, a card issuer may impose a late fee or finance charge for a late payment on the account.

ii. A card issuer changes the mailing address for receiving payments by mail from one post office box number to another post office box number. For a 60-day period following the change, the card issuer continues to use both post office box numbers for the collection of payments received by mail. The change in mailing address would not cause a material delay in crediting a payment because payments would be received and credited at both addresses. Therefore, a card issuer may impose a late fee or finance charge for a late payment on the account during the 60-day period following the date on which the change took effect.

iii. Same facts as paragraph ii. above, except the prior post office box number is no longer valid and mail sent to that address during the 60-day period following the change would be returned to sender. The change in mailing address is material and the change could cause a material delay in the crediting of a payment because a payment sent to the old address could be delayed past the due date. If, as a result, a consumer makes a late payment on the account during the 60-day period following the date on which the change took effect, a card issuer may not impose any late fee or finance charge for the late payment.

iv. A card issuer permanently closes a local branch office at which payments are accepted on credit card accounts. The permanent closing of the local branch office is a material change in address for receiving payment. Relying on the safe harbor, the card issuer elects not to impose a late fee or finance charge for the 60-day period following the local branch closing for late payments on consumer accounts which the issuer reasonably determines are associated with the local branch and which could reasonably be expected to have been caused by the branch closing.

v. A consumer has elected to make payments automatically to a credit card account, such as through a payroll deduction plan or a third party payor's preauthorized payment arrangement. A card issuer changes the procedures for handling such payments and as a result, a payment is delayed and not credited to the consumer's account before the due date. In these circumstances, a card issuer may not impose any late fee or finance charge during the 60-day period following the date on which the change took effect for a late payment on the account.

vi. A card issuer no longer accepts payments in person at a retail location as a conforming method of payment, which is a material change in the procedures for handling cardholder payment. In the 60-day period following the date on which the change took effect, a consumer attempts to make a payment in person at a retail location of a card issuer. As a result, the consumer makes a late payment and the issuer charges a late fee on the consumer's account. The consumer notifies the card issuer of the late fee for the late payment which was caused by the material change. In order to comply with § 226.10(f), the card issuer must waive or remove the late fee or finance charge, or credit the consumer's account in an amount equal to the late fee or finance charge.

5. Finance charge due to periodic interest rate. When an account is not eligible for a grace period, imposing a finance charge due to a periodic interest rate does not constitute imposition of a finance charge for a late payment for purposes

of § 226.10(f).

Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual Section 226.11

§ **226.11 Treatment of Credit Balances; Account Termination**

11(a) Credit balances.

1. Timing of refund. The creditor may also fulfill its obligations under § 226.11 by:

i. Refunding any credit balance to the consumer immediately.

ii. Refunding any credit balance prior to receiving a written request (under § 226.11(a)(2)) from the consumer.

iii. Refunding any credit balance upon the consumer's oral or electronic request.

iv. Making a good faith effort to refund any credit balance before 6 months have passed. If that attempt is unsuccessful, the creditor need not try again to refund the credit balance at the end of the 6-month period.

2. Amount of refund. The phrases any part of the remaining credit balance in § 226.11(a)(2) and any part of the credit balance remaining in the account in § 226.11(a)(3) mean the amount of the credit balance at the time the creditor is required to make the refund. The creditor may take into consideration intervening purchases or other debits to the consumer's account (including those that have not yet been reflected on a periodic statement) that decrease or eliminate

the credit balance.

Paragraph 11(a)(2).

1. Written requests--standing orders. The creditor is not required to honor standing orders requesting refunds of any credit balance that may be created on the consumer's account.

Paragraph 11(a)(3).

1. Good faith effort to refund. The creditor must take positive steps to return any credit balance that has remained in the account for over 6 months. This includes, if necessary, attempts to trace the consumer through the consumer's last known address or telephone number, or both.

2. Good faith effort unsuccessful. Section 226.11 imposes no further duties on the creditor if a good faith effort to return the balance is unsuccessful. The ultimate disposition of the credit balance (or any credit balance of $1 or less) is to be determined under other applicable law.

11(b) Account termination.

Paragraph 11(b)(1).

1. Expiration date. The credit agreement determines whether or not an open-end plan has a stated expiration (maturity) date. Creditors that offer accounts with no stated expiration date are prohibited from terminating those accounts solely because a consumer does not incur a finance charge, even if credit cards or other access devices associated with the account expire after a stated period. Creditors may still terminate such accounts for inactivity consistent with § 226.11(b)(2).

11(c) Timely settlement of estate debts

1. Administrator of an estate. For purposes of § 226.11(c), the term "administrator" means an administrator, executor, or any personal representative of an estate who is authorized to act on behalf of the estate.

2. Examples. The following are examples of reasonable procedures that satisfy this rule:

i. A card issuer may decline future transactions and terminate the account upon receiving reasonable notice of the consumer's death.

ii. A card issuer may credit the account for fees and charges imposed after the date of receiving reasonable notice of the consumer's death.

iii. A card issuer may waive the estate's liability for all charges made to the account after receiving reasonable notice of the consumer's death.

iv. A card issuer may authorize an agent to handle matters in accordance with the requirements of this rule.

v. A card issuer may require administrators of an estate to provide documentation indicating authority to act on behalf of the estate.

vi. A card issuer may establish or designate a department, business unit, or communication channel for administrators, such as a specific mailing address or toll-free number, to handle matters in accordance with the requirements of this rule.

vii. A card issuer may direct administrators, who call a general customer service toll-free number or who send correspondence by mail to an address for general correspondence, to an appropriate customer service representative, department, business unit, or communication channel to handle matters in accordance with the requirements of this rule.

2. Request by an administrator of an estate. A card issuer may receive a request for the amount of the balance on a deceased consumer's account in writing or by telephone call from the administrator of an estate. If a request is made in writing, such as by mail, the request is received on the date the card issuer receives the correspondence.

3. Timely statement of balance. A card issuer must disclose the balance on a deceased consumer's account, upon request by the administrator of the decedent's estate. A card issuer may provide the amount, if any, by a written statement or by telephone. This does not preclude a card issuer from providing the balance amount to appropriate persons, other than the administrator, such as the spouse or a relative of the decedent, who indicate that they may pay any balance. This provision does not relieve card issuers of the requirements to provide a periodic statement, under § 226.5(b)(2). A periodic statement, under § 226.5(b)(2), may satisfy the requirements of § 226.11(c)(2), if provided within 30 days of receiving a request by an administrator of the estate.

4. Imposition of fees and interest charges. Section 226.11(c)(3) does not prohibit a card issuer from imposing fees and finance charges due to a periodic interest rate based on balances for days that precede the date on which the card

issuer receives a request pursuant to § 226.11(c)(2). For example, if the last day of the billing cycle is June 30 and the card issuer receives a request pursuant to § 226.11(c)(2) on June 25, the card issuer may charge interest that accrued prior to June 25.

5. Example. A card issuer receives a request from an administrator for the amount of the balance on a deceased consumer's account on March 1. The card issuer discloses to the administrator on March 25 that the balance is $1,000. If the card issuer receives payment in full of the $1,000 on April 24, the card issuer must waive or rebate any additional interest that accrued on the $1,000 balance between March 25 and April 24. If the card issuer receives a payment of $1,000 on April 25, the card issuer is not required to waive or rebate interest charges on the $1,000 balance in respect of the period between March 25 and April 25. If the card issuer receives a partial payment of $500 on April 24, the card issuer is not required to waive or rebate interest charges on the $1,000 balance in respect of the period between March 25 and April 25.

6. Application to joint accounts. A card issuer may impose fees and charges on an account of a deceased consumer if a joint accountholder remains on the account. If only an authorized user remains on the account of a deceased consumer, however, then a card issuer may not impose fees and charges.

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual Section 226.12

§ **226.12 Special Credit Card Provisions**

1. Scope. Sections 226.12(a) and (b) deal with the issuance and liability rules for credit cards, whether the card is intended for consumer, business, or any other purposes. Sections 226.12(a) and (b) are exceptions to the general rule that the regulation applies only to consumer credit. (See §§ 226.1 and 226.3.)

2. Definition of "accepted credit card". For purposes of this section, "accepted credit card" means any credit card that a cardholder has requested or applied for and received, or has signed, used, or authorized another person to use to obtain credit. Any credit card issued as a renewal or substitute in accordance with § 226.12(a) becomes an accepted credit card when received by the cardholder.

12(a) Issuance of credit cards.

Paragraph 12(a)(1).

1. Explicit request. A request or application for a card must be explicit. For example, a request for an overdraft plan tied to a checking account does not constitute an application for a credit card with overdraft checking features.

2. Addition of credit features. If the consumer has a non-credit card, the addition of credit features to the card (for example, the granting of overdraft privileges on a checking account when the consumer already has a check guarantee card) constitutes issuance of a credit card.

3. Variance of card from request. The request or application need not correspond exactly to the card that is issued. For example:

i. The name of the card requested may be different when issued.

ii. The card may have features in addition to those reflected in the request or application.

4. Permissible form of request. The request or application may be oral (in response to a telephone solicitation by a card issuer, for example) or written.

5. Time of issuance. A credit card may be issued in response to a request made before any cards are ready for issuance (for example, if a new program is established), even if there is some delay in issuance.

6. Persons to whom cards may be issued. A card issuer may issue a credit card to the person who requests it, and to anyone else for whom that person requests a card and who will be an authorized user on the requester's account. In other words, cards may be sent to consumer A on A's request, and also (on A's request) to consumers B and C, who will be authorized users on A's account. In these circumstances, the following rules apply:

i. The additional cards may be imprinted in either A's name or in the names of B and C.

ii. No liability for unauthorized use (by persons other than B and C), not even the $50, may be imposed on B or C since they are merely users and not cardholders as that term is defined in § 226.2 and used in § 226.12(b); of course, liability of up to $50 for unauthorized use of B's and C's cards may be imposed on A.

iii. Whether B and C may be held liable for their own use, or on the account generally, is a matter of state or other applicable law.

7. Issuance of non-credit cards.

i. General. Under § 226.12(a)(1), a credit card cannot be issued except in response to a request or an application. (See comment 2(a)(15)-2 for examples of cards or devices that are and are not credit cards.) A non-credit card may be

sent on an unsolicited basis by an issuer that does not propose to connect the card to any credit plan; a credit feature may be added to a previously issued non-credit card only upon the consumer's specific request.

ii. Examples. A purchase-price discount card may be sent on an unsolicited basis by an issuer that does not propose to connect the card to any credit plan. An issuer demonstrates that it proposes to connect the card to a credit plan by, for example, including promotional materials about credit features or account agreements and disclosures required by § 226.6. The issuer will violate the rule against unsolicited issuance if, for example, at the time the card is sent a credit plan can be accessed by the card or the recipient of the unsolicited card has been preapproved for credit that the recipient can access by contacting the issuer and activating the card.

8. Unsolicited issuance of PINs. A card issuer may issue personal identification numbers (PINs) to existing credit cardholders without a specific request from the cardholders, provided the PINs cannot be used alone to obtain credit. For example, the PINs may be necessary if consumers wish to use their existing credit cards at automated teller machines or at merchant locations with point of sale terminals that require PINs.

Paragraph 12(a)(2).

1. Renewal. Renewal generally contemplates the regular replacement of existing cards because of, for example, security reasons or new technology or systems. It also includes the re-issuance of cards that have been suspended temporarily, but does not include the opening of a new account after a previous account was closed.

2. Substitution--examples. Substitution encompasses the replacement of one card with another because the underlying account relationship has changed in some way--such as when the card issuer has:

i. Changed its name.

ii. Changed the name of the card.

iii. Changed the credit or other features available on the account. For example, the original card could be used to make purchases and obtain cash advances at teller windows. The substitute card might be usable, in addition, for obtaining cash advances through automated teller machines. (If the substitute card constitutes an access device, as defined in Regulation E, then the Regulation E issuance rules would have to be followed.) The substitution of one card with another on an unsolicited basis is not permissible, however, where in conjunction with the substitution an additional credit card account is opened and the consumer is able to make new purchases or advances under both the original and the new account with the new card. For example, if a retail card issuer replaces its credit card with a combined retailer/bank card, each of the creditors maintains a separate account, and both accounts can be accessed for new transactions by use of the new credit card, the card cannot be provided to a consumer without solicitation.

iv. Substituted a card user's name on the substitute card for the cardholder's name appearing on the original card.

v. Changed the merchant base, provided that the new card is honored by at least one of the persons that honored the original card. However, unless the change in the merchant base is the addition of an affiliate of the existing merchant base, the substitution of a new card for another on an unsolicited basis is not permissible where the account is inactive. A credit card cannot be issued in these circumstances without a request or application. For purposes of § 226.12(a), an account is inactive if no credit has been extended and if the account has no outstanding balance for the prior 24 months. (See§ 226.11(b)(2).)

3. Substitution--successor card issuer. Substitution also occurs when a successor card issuer replaces the original card issuer (for example, when a new card issuer purchases the accounts of the original issuer and issues its own card to replace the original one). A permissible substitution exists even if the original issuer retains the existing receivables and the new card issuer acquires the right only to future receivables, provided use of the original card is cut off when use of the new card becomes possible.

4. Substitution--non-credit-card plan. A credit card that replaces a retailer's open-end credit plan not involving a credit card is not considered a substitute for the retailer's plan--even if the consumer used the retailer's plan. A credit card cannot be issued in these circumstances without a request or application.

5. One-for-one rule. An accepted card may be replaced by no more than one renewal or substitute card. For example, the card issuer may not replace a credit card permitting purchases and cash advances with two cards, one for the purchases and another for the cash advances.

6. One-for-one rule--exceptions. The regulation does not prohibit the card issuer from:

i. Replacing a debit/credit card with a credit card and another card with only debit functions (or debit functions plus an associated overdraft capability), since the latter card could be issued on an unsolicited basis under Regulation E.

ii. Replacing an accepted card with more than one renewal or substitute card, provided that:

A. No replacement card accesses any account not accessed by the accepted card;

B. For terms and conditions required to be disclosed under § 226.6, all replacement cards are issued subject to the same terms and conditions, except that a creditor may vary terms for which no change in terms notice is required under § 226.9(c); and

C. Under the account's terms the consumer's total liability for unauthorized use with respect to the account does not increase.

7. Methods of terminating replaced card. The card issuer need not physically retrieve the original card, provided the old card is voided in some way, for example:

i. The issuer includes with the new card a notification that the existing card is no longer valid and should be destroyed immediately.

ii. The original card contained an expiration date.

iii. The card issuer, in order to preclude use of the card, reprograms computers or issues instructions to authorization centers.

8. Incomplete replacement. If a consumer has duplicate credit cards on the same account (Card A--one type of bank credit card, for example), the card issuer may not replace the duplicate cards with one Card A and one Card B (Card B--another type of bank credit card) unless the consumer requests Card B.

9. Multiple entities. Where multiple entities share responsibilities with respect to a credit card issued by one of them, the entity that issued the card may replace it on an unsolicited basis, if that entity terminates the original card by voiding it in some way, as described in comment 12(a)(2)-7. The other entity or entities may not issue a card on an unsolicited basis in these circumstances.

12(b) Liability of cardholder for unauthorized use.

1. Meaning of cardholder. For purposes of this provision, cardholder includes any person (including organizations) to whom a credit card is issued for any purpose, including business. When a corporation is the cardholder, required disclosures should be provided to the corporation (as opposed to an employee user).

2. Imposing liability. A card issuer is not required to impose liability on a cardholder for the unauthorized use of a

credit card; if the card issuer does not seek to impose liability, the issuer need not conduct any investigation of the cardholder's claim.

3. Reasonable investigation. If a card issuer seeks to impose liability when a claim of unauthorized use is made by a cardholder, the card issuer must conduct a reasonable investigation of the claim. In conducting its investigation, the card issuer may reasonably request the cardholder's cooperation. The card issuer may not automatically deny a claim based solely on the cardholder's failure or refusal to comply with a particular request, including providing an affidavit or filing a police report; however, if the card issuer otherwise has no knowledge of facts confirming the unauthorized use, the lack of information resulting from the cardholder's failure or refusal to comply with a particular request may lead the card issuer reasonably to terminate the investigation. The procedures involved in investigating claims may differ, but actions such as the following represent steps that a card issuer may take, as appropriate, in conducting a reasonable investigation:

i. Reviewing the types or amounts of purchases made in relation to the cardholder's previous purchasing pattern.

ii. Reviewing where the purchases were delivered in relation to the cardholder's residence or place of business.

iii. Reviewing where the purchases were made in relation to where the cardholder resides or has normally shopped.

iv. Comparing any signature on credit slips for the purchases to the signature of the cardholder or an authorized user in the card issuer's records, including other credit slips.

v. Requesting documentation to assist in the verification of the claim.

vi. Requiring a written, signed statement from the cardholder or authorized user. For example, the creditor may include a signature line on a billing rights form that the cardholder may send in to provide notice of the claim. However, a creditor may not require the cardholder to provide an affidavit or signed statement under penalty of perjury as part of a reasonable investigation.

vii. Requesting a copy of a police report, if one was filed.

viii. Requesting information regarding the cardholder's knowledge of the person who allegedly used the card or of that person's authority to do so.

4. Checks that access a credit card account. The liability provisions for unauthorized use under § 226.12(b)(1) only apply to transactions involving the use of a credit card, and not if an unauthorized transaction is made using a check accessing the credit card account. However, the billing error provisions in § 226.13 apply to both of these types of transactions.

12(b)(1)(ii) Limitation on amount.

1. Meaning of authority. Section 226.12(b)(1)(i) defines unauthorized use in terms of whether the user has actual, implied, or apparent authority. Whether such authority exists must be determined under state or other applicable law.

2. Liability limits--dollar amounts. As a general rule, the cardholder's liability for a series of unauthorized uses cannot exceed either $50 or the value obtained through the unauthorized use before the card issuer is notified, whichever is less.

3. Implied or apparent authority. If a cardholder furnishes a credit card and grants authority to make credit transactions to a person (such as a family member or coworker) who exceeds the authority given, the cardholder is liable for the transaction(s) unless the cardholder has notified the creditor that use of the credit card by that person is no longer authorized.

4. Credit card obtained through robbery or fraud. An unauthorized use includes, but is not limited to, a transaction initiated by a person who has obtained the credit card from the consumer, or otherwise initiated the transaction, through fraud or robbery.

12(b)(2) Conditions of liability.

1. Issuer's option not to comply. A card issuer that chooses not to impose any liability on cardholders for unauthorized use need not comply with the disclosure and identification requirements discussed in§ 226.12(b)(2).

Paragraph 12(b)(2)(ii).

1. Disclosure of liability and means of notifying issuer. The disclosures referred to in § 226.12(b)(2)(ii) may be given, for example, with the initial disclosures under § 226.6, on the credit card itself, or on periodic statements. They may be given at any time preceding the unauthorized use of the card.

2. Meaning of "adequate notice." For purposes of this provision, "adequate notice" means a printed notice to a

cardholder that sets forth clearly the pertinent facts so that the cardholder may reasonably be expected to have noticed it and understood its meaning. The notice may be given by any means reasonably assuring receipt by the cardholder.

Paragraph 12(b)(2)(iii).

1. Means of identifying cardholder or user. To fulfill the condition set forth in § 226.12(b)(2)(iii), the issuer must provide some method whereby the cardholder or the authorized user can be identified. This could include, for example, a signature, photograph, or fingerprint on the card or other biometric means, or electronic or mechanical confirmation.

2. Identification by magnetic strip. Unless a magnetic strip (or similar device not readable without physical aids) must be used in conjunction with a secret code or the like, it would not constitute sufficient means of identification. Sufficient identification also does not exist if a "pool" or group card, issued to a corporation and signed by a corporate agent who will not be a user of the card, is intended to be used by another employee for whom no means of identification is provided.

3. Transactions not involving card. The cardholder may not be held liable under § 226.12(b) when the card itself (or some other sufficient means of identification of the cardholder) is not presented. Since the issuer has not provided a means to identify the user under these circumstances, the issuer has not fulfilled one of the conditions for imposing liability. For example, when merchandise is ordered by telephone or the Internet by a person without authority to do so, using a credit card account number by itself or with other information that appears on the card (for example, the card expiration date and a 3- or 4-digit cardholder identification number), no liability may be imposed on the cardholder.

12(b)(3) Notification to card issuer.

1. How notice must be provided. Notice given in a normal business manner--for example, by mail, telephone, or personal visit--is effective even though it is not given to, or does not reach, some particular person within the issuer's organization. Notice also may be effective even though it is not given at the address or phone number disclosed by the card issuer under § 226.12(b)(2)(ii).

2. Who must provide notice. Notice of loss, theft, or possible unauthorized use need not be initiated by the cardholder. Notice is sufficient so long as it gives the "pertinent information" which would include the name or card number of the cardholder and an indication that unauthorized use has or may have occurred.

3. Relationship to § 226.13. The liability protections afforded to cardholders in § 226.12 do not depend upon the cardholder's following the error resolution procedures in § 226.13. For example, the written notification and time limit requirements of § 226.13 do not affect the § 226.12 protections. (See also comment 12(b)-4.)

12(b)(5) Business use of credit cards.

1. Agreement for higher liability for business use cards. The card issuer may not rely on § 226.12(b)(5) if the business is clearly not in a position to provide 10 or more cards to employees (for example, if the business has only 3 employees). On the other hand, the issuer need not monitor the personnel practices of the business to make sure that it has at least 10 employees at all times.

2. Unauthorized use by employee. The protection afforded to an employee against liability for unauthorized use in excess of the limits set in § 226.12(b) applies only to unauthorized use by someone other than the employee. If the employee uses the card in an unauthorized manner, the regulation sets no restriction on the employee's potential liability for such use.

12(c) Right of cardholder to assert claims or defenses against card issuer.

1. Relationship to § 226.13. The § 226.12(c) credit card "holder in due course" provision deals with the consumer's right to assert against the card issuer a claim or defense concerning property or services purchased with a credit card, if the merchant has been unwilling to resolve the dispute. Even though certain merchandise disputes, such as non-delivery of goods, may also constitute "billing errors" under § 226.13, that section operates independently of § 226.12(c). The cardholder whose asserted billing error involves undelivered goods may institute the error resolution procedures of § 226.13; but whether or not the cardholder has done so, the cardholder may assert claims or defenses under § 226.12(c). Conversely, the consumer may pay a disputed balance and thus have no further right to assert claims and defenses, but still may assert a billing error if notice of that billing error is given in the proper time and manner. An assertion that a particular transaction resulted from unauthorized use of the card could also be both a "defense" and a billing error.

2. Claims and defenses assertible. Section 226.12(c) merely preserves the consumer's right to assert against the card issuer any claims or defenses that can be asserted against the merchant. It does not determine what claims or defenses are valid as to the merchant; this determination must be made under state or other applicable law.

3. Transactions excluded. Section 226.12(c) does not apply to the use of a check guarantee card or a debit card in connection with an overdraft credit plan, or to a check guarantee card used in connection with cash-advance checks.

4. Method of calculating the amount of credit outstanding. The amount of the claim or defense that the cardholder may assert shall not exceed the amount of credit outstanding for the disputed transaction at the time the cardholder first notifies the card issuer or the person honoring the credit card of the existence of the claim or defense. To determine the amount of credit outstanding for purposes of this section, payments and other credits shall be applied to: (i) Late charges in the order of entry to the account; then to (ii) finance charges in the order of entry to the account; and then to (iii) any other debits in the order of entry to the account. If more than one item is included in a single extension of credit, credits are to be distributed pro rata according to prices and applicable taxes.

12(c)(1) General rule.

1. Situations excluded and included. The consumer may assert claims or defenses only when the goods or services are "purchased with the credit card." This could include mail, the Internet or telephone orders, if the purchase is charged to the credit card account. But it would exclude:

i. Use of a credit card to obtain a cash advance, even if the consumer then uses the money to purchase goods or services. Such a transaction would not involve "property or services purchased with the credit card."

ii. The purchase of goods or services by use of a check accessing an overdraft account and a credit card used solely for identification of the consumer. (On the other hand, if the credit card is used to make partial payment for the purchase and not merely for identification, the right to assert claims or defenses would apply to credit extended via the credit card, although not to the credit extended on the overdraft line.)

iii. Purchases made by use of a check guarantee card in conjunction with a cash advance check (or by cash advance checks alone). (See comment 12(c)-3.) A cash advance check is a check that, when written, does not draw on an asset account; instead, it is charged entirely to an open-end credit account.

iv. Purchases effected by use of either a check guarantee card or a debit card when used to draw on overdraft credit plans. (See comment 12(c)-3.) The debit card exemption applies whether the card accesses an asset account via point of sale terminals, automated teller machines, or in any other way, and whether the card qualifies as an "access device" under Regulation E or is only a paper based debit card. If a card serves both as an ordinary credit card and also as check guarantee or debit card, a transaction will be subject to this rule on asserting claims and defenses when used as an ordinary credit card, but not when used as a check guarantee or debit card.

12(c)(2) Adverse credit reports prohibited.

1. Scope of prohibition. Although an amount in dispute may not be reported as delinquent until the matter is resolved:

i. That amount may be reported as disputed.

ii. Nothing in this provision prohibits the card issuer from undertaking its normal collection activities for the delinquent and undisputed portion of the account.

2. Settlement of dispute. A card issuer may not consider a dispute settled and report an amount disputed as delinquent

or begin collection of the disputed amount until it has completed a reasonable investigation of the cardholder's claim. A reasonable investigation requires an independent assessment of the cardholder's claim based on information obtained from both the cardholder and the merchant, if possible. In conducting an investigation, the card issuer may request the cardholder's reasonable cooperation. The card issuer may not automatically consider a dispute settled if the cardholder fails or refuses to comply with a particular request. However, if the card issuer otherwise has no means of obtaining information necessary to resolve the dispute, the lack of information resulting from the cardholder's failure or refusal to comply with a particular request may lead the card issuer reasonably to terminate the investigation.

12(c)(3) Limitations.

Paragraph 12(c)(3)(i)(A).

1. Resolution with merchant. The consumer must have tried to resolve the dispute with the merchant. This does not require any special procedures or correspondence between them, and is a matter for factual determination in each case. The consumer is not required to seek satisfaction from the manufacturer of the goods involved. When the merchant is in bankruptcy proceedings, the consumer is not required to file a claim in those proceedings, and may instead file a claim for the property or service purchased with the credit card with the card issuer directly.

Paragraph 12(c)(3)(i)(B).

1. Geographic limitation. The question of where a transaction occurs (as in the case of mail, Internet, or telephone orders, for example) is to be determined under state or other applicable law.

Paragraph 12(c)(3)(ii).

1. Merchant honoring card. The exceptions (stated in § 226.12(c)(3)(ii)) to the amount and geographic limitations in § 226.12(c)(3)(i)(B) do not apply if the merchant merely honors, or indicates through signs or advertising that it honors, a particular credit card.

12(d) Offsets by card issuer prohibited.

Paragraph 12(d)(1).

1. Holds on accounts. "Freezing" or placing a hold on funds in the cardholder's deposit account is the functional equivalent of an offset and would contravene the prohibition in § 226.12(d)(1), unless done in the context of one of the exceptions specified in § 226.12(d)(2). For example, if the terms of a security agreement permitted the card issuer to place a hold on the funds, the hold would not violate the offset prohibition. Similarly, if an order of a bankruptcy court required the card issuer to turn over deposit account funds to the trustee in bankruptcy, the issuer would not violate the regulation by placing a hold on the funds in order to comply with the court order.

2. Funds intended as deposits. If the consumer tenders funds as a deposit (to a checking account, for example), the

card issuer may not apply the funds to repay indebtedness on the consumer's credit card account.

3. Types of indebtedness; overdraft accounts. The offset prohibition applies to any indebtedness arising from transactions under a credit card plan, including accrued finance charges and other charges on the account. The prohibition also applies to balances arising from transactions not using the credit card itself but taking place under plans that involve credit cards. For example, if the consumer writes a check that accesses an overdraft line of credit, the resulting indebtedness is subject to the offset prohibition since it is incurred through a credit card plan, even though the consumer did not use an associated check guarantee or debit card.

4. When prohibition applies in case of termination of account. The offset prohibition applies even after the card issuer terminates the cardholder's credit card privileges, if the indebtedness was incurred prior to termination. If the indebtedness was incurred after termination, the prohibition does not apply.

Paragraph 12(d)(2).

1. Security interest--limitations. In order to qualify for the exception stated in § 226.12(d)(2), a security interest must be affirmatively agreed to by the consumer and must be disclosed in the issuer's account-opening disclosures under § 226.6. The security interest must not be the functional equivalent of a right of offset; as a result, routinely including in agreements contract language indicating that consumers are giving a security interest in any deposit accounts maintained with the issuer does not result in a security interest that falls within the exception in § 226.12(d)(2). For a security interest to qualify for the exception under § 226.12(d)(2) the following conditions must be met:

i. The consumer must be aware that granting a security interest is a condition for the credit card account (or for more favorable account terms) and must specifically intend to grant a security interest in a deposit account. Indicia of the consumer's awareness and intent include at least one of the following (or a substantially similar procedure that evidences the consumer's awareness and intent):

A. Separate signature or initials on the agreement indicating that a security interest is being given.

B. Placement of the security agreement on a separate page, or otherwise separating the security interest provisions from other contract and disclosure provisions.

C. Reference to a specific amount of deposited funds or to a specific deposit account number.

ii. The security interest must be obtainable and enforceable by creditors generally. If other creditors could not

obtain a security interest in the consumer's deposit accounts to the same extent as the card issuer, the security interest is prohibited by § 226.12(d)(2).

2. Security interest--after-acquired property. As used in § 226.12(d)(2), the term "security interest" does not exclude (as it does for other Regulation Z purposes) interests in after-acquired property. Thus, a consensual security interest in deposit-account funds, including funds deposited after the granting of the security interest would constitute a permissible exception to the prohibition on offsets.

3. Court order. If the card issuer obtains a judgment against the cardholder, and if state and other applicable law and the terms of the judgment do not so prohibit, the card issuer may offset the indebtedness against the cardholder's deposit account.

Paragraph 12(d)(3).

1. Automatic payment plans--scope of exception. With regard to automatic debit plans under § 226.12(d)(3), the following rules apply:

i. The cardholder's authorization must be in writing and signed or initialed by the cardholder.

ii. The authorizing language need not appear directly above or next to the cardholder's signature or initials, provided it appears on the same document and that it clearly spells out the terms of the automatic debit plan.

iii. If the cardholder has the option to accept or reject the automatic debit feature (such option may be required under section 913 of the Electronic Fund Transfer Act), the fact that the option exists should be clearly indicated.

2. Automatic payment plans--additional exceptions. The following practices are not prohibited by § 226.12(d)(1):

i. Automatically deducting charges for participation in a program of banking services (one aspect of which may be a credit card plan).

ii. Debiting the cardholder's deposit account on the cardholder's specific request rather than on an automatic periodic basis (for example, a cardholder might check a box on the credit card bill stub, requesting the issuer to debit the cardholder's account to pay that bill).

12(e) Prompt notification of returns and crediting of refunds.

Paragraph 12(e)(1).

1. Normal channels. The term normal channels refers to any network or interchange system used for the processing of the original charge slips (or equivalent information concerning the transaction).

Paragraph 12(e)(2).

1. Crediting account. The card issuer need not actually post the refund to the consumer's account within three business days after receiving the credit statement, provided that it credits the account as of a date within that time period.

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual Section 226.13

§ **226.13 Billing Error Resolution**

1. Creditor's failure to comply with billing error provisions. Failure to comply with the error resolution procedures may result in the forfeiture of disputed amounts as prescribed in section 161(e) of the act. (Any failure to comply may also be a violation subject to the liability provisions of section 130 of the act.)

2. Charges for error resolution. If a billing error occurred, whether as alleged or in a different amount or manner, the creditor may not impose a charge related to any aspect of the error resolution process (including charges for documentation or investigation) and must credit the consumer's account if such a charge was assessed pending resolution. Since the act grants the consumer error resolution rights, the creditor should avoid any chilling effect on the good faith assertion of errors that might result if charges are assessed when no billing error has occurred.

13(a) Definition of billing error.

Paragraph 13(a)(1).

1. Actual, implied, or apparent authority. Whether use of a credit card or open-end credit plan is authorized is determined by state or other applicable law. (See comment 12(b)(1)(ii)-1.)

Paragraph 13(a)(3).

1. Coverage.

i. Section 226.13(a)(3) covers disputes about goods or services that are "not accepted" or "not delivered * * * as

agreed"; for example:

A. The appearance on a periodic statement of a purchase, when the consumer refused to take delivery of goods because they did not comply with the contract.

B. Delivery of property or services different from that agreed upon.

C. Delivery of the wrong quantity.

D. Late delivery.

E. Delivery to the wrong location.

ii. Section 226.13(a)(3) does not apply to a dispute relating to the quality of property or services that the consumer accepts. Whether acceptance occurred is determined by state or other applicable law.

2. Application to purchases made using a third-party payment intermediary. Section 226.13(a)(3) generally applies to disputes about goods and services that are purchased using a third-party payment intermediary, such as a person-to-person Internet payment service, funded through use of a consumer's open-end credit plan when the goods or services are not accepted by the consumer or not delivered to the consumer as agreed. However, the extension of credit must be made at the time the consumer purchases the good or service and match the amount of the transaction to purchase the good or service (including ancillary taxes and fees). Under these circumstances, the property or service for which the extension of credit is made is not the payment service, but rather the good or service that the consumer has purchased using the payment service. Thus, for example, § 226.13(a)(3) would not apply to purchases using a third party payment intermediary that is funded through use of an open-end credit plan if:

i. The extension of credit is made to fund the third-party payment intermediary "account," but the consumer does not contemporaneously use those funds to purchase a good or service at that time.

ii. The extension of credit is made to fund only a portion of the purchase amount, and the consumer uses other sources to fund the remaining amount.

3. Notice to merchant not required. A consumer is not required to first notify the merchant or other payee from whom he or she has purchased goods or services and attempt to resolve a dispute regarding the good or service before providing a billing-error notice to the creditor under § 226.13(a)(3) asserting that the goods or services were not accepted or delivered as agreed.

Paragraph 13(a)(5).

1. Computational errors. In periodic statements that are combined with other information, the error resolution procedures are triggered only if the consumer asserts a computational billing error in the credit-related portion of the periodic statement. For example, if a bank combines a periodic statement reflecting the consumer's credit card transactions with the consumer's monthly checking statement, a computational error in the checking account portion of the combined statement is not a billing error.

Paragraph 13(a)(6).

1. Documentation requests. A request for documentation such as receipts or sales slips, unaccompanied by an allegation of an error under § 226.13(a) or a request for additional clarification under § 226.13(a)(6), does not trigger the error resolution procedures. For example, a request for documentation merely for purposes such as tax preparation or recordkeeping does not trigger the error resolution procedures.

13(b) Billing error notice.

1. Withdrawal of billing error notice by consumer. The creditor need not comply with the requirements of § 226.13(c) through (g) of this section if the consumer concludes that no billing error occurred and voluntarily withdraws the billing error notice. The consumer's withdrawal of a billing error notice may be oral, electronic or written.

2. Form of written notice. The creditor may require that the written notice not be made on the payment medium or other material accompanying the periodic statement if the creditor so stipulates in the billing rights statement required by §§ 226.6(a)(5) or (b)(5)(iii), and 226.9(a). In addition, if the creditor stipulates in the billing rights statement that it accepts billing error notices submitted electronically, and states the means by which a consumer may electronically submit a billing error notice, a notice sent in such manner will be deemed to satisfy the written notice requirement for purposes of § 226.13(b).

Paragraph 13(b)(1).

1. Failure to send periodic statement--timing. If the creditor has failed to send a periodic statement, the 60-day period runs from the time the statement should have been sent. Once the statement is provided, the consumer has another 60 days to assert any billing errors reflected on it.

2. Failure to reflect credit--timing. If the periodic statement fails to reflect a credit to the account, the 60-day period

runs from transmittal of the statement on which the credit should have appeared.

3. Transmittal. If a consumer has arranged for periodic statements to be held at the financial institution until called for, the statement is "transmitted" when it is first made available to the consumer.

Paragraph 13(b)(2).

1. Identity of the consumer. The billing error notice need not specify both the name and the account number if the information supplied enables the creditor to identify the consumer's name and account.

13(c) Time for resolution; general procedures.

1. Temporary or provisional corrections. A creditor may temporarily correct the consumer's account in response to a billing error notice, but is not excused from complying with the remaining error resolution procedures within the time limits for resolution.

2. Correction without investigation. A creditor may correct a billing error in the manner and amount asserted by the consumer without the investigation or the determination normally required. The creditor must comply, however, with all other applicable provisions. If a creditor follows this procedure, no presumption is created that a billing error occurred.

3. Relationship with § 226.12. The consumer's rights under the billing error provisions in § 226.13 are independent of the provisions set forth in § 226.12(b) and (c). (See comments 12(b)-4, 12(b)(3)-3, and 12(c)-1.)

Paragraph 13(c)(2).

1. Time for resolution. The phrase two complete billing cycles means two actual billing cycles occurring after receipt of the billing error notice, not a measure of time equal to two billing cycles. For example, if a creditor on a monthly billing cycle receives a billing error notice mid-cycle, it has the remainder of that cycle plus the next two full billing cycles to resolve the error.

2. Finality of error resolution procedure. A creditor must comply with the error resolution procedures and complete its investigation to determine whether an error occurred within two complete billing cycles as set forth in § 226.13(c)(2). Thus, for example, the creditor would be prohibited from reversing amounts previously credited for an alleged billing error even if the creditor obtains evidence after the error resolution time period has passed indicating that the billing error did not occur as asserted by the consumer. Similarly, if a creditor fails to mail or deliver a written explanation setting forth the reason why the billing error did not occur as asserted, or otherwise fails to comply with the error resolution procedures set forth in § 226.13(f), the creditor generally must credit the disputed amount and related finance or other charges, as applicable, to the consumer's account.

13(d) Rules pending resolution.

1. Disputed amount. Disputed amount is the dollar amount alleged by the consumer to be in error. When the allegation concerns the description or identification of the transaction (such as the date or the seller's name) rather than a dollar amount, the disputed amount is the amount of the transaction or charge that corresponds to the disputed transaction identification. If the consumer alleges a failure to send a periodic statement under § 226.13(a)(7), the disputed amount is the entire balance owing.

13(d)(1) Consumer's right to withhold disputed amount; collection action prohibited.

1. Prohibited collection actions. During the error resolution period, the creditor is prohibited from trying to collect the disputed amount from the consumer. Prohibited collection actions include, for example, instituting court action, taking a lien, or instituting attachment proceedings.

2. Right to withhold payment. If the creditor reflects any disputed amount or related finance or other charges on the periodic statement, and is therefore required to make the disclosure under § 226.13(d)(4), the creditor may comply with that disclosure requirement by indicating that payment of any disputed amount is not required pending resolution. Making a disclosure that only refers to the disputed amount would, of course, in no way affect the consumer's right under § 226.13(d)(1) to withhold related finance and other charges. The disclosure under § 226.13(d)(4) need not appear in any specific place on the periodic statement, need not state the specific amount that the consumer may withhold, and may be preprinted on the periodic statement.

3. Imposition of additional charges on undisputed amounts. The consumer's withholding of a disputed amount from the total bill cannot subject undisputed balances (including new purchases or cash advances made during the present or subsequent cycles) to the imposition of finance or other charges. For example, if on an account with a grace period (that is, an account in which paying the new balance in full allows the consumer to avoid the imposition of additional finance charges), a consumer disputes a $2 item out of a total bill of $300 and pays $298 within the grace period, the consumer would not lose the grace period as to any undisputed amounts, even if the creditor determines later that no billing error occurred. Furthermore, finance or other charges may not be imposed on any new purchases or advances that, absent the unpaid disputed balance, would not have finance or other charges imposed on them. Finance or other charges that would have been incurred even if the consumer had paid the disputed amount would not be affected.

4. Automatic payment plans--coverage. The coverage of this provision is limited to the card issuer's automatic payment plans, whether or not the consumer's asset account is held by the card issuer or by another financial institution. It does not apply to automatic or bill-payment plans offered by financial institutions other than the credit card issuer.

5. Automatic payment plans--time of notice. While the card issuer does not have to restore or prevent the debiting of a disputed amount if the billing error notice arrives after the three-business-day cut-off, the card issuer must, however, prevent the automatic debit of any part of the disputed amount that is still outstanding and unresolved at the time of the

next scheduled debit date.

13(d)(2) Adverse credit reports prohibited.

1. Report of dispute. Although the creditor must not issue an adverse credit report because the consumer fails to pay the disputed amount or any related charges, the creditor may report that the amount or the account is in dispute. Also, the creditor may report the account as delinquent if undisputed amounts remain unpaid.

2. Person. During the error resolution period, the creditor is prohibited from making an adverse credit report about the disputed amount to any person--including employers, insurance companies, other creditors, and credit bureaus.

3. Creditor's agent. Whether an agency relationship exists between a creditor and an issuer of an adverse credit report is determined by State or other applicable law.

13(e) Procedures if billing error occurred as asserted.

1. Correction of error. The phrase as applicable means that the necessary corrections vary with the type of billing error that occurred. For example, a misidentified transaction (or a transaction that is identified by one of the alternative methods in § 226.8) is cured by properly identifying the transaction and crediting related finance and any other charges imposed. The creditor is not required to cancel the amount of the underlying obligation incurred by the consumer.

2. Form of correction notice. The written correction notice may take a variety of forms. It may be sent separately, or it may be included on or with a periodic statement that is mailed within the time for resolution. If the periodic statement is used, the amount of the billing error must be specifically identified. If a separate billing error correction notice is provided, the accompanying or subsequent periodic statement reflecting the corrected amount may simply identify it as credit.

3. Discovery of information after investigation period. See comment 13(c)(2)-2.

13(f) Procedures if different billing error or no billing error occurred.

1. Different billing error. Examples of a different billing error include:

i. Differences in the amount of an error (for example, the customer asserts a $55.00 error but the error was only $53.00).

ii. Differences in other particulars asserted by the consumer (such as when a consumer asserts that a particular transaction never occurred, but the creditor determines that only the seller's name was disclosed incorrectly).

2. Form of creditor's explanation. The written explanation (which also may notify the consumer of corrections to the account) may take a variety of forms. It may be sent separately, or it may be included on or with a periodic statement that is mailed within the time for resolution. If the creditor uses the periodic statement for the explanation and correction(s), the corrections must be specifically identified. If a separate explanation, including the correction notice, is provided, the enclosed or subsequent periodic statement reflecting the corrected amount may simply identify it as a credit. The explanation may be combined with the creditor's notice to the consumer of amounts still owing, which is required under § 226.13(g)(1), provided it is sent within the time limit for resolution. (See commentary to § 226.13(e).)

3. Reasonable investigation. A creditor must conduct a reasonable investigation before it determines that no billing error occurred or that a different billing error occurred from that asserted. In conducting its investigation of an allegation of a billing error, the creditor may reasonably request the consumer's cooperation. The creditor may not automatically deny a claim based solely on the consumer's failure or refusal to comply with a particular request, including providing an affidavit or filing a police report. However, if the creditor otherwise has no knowledge of facts confirming the billing error, the lack of information resulting from the consumer's failure or refusal to comply with a particular request may lead the creditor reasonably to terminate the investigation. The procedures involved in investigating alleged billing errors may differ depending on the billing error type.

i. Unauthorized transaction. In conducting an investigation of a notice of billing error alleging an unauthorized transaction under § 226.13(a)(1), actions such as the following represent steps that a creditor may take, as appropriate, in conducting a reasonable investigation:

A. Reviewing the types or amounts of purchases made in relation to the consumer's previous purchasing pattern.

B. Reviewing where the purchases were delivered in relation to the consumer's residence or place of business.

C. Reviewing where the purchases were made in relation to where the consumer resides or has normally shopped.

D. Comparing any signature on credit slips for the purchases to the signature of the consumer (or an authorized user in the case of a credit card account) in the creditor's records, including other credit slips.

E. Requesting documentation to assist in the verification of the claim.

F. Requiring a written, signed statement from the consumer (or authorized user, in the case of a credit card account). For example, the creditor may include a signature line on a billing rights form that the consumer may send in to provide notice of the claim. However, a creditor may not require the consumer to provide an affidavit or signed statement under penalty of perjury as a part of a reasonable investigation.

G. Requesting a copy of a police report, if one was filed.

H. Requesting information regarding the consumer's knowledge of the person who allegedly obtained an extension of credit on the account or of that person's authority to do so.

ii. Nondelivery of property or services. In conducting an investigation of a billing error notice alleging the nondelivery of property or services under § 226.13(a)(3), the creditor shall not deny the assertion unless it conducts a reasonable investigation and determines that the property or services were actually delivered, mailed, or sent as agreed.

iii. Incorrect information. In conducting an investigation of a billing error notice alleging that information appearing on a periodic statement is incorrect because a person honoring the consumer's credit card or otherwise accepting an access device for an open-end plan has made an incorrect report to the creditor, the creditor shall not deny the assertion unless it conducts a reasonable investigation and determines that the information was correct.

13(g) Creditor's rights and duties after resolution.

Paragraph 13(g)(1).

1. Amounts owed by consumer. Amounts the consumer still owes may include both minimum periodic payments and related finance and other charges that accrued during the resolution period. As explained in the commentary to § 226.13(d)(1), even if the creditor later determines that no billing error occurred, the creditor may not include finance or other charges that are imposed on undisputed balances solely as a result of a consumer's withholding payment of a disputed amount.

2. Time of notice. The creditor need not send the notice of amount owed within the time period for resolution, although it is under a duty to send the notice promptly after resolution of the alleged error. If the creditor combines the notice of the amount owed with the explanation required under § 226.13(f)(1), the combined notice must be provided within the time limit for resolution.

Paragraph 13(g)(2).

1. Grace period if no error occurred. If the creditor determines, after a reasonable investigation, that a billing error did not occur as asserted, and the consumer was entitled to a grace period at the time the consumer provided the billing error notice, the consumer must be given a period of time equal to the grace period disclosed under § 226.6(a)(1) or (b)(2) and § 226.7(a)(8) or (b)(8) to pay any disputed amounts due without incurring additional finance or other charges. However, the creditor need not allow a grace period disclosed under the above-mentioned sections to pay the amount due under § 226.13(g)(1) if no error occurred and the consumer was not entitled to a grace period at the time the consumer asserted the error. For example, assume that a creditor provides a consumer a grace period of 20 days to pay a new balance to avoid finance charges, and that the consumer did not carry an outstanding balance from the prior month. If the consumer subsequently asserts a billing error for the current statement period within the 20-day grace period, and the creditor determines that no billing error in fact occurred, the consumer must be given at least 20 days (i.e., the full disclosed grace period) to pay the amount due without incurring additional finance charges. Conversely, if the consumer was not entitled to a grace period at the time the consumer asserted the billing error, for example, if the consumer did not pay the previous monthly balance of undisputed charges in full, the creditor may assess finance charges on the disputed balance for the entire period the item was in dispute.

Paragraph 13(g)(3).

1. Time for payment. The consumer has a minimum of 10 days to pay (measured from the time the consumer could reasonably be expected to have received notice of the amount owed) before the creditor may issue an adverse credit report; if an initially disclosed grace period allows the consumer a longer time in which to pay, the consumer has the benefit of that longer period.

Paragraph 13(g)(4).

1. Credit reporting. Under § 226.13(g)(4)(i) and (iii) the creditor's additional credit reporting responsibilities must be accomplished promptly. The creditor need not establish costly procedures to fulfill this requirement. For example, a creditor that reports to a credit bureau on scheduled updates need not transmit corrective information by an unscheduled computer or magnetic tape; it may provide the credit bureau with the correct information by letter or other commercially reasonable means when using the scheduled update would not be "prompt." The creditor is not responsible for ensuring that the credit bureau corrects its information immediately.

2. Adverse report to credit bureau. If a creditor made an adverse report to a credit bureau that disseminated the information to other creditors, the creditor fulfills its § 226.13(g)(4)(ii) obligations by providing the consumer with the name and address of the credit bureau.

13(i) Relation to Electronic Fund Transfer Act and Regulation E.

1. Coverage. Credit extended directly from a non-overdraft credit line is governed solely by Regulation Z, even though a combined credit card/access device is used to obtain the extension.

2. Incidental credit under agreement. Credit extended incident to an electronic fund transfer under an agreement between the consumer and the financial institution is governed by § 226.13(i), which provides that certain error resolution procedures in both this regulation and Regulation E apply. Incidental credit that is not extended under an agreement between the consumer and the financial institution is governed solely by the error resolution procedures in Regulation E. For example, credit inadvertently extended incident to an electronic fund-transfer, such as under an overdraft service not subject to Regulation Z, is governed solely by the Regulation E error resolution procedures, if the bank and the consumer do not have an agreement to extend credit when the consumer's account is overdrawn.

3. Application to debit/credit transactions-examples. If a consumer withdraws money at an automated teller machine and activates an overdraft credit feature on the checking account:

i. An error asserted with respect to the transaction is subject, for error resolution purposes, to the applicable Regulation E provisions (such as timing and notice) for the entire transaction.

ii. The creditor need not provisionally credit the consumer's account, under § 205.11(c)(2)(i) of Regulation E, for any portion of the unpaid extension of credit.

iii. The creditor must credit the consumer's account under § 205.11(c) with any finance or other charges incurred as a result of the alleged error.

iv. The provisions of §§ 226.13(d) and (g) apply only to the credit portion of the transaction.

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1B- Consumer Credit Law Manual Section 226.14

§ **226.14 Determination of Annual Percentage Rate**

14(a) General rule.

1. Tolerance. The tolerance of 1/8th of 1 percentage point above or below the annual percentage rate applies to any required disclosure of the annual percentage rate. The disclosure of the annual percentage rate is required in §§ 226.5a, 226.5b, 226.6, 226.7, 226.9, 226.15, 226.16, 226.26, 226.55, and 226.56.

2. Rounding. The regulation does not require that the annual percentage rate be calculated to any particular number of decimal places; rounding is permissible within the 1/8th of 1 percent tolerance. For example, an exact annual percentage rate of 14.33333% may be stated as 14.33% or as 14.3%, or even as 14 1/4%; but it could not be stated as 14.2% or 14%, since each varies by more than the permitted tolerance.

3. Periodic rates. No explicit tolerance exists for any periodic rate as such; a disclosed periodic rate may vary from precise accuracy (for example, due to rounding) only to the extent that its annualized equivalent is within the tolerance permitted by § 226.14(a). Further, a periodic rate need not be calculated to any particular number of decimal places.

4. Finance charges. The regulation does not prohibit creditors from assessing finance charges on balances that include prior, unpaid finance charges; state or other applicable law may do so, however.

5. Good faith reliance on faulty calculation tools. The regulation relieves a creditor of liability for an error in the

annual percentage rate or finance charge that resulted from a corresponding error in a calculation tool used in good faith by the creditor. Whether or not the creditor's use of the tool was in good faith must be determined on a case-by-case basis, but the creditor must in any case have taken reasonable steps to verify the accuracy of the tool, including any instructions, before using it. Generally, the safe harbor from liability is available only for errors directly attributable to the calculation tool itself, including software programs; it is not intended to absolve a creditor of liability for its own errors, or for errors arising from improper use of the tool, from incorrect data entry, or from misapplication of the law.

14(b) Annual percentage rate--in general.

1. Corresponding annual percentage rate computation. For purposes of §§ 226.5a, 226.5b, 226.6, 226.7(a)(4) or (b)(4), 226.9, 226.15, 226.16, 226.26, 226.55, and 226.56, the annual percentage rate is determined by multiplying the periodic rate by the number of periods in the year. This computation reflects the fact that, in such disclosures, the rate (known as the corresponding annual percentage rate) is prospective and does not involve any particular finance charge or periodic balance.

14(c) Optional effective annual percentage rate for periodic statements for creditors offering open-end plans subject to the requirements of § 226.5b.

1. General rule. The periodic statement may reflect (under § 226.7(a)(7)) the annualized equivalent of the rate actually applied during a particular cycle; this rate may differ from the corresponding annual percentage rate because of the inclusion of, for example, fixed, minimum, or transaction charges. Sections 226.14(c)(1) through (c)(4) state the computation rules for the effective rate.

2. Charges related to opening, renewing, or continuing an account. Sections 226.14(c)(2) and (c)(3) exclude from the calculation of the effective annual percentage rate finance charges that are imposed during the billing cycle such as a loan fee, points, or similar charge that relates to opening, renewing, or continuing an account. The charges involved here do not relate to a specific transaction or to specific activity on the account, but relate solely to the opening, renewing, or continuing of the account. For example, an annual fee to renew an open-end credit account that is a percentage of the credit limit on the account, or that is charged only to consumers that have not used their credit card for a certain dollar amount in transactions during the preceding year, would not be included in the calculation of the annual percentage rate, even though the fee may not be excluded from the finance charge under § 226.4(c)(4). (See comment 4(c)(4)-2.) This rule applies even if the loan fee, points, or similar charges are billed on a subsequent periodic statement or withheld from the proceeds of the first advance on the account.

3. Classification of charges. If the finance charge includes a charge not due to the application of a periodic rate, the creditor must use the annual percentage rate computation method that corresponds to the type of charge imposed. If the charge is tied to a specific transaction (for example, 3 percent of the amount of each transaction), then the method in § 226.14(c)(3) must be used. If a fixed or minimum charge is applied, that is, one not tied to any specific transaction, then the formula in § 226.14(c)(2) is appropriate.

4. Small finance charges. Section 226.14(c)(4) gives the creditor an alternative to § 226.14(c)(2) and (c)(3) if small

finance charges (50 cents or less) are involved; that is, if the finance charge includes minimum or fixed fees not due to the application of a periodic rate and the total finance charge for the cycle does not exceed 50 cents. For example, while a monthly activity fee of 50 cents on a balance of $20 would produce an annual percentage rate of 30 percent under the rule in § 226.14(c)(2), the creditor may disclose an annual percentage rate of 18 percent if the periodic rate generally applicable to all balances is 1 1/2 percent per month.

5. Prior-cycle adjustments.

i. The annual percentage rate reflects the finance charges imposed during the billing cycle. However, finance charges imposed during the billing cycle may relate to activity in a prior cycle. Examples of circumstances when this may occur are:

A. A cash advance occurs on the last day of a billing cycle on an account that uses the transaction date to figure finance charges, and it is impracticable to post the transaction until the following cycle.

B. An adjustment to the finance charge is made following the resolution of a billing error dispute.

C. A consumer fails to pay the purchase balance under a deferred payment feature by the payment due date, and finance charges are imposed from the date of purchase.

ii. Finance charges relating to activity in prior cycles should be reflected on the periodic statement as follows:

A. If a finance charge imposed in the current billing cycle is attributable to periodic rates applicable to prior billing cycles (such as when a deferred payment balance was not paid in full by the payment due date and finance charges from the date of purchase are now being debited to the account, or when a cash advance occurs on the last day of a billing cycle on an account that uses the transaction date to figure finance charges and it is impracticable to post the transaction until the following cycle), and the creditor uses the quotient method to calculate the annual percentage rate, the numerator would include the amount of any transaction charges plus any other finance charges posted during the billing cycle. At the creditor's option, balances relating to the finance charge adjustment may be included in the denominator if permitted by the legal obligation, if it was impracticable to post the transaction in the previous cycle because of timing, or if the adjustment is covered by comment 14(c)-5.ii.B.

B. If a finance charge that is posted to the account relates to activity for which a finance charge was debited or credited to the account in a previous billing cycle (for example, if the finance charge relates to an adjustment such as the resolution of a billing error dispute, or an unintentional posting error, or a payment by check that was later returned

unpaid for insufficient funds or other reasons), the creditor shall at its option:

1. Calculate the annual percentage rate in accordance with ii.A. of this paragraph, or

2. Disclose the finance charge adjustment on the periodic statement and calculate the annual percentage rate for the current billing cycle without including the finance charge adjustment in the numerator and balances associated with the finance charge adjustment in the denominator.

14(c)(1) Solely periodic rates imposed.

1. Periodic rates. Section 226.14(c)(1) applies if the only finance charge imposed is due to the application of a periodic rate to a balance. The creditor may compute the annual percentage rate either:

i. By multiplying each periodic rate by the number of periods in the year; or

ii. By the "quotient" method. This method refers to a composite annual percentage rate when different periodic rates apply to different balances. For example, a particular plan may involve a periodic rate of 1/2 percent on balances up to $500, and 1 percent on balances over $500. If, in a given cycle, the consumer has a balance of $800, the finance charge would consist of $7.50 (500 x.015) plus $3.00 (300 x.01), for a total finance charge of $10.50. The annual percentage rate for this period may be disclosed either as 18% on $500 and 12 percent on $300, or as 15.75 percent on a balance of $800 (the quotient of $10.50 divided by $800, multiplied by 12).

14(c)(2) Minimum or fixed charge, but not transaction charge, imposed.

1. Certain charges not based on periodic rates. Section 226.14(c)(2) specifies use of the quotient method to determine the annual percentage rate if the finance charge imposed includes a certain charge not due to the application of a periodic rate (other than a charge relating to a specific transaction). For example, if the creditor imposes a minimum $1 finance charge on all balances below $50, and the consumer's balance was $40 in a particular cycle, the creditor would disclose an annual percentage rate of 30 percent (1/40 x 12).

2. No balance. If there is no balance to which the finance charge is applicable, an annual percentage rate cannot be determined under § 226.14(c)(2). This could occur not only when minimum charges are imposed on an account with no balance, but also when a periodic rate is applied to advances from the date of the transaction. For example, if on May 19 the consumer pays the new balance in full from a statement dated May 1, and has no further transactions reflected on the June 1 statement, that statement would reflect a finance charge with no account balance.

14(c)(3) Transaction charge imposed.

1. Transaction charges.

i. Section 226.14(c)(3) transaction charges include, for example:

A. A loan fee of $10 imposed on a particular advance.

B. A charge of 3 percent of the amount of each transaction.

ii. The reference to avoiding duplication in the computation requires that the amounts of transactions on which transaction charges were imposed not be included both in the amount of total balances and in the "other amounts on which a finance charge was imposed" figure. In a multifeatured plan, creditors may consider each bona fide feature separately in the calculation of the denominator. A creditor has considerable flexibility in defining features for open-end plans, as long as the creditor has a reasonable basis for the distinctions. For further explanation and examples of how to determine the components of this formula, see appendix F to part 226.

2. Daily rate with specific transaction charge. Section 226.14(c)(3) sets forth an acceptable method for calculating the annual percentage rate if the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate. This section includes the requirement that the creditor follow the rules in appendix F to part 226 in calculating the annual percentage rate, especially the provision in the introductory section of appendix F which addresses the daily rate/transaction charge situation by providing that the "average of daily balances" shall be used instead of the "sum of the balances."

14(d) Calculations where daily periodic rate applied.

1. Quotient method. Section 226.14(d) addresses use of a daily periodic rate(s) to determine some or all of the finance charge and use of the quotient method to determine the annual percentage rate. Since the quotient formula in § 226.14(c)(1)(ii) and (c)(2) cannot be used when a daily rate is being applied to a series of daily balances, § 226.14(d) provides two alternative ways to calculate the annual percentage rate--either of which satisfies the provisions of § 226.7(a)(7).

2. Daily rate with specific transaction charge. If the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate, see comment 14(c)(3)-2 for guidance on an appropriate calculation method.

Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual Section 226.15

§ **226.15 Right of Rescission**

1. Transactions not covered. Credit extensions that are not subject to the regulation are not covered by § 226.15 even if the customer's principal dwelling is the collateral securing the credit. For this purpose, credit extensions also would include the occurrences listed in Comment 15(a)(1)-1. For example, the right of rescission does not apply to the opening of a business-purpose credit line, even though the loan is secured by the customer's principal dwelling.

15(a) Consumer's right to rescind.

Paragraph 15(a)(1).

1. Occurrences subject to right. Under an open-end credit plan secured by the consumer's principal dwelling, the right of rescission generally arises with each of the following occurrences:

- Opening the account.
- Each credit extension.
- Increasing the credit limit.
- Adding to an existing account a security interest in the consumer's principal dwelling.
- Increasing the dollar amount of the security interest taken in the dwelling to secure the plan. For example, a consumer may open an account with a $10,000 credit limit, $5,000 of which is initially secured by the consumer's principal dwelling. The consumer has the right to rescind at that time and (except as noted in § 226.15(a)(1)(ii)) with each extension on the account. Later, if the creditor decides that it wants the credit line fully secured, and increases the amount of its interest in the consumer's dwelling, the consumer has the right to rescind the increase.

2. Exceptions. Although the consumer generally has the right to rescind with each transaction on the account, section 125(e) of the Act provides an exception: the creditor need not provide the right to rescind at the time of each credit extension made under an open-end credit plan secured by the consumer's principal dwelling to the extent that the credit extended is in accordance with a previously established credit limit for the plan. This limited rescission option is available whether or not the plan existed prior to the effective date of the Act.

3. Security interest arising from transaction. In order for the right of rescission to apply, the security interest must be retained as part of the credit transaction. For example:

- A security interest that is acquired by a contractor who is also extending the credit in the transaction.
- A mechanic's or materialman's lien that is retained by a subcontractor or supplier of a contractor-creditor, even when the latter has waived its own security interest in the consumer's home.

The security interest is not part of the credit transaction, and therefore the transaction is not subject to the right of rescission when, for example:

- A mechanic's or materialman's lien is obtained by a contractor who is not a party to the credit transaction but merely is paid with the proceeds of the consumer's cash advance.
- All security interests that may arise in connection with the credit transaction are validly waived.
- The creditor obtains a lien and completion bond that in effect satisfies all liens against the consumer's principal dwelling as a result of the credit transaction.

Although liens arising by operation of law are not considered security interests for purposes of disclosure under § 226.2, that section specifically includes them in the definition for purposes of the right of rescission. Thus, even though an interest in the consumer's principal dwelling is not a required disclosure under § 226.6(c), it may still give rise to the right of rescission.

4. Consumer. To be a consumer within the meaning of § 226.2, that person must at least have an ownership interest in the dwelling that is encumbered by the creditor's security interest, although that person need not be a signatory to the credit agreement. For example, if only one spouse enters into a secured plan, the other spouse is a consumer if the ownership interest of that spouse is subject to the security interest.

5. Principal dwelling. A consumer can only have one principal dwelling at a time. (But see comment 15(a)(1)-6.) A vacation or other second home would not be a principal dwelling. A transaction secured by a second home (such as a vacation home) that is not currently being used as the consumer's principal dwelling is not rescindable, even if the consumer intends to reside there in the future. When a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within one year or upon completion of construction, the new dwelling is considered the principal dwelling if it secures the open-end credit line. In that case, the transaction secured by the new dwelling is a residential mortgage transaction and is not rescindable. For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, an advance on an open-end line

to finance B and secured by B is a residential mortgage transaction. Dwelling, as defined in § 226.2, includes structures that are classified as personalty under state law. For example, a transaction secured by a mobile home, trailer, or houseboat used as the consumer's principal dwelling may be rescindable.

6. Special rule for principal dwelling. Notwithstanding the general rule that consumers may have only one principal dwelling, when the consumer is acquiring or constructing a new principal dwelling, a credit plan or extension that is subject to Regulation Z and is secured by the equity in the consumer's current principal dwelling is subject to the right of rescission regardless of the purpose of that loan (for example, an advance to be used as a bridge loan). For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, a loan to finance B and secured by A is subject to the right of rescission. Moreover, a loan secured by both A and B is, likewise, rescindable.

Paragraph 15(a)(2).

1. Consumer's exercise of right. The consumer must exercise the right of rescission in writing but not necessarily on the notice supplied under § 226.15(b). Whatever the means of sending the notification of rescission -- mail, telegram or other written means -- the time period for the creditor's performance under § 226.15(d)(2) does not begin to run until the notification has been received. The creditor may designate an agent to receive the notification so long as the agent's name and address appear on the notice provided to the consumer under § 226.15(b). Where the creditor fails to provide the consumer with a designated address for sending the notification of rescission, delivery of the notification to the person or address to which the consumer has been directed to send payments constitutes delivery to the creditor or assignee. State law determines whether delivery of the notification to a third party other than the person to whom payments are made is delivery to the creditor or assignee, in the case where the creditor fails to designate an address for sending the notification of rescission.

Paragraph 15(a)(3).

1. Rescission period. the period within which the consumer may exercise the right to rescind runs for 3 business days from the last of 3 events:

- The occurrence that gives rise to the right of rescission.
- Delivery of all material disclosures that are relevant to the plan.
- Delivery to the consumer of the required rescission notice.

For example, an account is opened on Friday, June 1, and the disclosures and notice of the right to rescind were given on Thursday, May 31; the rescission period will expire at midnight of the third business day after June 1-- that is, Tuesday June 5. In another example, if the disclosures are given and the account is opened on Friday, June 1, and the rescission notice is given on Monday, June 4, the rescission period expires at midnight of the third business day after June 4-- that is Thursday, June 7. The consumer must place the rescission notice in the mail, file it for telegraphic transmission, or deliver it to the creditor's place of business within that period in order to exercise the right.

2. Material disclosures. Footnote 36 sets forth the material disclosures that must be provided before the rescission period can begin to run. The creditor must provide sufficient information to satisfy the requirements of § 226.6 for these disclosures. A creditor may satisfy this requirement by giving an initial disclosure statement that complies with the regulation. Failure to give the other required initial disclosures (such as the billing rights statement) or the information required under section 226.5b. does not prevent the running of the rescission period, although that failure may result in civil liability or administrative sanctions. The payment terms set forth in footnote 36 apply to any repayment phase set forth in the agreement. Thus, the payment terms described in § 226.6(e)(2) for any repayment phase as well as for the draw period are "material disclosures."

3. Material disclosures-- variable rate program. For a variable rate program, the material disclosures also include the disclosures listed in footnote 12 to § 226.6(a)(2): the circumstances under which the rate may increase; the limitations on the increase; and the effect of an increase. The disclosures listed in footnote 12 to section 226.6(a)(2) for any repayment phase also are material disclosures for variable-rate programs.

4. Unexpired right of rescission. When the creditor has failed to take the action necessary to start the three-day rescission period running the right to rescind automatically lapses on the occurrence of the earliest of the following three events:

- The expiration of three years after the occurrence giving rise to the right of rescission.
- Transfer of all the consumer's interest in the property.
- Sale of the consumer's interest in the property, including a transaction in which the consumer sells the dwelling and takes back a purchase money note and mortgage or retains legal title through a device such as an installment sale contract.

Transfer of all the consumer's interest includes such transfers as bequests and gifts. A sale or transfer of the property need not be voluntary to terminate the right to rescind. For example, a foreclosure sale would terminate an unexpired right to rescind. As provided in section 125 of the act, the three-year limit may be extended by an administrative proceeding to enforce the provisions of § 226.15. A partial transfer of the consumer's interest, such as a transfer bestowing co-ownership on a spouse, does not terminate the right of rescission.

Paragraph 15(a)(4).

1. Joint owners. When more than one consumer has the right to rescind a transaction, any one of them may exercise that right and cancel the transaction on behalf of all. For example, if both a husband and wife have the right to rescind a transaction, either spouse acting alone may exercise the right and both are bound by the rescission.

15(b) Notice of right to rescind.

1. Who receives notice. Each consumer entitled to rescind must be given:

- Two copies of the rescission notice.

- The material disclosures.

In a transaction involving joint owners, both of whom are entitled to rescind, both must receive the notice of the right to rescind and disclosures. For example, if both spouses are entitled to rescind a transaction, each must receive two copies of the rescission notice (one copy to each if the notice is provided in electronic form in accordance with the consumer consent and other applicable provisions of the E-Sign Act) and one copy of the disclosures.

2. Format. The rescission notice may be physically separated from the material disclosures or combined with the material disclosures, so long as the information required to be included on the notice is set forth in a clear and conspicuous manner. See the model notices in appendix G.

3. Content. The notice must include all of the information outlined in § 226.15(b)(1) through (5). The requirement in § 226.15(b) that the transaction or occurrence be identified may be met by providing the date of the transaction or occurrence. The notice may include additional information related to the required information, such as:

- A description of the property subject to the security interest.

- A statement that joint owners may have the right to rescind and that a rescission by one is effective for all.

- The name and address of an agent of the creditor to receive notice of rescission.

4. Time of providing notice. The notice required by § 226.15(b) need not be given before the occurrence giving rise to the right of rescission. The creditor may deliver the notice after the occurrence, but the rescission period will not begin to run until the notice is given. For example, if the creditor provides the notice on May 15, but disclosures were given and the credit limit was raised on May 10, the 3-business-day rescission period will run from May 15.

15(c) Delay of creditor's performance.

1. General rule. Until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded, the creditor must not, either directly or through a third party:

- Disburse advances to the consumer.

- Begin performing services for the consumer.

- Deliver materials to the consumer.

A creditor may, however, continue to allow transactions under an existing open-end credit plan during a rescission period that results solely from the addition of a security interest in the consumer's principal dwelling. (See comment 15(c)-3 for other actions that may be taken during the delay period.)

2. Escrow. The creditor may disburse advances during the rescission period in a valid escrow arrangement. The creditor may not, however, appoint the consumer as "trustee" or "escrow agent" and distribute funds to the consumer in that capacity during the delay period.

3. Actions during the delay period. Section 226.15(c) does not prevent the creditor from taking other steps during the delay, short of beginning actual performance. Unless otherwise prohibited, such as by state law, the creditor may, for example:

- Prepare the cash advance check.
- Perfect the security interest.
- Accrue finance charges during the delay period.

4. Performance by third party. The creditor is relieved from liability for failure to delay performance if a third party with no knowledge that the rescission right has been activated provides materials or services, as long as any debt incurred for materials or services obtained by the consumer during the rescission period is not secured by the security interest in the consumer's dwelling. For example, if a consumer uses a bank credit card to purchase materials from a merchant in an amount below the floor limit, the merchant might not contact the card issuer for authorization and therefore would not know that materials should not be provided.

5. Delay beyond rescission period. The creditor must wait until it is reasonably satisfied that the consumer has not rescinded. For example, the creditor may satisfy itself by doing one of the following:

- Waiting a reasonable time after expiration of the rescission period to allow for delivery of a mailed notice.
- Obtaining a written statement from the consumer that the right has not been exercised.

When more than one consumer has the right to rescind, the creditor cannot reasonably rely on the assurance of only one consumer, because other consumers may exercise the right.

15(d) Effects of rescission.

Paragraph 15(d)(1).

1. Termination of security interest. Any security interest giving rise to the right of rescission becomes void when the consumer exercises the right of rescission. The security interest is automatically negated, regardless of its status and whether or not it was recorded or perfected. Under § 226.15(d)(2), however, the creditor must take any action necessary to reflect the fact that the security interest no longer exists.

2. Extent of termination. The creditor's security interest is void to the extent that it is related to the occurrence giving rise to the right of rescission. For example, upon rescission:

- If the consumer's right to rescind is activated by the opening of a plan, any security interest in the principal dwelling is void.

- If the right arises due to an increase in the credit limit, the security interest is void as to the amount of credit extensions over the prior limit, but the security interest in amounts up to the original credit limit is unaffected.

- If the right arises with each individual credit extension, then the interest is void as to that extension, and other extensions are unaffected.

Paragraph 15(d)(2).

1. Refunds to consumer. The consumer cannot be required to pay any amount in the form of money or property either to the creditor or to a third party as part of the occurrence subject to the right of rescission. Any amounts of this nature already paid by the consumer must be refunded. "Any amount" includes finance charges already accrued, as well as other charges such as broker fees, application and commitment fees, or fees for a title search or appraisal, whether paid to the creditor, paid by the consumer directly to a third party, or passed on from the creditor to the third party. It is irrelevant that these amounts may not represent profit to the creditor. For example:

- If the occurrence is the opening of the plan, the creditor must return any membership or application fee paid.

- If the occurrence is the increase in a credit limit or the addition of a security interest, the creditor must return any fee imposed for a new credit report or filing fees.

- If the occurrence is a credit extension, the creditors must return fees such as application, title, and appraisal or survey fees, as well as any finance charges related to the credit extension.

2. Amounts not refundable to consumer. Creditors need not return any money given by the consumer to a third party outside of the occurrence, such as costs incurred for a building permit or for a zoning variance. Similarly, the term any amount does not apply to money or property given by the creditor to the consumer; those amounts must be tendered by the consumer to the creditor under § 226.15(d)(3).

3. Reflection of security interest termination. The creditor must take whatever steps are necessary to indicate that the security interest is terminated. Those steps include the cancellation of documents creating the security interest, and the filing of release or termination statements in the public record. In a transaction involving subcontractors or suppliers that also hold security interests related to the occurrence rescinded by the consumer, the creditor must insure that the termination of their security interests is also reflected. The 20-day period for the creditor's action refers to the time within which the creditor must begin the process. It does not require all necessary steps to have been completed within that time, but the creditor is responsible for seeing the process through to completion.

Paragraph 15(d)(3).

1. Property exchange. Once the creditor has fulfilled its obligation under § 226.15(d)(2), the consumer must tender to the creditor any property or money the creditor has already delivered to the consumer. At the consumer's option, property may be tendered at the location of the property. For example, if fixtures or furniture have been delivered to the consumer's home, the consumer may tender them to the creditor by making them available for pick-up at the home, rather than physically returning them to the creditor's premises. Money already given to the consumer must be tendered at the creditor's place of business. For purpose of property exchange, the following additional rules apply:

- A cash advance is considered money for purposes of this section even if the creditor knows what the consumer intends to purchase with the money.

- In a 3-party open-end credit plan (that is, if the creditor and seller are not the same or related persons), extensions by the creditor that are used by the consumer for purchases from third-party sellers are considered to be the same as cash advances for purposes of tendering value to the creditor, even though the transaction is a purchase for other purposes under the regulation. For example, if a consumer exercises the unexpired right to rescind after using a 3-party credit card for one year, the consumer would tender the amount of the purchase price for the items charged to the account, rather than tendering the items themselves to the creditor.

2. Reasonable value. If returning the property would be extremely burdensome to the consumer, the consumer may offer the creditor its reasonable value rather than returning the property itself. For example, if building materials have already been incorporated into the consumer's dwelling, the consumer may pay their reasonable value.

Paragraph 15(d)(4).

1. Modifications. The procedures outlined in § 226.15(d)(2) and (3) may be modified by a court. For example, when a consumer is in bankruptcy proceedings and prohibited from returning anything to the creditor, or when the equities dictate, a modification might be made. The sequence of procedures under § 226.15(d)(2) and (3), or a court's modification of those procedures under § 226.15(d)(4), does not affect a consumer's substantive right to rescind and to have the loan amount adjusted accordingly. Where the consumer's right to rescind is contested by the creditor, a court would normally determine whether the consumer has a right to rescind and determine the amounts owed before establishing the procedures for the parties to tender any money or property.

15(e) Consumer's waiver of right to rescind.

1. Need for waiver. To waive the right to rescind, the consumer must have a bona fide personal financial emergency that must be met before the end of the rescission period. The existence of the consumer's waiver will not, of itself, automatically insulate the creditor from liability for failing to provide the right of rescission.

2. Procedure. To waive or modify the right to rescind, the consumer must give a written statement that specifically

waives or modifies the right, and also includes a brief description of the emergency. Each consumer entitled to rescind must sign the waiver statement. In a transaction involving multiple consumers, such as a husband and wife using their home as collateral, the waiver must bear the signatures of both spouses.

15(f) Exempt transactions.

1. Residential mortgage transaction. Although residential mortgage transactions would seldom be made on bona fide open-end credit plans (under which repeated transactions must be reasonably contemplated), an advance on an open-end plan could be for a downpayment for the purchase of a dwelling that would then secure the remainder of the line. In such a case, only the particular advance for the downpayment would be exempt from the rescission right.

2. State creditors. Cities and other political subdivisions of states acting as creditors are not exempt from § 226.15.

3. Spreader clause. When the creditor holds a mortgage or deed of trust on the consumer's principal dwelling and that mortgage or deed of trust contains a "spreader clause" (also known as a "dragnet" or cross-collateralization clause), subsequent occurrences such as the opening of a plan or individual credit extensions are subject to the right of rescission to the same degree as if the security interest were taken directly to secure the open-end plan, unless the creditor effectively waives its security interest under the spreader clause with respect to the subsequent open-end credit extensions.

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual Section 226.16

§ **226.16 Advertising**

1. Clear and conspicuous standard--general. Section 226.16 is subject to the general "clear and conspicuous" standard for subpart B (see § 226.5(a)(1)) but prescribes no specific rules for the format of the necessary disclosures, other than the format requirements related to the disclosure of a promotional rate or payment under § 226.16(d)(6), a promotional rate under § 226.16(g), or a deferred interest or similar offer under § 226.16(h). Other than the disclosure of certain terms described in §§ 226.16(d)(6), (g), or (h), the credit terms need not be printed in a certain type size nor need they appear in any particular place in the advertisement.

2. Clear and conspicuous standard--promotional rates or payments; deferred interest or similar offers.

i. For purposes of § 226.16(d)(6), a clear and conspicuous disclosure means that the required information in § 226.16(d)(6)(ii)(A)-(C) is disclosed with equal prominence and in close proximity to the promotional rate or payment to which it applies. If the information in § 226.16(d)(6)(ii)(A)-(C) is the same type size and is located immediately next to or directly above or below the promotional rate or payment to which it applies, without any intervening text or graphical displays, the disclosures would be deemed to be equally prominent and in close proximity. Notwithstanding the above, for electronic advertisements that disclose promotional rates or payments, compliance with the requirements of § 226.16(c) is deemed to satisfy the clear and conspicuous standard.

ii. For purposes of § 226.16(g)(4) as it applies to written or electronic advertisements only, a clear and conspicuous disclosure means the required information in § 226.16(g)(4)(i) and (g)(4)(ii) must be equally prominent to the promotional rate to which it applies. If the information in § 226.16(g)(4)(i) and (g)(4)(ii) is the same type size as the promotional rate to which it applies, the disclosures would be deemed to be equally prominent. For purposes of § 226.16(h)(3) as it applies to written or electronic advertisements only, a clear and conspicuous disclosure means the required information in § 226.16(h)(3) must be equally prominent to each statement of "no interest," "no payments,"

"deferred interest," "same as cash," or similar term regarding interest or payments during the deferred interest period. If the information required to be disclosed under § 226.16(h)(3) is the same type size as the statement of "no interest," "no payments," "deferred interest," "same as cash," or similar term regarding interest or payments during the deferred interest period, the disclosure would be deemed to be equally prominent.

3. Clear and conspicuous standard--Internet advertisements for home-equity plans. For purposes of this section, a clear and conspicuous disclosure for visual text advertisements on the Internet for home-equity plans subject to the requirements of § 226.5b means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices and comply with all other requirements for clear and conspicuous disclosures under § 226.16(d). (See also comment 16(c)(1)-2.)

4. Clear and conspicuous standard--televised advertisements for home-equity plans. For purposes of this section, including alternative disclosures as provided for by § 226.16(e), a clear and conspicuous disclosure in the context of visual text advertisements on television for home-equity plans subject to the requirements of § 226.5b means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices, are displayed in a manner that allows for a consumer to read the information required to be disclosed, and comply with all other requirements for clear and conspicuous disclosures under § 226.16(d). For example, very fine print in a television advertisement would not meet the clear and conspicuous standard if consumers cannot see and read the information required to be disclosed.

5. Clear and conspicuous standard--oral advertisements for home-equity plans. For purposes of this section, including alternative disclosures as provided for by § 226.16(e), a clear and conspicuous disclosure in the context of an oral advertisement for home-equity plans subject to the requirements of § 226.5b, whether by radio, television, the Internet, or other medium, means that the required disclosures are given at a speed and volume sufficient for a consumer to hear and comprehend them. For example, information stated very rapidly at a low volume in a radio or television advertisement would not meet the clear and conspicuous standard if consumers cannot hear and comprehend the information required to be disclosed.

6. Expressing the annual percentage rate in abbreviated form. Whenever the annual percentage rate is used in an advertisement for open-end credit, it may be expressed using a readily understandable abbreviation such as APR.

7. Effective date. For guidance on the applicability of the Board's revisions to § 226.16 published on July 30, 2008, see comment 1(d)(5)-1.

16(a) Actually available terms.

1. General rule. To the extent that an advertisement mentions specific credit terms, it may state only those terms that the creditor is actually prepared to offer. For example, a creditor may not advertise a very low annual percentage rate that will not in fact be available at any time. Section 226.16(a) is not intended to inhibit the promotion of new credit

programs, but to bar the advertising of terms that are not and will not be available. For example, a creditor may advertise terms that will be offered for only a limited period, or terms that will become available at a future date.

2. Specific credit terms. Specific credit terms is not limited to the disclosures required by the regulation but would include any specific components of a credit plan, such as the minimum periodic payment amount or seller's points in a plan secured by real estate.

16(b) Advertisement of terms that require additional disclosures.

Paragraph (b)(1).

1. Triggering terms. Negative as well as affirmative references trigger the requirement for additional information. For example, if a creditor states no interest or no annual membership fee in an advertisement, additional information must be provided. Other examples of terms that trigger additional disclosures are:

i. Small monthly service charge on the remaining balance, which describes how the amount of a finance charge will be determined.

ii. 12 percent Annual Percentage Rate or A $15 annual membership fee buys you $2,000 in credit, which describe required disclosures under § 226.6.

2. Implicit terms. Section 226.16(b) applies even if the triggering term is not stated explicitly, but may be readily determined from the advertisement.

3. Membership fees. A membership fee is not a triggering term nor need it be disclosed under § 226.16(b)(1)(iii) if it is required for participation in the plan whether or not an open-end credit feature is attached. (See comment 6(a)(2)-1 and § 226.6(b)(3)(iii)(B).)

4. Deferred billing and deferred payment programs. Statements such as "Charge it--you won't be billed until May" or "You may skip your January payment" are not in themselves triggering terms, since the timing for initial billing or for monthly payments are not terms required to be disclosed under § 226.6. However, a statement such as "No interest charges until May" or any other statement regarding when interest or finance charges begin to accrue is a triggering term, whether appearing alone or in conjunction with a description of a deferred billing or deferred payment program such as the examples above.

5. Variable-rate plans. In disclosing the annual percentage rate in an advertisement for a variable-rate plan, as

required by § 226.16(b)(1)(ii), the creditor may use an insert showing the current rate; or may give the rate as of a specified recent date. The additional requirement in § 226.16(b)(1)(ii) to disclose the variable-rate feature may be satisfied by disclosing that the annual percentage rate may vary or a similar statement, but the advertisement need not include the information required by § 226.6(a)(1)(ii) or (b)(4)(ii).

6. Membership fees for open-end (not home-secured) plans. For purposes of § 226.16(b)(1)(iii), membership fees that may be imposed on open-end (not home-secured) plans shall have the same meaning as in § 226.5a(b)(2).

Paragraph (b)(2).

1. Assumptions. In stating the total of payments and the time period to repay the obligation, assuming that the consumer pays only the periodic payment amounts advertised, as required under § 226.16(b)(2), the following additional assumptions may be made:

i. Payments are made timely so as not to be considered late by the creditor;

ii. Payments are made each period, and no debt cancellation or suspension agreement, or skip payment feature applies to the account;

iii. No interest rate changes will affect the account;

iv. No other balances are currently carried or will be carried on the account;

v. No taxes or ancillary charges are or will be added to the obligation;

vi. Goods or services are delivered on a single date; and

vii. The consumer is not currently and will not become delinquent on the account.

2. Positive periodic payment amounts. Only positive periodic payment amounts trigger the additional disclosures under § 226.16(b)(2). Therefore, if the periodic payment amount advertised is not a positive amount (e.g., "No payments"), the advertisement need not state the total of payments and the time period to repay the obligation.

16(c) Catalogs or other multiple-page advertisements; electronic advertisements.

1. Definition. The multiple-page advertisements to which § 226.16(c) refers are advertisements consisting of a series of sequentially numbered pages--for example, a supplement to a newspaper. A mailing consisting of several separate flyers or pieces of promotional material in a single envelope does not constitute a single multiple-page advertisement for purposes of § 226.16(c).

Paragraph 16(c)(1).

1. General. Section 226.16(c)(1) permits creditors to put credit information together in one place in a catalog or other multiple-page advertisement or an electronic advertisement (such as an advertisement appearing on an Internet Web site). The rule applies only if the advertisement contains one or more of the triggering terms from § 226.16(b).

2. Electronic advertisement. If an electronic advertisement (such as an advertisement appearing on an Internet Web site) contains the table or schedule permitted under § 226.16(c)(1), any statement of terms set forth in § 226.6 appearing anywhere else in the advertisement must clearly direct the consumer to the location where the table or schedule begins. For example, a term triggering additional disclosures may be accompanied by a link that directly takes the consumer to the additional information.

Paragraph 16(c)(2).

1. Table or schedule if credit terms depend on outstanding balance. If the credit terms of a plan vary depending on the amount of the balance outstanding, rather than the amount of any property purchased, a table or schedule complies with § 226.16(c)(2) if it includes the required disclosures for representative balances. For example, a creditor would disclose that a periodic rate of 1.5% is applied to balances of $500 or less, and a 1% rate is applied to balances greater than $500.

16(d) Additional requirements for home-equity plans.

1. Trigger terms. Negative as well as affirmative references trigger the requirement for additional information. For example, if a creditor states no annual fee, no points, or we waive closing costs in an advertisement, additional information must be provided. (See comment 16(d)-4 regarding the use of a phrase such as no closing costs.) Inclusion of a statement such as low fees, however, would not trigger the need to state additional information. References to payment terms include references to the draw period or any repayment period, to the length of the plan, to how the minimum payments are determined and to the timing of such payments.

2. Fees to open the plan. Section 226.16(d)(1)(i) requires a disclosure of any fees imposed by the creditor or a third party to open the plan. In providing the fee information required under this paragraph, the corresponding rules for disclosure of this information apply. For example, fees to open the plan may be stated as a range. Similarly, if property insurance is required to open the plan, a creditor either may estimate the cost of the insurance or provide a statement that such insurance is required. (See the commentary to § 226.5b(d)(7) and (d)(8).)

3. Statements of tax deductibility. An advertisement that refers to deductibility for tax purposes is not misleading if it includes a statement such as "consult a tax advisor regarding the deductibility of interest." An advertisement distributed in paper form or through the Internet (rather than by radio or television) that states that the advertised extension of credit may exceed the fair market value of the consumer's dwelling is not misleading if it clearly and conspicuously states the required information in §§ 226.16(d)(4)(i) and (d)(4)(ii).

4. Misleading terms prohibited. Under § 226.16(d)(5), advertisements may not refer to home-equity plans as free money or use other misleading terms. For example, an advertisement could not state "no closing costs" or "we waive closing costs" if consumers may be required to pay any closing costs, such as recordation fees. In the case of property insurance, however, a creditor may state, for example, "no closing costs" even if property insurance may be required, as long as the creditor also provides a statement that such insurance may be required. (See the commentary to this section regarding fees to open a plan.)

5. Promotional rates and payments in advertisements for home-equity plans. Section 226.16(d)(6) requires additional disclosures for promotional rates or payments.

i. Variable-rate plans. In advertisements for variable-rate plans, if the advertised annual percentage rate is based on (or the advertised payment is derived from) the index and margin that will be used to make rate (or payment) adjustments over the term of the loan, then there is no promotional rate or promotional payment. If, however, the advertised annual percentage rate is not based on (or the advertised payment is not derived from) the index and margin that will be used to make rate (or payment) adjustments, and a reasonably current application of the index and margin would result in a higher annual percentage rate (or, given an assumed balance, a higher payment) then there is a promotional rate or promotional payment.

ii. Equal prominence, close proximity. Information required to be disclosed in § 226.16(d)(6)(ii) that is immediately next to or directly above or below the promotional rate or payment (but not in a footnote) is deemed to be closely proximate to the listing. Information required to be disclosed in § 226.16(d)(6)(ii) that is in the same type size as the promotional rate or payment is deemed to be equally prominent.

iii. Amounts and time periods of payments. Section 226.16(d)(6)(ii)(C) requires disclosure of the amount and time periods of any payments that will apply under the plan. This section may require disclosure of several payment amounts, including any balloon payment. For example, if an advertisement for a home-equity plan offers a $100,000 five-year line of credit and assumes that the entire line is drawn resulting in a minimum payment of $800 per month for the first six months, increasing to $1,000 per month after month six, followed by a $50,000 balloon payment after five years, the advertisement must disclose the amount and time period of each of the two monthly payment streams, as well as the amount and timing of the balloon payment, with equal prominence and in close proximity to the promotional payment. However, if the final payment could not be more than twice the amount of other minimum payments, the final payment need not be disclosed.

iv. Plans other than variable-rate plans. For a plan other than a variable-rate plan, if an advertised payment is calculated in the same way as other payments based on an assumed balance, the fact that the minimum payment could increase solely if the consumer made an additional draw does not make the payment a promotional payment. For example, if a payment of $500 results from an assumed $10,000 draw, and the payment would increase to $1,000 if the consumer made an additional $10,000 draw, the payment is not a promotional payment.

v. Conversion option. Some home-equity plans permit the consumer to repay all or part of the balance during the draw period at a fixed rate (rather than a variable rate) and over a specified time period. The fixed-rate conversion option does not, by itself, make the rate or payment that would apply if the consumer exercised the fixed-rate conversion option a promotional rate or payment.

vi. Preferred-rate provisions. Some home-equity plans contain a preferred-rate provision, where the rate will increase upon the occurrence of some event, such as the consumer-employee leaving the creditor's employ, the consumer closing an existing deposit account with the creditor, or the consumer revoking an election to make automated payments. A preferred-rate provision does not, by itself, make the rate or payment under the preferred-rate provision a promotional rate or payment.

6. Reasonably current index and margin. For the purposes of this section, an index and margin is considered reasonably current if:

i. For direct mail advertisements, it was in effect within 60 days before mailing;

ii. For advertisements in electronic form it was in effect within 30 days before the advertisement is sent to a consumer's e-mail address, or in the case of an advertisement made on an Internet Web site, when viewed by the public; or

iii. For printed advertisements made available to the general public, including ones contained in a catalog, magazine, or other generally available publication, it was in effect within 30 days before printing.

7. Relation to other sections. Advertisements for home-equity plans must comply with all provisions in § 226.16, not solely the rules in § 226.16(d). If an advertisement contains information (such as the payment terms) that triggers the duty under § 226.16(d) to state the annual percentage rate, the additional disclosures in § 226.16(b) must be provided in the advertisement. While § 226.16(d) does not require a statement of fees to use or maintain the plan (such as membership fees and transaction charges), such fees must be disclosed under § 226.16(b)(1)(i) and (b)(1)(iii).

8. Inapplicability of closed-end rules. Advertisements for home-equity plans are governed solely by the requirements in § 226.16, except § 226.16(g), and not by the closed-end advertising rules in § 226.24. Thus, if a creditor states payment information about the repayment phase, this will trigger the duty to provide additional information under § 226.16, but not under § 226.24.

9. Balloon payment. See comment 5b(d)(5)(ii)-3 for information not required to be stated in advertisements, and on situations in which the balloon payment requirement does not apply.

16(e) Alternative disclosures--television or radio advertisements.

1. Multi-purpose telephone number. When an advertised telephone number provides a recording, disclosures must be provided early in the sequence to ensure that the consumer receives the required disclosures. For example, in providing several options--such as providing directions to the advertiser's place of business--the option allowing the consumer to request disclosures should be provided early in the telephone message to ensure that the option to request disclosures is not obscured by other information.

2. Statement accompanying toll free number. Language must accompany a telephone number indicating that disclosures are available by calling the telephone number, such as "call 1-800-000-0000 for details about credit costs and terms."

16(g) Promotional rates.

1. Rate in effect at the end of the promotional period. If the annual percentage rate that will be in effect at the end of the promotional period (i.e., the post-promotional rate) is a variable rate, the post-promotional rate for purposes of § 226.16(g)(2)(i) is the rate that would have applied at the time the promotional rate was advertised if the promotional rate was not offered, consistent with the accuracy requirements in § 226.5a(c)(2) and (e)(4), as applicable.

2. Immediate proximity. For written or electronic advertisements, including the term "introductory" or "intro" in the same phrase as the listing of the introductory rate is deemed to be in immediate proximity of the listing.

3. Prominent location closely proximate. For written or electronic advertisements, information required to be disclosed in § 226.16(g)(4)(i) and (g)(4)(ii) that is in the same paragraph as the first listing of the promotional rate is deemed to be in a prominent location closely proximate to the listing. Information disclosed in a footnote will not be considered in a prominent location closely proximate to the listing.

4. First listing. For purposes of § 226.16(g)(4) as it applies to written or electronic advertisements, the first listing of

the promotional rate is the most prominent listing of the rate on the front side of the first page of the principal promotional document. The principal promotional document is the document designed to be seen first by the consumer in a mailing, such as a cover letter or solicitation letter. If the promotional rate does not appear on the front side of the first page of the principal promotional document, then the first listing of the promotional rate is the most prominent listing of the rate on the subsequent pages of the principal promotional document. If the promotional rate is not listed on the principal promotional document or there is no principal promotional document, the first listing is the most prominent listing of the rate on the front side of the first page of each document listing the promotional rate. If the promotional rate does not appear on the front side of the first page of a document, then the first listing of the promotional rate is the most prominent listing of the rate on the subsequent pages of the document. If the listing of the promotional rate with the largest type size on the front side of the first page (or subsequent pages if the promotional rate is not listed on the front side of the first page) of the principal promotional document (or each document listing the promotional rate if the promotional rate is not listed on the principal promotional document or there is no principal promotional document) is used as the most prominent listing, it will be deemed to be the first listing. Consistent with comment 16(c)-1, a catalog or multiple-page advertisement is considered one document for purposes of § 226.16(g)(4).

5. Post-promotional rate depends on consumer's creditworthiness. For purposes of disclosing the rate that may apply after the end of the promotional rate period, at the advertiser's option, the advertisement may disclose the rates that may apply as either specific rates, or a range of rates. For example, if there are three rates that may apply (9.99%, 12.99% or 17.99%), an issuer may disclose these three rates as specific rates (9.99%, 12.99% or 17.99%) or as a range of rates (9.99%-17.99%).

16(h) Deferred interest or similar offers.

1. Deferred interest or similar offers clarified. Deferred interest or similar offers do not include offers that allow a consumer to skip payments during a specified period of time, and under which the consumer is not obligated under any circumstances for any interest or other finance charges that could be attributable to that period. Deferred interest or similar offers also do not include 0% annual percentage rate offers where a consumer is not obligated under any circumstances for interest attributable to the time period the 0% annual percentage rate was in effect, though such offers may be considered promotional rates under § 226.16(g)(2)(i). Deferred interest or similar offers also do not include skip payment programs that have no required minimum payment for one or more billing cycles but where interest continues to accrue and is imposed during that period.

2. Deferred interest period clarified. Although the terms of an advertised deferred interest or similar offer may provide that a creditor may charge the accrued interest if the balance is not paid in full by a certain date, creditors sometimes have an informal policy or practice that delays charging the accrued interest for payment received a brief period of time after the date upon which a creditor has the contractual right to charge the accrued interest. The advertisement need not include the end of an informal "courtesy period" in disclosing the deferred interest period under § 226.16(h)(3).

3. Immediate proximity. For written or electronic advertisements, including the deferred interest period in the same phrase as the statement of "no interest," "no payments," "deferred interest," or "same as cash" or similar term regarding interest or payments during the deferred interest period is deemed to be in immediate proximity of the statement.

4. Prominent location closely proximate. For written or electronic advertisements, information required to be disclosed in § 226.16(h)(4)(i) and (ii) that is in the same paragraph as the first statement of "no interest," "no payments," "deferred interest," or "same as cash" or similar term regarding interest or payments during the deferred interest period is deemed to be in a prominent location closely proximate to the statement. Information disclosed in a footnote is not considered in a prominent location closely proximate to the statement.

5. First listing. For purposes of § 226.16(h)(4) as it applies to written or electronic advertisements, the first statement of "no interest," "no payments," "deferred interest," "same as cash," or similar term regarding interest or payments during the deferred interest period is the most prominent listing of one of these statements on the front side of the first page of the principal promotional document. The principal promotional document is the document designed to be seen first by the consumer in a mailing, such as a cover letter or solicitation letter. If one of the statements does not appear on the front side of the first page of the principal promotional document, then the first listing of one of these statements is the most prominent listing of a statement on the subsequent pages of the principal promotional document. If one of the statements is not listed on the principal promotional document or there is no principal promotional document, the first listing of one of these statements is the most prominent listing of the statement on the front side of the first page of each document containing one of these statements. If one of the statements does not appear on the front side of the first page of a document, then the first listing of one of these statements is the most prominent listing of a statement on the subsequent pages of the document. If the listing of one of these statements with the largest type size on the front side of the first page (or subsequent pages if one of these statements is not listed on the front side of the first page) of the principal promotional document (or each document listing one of these statements if a statement is not listed on the principal promotional document or there is no principal promotional document) is used as the most prominent listing, it will be deemed to be the first listing. Consistent with comment 16(c)-1, a catalog or multiple-page advertisement is considered one document for purposes of § 226.16(h)(4).

6. Additional information. Consistent with comment 5(a)-2, the information required under § 226.16(h)(4) need not be segregated from other information regarding the deferred interest or similar offer. Advertisements may also be required to provide additional information pursuant to § 226.16(b) though such information need not be integrated with the information required under § 226.16(h)(4).

7. Examples. Examples of disclosures that could be used to comply with the requirements of § 226.16(h)(3) include: "no interest if paid in full within 6 months" and "no interest if paid in full by December 31, 2010."

Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART II OF III)

1B- Consumer Credit Law Manual SUBPART C

§ C CLOSED-END CREDIT
Section 226.17--General Disclosure Requirements

17(a) Form of disclosures.

Paragraph 17(a)(1).

1. Clear and conspicuous. This standard requires that disclosures be in a reasonably understandable form. For example, while the regulation requires no mathematical progression or format, the disclosures must be presented in a way that does not obscure the relationship of the terms to each other. In addition, although no minimum type size is mandated, the disclosures must be legible, whether typewritten, handwritten, or printed by computer.

2. Segregation of disclosures. The disclosures may be grouped together and segregated from other information in a variety of ways. For example, the disclosures may appear on a separate sheet of paper or may be set off from other information on the contract or other documents:

- By outlining them in a box
- By bold print dividing lines
- By a different color background
- By a different type style

(The general segregation requirement described in this subparagraph does not apply to the disclosures required under §§ 226.19(b) and 226.20(c) although the disclosures must be clear and conspicuous.)

3. Location. The regulation imposes no specific location requirements on the segregated disclosures. For example:

- They may appear on a disclosure statement separate from all other material.
- They may be placed on the same document with the credit contract or other information, so long as they are segregated from that information.
- They may be shown on the front or back of a document.
- They need not begin at the top of a page.
- They may be continued from one page to another.

4. Content of segregated disclosures. Footnotes 37 and 38 contain exceptions to the requirement that the disclosures under § 226.18 be segregated from material that is not directly related to those disclosures. Footnote 37 lists the items that may be added to the segregated disclosures, even though not directly related to those disclosures. Footnote 38 lists the items required under § 226.18 that may be deleted from the segregated disclosures and appear elsewhere. Any one or more of these additions or deletions may be combined and appear either together with or separate from the segregated disclosures. The itemization of the amount financed under § 226.18(c), however, must be separate from the other segregated disclosures under § 226.18, except for private education loan disclosures made in compliance with § 226.47. If a creditor chooses to include the security interest charges required to be itemized under § 226.4(e) and § 226.18(o) in the amount financed itemization, it need not list these charges elsewhere.

5. Directly related. The segregated disclosures may, at the creditor's option, include any information that is directly related to those disclosures. The following is directly related information:

i. A description of a grace period after which a late payment charge will be imposed. For example, the disclosure given under § 226.18(l) may state that a late charge will apply to "any payment received more than 15 days after the due date."

ii. A statement that the transaction is not secured. For example, the creditor may add a category labelled "unsecured" or "not secured" to the security interest disclosures given under § 226.18(m).

iii. The basis for any estimates used in making disclosures. For example, if the maturity date of a loan depends solely on the occurrence of a future event, the creditor may indicate that the disclosures assume that event will occur at a certain time.

iv. The conditions under which a demand feature may be exercised. For example, in a loan subject to demand after five years, the disclosures may state that the loan will become payable on demand in five years.

v. An explanation of the use of pronouns or other references to the parties to the transaction. For example, the disclosures may state, "You 'refers to the customer and we' refers to the creditor."

vi. Instructions to the creditor or its employees on the use of a multiple-purpose form. For example, the disclosures may state, "Check box if applicable."

vii. A statement that the borrower may pay a minimum finance charge upon prepayment in a simple-interest transaction. For example, when state law prohibits penalties, but would allow a minimum finance charge in the event of prepayment, the creditor may make the § 226.18(k)(1) disclosure by stating, "You may be charged a minimum finance charge."

viii. A brief reference to negative amortization in variable-rate transactions. For example, in the variable-rate disclosure, the creditor may include a short statement such as "Unpaid interest will be added to principal." (See the commentary to § 226.18(f)(1)(iii).)

ix. A brief caption identifying the disclosures. For example, the disclosures may bear a general title such as "Federal Truth in Lending Disclosures" or a descriptive title such as "Real Estate Loan Disclosures."

x. A statement that a due-on-sale clause or other conditions on assumption are contained in the loan document. For example, the disclosure given under § 226.18(q) may state, "Someone buying your home may, subject to conditions in the due-on-sale clause contained in the loan document, assume the remainder of the mortgage on the original terms."

xi. If a state or Federal law prohibits prepayment penalties and excludes the charging of interest after prepayment from coverage as a penalty, a statement that the borrower may have to pay interest for some period after prepayment in full. The disclosure given under § 226.18(k) may state, for example, "If you prepay your loan on other than the regular installment date, you may be assessed interest charges until the end of the month."

xii. More than one hypothetical example under § 226.18(f)(1)(iv) in transactions with more than one variable-rate feature. For example, in a variable-rate transaction with an option permitting consumers to convert to a fixed-rate transaction, the disclosures may include an example illustrating the effects on the payment terms of an increase resulting from conversion in addition to the example illustrating an increase resulting from changes in the index.

xiii. The disclosures set forth under § 226.18(f)(1) for variable-rate transactions subject to § 226.18(f)(2).

xiv. A statement whether or not a subsequent purchaser of the property securing an obligation may be permitted to assume the remaining obligation on its original terms.

xv. A late-payment fee disclosure under § 226.18(l) on a single payment loan.

xvi. The notice set forth in § 226.19(a)(4), in a closed-end transaction not subject to § 226.19(a)(1)(i). In a mortgage transaction subject to § 226.19(a)(1)(i), the creditor must disclose the notice contained in § 226.19(a)(4) grouped together with the disclosures made under § 226.18. See comment 19(a)(4)-1.

6. Multiple-purpose forms. The creditor may design a disclosure statement that can be used for more than one type of transaction, so long as the required disclosures for individual transactions are clear and conspicuous. (See the Commentary to appendices G and H for a discussion of the treatment of disclosures that do not apply to specific transactions.) Any disclosure listed in § 226.18 (except the itemization of the amount financed under § 226.18(c) for transactions other than private education loans) may be included on a standard disclosure statement even though not all of the creditor's transactions include those features. For example, the statement may include:

- The variable rate disclosure under § 226.18(f).
- The demand feature disclosure under § 226.18(i).
- A reference to the possibility of a security interest arising from a spreader clause, under § 226.18(m).
- The assumption policy disclosure under § 226.18(q).
- The required deposit disclosure under § 226.18(r).

7. Balloon payment financing with leasing characteristics. In certain credit sale or loan transactions, a consumer may reduce the dollar amount of the payments to be made during the course of the transaction by agreeing to make, at the end of the loan term, a large final payment based on the expected residual value of the property. The consumer may have a number of options with respect to the final payment, including, among other things, retaining the property and making the final payment, refinancing the final payment, or transferring the property to the creditor in lieu of the final payment. Such transactions may have some of the characteristics of lease transactions subject to Regulation M, but are considered credit transactions where the consumer assumes the indicia of ownership, including the risks, burdens and benefits of ownership upon consummation. These transactions are governed by the disclosure requirements of this regulation instead of Regulation M. Creditors should not include in the segregated Truth in Lending disclosures additional information. Thus, disclosures should show the large final payment in the payment schedule and should not, for example, reflect the other options available to the consumer at maturity.

Paragraph 17(a)(2)

1. When disclosures must be more conspicuous. The following rules apply to the requirement that the terms "annual percentage rate" (except for private education loan disclosures made in compliance with § 226.47) and "finance charge" be shown more conspicuously:

- The terms must be more conspicuous only in relation to the other required disclosures under § 226.18. For example, when the disclosures are included on the contract document, those two terms need not be more conspicuous as compared to the heading on the contract document or information required by state law.

- The terms need not be more conspicuous except as part of the finance charge and annual percentage rate disclosures under § 226.18 (d) and (e), although they may, at the creditor's option, be highlighted wherever used in the required disclosures. For example, the terms may, but need not, be highlighted when used in disclosing a prepayment penalty under § 226.18(k) or a required deposit under § 226.18(r).

- The creditor's identity under § 226.18(a) may, but need not, be more prominently displayed than the finance charge and annual percentage rate.

- The terms need not be more conspicuous than figures (including, for example, numbers, percentages, and dollar signs).

2. Making disclosures more conspicuous. The terms "finance charge" and (except for private education loan disclosures made in compliance with § 226.47) "annual percentage rate" may be made more conspicuous in any way that highlights them in relation to the other required disclosures. For example, they may be:

- Capitalized when other disclosures are printed in capital and lower case.

- Printed in larger type, bold print or different type face.

- Printed in a contrasting color.

- Underlined.

- Set off with asterisks.

17(b) Time of Disclosures

1. Consummation. As a general rule, disclosures must be made before "consummation" of the transaction. The disclosures need not be given by any particular time before consummation, except in certain mortgage transactions and variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year under § 226.19, and in private education loan transactions disclosed in compliance with §§ 226.46 and 226.47. (See the commentary to § 226.2(a)(13) regarding the definition of consummation.)

2. Converting open-end to closed-end credit. Except for home equity plans subject to § 226.5b in which the agreement provides for a repayment phase, if an open-end credit account is converted to a closed-end transaction under a written agreement with the consumer, the creditor must provide a set of closed-end credit disclosures before consummation of the closed-end transaction. (See the commentary to § 226.19(b) for the timing rules for additional disclosures required upon the conversion to a variable-rate transaction secured by a consumer's principal dwelling with a term greater than one year.) If consummation of the closed-end transaction occurs at the same time as the consumer enters into the open-end agreement, the closed-end credit disclosures may be given at the time of conversion. If disclosures are delayed until conversion and the closed-end transaction has a variable-rate feature, disclosures should be based on the rate in effect at the time of conversion. (See the commentary to § 226.5 regarding conversion of closed-end to open-end credit.)

3. Disclosures provided on credit contracts. Creditors must give the required disclosures to the consumer in writing, in a form that the consumer may keep, before consummation of the transaction. See§ 226.17(a)(1) and (b). Sometimes the disclosures are placed on the same document with the credit contract. Creditors are not required to give the consumer two separate copies of the document before consummation, one for the consumer to keep and a second copy for the consumer to execute. The disclosure requirement is satisfied if the creditor gives a copy of the document containing the unexecuted credit contract and disclosures to the consumer to read and sign; and the consumer receives a copy to keep at the time the consumer becomes obligated. It is not sufficient for the creditor merely to show the consumer the document containing the disclosures before the consumer signs and becomes obligated. The consumer must be free to take possession of and review the document in its entirety before signing.

i. Example. To illustrate:

A. A creditor gives a consumer a multiple-copy form containing a credit agreement and TILA disclosures. The consumer reviews and signs the form and returns it to the creditor, who separates the copies and gives one copy to the consumer to keep. The creditor has satisfied the disclosure requirement.

17(c) Basis of disclosures and use of estimates.

Paragraph 17(c)(1).

1. Legal obligation. The disclosures shall reflect the credit terms to which the parties are legally bound as of the outset of the transaction. In the case of disclosures required under § 226.20(c), the disclosures shall reflect the credit terms to which the parties are legally bound when the disclosures are provided. The legal obligation is determined by applicable state law or other law. (Certain transactions are specifically addressed in this commentary. See, for example, the discussion of buydown transactions elsewhere in the commentary to § 226.17(c).)

- The fact that a term or contract may later be deemed unenforceable by a court on the basis of equity or other grounds does not, by itself, mean that disclosures based on that term or contract did not reflect the legal obligation.

2. Modification of obligation. The legal obligation normally is presumed to be contained in the note or contract that evidences the agreement. But this presumption is rebutted if another agreement between the parties legally modifies that note or contract. If the parties informally agree to a modification of the legal obligation, the modification should not be reflected in the disclosures unless it rises to the level of a change in the terms of the legal obligation. For example:

- If the creditor offers a preferential rate, such as an employee preferred rate, the disclosures should reflect the terms of the legal obligation. (See the commentary to § 226.19(b) for an example of a preferred-rate transaction that is a variable-rate transaction.)

- If the contract provides for a certain monthly payment schedule but payments are made on a voluntary payroll deduction plan or an informal principal-reduction agreement, the disclosures should reflect the schedule in the contract.

- If the contract provides for regular monthly payments but the creditor informally permits the consumer to defer payments from time to time, for instance, to take account of holiday seasons or seasonal employment, the disclosures should reflect the regular monthly payments.

3. Third-party buydowns. In certain transactions, a seller or other third party may pay an amount, either to the creditor or to the consumer, in order to reduce the consumer's payments or buy down the interest rate for all or a portion of the credit term. For example, a consumer and a bank agree to a mortgage with an interest rate of 15% and level payments over 25 years. By a separate agreement, the seller of the property agrees to subsidize the consumer's payments for the first 2 years of the mortgage, giving the consumer an effective rate of 12% for that period.

- If the lower rate is reflected in the credit contract between the consumer and the bank, the disclosures must take the buy-down into account. For example, the annual percentage rate must be a composite rate that takes account of both the lower initial rate and the higher subsequent rate, and the payment schedule disclosures must reflect the 2 payment levels. However, the amount paid by the seller would not be specifically reflected in the disclosures given by the bank, since that amount constitutes seller's points and thus is not part of the finance charge.

- If the lower rate is not reflected in the credit contract between the consumer and the bank and the consumer is legally bound to the 15% rate from the outset, the disclosures given by the bank must not reflect the seller buydown in any way. For example, the annual percentage rate and payment schedule would not take into account the reduction in the interest rate and payment level for the first 2 years resulting from the buydown.

4. Consumer buydowns. In certain transactions, the consumer may pay an amount to the creditor to reduce the payments or obtain a lower interest rate on the transaction. Consumer buydowns must be reflected in the disclosures given for that transaction. To illustrate, in a mortgage transaction, the creditor and consumer agree to a note specifying a 14 percent interest rate. However, in a separate document, the consumer agrees to pay an amount to the creditor at consummation in return for a reduction in the interest rate to 12 percent for a portion of the mortgage term. The amount paid by the consumer may be deposited in an escrow account or may be retained by the creditor. Depending upon the buydown plan, the consumer's prepayment of the obligation may or may not result in a portion of the amount being credited or refunded to the consumer. In the disclosures given for the mortgage, the creditor must reflect the terms of the buydown agreement. For example:

- The amount paid by the consumer is a prepaid finance charge (even if deposited in an escrow account).

- A composite annual percentage rate must be calculated, taking into account both interest rates, as well as the effect of the prepaid finance charge.

- The payment schedule must reflect the multiple payment levels resulting from the buydown.

The rules regarding consumer buydowns do not apply to transactions known as "lender buydowns," In lender buydowns. a creditor pays an amount (either into an account or to the party to whom the obligation is sold) to reduce the consumer's payments or interest rate for all or a portion of the credit term. Typically, these transactions are structured as a buydown of the interest rate during an initial period of the transaction with a higher than usual rate for the remainder of the term. The disclosures for lender buydowns should be based on the terms of the legal obligation between the consumer and the creditor. (See comment 17(c)(1)-3 for the analogous rules concerning third-party buydowns.)

5. Split buydowns. In certain transactions, a third party (such as a seller) and a consumer both pay an amount to the creditor to reduce the interest rate. The creditor must include the portion paid by the consumer in the finance charge and disclose the corresponding multiple payment levels and composite annual percentage rate. The portion paid by the third party and the corresponding reduction in interest rate, however, should not be reflected in the disclosures unless the lower rate is reflected in the credit contract. (See the discussion on third-party and consumer buydown transactions elsewhere in the commentary to § 226.17(c).)

6. Wrap-around financing. Wrap-around transactions, usually loans, involve the creditor's wrapping the outstanding balance on an existing loan and advancing additional funds to the consumer. The pre-existing loan, which is wrapped, may be to the same consumer or to a different consumer. In either case, the consumer makes a single payment to the new creditor, who makes the payments on the pre-existing loan to the original creditor. Wrap-around loans or sales are considered new single-advance transactions, with an amount financed equalling the sum of the new funds advanced by the wrap creditor and the remaining principal owed to the original creditor on the pre-existing loan. In disclosing the itemization of the amount financed, the creditor may use a label such as "the amount that will be paid to creditor X" to describe the remaining principal balance on the pre-existing loan. This approach to Truth in Lending calculations has no effect on calculations required by other statutes, such as state usury laws.

7. Wrap-around financing with balloon payments. For wrap-around transactions involving a large final payment of the new funds before the maturity of the pre-existing loan, the amount financed is the sum of the new funds and the remaining principal on the pre-existing loan. The disclosures should be based on the shorter term of the wrap loan, with a large final payment of both the new funds and the total remaining principal on the pre-existing loan (although only the wrap loan will actually be paid off at that time).

8. Basis of disclosures in variable-rate transactions. The disclosures for a variable-rate transaction must be given for the full term of the transaction and must be based on the terms in effect at the time of consummation. Creditors should base the disclosures only on the initial rate and should not assume that this rate will increase. For example, in a loan with an initial rate of 10 percent and a 5 percentage points rate cap, creditors should base the disclosures on the initial

rate and should not assume that this rate will increase 5 percentage points. However, in a variable-rate transaction with a seller buydown that is reflected in the credit contract, a consumer buydown, or a discounted or premium rate, disclosures should not be based solely on the initial terms. In those transactions, the disclosed annual percentage rate should be a composite rate based on the rate in effect during the initial period and the rate that is the basis of the variable-rate feature for the remainder of the term. (See the commentary to § 226.17(c) for a discussion of buydown, discounted, and premium transactions and the commentary to § 226.19(a)(2) for a discussion of the redisclosure in certain mortgage transactions with a variable-rate feature.)

9. Use of estimates in variable-rate transactions. The variable-rate feature does not, by itself, make the disclosures estimates.

10. Discounted and premium variable-rate transactions. In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. In a discounted transaction, for example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the Treasury bill rate at consummation is 10 percent, the creditor may forgo the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent.

i. When creditors use an initial interest rate that is not calculated using the index or formula for later rate adjustments, the disclosures should reflect a composite annual percentage rate based on the initial rate for as long as it is charged and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation. The rate at consummation need not be used if a contract provides for a delay in the implementation of changes in an index value. For example, if the contract specifies that rate changes are based on the index value in effect 45 days before the change date, creditors may use any index value in effect during the 45 day period before consummation in calculating a composite annual percentage rate.

ii. The effect of the multiple rates must also be reflected in the calculation and disclosure of the finance charge, total of payments, and payment schedule.

iii. If a loan contains a rate or payment cap that would prevent the initial rate or payment, at the time of the first adjustment, from changing to the rate determined by the index or formula at consummation, the effect of that rate or payment cap should be reflected in the disclosures.

iv. Because these transactions involve irregular payment amounts, an annual percentage rate tolerance of 1/4 of 1 percent applies, in accordance with § 226.22(a)(3).

v. Examples of discounted variable-rate transactions include:

A. A 30-year loan for $100,000 with no prepaid finance charges and rates determined by the Treasury bill rate plus 2 percent. Rate and payment adjustments are made annually. Although the Treasury bill rate at the time of consummation is 10 percent, the creditor sets the interest rate for one year at 9 percent, instead of 12 percent according to the formula. The disclosures should reflect a composite annual percentage rate of 11.63 percent based on 9 percent for one year and 12 percent for 29 years. Reflecting those two rate levels, the payment schedule should show 12 payments of $804.62 and 348 payments of $1,025.31. The finance charge should be $266,463.32 and the total of payments $366,463.32.

B. Same loan as above, except with a 2 percent rate cap on periodic adjustments. The disclosures should reflect a composite annual percentage rate of 11.53 percent based on 9 percent for the first year, 11 percent for the second year, and 12 percent for the remaining 28 years. Reflecting those three rate levels, the payment schedule should show 12 payments of $804.62, 12 payments of $950.09, and 336 payments of $1,024.34. The finance charge should be $265,234.76 and the total of payments $365,234.76.

C. Same loan as above, except with a 7 1/2 percent cap on payment adjustments. The disclosures should reflect a composite annual percentage rate of 11.64 percent, based on 9 percent for one year and 12 percent for 29 years. Because of the payment cap, five levels of payments should be reflected. The payment schedule should show 12 payments of $804.62, 12 payments of $864.97, 12 payments of $929.84, 12 payments of $999.58, and 312 payments of $1,070.04. The finance charge should be $277,040.60, and the total of payments $377,040.60.

vi. AA loan in which the initial interest rate is set according to the index or formula used for later adjustments but is not set at the value of the index or formula at consummation is not a discounted variable-rate loan. For example, if a creditor commits to an initial rate based on the formula on a date prior to consummation, but the index has moved during the period between that time and consummation, a creditor should base its disclosures on the initial rate.

11. Examples of variable-rate transactions. Variable-rate transactions include:

- Renewable balloon-payment instruments where the creditor is both unconditionally obligated to renew the balloon-payment loan at the consumer's option (or is obligated to renew subject to conditions within the consumer's control) and has the option of increasing the interest rate at the time of renewal. Disclosures must be based on the payment amortization (unless the specified term of the obligation with renewals is shorter) and on the rate in effect at the time of consummation of the transaction. (Examples of conditions within a consumer's control include requirements that a consumer be current in payments or continue to reside in the mortgaged property. In contrast, setting a limit on the rate at which the creditor would be obligated to renew or reserving the right to change the credit standards at the time of renewal are examples of conditions outside a consumer's control.) If, however, a creditor is not obligated to renew as described above, disclosures must be based on the term of the balloon-payment loan. Disclosures also must be based on the term of the balloon-payment loan in balloon-payment instruments in which the legal obligation provides that the loan will be renewed by a "refinancing" of the obligation,

as that term is defined by § 226.20(a). If it cannot be determined from the legal obligation that the loan will be renewed by a "refinancing," disclosures must be based either on the term of the balloon-payment loan or on the payment amortization, depending on whether the creditor is unconditionally obligated to renew the loan as described above. (This discussion does not apply to construction loans subject to § 226.17(c)(6).)

- "Shared-equity" or "shared-appreciation" mortgages that have a fixed rate of interest and an appreciation share based on the consumer's equity in the mortgaged property. The appreciation share is payable in a lump sum at a specified time. Disclosures must be based on the fixed interest rate. (As discussed in the commentary to § 226.2, other types of shared-equity arrangements are not considered "credit" and are not subject to Regulation Z.)

- Preferred-rate loans where the terms of the legal obligation provide that the initial underlying rate is fixed but will increase upon the occurrence of some event, such as an employee leaving the employ of the creditor, and the note reflects the preferred rate. The disclosures are to be based on the preferred rate.

- Graduated-payment mortgages and step-rate transactions without a variable-rate feature are not considered variable-rate transactions.

- "Price level adjusted mortgages" or other indexed mortgages that have a fixed rate of interest but provide for periodic adjustments to payments and the loan balance to reflect changes in an index measuring prices or inflation. Disclosures are to be based on the fixed interest rate.

12. Graduated payment adjustable rate mortgages. These mortgages involve both a variable interest rate and scheduled variations in payment amounts during the loan term. For example, under these plans, a series of graduated payments may be scheduled before rate adjustments affect payment amounts, or the initial scheduled payment may remain constant for a set period before rate adjustments affect the payment amount. In any case, the initial payment amount may be insufficient to cover the scheduled interest, causing negative amortization from the outset of the transaction. In these transactions, the disclosures should treat these features as follows:

- The finance charge includes the amount of negative amortization based on the assumption that the rate in effect at consummation remains unchanged.

- The amount financed does not include the amount of negative amortization.

- As in any variable-rate transaction, the annual percentage rate is based on the terms in effect at consummation.

- The schedule of payments discloses the amount of any scheduled initial payments followed by an adjusted level of payments based on the initial interest rate. Since some mortgage plans contain limits on the amount of the payment adjustment, the payment schedule may require several different levels of payments, even with the assumption that the original interest rate does not increase.

13. Growth-equity mortgages. Also referred to as payment-escalated mortgages, these mortgage plans involve scheduled payment increases to prematurely amortize the loan. The initial payment amount is determined as for a long-term loan with a fixed interest rate. Payment increases are scheduled periodically, based on changes in an index.

The larger payments result in accelerated amortization of the loan. In disclosing these mortgage plans, creditors may either:

- Estimate the amount of payment increases, based on the best information reasonably available; or
- Disclose by analogy to the variable-rate disclosures in 226.18(f)(1).

(This discussion does not apply to growth-equity mortgages in which the amount of payment increases can be accurately determined at the time of disclosure. For these mortgages, as for graduated-payment mortgages, disclosures should reflect the scheduled increases in payments.)

14. Reverse mortgages. Reverse mortgages, also known as reverse annuity or home equity conversion mortgages, typically involve the disbursement of monthly advances to the consumer for a fixed period or until the occurrence of an event such as the consumer's death. Repayment of the loan (generally a single payment of principal and accrued interest) may be required to be made at the end of the disbursements or, for example, upon the death of the consumer. In disclosing these transactions, creditors must apply the following rules, as applicable:

- If the reverse mortgage has a specified period for disbursements but repayment is due only upon the occurrence of a future event such as the death of the consumer, the creditor must assume that disbursements will be made until they are scheduled to end. The creditor must assume repayment will occur when disbursements end (or within a period following the final disbursement which is not longer than the regular interval between disbursements). This assumption should be used even though repayment may occur before or after the disbursements are scheduled to end. In such cases, the creditor may include a statement such as "The disclosures assume that you will repay the loan at the time our payments to you end. As provided in your agreement, your repayment may be required at a different time."

- If the reverse mortgage has neither a specified period for disbursements nor a specified repayment date and these terms will be determined solely by reference to future events including the consumer's death, the creditor may assume that the disbursements will end upon the consumer's death (estimated by using actuarial tables, for example) and that repayment will be required at the same time (or within a period following the date of the final disbursement which is not longer than the regular interval for disbursements). Alternatively, the creditor may base the disclosures upon another future event it estimates will be most likely to occur first. (If terms will be determined by reference to future events which do not include the consumer's death, the creditor must base the disclosures upon the occurence of the event estimated to be most likely to occur first.)

- In making the disclosures, the creditor must assume that all disbursements and accrued interest will be paid by the consumer. For example, if the the note has a nonrecourse provision providing that the consumer is not obligated for an amount greater than the value of the house, the creditor must nonetheless assume that the full amount to be disbursed will be repaid. In this case, however, the creditor may include a statement such as "The disclosures assume full repayment of the amount advanced plus accured interest, although the amount you may be required to pay is limited by your agreement."

- Some reverse mortgages provide that some or all of the appreciation in the value of the property will be shared between the consumer and the creditor. Such loans are considered variable-rate mortgages, as described in comment 17(c)(1)-11, and the appreciation feature must be disclosed in accordance with § 226.18(f)(1). If the reverse mortgage has a variable interest rate, is written for a term greater than one

year, and is secured by the consumer's principal dwelling, the shared appreciation feature must be described under § 226.19(b)(2)(vii).

15. Morris Plan transactions. When a deposit account is created for the sole purpose of accumulating payments and then is applied to satisfy entirely the consumer's obligation in the transaction, each deposit made into the account is considered the same as a payment on a loan for purposes of making disclosures.

16. Number of transactions. Creditors have flexibility in handling credit extensions that may be viewed as multiple transactions. For example:

- When a creditor finances the credit sale of a radio and a television on the same day, the creditor may disclose the sales as either 1 or 2 credit sale transactions.

- When a creditor finances a loan along with a credit sale of health insurance, the creditor may disclose in one of several ways: a single credit sale transaction, a single loan transaction, or a loan and a credit sale transaction.

- The separate financing of a downpayment in a credit sale transaction may, but need not, be disclosed as 2 transactions (a credit sale and a separate transaction for the financing of the downpayment).

17. Special rules for tax refund anticipation loans, Tax refund loans, also known as refund anticipation loans (RALs), are transactions in which a creditor will lend up to the amount of a consumer's expected tax refund. RAL agreements typically require repayment upon demand, but also may provide that repayment is required when the refund is made. The agreements also typically provide that if the amount of the refund is less than the payment due, the consumer must pay the difference. Repayment often is made by a preauthorized offset to a consumer's account held with the creditor when the refund has been deposited by electronic transfer. Creditors may charge fees for RALs in addition to fees for filing the consumer's tax return electronically. In RAL transactions subject to the regulation the following special rules apply:

- If, under the terms of the legal obligation, repayment of the loan is required when the refund is received by the consumer (such as by deposit into the consumer's account), the disclosures should be based on the creditor's estimate of the time the refund will be delivered even if the loan also contains a demand clause. The practice of a creditor to demand repayment upon delivery of refunds does not determine whether the legal obligation requires that repayment be made at that time; this determination must be made according to applicable state or other law. (See comment 17(c)(5)-1 for the rules regarding disclosures if the loan is payable solely on demand or is payable either on demand or on an alternate maturity date.)

- If the consumer is required to repay more than the amount borrowed, the difference is a finance charge unless excluded under § 226.4. In addition, to the extent that any fees charged in connection with the loan (such as for filing the tax return electronically) exceed those fees for a comparable cash transaction (that is, filing the tax return electronically without a loan), the difference must be included in the finance charge.

18. Pawn Transactions. When, in connection with an extension of credit, a consumer pledges or sells an item to a pawnbroker creditor in return for a sum of money and retains the right to redeem the item for a greater sum (the redemption price) within a specified period of time, disclosures are required. In addition to other disclosure requirements that may be applicable under § 226.18, for purposes of pawn transactions:

i. The amount financed is the initial sum paid to the consumer. The pawnbroker creditor need not provide a separate itemization of the amount financed if that entire amount is paid directly to the consumer and the disclosed description of the amount financed is "the amount of cash given directly to you" or a similar phrase.

ii. The finance charge is the difference between the initial sum paid to the consumer and the redemption price plus any other finance charges paid in connection with the transaction. (See § 226.4.)

iii. The term of the transaction, for calculating the annual percentage rate, is the period of time agreed to by the pawnbroker creditor and the consumer. The term of the transaction does not include a grace period (including any statutory grace period) after the agreed redemption date.

Paragraph 17(c)(2)(i).

1. Basis for estimates. Disclosures may be estimated when the exact information is unknown at the time disclosures are made. Information is unknown if it is not reasonably available to the creditor at the time the disclosures are made. The "reasonably available" standard requires that the creditor, acting in good faith, exercise due diligence in obtaining information. For example, the creditor must at a minimum utilize generally accepted calculation tools, but need not invest in the most sophisticated computer program to make a particular type of calculation. The creditor normally may rely on the representations of other parties in obtaining information. For example, the creditor might look to the consumer for the time of consummation, to insurance companies for the cost of insurance, or to realtors for taxes and escrow fees. The creditor may utilize estimates in making disclosures even though the creditor knows that more precise information will be available by the point of consummation. However, new disclosures may be required under § 226.17(f) or § 226.19.

2. Labelling estimates. Estimates must be designated as such in the segregated disclosures. Even though other disclosures are based on the same assumption on which a specific estimated disclosure was based, the creditor has some flexibility in labelling the estimates. Generally, only the particular disclosure for which the exact information is unknown is labelled as an estimate. However, when several disclosures are affected because of the unknown information, the creditor has the option of labelling either every affected disclosure or only the disclosure primarily affected. For example, when the finance charge is unknown because the date of consummation is unknown, the creditor must label the finance charge as an estimate and may also label as estimates the total of payments and the payment schedule. When many disclosures are estimates, the creditor may use a general statement, such as "all numerical disclosures except the late payment disclosure are estimates," as a method to label those disclosures as estimates.

3. Simple-interest transactions. If consumers do not make timely payments in a simple-interest transaction, some of the amounts calculated for Truth in Lending disclosures will differ from amounts that consumers will actually pay over the term of the transaction. Creditors may label disclosures as estimates in these transactions. For example, because the finance charge and total of payments may be larger than disclosed if consumers make late payments, creditors may label the finance charge and total of payments as estimates. On the other hand, creditors may choose not to label disclosures as estimates and may base all disclosures on the assumption that payments will be made on time, disregarding any possible inaccuracies resulting from consumers' payment patterns.

Paragraph 17(c)(2)(ii).

1. Per-diem interest. This paragraph applies to any numerical amount (such as the finance charge, annual percentage rate, or payment amount) that is affected by the amount of the per-diem interest charge that will be collected at consummation. If the amount of per-diem interest used in preparing the disclosures for consummation is based on the information known to the creditor at the time the disclosure document is prepared, the disclosures are considered accurate under this rule, and affected disclosures are also considered accurate, even if the disclosures are not labeled as estimates. For example, if the amount of per-diem interest used to prepare disclosures is less than the amount of per-diem interest charged at consummation, and as a result the finance charge is understated by $200, the disclosed finance charge is considered accurate even though the understatement is not within the $100 tolerance of § 226.18(d)(1), and the finance charge was not labeled as an estimate. In this example, if in addition to the understatement related to the per-diem interest, a $90 fee is incorrectly omitted from the finance charge, causing it to be understated by a total of $290, the finance charge is considered accurate because the $90 fee is within the tolerance in § 226.18(d)(1).

Paragraph 17(c)(3)

1. Minor variations. Section 226.17(c)(3) allows creditors to disregard certain factors in calculating and making disclosures. For example:

- Creditors may ignore the effects of collecting payments in whole cents. Because payments cannot be collected in fractional cents, it is often difficult to amortize exactly an obligation with equal payments; the amount of the last payment may require adjustment to account for the rounding of the other payments to whole cents.

- Creditors may base their disclosures on calculation tools that assume that all months have an equal number of days, even if their practice is to take account of the variations in months for purposes of collecting interest. For example, a creditor may use a calculation tool based on a 360-day year, when it in fact collects interest by applying a factor of1/365of the annual rate to 365 days. This rule does not, however, authorize creditors to ignore, for disclosure purposes, the effects of applying1/360of an annual rate to 365 days.

2. Use of special rules. A creditor may utilize the special rules in § 226.17(c)(3) for purposes of calculating and making all disclosures for a transaction or may, at its option, use the special rules for some disclosures and not others.

Paragraph 17(c)(4).

1. Payment schedule irregularities. When one or more payments in a transaction differ from the others because of a long or short first period, the variations may be ignored in disclosing the payment schedule, finance charge, annual percentage rate, and other terms. For example:

- A 36-month auto loan might be consummated on June 8 with payments due on July 1 and the first of each succeeding month. The creditor may base its calculations on a payment schedule that assumes 36 equal intervals and 36 equal installment payments, even though a precise computation would produce slightly different amounts because of the shorter first period.

- By contrast, in the same example, if the first payment were not scheduled until August 1, the irregular first period would exceed the limits in § 226.17(c)(4); the creditor could not use the special rule and could not ignore the extra days in the first period in calculating its disclosures.

2. Measuring odd periods. In determining whether a transaction may take advantage of the rule in § 226.17(c)(4), the creditor must measure the variation against a regular period. For purposes of that rule:

- The first period is the period from the date on which the finance charge begins to be earned to the date of the first payment.

- The term is the period from the date on which the finance charge begins to be earned to the date of the final payment.

- The regular period is the most common interval between payments in the transaction.

In transactions involving regular periods that are monthly, semimonthy or multiples of a month, the length of the irregular and regular periods may be calculated on the basis of either the actual number of days or an assumed 30-day month. In other transactions, the length of the periods is based on the actual number of days.

3. Use of special rules. A creditor may utilize the special rules in § 226.17(c)(4) for purposes of calculating and making some disclosures but may elect not to do so for all of the disclosures. For example, the variations may be ignored in calculating and disclosing the annual percentage rate but taken into account in calculating and disclosing the finance charge and payment schedule.

4. Relation to prepaid finance charges. Prepaid finance charges, including "odd-days" or "per-diem" interest, paid prior to or at closing may not be treated as the first payment on a loan. Thus, creditors may not disregard an irregularity in disclosing such finance charges.

Paragraph 17(c)(5).

1. Demand disclosures. Disclosures for demand obligations are based on an assumed 1-year term, unless an alternate maturity date is stated in the legal obligation. Whether an alternate maturity date is stated in the legal obligation is

determined by applicable law. An alternate maturity date is not inferred from an informal principal reduction agreement or a similar understanding between the parties. However, when the note itself specifies a principal reduction schedule (for example, "payable on demand or $2,000 plus interest quarterly"), an alternate maturity is stated and the disclosures must reflect that date.

2. Future event as maturity date. An obligation whose maturity date is determined solely by a future event, as for example, a loan payable only on the sale of property, is not a demand obligation. Because no demand feature is contained in the obligation, demand disclosures under § 226.18(i) are inapplicable. The disclosures should be based on the creditor's estimate of the time at which the specified event will occur, and may indicate the basis for the creditor's estimate, as noted in the commentary to § 226.17(a).

3. Demand after stated period. Most demand transactions contain a demand feature that may be exercised at any point during the term, but certain transactions convert to demand status only after a fixed period. For example, in States prohibiting due-on-sale clauses, the Federal National Mortgage Association (FNMA) requires mortgages that it purchases to include a call option rider that may be exercised after 7 years. These mortgages are generally written as long-term obligations, but contain a demand feature that may be exercised only within a 30-day period at 7 years. The disclosures for these transactions should be based upon the legally agreed-upon maturity date. Thus, if a mortgage containing the 7-year FNMA call option is written as a 20-year FNMA call option is written as a 20-year obligation, the disclosures should be based on the 20-year term, with the demand feature disclosed under § 226.18(i).

4. Balloon mortgages. Balloon payment mortgages, with payments based on a long-term amortization schedule and a large final payment due after a shorter term, are not demand obligations unless a demand feature is specifically contained in the contract. For example, a mortgage with a term of 5 years and a payment schedule based on 20 years would not be treated as a mortgage with a demand feature, in the absence of any contractual demand provisions. In this type of mortgage, disclosures should be based on the 5-year term.

Paragraph 17(c)(6).

1. Series of advances. Section 226.17(c)(6)(i) deals with a series of advances under an agreement to extend credit up to a certain amount. A creditor may treat all of the advances as a single transaction or disclose each advance as a separate transaction. If these advances are treated as 1 transaction and the timing and amounts of advances are unknown, creditors must make disclosures based on estimates, as provided in § 226.17(c)(2). If the advances are disclosed separately, disclosures must be provided before each advance occurs, with the disclosures for the first advance provided by consummation.

2. Construction loans. Section 226.17(c)(6)(ii) provides a flexible rule for disclosure of construction loans that may be permanently financed. These transactions have 2 distinct phases, similar to 2 separate transactions. The construction loan may be for initial construction or subsequent constructions, such as rehabilitation or remodelling. The construction period usually involves several disbursements of funds at times and in amounts that are unknown at the beginning of that period, with the consumer paying only accrued interest until construction is completed. Unless the obligation is paid at that time, the loan then converts to permanent financing in which the loan amount is amortized just as in a

standard mortgage transaction. Section 226.17(c)(6)(ii) permits the creditor to give either one combined disclosure for both the construction financing and the permanent financing, or a separate set of disclosures for the 2 phases. This rule is available whether the consumer is initially obligated to accept construction financing only or is obligated to accept both construction and permanent financing from the outset. If the consumer is obligated on both phases and the creditor chooses to give 2 sets of disclosures, both sets must be given to the consumer initially, because both transactions would be consummated at that time. (Appendix D provides a method of calculating the annual percentage rate and other disclosures for construction loans, which may be used, at the creditor's option, in disclosing construction financing.)

3. Multiple-advance construction loans. Section 226.17(c)(6)(i) and (ii) are not mutually exclusive. For example, in a transaction that finances the construction of a dwelling that may be permanently financed by the same creditor, the construction phase may consist of a series of advances under an agreement to extend credit up to a certain amount. In these cases, the creditor may disclose the construction phase as either 1 or more than 1 transaction and also disclose the permanent financing as a separate transaction.

4. Residential mortgage transaction. See the commentary to § 226.2(a)(24) for a discussion of the effect of § 226.17(c)(6) on the definition of a residential mortgage transaction.

5. Allocation of points. When a creditor utilizes the special rule in § 226.17(c)(6) to disclose credit extensions as multiple transactions, buyers points or similar amounts imposed on the consumer must be allocated for purposes of calculating disclosures. While such amounts should not be taken into account more than once in making calculations, they may be allocated between the transactions in any manner the creditor chooses. For example, if a construction-permanent loan is subject to 5 points imposed on the consumer and the creditor chooses to disclose the 2 phases separately, the 5 points may be allocated entirely to the construction loan, entirely to the permanent loan, or divided in any manner between the two. However, the entire 5 points may not be applied twice, that is, to both the construction and the permanent phases.

17(d) Multiple creditors; multiple consumers.

1. Multiple creditors. If a credit transaction involves more than one creditor:

- The creditors must choose which of them will make the disclosures.
- A single, complete set of disclosures must be provided, rather than partial disclosures from several creditors.
- All disclosures for the transaction must be given, even if the disclosing creditor would not otherwise have been obligated to make a particular disclosure. For example, if one of the creditors is the seller, the total sale price disclosure under § 226.18(j) must be made, even though the disclosing creditor is not the seller.

2. Multiple consumers. When two consumers are joint obligors with primary liability on an obligation, the disclosures

may be given to either one of them. If one consumer is merely a surety or guarantor, the disclosures must be given to the principal debtor. In rescindable transactions, however, separate disclosures must be given to each consumer who has the right to rescind under § 226.23, although the disclosures required under § 226.19(b) need only be provided to the consumer who expresses an interest in a variable-rate loan program.

17(e) Effect of subsequent events.

1. Events causing inaccuracies. Inaccuracies in disclosures are not violations if attributable to events occurring after the disclosures are made. For example, when the consumer fails to fulfill a prior commitment to keep the collateral insured and the creditor then provides the coverage and charges the consumer for it, such a change does not make the original disclosures inaccurate. The creditor may, however, be required to make new disclosures under § 226.17(f) or § 226.19 if the events occurred between disclosure and consummation or under § 226.20 if the events occurred after consummation.

17(f) Early disclosures.

1. Change in rate or other terms. Redisclosure is required for changes that occur between the time disclosures are made and consummation if the annual percentage rate in the consummated transaction exceeds the limits prescribed in this section, even if the initial disclosures would be considered accurate under the tolerances in §§ 226.18(d) or 226.22(a). To illustrate:

i. General.

A. If disclosures are made in a regular transaction on July 1, the transaction is consummated on July 15, and the actual annual percentage rate varies by more than1/8of 1 percentage point from the disclosed annual percentage rate, the creditor must either redisclose the changed terms or furnish a complete set of new disclosures before consummation. Redisclosure is required even if the disclosures made on July 1 are based on estimates and marked as such.

B. In a regular transaction, if early disclosures are marked as estimates and the disclosed annual percentage rate is within1/8of 1 percentage point of the rate at consummation, the creditor need not redisclose the changed terms (including the annual percentage rate).

ii. Nonmortgage loan. If disclosures are made on July 1, the transaction is consummated on July 15, and the finance charge increased by $35 but the disclosed annual percentage rate is within the permitted tolerance, the creditor must at least redisclose the changed terms that were not marked as estimates. (See§ 226.18(d)(2) of this part.)

iii. Mortgage loan. At the time TILA disclosures are prepared in July, the loan closing is scheduled for July 31 and

the creditor does not plan to collect per-diem interest at consummation. Consummation actually occurs on August 5, and per-diem interest for the remainder of August is collected as a prepaid finance charge. Assuming there were no other changes requiring redisclosure, the creditor may rely on the disclosures prepared in July that were accurate when they were prepared. However, if the creditor prepares new disclosures in August that will be provided at consummation, the new disclosures must take into account the amount of the per-diem interest known to the creditor at that time.

2. Variable rate. The addition of a variable rate feature to the credit terms, after early disclosures are given, requires new disclosures.

3. Content of new disclosures. If redisclosure is required, the creditor has the option of either providing a complete set of new disclosures, or providing disclosures of only the terms that vary from those originally disclosed. (See the commentary to § 226.19(a)(2).)

4. Special rules. In mortgage transactions subject to § 226.19, the creditor must redisclose if, between the delivery of the required early disclosures and consummation, the annual percentage rate changes by more than a stated tolerance. When subsequent events occur after consummation, new disclosures are required only if there is a refinancing or an assumption within the meaning of § 226.20.

Paragraph 17(f)(2).

1. Irregular transactions. For purposes of this paragraph, a transaction is deemed to be "irregular" according to the definition in footnote 46 of § 226.22(a)(3).

17(g) Mail or telephone orders-- delay in disclosures.

1. Conditions for use. When the creditor receives a mail or telephone request for credit, the creditor may delay making the disclosures until the first payment is due if the following conditions are met:

- The credit request is initiated without face-to-face or direct telephone solicitation. (Creditors may, however, use the special rule when credit requests are solicited by mail.)

- The creditor has supplied the specified credit information about its credit terms either to the individual consumer or to the public generally. That information may be distributed through advertisements, catalogs, brochures, special mailers, or similar means.

2. Insurance. The location requirements for the insurance disclosures under § 226.18(n) permit them to appear apart from the other disclosures. Therefore, a creditor may mail an insurance authorization to the consumer and then prepare the other disclosures to reflect whether or not the authorization is completed by the consumer. Creditors may also disclose the insurance cost on a unit-cost basis, if the transaction meets the requirements of § 226.17(g).

17(h) Series of sales -- delay in disclosures.

1. Applicability. The creditor may delay the disclosures for individual credit sales in a series of such sales until the first payment is due on the current sale, assuming the 2 conditions in this paragraph are met. If those conditions are not met, the general timing rules in § 266.17(b) apply.

2. Basis of disclosures. Creditors structuring disclosures for a series of sales under § 226.17(h) may compute the total sale price as either:

- The cash price for the sale plus that portion of the finance charge and other charges applicable to that sale; or

- The cash price for the sale, other charges applicable to the sale, and the total finance charge and outstanding principal.

17(i) Interim Student Credit Extensions

1. Definition. Student credit plans involve extensions of credit for education purposes where the repayment amount and schedule are not known at the time credit is advanced. These plans include loans made under any student credit plan, whether government or private, where the repayment period does not begin immediately. (Certain student credit plans that meet this definition are exempt from Regulation Z. See § 226.3(f).)

2. Relation to other sections. For disclosures made before the mandatory compliance date of the disclosures required under §§ 226.46, 47, and 48, paragraph 17(i) permitted creditors to omit from the disclosures the terms set forth in that paragraph at the time the credit was actually extended. However, creditors were required to make complete disclosures at the time the creditor and consumer agreed upon the repayment schedule for the total obligation. At that time, a new set of disclosures of all applicable items under § 226.18 was required. Most student credit plans are subject to the requirements in §§ 226.46, 47, and 48. Consequently, for applications for student credit plans received on or after the mandatory compliance date of §§ 226.46, 47, and 48, the creditor may not omit from the disclosures the terms set forth in paragraph 17(i). Instead, the creditor must comply with §§ 226.46, 47, and 48, if applicable, or with §§ 226.17 and 226.18.

3. Basis of disclosures. The disclosures given at the time of execution of the interim note should reflect two annual percentage rates, one for the interim period and one for the repayment period. The use of § 226.17(i) in making disclosures does not, by itself, make those disclosures estimates. Any portion of the finance charge, such as statutory interest, that is attributable to the interim period and is paid by the student (either as a prepaid finance charge, periodically during the interim period, in one payment at the end of the interim period, or capitalized at the beginning of the repayment period) must be reflected in the interim annual percentage rate. Interest subsidies, such as payments made by either a state or the Federal government on an interim loan, must be excluded in computing the annual percentage rate on the interim obligation, when the consumer has no contingent liability for payment of those amounts. Any finance charges that are paid separately by the student at the outset or withheld from the proceeds of the loan are prepaid finance

charges. An example of this type of charge is the loan guarantee fee. The sum of the prepaid finance charges is deducted from the loan proceeds to determine the amount financed and included in the calculation of the finance charge.

4. Consolidation. Consolidation of the interim student credit extensions through a renewal note with a set repayment schedule is treated as a new transaction with disclosures made as they would be for a refinancing. Any unearned portion of the finance charge must be reflected in the new finance charge and annual percentage rate, and is not added to the new amount financed. In itemizing the amount financed under § 226.18(c), the creditor may combine the principal balances remaining on the interim extensions at the time of consolidation and categorize them as the amount paid on the consumer's account.

5. Approved student credit forms. See the commentary to appendix H regarding disclosure forms approved for use in certain student credit programs for which applications were received prior to the mandatory compliance date of §§ 226.46, 47, and 48.

Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART III OF III)

1B- Consumer Credit Law Manual § 226.18

§ **226.18 Content of Disclosure**

1. As applicable. The disclosures required by this section need be made only as applicable. Any disclosure not relevant to a particular transaction may be eliminated entirely. For example:

- In a loan transaction, the creditor may delete disclosure of the total sale price.
- In a credit sale requiring disclosure of the total sale price under § 226.18(j), the creditor may delete any reference to a downpayment where no downpayment is involved.

Where the amounts of several numerical disclosures are the same, the "as applicable" language also permits creditors to combine the terms, so long as it is done in a clear and conspicuous manner. For example:

- In a transaction in which the amount financed equals the total of payments, the creditor may disclose "amount financed/total of payments," together with descriptive language, followed by a single amount.
- However, if the terms are separated on the disclosure statement and separate space is provided for each amount, both disclosures must be completed, even though the same amount is entered in each space.

2. Format. See the commentary to § 226.17 and appendix H for a discussion of the format to be used in making these disclosures, as well as acceptable modifications.

18(a) Creditor.

1. Identification of creditor.

The creditor making the disclosures must be identified. This disclosure may, at the creditor's option, appear apart from the other disclosures. Use of the creditor's name is sufficient, but the creditor may also include an address and/or telephone number. In transactions with multiple creditors, any one of them may make the disclosures; the one doing so must be identified.

18(b) Amount financed.

1. Disclosure required. The net amount of credit extended must be disclosed using the term amount financed and a descriptive explanation similar to the phrase in the regulation.

2. Rebates and loan premiums. In a loan transaction, the creditor may offer a premium in the form of cash or merchandise to prospective borrowers. Similarly, in a credit sale transaction, a seller's or manufacturer's rebate may be offered to prospective purchasers of the creditor's goods or services. At the creditor's option, these amounts may be either reflected in the Truth in Lending disclosures or disregarded in the disclosures. If the creditor chooses to reflect them in the § 226.18 disclosures, rather than disregard them, they may be taken into account in any manner as part of those disclosures.

Paragraph 18(b)(1).

1. Downpayments. A downpayment is defined in § 226.2(a)(18) to include, at the creditor's option, certain deferred downpayments or pick-up payments. A deferred downpayment that meets the criteria set forth in the definition may be treated as part of the downpayment, at the creditor's option.

- Deferred downpayments that are not treated as part of the downpayment (either because they do not meet the definition or because the creditor simply chooses not to treat them as downpayments) are included in the amount financed.

- Deferred downpayments that are treated as part of the downpayment are not part of the amount financed under § 226.18(b)(1).

Paragraph 18(b)(2).

1. Adding other amounts.

Fees or other charges that are not part of the finance charge and that are financed rather than paid separately at consummation of the transaction are included in the amount financed. Typical examples are real estate settlement charges and premiums for voluntary credit life and disability insurance excluded from the finance charge under § 226.4. This paragraph does not include any amounts already accounted for under § 226.18(b)(1), such as taxes, tag and title fees, or the costs of accessories or service policies that the creditor includes in the cash price.

Paragraph 18(b)(3).

1. Prepaid finance charges.

Prepaid finance charges that are paid separately in cash or by check should be deducted under § 226.18(b)(3) in calculating the amount financed. To illustrate:

- A consumer applies for a loan of $2,500 with a $40 loan fee. The face amount of the note is $2,500 and the consumer pays the loan fee separately by cash or check at closing. The principal loan amount for purposes of § 226.18(b)(1) is $2,500 and $40 should be deducted under § 226.18(b(3), thereby yielding an amount financed of $2,460.

In some instances, as when loan fees are financed by the creditor, finance charges are incorporated in the face amount of the note. Creditors have the option, when the charges are not add-on or discount charges, of determining a principal loan amount under § 226.18(b)(1) that either includes or does not include the amount of the finance charges. (Thus the principal loan amount may, but need not, be determined to equal the face amount of the note.) When the finance charges are included in the principal loan amount, they should be deducted as prepaid finance charges under § 226.18(b)(3). When the finance charges are not included in the principal loan amount, they should not be deducted under § 226.18(b)(3). The following examples illustrate the application of § 226.18(b) to this type of transaction. Each example assumes a loan request of $2,500 with a loan fee of $40; the creditor assesses the loan fee by increasing the face amount of the note to $2,540.

- If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,540, it has included the loan fee in the principal loan amount and should deduct $40 as a prepaid finance charge under § 226.18(b)(3), thereby obtaining an amount financed of $2,500.

- If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,500, it has not included the loan fee in the principal loan amount and should not deduct any amount under § 226.18(b)(3), thereby obtaining an amount financed of $2,500.

The same rules apply when the creditor does not increase the face amount of the note by the amount of the charge but collects the charge by withholding it from the amount advanced to the consumer. To illustrate, the following examples assume a loan request of $2,500 with a loan fee of $40; the creditor prepares a note for $2,500 and advances $2,460 to the consumer.

- If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,500, it has included the loan fee in the principal loan amount and should deduct $40 as a prepaid finance charge under § 226.18(b)(3), thereby obtaining an amount financed of $2,460.

- If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,460, it has not included the loan fee in the principal loan amount and should not deduct any amount under § 226.18(b)(3), thereby obtaining an amount financed of $2,460.

Thus in the examples where the creditor derives the net amount of credit by determining a principal loan amount that does not include the amount of the finance charge, no subtraction is appropriate. Creditors should note, however, that although the charges are not subtracted as prepaid finance charges in those examples, they are nonetheless finance charges and must be treated as such.

2. Add-on or discount charges. All finance charges must be deducted from the amount of credit in calculating the amount financed. If the principal loan amount reflects finance charges that meet the definition of a prepaid finance charge in § 226.2, those charges are included in the § 226.18(b)(1) amount and deducted under § 226.18(b)(3).

However, if the principal loan amount includes finance charges that do not meet the definition of a prepaid finance charge, the § 226.18(b)(1) amount must exclude those finance charges. The following examples illustrate the application of § 226.18(b) to these types of transactions. Each example assumes a loan request of $1000 for 1 year, subject to a 6 percent precomputed interest rate, with a $10 loan fee paid separately at consummation.

- The creditor assesses add-on interest of $60 which is added to the $1000 in loan proceeds for an obligation with a face amount of $1060. The principal for purposes of § 226.18(b)(1) is $1000, no amounts are added under § 226.18(b)(2), and the $10 loan fee is a prepaid finance charge to be deducted under § 226.18(b)(3). The amount financed is $990.

- The creditor assesses discount interest of $60 and distributes $940 to the consumer, who is liable for an obligation with a face amount of $1000. The principal under § 226.18(b)(1) is $940, which results in an amount financed of $930, after deduction of the $10 prepaid finance charge under § 226.18(b)(3).

- The creditor assesses $60 in discount interest by increasing the face amount of the obligation to $1060, with the consumer receiving $1000. The principal under § 226.18(b)(1) is thus $1000 and the amount financed $990, after deducting the $10 prepaid finance charge under § 226.18(b)(3).

18(c) Itemization of amount financed.

1. Disclosure required.

The creditor has 2 alternatives in complying with § 226.18(c):

- The creditor may inform the consumer, on the segregated disclosures, that a written itemization of the amount financed will be provided on request, furnishing the itemization only if the customer in fact requests it.

- The creditor may provide an itemization as a matter of course, without notifying the consumer of the right to receive it or waiting for a request.

Whether given as a matter of course or only on request, the itemization must be provided at the same time as the other disclosures required by § 226.18, although separate from those disclosures.

2. Additional information. Section 226.18(c) establishes only a minimum standard for the material to be included in the itemization of the amount financed. Creditors have considerable flexibility in revising or supplementing the information listed in § 226.18(c) and shown in model form H-3, although no changes are required. The creditor may, for example, do one or more of the following:

i. Include amounts that reflect payments not part of the amount financed. For example, escrow items and certain insurance premiums may be included, as discussed in the commentary to § 226.18(g).

ii. Organize the categories in any order. For example, the creditor may rearrange the terms in a mathematical

progression that depicts the arithmetic relationship of the terms.

iii. Add categories. For example, in a credit sale, the creditor may include the cash price and the downpayment. If the credit sale involves a trade-in of the consumer's car and an existing lien on that car exceeds the value of the trade-in amount, the creditor may disclose the consumer's trade-in value, the creditor's payoff of the existing lien, and the resulting additional amount financed.

iv. Further itemize each category. For example, the amount paid directly to the consumer may be subdivided into the amount given by check and the amount credited to the consumer's savings account.

v. Label categories with different language from that shown in § 226.18(c). For example, an amount paid on the consumer's account may be revised to specifically identify the account as "your auto loan with us."

vi. Delete, leave blank, mark "N/A" or otherwise not inapplicable categories in the itemization. For example, in a credit sale with no prepaid finance charges or amounts paid to others, the amount financed may consist of only the cash price less downpayment. In this case, the itemization may be composed of only a single category and all other categories may be eliminated.

3. Amounts appropriate to more than one category. When an amount may appropriately be placed in any of several categories and the creditor does not wish to revise the categories shown in § 226.18(c), the creditor has considerable flexibility in determining where to show the amount. For example:

- In a credit sale, the portion of the purchase price being financed by the creditor may be viewed as either an amount paid to the consumer or an amount paid on the consumer's account.

4. RESPA transactions. The Real Estate Settlement Procedures Act (RESPA) requires creditors to provide a good faith estimate of closing costs and a settlement statement listing the amounts paid by the consumer. Transactions subject to RESPA are exempt from the requirements of § 226.18(c) if the creditor complies with RESPA's requirements for a good faith estimate and settlement statement. The itemization of the amount financed need not be given, even though the content and timing of the good faith estimate and settlement statement under RESPA differ from the requirements of §§ 226.18(c) and 226.19(a)(2). If a creditor chooses to substitute RESPA's settlement statement for the itemization when redisclosure is required under § 226.19(a)(2), the statement must be delivered to the consumer at or prior to consummation. The disclosures required by §§ 226.18(c) and 226.19(a)(2) may appear on the same page or on the same document as the good faith estimate or the settlement statement, so long as the requirements of § 226.17(a) are met.

Paragraph 18(c)(1)(i).

1. Amounts paid to consumer. This encompasses funds given to the consumer in the form of cash or a check, including joint proceeds checks, as well as funds placed in an asset account. It may include money in an interest-bearing account even if that amount is considered a required deposit under § 226.18(r). For example, in a transaction with total loan proceeds of $500, the consumer receives a check for $300 and $200 is required by the creditor to be put into an interest-bearing account. Whether or not the $200 is a required deposit, it is part of the amount financed. At the creditor's option, it may be broken out and labeled in the itemization of the amount financed.

Paragraph 18(c)(1)(ii).

1. Amounts credited to consumer's account. The term consumer's account refers to an account in the nature of a debt with that creditor. It may include, for example, an unpaid balance on a prior loan, a credit sale balance or other amounts owing to that creditor. It does not include asset accounts of the consumer such as savings or checking accounts.

Paragraph 18(c)(1)(iii).

1. Amounts paid to others This includes, for example, tag and title fees; amounts paid to insurance companies for insurance premiums; security interest fees, and amounts paid to credit bureaus, appraisers or public officials. When several types of insurance premiums are financed, they may, at the creditor's option, be combined and listed in one sum, labeled "insurance" or similar term. This includes, but is not limited to, different types of insurance premiums paid to one company and different types of insurance premiums paid to different companies. Except for insurance companies and other categories noted in footnote 41, third parties must be identified by name.

2. Charges added to amounts paid to others. A sum is sometimes added to the amount of a fee charged to a consumer for a service provided by a third party (such as for an extended warranty or a service contract) that is payable in the same amount in comparable cash and credit transactions. In the credit transaction, the amount is retained by the creditor. Given the flexibility permitted in meeting the requirements of the amount financed itemization (see the commentary to § 226.18(c)), the creditor in such cases may reflect that the creditor has retained a portion of the amount paid to others. For example, the creditor could add to the category "amount paid to others" language such as "(we may be retaining a portion of this amount)."

Paragraph 18(c)(1)(iv).

1. Prepaid finance charge. Prepaid finance charges that are deducted under § 226.18(b)(3) must be disclosed under this section. The prepaid finance charges must be shown as a total amount but may, at the creditor's option, also be further itemized and described. All amounts must be reflected in this total, even if portions of the prepaid finance charge are also reflected elsewhere. For example, if at consummation the creditor collects interim interest of $30 and a credit report fee of $10, a total prepaid finance charge of $40 must be shown. At the creditor's option, the credit report fee paid to a third party may also be shown elsewhere as an amount included in § 226.18(c)(1)(iii). The creditor may also further describe the 2 components of the prepaid finance charge, although no itemization of this element is required by § 226.18(c)(1)(iv).

2. Prepaid mortgage insurance premiums. RESPA requires creditors to give consumers a settlement statement disclosing the costs associated with mortgage loan transactions. Included on the settlement statement are mortgage insurance premiums collected at settlement, which are prepaid finance charges. In calculating the total amount of prepaid finance charges, creditors should use the amount for mortgage insurance listed on the line for mortgage insurance on the settlement statement (line 1002 on HUD-1 or HUD 1-A), without adjustment, even if the actual amount collected at settlement may vary because of RESPA's escrow accounting rules. Figures for mortgage insurance disclosed in conformance with RESPA shall be deemed to be accurate for purposes of Regulation Z.

18(d) Finance charge.

1. Disclosure required. The creditor must disclose the finance charge as a dollar amount, using the term finance charge, and must include a brief description similar to that in § 226.18(d). The creditor may, but need not, further modify the descriptor for variable rate transactions with a phrase such as which is subject to change. The finance charge must be shown on the disclosures only as a total amount; the elements of the finance charge must not be itemized in the segregated disclosures, although the regulation does not prohibit their itemization elsewhere.

2. [Reserved]

18(d)(2) Other credit.

1. Tolerance. When a finance charge error results in a misstatement of the amount financed, or some other dollar amount for which the regulation provides no specific tolerance, the misstated disclosure does not violate the act or the regulation if the finance charge error is within the permissible tolerance under this paragraph.

2. Exception. Footnote 42 provides an exception for certain transactions in which no annual percentage rate disclosure is required.

18(f) Variable rate.

1. Coverage. The requirements of § 226.18(f) apply to all transactions in which the terms of the legal obligation allow the creditor to increase the rate originally disclosed to the consumer. It includes not only increases in the interest rate but also increases in other components, such as the rate of required credit life insurance. The provisions, however, do not apply to increases resulting from delinquency (including late payment), default, assumption, acceleration or transfer of the collateral. Section 226.18(f)(1) applies to variable-rate transactions that are not secured by the consumer's principal dwelling and to those that are secured by the principal dwelling but have a term of one year or less. Section 226.18(f)(2) applies to variable-rate transactions that are secured by the consumer's principal dwelling and have a term greater than one year. Moreover, transactions subject to § 226.18(f)(2) are subject to the special early disclosure requirements of § 226.19(b). (However, "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of § 226.18(f)(1) and not to the requirements of §§ 226.18(f)(2) and 226.19(b) regardless of the general coverage of those sections.) Creditors are permitted under footnote 43 to substitute in any variable-rate transaction the disclosures required under § 226.19(b) for those disclosures ordinarily required under 226.18(f)(1).

Creditors who provide variable-rate disclosures under § 226.19(b) must comply with all of the requirements of that section, including the timing of disclosures, and must also provide the disclosures required under § 226.18(f)(2). Creditors utilizing footnote 43 may, but need not, also provide disclosures pursuant to § 226.20(c). (Substitution of disclosures under § 226.18(f)(1) in transactions subject to § 226.19(b) is not permitted under the footnote.)

Paragraph 18(f)(1).

1. Terms used in disclosure. In describing the variable rate feature, the creditor need not use any prescribed terminology. For example, limitations and hypothetical examples may be described in terms of interest rates rather than annual percentage rates. The model forms in appendix H provide examples of ways in which the variable rate disclosures may be made.

2. Conversion feature. In variable-rate transactions with an option permitting consumers to convert to a fixed-rate transaction, the conversion option is a variable-rate feature that must be disclosed. In making disclosures under § 226.18(f)(1), creditors should disclose the fact that the rate may increase upon conversion; identify the index or formula used to set the fixed rate; and state any limitations on and effects of an increase resulting from conversion that differ from other variable-rate features. Because § 226.18(f)(1)(iv) requires only one hypothetical example (such as an example of the effect on payments resulting from changes in the index), a second hypothetical example need not be given.

Paragraph 18(f)(1)(i).

1. Circumstances. The circumstances under which the rate may increase include identification of any index to which the rate is tied, as well as any conditions or events on which the increase is contingent.

- When no specific index is used, any identifiable factors used to determine whether to increase the rate must be disclosed.

- When the increase in the rate is purely discretionary, the fact that any increase is within the creditor's discretion must be disclosed.

- When the index is internally defined (for example, by that creditor's prime rate), the creditor may comply with this requirement by either a brief description of that index or a statement that any increase is in the discretion of the creditor. An externally defined index, however, must be identified.

Paragraph 18(f)(1)(ii)

1. Limitations. This includes any maximum imposed on the amount of an increase in the rate at any time, as well as any maximum on the total increase over the life of the transaction. Except for private education loans disclosures, when there are no limitations, the creditor may, but need not, disclose that fact, and limitations do not include legal limits in the nature of usury or rate ceilings under State or Federal statutes or regulations. (See *§ 226.30* for the rule requiring that a maximum interest rate be included in certain variable-rate transactions.) For disclosures with respect to private education loan disclosures, see comment 47(b)(1)-2.

Paragraph 18(f)(1)(iii).

1. Effects. Disclosure of the effect of an increase refers to an increase in the number or amount of payments or an increase in the final payment. In addition, the creditor may make a brief reference to negative amortization that may result from a rate increase. (See the commentary to § 226.17(a)(1) regarding directly related information.) If the effect cannot be determined, the creditor must provide a statement of the possible effects. For example, if the exercise of the variable-rate feature may result in either more or larger payments, both possibilities must be noted.

Paragraph 18(f)(1)(iv).

1. Hypothetical example. The example may, at the creditor's option appear apart from the other disclosures. The creditor may provide either a standard example that illustrates the terms and conditions of that type of credit offered by that creditor or an example that directly reflects the terms and conditions of the particular transaction. In transactions with more than one variable-rate feature, only one hypothetical example need be provided. (See the commentary to section 226.17(a)(1) regarding disclosure of more than one hypothetical example as directly related information.)

2. Hypothetical example not required. The creditor need not provide a hypothetical example in the following transactions with a variable-rate feature:

- Demand obligations with no alternate maturity date.
- When the increase in the rate is purely discretionary, the fact that any increase is within the creditor's discretion must be disclosed
- When the index is internally defined (for example, by that creditor's prime rate), the creditor may comply with this requirement by either a brief description of that index or a statement that any increase is in the discretion of the creditor. An externally defined index, however, must be identified.

Paragraph 18(f)(2).

1. Disclosure required. In variable-rate transactions that have a term greater than one year and are secured by the consumer's principal dwelling, the creditor must give special early disclosures under § 226.19(b) in addition to the later disclosures required under § 226.18(f)(2). The disclosures under § 226.18(f)(2) must state that the transaction has a variable-rate feature and that variable-rate disclosures have been provided earlier. (See the commentary to § 226.17(a)(1) regarding the disclosure of certain directly related information in addition to the variable-rate disclosures required under § 226.18(f)(2).)

18(g) Payment schedule.

1. Amounts included in repayment schedule. The repayment schedule should reflect all components of the finance charge, not merely the portion attributable to interest. A prepaid finance charge, however, should not be shown in the

repayment schedule as a separate payment. The payments may include amounts beyond the amount financed and finance charge. For example, the disclosed payments may, at the creditor's option, reflect certain insurance premiums where the premiums are not part of either the amount financed or the finance charge, as well as real estate escrow amounts such as taxes added to the payment in mortage transactions.

2. Deferred downpayments. As discussed in the commentary to § 226.2(a)(18), deferred downpayments or pick-up payments that meet the conditions set forth in the definition of downpayment may be treated as part of the downpayment. Even if treated as a downpayment, that amount may nevertheless be disclosed as part of the payment schedule, at the creditor's option.

3. Total number of payments. In disclosing the number of payments for transactions with more than one payment level, creditors may but need not disclose as a single figure the total number of payments for all levels. For example, in a transaction calling for 108 payments of $350, 240 payments of $335, and 12 payments of $330, the creditor need not state that there will be a total of 360 payments.

4. Timing of payments

i. General rule. Section 226.18(g) requires creditors to disclose the timing of payments. To meet this requirement, creditors may list all of the payment due dates. They also have the option of specifying the "period of payments" scheduled to repay the obligation. As a general rule, creditors that choose this option must disclose the payment intervals or frequency, such as "monthly"or "bi-weekly," and the calendar date that the beginning payment is due. For example, a creditor may disclose that payments are due "monthly beginning on July 1, 1998." This information, when combined with the number of payments, is necessary to define the repayment period and enable a consumer to determine all of the payment due dates.

ii. Exception. In a limited number of circumstances, the beginning-payment date is unknown and difficult to determine at the time disclosures are made. For example, a consumer may become obligated on a credit contract that contemplates the delayed disbursement of funds based on a contingent event, such as the completion of home repairs. Disclosures may also accompany loan checks that are sent by mail, in which case the initial disbursement and repayment dates are solely within the consumer's control. In such cases, if the beginning-payment date is unknown the creditor may use an estimated date and label the disclosure as an estimate pursuant to § 226.17(c). Alternatively, the disclosure may refer to the occurrence of a particular event, for example, by disclosing that the beginning payment is due "30 days after the first loan disbursement." This information also may be included with an estimated date to explain the basis for the creditor's estimate. See Comment 17(a)(1)-5(iii).

5. Mortgage insurance. The payment schedule should reflect the consumer's mortgage insurance payments until the date on which the creditor must automatically terminate coverage under applicable law, even though the consumer may have a right to request that the insurance be cancelled earlier. The payment schedule must reflect the legal obligation, as determined by applicable state or other law. For example, assume that under applicable law, mortgage insurance must

terminate after the 130th scheduled monthly payment, and the creditor collects at closing and places in escrow two months of premiums. If, under the legal obligation, the creditor will include mortgage insurance premiums in 130 payments and refund the escrowed payments when the insurance is terminated, the payment schedule should reflect 130 premium payments. If, under the legal obligation, the creditor will apply the amount escrowed to the two final insurance payments, the payment schedule should reflect 128 monthly premium payments. (For assumptions in calculating a payment schedule that includes mortgage insurance that must be automatically terminated, see comments 17(c)(1)-8 and 17(c)(1)-10.)

Paragraph 18(g)(1).

1. Demand obligations. In demand obligations with no alternate maturity date, the creditor has the option of disclosing only the due dates or periods of scheduled interest payments in the first year (for example, "interest payable quarterly" or "interest due the first of each month"). The amounts of the interest payments need not be shown.

Paragraph 18(g)(2).

1. Abbreviated disclosure. The creditor may disclose an abbreviated payment schedule when the amount of each regularly scheduled payment (other than the first or last payment) includes an equal amount to be applied on principal and a finance charge computed by application of a rate to the decreasing unpaid balance. This option is also available when mortgage-guarantee insurance premiums, paid either monthly or annually, cause variations in the amount of the scheduled payments, reflecting the continual decrease or increase in the premium due. In addition, in transactions where payments vary because interest and principal are paid at different intervals, the two series of payments may be disclosed separately and the abbreviated payment schedule may be used for the interest payments. For example, in transactions with fixed quarterly principal payments and monthly interest payments based on the outstanding principal balance, the amount of the interest payments will change quarterly as principal declines. In such cases the creditor may treat the interest and principal payments as two separate series of payments, separately disclosing the number, amount, and due dates of principal payments, and, using the abbreviated payment schedule, the number, amount, and due dates of interest payments. This option may be used when interest and principal are scheduled to be paid on the same date of the month as well as on different dates of the month. The creditor using this alternative must disclose the dollar amount of the highest and lowest payments and make reference to the variation in payments.

2. Combined payment schedule disclosures. Creditors may combine the option in this paragraph with the general payment schedule requirements in transactions where only a portion of the payment schedule meets the conditions of § 226.18(g)(2). For example, in a graduated payment mortgage where payments rise sharply for 5 years and then decline over the next 25 years because of decreasing mortgage insurance premiums, the first 5 years would be disclosed under the general rule in § 226.18(g) and the next 25 years according to the abbreviated schedule in § 226.18(g)(2).

3. Effect on other disclosures. Section 226.18(g)(2) applies only to the payment schedule disclosure. The actual amounts of payments must be taken into account in calculating and disclosing the finance charge and the annual percentage rate.

Paragraph 18(h) Total of payments.

1. Disclosure required. The total of payments must be disclosed using that term, along with a descriptive phrase similar to the one in the regulation. The descriptive explanation may be revised to reflect a variable rate feature with a brief phrase such as "based on the current annual percentage rate which may change."

2. Calculation of total of payments. The total of payments is the sum of the payments disclosed under § 226.18(g). For example, if the creditor disclosed a deferred portion of the downpayment as part of the payment schedule, that payment must be reflected in the total disclosed under this paragraph.

3. Exception. Footnote 44 permits creditors to omit disclosure of the total of payments in single-payment transactions. This exception does not apply to a transaction calling for a single payment of principal combined with periodic payments of interest.

4. Demand obligations. In demand obligations with no alternate maturity date, the creditor may omit disclosure of payment amounts under § 226.18(g)(1). In those transactions, the creditor need not disclose the total of payments.

Paragraph 18(i) Demand feature.

1. Disclosure requirements. The disclosure requirements of this provision apply not only to transactions payable on demand from the outset, but also to transactions that are not payable on demand at the time of consummation but convert to a demand status after a stated period. In demand obligations in which the disclosures are based on an assumed maturity of 1 year under § 226.17(c)(5), that fact must also be stated. Appendix H contains model clauses that may be used in making this disclosure.

2. Covered demand features. The type of demand feature triggering the disclosures required by § 226.18(i) includes only those demand features contemplated by the parties as part of the legal obligation. For example, this provision does not apply to transactions that covert to a demand status as a result of the consumer's default. A due-on-sale clause is not considered a demand feature. A creditor may, but need not, treat its contractual right to demand payment of a loan made to its executive officers as a demand feature to the extent that the contractual right is required by Regulation O (*12 CFR 215.5*) or other federal law.

3. Relationship to payment schedule disclosures. As provided in § 226.18(g)(1), in demand obligations with no alternate maturity date, the creditor need only disclose the due dates or payment periods of any scheduled interest payments for the first year. If the demand obligation states an alternate maturity, however, the disclosed payment schedule must reflect that stated term; the special rule in § 226.18(g)(1) is not available.

Paragraph 18(j) Total sale price.

1. Disclosure required. In a credit sale transaction, the total sale price must be disclosed using that term, along with a descriptive explanation similar to the one in the regulation. For variable rate transactions, the descriptive phrase may, at the creditor's option, be modified to reflect the variable rate feature. For example, the descriptor may read: "The total cost of your purchase on credit, which is subject to change, including your downpayment of * * *." The reference to a downpayment may be eliminated in transactions calling for no downpayment.

2. Calculation of total sale price. The figure to be disclosed is the sum of the cash price, other charges added under § 226.18(b)(2), and the finance charge disclosed under § 226.18(d).

3. Effect of existing liens. When a credit sale transaction involves property that is being used as a trade-in (an automobile, for example) and that has a lien exceeding the value of the trade-in, the total sale price is affected by the amount of any cash provided. (See comment 2(a)(18)-3.) To illustrate, assume a consumer finances the purchase of an automobile with a cash price of $20,000. Another vehicle used as a trade-in has a value of $8,000 but has an existing lien of $10,000, leaving a $2,000 deficit that the consumer must finance.

i. If the consumer pays $1,500 in cash, the creditor may apply the cash first to the lien, leaving a $500 deficit, and reflect a downpayment of $0. The total sale price would include the $20,000 cash price, an additional $500 financed under § 226.18(b)(2), and the amount of the finance charge. Alternatively, the creditor may reflect a downpayment of $1,500 and finance the $2,000 deficit. In that case, the total sale price would include the sum of the $20,000 cash price, the $2,000 lien payoff amount as an additional amount financed, and the amount of the finance charge.

ii. If the consumer pays $3,000 in cash, the creditor may apply the cash first to extinguish the lien and reflect the remainder as a downpayment of $1,000. The total sale price would reflect the $20,000 cash price and the amount of the finance charge. (The cash payment extinguishes the trade-in deficit and no charges are added under § 226.18(b)(2).) Alternatively, the creditor may elect to reflect a downpayment of $3,000 and finance the $2,000 deficit. In that case, the total sale price would include the sum of the $20,000 cash price, the $2,000 lien payoff amount as an additional amount financed, and the amount of the finance charge.

Paragraph 18(k) Prepayment.

1. Disclosure required. The creditor must give a definitive statement of whether or not a penalty will be imposed or a rebate will be given.

- The fact that no penalty will be imposed may not simply be inferred from the absence of a penalty disclosure; the creditor must indicate that prepayment will not result in a penalty.

- If a penalty or refund is possible for one type of prepayment, even though not for all, a positive disclosure is required. This applies to any type of prepayment, whether voluntary or involuntary as in the case of prepayments resulting from acceleration.

- Any difference in rebate or penalty policy, depending on whether prepayment is voluntary or not,

must not be disclosed with the segregated disclosures.

2. Rebate-penalty disclosure. A single transaction may involve both a precomputed finance charge and a finance charge computed by application of a rate to the unpaid balance (for example, mortgages with mortgage-guarantee insurance). In these cases, disclosures about both prepayment rebates and penalties are required. Sample form H-15 in appendix H illustrates a mortgage transaction in which both rebate and penalty disclosures are necessary.

3. Prepaid finance charge. The existence of a prepaid finance charge in a transaction does not, by itself, require a disclosure under § 226.18(k). A prepaid finance charge is not considered a penalty under § 226.18(k)(1), nor does it require a disclosure under § 226.18(k)(2). At its option, however, a creditor may consider a prepaid finance charge to be under § 226.18(k)(2). If a disclosure is made under § 226.18(k)(2) with respect to a prepaid finance charge or other finance charge, the creditor may further identify that finance charge. For example, the disclosure may state that the borrower "will not be entitled to a refund of the prepaid finance charge" or some other term that describes the finance charge.

Paragraph 18(k)(1)

1. Penalty. This applies only to those transactions in which the interest calculation takes account of all scheduled reductions in principal, as well as transactions in which interest calculations are made daily. The term penalty as used here encompasses only those charges that are assessed strictly because of the prepayment in full of a simple-interest obligation, as an addition to all other amounts. Items which are penalties include, for example:

- Interest charges for any period after prepayment in full is made. (See the commentary to § 226.17(a)(1) regarding disclosure of interest charges assessed for periods after prepayment in full as directly related information.)

- A minimum finance charge in a simple-interest transaction. (See the commentary to § 226.17(a)(1) regarding the disclosure of a minimum finance charge as directly related information.) Items which are not penalties include, for example, loan guarantee fees.

Paragraph 18(k)(2).

1. Rebate of finance charge. This applies to any finance charges that do not take account of each reduction in the principal balance of an obligation. This category includes, for example:

- Precomputed finance charges such as add-on charges.

- Charges that take account of some but not all reductions in principal, such as mortgage guarantee insurance assessed on the basis of an annual declining balance, when the principal is reduced on a monthly basis.

No description of the method of computing earned or unearned finance charges is required or permitted as part of the segregated disclosures under this section.

Paragraph 18(l) Late payment.

1. Definition. This paragraph requires a disclosure only if charges are added to individual delinquent installments by a creditor who otherwise considers the transaction ongoing on its original terms. Late payment charges do not include:

- The right of acceleration.
- Fees imposed for actual collection costs, such as repossession charges or attorney's fees.
- Deferral and extension charges.
- The continued accrual of simple interest at the contract rate after the payment due date. However, an increase in the interest rate is a late payment charge to the extent of the increase.

2. Content of disclosure. Many state laws authorize the calculation of late charges on the basis of either a percentage or a specified dollar amount, and permit imposition of the lesser or greater of the 2 charges. The disclosure made under § 226.18(l) may reflect this alternative. For example, stating that the charge in the event of a late payment is 5% of the late amount, not to exceed $5.00, is sufficient. Many creditors also permit a grace period during which no late charge will be assessed; this fact may be disclosed as directly related information. (See the commentary to § 226.17(a).)

Paragraph 18(m) Security interest.

1. Purchase money transactions. When the collateral is the item purchased as part of, or with the proceeds of, the credit transaction, section 226.18(m) requires only a general identification such as "the property purchased in this transaction." However, the creditor may identify the property by item or type instead of identifying it more generally with a phrase such as "the property purchased in this transaction." For example, a creditor may identify collateral as "a motor vehicle," or as "the property purchased in this transaction." Any transaction in which the credit is being used to purchase the collateral is considered a purchase money transaction and the abbreviated identification may be used, whether the obligation is treated as a loan or a credit sale.

2. Nonpurchase money transactions. In nonpurchase money transactions, the property subject to the security interest must be identified by item or type. This disclosure is satisfied by a general disclosure of the category of property subject to the security interest, such as "motor vehicles," "securities," "certain household items," or "household goods." (Creditors should be aware, however, that the Federal credit practices rules, as well as some state laws, prohibit certain security interests in household goods.) At the creditor's option, however, a more precise identification of the property or goods may be provided.

3. Mixed collateral. In some transactions in which the credit is used to purchase the collateral, the creditor may also take other property of the consumer as security. In those cases, a combined disclosure must be provided, consisting of an identification of the purchase money collateral consistent with comment 18(m)-1 and a specific identification of the other collateral consistent with comment 18(m)-2.

4. After-acquired property. An after-acquired *property clause* is not a security interest to be disclosed under § 226.18(m).

5. Spreader clause. The fact that collateral for pre-existing credit with the institution is being used to secure the present obligation constitutes a security interest and must be disclosed. (Such security interests may be known as "spreader" or "dragnet" clauses, or as "cross-collateralization" clauses.) A specific identification of that collateral is unnecessary but a reminder of the interest arising from the prior indebtedness is required. The disclosure may be made by using language such as "collateral securing other loans with us may also secure this loan." At the creditor's option, a more specific description of the property involved may be given.

6. Terms used in disclosure. No specified terminology is required in disclosing a security interest. Although the disclosure may, at the creditor's option, use the term security interest, the creditor may designate its interest by using, for example, pledge, lien, or mortgage.

7. Collateral from third party. In certain transactions, the consumer's obligation may be secured by collateral belonging to a third party. For example, a loan to a student may be secured by an interest in the property of the student's parents. In such cases, the security interest is taken in connection with the transaction and must be disclosed, even though the property encumbered is owned by someone other than the consumer.

18(n) Insurance and debt cancellation.

1. Location. This disclosure may, at the creditor's option, appear apart from the other disclosures. It may appear with any other information, including the amount financed itemization, any information prescribed by state law, or other supplementary material. When this information is disclosed with the other segregated disclosures, however, no additional explanatory material may be included.

2. Debt cancellation. Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law. Otherwise, they may provide a parallel disclosure that refers to debt cancellation coverage.

Paragraph 18(o) Certain security interest charges.

1. Format. No special format is required for these disclosures; under § 226.4(e), taxes and fees paid to government officials with respect to a security interest may be aggregated, or may be broken down by individual charge. For example, the disclosure could be labelled "filing fees and taxes" and all funds disbursed for such purposes may be aggregated in a single disclosure. This disclosure may appear, at the creditor's option, apart from the other required disclosures. The inclusion of this information on a statement required under the Real Estate Settlement Procedures Act

is sufficient disclosure for purposes of Truth in Lending.

Paragraph 18(p) Contract reference.

1. Content. Creditors may substitute, for the phrase "appropriate contract document," a reference to specific transaction documents in which the additional information is found, such as "promissory note" or "retail installment sale contract." A creditor may, at its option, delete inapplicable items in the contract reference, as for example when the contract documents contain no information regarding the right of acceleration.

Paragraph 18(q) Assumption policy.

1. Policy statement. In many mortgages, the creditor cannot determine, at the time disclosure must be made, whether a loan may be assumable at a future date on its original terms. For example, the assumption clause commonly used in mortgages sold to the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation conditions an assumption on a variety of factors such as the creditworthiness of the subsequent borrower, the potential for impairment of the lender's security, and execution of an assumption agreement by the subsequent borrower. In cases where uncertainty exists as to the future assumability of a mortgage, the disclosure under § 226.18(q) should reflect that fact. In making disclosures in such cases, the creditor may use phrases such as "subject to conditions," "under certain circumstances," or "depending on future conditions." The creditor may provide a brief reference to more specific criteria such as a due-on-sale clause, although a complete explanation of all conditions is not appropriate. For example, the disclosure may state, "Someone buying your home may be allowed to assume the mortgage on its original terms, subject to certain conditions, such as payment of an assumption fee." See comment 17(a)(1)-5 for an example for a reference to a due-on-sale clause.

2. Original terms. The phrase original terms for purposes of § 226.18(q) does not preclude the imposition of an assumption fee, but a modification of the basic credit agreement, such as a change in the contract interest rate, represents different terms.

Paragraph 18(r) Required deposit.

1. Disclosure required. The creditor must inform the consumer of the existence of a required deposit. (Appendix H provides a model clause that may be used in making that disclosure.) Footnote 45 describes 3 types of deposits that need not be considered required deposits. Use of the phrase "need not" permits creditors to include the disclosure even in cases where there is doubt as to whether the deposit constitutes a required deposit.

2. Pledged account mortgages. In these transactions, a consumer pledges as collateral funds that the consumer deposits in an account held by the creditor. The creditor withdraws sums from that account to supplement the consumer's periodic payments. Creditors may treat these pledged accounts as required deposits or they may treat them as consumer buydowns in accordance with the commentary to § 226.17(c)(1).

3. Escrow accounts. The escrow exception in footnote 45 applies, for example, to accounts for such items as maintenance fees, repairs, or improvements, whether in a realty or a nonrealty transaction. (See the commentary to § 226.17(c)(1) regarding the use of escrow accounts in consumer buydown transactions.)

4. Interest-bearing accounts. When a deposit earns at least 5 percent interest per year, no disclosure is required under § 226.18(r). This exception applies whether the deposit is held by the creditor or by a third party.

5. Morris Plan transactions. A deposit under a Morris Plan, in which a deposit account is created for the sole purpose of accumulating payments and this is applied to satisfy entirely the consumer's obligation in the transaction, is not a required deposit.

6. Examples of amounts excluded. The following are among the types of deposits that need not be treated as required deposits:

- Requirement that a borrower be a customer or a member even if that involves a fee or a minimum balance.
- Required property insurance escrow on a mobile home transaction.
- Refund of interest when the obligation is paid in full.
- Deposits that are immediately available to the consumer.
- Funds deposited with the creditor to be disbursed (for example, for construction) before the loan proceeds are advanced.
- Escrow of condominium fees.
- Escrow of loan proceeds to be released when the repairs are completed.

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Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART III OF III)

1B- Consumer Credit Law Manual § 226.19

§ 226.19 Certain Mortgage and Variable-Rate Transactions

19(a)(1)(i) Time of disclosure.

1. Coverage. This section requires early disclosure of credit terms in mortgage transactions that are secured by a consumer's dwelling (other than home equity lines of credit subject to § 226.5b or mortgage transactions secured by an interest in a timeshare plan) that are also subject to the Real Estate Settlement Procedures Act (RESPA) and its implementing Regulation X, administered by the Department of Housing and Urban Development (HUD). To be covered by § 226.19, a transaction must be a Federally related mortgage loan under RESPA. "Federally related mortgage loan" is defined under RESPA (*12 U.S.C. 2602*) and Regulation X (*24 CFR 3500.2*), and is subject to any interpretations by HUD.

2. Timing and use of estimates. The disclosures required by § 226.19(a)(1)(i) must be delivered or mailed not later than three business days after the creditor receives the consumer's written application. The general definition of "business day" in § 226.2(a)(6)--a day on which the creditor's offices are open to the public for substantially all of its business functions--is used for purposes of § 226.19(a)(1)(i). See comment 2(a)(6)-1. This general definition is consistent with the definition of "business day" in HUD's Regulation X--a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions. See *24 CFR 3500.2* . Accordingly, the three-business-day period in § 226.19(a)(1)(i) for making early disclosures coincides with the time period within which creditors subject to RESPA must provide good faith estimates of settlement costs. If the creditor does not know the precise credit terms, the creditor must base the disclosures on the best information reasonably available and indicate that the disclosures are estimates under § 226.17(c)(2). If many of the disclosures are estimates, the creditor may include a statement to that effect (such as "all numerical disclosures except the late-payment disclosure are estimates") instead of separately labelling each estimate. In the alternative, the creditor may label as an estimate only the items primarily affected by unknown information. (See the commentary to § 226.17(c)(2).) The creditor may provide explanatory material concerning the estimates and the contingencies that may affect the actual terms, in accordance with the commentary to § 226.17(a)(1).

3. Written application. Creditors may rely on RESPA and Regulation X (including any interpretations issued by HUD) in deciding whether a "written application" has been received. In general, Regulation X defines "application" to mean the submission of a borrower's financial information in anticipation of a credit decision relating to a Federally related mortgage loan. See *24 CFR 3500.2(b)* . An application is received when it reaches the creditor in any of the ways applications are normally transmitted--by mail, hand delivery, or through an intermediary agent or broker. (See comment 19(b)-3 for guidance in determining whether or not the transaction involves an intermediary agent or broker.) If an application reaches the creditor through an intermediary agent or broker, the application is received when it reaches the creditor, rather than when it reaches the agent or broker.

4. Denied or withdrawn applications. The creditor may determine within the three-business-day period that the application will not or cannot be approved on the terms requested, as, for example, when a consumer applies for a type or amount of credit that the creditor does not offer, or the consumer's application cannot be approved for some other reason. In that case, or if the consumer withdraws the application within the three-business-day period, the creditor need not make the disclosures under this section. If the creditor fails to provide early disclosures and the transaction is later consummated on the original terms, the creditor will be in violation of this provision. If, however, the consumer amends the application because of the creditor's unwillingness to approve it on its original terms, no violation occurs for not providing disclosures based on the original terms. But the amended application is a new application subject to § 226.19(a)(1)(i).

5. Itemization of amount financed. In many mortgage transactions, the itemization of the amount financed required by § 226.18(c) will contain items, such as origination fees or points, that also must be disclosed as part of the good faith estimates of settlement costs required under RESPA. Creditors furnishing the RESPA good faith estimates need not give consumers any itemization of the amount financed.

19(a)(1)(ii) Imposition of fees.

1. Timing of fees. The consumer must receive the disclosures required by this section before paying or incurring any fee imposed by a creditor or other person in connection with the consumer's application for a mortgage transaction that is subject to § 226.19(a)(1)(i), except as provided in § 226.19(a)(1)(iii). If the creditor delivers the disclosures to the consumer in person, a fee may be imposed anytime after delivery. If the creditor places the disclosures in the mail, the creditor may impose a fee after the consumer receives the disclosures or, in all cases, after midnight on the third business day following mailing of the disclosures. For purposes of § 226.19(a)(1)(ii), the term "business day" means all calendar days except Sundays and legal public holidays referred to in § 226.2(a)(6). See Comment 2(a)(6)-2. For example, assuming that there are no intervening legal public holidays, a creditor that receives the consumer's written application on Monday and mails the early mortgage loan disclosure on Tuesday may impose a fee on the consumer after midnight on Friday.

2. Fees restricted. A creditor or other person may not impose any fee, such as for an appraisal, underwriting, or broker services, until the consumer has received the disclosures required by § 226.19(a)(1)(i). The only exception to the fee restriction allows the creditor or other person to impose a bona fide and reasonable fee for obtaining a consumer's credit history, such as for a credit report(s).

3. Collection of fees. A creditor complies with § 226.19(a)(1)(ii) if --

i. The creditor receives a consumer's written application directly from the consumer and does not collect any fee, other than a fee for obtaining a consumer's credit history, until the consumer receives the early mortgage loan disclosure.

ii. A third party submits a consumer's written application to a creditor and both the creditor and third party do not collect any fee, other than a fee for obtaining a consumer's credit history, until the consumer receives the early mortgage loan disclosure from the creditor.

iii. A third party submits a consumer's written application to a second creditor following a prior creditor's denial of an application made by the same consumer (or following the consumer's withdrawal), and, if a fee already has been assessed, the new creditor or third party does not collect or impose any additional fee until the consumer receives an early mortgage loan disclosure from the new creditor.

19(a)(1)(iii) Exception to fee restriction.

1. Requirements. A creditor or other person may impose a fee before the consumer receives the required disclosures if it is for obtaining the consumer's credit history, such as by purchasing a credit report(s) on the consumer. The fee also must be bona fide and reasonable in amount. For example, a creditor may collect a fee for obtaining a credit report(s) if it is in the creditor's ordinary course of business to obtain a credit report(s). If the criteria in § 226.19(a)(1)(iii) are met, the creditor may describe or refer to this fee, for example, as an "application fee."

19(a)(2) Waiting period(s) required.

1. Business day definition.

For purposes of § 226.19(a)(2), "business day" means all calendar days except Sundays and the legal public holidays referred to in § 226.2(a)(6). See comment 2(a)(6)-2.

2. Consummation after both waiting periods expire. Consummation may not occur until both the seven-business-day waiting period and the three-business-day waiting period have expired. For example, assume a creditor delivers the early disclosures to the consumer in person or places them in the mail on Monday, June 1, and the creditor then delivers corrected disclosures in person to the consumer on Wednesday, June 3. Although Saturday, June 6 is the third business day after the consumer received the corrected disclosures, consummation may not occur before Tuesday, June 9, the seventh business day following delivery or mailing of the early disclosures.

19(a)(2)(i) Seven-business-day waiting period.

1. Timing. The disclosures required by § 226.19(a)(1)(i) must be delivered or placed in the mail no later than the seventh business day before consummation. The seven-business-day waiting period begins when the creditor delivers the early disclosures or places them in the mail, not when the consumer receives or is deemed to have received the early disclosures. For example, if a creditor delivers the early disclosures to the consumer in person or places them in the mail on Monday, June 1, consummation may occur on or after Tuesday, June 9, the seventh business day following delivery or mailing of the early disclosures.

19(a)(2)(ii) Three-business-day waiting period.

1. Conditions for redisclosure. If, at the time of consummation, the annual percentage rate disclosed is accurate under § 226.22, the creditor does not have to make corrected disclosures under § 226.19(a)(2). If, on the other hand, the annual percentage rate disclosed is not accurate under § 226.22, the creditor must make corrected disclosures of all changed terms (including the annual percentage rate) so that the consumer receives them not later than the third business day before consummation. For example, assume consummation is scheduled for Thursday, June 11 and the early disclosures for a regular mortgage transaction disclose an annual percentage rate of 7.00%:

- On Thursday, June 11, the annual percentage rate will be 7.10%. The creditor is not required to make corrected disclosures under § 226.19(a)(2).

- On Thursday, June 11, the annual percentage rate will be 7.15%. The creditor must make corrected disclosures so that the consumer receives them on or before Monday, June 8.

2. Content of new disclosures. If redisclosure is required, the creditor may provide a complete set of new disclosures, or may redisclose only the changed terms. If the creditor chooses to provide a complete set of new disclosures, the creditor may but need not highlight the new terms, provided that the disclosures comply with the format requirements of § 226.17(a). If the creditor chooses to disclose only the new terms, all the new terms must be disclosed. For example, a different annual percentage rate will almost always produce a different finance charge, and often a new schedule of payments; all of these changes would have to be disclosed. If, in addition, unrelated terms such as the amount financed or prepayment penalty vary from those originally disclosed, the accurate terms must be disclosed. However, no new disclosures are required if the only inaccuracies involve estimates other than the annual percentage rate, and no variable rate feature has been added. For a discussion of the requirement to redisclose when a variable-rate feature is added, See comment 17(f)-2. For a discussion of redisclosure requirements in general, See the commentary on § 226.17(f). 3. Timing. When redisclosures are necessary because the annual percentage rate has become inaccurate, they must be received by the consumer no later than the third business day before consummation. (For redisclosures triggered by other events, the creditor must provide corrected disclosures before consummation. See *§ 226.17*(f).) If the creditor delivers the corrected disclosures to the consumer in person, consummation may occur any time on the third business day following delivery. If the creditor provides the corrected disclosures by mail, the consumer is considered to have received them three business days after they are placed in the mail, for purposes of determining when the three-business-day waiting period required under § 226.19(a)(2)(ii) begins. Creditors that use electronic mail or a courier other than the postal service may also follow this approach.

4. Basis for annual percentage rate comparison. To determine whether a creditor must make corrected disclosures under § 226.22, a creditor compares (a) what the annual percentage rate will be at consummation to (b) the annual

percentage rate stated in the most recent disclosures the creditor made to the consumer. For example, assume consummation for a regular mortgage transaction is scheduled for Thursday, June 11, the early disclosures provided in May stated an annual percentage rate of 7.00%, and corrected disclosures received by the consumer on Friday, June 5 stated an annual percentage rate of 7.15%:

i. On Thursday, June 11, the annual percentage rate will be 7.25%, which exceeds the most recently disclosed annual percentage rate by less than the applicable tolerance. The creditor is not required to make additional corrected disclosures or wait an additional three business days under § 226.19(a)(2).

ii. On Thursday, June 11, the annual percentage rate will be 7.30%, which exceeds the most recently disclosed annual percentage rate by more than the applicable tolerance. The creditor must make corrected disclosures such that the consumer receives them on or before Monday, June 8.

19(a)(3) Consumer's waiver of waiting period before consummation.

1. Modification or waiver. A consumer may modify or waive the right to a waiting period required by § 226.19(a)(2) only after the creditor makes the disclosures required by § 226.18. The consumer must have a bona fide personal financial emergency that necessitates consummating the credit transaction before the end of the waiting period. Whether these conditions are met is determined by the facts surrounding individual situations. The imminent sale of the consumer's home at foreclosure, where the foreclosure sale will proceed unless loan proceeds are made available to the consumer during the waiting period, is one example of a bona fide personal financial emergency. Each consumer who is primarily liable on the legal obligation must sign the written.

2. Examples of waivers within the seven-business-day waiting period Assume the early disclosures are delivered to the consumer in person on Monday, June 1, and at that time the consumer executes a waiver of the seven-business-day waiting period (which would end on Tuesday, June 9) so that the loan can be consummated on Friday, June 5:

i. If the annual percentage rate on the early disclosures is inaccurate under § 226.22, the creditor must provide a corrected disclosure to the consumer before consummation, which triggers the three-business-day waiting period in § 226.19(a)(2)(ii). After the consumer receives the corrected disclosure, the consumer must execute a waiver of the three-business-day waiting period in order to consummate the transaction on Friday, June 5.

ii. If a change occurs that does not render the annual percentage rate on the early disclosures inaccurate under § 226.22, the creditor must disclose the changed terms before consummation, consistent with § 226.17(f). Disclosure of the changed terms does not trigger an additional waiting period, and the transaction may be consummated on June 5 without the consumer giving the creditor an additional modification or waiver.

3. Examples of waivers made after the seven-business-day waiting period. Assume the early disclosures are delivered to the consumer in person on Monday, June 1 and consummation is scheduled for Friday, June 19. On Wednesday, June 17, a change to the annual percentage rate occurs:

i. If the annual percentage rate on the early disclosures is inaccurate under § 226.22, the creditor must provide a corrected disclosure to the consumer before consummation, which triggers the three-business-day waiting period in § 226.19(a)(2). After the consumer receives the corrected disclosure, the consumer must execute a waiver of the three-business-day waiting period in order to consummate the transaction on Friday, June 19.

ii. If a change occurs that does not render the annual percentage rate on the early disclosures inaccurate under § 226.22, the creditor must disclose the changed terms before consummation, consistent with § 226.17(f). Disclosure of the changed terms does not trigger an additional waiting period, and the transaction may be consummated on Friday, June 19 without the consumer giving the creditor an additional modification or waiver.

19(a)(4) Notice

1. Inclusion in other disclosures. The notice required by § 226.19(a)(4) must be grouped together with the disclosures required by § 226.19(a)(1)(i) or § 226.19(a)(2). See comment 17(a)(1)-2 for a discussion of the rules for segregating disclosures. In other cases, the notice set forth in § 226.19(a)(4) may be disclosed together with or separately from the disclosures required under § 226.18. See comment 17(a)(1)-5(xvi).

19(a)(5)(ii) Time of disclosures for timeshare plans.

1. Timing. A mortgage transaction secured by a consumer's interest in a "timeshare plan," as defined in *11 U.S.C. 101(53D)* , that is also a Federally related mortgage loan under RESPA is subject to the requirements of § 226.19(a)(5) instead of the requirements of § 226.19(a)(1) through § 226.19(a)(4). See comment 19(a)(1)(i)-1. Early disclosures for transactions subject to § 226.19(a)(5) must be given (a) before consummation or (b) within three business days after the creditor receives the consumer's written application, whichever is earlier. The general definition of "business day" in § 226.2(a)(6)--a day on which the creditor's offices are open to the public for substantially all of its business functions--applies for purposes of § 226.19(a)(5)(ii). See comment 2(a)(6)-1. These timing requirements are different from the timing requirements under § 226.19(a)(1)(i). Timeshare transactions covered by § 226.19(a)(5) may be consummated any time after the disclosures required by § 226.19(a)(5)(ii) are provided.

2. Use of estimates. If the creditor does not know the precise credit terms, the creditor must base the disclosures on the best information reasonably available and indicate that the disclosures are estimates under § 226.17(c)(2). If many of the disclosures are estimates, the creditor may include a statement to that effect (such as "all numerical disclosures except the late-payment disclosure are estimates") instead of separately labelling each estimate. In the alternative, the creditor may label as an estimate only the items primarily affected by unknown information. (See the commentary to § 226.17(c)(2).) The creditor may provide explanatory material concerning the estimates and the contingencies that may affect the actual terms, in accordance with the commentary to § 226.17(a)(1).

3. Written application. For timeshare transactions, creditors may rely on comment 19(a)(1)(i)-3 in determining whether a "written application" has been received.

4. Denied or withdrawn applications. For timeshare transactions, creditors may rely on comment 19(a)(1)(i)-4 in determining that disclosures are not required by § 226.19(a)(5)(ii) because the consumer's application will not or cannot be approved on the terms requested or the consumer has withdrawn the application.

5. Itemization of amount financed. For timeshare transactions, creditors may rely on comment 19(a)(1)(i)-5 in determining whether providing the good faith estimates of settlement costs required by RESPA satisfies the requirement of § 226.18(c) to provide an itemization of the amount financed.

19(a)(5)(iii) Redisclosure for timeshare plans.

1. Consummation or settlement. For extensions of credit secured by a consumer's timeshare plan, when corrected disclosures are required, they must be given no later than "consummation or settlement." "Consummation" is defined in § 226.2(a). "Settlement" is defined in Regulation X *(24 CFR 3500.2(b)*) and is subject to any interpretations issued by HUD. In some cases, a creditor may delay redisclosure until settlement, which may be at a time later than consummation. If a creditor chooses to redisclose at settlement, disclosures may be based on the terms in effect at settlement, rather than at consummation. For example, in a variable-rate transaction, a creditor may choose to base disclosures on the terms in effect at settlement, despite the general rule in comment 17(c)(1)-8 that variable-rate disclosures should be based on the terms in effect at consummation.

2. Content of new disclosures Creditors may rely on comment 19(a)(2)(ii)-2 in determining the content of corrected disclosures required under § 226.19(a)(5)(iii).

19(b) Certain variable-rate transactions.

1. Coverage. Section 226.19(b) applies to all closed-end variable-rate transactions that are secured by the consumer's principal dwelling and have a term greater than one year. The requirements of this section apply not only to transactions financing the initial acquisition of the consumer's principal dwelling, but also to any other closed-end variable-rate transaction secured by the principal dwelling. Closed-end variable-rate transactions that are not secured by the principal dwelling, or are secured by the principal dwelling but have a term of one year or less, are subject to the disclosure requirements of § 226.18(f)(1) rather than those of § 226.19(b). (Furthermore, "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of § 226.18(f)(1) rather than those of § 226.19(b) regardless of the general coverage of those sections.) For purposes of this section, the term of a variable-rate demand loan is determined in accordance with the commentary to § 226.17(c)(5). In determining whether a construction loan that may be permanently financed by the same creditor is covered under this section, the creditor may treat the construction and the permanent phases as separate transactions with distinct terms to maturity or as a single combined transaction. For purposes of the disclosures required under § 226.18, the creditor may nevertheless treat the two phases

either as separate transactions or as a single combined transaction in accordance with § 226.17(c)(6). Finally, in any assumption of a variable-rate transaction secured by the consumer's principal dwelling with a term greater than one year, disclosures need not be provided under §§ 226.18(f)(2)(ii) or 226.19(b).

2. Timing. A creditor must give the disclosures required under this section at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier.

i. Intermediary agent or broker. In cases where a creditor receives a written application through an intermediary agent or broker, however, footnote 45b provides a substitute timing rule requiring the creditor to deliver the disclosures or place them in the mail not later than three business days after the creditor receives the consumer's written application. (See comment 19(b)-3 for guidance in determining whether or not the transaction involves an intermediary agent or broker.) This three-day rule also applies where the creditor takes an application over the telephone.

ii. Telephone request. In cases where the consumer merely requests an application over the telephone, the creditor must include the early disclosures required under this section with the application that is sent to the consumer.

iii. Mail solicitations. In cases where the creditor solicits applications through the mail, the creditor must also send the disclosures required under this section if an application form is included with the solicitation.

iv. Conversion. In cases where an open-end credit account will convert to a closed-end transaction subject to this section under a written agreement with the consumer, disclosures under this section may be given at the time of conversion. (See the commentary to § 226.20(a) for information on the timing requirements for § 226.19(b)(2) disclosures when a variable-rate feature is later added to a transaction.)

v. Form of electronic disclosures provided on or with electronic applications. Creditors must provide the disclosures required by this section (including the brochure) on or with a blank application that is made available to the consumer in electronic form, such as on a creditor's Internet Web site. Creditors have flexibility in satisfying this requirement. Methods creditors could use to satisfy the requirement include, but are not limited to, the following examples:

A. The disclosures could automatically appear on the screen when the application appears;

B. The disclosures could be located on the same web page as the application (whether or not they appear on the initial screen), if the application contains a clear and conspicuous reference to the location of the disclosures and indicates that the disclosures contain rate, fee, and other cost information, as applicable;

C. Creditors could provide a link to the electronic disclosures on or with the application as long as consumers cannot bypass the disclosures before submitting the application. The link would take the consumer to the disclosures, but the consumer need not be required to scroll completely through the disclosures; or

D. The disclosures could be located on the same web page as the application without necessarily appearing on the initial screen, immediately preceding the button that the consumer will click to submit the application.

Whatever method is used, a creditor need not confirm that the consumer has read the disclosures.

3. Intermediary agent or broker. In certain transactions involving an "intermediary agent or broker," a creditor may delay providing disclosures. A creditor may not delay providing disclosures in transactions involving either a legal agent (as determined by applicable law) or any other third party that is not an "intermediary agent or broker." In determining whether or not a transaction involves an "intermediary agent or broker" the following factors should be considered:

- The number of applications submitted by the broker to the creditor as compared to the total number of applications received by the creditor. The greater the percentage of total loan applications submitted by the broker in any given period of time, the less likely it is that the broker would be considered an "intermediary agent or broker" of the creditor during the next period.

- The number of applications submitted by the broker to the creditor as compared to the total number of applications received by the broker. (This factor is applicable only if the creditor has such information.) The greater the percentage of total loan applications received by the broker that is submitted to a creditor in any given period of time, the less likely it is that the broker would be considered an "intermediary agent or broker" of the creditor during the next period.

- The amount of work (such as document preparation) the creditor expects to be done by the broker on an application based on the creditor's prior dealings with the broker and on the creditor's requirements for accepting applications, taking into consideration the customary practice of brokers in a particular area. The more work that the creditor expects the broker to do on an application, in excess of what is usually expected of a broker in that area, the less likely it is that the broker would be considered an "intermediary agent or broker" of the creditor.

An example of an "intermediary agent or broker" is a broker who, customarily within a brief period of time after receiving an application, inquires about the credit terms of several creditors with whom the broker does business and submits the application to one of them. The broker is responsible for only a small percentage of the applications received by that creditor. During the time the broker has the application, it might request a credit report and an appraisal (or even prepare an entire loan package if customary in that particular area).

4. Other variable-rate regulations. Transactions in which the creditor is required to comply with and has complied with the disclosure requirements of the variable-rate regulations of other Federal agencies are exempt from the requirements of § 226.19(b), by virtue of footnote 45a, and are exempt from the requirements of § 226.20(c), by virtue of footnote 45c. Those variable-rate regulations include the regulations issued by the Federal Home Loan Bank Board

and those issued by the Department of Housing and Urban Development. The exception in footnotes 45a and 45c is also available to creditors that are required by state law to comply with the federal variable-rate regulations noted above and to creditors that are authorized by title VIII of the Depository Institutions Act of 1982 (*12 U.S.C. 3801 et seq.*) to make loans in accordance with those regulations. Creditors using this exception should comply with the timing requirements of those regulations rather than the timing requirements of Regulation Z in making the variable-rate disclosures.

5. Examples of variable-rate transactions.

i. The following transactions, if they have a term greater than one year and are secured by the consumer's principal dwelling, constitute variable-rate transactions subject to the disclosure requirements of § 226.19(b).

A. Renewable balloon-payment instruments where the creditor is both unconditionally obligated to renew the balloon-payment loan at the consumer's option (or is obligated to renew subject to conditions within the consumer's control) and has the option of increasing the interest rate at the time of renewal. (See comment 17(c)(1)-11 for a discussion of conditions within a consumer's control in connection with renewable balloon-payment loans.)

B. Preferred-rate loans where the terms of the legal obligation provide that the initial underlying rate is fixed but will increase upon the occurrence of some event, such as an employee leaving the employ of the creditor, and the note reflects the preferred rate. The disclosures under §§ 226.19(b)(1) and 226.19(b)(2)(v), (viii), (ix), and (xii) are not applicable to such loans.

C. "Price-level-adjusted mortgages" or other indexed mortgages that have a fixed rate of interest but provide for periodic adjustments to payments and the loan balance to reflect changes in an index measuring prices or inflation. The disclosures under § 226.19(b)(1) are not applicable to such loans, nor are the following provisions to the extent they relate to the determination of the interest rate by the addition of a margin, changes in the interest rate, or interest-rate discounts: Section 226.19(b)(2)(i), (iii), (iv), (v), (vi), (vii), (viii), and (ix). (See comments 20(c)-2 and 30-1 regarding the inapplicability of variable-rate adjustment notices and interest-rate limitations to price-level-adjusted or similar mortgages.)

ii. Graduated-payment mortgages and step-rate transactions without a variable-rate feature are not considered variable-rate transactions.

Paragraph 19(b)(1).

1. Substitute. Creditors who wish to use publications other than the Consumer Handbook on Adjustable Rate Mortgages must make a good faith determination that their brochures are suitable substitutes to the Consumer Handbook. A substitute is suitable if it is, at a minimum, comparable to the Consumer Handbook in substance and

comprehensiveness. Creditors are permitted to provide more detailed information than is contained in the Consumer Handbook.

2. Applicability. The Consumer Handbook need not be given for variable-rate transactions subject to this section in which the underlying interest rate is fixed. (See comment 19(b)-5 for an example of a variable-rate transaction where the underlying interest rate is fixed.)

Paragraph 19(b)(2).

1. Disclosure for each variable-rate program. A creditor must provide disclosures to the consumer that fully describe each of the creditor's variable-rate loan programs in which the consumer expresses an interest. If a program is made available only to certain customers of an institution, a creditor need not provide disclosures for that program to other consumers who express a general interest in a creditor's ARM programs. Disclosures must be given at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier. If program disclosures cannot be provided because a consumer expresses an interest in individually negotiating loan terms that are not generally offered, disclosures reflecting those terms may be provided as soon as reasonably possible after the terms have been decided upon, but not later than the time a non-refundable fee is paid. If a consumer who has received program disclosures subsequently expresses an interest in other available variable-rate programs subject to 226.19(b)(2), or the creditor and consumer decide on a program for which the consumer has not received disclosures, the creditor must provide appropriate disclosures as soon as reasonably possible. The creditor, of course, is permitted to give the consumer information about additional programs subject to § 226.19(b) initially.

2. Variable-rate loan program defined.

i. Generally, if the identification, the presence or absence, or the exact value of a loan feature must be disclosed under this section, variable-rate loans that differ as to such features constitute separate loan programs. For example, separate loan programs would exist based on differences in any of the following loan features

A. The index or other formula used to calculate interest rate adjustments.

B. The rules relating to changes in the index value, interest rate, payments, and loan balance.

C. The presence or absence of, and the amount of, rate or payment caps.

D. The presence of a demand feature.

E. The possibility of negative amortization.

F. The possibility of interest rate carryover.

G. The frequency of interest rate and payment adjustments.

H. The presence of a discount feature.

I. In addition, if a loan feature must be taken into account in preparing the disclosures required by § 226.19(b)(2)(viii), variable-rate loans that differ as to that feature constitute separate programs under § 226.19(b)(2).

ii. If, however, a representative value may be given for a loan feature or the feature need not be disclosed under § 226.19(b)(2), variable-rate loans that differ as to such features do not constitute separate loan programs. For example, separate programs would not exist based on differences in the following loan features:

A. The amount of a discount.

B. The amount of a margin.

3. Form of program disclosures. A creditor may provide separate program disclosure forms for each ARM program it offers or a single disclosure form that describes multiple programs. A disclosure form may consist of more than one page. For example, a creditor may attach a separate page containing the historical payment example for a particular program. A disclosure form describing more than one program need not repeat information applicable to each program that is described. For example, a form describing multiple programs may disclose the information applicable to all of the programs in one place with the various program features (such as options permitting conversion to a fixed rate) disclosed separately. The form, however, must state if any program feature that is described is available only in conjunction with certain other program features. Both the separate and multiple program disclosures may illustrate more than one loan maturity or payment amortization--for example, by including multiple payment and loan balance columns in the historical payment example. Disclosures may be inserted or printed in the Consumer Handbook (or a suitable substitute) as long as they are identified as the creditor's loan program disclosures.

4. As applicable. The disclosures required by this section need only be made as applicable. Any disclosure not

relevant to a particular transaction may be eliminated. For example, if the transaction does not contain a demand feature, the disclosure required under § 226.19(b)(2)(x) need not be given. As used in this section, payment refers only to a payment based on the interest rate, loan balance and loan term, and does not refer to payment of other elements such as mortgage insurance premiums.

5. Revisions. A creditor must revise the disclosures required under this section once a year as soon as reasonably possible after the new index value becomes available. Revisions to the disclosures also are required when the loan program changes.

Paragraph 19(b)(2)(i).

1. Change in interest rate, payment, or term. A creditor must disclose the fact that the terms of the legal obligation permit the creditor, after consummation of the transaction, to increase (or decrease) the interest rate, payment, or term of the loan initially disclosed to the consumer. For example, the disclosures for a variable-rate program in which the interest rate and payment (but not loan term) can change might read, "Your interest rate and payment can change yearly." In transactions where the term of the loan may change due to rate fluctuations, the creditor must state that fact

Paragraph 19(b)(2)(ii).

1. Identification of index or formula. If a creditor ties interest rate changes to a particular index, this fact must be disclosed, along with a source of information about the index. For example, if a creditor uses the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity as its index, the disclosure might read, "Your index is the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year published weekly in the Wall Street Journal." If no particular index is used, the creditor must briefly describe the formula used to calculate interest rate changes.

2. Changes at creditor's discretion. If interest rate changes are at the creditor's discretion, this fact must be disclosed. If an index is internally defined, such as by a creditor's prime rate, the creditor should either briefly describe that index or state that interest rate changes are at the creditor's discretion.

Paragraph 19(b)(2)(iii).

1. Determination of interest rate and payment. This provision requires an explanation of how the creditor will determine the consumer's interest rate and payment. In cases where a creditor bases its interest rate on a specific index and adjusts the index through the addition of a margin, for example, the disclosure might read, "Your interest rate is based on the index plus a margin, and your payment will be based on the interest rate, loan balance, and remaining loan term." In transactions where paying the periodic payments will not fully amortize the outstanding balance at the end of the loan term and where the final payment will equal the periodic payment plus the remaining unpaid balance, the creditor must disclose this fact. For example, the disclosure might read, "Your periodic payments will not fully amortize your loan and you will be required to make a single payment of the periodic payment plus the remaining unpaid balance

at the end of the loan term." The creditor, however, need not reflect any irregular final payment in the historical example or in the disclosure of the initial and maximum rates and payments. If applicable, the creditor should also disclose that the rate and payment will be rounded.

Paragraph 19(b)(2)(iv).

1. Current margin value and interest rate. Because the disclosures can be prepared in advance, the interest rate and margin may be several months old when the disclosures are delivered. A statement, therefore, is required alerting consumers to the fact that they should inquire about the current margin value applied to the index and the current interest rate. For example, the disclosure might state, "Ask us for our current interest rate and margin."

Paragraph 19(b)(2)(v).

1. Discounted and premium interest rate. In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. If the initial interest rate will be a discount or a premium rate, creditors must alert the consumer to this fact. For example, if a creditor discounted a consumer's initial rate, the disclosure might state, "Your initial interest rate is not based on the index used to make later adjustments." (See the commentary to § 226.17(c)(1) for a further discussion of discounted and premium variable-rate transactions.) In addition, the disclosure must suggest that consumers inquire about the amount that the program is currently discounted. For example, the disclosure might state, "Ask us for the amount our adjustable rate mortgages are currently discounted." In a transaction with a consumer buydown or with a third-party buydown that will be incorporated in the legal obligation, the creditor should disclose the program as a discounted variable-rate transaction, but need not disclose additional information regarding the buydown in its program disclosures. (See the commentary to § 226.19(b)(2)(viii) for a discussion of how to reflect the discount or premium in the historical example or the maximum rate and payment disclosure).

Paragraph 19(b)(2)(vi).

1. Frequency. The frequency of interest rate and payment adjustments must be disclosed. If interest rate changes will be imposed more frequently or at different intervals than payment changes, a creditor must disclose the frequency and timing of both types of changes. For example, in a variable- rate transaction where interest rate changes are made monthly, but payment changes occur on an annual basis, this fact must be disclosed. In certain ARM transactions, the interval between loan closing and the initial adjustment is not known and may be different from the regular interval for adjustments. In such cases, the creditor may disclose the initial adjustment period as a range of the minimum and maximum amount of time from consummation or closing. For example, the creditor might state: "The first adjustment to your interest rate and payment will occur no sooner than 6 months and no later than 18 months after closing. Subsequent adjustments may occur once each year after the first adjustment." (See comments 19(b)(2)(viii)(A)-7 and 19(b)(2)(viii)(B)-4 for guidance on other disclosures when this alternative disclosure rule is used.)

Paragraph 19(b)(2)(vii).

1. Rate and payment caps. The creditor must disclose limits on changes (increases or decreases) in the interest rate or payment. If an initial discount is not taken into account in applying overall or periodic rate limitations, that fact must be disclosed. If separate overall or periodic limitations apply to interest rate increases resulting from other events, such as the exercise of a fixed-rate conversion option or leaving the creditor's employ, those limitations must also be stated. Limitations do not include legal limits in the nature of usury or rate ceilings under state or Federal statutes or regulations. (See *§ 226.30* for the rule requiring that a maximum interest rate be included in certain variable-rate transactions.) The creditor need not disclose each periodic or overall rate limitation that is currently available. As an alternative, the creditor may disclose the range of the lowest and highest periodic and overall rate limitations that may be applicable to the creditor's ARM transactions. For example, the creditor might state: "The limitation on increases to your interest rate at each adjustment will be set at an amount in the following range: Between 1 and 2 percentage points at each adjustment. The limitation on increases to your interest rate over the term of the loan will be set at an amount in the following range: Between 4 and 7 percentage points above the initial interest rate." A creditor using this alternative rule must include a statement in its program disclosures suggesting that the consumer ask about the overall rate limitations currently offered for the creditor's ARM programs. (See comments 19(b)(2)(viii)(A)-6 and 19(b)(2)(viii)(B)-3 for an explanation of the additional requirements for a creditor using this alternative rule for disclosure of periodic and overall rate limitations.)

2. Negative amortization and interest rate carryover. A creditor must disclose, where applicable, the possibility of negative amortization. For example, the disclosure might state, "If any of your payments is not sufficient to cover the interest due, the difference will be added to your loan amount." Loans that provide for more than one way to trigger negative amortization are separate variable-rate programs requiring separate disclosures. (See the commentary to § 226.19(b)(2) for a discussion on the definition of a variable-rate loan program and the format for disclosure.) If a consumer is given the option to cap monthly payments that may result in negative amortization, the creditor must fully disclose the rules relating to the option, including the effects of exercising the option (such as negative amortization will occur and the principal loan balance will increase); however, the disclosure in § 226.19(b)(2)(viii) need not be provided.

3. Conversion option. If a loan program permits consumers to convert their variable-rate loans to fixed-rate loans, the creditor must disclose that the interest rate may increase if the consumer converts the loan to a fixed-rate loan. The creditor must also disclose the rules relating to the conversion feature, such as the period during which the loan may be converted, that fees may be charged at conversion, and how the fixed rate will be determined. The creditor should identify any index or other measure or formula used to determine the fixed rate and state any margin to be added. In disclosing the period during which the loan may be converted and the margin, the creditor may use information applicable to the conversion feature during the six months preceding preparation of the disclosures and state that the information is representative of conversion features recently offered by the creditor. The information may be used until the program disclosures are otherwise revised. Although the rules relating to the conversion option must be disclosed, the effect of exercising the option should not be reflected elsewhere in the disclosures, such as in the historical example or in the calculation of the initial and maximum interest rate and payments.

4. Preferred-rate loans. Section 226.19(b) applies to preferred-rate loans, where the rate will increase upon the occurrence of some event, such as an employee leaving the creditor's employ, whether or not the underlying rate is fixed or variable. In these transactions, the creditor must disclose the event that would allow the creditor to increase the rate such as that the rate may increase if the employee leaves the creditor's employ. The creditor must also disclose the rules relating to termination of the preferred rate, such as that fees may be charged when the rate is changed and how the new rate will be determined.

Paragraph 19(b)(2)(viii).

1. Historical example and initial and maximum interest rates and payments. A creditor may disclose both the historical example and the initial and maximum interest rates and payments.

Paragraph 19(b)(2)(viii)(A).

1. Index movement. This section requires a creditor to provide an historical example, based on a $10,000 loan amount originating in 1977, showing how interest rate changes implemented according to the terms of the loan program would have affected payments and the loan balance at the end of each year during a 15-year period. (In all cases, the creditor need only calculate the payments and loan balance for the term of the loan. For example, in a five-year loan, a creditor would show the payments and loan balance for the five-year term, from 1977 to 1981, with a zero loan balance reflected for 1981. For the remaining ten years, 1982-1991, the creditor need only show the remaining index values, margin and interest rate and must continue to reflect all significant loan program terms such as rate limitations affecting them.) Pursuant to this section, the creditor must provide a history of index values for the preceding 15 years. Initially, the disclosures would give the index values from 1977 to the present. Each year thereafter, the revised program disclosures should include an additional year's index value until 15 years of values are shown. If the values for an index have not been available for 15 years, a creditor need only go back as far as the values are available in giving a history and payment example. In all cases, only one index value per year need be shown. Thus, in transactions where interest rate adjustments are implemented more frequently than once per year, a creditor may assume that the interest rate and payment resulting from the index value chosen will stay in effect for the entire year for purposes of calculating the loan balance as of the end of the year and for reflecting other loan program terms. In cases where interest rate changes are at the creditor's discretion (see the commentary to § 226.19(b)(2)(ii)), the creditor must provide a history of the rates imposed for the preceding 15 years, beginning with the rates in 1977. In giving this history, the creditor need only go back as far as the creditor's rates can reasonably be determined.

2. Selection of index values. The historical example must reflect the method by which index values are determined under the program. If a creditor uses an average of index values or any other index formula, the history given should reflect those values. The creditor should select one date or, when an average of single values is used as an index, one period and should base the example on index values measured as of that same date or period for each year shown in the history. A date or period at any time during the year may be selected, but the same date or period must be used for each year in the historical example. For example, a creditor could use values for the first business day in July or for the first week ending in July for each of the 15 years shown in the example.

3. Selection of margin. For purposes of the disclosure required under § 226.19(b)(2)(viii)(A), a creditor may select a representative margin that has been used during the six months preceding preparation of the disclosures, and should disclose that the margin is one that the creditor has used recently. The margin selected may be used until a creditor revises the disclosure form.

4. Amount of discount or premium. For purposes of the disclosure required under § 226.19(b)(2)(viii)(A), a creditor may select a discount or premium (amount and term) that has been used during the six months preceding

preparation of the disclosures, and should disclose that the discount or premium is one that the creditor has used recently. The discount or premium should be reflected in the historical example for as long as the discount or premium is in effect. A creditor may assume that a discount that would have been in effect for any part of a year was in effect for the full year for purposes of reflecting it in the historical example. For example, a 3-month discount may be treated as being in effect for the entire first year of the example; a 15-month discount may be treated as being in effect for the first two years of the example. In illustrating the effect of the discount or premium, creditors should adjust the value of the interest rate in the historical example, and should not adjust the margin or index values. For example, if during the six months preceding preparation of the disclosures the fully indexed rate would have been 10% but the first year's rate under the program was 8%, the creditor would discount the first interest rate in the historical example by 2 percentage points.

5. Term of the loan. In calculating the payments and loan balances in the historical example, a creditor need not base the disclosures on each term to maturity or payment amortization that it offers. Instead, disclosures for ARMs may be based upon terms to maturity or payment amortizations of 5, 15 and 30 years, as follows: ARMs with terms or amortizations from over 1 year to 10 years may be based on a 5-year term or amortization; ARMs with terms or amortizations from over 10 years to 20 years may be based on a 15-year term or amortization; and ARMs with terms or amortizations over 20 years may be based on a 30-year term or amortization. Thus, disclosures for ARMs offered with any term from over 1 year to 40 years may be based solely on terms of 5, 15 and 30 years. Of course, a creditor may always base the disclosures on the actual terms or amortizations offered. If the creditor bases the disclosures on 5-, 15- or 30-year terms or payment amortization as provided above, the term or payment amortization used in making the disclosure must be stated.

6. Rate caps. A creditor using the alternative rule described in comment 19(b)(2)(vii)-1 for disclosure of rate limitations must base the historical example upon the highest periodic and overall rate limitations disclosed under section 226.19(b)(2)vii). In addition, the creditor must state the limitations used in the historical example. (See comment 19(b)(2)(viii)(B)-3 for an explanation of the use of the highest rate limitation in other disclosures.)

7. Frequency of adjustments. In certain transactions, creditors may use the alternative rule described in comment 19(b)(2)(vi)-1 for disclosure of the frequency of rate and payment adjustments. In such cases, the creditor may assume for purposes of the historical example that the first adjustment occurred at the end of the first full year in which the adjustment could occur. For example, in an ARM in which the first adjustment may occur between 6 and 18 months after closing and annually thereafter, the creditor may assume that the first adjustment occurred at the end of the first year in the historical example. (See comment 19(b)(2)(viii)(B)-4 for an explanation of how to compute the maximum interest rate and payment when the initial adjustment period is not known.)

Paragraph 19(b)(2)(viii)(B).

1. Initial and maximum interest rates and payments. The disclosure form must state the initial and maximum interest rates and payments for a $10,000 loan originated at an initial interest rate (index value plus margin adjusted by the amount of any discount or premium) in effect as of an identified month and year for the loan program disclosure. (See comment 19(b)(2)-5 on revisions to the loan program disclosure.) In calculating the maximum payment under this paragraph, a creditor should assume that the interest rate increases as rapidly as possible under the loan program, and the maximum payment disclosed should reflect the amortization of the loan during this period. Thus, in a loan with 2

percentage point annual (and 5 percentage point overall) interest rate limitations or "caps," the maximum interest rate would be 5 percentage points higher than the initial interest rate disclosed. Moreover, the loan would not reach the maximum interest rate until the fourth year because of the 2 percentage point annual rate limitations, and the maximum payment disclosed would reflect the amortization of the loan during this period. If the loan program includes a discounted or premium initial interest rate, the initial interest rate should be adjusted by the amount of the discount or premium.

2. Term of the loan. In calculating the initial and maximum payments, the creditor need not base the disclosures on each term to maturity or payment amortization offered under the program. Instead, the creditor may follow the rules set out in comment 19(b)(2)(viii)(A)-5.

If a historical example is provided under § 226.19(b)(2)(viii)(A), the terms to maturity or payment amortization used in the historical example must be used in calculating the initial and maximum payment. In addition, creditors must state the term or payment amortization used in making the disclosures under this section.

3. Rate caps. A creditor using the alternative rule for disclosure of interest rate limitations described in comment 19(b)(2)(vii)-1 must calculate the maximum interest rate and payment based upon the highest periodic and overall rate limitations disclosed under § 226.19(b)(2)(vii). In addition, the creditor must state the rate limitations used in calculating the maximum interest rate and payment. (See comment 19(b)(2)(viii)(A)-6 for an explanation of the use of the highest rate limitation in other disclosures.)

4. Frequency of adjustments. In certain transactions, a creditor may use the alternative rule for disclosure of the frequency of rate and payment adjustments described in comment 19(b)(2)(vi)-1. In such cases, the creditor must base the calculations of the initial and maximum rates and payments upon the earliest possible first adjustment disclosed under § 226.19(b)(2)(vi). (See comment 19(b)(2)(viii)(A)-7 for an explanation of how to disclose the historical example when the initial adjustment period is not known.)

5. Periodic payment statement The statement that the periodic payment may increase or decrease substantially may be satisfied by the disclosure in paragraph 19(b)(2)(vi) if it states for example, "your monthly payment can increase or decrease substantially based on annual changes in the interest rate."

Paragraph 19(b)(2)(ix).

1. Calculation of payments A creditor is required to include a statement on the disclosure form that explains how a consumer may calculate his or her actual monthly payments for a loan amount other than $10,000. The example should be based upon the most recent payment shown in the historical example or upon the initial interest rate reflected in the maximum rate and payment disclosure. In transactions in which the latest payment shown in the historical example is not for the latest year of index values shown (such as in a five-year loan), a creditor may provide additional examples based on the initial and maximum payments disclosed under § 226.19(b)(2)(viii)(B). The creditor, however, is not required to calculate the consumer's payments. (See the model clauses in appendix H-4(C).)

Paragraph 19(b)(2)(x).

1. Demand feature. If a variable-rate loan subject to § 226.19(b) requirements contains a demand feature as discussed in the commentary to § 226.18(i), this fact must be disclosed. (Pursuant to § 226.18(i), creditors would also disclose the demand feature in the standard disclosures given later.)

Paragraph 19(b)(2)(xi).

1. Adjustment notices. A creditor must disclose to the consumer the type of information that will be contained in subsequent notices of adjustments and when such notices will be provided. (See the commentary to § 226.20(c) regarding notices of adjustments.) For example, the disclosure might state, "You will be notified at least 25, but no more than 120, days before the due date of a payment at a new level. This notice will contain information about the index and interest rates, payment amount, and loan balance." In transactions where there may be interest rate adjustments without accompanying payment adjustments in a year, the disclosure might read, "You will be notified once each year during which interest rate adjustments, but no payment adjustments, have been made to your loan. This notice will contain information about the index and interest rates, payment amount, and loan balance."

Paragraph 19(b)(2)(xii).

1. Multiple loan programs. A creditor that offers multiple variable-rate loan programs is required to have disclosures for each variable-rate loan program subject to § 226.19(b)(2). Unless disclosures for all of its variable-rate programs are provided initially, the creditor must inform the consumer that other closed-end variable-rate programs exist, and that disclosure forms are available for these additional loan programs. For example, the disclosure form might state, "Information on other adjustable rate mortgage programs is available upon request."

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§ 19(c) Electronic disclosures

1. Form of disclosures. Whether disclosures must be in electronic form depends upon the following:

i. If a consumer accesses an ARM loan application electronically (other than as described under ii. below), such as online at a home computer, the creditor must provide the disclosures in electronic form (such as with the application form on its Web site) in order to meet the requirement to provide disclosures in a timely manner on or with the application. If the creditor instead mailed paper disclosures to the consumer, this requirement would not be met.

ii. In contrast, if a consumer is physically present in the creditor's office, and accesses an ARM loan application electronically, such as via a terminal or kiosk (or if the consumer uses a terminal or kiosk located on the premises of an affiliate or third party that has arranged with the creditor to provide applications to consumers), the creditor may provide disclosures in either electronic or paper form, provided the creditor complies with the timing, delivery, and retainability requirements of the regulation.

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1B- Consumer Credit Law Manual § 226.20

§ 226.20 Subsequent Disclosure Requirements

Paragraph 20(a) Refinancings.

1. Definition. A refinancing is a new transaction requiring a complete new set of disclosures. Whether a refinancing has occurred is determined by reference to whether the original obligation has been satisfied or extinguished and replaced by a new obligation, based on the parties' contract and applicable law. The refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer or on the consumer's behalf, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the prior one.

- Changes in the terms of an existing obligation, such as the deferral of individual installments, will not constitute a refinancing unless accomplished by the cancellation of that obligation and the substitution of a new obligation.

- A substitution of agreements that meets the refinancing definition will require new disclosures, even if the substitution does not substantially alter the prior credit terms.

2. Exceptions. A transaction is subject to § 226.20(a) only if it meets the general definition of a refinancing. Section 226.20(a)(1) through (5) lists 5 events that are not treated as refinancings, even if they are accomplished by cancellation of the old obligation and substitution of a new one.

3. Variable-rate.

i. If a variable-rate feature was properly disclosed under the regulation, a rate change in accord with those

disclosures is not a refinancing. For example, no new disclosures are required when the variable-rate feature is invoked on a renewable balloon-payment mortgage that was previously disclosed as a variable-rate transaction.

ii. Even if it is not accomplished by the cancellation of the old obligation and substitution of a new one, a new transaction subject to new disclosures results if the creditor either

A. Increases the rate based on a variable-rate feature that was not previously disclosed; or

B. Adds a variable-rate feature to the obligation. A creditor does not add a variable-rate feature by changing the index of a variable-rate transaction to a comparable index, whether the change replaces the existing index or substitutes an index for one that no longer exists.

iii. If either of the events in paragraph 20(a)3.ii.A. or ii.B. occurs in a transaction secured by a principal dwelling with a term longer than one year, the disclosures required under § 226.19(b) also must be given at that time

4. Unearned finance charge. In a transaction involving precomputed finance charges, the creditor must include in the finance charge on the refinanced obligation any unearned portion of the original finance charge that is not rebated to the consumer or credited against the underlying obligation. For example, in a transaction with an add-on finance charge, a creditor advances new money to a consumer in a fashion that extinguishes the original obligation and replaces it with a new one. The creditor neither refunds the unearned finance charge on the original obligation to the consumer nor credits it to the remaining balance on the old obligation. Under these circumstances, the unearned finance charge must be included in the finance charge on the new obligation and reflected in the annual percentage rate disclosed on refinancing. Accrued but unpaid finance charges are included in the amount financed in the new obligation.

5. Coverage. Section 226.20(a) applies only to refinancings undertaken by the original creditor or a holder or servicer of the original obligation. A "refinancing" by any other person is a new transaction under the regulation, not a refinancing under this section.

Paragraph 20(a)(1).

1. Renewal. This exception applies both to obligations with a single payment of principal and interest and to obligations with periodic payments of interest and a final payment of principal. In determining whether a new obligation replacing an old one is a renewal of the original terms or a refinancing, the creditor may consider it a renewal even if:

- Accrued unpaid interest is added to the principal balance.
- Changes are made in the terms of renewal resulting from the factors listed in § 226.17(c)(3).

- The principal at renewal is reduced by a curtailment of the obligation.

Paragraph 20(a)(2).

1. Annual percentage rate reduction. A reduction in the annual percentage rate with a corresponding change in the payment schedule is not a refinancing. If the annual percentage rate is subsequently increased (even though it remains below its original level) and the increase is effected in such a way that the old obligation is satisfied and replaced, new disclosures must then be made.

2. Corresponding change. A corresponding change in the payment schedule to implement a lower annual percentage rate would be a shortening of the maturity, or a reduction in the payment amount or the number of payments of an obligation. The exception in § 226.20(a)(2) does not apply if the maturity is lengthened, or if the payment amount or number of payments is increased beyond that remaining on the existing transaction.

Paragraph 20(a)(3).

1. Court agreements. This exception includes, for example, agreements such as reaffirmations of debts discharged in bankruptcy, settlement agreements, and post-judgment agreements. (See the commentary to § 226.2(a)(14) for a discussion of court-approved agreements that are not considered "credit.")

Paragraph 20(a)(4).

1. Workout agreements. A workout agreement is not a refinancing unless the annual percentage rate is increased or additional credit is advanced beyond amounts already accrued plus insurance premiums.

Paragraph 20(a)(5).

1. Insurance renewal. The renewal of optional insurance added to an existing credit transaction is not a refinancing, assuming that appropriate Truth in Lending disclosures were provided for the initial purchase of the insurance.

1. General definition An assumption as defined in § 226.20(b) is a new transaction and new disclosures must be made to the subsequent consumer. An assumption under the regulation requires the following three elements:

- A residential mortgage transaction.
- An express acceptance of the subsequent consumer by the creditor.
- A written agreement.

The assumption of a nonexempt consumer credit obligation requires no disclosures unless all three elements are present. For example, an automobile dealer need not provide Truth in Lending disclosures to a customer who assumes an existing obligation secured by an automobile. However, a residential mortgage transaction with the elements described in § 226.20(b) is an assumption that calls for new disclosures; the disclosures must be given whether or not the assumption is accompanied by changes in the terms of the obligation. (See comment 2(a)(24)-5 for a discussion of assumptions that are not considered residential mortgage transactions.)

2. Existing residential mortgage transaction. A transaction may be a residential mortgage transaction as to one consumer and not to the other consumer. In that case, the creditor must look to the assuming consumer in determining whether a residential mortgage transaction exists. To illustrate:

- The original consumer obtained a mortgage to purchase a home for vacation purposes. The loan was not a residential mortgage transaction as to that consumer. The mortgage is assumed by a consumer who will use the home as a principal dwelling. As to that consumer, the loan is a residential mortgage transaction. For purposes of § 226.20(b), the assumed loan is an "existing residential mortgage transaction" requiring disclosures, if the other criteria for an assumption are met.

3. Express agreement. Expressly agrees means that the creditor's agreement must relate specifically to the new debtor and must unequivocally accept that debtor as a primary obligor. The following events are not construed to be express agreements between the creditor and the subsequent consumer:

- Approval of creditworthiness.
- Notification of a change in records.
- Mailing of a coupon book to the subsequent consumer.
- Acceptance of payments from the new consumer.

4. Retention of original consumer. The retention of the original consumer as an obligor in some capacity does not prevent the change from being an assumption, provided the new consumer becomes a primary obligor. But the mere addition of a guarantor to an obligation for which the original consumer remains primarily liable does not give rise to an assumption. However, if neither party is designated as the primary obligor but the creditor accepts payment from the subsequent consumer, an assumption exists for purposes of § 226.20(b).

5. Status of parties. Section 226.20(b) applies only if the previous debtor was a consumer and the obligation is assumed by another consumer. It does not apply, for example, when an individual takes over the obligation of a corporation.

6. Disclosures. For transactions that are assumptions within this provision, the creditor must make disclosures based on the "remaining obligation." For example:

- The amount financed is the remaining principal balance plus any arrearages or other accrued charges from the original transaction.

- If the finance charge is computed from time to time by application of a percentage rate to an unpaid balance, in determining the amount of the finance charge and the annual percentage rate to be disclosed, the creditor should disregard any prepaid finance charges paid by the original obligor, but must include in the finance charge any prepaid finance charge imposed in connection with the assumption.

- If the creditor requires the assuming consumer to pay any charges as a condition of the assumption, those sums are prepaid finance charges as to that consumer, unless exempt from the finance charge under § 226.4. If a transaction involves add-on or discount finance charges, the creditor may make abbreviated disclosures, as outlined in § 226.20(b)(1) through (5). Creditors providing disclosures pursuant to this section for assumptions of variable-rate transactions secured by the consumer's principal dwelling with a term longer than one year need not provide new disclosures under § 226.18(f)(2)(ii) or § 226.19(b). In such transactions, a creditor may disclose the variable-rate feature solely in accordance with § 226.18(f)(1).

7. Abbreviated disclosures. The abbreviated disclosures permitted for assumptions of transactions involving add-on or discount finance charges must be made clearly and conspicuously in writing in a form that the consumer may keep. However, the creditor need not comply with the segregation requirement of § 226.17(a)(1). The terms annual percentage rate and total of payments, when disclosed according to § 226.20(b)(4) and (5), are not subject to the description requirements of § 226.18(e) and (h). The term annual percentage rate disclosed under § 226.20(b)(4) need not be more conspicuous than other disclosures.

Paragraph 20(c) Variable-rate adjustments.

1. Timing of adjustment notices. This section requires a creditor (or a subsequent holder) to provide certain disclosures in cases where an adjustment to the interest rate is made in a variable-rate transaction subject to § 226.19(b). There are two timing rules, depending on whether payment changes accompany interest rate changes. A creditor is required to provide at least one notice each year during which interest rate adjustments have occurred without accompanying payment adjustments. For payment adjustments, a creditor must deliver or place in the mail notices to borrowers at least 25, but not more than 120, calendar days before a payment at a new level is due. The timing rules also apply to the notice required to be given in connection with the adjustment to the rate and payment that follows conversion of a transaction subject to § 226.19(b) to a fixed-rate transaction. (In cases where an open-end account is converted to a closed-end transaction subject to § 226.19(b), the requirements of this section do not apply until adjustments are made following conversion.)

2. Exceptions. Section 226.20(c) does not apply to "shared-equity," "shared-appreciation," or "price level adjusted" or similar mortgages.

3. Basis of disclosures. The disclosures required under this section shall reflect the terms of the parties' legal obligation, as required under § 226.17(c)(1).

Paragraph 20(c)(1).

1. Current and prior interest rates. The requirements under this paragraph are satisfied by disclosing the interest rate used to compute the new adjusted payment amount ("current rate") and the adjusted interest rate that was disclosed in the last adjustment notice, as well as all other interest rates applied to the transaction in the period since the last notice ("prior rates"). (If there has been no prior adjustment notice, the prior rates are the interest rate applicable to the transaction at consummation, as well as all other interest rates applied to the transaction in the period since consummation.) If no payment adjustment has been made in a year, the current rate is the new adjusted interest rate for the transaction, and the prior rates are the adjusted interest rate applicable to the loan at the time of the last adjustment notice, and all other rates applied to the transaction in the period between the current and last adjustment notices. In disclosing all other rates applied to the transaction during the period between notices, a creditor may disclose a range of the highest and lowest rates applied during that period.

Paragraph 20(c)(2).

1. Current and prior index values. This section requires disclosure of the index or formula values used to compute the current and prior interest rates disclosed in § 226.20(c)(1). The creditor need not disclose the margin used in computing the rates. If the prior interest rate was not based on an index or formula value, the creditor also need not disclose the value of the index that would otherwise have been used to compute the prior interest rate.

Paragraph 20(c)(3).

1. Unapplied index increases. The requirement that the consumer receive information about the extent to which the creditor has foregone any increase in the interest rate is applicable only to those transactions permitting interest rate carryover. The amount of increase that is foregone at an adjustment is the amount that, subject to rate caps, can be applied to future adjustments independently to increase, or offset decreases in, the rate that is determined according to the index or formula.

Paragraph 20(c)(4).

1. Contractual effects of the adjustment. The contractual effects of an interest rate adjustment must be disclosed including the payment due after the adjustment is made whether or not the payment has been adjusted. A contractual effect of a rate adjustment would include, for example, disclosure of any change in the term or maturity of the loan if the change resulted from the rate adjustment. In transactions where paying the periodic payments will not fully amortize the outstanding balance at the end of the loan term and where the final payment will equal the periodic payment plus the remaining unpaid balance, the amount of the adjusted payment must be disclosed if such payment has changed as a result of the rate adjustment. A statement of the loan balance also is required. The balance required to be disclosed is the balance on which the new adjusted payment is based. If no payment adjustment is disclosed in the notice, the balance disclosed should be the loan balance on which the payment disclosed under § 226.20(c)(5) is based, if applicable, or the balance at the time the disclosure is prepared.

Paragraph 20(c)(5).

1. Fully-amortizing payment. This paragraph requires a disclosure only when negative amortization occurs as a result of the adjustment. A disclosure is not required simply because a loan calls for non- amortizing or partially amortizing payments. For example, in a transaction with a five-year term and payments based on a longer amortization schedule, and where the final payment will equal the periodic payment plus the remaining unpaid balance, the creditor would not have to disclose the payment necessary to fully amortize the loan in the remainder of the five-year term. A disclosure is required, however, if the payment disclosed under § 226.20(c)(4) is not sufficient to prevent negative amortization in the loan. The adjustment notice must state the payment required to prevent negative amortization. (This paragraph does not apply if the payment disclosed in § 226.20(c)(4) is sufficient to prevent negative amortization in the loan but the final payment will be a different amount due to rounding.)

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1B- Consumer Credit Law Manual § 226.21

§ 226.21 Treatment of Credit Balances

Paragraph 21(a).

1. Credit balance. A credit balance arises whenever the creditor receives or holds funds in an account in excess of the total balance due from the consumer on that account. A balance might result, for example, from the debtor's paying off a loan by transmitting funds in excess of the total balance owed on the account, or from the early payoff of a loan entitling the consumer to a rebate of insurance premiums and finance charges. However, § 226.21 does not determine whether the creditor in fact owes or holds sums for the consumer. For example, if a creditor has no obligation to rebate any portion of precomputed finance charges on prepayment, the consumer's early payoff would not create a credit balance with respect to those charges. Similarly, nothing in this provision interferes with any rights the creditor may have under the contract or under state law with respect to set-off, cross collateralization, or similar provisions.

2. Total balance due. The phrase total balance due refers to the total outstanding balance. Thus, this provision does not apply where the consumer has simply paid an amount in excess of the payment due for a given period.

3. Timing of refund. The creditor may also fulfill its obligation under this section by:

- Refunding any credit balance to the consumer immediately.
- Refunding any credit balance prior to a written request from the consumer.
- Making a good faith effort to refund any credit balance before 6 months have passed. If that attempt is unsuccessful, the creditor need not try again to refund the credit balance at the end of the 6-month period.

Paragraph 21(b).

1. Written requests--standing orders. The creditor is not required to honor standing orders requesting refunds of any credit balance that may be created on the consumer's account.

Paragraph 21(c).

1. Good faith effort to refund. The creditor must take positive steps to return any credit balance that has remained in the account for over 6 months. This includes, if necessary, attempts to trace the consumer through the consumer's last known address or telephone number, or both.

2. Good faith effort unsuccessful. Section 226.21 imposes no further duties on the creditor if a good faith effort to return the balance is unsuccessful. The ultimate disposition of the credit balance (or any credit balance of $1 or less) is to be determined under other applicable law.

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1B- Consumer Credit Law Manual § 226.22

§ 226.22 Determination of the Annual Percentage Rate

22(a) Accuracy of the annual percentage rate.

Paragraph 22(a)(1).

1. Calculation method. The regulation recognizes both the actuarial method and the United States Rule Method (U.S. Rule) as measures of an exact annual percentage rate. Both methods yield the same annual percentage rate when payment intervals are equal. They differ in their treatment of unpaid accrued interest.

2. Actuarial method. When no payment is made,or when the payment is insufficient to pay the accumulated finance charge, the actuarial method requires that the unpaid finance charge be added to the amount financed and thereby capitalized. Interest is computed on interest since in succeeding periods the interest rate is applied to the unpaid balance including the unpaid finance charge. Appendix J provides instructions and examples for calculating the annual percentage rate using the actuarial method.

3. U.S. Rule. The U.S. Rule produces no compounding of interest in that any unpaid accrued interest is accumulated separately and is not added to principal. In addition, under the U.S. Rule, no interest calculation is made until a payment is received.

4. Basis for calculations. When a transaction involves "step rates" or "split rates" -- that is, different rates applied at different times or to different portions of the principal balance -- a single composite annual percentage rate must be calculated and disclosed for the entire transaction. Assume, for example, a step-rate transaction in which a $10,000 loan is repayable in 5 years at 10 percent interest for the first 2 years, 12 percent for years 3 and 4, and 14 percent for year 5. The monthly payments are $210.71 during the first 2 years of the term, $220.25 for years 3 and 4, and $222.59 for year

5. The composite annual percentage rate, using a calculator with a "discounted cash flow analysis" or "internal rate of return" function, is 10.75 percent.

5. Good faith reliance on faulty calculation tools. Footnote 45d absolves a creditor of liability for an error in the annual percentage rate or finance charge that resulted from a corresponding error in a calculation tool used in good faith by the creditor. Whether or not the creditor's use of the tool was in good faith must be determined on a case-by-case basis, but the creditor must in any case have taken reasonable steps to verify the accuracy of the tool, including any instructions, before using it. Generally, the footnote is available only for errors directly attributable to the calculation tool itself, including software programs; it is not intended to absolve a creditor of liability for its own errors, or for errors arising from improper use of the tool, from incorrect data entry, or from misapplication of the law.

Paragraph 22(a)(2).

1. Regular transactions. The annual percentage rate for a regular transaction is considered accurate if it varies in either direction by not more than 1/8 of 1 percentage point from the actual annual percentage rate. For example, when the exact annual percentage rate is determined to be 10 1/8%, a disclosed annual percentage rate from 10% to 10 1/4%, or the decimal equivalent, is deemed to comply with the regulation.

Paragraph 22(a)(3).

1. Irregular transactions. The annual percentage rate for an irregular transaction is considered accurate if it varies in either direction by not more than 1/4 of 1 percentage point from the actual annual percentage rate. This tolerance is intended for more complex transactions that do not call for a single advance and a regular series of equal payments at equal intervals. The 1/4 of 1 percentage point tolerance may be used, for example, in a construction loan where advances are made as construction progresses, or in a transaction where payments vary to reflect the consumer's seasonal income. It may also be used in transactions with graduated payment schedules where the contract commits the consumer to several series of payments in different amounts. It does not apply, however, to loans with variable rate features where the initial disclosures are based on a regular amortization schedule over the life of the loan, even though payments may later change because of the variable rate feature.

22(a)(4) Mortgage loans.

1. Example. If a creditor improperly omits a $75 fee from the finance charge on a regular transaction, the understated finance charge is considered accurate under § 226.18(d)(1), and the annual percentage rate corresponding to that understated finance charge also is considered accurate even if it falls outside the tolerance of 1/8 of 1 percentage point provided under § 226.22(a)(2). Because a $75 error was made, an annual percentage rate corresponding to a $100 understatement of the finance charge would not be considered accurate.

22(a)(5) Additional tolerance for mortgage loans.

1. Example. This paragraph contains an additional tolerance for a disclosed annual percentage rate that is incorrect but is closer to the actual annual percentage rate than the rate that would be considered accurate under the tolerance in §

226.22(a)(4). To illustrate: in an irregular transaction subject to a 1/4 of 1 percentage point tolerance, if the actual annual percentage rate is 9.00 percent and a $75 omission from the finance charge corresponds to a rate of 8.50 percent that is considered accurate under § 226.22(a)(4), a disclosed APR of 8.65 percent is within the tolerance in § 226.22(a)(5). In this example of an understated finance charge, a disclosed annual percentage rate below 8.50 or above 9.25 percent will not be considered accurate.

22(b) Computation tools.

Paragraph 22(b)(1).

1. Board tables. Volumes I and II of the Board's Annual Percentage Rate Tables provide a means of calculating annual percentage rates for regular and irregular transactions, respectively. An annual percentage rate computed in accordance with the instructions in the tables is deemed to comply with the regulation, even where use of the tables produces a rate that falls outside the general standard of accuracy. To illustrate:

- Volume I may be used for single advance transactions with completely regular payment schedules or with payment schedules that are regular except for an odd first payment, odd first period or odd final payment. When used for a transaction with a large final balloon payment, Volume I may produce a rate that is considerably higher than the exact rate produced using a computer program based directly on appendix J. However, the Volume I rate -- produced using certain adjustments in that volume--is considered to be in compliance.

Paragraph 22(b)(2).

1. Other calculation tools. Creditors need not use the Board tables in calculating the annual percentage rates. Any computation tools may be used, so long as they produce annual percentage rates within 1/8 or 1/4 of 1 percentage point, as applicable, of the precise actuarial or U.S. Rule annual percentage rate.

22(c) Single add-on rate transactions.

1. General rule Creditors applying a single add-on rate to all transactions up to 60 months in length may disclose the same annual percentage rate for all those transactions, although the actual annual percentage rate varies according to the length of the transaction. Creditors utilizing this provision must show the highest of those rates. For example:

- An add-on rate of 10 percent converted to an annual percentage rate produce the following actual annual percentage rates at various maturities: at 3 months, 14.94 percent; at 21 months, 18.18 percent; and at 60 months, 17.27 percent. The creditor must disclose an annual percentage rate of 18.18 percent (the highest annual percentage rate) for any transaction up to 5 years, even though that rate is precise only for a transaction of 21 months.

22(d) Certain transactions involving ranges of balances.

1. General rule. Creditors applying a fixed dollar finance charge to all balances within a specified range of balances may understate the annual percentage rate by up to 8 percent of that rate, by disclosing for all those balances the annual

percentage rate computed on the median balance within that range. For example:

- If a finance charge of $9 applies to all balances between $91 and $100, an annual percentage rate of 10 percent (the rate on the median balance) may be disclosed as the annual percentage rate for all balances, even though a $9 finance charge applied to the lowest balance ($91) would actually produce an annual percentage rate of 10.7 percent.

Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART III OF III)

1B- Consumer Credit Law Manual § 226.23

§ **226.23 Right of Rescission**

1. Transactions not covered. Credit extensions that are not subject to the regulation are not covered by § 226.23 even if a customer's principal dwelling is the collateral securing the credit. For example, the right of rescission does not apply to a business purpose loan, even though the loan is secured by the customer's principal dwelling.

23(a) Consumer's right to rescind.

Paragraph 23(a)(1).

1. Security interest arising from transaction. In order for the right of rescission to apply, the security interest must be retained as part of the credit transaction. For example:

- A security interest that is acquired by a contractor who is also extending the credit in the transaction.
- A mechanic's or materialman's lien that is retained by a subcontractor or supplier of the contractor-creditor, even when the latter has waived its own security interest in the consumer's home.

The security interest is not part of the credit transaction and therefore the transaction is not subject to the right of rescission when, for example:

- A mechanic's or materialman's lien is obtained by a contractor who is not a party to the credit transaction but is merely paid with the proceeds of the consumer's unsecured bank loan.
- All security interests that may arise in connection with the credit transaction are validly waived.
- The creditor obtains a lien and completion bond that in effect satisfies all liens against the consumer's principal dwelling as a result of the credit transaction.

Although liens arising by operation of law are not considered security interests for purposes of disclosure under § 226.2, that section specifically includes them in the definition for purposes of the right of rescission. Thus, even though an interest in the consumer's principal dwelling is not a required disclosure under § 226.18(m), it may still give rise to the right of rescission.

2. Consumer. To be a consumer within the meaning of § 226.2, that person must at least have an ownership interest in the dwelling that is encumbered by the creditor's security interest, although that person need not be a signatory to the credit agreement. For example, if only one spouse signs a credit contract, the other spouse is a consumer if the ownership interest of that spouse is subject to the security interest.

3. Principal dwelling. A consumer can only have one principal dwelling at a time. (But see comment 23(a)(1)-4.) A vacation or other second home would not be a principal dwelling. A transaction secured by a second home (such as a vacation home) that is not currently being used as the consumer's principal dwelling is not rescindable, even if the consumer intends to reside there in the future. When a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within one year or upon completion of construction, the new dwelling is considered the principal dwelling if it secures the acquisition or construction loan. In that case, the transaction secured by the new dwelling is a residential mortgage transaction and is not rescindable. For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, a construction loan to finance B and secured by B is a residential mortgage transaction. Dwelling, as defined in § 226.2, includes structures that are classified as personalty under state law. For example, a transaction secured by a mobile home, trailer, or houseboat used as the consumer's principal dwelling may be rescindable.

4. Special rule for principal dwelling. Notwithstanding the general rule that consumers may have only one principal dwelling, when the consumer is acquiring or constructing a new principal dwelling, any loan subject to Regulation Z and secured by the equity in the consumer's current principal dwelling (for example, a bridge loan) is subject to the right of rescission regardless of the purpose of that loan. For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, a construction loan to finance B and secured by A is subject to the right of rescission. A loan secured by both A and B is, likewise, rescindable.

5. Addition of a security interest. Under footnote 47, the addition of a security interest in a consumer's principal dwelling to an existing obligation is rescindable even if the existing obligation is not satisfied and replaced by a new obligation, and even if the existing obligation was previously exempt (because it was credit over $25,000 not secured by real property or a consumer's principal dwelling). The right of rescission applies only to the added security interest, however, and not to the original obligation. In those situations, only the § 226.23(b) notice need be delivered, not new material disclosures; the rescission period will begin to run from the delivery of the notice.

Paragraph 23(a)(2).

1. Consumer's exercise of right. The consumer must exercise the right of rescission in writing but not necessarily on the notice supplied under § 226.23(b). Whatever the means of sending the notification of rescission -- mail, telegram or other written means -- the time period for the creditor's performance under § 226.23(d)(2) does not begin to run until the

notification has been received. The creditor may designate an agent to receive the notification so long as the agent's name and address appear on the notice provided to the consumer under § 226.23(b). Where the creditor fails to provide the consumer with a designated address for sending the notification of rescission, delivering notification to the person or address to which the consumer has been directed to send, payments constitutes delivery to the creditor or assignee. State law determines whether delivery of the notification to a third party other than the person to whom payments are made is delivery to the creditor or assignee, in the case where the creditor fails to designate an address for sending the notification of rescission.

Paragraph 23(a)(3).

1. Rescission period. The period within which the consumer may exercise the right to rescind runs for 3 business days from the last of 3 events:

- Consummation of the transaction.
- Delivery of all material disclosures.
- Delivery to the consumer of the required rescission notice.

For example, if a transaction is consummated on Friday, June 1, and the disclosures and notice of the right to rescind were given on Thursday, May 31, the rescission period will expire at midnight of the third business day after June 1--that is, Tuesday, June 5. In another example, if the disclosures are given and the transaction consummated on Friday, June 1, and the rescission notice is given on Monday, June 4, the rescission period expires at midnight of the third business day after June 4--that is, Thursday, June 7. The consumer must place the rescission notice in the mail, file it for telegraphic transmission, or deliver it to the creditor's place of business within that period in order to exercise the right.

2. Material disclosures. Footnote 48 sets forth the material disclosures that must be provided before the rescission period can begin to run. Failure to provide information regarding the annual percentage rate also includes failure to inform the consumer of the existence of a variable rate feature. Failure to give the other required disclosures does not prevent the running of the rescission period, although that failure may result in civil liability or administrative sanctions.

3. Unexpired right of rescission When the creditor has failed to take the action necessary to start the three-business day rescission period running, the right to rescind automatically lapses on the occurrence of the earliest of the following three events:

- The expiration of three years after consummation of the transaction.
- Transfer of all the consumer's interest in the property.
- Sale of the consumer's interest in the property, including a transaction in which the consumer sells the dwelling and takes back a purchase money note and mortgage or retains legal title through a device such as an installment sale contract.

Transfer of all the consumers' interest includes such transfers as bequests and gifts. A sale or transfer of the

property need not be voluntary to terminate the right to rescind. For example, a foreclosure sale would terminate an unexpired right to rescind. As provided in section 125 of the Act, the three-year limit may be extended by an administrative proceeding to enforce the provisions of this section. A partial transfer of the consumer's interest, such as a transfer bestowing co-ownership on a spouse, does not terminate the right of rescission.

Paragraph 23(a)(4).

1. Joint owners. When more than one consumer has the right to rescind a transaction, any of them may exercise that right and cancel the transaction on behalf of all. For example, if both husband and wife have the right to rescind a transaction, either spouse acting alone may exercise the right and both are bound by the rescission.

23(b) Notice of right to rescind.

1 Who receives notice. Each consumer entitled to rescind must be given:

- Two copies of the rescission notice
- The material disclosures.

In a transaction involving joint owners, both of whom are entitled to rescind, both must receive the notice of the right to rescind and disclosures. For example, if both spouses are entitled to rescind a transaction, each must receive two copies of the rescission notice (one copy to each if the notice is provided in electronic form in accordance with the consumer consent and other applicable provisions of the E-Sign Act) and one copy of the disclosures.

2. Format. The notice must be on a separate piece of paper but may appear with other information such as the itemization of the amount financed. The material must be clear and conspicuous, but no minimum type size or other technical requirements are imposed. The notices in appendix H provide models that creditors may use in giving the notice.

3. Content. The notice must include all of the information outlined in Section 226.23(b)(1)(i) through (v). The requirement in § 226.23(b) that the transaction be identified may be met by providing the date of the transaction. The creditor may provide a separate form that the consumer may use to exercise the right of rescission, or that form may be combined with the other rescission disclosures, as illustrated in appendix H. The notice may include additional information related to the required information, such as:

- A description of the property subject to the security interest.
- A statement that joint owners may have the right to rescind and that a rescission by one is effective for all.
- The name and address of an agent of the creditor to receive notice of rescission.

4. Time of providing notice. The notice required by § 226.23(b) need not be given before consummation of the transaction. The creditor may deliver the notice after the transaction is consummated, but the rescission period will not begin to run until the notice is given. For example, if the creditor provides the notice on May 15, but disclosures were given and the transaction was consummated on May 10, the 3-business day rescission period will run from May 15.

23(c) Delay of creditor's performance.

1. General rule. Until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded, the creditor must not, either directly or through a third party:

- Disburse loan proceeds to the consumer.
- Begin performing services for the consumer.
- Deliver materials to the consumer.

2. Escrow. The creditor may disburse loan proceeds during the rescission period in a valid escrow arrangement. The creditor may not, however, appoint the consumer as "trustee" or "escrow agent" and distribute funds to the consumer in that capacity during the delay period.

3. Actions during the delay period. Section 226.23(c) does not prevent the creditor from taking other steps during the delay, short of beginning actual performance. Unless otherwise prohibited, such as by state law, the creditor may, for example:

- Prepare the loan check.
- Perfect the security interest.
- Prepare to discount or assign the contract to a third party.
- Accrue finance charges during the delay period.

4. Delay beyond rescission period. The creditor must wait until it is reasonably satisfied that the consumer has not rescinded. For example, the creditor may satisfy itself by doing one of the following:

- Waiting a reasonable time after expiration of the rescission period to allow for delivery of a mailed notice.
- Obtaining a written statement from the consumer that the right has not been exercised.

When more than one consumer has the right to rescind, the creditor cannot reasonably rely on the assurance of only one consumer, because other consumers may exercise the right.

23(d) Effects of rescission.

Paragraph 23(d)(1).

1. Termination of security interest. Any security interest giving rise to the right of rescission becomes void when the consumer exercises the right of rescission. The security interest is automatically negated regardless of its status and whether or not it was recorded or perfected. Under § 226.23(d)(2), however, the creditor must take any action necessary to reflect the fact that the security interest no longer exists.

Paragraph 23(d)(2).

1. Refunds to consumer. The consumer cannot be required to pay any amount in the form of money or property either to the creditor or to a third party as part of the credit transaction. Any amounts of this nature already paid by the consumer must be refunded. "Any amount" includes finance charges already accrued, as well as other charges, such as broker fees, application and commitment fees, or fees for a title search or appraisal, whether paid to the creditor, paid directly to a third party, or passed on from the creditor to the third party. It is irrelevant that these amounts may not represent profit to the creditor.

2. Amounts not refundable to consumer. Creditors need not return any money given by the consumer to a third party outside of the credit transaction, such as costs incurred for a building permit or for a zoning variance. Similarly, the term any amount does not apply to any money or property given by the creditor to the consumer; those amounts must be tendered by the consumer to the creditor under § 226.23(d)(3).

3. Reflection of security interest termination. The creditor must take whatever steps are necessary to indicate that the security interest is terminated. Those steps include the cancellation of documents creating the security interest, and the filing of release or termination statements in the public record. In a transaction involving subcontractors or suppliers that also hold security interests related to the credit transaction, the creditor must insure that the termination of their security interests is also reflected. The 20-day period for the creditor's action refers to the time within which the creditor must begin the process. It does not require all necessary steps to have been completed within that time, but the creditor is responsible for seeing the process through to completion.

Paragraph 23(d)(3).

1. Property exchange. Once the creditor has fulfilled its obligations under § 226.23(d)(2), the consumer must tender to the creditor any property or money the creditor has already delivered to the consumer. At the consumer's option, property may be tendered at the location of the property. For example, if lumber or fixtures have been delivered to the consumer's home, the consumer may tender them to the creditor by making them available for pick-up at the home, rather than physically returning them to the creditor's premises. Money already given to the consumer must be tendered at the creditor's place of business.

2. Reasonable value If returning the property would be extremely burdensome to the consumer, the consumer may offer the creditor its reasonable value rather than returning the property itself. For example, if building materials have already been incorporated into the consumer's dwelling, the consumer may pay their reasonable value.

Paragraph 23(d)(4).

1. Modifications. The procedures outlined in § 226.23(d)(2) and (3) may be modified by a court. For example, when a consumer is in bankruptcy proceedings and prohibited from returning anything to the creditor, or when the equities dictate, a modification might be made. The sequence of procedures under § 226.23(d)(2) and (3), or a court's modification of those procedures under § 226.23(d)(4), does not affect a consumer's substantive right to rescind and to have the loan amount adjusted accordingly. Where the consumer's right to rescind is contested by the creditor, a court would normally determine whether the consumer has a right to rescind and determine the amounts owed before establishing the procedures for the parties to tender any money or property.

23(e) Consumer's waiver of right to rescind.

1. Need for waiver. To waive the right to rescind,the consumer must have a bona fide personal financial emergency that must be met before the end of the rescission period. The existence of the consumer's waiver will not, of itself, automatically insulate the creditor from liability for failing to provide the right of rescission.

2. Procedure. To waive or modify the right to rescind, the consumer must give a written statement that specifically waives or modifies the right, and also includes a brief description of the emergency. Each consumer entitled to rescind must sign the waiver statement. In a transaction involving multiple consumers, such as a husband and wife using their home as collateral, the waiver must bear the signatures of both spouses.

23(f) Exempt transactions.

1 Residential mortgage transaction. Any transaction to construct or acquire a principal dwelling, whether considered real or personal property, is exempt. (See the commentary to § 226.23(a).) For example, a credit transaction to acquire a mobile home or houseboat to be used as the consumer's principal dwelling would not be rescindable.Any transaction to construct or acquire a principal dwelling, whether considered real or personal property, is exempt. (See the commentary to § 226.23(a).) For example, a credit transaction to acquire a mobile home or houseboat to be used as the consumer's principal dwelling would not be rescindable.

2. Lien status. The lien status of the mortgage is irrelevant for purposes of the exemption in § 226.23(f)(1); the fact that a loan has junior lien status does not by itself preclude application of this exemption. For example, a home buyer may assume the existing first mortgage and create a second mortgage to finance the balance of the purchase price. Such a transaction would not be rescindable.

3. Combined-purpose transaction. A loan to acquire a principal dwelling and make improvements to that dwelling is

exempt if treated as one transaction. If, on the other hand, the loan for the acquisition of the principal dwelling and the subsequent advances for improvements are treated as more than one transaction, then only the transaction that finances the acquisition of that dwelling is exempt.

4. New advances. The exemption in § 226.23(f)(2) applies only to refinancings (including consolidations) by the original creditor. The original creditor is the creditor to whom the written agreement was initially made payable. In a merger, consolidation or acquisition, the successor institution is considered the original creditor for purposes of the exemption in § 226.23(f)(2). If the refinancing involves a new advance of money, the amount of the new advance is rescindable. In determining whether there is a new advance, a creditor may rely on the amount financed, refinancing costs, and other figures stated in the latest Truth in Lending disclosures provided to the consumer and is not required to use, for example, more precise information that may only become available when the loan is closed. For purposes of the right of rescission, a new advance does not include amounts attributed solely to the costs of the refinancing. These amounts would include § 226.4(c)(7) charges (such as attorneys fees and title examination and insurance fees, if bona fide and reasonable in amount), as well as insurance premiums and other charges that are not finance charges. (Finance charges on the new transaction -- points, for example -- would not be considered in determining whether there is a new advance of money in a refinancing since finance charges are not part of the amount financed.) To illustrate, if the sum of the outstanding principal balance plus the earned unpaid finance charge is $50,000 and the new amount financed is $51,000, then the refinancing would be exempt if the extra $1,000 is attributed solely to costs financed in connection with the refinancing that are not finance charges. Of course, if new advances of money are made (for example, to pay for home improvements) and the consumer exercises the right of rescission, the consumer must be placed in the same position as he or she was in prior to entering into the new credit transaction. Thus, all amounts of money (which would include all the costs of the refinancing) already paid by the consumer to the creditor or to a third party as part of the refinancing would have to be refunded to the consumer. (See the commentary to § 226.23(d)(2) for a discussion of refunds to consumers.) A model rescission notice applicable to transactions involving new advances appears in appendix H. The general rescission notice (model form H-8) is the appropriate form for use by creditors not considered original creditors in refinancing transactions.

5. State creditors. Cities and other political subdivisions of states acting as creditors are not exempted from this section.

6. Multiple advances. Just as new disclosures need not be made for subsequent advances when treated as one transaction, no new rescission rights arise so long as the appropriate notice and disclosures are given at the outset of the transaction. For example, the creditor extends credit for home improvements secured by the consumer's principal dwelling, with advances made as repairs progress. As permitted by § 226.17(c)(6), the creditor makes a single set of disclosures at the beginning of the construction period, rather than separate disclosures for each advance. The right of rescission does not arise with each advance. However, if the advances are treated as separate transactions, the right of rescission applies to each advance.

7. Spreader clauses. When the creditor holds a mortgage or deed of trust on the consumer's principal dwelling and that mortgage or deed of trust contains a "spreader clause," subsequent loans made are separate transactions and are subject to the right of rescission. Those loans are rescindable unless the creditor effectively waives its security interest under the spreader clause with respect to the subsequent transactions.

8. Converting open-end to closed-end credit. Under certain state laws, consummation of a closed-end credit transaction may occur at the time a consumer enters into the initial open-end credit agreement. As provided in the commentary to § 226.17(b), closed-end credit disclosures may be delayed under these circumstances until the conversion of the open-end account to a closed-end transaction. In accounts secured by the consumer's principal dwelling, no new right of rescission arises at the time of conversion. Rescission rights under § 226.15 are unaffected.

23(g) Tolerances for accuracy. 23(g)(2) One percent tolerance.

1. New advance. The phrase "new advance" has the same meaning as in comment 23(f)-4.

23(h) Special Rules for Foreclosures.

1. Rescission. Section 226.23(h) applies only to transactions that are subject to rescission under § 226.23(a)(1).

Paragraph 23(h)(1)(i).

1. Mortgage broker fees. A consumer may rescind a loan in foreclosure if a mortgage broker fee that should have been included in the finance charge was omitted, without regard to the dollar amount involved. If the amount of the mortgage broker fee is included but misstated the rule in § 226.23(h)(2) applies.

23(h)(2) Tolerance for disclosures.

1. General. This section is based on the accuracy of the total finance charge rather than its component charges.

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
SUPP I TO PART 226 OFFICIAL STAFF INTERPRETATIONS (PART III OF III)

1B- Consumer Credit Law Manual § 226.24

§ **226.24 Advertising**

1. Effective date. For guidance on the applicability of the Board's changes to § 226.24 published on July 30, 2008, see comment 1(d)(5)-1.

24(a) Actually available terms.

1. General rule. To the extent that an advertisement mentions specific credit terms, it may state only those terms that the creditor is actually prepared to offer. For example, a creditor may not advertise a very low annual percentage rate that will not in fact be available at any time. This provision is not intended to inhibit the promotion of new credit programs, but to bar the advertising of terms that are not and will not be available. For example, a creditor may advertise terms that will be offered for only a limited period, or terms that will become available at a future date.

24(b) Clear and conspicuous standard.

1. Clear and conspicuous standard--general. This section is subject to the general "clear and conspicuous" standard for this subpart, See *§ 226.17*(a)(1), but prescribes no specific rules for the format of the necessary disclosures, other than the format requirements related to the advertisement of rates and payments as described in comment 24(b)-2 below. The credit terms need not be printed in a certain type size nor need they appear in any particular place in the advertisement. For example, a merchandise tag that is an advertisement under the regulation complies with this section if the necessary credit terms are on both sides of the tag, so long as each side is accessible.

2. Clear and conspicuous standard--rates and payments in advertisements for credit secured by a dwelling. For purposes of § 226.24(f), a clear and conspicuous disclosure means that the required information in §§ 226.24(f)(2)(i) and 226.24(f)(3)(i)(A) and (B) is disclosed with equal prominence and in close proximity to the advertised rates or

payments triggering the required disclosures, and that the required information in § 226.24(f)(3)(i)(C) is disclosed prominently and in close proximity to the advertised rates or payments triggering the required disclosures. If the required information in §§ 226.24(f)(2)(i) and 226.24(f)(3)(i)(A) and (B) is the same type size as the advertised rates or payments triggering the required disclosures, the disclosures are deemed to be equally prominent. The information in § 226.24(f)(3)(i)(C) must be disclosed prominently, but need not be disclosed with equal prominence or be the same type size as the payments triggering the required disclosures. If the required information in §§ 226.24(f)(2)(i) and 226.24(f)(3)(i) is located immediately next to or directly above or below the advertised rates or payments triggering the required disclosures, without any intervening text or graphical displays, the disclosures are deemed to be in close proximity. Notwithstanding the above, for electronic advertisements that disclose rates or payments, compliance with the requirements of § 226.24(e) is deemed to satisfy the clear and conspicuous standard.

3. Clear and conspicuous standard--Internet advertisements for credit secured by a dwelling. For purposes of this section, a clear and conspicuous disclosure for visual text advertisements on the Internet for credit secured by a dwelling means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices and comply with all other requirements for clear and conspicuous disclosures under § 226.24. See also comment 24(e)-4.

4. Clear and conspicuous standard--televised advertisements for credit secured by a dwelling. For purposes of this section, including alternative disclosures as provided for by § 226.24(g), a clear and conspicuous disclosure in the context of visual text advertisements on television for credit secured by a dwelling means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices, are displayed in a manner that allows a consumer to read the information required to be disclosed, and comply with all other requirements for clear and conspicuous disclosures under § 226.24. For example, very fine print in a television advertisement would not meet the clear and conspicuous standard if consumers cannot see and read the information required to be disclosed.

5. Clear and conspicuous standard--oral advertisements for credit secured by a dwelling. For purposes of this section, including alternative disclosures as provided for by § 226.24(g), a clear and conspicuous disclosure in the context of an oral advertisement for credit secured by a dwelling, whether by radio, television, or other medium, means that the required disclosures are given at a speed and volume sufficient for a consumer to hear and comprehend them. For example, information stated very rapidly at a low volume in a radio or television advertisement would not meet the clear and conspicuous standard if consumers cannot hear and comprehend the information required to be disclosed.

24(c) Advertisement of rate of finance charge.

1. Annual percentage rate. Advertised rates must be stated in terms of an annual percentage rate, as defined in § 226.22. Even though state or local law permits the use of add-on, discount, time-price differential, or other methods of stating rates, advertisements must state them as annual percentage rates. Unlike the transactional disclosure of an annual percentage rate under § 226.18(e), the advertised annual percentage rate need not include a descriptive explanation of the term and may be expressed using the abbreviation APR. The advertisement must state that the rate is subject to increase after consummation if that is the case, but the advertisement need not describe the rate increase, its limits, or how it would affect the payment schedule. As under § 226.18(f), relating to disclosure of a variable rate, the rate increase disclosure requirement in this provision does not apply to any rate increase due to delinquency (including late payment), default, acceleration, assumption, or transfer of collateral.

2. Simple or periodic rates. The advertisement may not simultaneously state any other rate, except that a simple annual rate or periodic rate applicable to an unpaid balance may appear along with (but not more conspicuously than) the annual percentage rate. An advertisement for credit secured by a dwelling may not state a periodic rate, other than a simple annual rate, that is applied to an unpaid balance. For example, in an advertisement for credit secured by a dwelling, a simple annual interest rate may be shown in the same type size as the annual percentage rate for the advertised credit, subject to the requirements of section 226.24(f). A simple annual rate or periodic rate that is applied to an unpaid balance is the rate at which interest is accruing; those terms do not include a rate lower than the rate at which interest is accruing, such as an effective rate, payment rate, or qualifying rate.

3. Buydowns. When a third party (such as a seller) or a creditor wishes to promote the availability of reduced interest rates (consumer or seller buydowns), the advertised annual percentage rate must be determined in accordance with the commentary to § 226.17(c) regarding the basis of transactional disclosures for buydowns. The seller or creditor may advertise the reduced simple interest rate, provided the advertisement shows the limited term to which the reduced rate applies and states the simple interest rate applicable to the balance of the term. The advertisement may also show the effect of the buydown agreement on the payment schedule for the buydown period, but this will trigger the additional disclosures under § 226.24(d)(2).

4. Discounted variable-rate transactions. The advertised annual percentage rate for discounted variable-rate transactions must be determined in accordance with comment 17(c)(1)-10 regarding the basis of transactional disclosures for such financing.

i. A creditor or seller may promote the availability of the initial rate reduction in such transactions by advertising the reduced simple annual rate, provided the advertisement shows with equal prominence and in close proximity the limited term to which the reduced rate applies and the annual percentage rate that will apply after the term of the initial rate reduction expires. See *§ 226.24*(f).

ii. Limits or caps on periodic rate or payment adjustments need not be stated. To illustrate using the second example in comment 17(c)(1)-10, the fact that the rate is presumed to be 11 percent in the second year and 12 percent for the remaining 28 years need not be included in the advertisement.

iii. The advertisement may also show the effect of the discount on the payment schedule for the discount period, but this will trigger the additional disclosures under § 226.24(d).

24(d) Advertisement of terms that require additional disclosures.

1. General rule. Under § 226.24(d)(1), whenever certain triggering terms appear in credit advertisements, the additional credit terms enumerated in § 226.24(d)(2) must also appear. These provisions apply even if the triggering

term is not stated explicitly but may be readily determined from the advertisement. For example, an advertisement may state "80 percent financing available," which is in fact indicating that a 20 percent downpayment is required.

Paragraph 24(d)(1).

1. Downpayment. The dollar amount of a downpayment or a statement of the downpayment as a percentage of the price requires further information. By virtue of the definition of downpayment in § 226.2, this triggering term is limited to credit sale transactions. It includes such statements as:

- Only 5% down.
- As low as $100 down.
- Total move-in costs of $800.

This provision applies only if a downpayment is actually required; statements such as no downpayment or no trade-in required do not trigger the additional disclosures under this paragraph.

2. Payment period. The number of payments required or the total period of repayment includes such statements as:

- 48-month payment terms.
- 30-year mortgage
- Repayment in as many as 36 monthly installments.

But it does not include such statements as "pay weekly," "monthly payment terms arranged," or "take years to repay," since these statements do not indicate a time period over which a loan may be financed.

3. Payment amount. The dollar amount of any payment includes statements such as:

- "Payable in installments of $103".
- "$25 weekly".
- "$500,000 loan for just $1,650 per month".
- "$1,200 balance payable in 10 equal installments".

In the last example, the amount of each payment is readily determinable, even though not explicitly stated. But statements such as "monthly payments to suit your needs" or "regular monthly payments" are not deemed to be statements of the amount of any payment.

4. Finance charge. The dollar amount of the finance charge or any portion of it includes statements such as:

- "$500 total cost of credit."
- "$2 monthly carrying charge."
- "$50,000 mortgages, 2 points to the borrower."

In the last example, the $1,000 prepaid finance charge can be readily determined from the information given. Statements of the annual percentage rate or statements that there is no particular charge for credit (such as "no closing costs") are not triggering terms under this paragraph.

Paragraph 24(d)(2).

1. Disclosure of downpayment. The total downpayment as a dollar amount or percentage must be shown, but the word "downpayment" need not be used in making this disclosure. For example, "10% cash required from buyer" or "credit terms require minimum $100 trade-in" would suffice.

2. Disclosure of repayment terms The phrase "terms of repayment" generally has the same meaning as the "payment schedule" required to be disclosed under § 226.18(g). Section 226.24(d)(2)(ii) provides flexibility to creditors in making this disclosure for advertising purposes. Repayment terms may be expressed in a variety of ways in addition to an exact repayment schedule; this is particularly true for advertisements that do not contemplate a single specific transaction. Repayment terms, however, must reflect the consumer's repayment obligations over the full term of the loan, including any balloon payment, See comment 24(d)(2)-3, not just the repayment terms that will apply for a limited period of time. For example:

i. A creditor may use a unit-cost approach in making the required disclosure, such as "48 monthly payments of $27.83 per $1,000 borrowed."

ii. In an advertisement for credit secured by a dwelling, when any series of payments varies because of the inclusion of mortgage insurance premiums, a creditor may state the number and timing of payments, the fact that payments do not include amounts for mortgage insurance premiums, and that the actual payment obligation will be higher.

iii. In an advertisement for credit secured by a dwelling, when one series of monthly payments will apply for a limited period of time followed by a series of higher monthly payments for the remaining term of the loan, the advertisement must state the number and time period of each series of payments, and the amounts of each of those payments. For this purpose, the creditor must assume that the consumer makes the lower series of payments for the maximum allowable period of time.

3. Balloon payment; disclosure of repayment terms In some transactions, a balloon payment will occur when the consumer only makes the minimum payments specified in an advertisement. A balloon payment results if paying the minimum payments does not fully amortize the outstanding balance by a specified date or time, usually the end of the term of the loan, and the consumer must repay the entire outstanding balance at such time. If a balloon payment will occur when the consumer only makes the minimum payments specified in an advertisement, the advertisement must state with equal prominence and in close proximity to the minimum payment statement the amount and timing of the balloon payment that will result if the consumer makes only the minimum payments for the maximum period of time that the consumer is permitted to make such payments.

4. Annual percentage rate. The advertised annual percentage rate may be expressed using the abbreviation "APR." The advertisement must also state, if applicable, that the annual percentage rate is subject to increase after consummation.

5. Use of examples. A creditor may use illustrative credit transactions to make the necessary disclosures under § 226.24(d)(2). That is, where a range of possible combinations of credit terms is offered, the advertisement may use examples of typical transactions, so long as each example contains all of the applicable terms required by § 226.24(d). The examples must be labeled as such and must reflect representative credit terms made available by the creditor to present and prospective customers.

24(e) Catalogs or other multiple-page advertisements; electronic advertisements.

1. Definition. The multiple-page advertisements to which this section refers are advertisements consisting of a series of sequentially numbered pages -- for example, a supplement to a newspaper. A mailing consisting of several separate flyers or pieces of promotional material in a single envelope does not constitute a single multiple-page advertisement for purposes of § 226.24(e).

2. General. Section 226.24(e) permits creditors to put credit information together in one place in a catalog or other multiple-page advertisement or in an electronic advertisement (such as an advertisement appearing on an Internet Web site). The rule applies only if the advertisement contains one or more of the triggering terms from § 226.24(d)(1). A list of different annual percentage rates applicable to different balances, for example, does not trigger further disclosures under § 226.24(d)(2) and so is not covered by § 226.24(e).

3. Representative examples The table or schedule must state all the necessary information for a representative sampling of amounts of credit. This must reflect amounts of credit the creditor actually offers, up to and including the higher-priced items. This does not mean that the chart must make the disclosures for the single most expensive item the seller offers, but only that the chart cannot be limited to information about less expensive sales when the seller commonly offers a distinct level of more expensive goods or services. The range of transactions shown in the table or schedule in a particular catalog or multiple-page advertisement need not exceed the range of transactions actually offered in that advertisement.

4. Electronic advertisement. If an electronic advertisement (such as an advertisement appearing on an Internet Web site) contains the table or schedule permitted under § 226.24(e)(1), any statement of terms set forth in § 226.24(d)(1) appearing anywhere else in the advertisement must clearly direct the consumer to the location where the table or schedule begins. For example, a term triggering additional disclosures may be accompanied by a link that directly takes the consumer to the additional information.

References

Statute: Sections 141, 142, and 144.

Other sections: Sections 226.2, 226.4, and 226.22.

Previous regulation: Section 226.10 (a), (b), and (d).

1981 changes: This section retains the advertising rules in a form very similar to the previous regulation, but with certain changes to reflect the 1980 statutory amendments. For example, if triggering terms appear in any advertisement, the additional disclosures required no longer include the cash price. The special rule for FHA section 235 financing has been eliminated, as well as the rule for advertising credit payable in more than four installments with no identified finance charge. Interpretation § 226.1002, requiring disclosure of representative amounts of credit in catalogs and multiple-page advertisements, 'has been incorporated in simplified form in § 226.24(d).

Unlike the previous regulation, if the advertised annual percentage rate is subject to increase, that fact must now be disclosed.

24(f) Disclosure of rates and payments in advertisements for credit secured by a dwelling.

1. Applicability. The requirements of § 226.24(f)(2) apply to advertisements for loans where more than one simple annual rate of interest will apply. The requirements of § 226.24(f)(3)(i)(A) require a clear and conspicuous disclosure of each payment that will apply over the term of the loan. In determining whether a payment will apply when the consumer may choose to make a series of lower monthly payments that will apply for a limited period of time, the creditor must assume that the consumer makes the series of lower payments for the maximum allowable period of time. See comment 24(d)(2)-2.iii. However, for purposes of § 226.24(f), the creditor may, but need not, assume that specific events which trigger changes to the simple annual rate of interest or to the applicable payments will occur. For example:

i. Fixed-rate conversion loans. If a loan program permits consumers to convert their variable-rate loans to fixed rate loans, the creditor need not assume that the fixed-rate conversion option, by itself, means that more than one simple annual rate of interest will apply to the loan under § 226.24(f)(2) and need not disclose as a separate payment under § 226.24(f)(3)(i)(A) the payment that would apply if the consumer exercised the fixed-rate conversion option.

ii. Preferred-rate loans. Some loans contain a preferred-rate provision, where the rate will increase upon the occurrence of some event, such as the consumer-employee leaving the creditor's employ or the consumer closing an existing deposit account with the creditor or the consumer revoking an election to make automated payments. A creditor need not assume that the preferred-rate provision, by itself, means that more than one simple annual rate of interest will apply to the loan under § 226.24(f)(2) and the payments that would apply upon occurrence of the event that triggers the

rate increase need not be disclosed as a separate payments under § 226.24(f)(3)(i)(A).

iii. Rate reductions. Some loans contain a provision where the rate will decrease upon the occurrence of some event, such as if the consumer makes a series of payments on time. A creditor need not assume that the rate reduction provision, by itself, means that more than one simple annual rate of interest will apply to the loan under § 226.24(f)(2) and need not disclose the payments that would apply upon occurrence of the event that triggers the rate reduction as a separate payments under § 226.24(f)(3)(i)(A).

2. Equal prominence, close proximity. Information required to be disclosed under §§ 226.24(f)(2)(i) and 226.24(f)(3)(i) that is immediately next to or directly above or below the simple annual rate or payment amount (but not in a footnote) is deemed to be closely proximate to the listing. Information required to be disclosed under §§ 226.24(f)(2)(i) and 226.24(f)(3)(i)(A) and (B) that is in the same type size as the simple annual rate or payment amount is deemed to be equally prominent.

3. Clear and conspicuous standard. For more information about the applicable clear and conspicuous standard, see comment 24(b)-2.

4. Comparisons in advertisements. When making any comparison in an advertisement between actual or hypothetical credit payments or rates and the payments or rates available under the advertised product, the advertisement must state all applicable payments or rates for the advertised product and the time periods for which those payments or rates will apply, as required by this section.

5. Application to variable-rate transactions--disclosure of rates. In advertisements for variable-rate transactions, if a simple annual rate that applies at consummation is not based on the index and margin that will be used to make subsequent rate adjustments over the term of the loan, the requirements of § 226.24(f)(2)(i) apply.

6. Reasonably current index and margin. For the purposes of this section, an index and margin is considered reasonably current if:

i. For direct mail advertisements, it was in effect within 60 days before mailing;

ii. For advertisements in electronic form it was in effect within 30 days before the advertisement is sent to a consumer's e-mail address, or in the case of an advertisement made on an Internet Web site, when viewed by the public; or

iii. For printed advertisements made available to the general public, including ones contained in a catalog, magazine, or other generally available publication, it was in effect within 30 days before printing.

24(f)(3) Disclosure of payments.

1. Amounts and time periods of payments. Section 226.24(f)(3)(i) requires disclosure of the amounts and time periods of all payments that will apply over the term of the loan. This section may require disclosure of several payment amounts, including any balloon payment. For example, if an advertisement for credit secured by a dwelling offers $300,000 of credit with a 30-year loan term for a payment of $600 per month for the first six months, increasing to $1,500 per month after month six, followed by a balloon payment of $30,000 at the end of the loan term, the advertisement must disclose the amount and time periods of each of the two monthly payment streams, as well as the amount and timing of the balloon payment, with equal prominence and in close proximity to each other. However, if the final scheduled payment of a fully amortizing loan is not greater than two times the amount of any other regularly scheduled payment, the final payment need not be disclosed.

2. Application to variable-rate transactions--disclosure of payments. In advertisements for variable-rate transactions, if the payment that applies at consummation is not based on the index and margin that will be used to make subsequent payment adjustments over the term of the loan, the requirements of § 226.24(f)(3)(i) apply.

24(g) Alternative disclosures--television or radio advertisements.

1. Multi-purpose telephone number. When an advertised telephone number provides a recording, disclosures should be provided early in the sequence to ensure that the consumer receives the required disclosures. For example, in providing several options -- such as providing directions to the advertiser's place of business--the option allowing the consumer to request disclosures should be provided early in the telephone message to ensure that the option to request disclosures is not obscured by other information.

2. Statement accompanying telephone number. Language must accompany a telephone number indicating that disclosures are available by calling the telephone number, such as "call 1-800-000-0000 for details about credit costs and terms."

24(i) Prohibited acts or practices in advertisements for credit secured by a dwelling.

1. Comparisons in advertisements. The requirements of § 226.24(i)(2) apply to all advertisements for credit secured by a dwelling, including radio and television advertisements. A comparison includes a claim about the amount a consumer may save under the advertised product. For example, a statement such as "save $300 per month on a $300,000 loan" constitutes an implied comparison between the advertised product's payment and a consumer's current payment.

2. Misrepresentations about government endorsement. A statement that the federal Community Reinvestment Act

entitles the consumer to refinance his or her mortgage at the low rate offered in the advertisement is prohibited because it conveys a misleading impression that the advertised product is endorsed or sponsored by the federal government.

3. Misleading claims of debt elimination. The prohibition against misleading claims of debt elimination or waiver or forgiveness does not apply to legitimate statements that the advertised product may reduce debt payments, consolidate debts, or shorten the term of the debt. Examples of misleading claims of debt elimination or waiver or forgiveness of loan terms with, or obligations to, another creditor of debt include: "Wipe-Out Personal Debts!", "New DEBT-FREE Payment", "Set yourself free; get out of debt today", "Refinance today and wipe your debt clean!", "Get yourself out of debt * * * Forever!", and "Pre-payment Penalty Waiver."

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1B- Consumer Credit Law Manual § 226.25

§ **226.25 Record Retention**

(a) General rule.

1. Evidence of required actions. The creditor must retain evidence that it performed the required actions as well as made the required disclosures. This includes, for example, evidence that the creditor properly handled adverse credit reports in connection with amounts subject to a billing dispute under § 226.13, and properly handled the refunding of credit balances under §§ 226.11 and 226.21.

2. Methods of retaining evidence. Adequate evidence of compliance does not necessarily mean actual paper copies of disclosure statements or other business records. The evidence may be retained on microfilm, microfiche, or by any other method that reproduces records accurately (including computer programs). The creditor need retain only enough information to reconstruct the required disclosures or other records. Thus, for example, the creditor need not retain each open-end periodic statement, so long as the specific information on each statement can be retrieved.

3. Certain variable-rate transactions. In variable-rate transactions that are subject to the disclosure requirements of § 226.19(b), written procedures for compliance with those requirements as well as a sample disclosure form for each loan program represent adequate evidence of compliance. (See comment 25(a)-2 pertaining to permissible methods of retaining the required disclosures.)

4. Home equity plans. In home equity plans that are subject to the requirements of § 226.5b, written procedures for compliance with those requirements as well as a sample disclosure form and contract for each home equity program represent adequate evidence of compliance. (See comment 25(a)-2 pertaining to permissible methods of retaining the

required disclosures.)

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1B- Consumer Credit Law Manual § 226.26

§ 226.26 Use of Annual Percentage Rate in Oral Disclosures

1. Application of rules. The restrictions of § 226.26 apply only if the creditor chooses to respond orally to the consumer's request for credit cost information. Nothing in the regulation requires the creditor to supply rate information orally. If the creditor volunteers information (including rate information) through oral solicitations directed generally to prospective customers, as through a telephone solicitation, those communications may be advertisements subject to the rules in §§ 226.16 and 226.24.

26(a) Open-end credit.

1. Information that may be given. The creditor may state periodic rates in addition to the required annual percentage rate, but it need not do so. If the annual percentage rate is unknown because transaction charges, loan fees, or similar finance charges may be imposed, the creditor must give the corresponding annual percentage rate (that is, the periodic rate multiplied by the number of periods in a year, as described in §§ 226.6(a)(1)(ii) and (b)(4)(i)(A) and 226.7(a)(4) and (b)(4)). In such cases, the creditor may, but need not, also give the consumer information about other finance charges and other charges.

26(b) Closed-end credit.

1. Information that may be given. The creditor may state other annual or periodic rates that are applied to an unpaid balance, along with the required annual percentage rate. This rule permits disclosure of a simple interest rate, for example, but not an add-on, discount, or similar rate. If the creditor cannot give a precise annual percentage rate in its oral response because of variables in the transaction, it must give the annual percentage rate for a comparable sample transaction; in this case, other cost information may, but need not, be given. For example, the creditor may be unable to state a precise annual percentage rate for a mortgage loan without knowing the exact amount to be financed, the amount of loan fees or mortgage insurance premiums, or similar factors. In this situation, the creditor should state an annual percentage rate for a sample transaction; it may also provide information about the consumer's specific case, such as the

contract interest rate, points, other finance charges, and other charges.

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1B- Consumer Credit Law Manual § 226.27

§ **226.27 Language of Disclosures**

1. Subsequent disclosures. If a creditor provides account-opening disclosures in a language other than English, subsequent disclosures need not be in that other language. For example, if the creditor gave Spanish-language account-opening disclosures, periodic statements and change-in-terms notices may be made in English.

2. [Reserved]

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1B- Consumer Credit Law Manual § 226.28

§ 226.28 Effect on State Laws

28(a) Inconsistent disclosure requirements

1. General. There are 3 sets of preemption criteria: 1 applies to the general disclosure and advertising rules of the regulation, and 2 apply to the credit billing provisions. Section 226.28 also provides for Board determinations of preemption.

2. Rules for chapters 1, 2, and 3. The standard for judging whether State laws that cover the types of requirements in chapters 1 (General provisions), 2 (Credit transactions), and 3 (Credit advertising) of the Act are inconsistent and therefore preempted, is contradiction of the Federal law. Examples of laws that would be preempted include:

- A State law that requires use of the term finance charge, but defines the term to include fees that the Federal law excludes, or to exclude fees the Federal law includes.

- A State law that requires a label such as nominal annual interest rate to be used for what the Federal law calls the annual percentage rate.

3. Laws not contradictory to chapters 1, 2, and 3. Generally, State law requirements that call for the disclosure of items of information not covered by the Federal law, or that require more detailed disclosures, do not contradict the Federal requirements. Examples of laws that are not preempted include:

- A State law that requires disclosure of the minimum periodic payment for open-end credit, even though not required by § 226.7.

- A State law that requires contracts to contain warnings such as: "Read this contract before you sign. Do not sign if any spaces are left blank. You are entitled to a copy of this contract."

Similarly, a State law that requires itemization of the amount financed does not automatically contradict the permissive itemization under § 226.18(c). However, a State law requirement that the itemization appear with the disclosure of the amount financed in the segregated closed-end credit disclosures is inconsistent, and this location requirement would be preempted.

4. Creditor's options. Before the Board makes a determination about a specific State law, the creditor has certain options. Since the prohibition against giving the State disclosures does not apply until the Board makes its determination, the creditor may choose to give State disclosures until the Board formally determines that the State law is inconsistent. (The Board will provide sufficient time for creditors to revise forms and procedures as necessary to conform to its determinations.)

- Under this first approach, as in all cases, the Federal disclosures must be clear and conspicuous, and the closed-end disclosures must be properly segregated in accordance with § 226.17(a)(1).

- This ability to give State disclosures relieves any uncertainty that the creditor might have prior to Board determinations of inconsistency.

As a second option, the creditor may apply the preemption standards to a State law, conclude that it is inconsistent, and choose not to give the state-required disclosures. However, nothing in § 226.28(a) provides the creditor with immunity for violations of State law if the creditor chooses not to make State disclosures and the Board later determines that the State law is not preempted.

5. Rules for correction of billing errors and regulation of credit reports. The preemption criteria for the fair credit billing provisions set forth in § 226.28 have 2 parts. With respect to the rules on correction of billing errors and regulation of credit reports (which are in § 226.13), § 226.28(a)(2)(i) provides that a State law is inconsistent and preempted if its requirements are different from the Federal law. An exception is made, however, for State laws that allow the consumer to inquire about an account and require the creditor to respond to such inquiries beyond the time limits in the Federal law. Such a State law is not preempted with respect to the extra time period. For example, § 226.13 requires the consumer to submit a written notice of billing error within 60 days after transmittal of the periodic statement showing the alleged error. If a State law allows the consumer 90 days to submit a notice, the State law remains in effect to provide the extra 30 days. Any State law disclosures concerning this extended state time limit must reflect the qualifications and conform to the format specified in § 226.28(a)(2)(i). Examples of laws that would be preempted include:

- A State law that has a narrower or broader definition of billing error.

- A State law that requires the creditor to take different steps to resolve errors.

- A State law that provides different timing rules for error resolution (subject to the exception discussed above).

6. Rules for other fair credit billing provisions. The second part of the criteria for fair credit billing relates to the other rules implementing chapter 4 of the act (addressed in §§ 226.4(c)(8), 226.5(b)(2)(ii), 226.6(a)(5) and (b)(5)(iii), 226.7(a)(9) and (b)(9), 226.9(a), 226.10, 226.11, 226.12(c) through (f), 226.13, and 226.21). Section 226.28(a)(2)(ii) provides that the test of inconsistency is whether the creditor can comply with state law without violating Federal law.

For example:

i. A state law that allows the card issuer to offset the consumer's credit-card indebtedness against funds held by the card issuer would be preempted, since § 226.12(d) prohibits such action.

ii. A state law that requires periodic statements to be sent more than 14 days before the end of a free-ride period would not be preempted.

iii. A state law that permits consumers to assert claims and defenses against the card issuer without regard to the $50 and 100-mile limitations of § 226.12(c)(3)(ii) would not be preempted.

iv. In paragraphs ii. and iii. of this comment, compliance with state law would involve no violation of the Federal law.

7. Who may receive a chapter 4 determination. Only states (through their authorized officials) may request and receive determinations on inconsistency with respect to the fair credit billing provisions.

8. Preemption determination--Arizona. Effective October 1, 1983, the Board has determined that the following provisions in the State law of Arizona are preempted by the Federal law:

- Section 44-287 B.5--Disclosure of final cash price balance.This provision is preempted in those transactions in which the amount of the final cash price balance is the same as the Federal amount financed, since in such transactions the State law requires the use of a term different from the Federal term to represent the same amount.

- Section 44-287 B.6--Disclosure of finance charge. This provision is preempted in those transactions in which the amount of the finance charge is different from the amount of the Federal finance charge, since in such transactions the State law requires the use of the same term as the Federal law to represent a different amount.

- Section 44-267 B.7--Disclosure of the time balance. The time balance disclosure provision is preempted in those transactions in which the amount is the same as the amount of the Federal total of payments, since in such transactions the State law requires the use of a term different from the Federal term to represent the same amount.

9. Preemption determination--Florida. Effective October 1, 1983, the Board has determined that the following provisions in the State law of Florida are preempted by the Federal law:

- Sections 520.07(2)(f) and 520.34(2)(f)--Disclosure of amount financed. This disclosure is preempted in those transactions in which the amount is different from the Federal amount financed, since in such transactions the State law requires the use of the same term as the Federal law to represent a different amount.

- Sections 520.07(2)(g), 520.34(2)(g), and 520.35(2)(d)--Disclosure of finance charge and a description of its components. The finance charge disclosure is preempted in those transactions in which the amount of the finance charge is different from the Federal amount, since in such transactions the State law requires the use of the same term as the Federal law to represent a different amount. The requirement to describe or itemize the components of the finance charge, which is also included in these provisions, is not preempted.

- Sections 520.07(2)(h) and 520.34(2)(h)--Disclosure of total of payments. The total of payments disclosure is preempted in those transactions in which the amount differs from the amount of the Federal total of payments, since in such transactions the State law requires the use of the same term as the Federal law to represent a different amount than the Federal law.

- Sections 520.07(2)(i) and 520.34(2)(i)--Disclosure of deferred payment price. This disclosure is preempted in those transactions in which the amount is the same as the Federal total sale price, since in such transactions the State law requires the use of a different term than the Federal law to represent the same amount as the Federal law.

10. Preemption determination--Missouri. Effective October 1, 1983, the Board has determined that the following provisions in the State law of Missouri are preempted by the Federal law:

- Sections 365.070-6(9) and 408.260-5(6)--Disclosure of principal balance. This disclosure is preempted in those transactions in which the amount of the principal balance is the same as the Federal amount financed, since in such transactions the State law requires the use of a term different from the Federal term to represent the same amount.

- Sections 365.070-6(10) and 408.260-5(7)--Disclosure of time price differential and time charge, respectively. These disclosures are preempted in those transactions in which the amount is the same as the Federal finance charge, since in such transactions the State law requires the use of a term different from the Federal law to represent the same amount.

- Sections 365.070-2 and 408.260-2--Use of the terms time price differential and time charge in certain notices to the buyer. In those transactions in which the State disclosure of the time price differential or time charge is preempted, the use of the terms in this notice also is preempted. The notice itself is not preempted.

- Sections 365.070-6(11) and 408.260-5(8)--Disclosure of time balance. The time balance disclosure is preempted in those transactions in which the amount is the same as the amount of the Federal total of payments, since in such transactions the State law requires the use of a different term than the Federal law to represent the same amount.

- Sections 365.070-6(12) and 408.260-5(9)--Disclosure of time sale price. This disclosure is preempted in those transactions in which the amount is the same as the Federal total sale price, since in

such transactions the State law requires the use of a different term from the Federal law to represent the same amount.

11. Preemption determination--Mississippi. Effective October 1, 1984, the Board has determined that the following provision in the State law of Mississippi is preempted by the Federal law:

- Section 63-19-31(2)(g)--Disclosure of finance charge. This disclosure is preempted in those cases in which the term finance charge would be used under State law to describe a different amount than the finance charge disclosed under Federal law.

12. Preemption determination--South Carolina. Effective October 1, 1984, the Board has determined that the following provision in the State law of South Carolina is preempted by the Federal law.

- Section 37-10-102(c)--Disclosure of due-on-sale clause. This provision is preempted, but only to the extent that the creditor is required to include the disclosure with the segregated Federal disclosures. If the creditor may comply with the State law by placing the due-on-sale notice apart from the Federal disclosures, the state law is not preempted.

13. Preemption determination--Arizona. Effective October 1, 1986, the Board has determined that the following provision in the State law of Arizona is preempted by the Federal law:

- Section 6-621A.2--Use of the term the total sum of $------ in certain notices provided to borrowers. This term describes the same item that is disclosed under Federal law as the total of payments. Since the State law requires the use of a different term than Federal law to describe the same item, the State-required term is preempted. The notice itself is not preempted.

(NOTE:
The State disclosure notice that incorporated the above preempted term was amended on May 4, 1987, to provide that disclosures must now be made pursuant to the Federal disclosure provisions.)

14. Preemption determination--Indiana. Effective October 1, 1988, the Board has determined that the following provision in the State law of Indiana is preempted by the Federal law:

- Section 23-2-5-8--Inclusion of the loan broker's fees and charges in the calculation of, among other items, the finance charge and annual percentage rate disclosed to potential borrowers. This disclosure is inconsistent with sections 106(a) and § 226.4(a) of the Federal statute and regulation, respectively, and is preempted in those instances where the use of the same term would disclose a different amount than that required to be disclosed under Federal law.

15. Preemption determination--Wisconsin. Effective October 1, 1991, the Board has determined that the following provisions in the state law of Wisconsin are preempted by the federal law:

- Section 422.308(1)--the disclosure of the annual percentage rate in cases where the amount of the annual percentage rate disclosed to consumers under the state law differs from the amount that would be disclosed under federal law, since in those cases the state law requires the use of the same term as the federal law to represent a different amount than the federal law.

- Section 766.565(5)--the provision permitting a creditor to include in an open-end home equity agreement authorization to declare the account balance due and payable upon receiving notice of termination from a non-obligor spouse, since such provision is inconsistent with the purpose of the federal law.

28(b) Equivalent disclosure requirements.

1. General. A state disclosure may be substituted for a Federal disclosure only after the Board has made a finding of substantial similarity. Thus, the creditor may not unilaterally choose to make a state disclosure in place of a Federal disclosure, even if it believes that the state disclosure is substantially similar. Since the rule stated in § 226.28(b) does not extend to any requirement relating to the finance charge or annual percentage rate, no state provision on computation, description, or disclosure of these terms may be substituted for the Federal provision.

28(c) Special Rule for Credit and Charge Cards.

1. General. The standard that applies to preemption of state laws as they affect transactions of the type subject to §§ 226.5a and 226.9(e) differs from the preemption standards generally applicable under the Truth in Lending Act. The Fair Credit and Charge Card Disclosure Act fully preempts state laws relating to the disclosure of credit information in consumer credit or charge card applications or solicitations. (For purposes of this section, a single credit or charge card application or solicitation that may be used to open either an account for consumer purposes or an account for business purposes is deemed to be a "consumer credit or charge card application or solicitation.") For example, a state law requiring disclosure of credit terms in direct mail solicitations for consumer credit card accounts is preempted. A state law requiring disclosures in telephone applications for consumer credit card accounts also is preempted, even if it applies to applications initiated by the consumer rather than the issuer, because the state law relates to the disclosure of credit information in applications or solicitations within the general field of preemption, that is, consumer credit and charge cards.

2. Limitations on field of preemption. Preemption under the Fair Credit and Charge Card Disclosure Act does not extend to state laws applying to types of credit other than open-end consumer credit and charge card accounts. Thus, for example, a state law is not preempted as it applies to disclosures in credit and charge card applications and solicitations solely for business-purpose accounts. On the other hand, state credit disclosure laws will not apply to a single application or solicitation to open either an account for consumer purposes or an account for business purposes. Such "dual purpose" applications and solicitations are treated as "consumer credit or charge card applications or solicitations" under this section and state credit disclosure laws applicable to them are preempted. Preemption under this statute does not extend to state laws applicable to home equity plans; preemption determinations in this area are based on the Home Equity Loan Consumer Protection Act, as implemented in § 226.5b of the regulation.

3. Laws not preempted. State laws relating to disclosures concerning credit and charge cards other than in applications, solicitations, or renewal notices are not preempted under § 226.28(d). In addition, state laws regulating the terms of credit and charge card accounts are not preempted, nor are laws preempted that regulate the form or content of information unrelated to the information required to be disclosed under §§ 226.5a and 226.9(e). Finally, state laws concerning the enforcement of the requirements of §§ 226.5a and 226.9(e) and state laws prohibiting unfair or deceptive acts or practices concerning credit and charge card applications, solicitations and renewals are not preempted. Examples of laws that are not preempted include:

- A state law that requires card issuers to offer a grace period or that prohibits certain fees in credit and charge card transactions.

- A state retail installment sales law or a state plain language law, except to the extent that it regulates the disclosure of credit information in applications, solicitations and renewals of accounts of the type subject to §§ 226.5a and 226.9(e).

- A state law requiring notice of a consumer's rights under antidiscrimination or similar laws or a state law requiring notice about credit information available from state authorities.

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
Subpart D MISCELLANEOUS

1B- Consumer Credit Law Manual § 226.29

§ 226.29 State Exemption

29(a) General rule.

1. Classes eligible. The state determines the classes of transactions for which it will request an exemption, and makes its application for those classes. Classes might be, for example, all open-end credit transactions, all open-end and closed-end transactions, or all transactions in which the creditor is a bank.

2. Substantial similarity. The "substantially similar" standard requires that state statutory or regulatory provisions and state interpretations of those provisions be generally the same as the Federal Act and Regulation Z. This includes the requirement that state provisions for reimbursement to consumers for overcharges be at least equivalent to those required in section 108 of the act. A State will be eligible for an exemption even if its law covers classes of transactions not covered by the Federal law. For example, if a state's law covers agricultural credit, this will not prevent the Board from granting an exemption for consumer credit, even though agricultural credit is not covered by the Federal law.

3. Adequate enforcement. The standard requiring adequate provision for enforcement generally means that appropriate state officials must be authorized to enforce the state law through procedures and sanctions comparable to those available to Federal enforcement agencies. Furthermore, state law must make adequate provision for enforcement of the reimbursement rules.

4. Exemptions granted. Effective October 1, 1982, the Board has granted the following exemptions from portions of the revised Truth in Lending Act:

- Maine. Credit or lease transactions subject to the Maine Consumer Credit Code and its implementing regulations are exempt from chapters 2, 4 and 5 of the Federal Act. (The exemption does not apply to

transactions in which a federally chartered institution is a creditor or lessor.)

- Connecticut. Credit transactions subject to the Connecticut Truth in Lending Act are exempt from chapters 2 and 4 of the Federal Act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor.)

- Massachusetts. Credit transactions subject to the Massachusetts Truth in Lending Act are exempt from chapters 2 and 4 of the Federal Act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor.)

- Oklahoma. Credit or lease transactions subject to the Oklahoma Consumer Credit Code are exempt from chapters 2 and 5 of the Federal Act. (The exemption does not apply to sections 132 through 135 of the Federal Act, nor does it apply to transactions in which a federally chartered institution is a creditor or lessor.)

- Wyoming. Credit transactions subject to the Wyoming Consumer Credit Code are exempt from chapter 2 of the Federal Act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor.)

29(b) Civil liability.

1. Not eligible for exemption. The provision that an exemption may not extend to sections 130 and 131 of the Act assures that consumers retain access to both Federal and State courts in seeking damages or civil penalties for violations, while creditors retain the defenses specified in those sections.

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1B- Consumer Credit Law Manual § 226.30

§ 226.30 Limitation on Rates

1. Scope of coverage. The requirement of this section applies to consumer credit obligations secured by a dwelling (as dwelling is defined in § 226.2(a)(19)) in which the annual percentage rate may increase after consummation (or during the term of the plan, in the case of open-end credit) as a result of an increase in the interest rate component of the finance charge--whether those increases are tied to an index or formula or are within a creditor's discretion. The section applies to credit sales as well as loans. Examples of credit obligations subject to this section include:

- Dwelling-secured credit obligations that require variable-rate disclosures under the regulation because the interest rate may increase during the term of the obligation.

- Dwelling-secured open-end credit plans entered into before November 7, 1989 (the effective date of the home equity rules) that are not considered variable-rate obligations for purposes of disclosure under the regulation but where the creditor reserves the contractual right to increase the interest rate--periodic rate and corresponding annual percentage rate--during the term of the plan.

In contrast, credit obligations in which there is no contractual right to increase the interest rate during the term of the obligation are not subject to this section. Examples include:

- "Shared-equity" or "shared-appreciation" mortgage loans that have a fixed rate of interest and a shared-appreciation feature based on the consumer's equity in the mortgaged property. (The appreciation share is payable in a lump sum at a specified time.)

- Dwelling-secured fixed-rate closed-end balloon-payment mortgage loans and dwelling-secured fixed-rate open-end plans with a stated term that the creditor may renew at maturity. (Contrast with the renewable balloon-payment mortgage instrument described in comment 17(c)(1)-11.)

- Dwelling-secured fixed rate closed-end multiple advance transactions in which each advance is disclosed as a separate transaction.

- "Price level adjusted mortgages" or other indexed mortgages that have a fixed rate of interest but provide for periodic adjustments to payments and the loan balance to reflect changes in an index measuring prices or inflation.

The requirement of this section does not apply to credit obligations entered into prior to December 9, 1987. Consequently, new advances under open-end credit plans existing prior to December 9, 1987, are not subject to this section.

2. Refinanced obligations. On or after December 9, 1987, when a credit obligation is refinanced, as defined in § 226.20(a), the new obligation is subject to this section if it is dwelling-secured and allows for increases in the interest rate.

3. Assumptions. On or after December 9, 1987, when a credit obligation is assumed, as defined in § 226.20(b), the obligation becomes subject to this section if it is dwelling-secured and allows for increases in the interest rate.

4. Modifications of obligations. The modification of an obligation, regardless of when the obligation was entered into, is generally not covered by this section. For example, increasing the credit limit on a dwelling-secured, open-end plan with a variable interest rate entered into before the effective date of the rule does not make the obligation subject to this section. If, however, a security interest in a dwelling is added on or after December 9, 1987, to a credit obligation that allows for interest rate increases, the obligation becomes subject to this section. Similarly, if a variable interest rate feature is added to a dwelling-secured credit obligation, the obligation becomes subject to this section.

5. Land trusts In some states, a land trust is used in residential real estate transactions. (See discussion in comment 3(a)-8).) If a consumer-purpose loan that allows for interest rate increases is secured by an assignment of a beneficial interest in a land trust that holds title to a consumer's dwelling, that loan is subject to this section.

6. Relationship to other sections. Unless otherwise provided for in the commentary to this section, other provisions of the regulation such as definitions, exemptions, rules and interpretations also apply to this section where appropriate. To illustrate:

- An adjustable interest rate business-purpose loan is not subject to this section even if the loan is secured by a dwelling because such credit extensions are not subject to the regulation. (See generally § 226.3(a).)

- Creditors subject to this section are only those that fall within the definition of a creditor in § 226.2(a)(17).

7. Consumer credit contract. Creditors are required to specify a lifetime maximum interest rate in their credit contracts--the instrument that creates personal liability and generally contains the terms and conditions of the agreement

(for example, a promissory note or home-equity line of credit agreement). In some states, the signing of a commitment letter may create a binding obligation, for example, constituting consummation as defined in § 226.2(a)(13). The maximum interest rate must be included in the credit contract, but a creditor may include the rate ceiling in the commitment instrument as well.

8. Manner of stating the maximum interest rate. The maximum interest rate must be stated in the credit contract either as a specific amount or in any other manner that would allow the consumer to easily ascertain, at the time of entering into the obligation, what the rate ceiling will be over the term of the obligation.

i. For example, the following statements would be sufficiently specific:

A. The maximum interest rate will not exceed X%.

B. The interest rate will never be higher than X percentage points above the initial rate of Y%.

C. The interest rate will not exceed X%, or X percentage points about [a rate to be determined at some future point in time], whichever is less.

D. The maximum interest rate will not exceed X%, or the state usury ceiling, whichever is less.

ii. The following statements would not comply with this section:

A. The interest rate will never be higher than X percentage points over the prevailing market rate.

B. The interest rate will never be higher than X percentage points above [a rate to be determined at some future point in time].

C. The interest rate will not exceed the state usury ceiling which is currently X%.

iii. A creditor may state the maximum rate in terms of a maximum annual percentage rate that may be imposed. Under

an open-end credit plan, this normally would be the corresponding annual percentage rate. (See generally § 226.6(a)(1)(ii) and (b)(4)(i)(A).)

9. Multiple interest rate ceilings. Creditors are not prohibited from setting multiple interest rate ceilings. For example, on loans with multiple variable-rate features, creditors may establish a maximum interest rate for each feature. To illustrate, in a variable-rate loan that has an option to convert to a fixed rate, a creditor may set one maximum interest rate for the initially imposed index-based variable-rate feature and another for the conversion option. Of course, a creditor may establish one maximum interest rate applicable to all features.

10. Interest rate charged after default. State law may allow an interest rate after default higher than the contract rate in effect at the time of default; however, the interest rate after default is subject to a maximum interest rate set forth in a credit obligation that is otherwise subject to this section. This rule applies only in situations in which a post-default agreement is still considered part of the original obligation.

11. Increasing the maximum interest rate--general rule. Generally, a creditor may not increase the maximum interest rate originally set on a credit obligation subject to this section unless the consumer and the creditor enter into a new obligation. Therefore, under an open-end plan, a creditor may not increase the rate ceiling imposed merely because there is an increase in the credit limit. If an open-end plan is closed and another opened, a new rate ceiling may be imposed. Furthermore, where an open-end plan has a fixed maturity and a creditor renews the plan at maturity, or enters into a closed-end credit transaction, a new maximum interest rate may be set at that time. If the open-end plan provides for a repayment phase, the maximum interest rate cannot be increased when the repayment phase begins unless the agreement provided for such an increase. For a closed-end credit transaction, a new maximum interest rate may be set only if the transaction is satisfied and replaced by a new obligation. (The exceptions in § 226.20(a)(1)-(5) which limit what transactions are considered refinancings for purposes of disclosure do not apply with respect to increasing a rate ceiling that has been imposed; if a transaction is satisfied and replaced, the rate ceiling may be increased.)

12. Increasing the maximum interest rate--assumption of an obligation. If an obligation subject to this section is assumed by a new obligor and the original obligor is released from liability, the maximum interest rate set on the obligation may be increased as part of the assumption agreement. (This rule applies whether or not the transaction constitutes an assumption as defined in § 226.20(b).)

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Subpart E Special Rules For Certain Home Mortgage Transactions

1B- Consumer Credit Law Manual § 226.31

§ **226.31 General Rules**

31(c) Timing of disclosure.

1. Furnishing disclosures. Disclosures are considered furnished when received by the consumer. Furnishing disclosures. Disclosures are considered furnished when received by the consumer.

Paragraph 31(c)(1) Disclosures for certain closed-end home mortgages.

1. Pre-consummation waiting period. A creditor must furnish § 226.32 disclosures at least three business days prior to consummation. Under § 226.32, "business day" has the same meaning as the rescission rule in comment 2(a)(6)-2-all calendar days except Sundays and the federal legal holidays listed in *5 USC 6103(a)* . However, while the disclosure rule under §§ 226.15 and 226.23 extends to midnight of the third business day, the rule under § 226.32 does not. For example, under § 226.32, if disclosures were provided on a Friday, consummation could occur any time on Tuesday, the third business day following receipt of the disclosures. If the timing of the rescission rule were to be used, consummation could not occur until after midnight on Tuesday.

Paragraph 31(c)(1)(i) Change in terms.

1. Redisclosure required. Creditors must provide new disclosures when a change in terms makes disclosures previously provided under § 226.32(c) inaccurate, including disclosures based on and labeled as an estimate. A change in terms may result from a formal written agreement or otherwise.

2. Sale of optional products at consummation. If the consumer finances the purchase of optional products such as credit insurance and as a result the monthly payment differs from what was previously disclosed under § 226.32,

redisclosure is required and a new three-day waiting period applies. (See comment 32(c)(3)-1 on when optional items may be included in the regular payment disclosure.)

Paragraph 31(c)(1)(ii) Telephone disclosures.

1. Telephone disclosures. Disclosures by telephone must be furnished at least three business days prior to consummation, calculated in accord with the timing rules under § 226.31(c)(1).

Paragraph 31(c)(1)(iii) Consumer's waiver of waiting period before consummation.

1. Modification or waiver. A consumer may modify or waive the right to the three-day waiting period only after receiving the disclosures required by § 226.32 and only if the circumstances meet the criteria for establishing a bona fide personal financial emergency under § 226.23(e). Whether these criteria are met is determined by the facts surrounding individual situations. The imminent sale of the consumer's home at foreclosure during the three-day period is one example of a bona fide personal financial emergency. Each consumer entitled to the three-day waiting period must sign the handwritten statement for the waiver to be effective.

Paragraph 31(c)(2) Disclosures for reverse mortgages.

1. Business days. For purposes of providing reverse mortgage disclosures, "business day" has the same meaning as in comment 31(c)(1)-1--all calendar days except Sundays and the Federal legal holidays listed in *5 U.S.C. 6103(a)* . This means if disclosures are provided on a Friday, consummation could occur any time on Tuesday, the third business day following receipt of the disclosures.

2. Open-end plans.

Disclosures for open-end reverse mortgages must be provided at least three business days before the first transaction under the plan (see § 226.5(b)(1)).

31(d) Basis of disclosures and use of estimates.

1. Redisclosure. Section 226.31(d) allows the use of estimates when information necessary for an accurate disclosure is unknown to the creditor, provided that the disclosure is clearly identified as an estimate. For purposes of Subpart E, the rule in § 226.31(c)(1)(i) requiring new disclosures when the creditor changes terms also applies to disclosures labeled as estimates.

31(d)(3) Per-diem interest.

1. Per-diem interest. This paragraph applies to the disclosure of any numerical amount (such as the finance charge, annual percentage rate, or payment amount) that is affected by the amount of the per-diem interest charge that will be

collected at consummation. If the amount of per-diem interest used in preparing the disclosures for consummation is based on the information known to the creditor at the time the disclosure document is prepared, the disclosures are considered accurate under this rule, and affected disclosures are also considered accurate, even if the disclosures were not labeled as estimates. (See comment 17(c)(2)(ii)-1 generally.)

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1B- Consumer Credit Law Manual Section 226.32

§ 226.32 Requirements for Certain Closed-End Home Mortgages

32(a) Coverage.

Paragraph 32(a)(1)(i).

1. Application date. An application is deemed received when it reaches the creditor in any of the ways applications are normally transmitted. (See *§ 226.19*(a).) For example, if a borrower applies for a 10-year loan on September 30 and the creditor counteroffers with a 7-year loan on October 10, the application is deemed received in September and the creditor must measure the annual percentage rate against the appropriate Treasury security yield as of August 15. An application transmitted through an intermediary agent or broker is received when it reaches the creditor, rather than when it reaches the agent or broker. (See comment 19(b)-3 to determine whether a transaction involves an intermediary agent or broker.)

2. When fifteenth not a business day. If the 15th day of the month immediately preceding the application date is not a business day, the creditor must use the yield as of the business day immediately preceding the 15th.

3. Calculating annual percentage rates for variable-rate loans and discount loans. Creditors must use the rules set out in the commentary to § 226.17(c)(1) in calculating the annual percentage rate for variable-rate loans (assume the rate in effect at the time of disclosure remains unchanged) and for discount, premium, and stepped-rate transactions (which must reflect composite annual percentage rates).

4. Treasury securities. To determine the yield on comparable Treasury securities for the annual percentage rate test, creditors may use the yield on actively traded issues adjusted to constant maturities published in the Board's "Selected Interest Rates" (statistical release H-15). Creditors must use the yield corresponding to the constant maturity that is

closest to the loan's maturity. If the loan's maturity is exactly halfway between security maturities, the annual percentage rate on the loan should be compared with the yield for Treasury securities having the lower yield. In determining the loan's maturity, creditors may rely on the rules in § 226.17(c)(4) regarding irregular first payment periods. For example:

i. If the H-15 contains a yield for Treasury securities with constant maturities of 7 years and 10 years and no maturity in between, the annual percentage rate for an 8-year mortgage loan is compared with the yield of securities having a 7-year maturity, and the annual percentage rate for a 9-year mortgage loan is compared with the yield of securities having a 10-year maturity.

ii. If a mortgage loan has a term of 15 years, and the H-15 contains a yield of 5.21 percent for constant maturities of 10 years, and also contains a yield of 6.33 percent for constant maturities of 20 years, then the creditor compares the annual percentage rate for a 15-year mortgage loan with the yield for constant maturities of 10 years.

iii. If a mortgage loan has a term of 30 years, and the H-15 does not contain a yield for 30-year constant maturities, but contains a yield for 20-year constant maturities, and an average yield for securities with remaining terms to maturity of 25 years and over, then the annual percentage rate on the loan is compared with the yield for 20-year constant maturities.

Paragraph 32(a)(1)(ii).

1. Total loan amount. For purposes of the "points and fees" test, the total loan amount is calculated by taking the amount financed, as determined according to § 226.18(b), and deducting any cost listed in § 226.32(b)(1)(iii) and § 226.32(b)(1)(iv) that is both included as points and fees under § 226.32(b)(1) and financed by the creditor. Some examples follow, each using a $10,000 amount borrowed, a $300 appraisal fee, and $400 in points. A $500 premium for optional credit life insurance is used in one example.

i. If the consumer finances a $300 fee for a creditor-conducted appraisal and pays $400 in points at closing, the amount financed under § 226.18(b) is $9,900 ($10,000 plus the $300 appraisal fee that is paid to and financed by the creditor, less $400 in prepaid finance charges). The $300 appraisal fee paid to the creditor is added to other points and fees under § 226.32(b)(1)(iii). It is deducted from the amount financed ($9,900) to derive a total loan amount of $9,600.

ii. If the consumer pays the $300 fee for the creditor-conducted appraisal in cash at closing, the $300 is included in the points and fees calculation because it is paid to the creditor. However, because the $300 is not financed by the creditor, the fee is not part of the amount financed under § 226.18(b). In this case, the amount financed is the same as the total loan amount: $9,600 ($10,000, less $400 in prepaid finance charges).

iii. If the consumer finances a $300 fee for an appraisal conducted by someone other than the creditor or an

affiliate, the $300 fee is not included with other points and fees under § 226.32(b)(1)(iii). The amount financed under § 226.18(b) is $9,900 ($10,000 plus the $300 fee for an independently-conducted appraisal that is financed by the creditor, less the $400 paid in cash and deducted as prepaid finance charges).

iv. If the consumer finances a $300 fee for a creditor-conducted appraisal and a $500 single premium for optional credit life insurance, and pays $400 in points at closing, the amount financed under § 226.18(b) is $10,400 ($10,000, plus the $300 appraisal fee that is paid to and financed by the creditor, plus the $500 insurance premium that is financed by the creditor, less $400 in prepaid finance charges). The $300 appraisal fee paid to the creditor is added to other points and fees under § 226.32(b)(1)(iii), and the $500 insurance premium is added under 226.32(b)(1)(iv). The $300 and $500 costs are deducted from the amount financed ($10,400) to derive a total loan amount of $9,600.

2. Annual adjustment of $400 amount. A mortgage loan is covered by § 226.32 if the total points and fees payable by the consumer at or before loan consummation exceed the greater of $400 or 8 percent of the total loan amount. The $400 figure is adjusted annually on January 1 by the annual percentage change in the CPI that was in effect on the preceding June 1. The Board will publish adjustments after the June figures become available each year. The adjustment for the upcoming year will be included in any proposed commentary published in the fall, and incorporated into the commentary the following spring. The adjusted figures are:

i. For 1996, $412, reflecting a 3.00 percent increase in the CPI-U from June 1994 to June 1995, rounded to the nearest whole dollar.

ii. For 1997, $424, reflecting a 2.9 percent increase in the CPI-U from June 1995 to June 1996, rounded to the nearest whole dollar.

iii. For 1998, $435, reflecting a 2.5 percent increase in the CPI-U from June 1996 to June 1997, rounded to the nearest whole dollar.

iv. For 1999, $441, reflecting a 1.4 percent increase in the CPI-U from June 1997 to June 1998, rounded to the nearest whole dollar.

v. For 2000, $451, reflecting a 2.3 percent increase in the CPI-U from June 1998 to June 1999, rounded to the nearest whole dollar.

vi. For 2001, $465, reflecting a 3.1 percent increase in the CPI-U from June 1999 to June 2000, rounded to the nearest whole dollar.

vii. For 2002, $480, reflecting a 3.27 percent increase in the CPI-U from June 2000 to June 2001, rounded to the nearest whole dollar.

viii. For 2003, $488, reflecting a 1.64 percent increase in the CPI-U from June 2001 to June 2002, rounded to the nearest whole dollar.

ix. For 2004, $499, reflecting a 2.22 percent increase in the CPI-U from June 2002 to June 2003, rounded to the nearest whole dollar.

x. For 2005, $510, reflecting a 2. 29 percent increase in the CPI-U from June 2003 to June 2004, rounded to the nearest whole dollar.

xi. For 2006, $528, reflecting a 3.51 percent increase in the CPI-U from June 2004 to June 2005, rounded to the nearest whole dollar.

xii. For 2007, $547, refelcting a 3.55 percent increase in the CPI-U from June 2005 to June 2006, rounded to the nearest whole dollar.

xiii. For 2008, $561, reflecting a 2.56 percent increase in the CPI-U from June 2006 to June 2007, rounded to the nearest whole dollar.

xiv. For 2009, $583, reflecting a 3.94 percent increase in the CPI-U from June 2007 to June 2008, rounded to the nearest whole dollar.

xv. For 2010, $579, reflecting a 0.74 percent decrease in the CPI-U from June 2008 to June 2009, rounded to the nearest whole dollar.

Paragraph 32(a)(2).

1. Exemption limited. Section 226.32(a)(2) lists certain transactions exempt from the provisions of § 226.32. Nevertheless, those transactions may be subject to the provisions of § 226.35, including any provisions of § 226.32 to which § 226.35 refers. See *12 CFR 226.35(a)* .

32(b) Definitions

Paragraph 32(b)(1)(i).

1. General. Exemption limited. Section 226.32(a)(2) lists certain transactions exempt from the provisions of § 226.32. Nevertheless, those transactions may be subject to the provisions of § 226.35, including any provisions of § 226.32 to which § 226.35 refers. See *12 CFR 226.35(a)* .

Paragraph 32(b)(1)(ii).

1. Mortgage broker fees. In determining "points and fees" for purposes of this section, compensation paid by a consumer to a mortgage broker (directly or through the creditor for delivery to the broker) is included in the calculation whether or not the amount is disclosed as a finance charge. Mortgage broker fees that are not paid by the consumer are not included. Mortgage broker fees already included in the calculation as finance charges under § 226.32(b)(1)(i) need not be counted again under § 226.32(b)(1)(ii).

1. Example. Section 226.32(b)(1)(iii) defines "points and fees" to include all items listed in § 226.4(c)(7), other than amounts held for the future payment of taxes. An item listed in § 226.4(c)(7) may be excluded from the "points and fees" calculation, however, if the charge is reasonable, the creditor receives no direct or indirect compensation from the charge, and the charge is not paid to an affiliate of the creditor. For example, a reasonable fee paid by the consumer to an independent, third-party appraiser may be excluded from the "points and fees" calculation (assuming no compensation is paid to the creditor). A fee paid by the consumer for an appraisal performed by the creditor must be included in the calculation, even though the fee may be excluded from the finance charge if it is bona fide and reasonable in amount.

Paragraph 32(b)(1)(iv).

1. Premium amount. In determining "points and fees" for purposes of this section, premiums paid at or before closing for credit insurance are included whether they are paid in cash or financed, and whether the amount represents the entire premium for the coverage or an initial payment.

32(c) Disclosures.

1. Format.

The disclosures must be clear and conspicuous but need not be in any particular type size or typeface, nor presented in any particular manner. The disclosures need not be a part of the note or mortgage document.

Paragraph 32(c)(3) Regular payment; balloon payment.

1. General. The regular payment is the amount due from the borrower at regular intervals, such as monthly, bimonthly, quarterly, or annually. There must be at least two payments, and the payments must be in an amount and at such intervals that they fully amortize the amount owed. In disclosing the regular payment, creditors may rely on the rules set forth in § 226.18(g); however, the amounts for voluntary items, such as credit life insurance, may be included in the regular payment disclosure only if the consumer has previously agreed to the amounts.

i. If the loan has more than one payment level, the regular payment for each level must be disclosed. For example:

A. In a 30-year graduated payment mortgage where there will be payments of $300 for the first 120 months, $400 for the next 120 months, and $500 for the last 120 months, each payment amount must be disclosed, along with the length of time that the payment will be in effect.

B. If interest and principal are paid at different times, the regular amount for each must be disclosed.

C. In discounted or premium variable-rate transactions where the creditor sets the initial interest rate and later rate adjustments are determined by an index or formula, the creditor must disclose both the initial payment based on the discount or premium and the payment that will be in effect thereafter. Additional explanatory material which does not detract from the required disclosures may accompany the disclosed amounts. For example, if a monthly payment is $250 for the first six months and then increases based on an index and margin, the creditor could use language such as the following: "Your regular monthly payment will be $250 for six months. After six months your regular monthly payment will be based on an index and margin, which currently would make your payment $350. Your actual payment at that time may be higher or lower."

Paragraph 32(c)(4) Variable-rate.

1. Calculating "worst-case" payment example Creditors may rely on instructions in § 226.19(b)(2)(viii)(B) for calculating the maximum possible increases in rates in the shortest possible timeframe, based on the face amount of the note (not the hypothetical loan amount of $10,000 required by § 226.19(b)(2)(viii)(B)). The creditor must provide a maximum payment for each payment level, where a payment schedule provides for more than one payment level and more than one maximum payment amount is possible.

Paragraph 32(c)(5) Amount borrowed.

1. Optional insurance; debt-cancellation coverage. This disclosure is required when the amount borrowed in a refinancing includes premiums or other charges for credit life, accident, health, or loss-of-income insurance, or debt-cancellation coverage (whether or not the debt-cancellation coverage is insurance under applicable law) that provides for cancellation of all or part of the consumer's liability in the event of the loss of life, health, or income or in the case of accident. See comment 4(d)(3)-2 and comment app. G and H-2 regarding terminology for debt-cancellation coverage.

32(d) Limitations

1. Additional prohibitions applicable under other sections. Section 226.34 sets forth certain prohibitions in connection with mortgage credit subject to § 226.32, in addition to the limitations in § 226.32(d). Further, § 226.35(b) prohibits certain practices in connection with transactions that meet the coverage test in § 226.35(a). Because the coverage test in § 226.35(a) is generally broader than the coverage test in § 226.32(a), most § 226.32 mortgage loans are also subject to the prohibitions set forth in § 226.35(b) (such as escrows), in addition to the limitations in § 226.32(d).

2. Effective date. For guidance on the application of the Board's revisions published on July 30, 2008 to § 226.32, see comment 1(d)(5)-1.

Paragraph 32(d)(1)(i) Balloon payment.

1. Regular periodic payments. The repayment schedule for a § 226.32 mortgage loan with a term of less than five years must fully amortize the outstanding principal balance through "regular periodic payments." A payment is a "regular periodic payment" if it is not more than twice the amount of other payments.

Paragraph 32(d)(2) Negative amortization.

1. Negative amortization. The prohibition against negative amortization in a mortgage covered by § 226.32 does not preclude reasonable increases in the principal balance that result from events permitted by the legal obligation unrelated to the payment schedule. For example, when a consumer fails to obtain property insurance and the creditor purchases insurance, the creditor may add a reasonable premium to the consumer's principal balance, to the extent permitted by the legal obligation.

Paragraph 32(d)(4) Increased interest rate.

1. Variable-rate transactions. The limitation on interest rate increases does not apply to rate increases resulting from changes in accordance with the legal obligation in a variable-rate transaction, even if the increase occurs after default by the consumer.

Paragraph 32(d)(5) Rebates.

1. Variable-rate transactions. Calculation of refunds. The limitation applies only to refunds of precomputed (such as add-on) interest and not to any other charges that are considered finance charges under § 226.4 (for example, points and fees paid at closing). The calculation of the refund of interest includes odd-days interest, whether paid at or after consummation.

Paragraph 32(d)(6) Prepayment penalties.

1. State law. For purposes of computing a refund of unearned interest, if using the actuarial method defined by applicable state law results in a refund that is greater than the refund calculated by using the method described in section 933(d) of the Housing and Community Development Act of 1992, creditors should use the state law definition in determining if a refund is a prepayment penalty.

32(d)(7) Prepayment penalty exception.

1. State law. For purposes of computing a refund of unearned interest, if using the actuarial method defined by applicable state law results in a refund that is greater than the refund calculated by using the method described in section 933(d) of the Housing and Community Development Act of 1992, creditors should use the state law definition in determining if a refund is a prepayment penalty.

Paragraph 32(d)(7)(iii).

1. Calculating debt-to-income ratio. "Debt" does not include amounts paid by the borrower in cash at closing or amounts from the loan proceeds that directly repay an existing debt. Creditors may consider combined debt-to-income ratios for transactions involving joint applicants. For more information about obligations and inflows that may constitute "debt" or "income" for purposes of § 226.32(d)(7)(iii), see comment 34(a)(4)-6 and comment 34(a)(4)(iii)(C)-1.

2. Verification. Creditors shall verify income in the manner described in § 226.34(a)(4)(ii) and the related comments. Creditors may verify debt with a credit report. However, a credit report may not reflect certain obligations undertaken just before or at consummation of the transaction and secured by the same dwelling that secures the transaction. Section 226.34(a)(4) may require creditors to consider such obligations; see comment 34(a)(4)-3 and comment 34(a)(4)(ii)(C)-1.

3. Interaction with Regulation B. Section 226.32(d)(7)(iii) does not require or permit the creditor to make inquiries or verifications that would be prohibited by Regulation B, 12 CFR part 202.

Paragraph 32(d)(7)(iv).

1. Payment change. Section 226.32(d)(7) sets forth the conditions under which a mortgage transaction subject to this section may have a prepayment penalty. Section 226.32(d)(7)(iv) lists as a condition that the amount of the periodic payment of principal or interest or both may not change during the four-year. The following examples show whether prepayment penalties are permitted or prohibited under § 226.32(d)(7)(iv) in particular circumstances.

i. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is January 1, 2014. A

prepayment penalty is permitted with this mortgage transaction provided that the other § 226.32(d)(7) conditions are met, that is: provided that the prepayment penalty is permitted by other applicable law, the penalty expires on or before Dec. 31, 2011, the penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or its affiliate, and at consummation the consumer's total monthly debts do not exceed 50 percent of the consumer's monthly gross income, as verified.

ii. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is December 31, 2013. A prepayment penalty is prohibited with this mortgage transaction because the payment may change within the four-year.

iii. Initial payments for a graduated-payment transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is January 1, 2014. A prepayment penalty is permitted with this mortgage transaction provided that the other § 226.32(d)(7) conditions are met, that is: provided that the prepayment penalty is permitted by other applicable law, the penalty expires on or before December 31, 2011, the penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or its affiliate, and at consummation the consumer's total monthly debts do not exceed 50 percent of the consumer's monthly gross income, as verified.

iv. Initial payments for a step-rate transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is December 31, 2013. A prepayment penalty is prohibited with this mortgage transaction because the payment may change within the four-year.

2. Payment changes excluded. Payment changes due to the following circumstances are not considered payment changes for purposes of this section:

i. A change in the amount of a periodic payment that is allocated to principal or interest that does not change the total amount of the periodic payment.

ii. The borrower's actual unanticipated late payment, delinquency, or default; and

iii. The borrower's voluntary payment of additional amounts (for example when a consumer chooses to make a payment of interest and principal on a loan that only requires the consumer to pay interest).

32(d)(8) Due-on-demand clause.

Paragraph 32(d)(8)(ii).

1. Failure to meet repayment terms. A creditor may terminate a loan and accelerate the balance when the consumer fails to meet the repayment terms provided for in the agreement; a creditor may do so, however, only if the consumer actually fails to make payments. For example, a creditor may not terminate and accelerate if the consumer, in error, sends a payment to the wrong location, such as a branch rather than the main office of the creditor. If a consumer files for or is placed in bankruptcy, the creditor may terminate and accelerate under this provision if the consumer fails to meet the repayment terms of the agreement. Section 226.32(d)(8)(ii) does not override any state or other law that requires a creditor to notify a borrower of a right to cure, or otherwise places a duty on the creditor before it can terminate a loan and accelerate the balance.

Paragraph 32(d)(8)(iii).

1. Impairment of security. A creditor may terminate a loan and accelerate the balance if the consumer's action or inaction adversely affects the creditor's security for the loan, or any right of the creditor in that security. Action or inaction by third parties does not, in itself, permit the creditor to terminate and accelerate.

2. Examples.

i. A creditor may terminate and accelerate, for example, if:

A. The consumer transfers title to the property or sells the property without the permission of the creditor.

B. The consumer fails to maintain required insurance on the dwelling.

C. The consumer fails to pay taxes on the property.

D. The consumer permits the filing of a lien senior to that held by the creditor.

E. The sole consumer obligated on the credit dies.

F. The property is taken through eminent domain.

G. A prior lienholder forecloses.

ii. By contrast, the filing of a judgment against the consumer would permit termination and acceleration only if the amount of the judgment and collateral subject to the judgment is such that the creditor's security is adversely affected. If the consumer commits waste or otherwise destructively uses or fails to maintain the property such that the action adversely affects the security, the loan may be terminated and the balance accelerated. Illegal use of the property by the consumer would permit termination and acceleration if it subjects the property to seizure. If one of two consumers obligated on a loan dies, the creditor may terminate the loan and accelerate the balance if the security is adversely affected. If the consumer moves out of the dwelling that secures the loan and that action adversely affects the security, the creditor may terminate a loan and accelerate the balance.

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
Subpart E Special Rules For Certain Home Mortgage Transactions

1B- Consumer Credit Law Manual Section 226.33

§ 226.33 Requirements for Reverse Mortgages

33(a) Definition.

1. Nonrecourse transaction. A nonrecourse reverse mortgage transaction limits the homeowner's liability to the proceeds of the sale of the home (or any lesser amount specified in the credit obligation). If a transaction structured as a closed-end reverse mortgage transaction allows recourse against the consumer, and the annual percentage rate or the points and fees exceed those specified under § 226.32(a)(1), the transaction is subject to all the requirements of § 226.32, including the limitations concerning balloon payments and negative amortization.

Paragraph 33(a)(2).

1. Default. Default is not defined by the statute or regulation, but rather by the legal obligation between the parties and state or other law.

2. Definite term or maturity date. To meet the definition of a reverse mortgage transaction, a creditor cannot require any principal, interest, or shared appreciation or equity to be due and payable (other than in the case of default) until after the consumer's death, transfer of the dwelling, or the consumer ceases to occupy the dwelling as a principal dwelling. Some state laws require legal obligations secured by a mortgage to specify a definite maturity date or term of repayment in the instrument. An obligation may state a definite maturity date or term of repayment and still meet the definition of a reverse-mortgage transaction if the maturity date or term of repayment used would not operate to cause maturity prior to the occurrence of any of the maturity events recognized in the regulation. For example, some reverse mortgage programs specify that the final maturity date is the borrower's 150th birthday; other programs include a shorter term but provide that the term is automatically extended for consecutive periods if none of the other maturity events has yet occurred. These programs would be permissible.

33(c) Projected total cost of credit.

Paragraph 33(c)(1) Costs to consumer.

1. Costs and charges to consumer -- relation to finance charge. All costs and charges to the consumer that are incurred in a reverse mortgage transaction are included in the projected total cost of credit, and thus in the total annual loan cost rates, whether or not the cost or charge is a finance charge under § 226.4.

2. Annuity costs. As part of the credit transaction, some creditors require or permit a consumer to purchase an annuity that immediately--or at some future time -- supplements or replaces the creditor's payments. The amount paid by the consumer for the annuity is a cost to the consumer under this section, regardless of whether the annuity is purchased through the creditor or a third party, or whether the purchase is mandatory or voluntary. For example, this includes the costs of an annuity that a creditor offers, arranges, assists the consumer in purchasing, or that the creditor is aware the consumer is purchasing as a part of the transaction.

3. Disposition costs excluded. Disposition costs incurred in connection with the sale or transfer of the property subject to the reverse mortgage are not included in the costs to the consumer under this paragraph. (However, see the definition of Val[sub]n in appendix K to the regulation to determine the effect certain disposition costs may have on the total annual loan cost rates.)

Paragraph 33(c)(2) Payments to consumer.

1. Payments upon a specified event. The projected total cost of credit should not reflect contingent payments in which a credit to the outstanding loan balance or a payment to the consumer's estate is made upon the occurrence of an event (for example, a "death benefit" payable if the consumer's death occurs within a certain period of time). Thus, the table of total annual loan cost rates required under § 226.33(b)(2) would not reflect such payments. At its option, however, a creditor may put an asterisk, footnote, or similar type of notation in the table next to the applicable total annual loan cost rate, and state in the body of the note, apart from the table, the assumption upon which the total annual loan cost is made and any different rate that would apply if the contingent benefit were paid.

Paragraph 33(c)(3) Additional creditor compensation.

1. Shared appreciation or equity. Any shared appreciation or equity that the creditor is entitled to receive pursuant to the legal obligation must be included in the total cost of a reverse mortgage loan. For example, if a creditor agrees to a reduced interest rate on the transaction in exchange for a portion of the appreciation or equity that may be realized when the dwelling is sold, that portion is included in the projected total cost of credit.

Paragraph 33(c)(4) Additional creditor compensation.

1. In general. Creditors must include any limitation on the consumer's liability (such as a nonrecourse limit or an equity conservation agreement) in the projected total cost of credit. These limits and agreements protect a portion of the equity in the dwelling for the consumer or the consumer's estate. For example, the following are limitations on the

consumer's liability that must be included in the projected total cost of credit:

i. A limit on the consumer's liability to a certain percentage of the projected value of the home.

ii. A limit on the consumer's liability to the net proceeds from the sale of the property subject to the reverse mortgage.

2. Uniform assumption for "net proceeds" recourse limitations. If the legal obligation between the parties does not specify a percentage for the "net proceeds" liability of the consumer, for purposes of the disclosures required by § 226.33, a creditor must assume that the costs associated with selling the property will equal 7 percent of the projected sale price (see the definition of the Val[n] symbol under appendix K(b)(6)).

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PART I Consumer Credit
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Subpart E Special Rules For Certain Home Mortgage Transactions

1B- Consumer Credit Law Manual Section 226.34

§ 226.34 Prohibited Acts or Practices in Connection with Credit Subject to § 226.32

34(a) Prohibited acts or practices for loans subject to § 226.32.

Paragraph 34(a)(1) Home-improvement contracts.

Paragraph 34(a)(1)(i).

1. Joint payees. If a creditor pays a contractor with an instrument jointly payable to the contractor and the consumer, the instrument must name as payee each consumer who is primarily obligated on the note.

Paragraph 34(a)(2) Notice to Assignee.

1. Subsequent sellers or assignors. Any person, whether or not the original creditor, that sells or assigns a mortgage subject to § 226.32 must furnish the notice of potential liability to the purchaser or assignee.

2. Format. While the notice of potential liability need not be in any particular format, the notice must be prominent. Placing it on the face of the note, such as with a stamp, is one means of satisfying the prominence requirement.

3. Assignee liability. Pursuant to section 131(d) of the act, the act's general holder-in-due course protections do not apply to purchasers and assignees of loans covered by § 226.32. For such loans, a purchaser's or other assignee's liability for all claims and defenses that the consumer could assert against the creditor is not limited to violations of the act.

Paragraph 34(a)(3) Refinancings within one-year period.

1. In the borrower's interest. The determination of whether or not a refinancing covered by § 226.34(a)(3) is in the borrower's interest is based on the totality of the circumstances, at the time the credit is extended. A written statement by the borrower that "this loan is in my interest" alone does not meet this standard.

i. A refinancing would be in the borrower's interest if needed to meet the borrower's "bona fide personal financial emergency" (see generally § 226.23(e) and § 226.31(c)(1)(iii)).

ii. In connection with a refinancing that provides additional funds to the borrower, in determining whether a loan is in the borrower's interest consideration should be given to whether the loan fees and charges are commensurate with the amount of new funds advanced, and whether the real estate-related charges are bona fide and reasonable in amount (see generally § 226.4(c)(7)).

2. Application of the one-year refinancing prohibition to creditors and assignees. The prohibition in § 226.34(a)(3) applies where an extension of credit subject to § 226.32 is refinanced into another loan subject to § 226.32. The prohibition is illustrated by the following examples. Assume that Creditor A makes a loan subject to § 226.32 on January 15, 2003, secured by a first lien; this loan is assigned to Creditor B on February 15, 2003:

i. Creditor A is prohibited from refinancing the January 2003 loan (or any other loan subject to § 226.32 to the same borrower) into a loan subject to § 226.32, until January 15, 2004. Creditor B is restricted until January 15, 2004, or such date prior to January 15, 2004 that Creditor B ceases to hold or service the loan. During the prohibition period, Creditors A and B may make a subordinate lien loan that does not refinance a loan subject to § 226.32. Assume that on April 1, 2003, Creditor A makes but does not assign a second-lien loan subject to § 226.32. In that case, Creditor A would be prohibited from refinancing either the first-lien or second-lien loans (or any other loans to that borrower subject to § 226.32) into another loan subject to § 226.32 until April 1, 2004.

ii. The loan made by Creditor A on January 15, 2003 (and assigned to Creditor B) may be refinanced by Creditor C at any time. If Creditor C refinances this loan on March 1, 2003 into a new loan subject to § 226.32, Creditor A is prohibited from refinancing the loan made by Creditor C (or any other loan subject to §?226.32 to the same borrower) into another loan subject to § 226.32 until January 15, 2004. Creditor C is similarly prohibited from refinancing any loan subject to § 226.32 to that borrower into another until March 1, 2004. (The limitations of § 226.34(a)(3) no longer apply to Creditor B after Creditor C refinanced the January 2003 loan and Creditor B ceased to hold or service the loan).

Paragraph 34(a)(4) Repayment ability.

1. Application of repayment ability rule. The § 226.34(a)(4) prohibition against making loans without regard to consumers' repayment ability applies to mortgage loans described in § 226.32(a). In addition, the § 226.34(a)(4) prohibition applies to higher-priced mortgage loans described in § 226.35(a). See *12 CFR 226.35(b)(1)*. For guidance on

the application of the Board's revisions to § 226.34(a)(4) published on July 30, 2008, see comment 1(d)(5)-1.

2. General prohibition. Section 226.34(a)(4) prohibits a creditor from extending credit subject to § 226.32 to a consumer based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation, including the consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and property tax and insurance obligations. A creditor may base its determination of repayment ability on current or reasonably expected income from employment or other sources, on assets other than the collateral, or both.

3. Other dwelling-secured obligations. For purposes of § 226.34(a)(4), current obligations include another credit obligation of which the creditor has knowledge undertaken prior to or at consummation of the transaction and secured by the same dwelling that secures the transaction subject to § 226.32 or § 226.35. For example, where a transaction subject to § 226.35 is a first-lien transaction for the purchase of a home, a creditor must consider a "piggyback" second-lien transaction of which it has knowledge that is used to finance part of the down payment on the house.

4. Discounted introductory rates and non-amortizing or negatively-amortizing payments. A credit agreement may determine a consumer's initial payments using a temporarily discounted interest rate or permit the consumer to make initial payments that are non-amortizing or negatively amortizing. (Negative amortization is permissible for loans covered by § 226.35(a), but not § 226.32). In such cases the creditor may determine repayment ability using the assumptions provided in § 226.34(a)(4)(iv).

5. Repayment ability as of consummation. Section 226.34(a)(4) prohibits a creditor from disregarding repayment ability based on the facts and circumstances known to the creditor as of consummation. In general, a creditor does not violate this provision if a consumer defaults because of a significant reduction in income (for example, a job loss) or a significant obligation (for example, an obligation arising from a major medical expense) that occurs after consummation. However, if a creditor has knowledge as of consummation of reductions in income, for example, if a consumer's written application states that the consumer plans to retire within twelve months without obtaining new employment, or states that the consumer will transition from full-time to part-time employment, the creditor must consider that information.

6. Income, assets, and employment. Any current or reasonably expected assets or income may be considered by the creditor, except the collateral itself. For example, a creditor may use information about current or expected salary, wages, bonus pay, tips, and commissions. Employment may be full-time, part-time, seasonal, irregular, military, or self-employment. Other sources of income could include interest or dividends; retirement benefits; public assistance; and alimony, child support, or separate maintenance payments. A creditor may also take into account assets such as savings accounts or investments that the consumer can or will be able to use.

7. Interaction with Regulation B. Section 226.34(a)(4) does not require or permit the creditor to make inquiries or verifications that would be prohibited by Regulation B, 12 CFR part 202.

34(a)(4)(i) Mortgage-related obligations.

1. Mortgage-related obligations. A creditor must include in its repayment ability analysis the expected property taxes and premiums for mortgage-related insurance required by the creditor as set forth in § 226.35(b)(3)(i), as well as similar mortgage-related expenses. Similar mortgage-related expenses include homeowners' association dues and condominium or cooperative fees.

34(a)(4)(ii) Verification of repayment ability.

1. Income and assets relied on. A creditor must verify the income and assets the creditor relies on to evaluate the consumer's repayment ability. For example, if a consumer earns a salary and also states that he or she is paid an annual bonus, but the creditor only relies on the applicant's salary to evaluate repayment ability, the creditor need only verify the salary.

2. Income and assets -- co-applicant. If two persons jointly apply for credit and both list income or assets on the application, the creditor must verify repayment ability with respect to both applicants unless the creditor relies only on the income or assets of one of the applicants in determining repayment ability.

3. Expected income. If a creditor relies on expected income, the expectation must be reasonable and it must be verified with third-party documents that provide reasonably reliable evidence of the consumer's expected income. For example, if the creditor relies on an expectation that a consumer will receive an annual bonus, the creditor may verify the basis for that expectation with documents that show the consumer's past annual bonuses and the expected bonus must bear a reasonable relationship to past bonuses. Similarly, if the creditor relies on a consumer's expected salary following the consumer's receipt of an educational degree, the creditor may verify that expectation with a written statement from an employer indicating that the consumer will be employed upon graduation at a specified salary.

Paragraph 34(a)(4)(ii)(A).

1. Internal Revenue Service (IRS) Form W-2. A creditor may verify a consumer's income using a consumer's IRS Form W-2 (or any subsequent revisions or similar IRS Forms used for reporting wages and tax withholding). The creditor may also use an electronic retrieval service for obtaining the consumer's W-2 information.

2. Tax returns. A creditor may verify a consumer's income or assets using the consumer's tax return. A creditor may also use IRS Form 4506 "Request for Copy of Tax Return," Form 4506-T "Request for Transcript of Tax Return," or Form 8821 "Tax Information Authorization" (or any subsequent revisions or similar IRS Forms appropriate for obtaining tax return information directly from the IRS) to verify the consumer's income or assets. The creditor may also use an electronic retrieval service for obtaining tax return information.

3. Other third-party documents that provide reasonably reliable evidence of consumer's income or assets. Creditors may verify income and assets using documents produced by third parties. Creditors may not rely on information provided orally by third parties, but may rely on correspondence from the third party, such as by letter or e-mail. The creditor may rely on any third-party document that provides reasonably reliable evidence of the consumer's income or assets. For example, creditors may verify the consumer's income using receipts from a check-cashing or remittance service, or by obtaining a written statement from the consumer's employer that states the consumer's income.

4. Information specific to the consumer. Creditors may verify income and assets using documents produced by third parties. Creditors may not rely on information provided orally by third parties, but may rely on correspondence from the third party, such as by letter or e-mail. The creditor may rely on any third-party document that provides reasonably reliable evidence of the consumer's income or assets. For example, creditors may verify the consumer's income using receipts from a check-cashing or remittance service, or by obtaining a written statement from the consumer's employer that states the consumer's income.

5. Duplicative collection of documentation. A creditor that has made a loan to a consumer and is refinancing or extending new credit to the same consumer need not collect from the consumer a document the creditor previously obtained if the creditor has no information that would reasonably lead the creditor to believe that document has changed since it was initially collected. For example, if the creditor has obtained the consumer's 2006 tax return to make a home purchase loan in May 2007, the creditor may rely on the 2006 tax return if the creditor makes a home equity loan to the same consumer in August 2007. Similarly, if the creditor has obtained the consumer's bank statement for May 2007 in making the first loan, the creditor may rely on that bank statement for that month in making the subsequent loan in August 2007.

Paragraph 34(a)(4)(ii)(B).

1. No violation if income or assets relied on not materially greater than verifiable amounts. A creditor that does not verify income or assets used to determine repayment ability with reasonably reliable third-party documents does not violate § 226.34(a)(4)(ii) if the creditor demonstrates that the income or assets it relied upon were not materially greater than the amounts that the creditor would have been able to verify pursuant to § 226.34(a)(4)(ii). For example, if a creditor determines a consumer's repayment ability by relying on the consumer's annual income of $40,000 but fails to obtain documentation of that amount before extending the credit, the creditor will not have violated this section if the creditor later obtains evidence that would satisfy § 226.34(a)(4)(ii)(A), such as tax return information, showing that the creditor could have documented, at the time the loan was consummated, that the consumer had an annual income not materially less than $40,000.

2. Materially greater than. Amounts of income or assets relied on are not materially greater than amounts that could have been verified at consummation if relying on the verifiable amounts would not have altered a reasonable creditor's decision to extend credit or the terms of the credit.

34(a)(4)(iii) Presumption of compliance.

1. In general. A creditor is presumed to have complied with § 226.34(a)(4) if the creditor follows the three underwriting procedures specified in paragraph 34(a)(4)(iii) for verifying repayment ability, determining the payment obligation, and measuring the relationship of obligations to income. The procedures for verifying repayment ability are required under paragraph 34(a)(4)(ii); the other procedures are not required but, if followed along with the required procedures, create a presumption that the creditor has complied with § 226.34(a)(4). The consumer may rebut the presumption with evidence that the creditor nonetheless disregarded repayment ability despite following these procedures. For example, evidence of a very high debt-to-income ratio and a very limited residual income could be sufficient to rebut the presumption, depending on all of the facts and circumstances. If a creditor fails to follow one of the non-required procedures set forth in paragraph 34(a)(4)(iii), then the creditor's compliance is determined based on all of the facts and circumstances without there being a presumption of either compliance or violation.

Paragraph 34(a)(4)(iii)(B).

1. Determination of payment schedule. To retain a presumption of compliance under § 226.34(a)(4)(iii), a creditor must determine the consumer's ability to pay the principal and interest obligation based on the maximum scheduled payment in the first seven years following consummation. In general, a creditor should determine a payment schedule for purposes of § 226.34(a)(4)(iii)(B) based on the guidance in the staff commentary to § 226.17(c)(1). Examples of how to determine the maximum scheduled payment in the first seven years are provided as follows (all payment amounts are rounded):

i. Balloon-payment loan; fixed interest rate. A loan in an amount of $100,000 with a fixed interest rate of 8.0 percent (no points) has a 7-year term but is amortized over 30 years. The monthly payment scheduled for 7 years is $733 with a balloon payment of remaining principal due at the end of 7 years. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $733.

ii. Fixed-rate loan with interest-only payment for five years. A loan in an amount of $100,000 with a fixed interest rate of 8.0 percent (no points) has a 30-year term. The monthly payment of $667 scheduled for the first 5 years would cover only the interest due. After the fifth year, the scheduled payment would increase to $772, an amount that fully amortizes the principal balance over the remaining 25 years. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $772.

iii. Fixed-rate loan with interest-only payment for seven years. A loan in an amount of $100,000 with a fixed interest rate of 8.0 percent (no points) has a 30-year term. The monthly payment of $667 scheduled for the first 7 years would cover only the interest due. After the seventh year, the scheduled payment would increase to $793, an amount that fully amortizes the principal balance over the remaining 23 years. The creditor will retain the presumption of compliance if it assesses repayment ability based on the interest-only payment of $667.

iv. Variable-rate loan with discount for five years. A loan in an amount of $100,000 has a 30-year term. The loan agreement provides for a fixed interest rate of 7.0 percent for an initial period of 5 years. Accordingly, the payment scheduled for the first 5 years is $665. The agreement provides that, after 5 years, the interest rate will adjust each year based on a specified index and margin. As of consummation, the sum of the index value and margin (the fully-indexed

rate) is 8.0 percent. Accordingly, the payment scheduled for the remaining 25 years is $727. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $727.

v. Variable-rate loan with discount for seven years. A loan in an amount of $100,000 has a 30-year term. The loan agreement provides for a fixed interest rate of 7.125 percent for an initial period of 7 years. Accordingly, the payment scheduled for the first 7 years is $674. After 7 years, the agreement provides that the interest rate will adjust each year based on a specified index and margin. As of consummation, the sum of the index value and margin (the fully-indexed rate) is 8.0 percent. Accordingly, the payment scheduled for the remaining years is $725. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $674.

vi. Step-rate loan. A loan in an amount of $100,000 has a 30-year term. The agreement provides that the interest rate will be 5 percent for two years, 6 percent for three years, and 7 percent thereafter. Accordingly, the payment amounts are $537 for two years, $597 for three years, and $654 thereafter. To retain the presumption of compliance, the creditor must assess repayment ability based on the payment of $654.

Paragraph 34(a)(4)(iii)(C).

1. "Income" and "debt". To determine whether to classify particular inflows or obligations as "income" or "debt," creditors may look to widely accepted governmental and non-governmental underwriting standards, including, for example, those set forth in the Federal Housing Administration's handbook on Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans.

34(a)(4)(iv) Exclusions from the presumption of compliance.

1. In general. The exclusions from the presumption of compliance should be interpreted consistent with staff comments 32(d)(1)(i)-1 and 32(d)(2)-1.

2. Renewable balloon loan. If a creditor is unconditionally obligated to renew a balloon-payment loan at the consumer's option (or is obligated to renew subject to conditions within the consumer's control), the full term resulting from such renewal is the relevant term for purposes of the exclusion of certain balloon-payment loans. See comment 17(c)(1)-11 for a discussion of conditions within a consumer's control in connection with renewable balloon-payment loans.

Paragraph 34(b) Prohibited acts or practices for dwelling-secured loans; open-end credit.

1. Amount of credit extended. Where a loan is documented as open-end credit but the features and terms or other circumstances demonstrate that it does not meet the definition of open-end credit, the loan is subject to the rules for closed-end credit, including § 226.32 if the rate or fee trigger is met. In applying the triggers under § 226.32, the "amount financed," including the "principal loan amount" must be determined. In making the determination, the amount of credit that would have been extended if the loan had been documented as a closed-end loan is a factual determination

to be made in each case. Factors to be considered include the amount of money the consumer originally requested, the amount of the first advance or the highest outstanding balance, or the amount of the credit line. The full amount of the credit line is considered only to the extent that it is reasonable to expect that the consumer might use the full amount of credit.

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
Subpart E Special Rules For Certain Home Mortgage Transactions

1B- Consumer Credit Law Manual Section 226.35

§ 226.35 Prohibited Acts or Practices in Connection With Higher-priced Mortgage LoansProhibited Acts or Practices in Connection With Higher-priced Mortgage Loans

35(a) Higher-priced mortgage loans.

Paragraph 35(a)(2).

1. Average prime offer rate. Average prime offer rates are annual percentage rates derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. Other pricing terms include commonly used indices, margins, and initial fixed-rate periods for variable-rate transactions. Relevant pricing characteristics include a consumer's credit history and transaction characteristics such as the loan-to-value ratio, owner-occupant status, and purpose of the transaction. To obtain average prime offer rates, the Board uses a survey of creditors that both meets the criteria of § 226.35(a)(2) and provides pricing terms for at least two types of variable-rate transactions and at least two types of non-variable-rate transactions. An example of such a survey is the Freddie Mac Primary Mortgage Market Survey(R).

2. Comparable transaction. A higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by the specified margin. The table of average prime offer rates published by the Board indicates how to identify the comparable transaction.

3. Rate set. A transaction's annual percentage rate is compared to the average prime offer rate as of the date the transaction's interest rate is set (or "locked") before consummation. Sometimes a creditor sets the interest rate initially and then re-sets it at a different level before consummation. The creditor should use the last date the interest rate is set before consummation.

4. Board table. The Board publishes on the Internet, in table form, average prime offer rates for a wide variety of transaction types. The Board calculates an annual percentage rate, consistent with Regulation Z (see *§ 226.22* and appendix J), for each transaction type for which pricing terms are available from a survey. The Board estimates annual percentage rates for other types of transactions for which direct survey data are not available based on the loan pricing terms available in the survey and other information. The Board publishes on the Internet the methodology it uses to arrive at these estimates.

35(b) Rules for higher-priced mortgage loans.

1. Effective date. For guidance on the applicability of the rules in § 226.35(b), see comment 1(d)(5)-1.

Paragraph 35(b)(2)(ii)(C).

1. Payment change. Section 226.35(b)(2) provides that a loan subject to this section may not have a penalty described by § 226.32(d)(6) unless certain conditions are met. Section 226.35(b)(2)(ii)(C) lists as a condition that the amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation. For examples showing whether a prepayment penalty is permitted or prohibited in connection with particular payment changes, see comment 32(d)(7)(iv)-1. Those examples, however, include a condition that § 226.35(b)(2) does not include: the condition that, at consummation, the consumer's total monthly debt payments may not exceed 50 percent of the consumer's monthly gross income. For guidance about circumstances in which payment changes are not considered payment changes for purposes of this section, see comment 32(d)(7)(iv)-2.

2. Negative amortization. Section 226.32(d)(2) provides that a loan described in § 226.32(a) may not have a payment schedule with regular periodic payments that cause the principal balance to increase. Therefore, the commentary to § 226.32(d)(7)(iv) does not include examples of payment changes in connection with negative amortization. The following examples show whether, under § 226.35(b)(2), prepayment penalties are permitted or prohibited in connection with particular payment changes, when a loan agreement permits negative amortization:

i. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month and the loan agreement permits negative amortization to occur. Under the loan agreement, the first date that a scheduled payment in a different amount may be due is January 1, 2014 and the creditor does not have the right to change scheduled payments prior to that date even if negative amortization occurs. A prepayment penalty is permitted with this mortgage transaction provided that the other § 226.35(b)(2) conditions are met, that is: provided that the prepayment penalty is permitted by other applicable law, the penalty expires on or before December 31, 2011, and the penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or its affiliate.

ii. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month and the loan agreement permits negative amortization to occur. Under the loan agreement, the first date that a scheduled payment in a different amount may be due is January 1, 2014, but the creditor has the right to change scheduled

payments prior to that date if negative amortization occurs. A prepayment penalty is prohibited with this mortgage transaction because the payment may change within the four-year period following consummation.

35(b)(3) Escrows.

Paragraph 35(b)(3)(i).

1. Section 226.35(b)(3) applies to principal dwellings, including structures that are classified as personal property under state law. For example, an escrow account must be established on a higher-priced mortgage loan secured by a first-lien on a mobile home, boat or a trailer used as the consumer's principal dwelling. See the commentary under §§ 226.2(a)(19), 226.2(a)(24), 226.15 and 226.23. Section 226.35(b)(3) also applies to higher-priced mortgage loans secured by a first lien on a condominium or a cooperative unit if it is in fact used as principal residence.

2. Administration of escrow accounts. Section 226.35(b)(3) requires creditors to establish before the consummation of a loan secured by a first lien on a principal dwelling an escrow account for payment of property taxes and premiums for mortgage-related insurance required by creditor. Section 6 of RESPA, *12 U.S.C. 2605*, and Regulation X address how escrow accounts must be administered.

3. Optional insurance items. Section 226.35(b)(3) does not require that escrow accounts be established for premiums for mortgage-related insurance that the creditor does not require in connection with the credit transaction, such as an earthquake insurance or debt-protection insurance.

Paragraph 35(b)(3)(ii)(B).

1. Limited exception. A creditor is required to escrow for payment of property taxes for all first lien loans secured by condominium units regardless of whether the creditors escrows insurance premiums for condominium unit.

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1B- Consumer Credit Law Manual Section 226.36

§ 226.36 Prohibited Acts or Practices in Connection With Credit Secured by a Consumer's Principal Dwelling

1. Effective date. For guidance on the applicability of the rules in § 226.36, see comment 1(d)(5)-1.

36(a) Mortgage broker defined.

1. Meaning of mortgage broker. Section 226.36(a) provides that a mortgage broker is any person who for compensation or other monetary gain arranges, negotiates, or otherwise obtains an extension of consumer credit for another person, but is not an employee of a creditor. In addition, this definition expressly includes any person that satisfies this definition but makes use of "table funding." Table funding occurs when a transaction is consummated with the debt obligation initially payable by its terms to one person, but another person provides the funds for the transaction at consummation and receives an immediate assignment of the note, loan contract, or other evidence of the debt obligation. Although § 226.2(a)(17)(1)(B) provides that a person to whom a debt obligation is initially payable on its face generally is a creditor, § 226.36(a) provides that, solely for the purposes of § 226.36, such a person is considered a mortgage broker. In addition, although consumers themselves often arrange, negotiate, or otherwise obtain extensions of consumer credit on their own behalf, they do not do so for compensation or other monetary gain or for another person and, therefore, are not mortgage brokers under this section.

36(b) Misrepresentation of value of consumer's principal dwelling.

36(b)(2) When extension of credit prohibited.

1. Reasonable diligence. A creditor will be deemed to have acted with reasonable diligence under § 226.36(b)(2) if the creditor extends credit based on an appraisal other than the one subject to the restriction in § 226.36(b)(2).

2. Material misstatement or misrepresentation. Section 226.36(b)(2) prohibits a creditor who knows of a violation of § 226.36(b)(1) in connection with an appraisal from extending credit based on such appraisal, unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling. A misstatement or misrepresentation of such dwelling's value is not material if it does not affect the credit decision or the terms on which credit is extended.

36(c) Servicing practices.

Paragraph 36(c)(1)(i).

1. Crediting of payments. Under § 226.36(c)(1)(i), a mortgage servicer must credit a payment to a consumer's loan account as of the date of receipt. This does not require that a mortgage servicer post the payment to the consumer's loan account on a particular date; the servicer is only required to credit the payment as of the date of receipt. Accordingly, a servicer that receives a payment on or before its due date (or within any grace period), and does not enter the payment on its books or in its system until after the payment's due date (or expiration of any grace period), does not violate this rule as long as the entry does not result in the imposition of a late charge, additional interest, or similar penalty to the consumer, or in the reporting of negative information to a consumer reporting agency.

2. Payments to be credited. Payments should be credited based on the legal obligation between the creditor and consumer. The legal obligation is determined by applicable state or other law.

3. Date of receipt. The "date of receipt" is the date that the payment instrument or other means of payment reaches the mortgage servicer. For example, payment by check is received when the mortgage servicer receives it, not when the funds are collected. If the consumer elects to have payment made by a third-party payor such as a financial institution, through a preauthorized payment or telephone bill-payment arrangement, payment is received when the mortgage servicer receives the third-party payor's check or other transfer medium, such as an electronic fund transfer.

Paragraph 36(c)(1)(ii).

1. Pyramiding of late fees. The prohibition on pyramiding of late fees in this subsection should be construed consistently with the "credit practices rule" of Regulation AA, *12 CFR 227.15* .

Paragraph 36(c)(1)(iii).

1. Reasonable time. The payoff statement must be provided to the consumer, or person acting on behalf of the consumer, within a reasonable time after the request. For example, it would be reasonable under most circumstances to provide the statement within five business days of receipt of a consumer's request. This time frame might be longer, for example, when the servicer is experiencing an unusually high volume of refinancing requests.

2. Person acting on behalf of the consumer. For purposes of § 226.36(c)(1)(iii), a person acting on behalf of the

consumer may include the consumer's representative, such as an attorney representing the individual, a non-profit consumer counseling or similar organization, or a creditor with which the consumer is refinancing and which requires the payoff statement to complete the refinancing. A servicer may take reasonable measures to verify the identity of any person acting on behalf of the consumer and to obtain the consumer's authorization to release information to any such person before the "reasonable time" period begins to run.

3. Payment requirements. The servicer may specify reasonable requirements for making payoff requests, such as requiring requests to be in writing and directed to a mailing address, e-mail address or fax number specified by the servicer or orally to a telephone number specified by the servicer, or any other reasonable requirement or method. If the consumer does not follow these requirements, a longer time frame for responding to the request would be reasonable.

4. Accuracy of payoff statements. Payoff statements must be accurate when issued.

Paragraph 36(c)(2).

1. Payment requirements. The servicer may specify reasonable requirements for making payments in writing, such as requiring that payments be accompanied by the account number or payment coupon; setting a cut-off hour for payment to be received, or setting different hours for payment by mail and payments made in person; specifying that only checks or money orders should be sent by mail; specifying that payment is to be made in U.S. dollars; or specifying one particular address for receiving payments, such as a post office box. The servicer may be prohibited, however, from requiring payment solely by preauthorized electronic fund transfer. (See section 913 of the Electronic Fund Transfer Act, *15 U.S.C. 1693k*.)

2. Payment requirements--limitations. Requirements for making payments must be reasonable; it should not be difficult for most consumers to make conforming payments. For example, it would be reasonable to require a cut-off time of 5 p.m. for receipt of a mailed check at the location specified by the servicer for receipt of such check.

3. Implied guidelines for payments. In the absence of specified requirements for making payments, payments may be made at any location where the servicer conducts business; any time during the servicer's normal business hours; and by cash, money order, draft, or other similar instrument in properly negotiable form, or by electronic fund transfer if the servicer and consumer have so agreed.

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CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
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1B- Consumer Credit Law Manual Section 226.39

§ **226.39 Mortgage transfer disclosures.**

39(a) Scope.

Paragraph 39(a)(1).

1. Covered persons. The disclosure requirements of § 226.39 apply to any "covered person" that becomes the legal owner of an existing mortgage loan, whether through a purchase, assignment, or other transfer, regardless of whether the person also meets the definition of a "creditor" in Regulation Z. The fact that a person purchases or acquires mortgage loans and provides disclosures under § 226.39 does not by itself make that person a "creditor" as defined in the regulation.

2. Acquisition of legal title. To become a "covered person" subject to § 226.39, a person must become the owner of an existing mortgage loan by acquiring legal title to the debt obligation. The transfer of ownership of a mortgage loan is subject to the disclosure requirements of this section when the acquiring party is a separate legal entity from the transferor, even if the parties are affiliated entities. Section 226.39 does not apply to persons who acquire only a beneficial interest in the loan or a security interest in the loan. Section 226.39 also does not apply to a party that assumes the credit risk without acquiring legal title to the loan. Thus, an investor that acquires mortgage-backed securities, pass-through certificates, or participation interests and does not directly acquire legal title in the underlying mortgage loans is not covered by this section.

3. Loan servicers. Pursuant to TILA Section 131(f)(2), the servicer of a mortgage loan is not treated as the owner of the obligation for purposes of §226.39 if the servicer holds title to the loan as a result of the assignment of the obligation to the servicer solely for the administrative convenience of the servicer in servicing the obligation.

4. Mergers, corporate acquisitions, or reorganizations. Disclosures are required under §226.39 when, as a result of a merger, corporate acquisition, or reorganization the ownership of a mortgage loan is transferred to a different legal entity.

Paragraph 39(a)(2).

1. Mortgage transactions covered. Section 226.39 applies to any consumer credit transaction secured by the principal dwelling of a consumer, which includes closed-end mortgage loans as well as home equity lines of credit.

39(b) Disclosure required.

1. Generally. A covered person must mail or deliver the disclosures required by §226.39 on or before the 30th calendar day following the date that the covered person acquired the loan, unless the exception in § 226.39(c) applies. For example, if a covered person acquires a mortgage loan on March 1, the required disclosure must be mailed or delivered on or before March 31. For purposes of this requirement, the date that the covered person acquires the loan is the acquisition date recognized in its books and records.

2. Disclosure provided on behalf of multiple entities. A mortgage loan may be acquired by a covered person and subsequently transferred to an affiliate or other entity that is also a covered person required to provide disclosures under § 226.39. In such cases, a single disclosure may be provided on behalf of both entities instead of providing two separate disclosures, as long as the disclosure satisfies the timing and content requirements applicable to both entities. For example, if a covered person acquires a loan on August 31 with the knowledge that it will assign the loan to another entity on October 15, the covered person could mail a single disclosure on or before September 30 which provides the required information for both entities and indicates when the subsequent transfer is expected to occur. Even though one person delegates responsibility for the disclosures to another covered person, each has a duty to ensure that disclosures related to its acquisition are accurate and provided in a timely manner.

39(c) Exceptions.

Paragraph 39(c)(1).

1. Example. If a mortgage loan is originated on February 22nd and the original creditor sells the loan on March 1 to a covered person, under the exception in § 226.39(c) the covered person would not be required to provide disclosures under § 226.39 if the loan is sold or otherwise transferred or assigned to another party on or before March 31.

Paragraph 39(c)(2).

1. Repurchase agreements. The original creditor or owner of the mortgage loan might sell or transfer legal title to the loan to secure short-term business financing under an agreement where the original creditor or owner is also obligated to repurchase the loan within a brief period, typically a month or less. If the original creditor or owner does not recognize such transactions as a sale of the loan on its own books and records for accounting purposes, the transfer of the loan in connection with such a repurchase agreement is not covered by § 226.39 and the acquiring party is not

required to provide disclosures. However, if the transferor does not repurchase the mortgage loan, the acquiring party must make the disclosures required by § 226.39 within 30 days after the date that the transaction is recognized as an acquisition in its books and records.

Paragraph 39(d).

1. Identifying the loan. The disclosures required by this section should identify the loan that was acquired or transferred. The covered person has flexibility in determining what information to provide for this purpose. For example, the covered person may identify the loan by stating the address of the mortgaged property along with the account number or other identification number previously known to the consumer, which may appear in a truncated format. Alternatively, the covered person might identify the loan by specifying the date on which the credit was extended and the original amount of the loan or credit line.

Paragraph 39(d)(1).

1. Identification of covered person. Section 226.39(d)(1) requires acquiring parties to provide their name, address, and telephone number. The party identified must be the covered person who owns the mortgage loan, regardless of whether another party has been appointed to service the loan or otherwise serve as the covered person's agent. In addition to providing a postal address and a telephone number, the covered person may, at its option, provide an address for receiving electronic mail or an internet web site address but is not required to do so.

Paragraph 39(d)(3).

1. Identifying agents. Under § 226.39(d)(3), the covered person must provide contact information for the agent or other party having authority to act on behalf of the covered person and who is authorized to receive legal notices on behalf of the covered person and resolve issues concerning the consumer's payments on the loan. Section 226.39(d)(3) does not require that a covered person designate an agent or other party, but if the consumer cannot use the covered person's contact information for these purposes the disclosure must provide contact information for an agent or other party that can address these matters. If multiple agents are listed on the disclosure, the disclosure shall state the extent to which the authority of each agent differs by indicating if only one of the agents is authorized to receive legal notices, or only one of the agents is authorized to resolve issues concerning payments. For purposes of § 226.39(d)(3), it is sufficient to provide a telephone number as the contact information provided that consumers can use the telephone number to obtain the mailing address for the agent or other person identified.

2. Other contact information. The covered person may also provide an agent's electronic mail address or internet web site address but is not required to do so.

Paragraph 39(d)(4).

1. Recording location. Section 226.39(d)(4) requires disclosure of the location where transfer of ownership of the debt to the covered person is recorded. If the transfer of ownership has not been recorded in public records at the time the disclosure is provided, the covered person complies with § 226.39(d)(4) by stating this fact. Whether or not the

transfer has been recorded at the time the disclosure is made, the disclosure may state that the transfer "is or may be recorded" at the specified location.

2. Postal address not required. In disclosing the location where the transfer of ownership is recorded, the covered person is not required to provide a postal address for the governmental office where the covered person's ownership interest is recorded. The covered person also is not required to provide the name of the county or jurisdiction where the property is located. For example, it would be sufficient to disclose that the transaction is or may be recorded in the office of public land records or the recorder of deeds office "for the county or local jurisdiction where the property is located."

39(e) Optional disclosures.

1. Generally. Section 226.39(e) provides that covered persons may, at their option, include additional information about the mortgage transaction that they consider relevant or helpful to consumers. For example, the covered person may choose to inform consumers that the location where they should send mortgage payments has not changed.

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PART I Consumer Credit
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Subpart F Special Rules For Private Education Loans

1B- Consumer Credit Law Manual § 226.46

§ 226.46 Special disclosure requirements for private education loans.

(a) Coverage. The requirements of this subpart apply to private education loans as defined in § 226.46(b)(5). A creditor may, at its option, comply with the requirements of this subpart for an extension of credit subject to §§ 226.17 and 226.18 that is extended to a consumer for expenses incurred after graduation from a law, medical, dental, veterinary, or other graduate school and related to relocation, study for a bar or other examination, participation in an internship or residency program, or similar purposes.

(1) Relation to other subparts in this part Except as otherwise specifically provided, the requirements and limitations of this subpart are in addition to and not in lieu of those contained in other subparts of this Part.

(b) Definitions. For purposes of this subpart, the following definitions apply:

(1) Covered educational institution means:

(i) An educational institution that meets the definition of an institution of higher education, as defined in paragraph (b)(2) of this section, without regard to the institution's accreditation status; and

(ii) Includes an agent, officer, or employee of the institution of higher education. An agent means an institution-affiliated organization as defined by section 151 of the Higher Education Act of 1965 (*20 U.S.C. 1019*) or an officer or employee of an institution-affiliated organization.

(2) Institution of higher education has the same meaning as in sections 101 and 102 of the Higher Education Act of 1965 (*20 U.S.C. 1001-1002*) and the implementing regulations published by the U.S. Department of Education.

(3) Postsecondary educational expenses means any of the expenses that are listed as part of the cost of attendance, as defined under section 472 of the Higher Education Act of 1965 (*20 U.S.C. 1087ll*), of a student at a covered educational institution. These expenses include tuition and fees, books, supplies, miscellaneous personal expenses, room and board, and an allowance for any loan fee, origination fee, or insurance premium charged to a student or parent for a loan incurred to cover the cost of the student's attendance.

(4) Preferred lender arrangement has the same meaning as in section 151 of the Higher Education Act of 1965 (*20 U.S.C. 1019*).

(5) Private education loan means an extension of credit that:

(i) Is not made, insured, or guaranteed under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*);

(ii) Is extended to a consumer expressly, in whole or in part, for postsecondary educational expenses, regardless of whether the loan is provided by the educational institution that the student attends;

(iii) Does not include open-end credit any loan that is secured by real property or a dwelling; and

(iv) Does not include an extension of credit in which the covered educational institution is the creditor if:

(A) The term of the extension of credit is 90 days or less; or

(B) an interest rate will not be applied to the credit balance and the term of the extension of credit is one year or less, even if the credit is payable in more than four installments.

(c) Form of disclosures

(1) Clear and conspicuous. The disclosures required by this subpart shall be made clearly and conspicuously.

(2) Transaction disclosures.

(i) The disclosures required under §§ 226.47(b) and (c) shall be made in writing, in a form that the consumer may keep. The disclosures shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related to the disclosures required under §§ 226.47(b) and (c), which include the disclosures required under § 226.18.

(ii) The disclosures may include an acknowledgement of receipt, the date of the transaction, and the consumer's name, address, and account number. The following disclosures may be made together with or separately from other required disclosures: the creditor's identity under § 226.18(a), insurance or debt cancellation under § 226.18(n), and certain security interest charges under § 226.18(o).

(iii) The term "finance charge" and corresponding amount, when required to be disclosed under § 226.18(d), and the interest rate required to be disclosed under §§ 226.47(b)(1)(i) and (c)(1), shall be more conspicuous than any other disclosure, except the creditor's identity under § 228.18(a).

(3) Electronic disclosures. The disclosures required under §§ 226.47(b) and (c) may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (*15 U.S.C. 7001 et seq.*). The disclosures required by § 226.47(a) may be provided to the consumer in electronic form on or with an application or solicitation that is accessed by the consumer in electronic form without regard to the consumer consent or other provisions of the E-Sign Act. The form required to be received under § 226.48(e) may be accepted by the creditor in electronic form as provided for in that section.

(d) Timing of disclosures.

(1) Application or solicitation disclosures.

(i) The disclosures required by § 226.47(a) shall be provided on or with any application or solicitation. For purposes of this subpart, the term solicitation means an offer of credit that does not require the consumer to complete an application. A "firm offer of credit" as defined in section 603(l) of the Fair Credit Reporting Act (*15 U.S.C. 1681a(l)*) is

a solicitation for purposes of this section

(ii) The creditor may, at its option, disclose orally the information in § 226.47(a) in a telephone application or solicitation. Alternatively, if the creditor does not disclose orally the information in § 226.47(a), the creditor must provide the disclosures or place them in the mail no later than three business days after the consumer has applied for the credit, except that, if the creditor either denies the consumer's application or provides or places in the mail the disclosures in § 226.47(b) no later than three business days after the consumer requests the credit, the creditor need not also provide the § 226.47(a) disclosures.

(iii) Notwithstanding paragraph (d)(1)(i), for a loan that the consumer may use for multiple purposes including, but not limited to, postsecondary educational expenses, the creditor need not provide the disclosures required by § 226.47(a).

(2) Approval disclosures. The creditor shall provide the disclosures required by § 226.47(b) before consummation on or with any notice of approval provided to the consumer. If the creditor mails notice of approval, the disclosures must be mailed with the notice. If the creditor communicates notice of approval by telephone, the creditor must mail the disclosures within three business days of providing the notice of approval. If the creditor communicates notice of approval electronically, the creditor may provide the disclosures in electronic form in accordance with § 226.46(d)(3); otherwise the creditor must mail the disclosures within three business days of communicating the notice of approval. If the creditor communicates approval in person, the creditor must provide the disclosures to the consumer at that time.

(3) Final disclosures. The disclosures required by § 226.47(c) shall be provided after the consumer accepts the loan in accordance with § 226.48(c)(1).

(4) Receipt of mailed disclosures. If the disclosures under paragraphs (d)(1), (d)(2) or (d)(3), are mailed to the consumer, the consumer is considered to have received them three business days after they are mailed.

(e) Basis of disclosures and use of estimates.

(1) Legal obligation. Disclosures shall reflect the terms of the legal obligation between the parties.

(2) Estimates. If any information necessary for an accurate disclosure is unknown to the creditor, the creditor shall make the disclosure based on the best information reasonably available at the time the disclosure is provided, and shall state clearly that the disclosure is an estimate.

(f) Multiple creditors; multiple consumers. If a transaction involves more than one creditor, only one set of disclosures shall be given and the creditors shall agree among themselves which creditor will comply with the requirements that this part imposes on any or all of them. If there is more than one consumer, the disclosures may be made to any consumer who is primarily liable on the obligation.

(g) Effect of subsequent events.

(1) Approval disclosures. If a disclosure under § 226.47(b) becomes inaccurate because of an event that occurs after the creditor delivers the required disclosures, the inaccuracy is not a violation of Regulation Z (12 CFR part 226), although new disclosures may be required under § 226.48(c).

(2) Final disclosures. If a disclosure under § 226.47(c) becomes inaccurate because of an event that occurs after the creditor delivers the required disclosures, the inaccuracy is not a violation of Regulation Z (12 CFR part 226).

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1B- Consumer Credit Law Manual § 226.47

§ **226.47 Content of disclosures.**

(a) Application or solicitation disclosures. A creditor shall provide the disclosures required under paragraph (a) of this section on or with a solicitation or an application for a private education loan.

(1) Interest Rates.

(i) The interest rate or range of interest rates applicable to the loan and actually offered by the creditor at the time of application or solicitation. If the rate will depend, in part, on a later determination of the consumer's creditworthiness or other factors, a statement that the rate for which the consumer may qualify will depend on the consumer's creditworthiness and other factors, if applicable.

(ii) Whether the interest rates applicable to the loan are fixed or variable.

(iii) If the interest rate may increase after consummation of the transaction, any limitations on the interest rate adjustments, or lack thereof; a statement that the consumer's actual rate could be higher or lower than the rates disclosed under paragraph (a)(1)(i) of this section, if applicable; and, if the limitation is determined by applicable law, that fact.

(iv) Whether the applicable interest rates typically will be higher if the loan is not co-signed or guaranteed.

(2) Fees and default or late payment costs.

(i) An itemization of the fees or range of fees required to obtain the private education loan.

(ii) Any fees, changes to the interest rate, and adjustments to principal based on the consumer's defaults or late payments.

(3) Repayment terms.

(i) The term of the loan, which is the period during which regularly scheduled payments of principal and interest will be due.

(ii) A description of any payment deferral options, or, if the consumer does not have the option to defer payments, that fact.

(iii) For each payment deferral option applicable while the student is enrolled at a covered educational institution:

(A) Whether interest will accrue during the deferral period; and

(B) If interest accrues, whether payment of interest may be deferred and added to the principal balance.

(iv) A statement that if the consumer files for bankruptcy, the consumer may still be required to pay back the loan.

(4) Cost estimates. An example of the total cost of the loan calculated as the total of payments over the term of the loan:

(i) Using the highest rate of interest disclosed under paragraph (a)(1) of this section and including all finance charges applicable to loans at that rate;

(ii) Using an amount financed of $10,000, or $5000 if the creditor only offers loans of this type for less than $10,000; and

(iii) Calculated for each payment option.

(5) Eligibility. Any age or school enrollment eligibility requirements relating to the consumer or co-signer.

(6) Alternatives to private education loans.

(i) A statement that the consumer may qualify for Federal student financial assistance through a program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*).

(ii) The interest rates available under each program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*) and whether the rates are fixed or variable.

(iii) A statement that the consumer may obtain additional information concerning Federal student financial assistance from the institution of higher education that the student attends, or at the Web site of the U.S. Department of Education, including an appropriate Web site address.

(iv) A statement that a covered educational institution may have school-specific education loan benefits and terms not detailed on the disclosure form.

(7) Rights of the consumer. A statement that if the loan is approved, the terms of the loan will be available and will not change for 30 days except as a result of adjustments to the interest rate and other changes permitted by law.

(8) Self-certification information. A statement that, before the loan may be consummated, the consumer must complete the self-certification form and that the form may be obtained from the institution of higher education that the student attends.

(b) Approval disclosures. On or with any notice of approval provided to the consumer, the creditor shall disclose the

information required under § 226.18 and the following information:

(1) Interest rate

(i) The interest rate applicable to the loan.

(ii) Whether the interest rate is fixed or variable.

(iii) If the interest rate may increase after consummation of the transaction, any limitations on the rate adjustments, or lack thereof.

(2) Fees and default or late payment costs.

(i) An itemization of the fees or range of fees required to obtain the private education loan.

(ii) Any fees, changes to the interest rate, and adjustments to principal based on the consumer's defaults or late payments.

(3) Repayment terms.

(i) The principal amount of the loan for which the consumer has been approved.

(ii) The term of the loan, which is the period during which regularly scheduled payments of principal and interest will be due.

(iii) A description of the payment deferral option chosen by the consumer, if applicable, and any other payment deferral options that the consumer may elect at a later time.

(iv) Any payments required while the student is enrolled at a covered educational institution, based on the deferral option chosen by the consumer.

(v) The amount of any unpaid interest that will accrue while the student is enrolled at a covered educational institution, based on the deferral option chosen by the consumer.

(vi) A statement that if the consumer files for bankruptcy, the consumer may still be required to pay back the loan.

(vii) An estimate of the total amount of payments calculated based on:

(A) The interest rate applicable to the loan. Compliance with § 226.18(h) constitutes compliance with this requirement.

(B) The maximum possible rate of interest for the loan or, if a maximum rate cannot be determined, a rate of 25%.

(C) If a maximum rate cannot be determined, the estimate of the total amount for repayment must include a statement that there is no maximum rate and that the total amount for repayment disclosed under paragraph (b)(3)(vii)(B) of this section is an estimate and will be higher if the applicable interest rate increases

(vii) The maximum monthly payment based on the maximum rate of interest for the loan or, if a maximum rate cannot be determined, a rate of 25%. If a maximum cannot be determined, a statement that there is no maximum rate and that the monthly payment amount disclosed is an estimate and will be higher if the applicable interest rate increases.

(4) Alternatives to private education loans.

(i) A statement that the consumer may qualify for Federal student financial assistance through a program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*).

(ii) The interest rates available under each program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*), and whether the rates are fixed or variable.

(iii) A statement that the consumer may obtain additional information concerning Federal student financial assistance from the institution of higher education that the student attends, or at the Web site of the U.S. Department of Education, including an appropriate Web site address.

(5) Rights of the consumer.

(i) A statement that the consumer may accept the terms of the loan until the acceptance period under § 226.48(c)(1) has expired. The statement must include the specific date on which the acceptance period expires, based on the date upon which the consumer receives the disclosures required under this subsection for the loan. The disclosure must also specify the method or methods by which the consumer may communicate acceptance.

(ii) A statement that, except for changes to the interest rate and other changes permitted by law, the rates and terms of the loan may not be changed by the creditor during the period described in paragraph (b)(5)(i) of this section.

(c) Final disclosures. After the consumer has accepted the loan in accordance with § 226.48(c)(1), the creditor shall disclose to the consumer the information required by § 226.18 and the following information:

(1) Interest rate. Information required to be disclosed under §§ 226.47(b)(1).

(2) Fees and default or late payment costs. Information required to be disclosed under § 226.47(b)(2).

(3) Repayment terms. Information required to be disclosed under § 226.47(b)(3).

(4) Cancellation right. A statement that:

(i) the consumer has the right to cancel the loan, without penalty, at any time before the cancellation period under § 226.48(d) expires, and

(ii) loan proceeds will not be disbursed until after the cancellation period under § 226.48(d) expires. The statement must include the specific date on which the cancellation period expires and state that the consumer may cancel by that date. The statement must also specify the method or methods by which the consumer may cancel. If the creditor permits

cancellation by mail, the statement must specify that the consumer's mailed request will be deemed timely if placed in the mail not later than the cancellation date specified on the disclosure. The disclosures required by this paragraph (c)(4) must be made more conspicuous than any other disclosure required under this section, except for the finance charge, the interest rate, and the creditor's identity, which must be disclosed in accordance with the requirements of § 226.46(c)(2)(iii).

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Subpart F Special Rules For Private Education Loans

1B- Consumer Credit Law Manual § 226.48

§ 226.48 Limitations on private education loans.

(a) Co-branding prohibited.

(1) Except as provided in paragraph (b) of this section, a creditor, other than the covered educational institution itself, shall not use the name, emblem, mascot, or logo of a covered educational institution, or other words, pictures, or symbols identified with a covered educational institution, in the marketing of private education loans in a way that implies that the covered education institution endorses the creditor's loans.

(2) A creditor's marketing of private education loans does not imply that the covered education institution endorses the creditor's loans if the marketing includes a clear and conspicuous disclosure that is equally prominent and closely proximate to the reference to the covered educational institution that the covered educational institution does not endorse the creditor's loans and that the creditor is not affiliated with the covered educational institution.

(b) Endorsed lender arrangements. If a creditor and a covered educational institution have entered into an arrangement where the covered educational institution agrees to endorse the creditor's private education loans, and such arrangement is not prohibited by other applicable law or regulation, paragraph (a)(1) of this section does not apply if the private education loan marketing includes a clear and conspicuous disclosure that is equally prominent and closely proximate to the reference to the covered educational institution that the creditor's loans are not offered or made by the covered educational institution, but are made by the creditor.

(c) Consumer's right to accept.

(1) The consumer has the right to accept the terms of a private education loan at any time within 30 calendar days following the date on which the consumer receives the disclosures required under § 226.47(b).

(2) Except for changes permitted under paragraphs (c)(3) and (c)(4), the rate and terms of the private education loan that are required to be disclosed under §§ 226.47(b) and (c) may not be changed by the creditor prior to the earlier of:

(i) The date of disbursement of the loan; or

(ii) The expiration of the 30 calendar day period described in paragraph (c)(1) of this section if the consumer has not accepted the loan within that time.

(3) Exceptions not requiring re-disclosure.

(i) Notwithstanding paragraph (c)(2) of this section, nothing in this section prevents the creditor from:

(A) Withdrawing an offer before consummation of the transaction if the extension of credit would be prohibited by law or if the creditor has reason to believe that the consumer has committed fraud in connection with the loan application;

(B) Changing the interest rate based on adjustments to the index used for a loan;

(C) Changing the interest rate and terms if the change will unequivocally benefit the consumer; or

(D) Reducing the loan amount based upon a certification or other information received from the covered educational institution, or from the consumer, indicating that the student's cost of attendance has decreased or the consumer's other financial aid has increased. A creditor may make corresponding changes to the rate and other terms only to the extent that the consumer would have received the terms if the consumer had applied for the reduced loan amount.

(ii) If the creditor changes the rate or terms of the loan under this paragraph (c)(3), the creditor need not provide the

disclosures required under § 228.47(b) for the new loan terms, nor need the creditor provide an additional 30-day period to the consumer to accept the new terms of the loan under paragraph (c)(1) of this section.

(4) Exceptions requiring re-disclosure.

(i) Notwithstanding paragraphs (c)(2) or (c)(3) of this section, nothing in this section prevents the creditor, at its option, from changing the rate or terms of the loan to accommodate a specific request by the consumer. For example, if the consumer requests a different repayment option, the creditor may, but need not, offer to provide the requested repayment option and make any other changes to the rate and terms.

(ii) If the creditor changes the rate or terms of the loan under this paragraph (c)(4), the creditor shall provide the disclosures required under § 228.47(b) and shall provide the consumer the 30-day period to accept the loan under paragraph (c)(1) of this section. The creditor shall not make further changes to the rates and terms of the loan, except as specified in paragraphs (c)(3) and (4) of this section. Except as permitted under § 226.48(c)(3), unless the consumer accepts the loan offered by the creditor in response to the consumer's request, the creditor may not withdraw or change the rates or terms of the loan for which the consumer was approved prior to the consumer's request for a change in loan terms.

(d) Consumer's right to cancel. The consumer may cancel a private education loan, without penalty, until midnight of the third business day following the date on which the consumer receives the disclosures required by § 226.47(c). No funds may be disbursed for a private education loan until the three-business day period has expired.

(e) Self-certification form. For a private education loan intended to be used for the postsecondary educational expenses of a student while the student is attending an institution of higher education, the creditor shall obtain from the consumer or the institution of higher education the form developed by the Secretary of Education under section 155 of the Higher Education Act of 1965, signed by the consumer, in written or electronic form, before consummating the private education loan.

(f) Provision of information by preferred lenders. A creditor that has a preferred lender arrangement with a covered educational institution shall provide to the covered educational institution the information required under §§ 226.47(a)(1) through (5), for each type of private education loan that the lender plans to offer to consumers for students attending the covered educational institution for the period beginning July 1 of the current year and ending June 30 of the following year. The creditor shall provide the information annually by the later of the 1st day of April, or within 30 days after entering into, or learning the creditor is a party to, a preferred lender arrangement.

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1B- Consumer Credit Law Manual Section 226.51

§ **226.51 Ability To Pay**

51(a) General rule.

51(a)(1) Consideration of ability to pay.

1. Consideration of additional factors. Section 226.51(a) requires a card issuer to consider a consumer's ability to make the required minimum periodic payments under the terms of an account based on the consumer's income or assets and current obligations. The card issuer may also consider consumer reports, credit scores, and other factors, consistent with Regulation B (12 CFR part 202).

2. Ability to pay as of application or consideration of increase. A card issuer complies with § 226.51(a) if it bases its determination regarding a consumer's ability to make the required minimum periodic payments on the facts and circumstances known to the card issuer at the time the consumer applies to open the credit card account or when the card issuer considers increasing the credit line on an existing account.

3. Credit line increase. When a card issuer considers increasing the credit line on an existing account, § 226.51(a) applies whether the consideration is based upon a request of the consumer or is initiated by the card issuer.

4. Income, assets, and employment. Any current or reasonably expected assets or income may be considered by the card issuer. For example, a card issuer may use information about current or expected salary, wages, bonus pay, tips and commissions. Employment may be full-time, part-time, seasonal, irregular, military, or self-employment. Other sources of income could include interest or dividends, retirement benefits, public assistance, alimony, child support, or separate maintenance payments. A card issuer may also take into account assets such as savings accounts or investments that the consumer can or will be able to use. A card issuer may consider the consumer's income or assets based on information

provided by the consumer, in connection with this credit card account or any other financial relationship the card issuer or its affiliates has with the consumer, subject to any applicable information-sharing rules, and information obtained through third parties, subject to any applicable information-sharing rules. A card issuer may also consider information obtained through any empirically derived, demonstrably and statistically sound model that reasonably estimates a consumer's income or assets.

5. Current obligations. A card issuer may consider the consumer's current obligations based on information provided by the consumer or in a consumer report. In evaluating a consumer's current obligations, a card issuer need not assume that credit lines for other obligations are fully utilized.

6. Joint applicants and joint accountholders. With respect to the opening of a joint account between two or more consumers or a credit line increase on a joint account between two or more consumers, the card issuer may consider the collective ability of all joint applicants or joint accountholders to make the required payments.

51(a)(2) Minimum periodic payments.

1. Applicable minimum payment formula. For purposes of estimating required minimum periodic payments under the safe harbor set forth in § 226.51(a)(2)(ii), if the account has or may have a promotional program, such as a deferred payment or similar program, where there is no applicable minimum payment formula during the promotional period, the issuer must estimate the required minimum periodic payment based on the minimum payment formula that will apply when the promotion ends.

2. Interest rate for purchases. For purposes of estimating required minimum periodic payments under the safe harbor set forth in § 226.51(a)(2)(ii), if the interest rate for purchases is or may be a promotional rate, the issuer must use the post-promotional rate to estimate interest charges.

3. Mandatory fees. For purposes of estimating required minimum periodic payments under the safe harbor set forth in § 226.51(a)(2)(ii), mandatory fees that must be assumed to be charged include those fees the card issuer knows the consumer will be required to pay under the terms of the account if the account is opened, such as an annual fee.

51(b) Rules affecting young consumers.

1. Age as of date of application or consideration of credit line increase. Sections 226.51(b)(1) and (b)(2) apply only to a consumer who has not attained the age of 21 as of the date of submission of the application under § 226.51(b)(1) or the date the credit line increase is requested by the consumer (or if no request has been made, the date the credit line increase is considered by the card issuer) under § 226.51(b)(2).

2. Liability of cosigner, guarantor, or joint accountholder. Sections 226.51(b)(1)(ii) and (b)(2) require the signature

or written consent of a cosigner, guarantor, or joint accountholder agreeing either to be secondarily liable for any debt on the account incurred by the consumer before the consumer has attained the age of 21 or to be jointly liable with the consumer for any debt on the account. Sections 226.51(b)(1)(ii) and (b)(2) do not prohibit a card issuer from also requiring the cosigner, guarantor, or joint accountholder to assume liability for debts incurred after the consumer has attained the age of 21, consistent with any agreement made between the parties.

3. Authorized users exempt. If a consumer who has not attained the age of 21 is being added to another person's account as an authorized user and has no liability for debts incurred on the account, § 226.51(b)(1) and (b)(2) do not apply.

4. Electronic application. Consistent with § 226.5(a)(1)(iii), an application may be provided to the consumer in electronic form without regard to the consumer consent or other provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (*15 U.S.C. 7001 et seq.*) in the circumstances set forth in § 226.5a. The electronic submission of an application from a consumer or a consent to a credit line increase from a cosigner, guarantor, or joint accountholder to a card issuer would constitute a written application or consent for purposes of § 226.51(b) and would not be considered a consumer disclosure for purposes of the E-Sign Act.

51(b)(1) Applications from young consumers.

1. Relation to Regulation B. In considering an application or credit line increase on the credit card account of a consumer who is less than 21 years old, creditors must comply with the applicable rules in Regulation B (12 CFR part 202).

51(b)(2) Credit line increases for young consumers.

1. Credit line request by joint accountholder aged 21 or older. The requirement under § 226.51(b)(2) that a cosigner, guarantor, or joint accountholder for a credit card account opened pursuant to § 226.51(b)(1)(ii) must agree in writing to assume liability for the increase before a credit line is increased, does not apply if the cosigner, guarantor or joint accountholder who is at least 21 years old initiates the request for the increase.

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1B- Consumer Credit Law Manual Section 226.52

§ **226.52 Limitations on Fees**

52(a) Limitations during first year after account opening.

52(a)(1) General rule.

1. Application. Section 226.52(a)(1) applies if a card issuer charges any fees to the account during the first year after the account is opened (unless the fees are specifically exempted by § 226.52(a)(2)). Thus, if a card issuer charges a non-exempt fee to the account during the first year after account opening, § 226.52(a)(1) provides that the total amount of non-exempt fees the consumer is required to pay with respect to the account during the first year cannot exceed 25 percent of the credit limit in effect when the account is opened. This 25 percent limit applies to fees that the card issuer charges to the account as well as to fees that the card issuer requires the consumer to pay with respect to the account through other means (such as through a payment from the consumer to the card issuer or from another credit account provided by the card issuer).

For example:

i. Assume that, under the terms of a credit card account, a consumer is required to pay $120 in fees for the issuance or availability of credit at account opening. The consumer is also required to pay a cash advance fee that is equal to five percent of the cash advance and a late payment fee of $15 if the required minimum periodic payment is not received by the payment due date (which is the twenty-fifth of the month). At account opening on January 1 of year one, the credit limit for the account is $500. Section 226.52(a)(1) permits the card issuer to charge to the account the $120 in fees for the issuance or availability of credit at account opening. On February 1 of year one, the consumer uses the account for a $100 cash advance. Section 226.52(a)(1) permits the card issuer to charge a $5 cash-advance fee to the account. On March 26 of year one, the card issuer has not received the consumer's required minimum periodic payment. Section 226.52(a)(2) permits the card issuer to charge a $15 late payment fee to the account. On July 15 of year one, the consumer uses the account for a $50 cash advance. Section 226.52(a)(1) does not permit the card issuer to charge a $2.50 cash advance fee to the account. Furthermore, § 225.52(a)(1) prohibits the card issuer from collecting the $2.50 cash advance fee from the consumer by other means.

ii. Assume that, under the terms of a credit card account, a consumer is required to pay $125 in fees for the issuance or availability of credit during the first year after account opening. At account opening on January 1 of year one, the credit limit for the account is $500. Section 226.52(a)(1) permits the card issuer to charge the $125 in fees to the account. However, § 226.52(a)(1) prohibits the card issuer from requiring the consumer to make payments to the card issuer for additional non-exempt fees with respect to the account during the first year after account opening or requiring the consumer to open a separate credit account with the card issuer to fund the payment of additional non-exempt fees during the first year.

2. Fees that exceed 25 percent limit. A card issuer that charges a fee to a credit card account that exceeds the 25 percent limit complies with § 226.52(a)(1) if the card issuer waives or removes the fee and any associated interest charges or credits the account for an amount equal to the fee and any associated interest charges within a reasonable amount of time but no later than the end of the billing cycle following the billing cycle during which the fee was charged. For example, assuming the facts in comment 52(a)(1)-1 above, the card issuer complies with § 226.52(a)(1) if the card issuer charged the $2.50 cash advance fee to the account on July 15 of year one but waived or removed the fee or credited the account for $2.50 (plus any interest charges on that $2.50) at the end of the billing cycle.

3. Changes in credit limit during first year.

i. Increases in credit limit. If a card issuer increases the credit limit during the first year after the account is opened, § 226.52(a)(1) does not permit the card issuer to require the consumer to pay additional fees that would otherwise be prohibited (such as a fee for increasing the credit limit). For example, assume that, at account opening on January 1, the credit limit for a credit card account is $400 and the consumer is required to pay $100 in fees for the issuance or availability of credit. On July 1, the card issuer increases the credit limit for the account to $600. Section 226.52(a)(1) does not permit the card issuer to require the consumer to pay additional fees based on the increased credit limit.

ii. Decreases in credit limit. If a card issuer decreases the credit limit during the first year after the account is opened, § 226.52(a)(1) requires the card issuer to waive or remove any fees charged to the account that exceed 25 percent of the reduced credit limit or to credit the account for an amount equal to any fees the consumer was required to pay with respect to the account that exceed 25 percent of the reduced credit limit within a reasonable amount of time but no later than the end of the billing cycle following the billing cycle during which the fee was charged. For example, assume that, at account opening on January 1, the credit limit for a credit card account is $1,000 and the consumer is required to pay $250 in fees for the issuance or availability of credit. The billing cycles for the account begin on the first day of the month and end on the last day of the month. On July 30, the card issuer decreases the credit limit for the account to $500. Section 226.52(a)(1) requires the card issuer to waive or remove $175 in fees from the account or to credit the account for an amount equal to $175 within a reasonable amount of time but no later than August 31.

52(a)(2) Fees not subject to limitations.

1. Covered fees. Except as provided in § 226.52(a)(2), § 226.52(a) applies to any fees that a card issuer will or may require the consumer to pay with respect to a credit card account during the first year after account opening. For example, § 226.52(a) applies to:

i. Fees that the consumer is required to pay for the issuance or availability of credit described in § 226.5a(b)(2), including any fee based on account activity or inactivity and any fee that a consumer is required to pay in order to receive a particular credit limit;

ii. Fees for insurance described in § 226.4(b)(7) or debt cancellation or debt suspension coverage described in § 226.4(b)(10) written in connection with a credit transaction, if the insurance or debt cancellation or debt suspension coverage is required by the terms of the account;

iii. Fees that the consumer is required to pay in order to engage in transactions using the account (such as cash advance fees, balance transfer fees, foreign transaction fees, and fees for using the account for purchases); and

iv. Fees that the consumer is required to pay for violating the terms of the account (except to the extent specifically excluded by § 226.52(a)(2)(i)).

2. Fees the consumer is not required to pay. Section 226.52(a)(2)(ii) provides that § 226.52(a) does not apply to fees that the consumer is not required to pay with respect to the account. For example, § 226.52(a) generally does not apply to fees for making an expedited payment (to the extent permitted by § 226.10(e)), fees for optional services (such as travel insurance), fees for reissuing a lost or stolen card, or statement reproduction fees.

3. Security deposits. A security deposit that is charged to a credit card account is a fee for purposes of § 226.52(a). In contrast, however, a security deposit is not subject to the 25 percent limit in § 226.52(a)(1) if it is not charged to the account. For example, § 226.52(a)(1) does not prohibit a card issuer from requiring a consumer to provide funds at account opening pledged as security for the account that exceed 25 percent of the credit limit at account opening so long as those funds are not obtained from the account.

52(a)(3) Rule of construction.

1. Fees or charges otherwise prohibited by law. Section 226.52(a) does not authorize the imposition or payment of fees or charges otherwise prohibited by law. For example, see *16 CFR § 310.4(a)(4)*.

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1B- Consumer Credit Law Manual Section 226.53

§ 226.53 Allocation of Payments

1. Required minimum periodic payment. Section 226.53 addresses the allocation of amounts paid by the consumer in excess of the minimum periodic payment required by the card issuer. Section 226.53 does not limit or otherwise address the card issuer's ability to determine, consistent with applicable law and regulatory guidance, the amount of the required minimum periodic payment or how that payment is allocated. A card issuer may, but is not required to, allocate the required minimum periodic payment consistent with the requirements in § 226.53 to the extent consistent with other applicable law or regulatory guidance.

2. Applicable rates and balances. Section 226.53 permits a card issuer to allocate an amount paid by the consumer in excess of the required minimum periodic payment based on the annual percentage rates and balances on the day the preceding billing cycle ends, on the day the payment is credited to the account, or on any day in between those two dates. The day used by the card issuer to determine the applicable annual percentage rates and balances for purposes of § 226.53 generally must be consistent from billing cycle to billing cycle, although the card issuer may adjust this day from time to time. For example:

i. Assume that the billing cycles for a credit card account start on the first day of the month and end on the last day of the month. On the date the March billing cycle ends (March 31), the account has a purchase balance of $500 at a promotional annual percentage rate of 5% and another purchase balance of $200 at a non-promotional annual percentage rate of 15%. On April 5, a $100 purchase to which the 15% rate applies is charged to the account. On April 15, the promotional rate expires and § 226.55(b)(1) permits the card issuer to increase the rate that applies to the $500 balance from 5% to 18%. On April 25, the card issuer credits to the account $400 paid by the consumer in excess of the required minimum periodic payment. If the card issuer's practice is to allocate payments based on the rates and balances on the last day of the prior billing cycle, the card issuer would allocate the $400 payment to pay in full the $200 balance to which the 15% rate applied on March 31 and then allocate the remaining $200 to the $500 balance to which the 5%

rate applied on March 31. In the alternative, if the card issuer's practice is to allocate payments based on the rates and balances on the day a payment is credited to the account, the card issuer would allocate the $400 payment to the $500 balance to which the 18% rate applied on April 25.

ii. Same facts as above except that, on April 25, the card issuer credits to the account $750 paid by the consumer in excess of the required minimum periodic payment. If the card issuer's practice is to allocate payments based on the rates and balances on the last day of the prior billing cycle, the card issuer would allocate the $750 payment to pay in full the $200 balance to which the 15% rate applied on March 31 and the $500 balance to which the 5% rate applied on March 31 and then allocate the remaining $50 to the $100 purchase made on April 5. In the alternative, if the card issuer's practice is to allocate payments based on the rates and balances on the day a payment is credited to the account, the card issuer would allocate the $750 payment to pay in full the $500 balance to which the 18% rate applied on April 25 and then allocate the remaining $250 to the $300 balance to which the 15% rate applied on April 25.

3. Claims or defenses under § 226.12(c) and billing error disputes under § 226.13. When a consumer has asserted a claim or defense against the card issuer pursuant to § 226.12(c) or alleged a billing error under § 226.13, the card issuer must apply the consumer's payment in a manner that avoids or minimizes any reduction in the amount subject to that claim, defense, or dispute. For example:

i. Assume that a credit card account has a $500 cash advance balance at an annual percentage rate of 25% and a $1,000 purchase balance at an annual percentage rate of 17%. Assume also that $200 of the cash advance balance is subject to a claim or defense under § 226.12(c) or a billing error dispute under § 226.13. If the consumer pays $900 in excess of the required minimum periodic payment, the card issuer must allocate $300 of the excess payment to pay in full the portion of the cash advance balance that is not subject to the claim, defense, or dispute and then allocate the remaining $600 to the $1,000 purchase balance.

ii. Same facts as above except that the consumer pays $1,400 in excess of the required minimum periodic payment. The card issuer must allocate $1,300 of the excess payment to pay in full the $300 cash advance balance that is not subject to the claim, defense, or dispute and the $1,000 purchase balance. If there are no new transactions or other amounts to which the remaining $100 can be allocated, the card issuer may apply that amount to the $200 cash advance balance that is subject to the claim, defense, or dispute. However, if the card issuer subsequently determines that a billing error occurred as asserted by the consumer, the card issuer must credit the account for the disputed amount and any related finance or other charges and send a correction notice consistent with § 226.13(e).

4. Balances with the same rate. When the same annual percentage rate applies to more than one balance on an account and a different annual percentage rate applies to at least one other balance on that account, § 226.53 generally does not require that any particular method be used when allocating among the balances with the same annual percentage rate. Under these circumstances, a card issuer may treat the balances with the same rate as a single balance or separate balances. See example in comment 53-5.iv. However, when a balance on a credit card account is subject to a deferred interest or similar program that provides that a consumer will not be obligated to pay interest that accrues on the balance if the balance is paid in full prior to the expiration of a specified period of time, that balance must be treated as a balance with an annual percentage rate of zero for purposes of § 226.53 during that period of time. For example, if an account

has a $1,000 purchase balance and a $2,000 balance that is subject to a deferred interest program that expires on July 1 and a 15% annual percentage rate applies to both, the balances must be treated as balances with different rates for purposes of § 226.53 until July 1. In addition, unless the card issuer allocates amounts paid by the consumer in excess of the required minimum periodic payment in the manner requested by the consumer pursuant to § 226.53(b)(2), § 226.53(b)(1) requires the card issuer to apply any excess payments first to the $1,000 purchase balance except during the last two billing cycles of the deferred interest period (when it must be applied first to any remaining portion of the $2,000 balance). See example in comment 53-5.v.

5. Examples. For purposes of the following examples, assume that none of the required minimum periodic payment is allocated to the balances discussed (unless otherwise stated).

i. Assume that a credit card account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $800 in excess of the required minimum periodic payment. Under § 226.53(a), the card issuer must allocate $500 to pay off the cash advance balance and then allocate the remaining $300 to the purchase balance.

ii. Assume that a credit card account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $400 in excess of the required minimum periodic payment. Under § 226.53(a), the card issuer must allocate the entire $400 to the cash advance balance.

iii. Assume that a credit card account has a cash advance balance of $100 at an annual percentage rate of 20%, a purchase balance of $300 at an annual percentage rate of 18%, and a $600 protected balance on which the 12% annual percentage rate cannot be increased pursuant to § 226.55. If the consumer pays $500 in excess of the required minimum periodic payment, § 226.53(a) requires the card issuer to allocate $100 to pay off the cash advance balance, $300 to pay off the purchase balance, and $100 to the protected balance.

iv. Assume that a credit card account has a cash advance balance of $500 at an annual percentage rate of 20%, a purchase balance of $1,000 at an annual percentage rate of 15%, and a transferred balance of $2,000 that was previously at a discounted annual percentage rate of 5% but is now at an annual percentage rate of 15%. Assume also that the consumer pays $800 in excess of the required minimum periodic payment. Under § 226.53(a), the card issuer must allocate $500 to pay off the cash advance balance and allocate the remaining $300 among the purchase balance and the transferred balance in the manner the card issuer deems appropriate.

v. Assume that on January 1 a consumer uses a credit card account to make a $1,200 purchase subject to a deferred interest program under which interest accrues at an annual percentage rate of 15% but the consumer will not be obligated to pay that interest if the balance is paid in full on or before June 30. The billing cycles for this account begin on the first day of the month and end on the last day of the month. Each month from January through June, the consumer uses the account to make $200 in purchases that are not subject to the deferred interest program but are

subject to the 15% rate.

A. Each month from February through June, the consumer pays $400 in excess of the required minimum periodic payment on the payment due date, which is the twenty-fifth of the month. Any interest that accrues on the purchases not subject to the deferred interest program is paid by the required minimum periodic payment. The card issuer does not accept requests from consumers regarding the allocation of excess payments pursuant to § 226.53(b)(2). Thus, § 226.53(b)(1) requires the card issuer to allocate the $400 excess payments received on February 25, March 25, and April 25 consistent with § 226.53(a). In other words, the card issuer must allocate those payments as follows: $200 to pay off the balance not subject to the deferred interest program (which is subject to the 15% rate) and the remaining $200 to the deferred interest balance (which is treated as a balance with a rate of zero). However, § 226.53(b)(1) requires the card issuer to allocate the entire $400 excess payment received on May 25 to the deferred interest balance. Similarly, § 226.53(b)(1) requires the card issuer to allocate the $400 excess payment received on June 25 as follows: $200 to the deferred interest balance (which pays that balance in full) and the remaining $200 to the balance not subject to the deferred interest program.

B. Same facts as above, except that the card issuer does accept requests from consumers regarding the allocation of excess payments pursuant to § 226.53(b)(2). In addition, on April 25, the card issuer receives an excess payment of $800, which the consumer requests be allocated to pay off the $800 balance subject to the deferred interest program. Section 226.53(b)(2) permits the card issuer to allocate the $800 excess payment in the manner requested by the consumer.

53(b) Special rule for accounts with balances subject to deferred interest or similar programs.

1. Deferred interest and similar programs. Section 226.53(b) applies to deferred interest or similar programs under which the consumer is not obligated to pay interest that accrues on a balance if that balance is paid in full prior to the expiration of a specified period of time. For purposes of § 226.53(b), "deferred interest" has the same meaning as in § 226.16(h)(2) and associated commentary. Section 226.53(b) applies regardless of whether the consumer is required to make payments with respect to that balance during the specified period. However, a grace period during which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate is not a deferred interest or similar program for purposes of § 226.53(b). Similarly, a temporary annual percentage rate of zero percent that applies for a specified period of time consistent with § 226.55(b)(1) is not a deferred interest or similar program for purposes of § 226.53(b) unless the consumer may be obligated to pay interest that accrues during the period if a balance is not paid in full prior to expiration of the period.

2. Expiration of program during billing cycle. For purposes of § 226.53(b)(1), a billing cycle does not constitute one of the two billing cycles immediately preceding expiration of a deferred interest or similar program if the expiration date for the program precedes the payment due date in that billing cycle. For example, assume that a credit card account has a balance subject to a deferred interest program that expires on June 15. Assume also that the billing cycles for the account begin on the first day of the month and end on the last day of the month and that the required minimum periodic payment is due on the twenty-fifth day of the month. The card issuer does not accept requests from consumers regarding the allocation of excess payments pursuant to § 226.53(b)(2). Because the expiration date for the deferred interest program (June 15) precedes the due date in the June billing cycle (June 25), § 226.53(b)(1) requires the card issuer to allocate first to the deferred interest balance any amount paid by the consumer in excess of the required minimum

periodic payment during the April and May billing cycles (as well as any amount paid by the consumer before June 15). However, if the deferred interest program expired on June 25 or on June 30 (or on any day in between), § 226.53(b)(1) would apply only to the May and June billing cycles.

3. Consumer requests.

i. Generally. Section 226.53(b) does not require a card issuer to allocate amounts paid by the consumer in excess of the required minimum periodic payment in the manner requested by the consumer, provided that the card issuer instead allocates such amounts consistent with § 226.53(b)(1). For example, a card issuer may decline consumer requests regarding payment allocation as a general matter or may decline such requests when a consumer does not comply with requirements set by the card issuer (such as submitting the request in writing or submitting the request prior to or contemporaneously with submission of the payment), provided that amounts paid by the consumer in excess of the required minimum periodic payment are allocated consistent with § 226.53(b)(1). Similarly, a card issuer that accepts requests pursuant to § 226.53(b)(2) must allocate amounts paid by a consumer in excess of the required minimum periodic payment consistent with § 226.53(b)(1) if the consumer does not submit a request. Furthermore, in these circumstances, a card issuer must allocate consistent with § 226.53(b)(1) if the consumer submits a request with which the card issuer cannot comply (such as a request that contains a mathematical error), unless the consumer submits an additional request with which the card issuer can comply.

ii. Examples of consumer requests that satisfy § 226.53(b)(2). A consumer has made a request for purposes of § 226.53(b)(2) if:

A. The consumer contacts the card issuer orally, electronically, or in writing and specifically requests that a payment or payments be allocated in a particular manner during the period of time that the deferred interest or similar program applies to a balance on the account.

B. The consumer completes a form or payment coupon provided by the card issuer for the purpose of requesting that a payment or payments be allocated in a particular manner during the period of time that the deferred interest or similar program applies to a balance on the account and submits that form or coupon to the card issuer.

C. The consumer contacts the card issuer orally, electronically, or in writing and specifically requests that a payment that the card issuer has previously allocated consistent with § 226.53(b)(1) instead be allocated in a different manner.

iii. Examples of consumer requests that do not satisfy § 226.53(b)(2). A consumer has not made a request for purposes of § 226.53(b)(2) if:

A. The terms and conditions of the account agreement contain preprinted language stating that by applying to open an account or by using that account for transactions subject to a deferred interest or similar program the consumer requests that payments be allocated in a particular manner.

B. The card issuer's on-line application contains a preselected check box indicating that the consumer requests that payments be allocated in a particular manner and the consumer does not deselect the box.

C. The payment coupon provided by the card issuer contains preprinted language or a preselected check box stating that by submitting a payment the consumer requests that the payment be allocated in a particular manner.

D. The card issuer requires a consumer to accept a particular payment allocation method as a condition of using a deferred interest or similar program, making a payment, or receiving account services or features.

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1B- Consumer Credit Law Manual Section 226.54

§ **226.54 Limitations on the Imposition of Finance Charges**

54(a) Limitations on imposing finance charges as a result of the loss of a grace period.

54(a)(1) General rule.

1. Eligibility for grace period. Section 226.54 prohibits the imposition of finance charges as a result of the loss of a grace period in certain specified circumstances. Section 226.54 does not require the card issuer to provide a grace period. Furthermore, § 226.54 does not prohibit the card issuer from placing limitations and conditions on a grace period (such as limiting application of the grace period to certain types of transactions or conditioning eligibility for the grace period on certain transactions being paid in full by a particular date), provided that such limitations and conditions are consistent with § 226.5(b)(2)(ii)(B) and § 226.54. Finally, § 226.54 does not limit the imposition of finance charges with respect to a transaction when the consumer is not eligible for a grace period on that transaction at the end of the billing cycle in which the transaction occurred. For example:

i. Assume that the billing cycles for a credit card account begin on the first day of the month and end on the last day of the month and that the payment due date is the twenty-fifth day of the month. Assume also that, for purchases made during the current billing cycle (for purposes of this example, the June billing cycle), the grace period applies from the date of the purchase until the payment due date in the following billing cycle (July 25), subject to two conditions. First, the purchase balance at the end of the preceding billing cycle (the May billing cycle) must have been paid in full by the payment due date in the current billing cycle (June 25). Second, the purchase balance at the end of the current billing cycle (the June billing cycle) must be paid in full by the following payment due date (July 25). Finally, assume that the consumer was eligible for a grace period at the start of the June billing cycle (in other words, assume that the purchase balance for the April billing cycle was paid in full by May 25).

A. If the consumer pays the purchase balance for the May billing cycle in full by June 25, then at the end of the June billing cycle the consumer is eligible for a grace period with respect to purchases made during that billing cycle.

Therefore, § 226.54 limits the imposition of finance charges with respect to purchases made during the June billing cycle if the consumer does not pay the purchase balance for the June billing cycle in full by July 25. Specifically, § 226.54(a)(1)(i) prohibits the card issuer from imposing finance charges based on the purchase balance at the end of the June billing cycle for days that precede the July billing cycle. Furthermore, § 226.54(a)(1)(ii) prohibits the card issuer from imposing finance charges based on any portion of the balance at the end of the June billing cycle that was paid on or before July 25.

B. If the consumer does not pay the purchase balance for the May billing cycle in full by June 25, then the consumer is not eligible for a grace period with respect to purchases made during the June billing cycle at the end of that cycle. Therefore, § 226.54 does not limit the imposition of finance charges with respect to purchases made during the June billing cycle regardless of whether the consumer pays the purchase balance for the June billing cycle in full by July 25.

ii. Same facts as above except that the card issuer places only one condition on the provision of a grace period for purchases made during the current billing cycle (the June billing cycle): that the purchase balance at the end of the current billing cycle (the June billing cycle) be paid in full by the following payment due date (July 25). In these circumstances, § 226.54 applies to the same extent as discussed in paragraphs i.A. and i.B. above regardless of whether the purchase balance for the April billing cycle was paid in full by May 25.

2. Definition of grace period. For purposes of §§ 226.5(b)(2)(ii)(B) and 226.54, a grace period is a period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate. The following are not grace periods for purposes of § 226.54:

i. Deferred interest and similar programs. A deferred interest or similar promotional program under which a consumer will not be obligated to pay interest that accrues on a balance if that balance is paid in full prior to the expiration of a specified period of time is not a grace period for purposes of § 226.54. Thus, § 226.54 does not prohibit the card issuer from charging accrued interest to an account upon expiration of a deferred interest or similar program if the balance was not paid in full prior to expiration (to the extent consistent with § 226.55 and other applicable law and regulatory guidance).

ii. Waivers or rebates of interest. As a general matter, a card issuer has not provided a grace period with respect to transactions for purposes of § 226.54 if, on an individualized basis (such as in response to a consumer's request), the card issuer waives or rebates finance charges that have accrued on transactions. In addition, when a balance at the end of the preceding billing cycle is paid in full on or before the payment due date in the current billing cycle, a card issuer that waives or rebates trailing or residual interest accrued on that balance or any other transactions during the current billing cycle has not provided a grace period with respect to that balance or any other transactions for purposes of § 226.54. However, if the terms of the account provide that all interest accrued on transactions will be waived or rebated if the balance for those transactions at the end of the billing cycle during which the transactions occurred is paid in full by the following payment due date, the card issuer is providing a grace period with respect to those transactions for purposes of § 226.54. For example:

A. Assume that the billing cycles for a credit card account begin on the first day of the month and end on the last day of the month and that the payment due date is the twenty-fifth day of the month. On March 31, the balance on the account is $1,000 and the consumer is not eligible for a grace period with respect to that balance because the balance at the end of the prior billing cycle was not paid in full on March 25. On April 15, the consumer uses the account for a $500 purchase. On April 25, the card issuer receives a payment of $1,000. On May 3, the card issuer mails or delivers a periodic statement reflecting trailing or residual interest that accrued on the $1,000 balance from April 1 through April 24 as well as interest that accrued on the $500 purchase from April 15 through April 30. On May 10, the consumer requests that the trailing or residual interest charges be waived and the card issuer complies. By waiving these interest charges, the card issuer has not provided a grace period with respect to the $1,000 balance or the $500 purchase.

B. Same facts as in paragraph ii.A. above except that the terms of the account state that trailing or residual interest will be waived in these circumstances or it is the card issuer's practice to waive trailing or residual interest in these circumstances. By waiving these interest charges, the card issuer has not provided a grace period with respect to the $1,000 balance or the $500 purchase.

C. Assume that the billing cycles for a credit card account begin on the first day of the month and end on the last day of the month and that the payment due date is the twenty-fifth day of the month. Assume also that, for purchases made during the current billing cycle (for purposes of this example, the June billing cycle), the terms of the account provide that interest accrued on those purchases from the date of the purchase until the payment due date in the following billing cycle (July 25) will be waived or rebated, subject to two conditions. First, the purchase balance at the end of the preceding billing cycle (the May billing cycle) must have been paid in full by the payment due date in the current billing cycle (June 25). Second, the purchase balance at the end of the current billing cycle (the June billing cycle) must be paid in full by the following payment due date (July 25). Under these circumstances, the card issuer is providing a grace period on purchases for purposes of § 226.54. Therefore, assuming that the consumer was eligible for this grace period at the start of the June billing cycle (in other words, assuming that the purchase balance for the April billing cycle was paid in full by May 25) and assuming that the consumer pays the purchase balance for the May billing cycle in full by June 25, § 226.54 applies to the imposition of finance charges with respect to purchases made during the June billing cycle. Specifically, § 226.54(a)(1)(i) prohibits the card issuer from imposing finance charges based on the purchase balance at the end of the June billing cycle for days that precede the July billing cycle. Furthermore, § 226.54(a)(1)(ii) prohibits the card issuer from imposing finance charges based on any portion of the balance at the end of the June billing cycle that was paid on or before July 25.

3. Relationship to payment allocation requirements in § 226.53. Card issuers must comply with the payment allocation requirements in § 226.53 even if doing so will result in the loss of a grace period.

4. Prohibition on two-cycle balance computation method. When a consumer ceases to be eligible for a grace period, § 226.54(a)(1)(i) prohibits the card issuer from computing the finance charge using the two-cycle average daily balance computation method. This method calculates the finance charge using a balance that is the sum of the average daily balances for two billing cycles. The first balance is for the current billing cycle, and is calculated by adding the total balance (including or excluding new purchases and deducting payments and credits) for each day in the billing cycle, and then dividing by the number of days in the billing cycle. The second balance is for the preceding billing cycle.

5. Prohibition on imposing finance charges on amounts paid within grace period. When a balance on a credit card account is eligible for a grace period and the card issuer receives payment for some but not all of that balance prior to the expiration of the grace period, § 226.54(a)(1)(ii) prohibits the card issuer from imposing finance charges on the portion of the balance paid. Card issuers are not required to use a particular method to comply with § 226.54(a)(1)(ii). However, when § 226.54(a)(1)(ii) applies, a card issuer is in compliance if, for example, it applies the consumer's payment to the balance subject to the grace period at the end of the preceding billing cycle (in a manner consistent with the payment allocation requirements in § 226.53) and then calculates interest charges based on the amount of the balance that remains unpaid.

6. Examples. Assume that the annual percentage rate for purchases on a credit card account is 15%. The billing cycle starts on the first day of the month and ends on the last day of the month. The payment due date for the account is the twenty-fifth day of the month. For purchases made during the current billing cycle, the card issuer provides a grace period from the date of the purchase until the payment due date in the following billing cycle, provided that the purchase balance at the end of the current billing cycle is paid in full by the following payment due date. For purposes of this example, assume that none of the required minimum periodic payment is allocated to the balances discussed. During the March billing cycle, the following transactions are charged to the account: A $100 purchase on March 10, a $200 purchase on March 15, and a $300 purchase on March 20. On March 25, the purchase balance for the February billing cycle is paid in full. Thus, for purposes of § 226.54, the consumer is eligible for a grace period on the March purchases. At the end of the March billing cycle (March 31), the consumer's total purchase balance is $600 and the consumer will not be charged interest on that balance if it is paid in full by the following due date (April 25).

i. On April 10, a $150 purchase is charged to the account. On April 25, the card issuer receives $500 in excess of the required minimum periodic payment. Section 226.54(a)(1)(i) prohibits the card issuer from reaching back and charging interest on any of the March transactions from the date of the transaction through the end of the March billing cycle (March 31). In these circumstances, the card issuer may comply with § 226.54(a)(1)(ii) by applying the $500 excess payment to the $600 purchase balance and then charging interest only on the portion of the $600 purchase balance that remains unpaid ($100) from the start of the April billing cycle (April 1) through the end of the April billing cycle (April 30). In addition, the card issuer may charge interest on the $150 purchase from the date of the transaction (April 10) through the end of the April billing cycle (April 31).

ii. Same facts as in paragraph 6. above except that, on March 18, a $250 cash advance is charged to the account at an annual percentage rate of 25%. The card issuer's grace period does not apply to cash advances, but the card issuer does provide a grace period on the March purchases because the purchase balance for the February billing cycle is paid in full on March 25. On April 25, the card issuer receives $600 in excess of the required minimum periodic payment. As required by § 226.53, the card issuer allocates the $600 excess payment first to the balance with the highest annual percentage rate (the $250 cash advance balance). Although § 226.54(a)(1)(i) prohibits the card issuer from charging interest on the March purchases based on days in the March billing cycle, the card issuer may charge interest on the $250 cash advance from the date of the transaction (March 18) through April 24. In these circumstances, the card issuer may comply with § 226.54(a)(1)(ii) by applying the remainder of the excess payment ($350) to the $600 purchase balance and then charging interest only on the portion of the $600 purchase balance that remains unpaid ($250) from the start of the April billing cycle (April 1) through the end of the April billing cycle (April 30).

iii. Same facts as in paragraph 6. above except that the consumer does not pay the balance for the February billing cycle in full on March 25 and therefore is not eligible for a grace period on the March purchases. Under these circumstances, § 226.54 does not apply and the card issuer may charge interest from the date of each transaction through April 24 and interest on the remaining $100 from April 25 through the end of the April billing cycle (April 25).

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1B- Consumer Credit Law Manual Section 226.55

§ 226.55 Limitations on Increasing Annual Percentage Rates, Fees, and Charges

55(a) General rule.

1. Examples. Section 226.55(a) prohibits card issuers from increasing an annual percentage rate or any fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) on a credit card account unless specifically permitted by one of the exceptions in § 226.55(b). The following examples illustrate the general application of § 226.55(a) and (b). Additional examples illustrating specific aspects of the exceptions in § 226.55(b) are provided in the commentary to those exceptions.

i. Account-opening disclosure of non-variable rate for six months, then variable rate. Assume that, at account opening on January 1 of year one, a card issuer discloses that the annual percentage rate for purchases is a non-variable rate of 15% and will apply for six months. The card issuer also discloses that, after six months, the annual percentage rate for purchases will be a variable rate that is currently 18% and will be adjusted quarterly by adding a margin of 8 percentage points to a publicly-available index not under the card issuer's control. Furthermore, the card issuer discloses that the annual percentage rate for cash advances is the same variable rate that will apply to purchases after six months. Finally, the card issuer discloses that, to the extent consistent with § 226.55 and other applicable law, a non-variable penalty rate of 30% may apply if the consumer makes a late payment. The payment due date for the account is the twenty-fifth day of the month and the required minimum periodic payments are applied to accrued interest and fees but do not reduce the purchase and cash advance balances.

A. Change-in-terms rate increase for new transactions after first year. On January 15 of year one, the consumer uses the account to make a $2,000 purchase and a $500 cash advance. No other transactions are made on the account. At the start of each quarter, the card issuer may adjust the variable rate that applies to the $500 cash advance consistent with changes in the index (pursuant to § 226.55(b)(2)). All required minimum periodic payments are received on or before the payment due date until May of year one, when the payment due on May 25 is received by the creditor on May 28. At this time, the card issuer is prohibited by § 226.55 from increasing the rates that apply to the $2,000

purchase, the $500 cash advance, or future purchases and cash advances. Six months after account opening (July 1), the card issuer may begin to accrue interest on the $2,000 purchase at the previously-disclosed variable rate determined using an 8-point margin (pursuant to § 226.55(b)(1)). Because no other increases in rate were disclosed at account opening, the card issuer may not subsequently increase the variable rate that applies to the $2,000 purchase and the $500 cash advance (except due to increases in the index pursuant to § 226.55(b)(2)). On November 16, the card issuer provides a notice pursuant to § 226.9(c) informing the consumer of a new variable rate that will apply on January 1 of year two (calculated using the same index and an increased margin of 12 percentage points). On December 15, the consumer makes a $100 purchase. On January 1 of year two, the card issuer may increase the margin used to determine the variable rate that applies to new purchases to 12 percentage points (pursuant to § 226.55(b)(3)). However, § 226.55(b)(3)(ii) does not permit the card issuer to apply the variable rate determined using the 12-point margin to the $2,000 purchase balance. Furthermore, although the $100 purchase occurred more than 14 days after provision of the § 226.9(c) notice, § 226.55(b)(3)(iii) does not permit the card issuer to apply the variable rate determined using the 12-point margin to that purchase because it occurred during the first year after account opening. On January 15 of year two, the consumer makes a $300 purchase. The card issuer may apply the variable rate determined using the 12-point margin to the $300 purchase.

B. Account becomes more than 60 days delinquent during first year. Same facts as above except that the required minimum periodic payment due on May 25 of year one is not received by the card issuer until July 30 of year one. Because the card issuer received the required minimum periodic payment more than 60 days after the payment due date, § 226.55(b)(4) permits the card issuer to increase the annual percentage rate applicable to the $2,000 purchase, the $500 cash advance, and future purchases and cash advances. However, § 226.55(b)(4)(i) requires the card issuer to first comply with the notice requirements in § 226.9(g). Thus, if the card issuer provided a § 226.9(g) notice on July 25 stating that all rates on the account would be increased to the 30% penalty rate, the card issuer could apply that rate beginning on September 8 to all balances and to future transactions.

ii. Account-opening disclosure of non-variable rate for six months, then increased non-variable rate for six months, then variable rate; change-in-terms rate increase for new transactions after first year. Assume that, at account opening on January 1 of year one, a card issuer discloses that the annual percentage rate for purchases will increase as follows: A non-variable rate of 5% for six months; a non-variable rate of 10% for an additional six months; and thereafter a variable rate that is currently 15% and will be adjusted monthly by adding a margin of 5 percentage points to a publicly-available index not under the card issuer's control. The payment due date for the account is the fifteenth day of the month and the required minimum periodic payments are applied to accrued interest and fees but do not reduce the purchase balance. On January 15 of year one, the consumer uses the account to make a $1,500 purchase. Six months after account opening (July 1), the card issuer may begin to accrue interest on the $1,500 purchase at the previously-disclosed 10% non-variable rate (pursuant to § 226.55(b)(1)). On September 15, the consumer uses the account for a $700 purchase. On November 16, the card issuer provides a notice pursuant to § 226.9(c) informing the consumer of a new variable rate that will apply on January 1 of year two (calculated using the same index and an increased margin of 8 percentage points). One year after account opening (January 1 of year two), the card issuer may begin accruing interest on the $2,200 purchase balance at the previously-disclosed variable rate determined using a 5-point margin (pursuant to § 226.55(b)(1)). Section 226.55 does not permit the card issuer to apply the variable rate determined using the 8-point margin to the $2,200 purchase balance. Furthermore, § 226.55 does not permit the card issuer to subsequently increase the variable rate determined using the 5-point margin that applies to the $2,200 purchase balance (except due to increases in the index pursuant to § 226.55(b)(2)). The card issuer may, however, apply the variable rate determined using the 8-point margin to purchases made on or after January 1 of year two (pursuant to § 226.55(b)(3)).

iii. Change-in-terms rate increase for new transactions after first year; penalty rate increase after first year. Assume that, at account opening on January 1 of year one, a card issuer discloses that the annual percentage rate for purchases is a variable rate determined by adding a margin of 6 percentage points to a publicly-available index outside of the card issuer's control. The card issuer also discloses that, to the extent consistent with § 226.55 and other applicable law, a non-variable penalty rate of 28% may apply if the consumer makes a late payment. The due date for the account is the fifteenth of the month. On May 30 of year two, the account has a purchase balance of $1,000. On May 31, the card issuer provides a notice pursuant to § 226.9(c) informing the consumer of a new variable rate that will apply on July 16 for all purchases made on or after June 15 (calculated by using the same index and an increased margin of 8 percentage points). On June 14, the consumer makes a $500 purchase. On June 15, the consumer makes a $200 purchase. On July 1, the card issuer has not received the payment due on June 15 and provides the consumer with a notice pursuant to § 226.9(g) stating that the 28% penalty rate will apply as of August 15 to all transactions made on or after July 16 and that, if the consumer becomes more than 60 days late, the penalty rate will apply to all balances on the account. On July 17, the consumer makes a $300 purchase.

A. Account does not become more than 60 days delinquent. The payment due on June 15 of year two is received on July 2. On July 16, § 226.55(b)(3)(ii) permits the card issuer to apply the variable rate determined using the 8-point margin disclosed in the § 226.9(c) notice to the $200 purchase made on June 15 but does not permit the card issuer to apply this rate to the $1,500 purchase balance. On August 15, § 226.55(b)(3)(ii) permits the card issuer to apply the 28% penalty rate disclosed at account opening and in the § 226.9(g) notice to the $300 purchase made on July 17 but does not permit the card issuer to apply this rate to the $1,500 purchase balance (which remains at the variable rate determined using the 6-point margin) or the $200 purchase (which remains at the variable rate determined using the 8-point margin).

B. Account becomes more than 60 days delinquent after provision of § 226.9(g) notice. Same facts as above except the payment due on June 15 of year two has not been received by August 15. Section 226.55(b)(4) permits the card issuer to apply the 28% penalty rate to the $1,500 purchase balance and the $200 purchase because it has not received the June 15 payment within 60 days after the due date. However, in order to do so, § 226.55(b)(4)(i) requires the card issuer to first provide an additional notice pursuant to § 226.9(g). This notice must be sent no earlier than August 15, which is the first day the account became more than 60 days' delinquent. If the notice is sent on August 15, the card issuer may begin accruing interest on the $1,500 purchase balance and the $200 purchase at the 28% penalty rate beginning on September 29.

2. Relationship to grace period. Nothing in § 226.55 prohibits a card issuer from assessing interest due to the loss of a grace period to the extent consistent with § 226.5(b)(2)(ii)(B) and § 226.54. In addition, a card issuer has not reduced an annual percentage rate on a credit card account for purposes of § 226.55 if the card issuer does not charge interest on a balance or a portion thereof based on a payment received prior to the expiration of a grace period. For example, if the annual percentage rate for purchases on an account is 15% but the card issuer does not charge any interest on a $500 purchase balance because that balance was paid in full prior to the expiration of the grace period, the card issuer has not reduced the 15% purchase rate to 0% for purposes of § 226.55.

55(b) Exceptions.

1. Exceptions not mutually exclusive. A card issuer may increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) pursuant to an exception set forth in § 226.55(b) even if that increase would not be permitted under a different exception. For example, although a card issuer cannot increase an annual percentage rate pursuant to § 226.55(b)(1) unless that rate is provided for a specified period of at least six months, the card issuer may increase an annual percentage rate during a specified period due to an increase in an index consistent with § 226.55(b)(2). Similarly, although § 226.55(b)(3) does not permit a card issuer to increase an annual percentage rate during the first year after account opening, the card issuer may increase the rate during the first year after account opening pursuant to § 226.55(b)(4) if the required minimum periodic payment is not received within 60 days after the due date.

2. Relationship between exceptions in § 226.55(b) and notice requirements in § 226.9. Nothing in § 226.55 alters the requirements in § 226.9(c) and (g) that creditors provide written notice at least 45 days prior to the effective date of certain increases in annual percentage rates, fees, and charges.

i. 14-day rule in § 226.55(b)(3)(ii). Although § 226.55(b)(3)(ii) permits a card issuer that discloses an increased rate pursuant to § 226.9(c) or (g) to apply that rate to transactions that occur more than 14 days after provision of the notice, the card issuer cannot begin to accrue interest at the increased rate until that increase goes into effect, consistent with § 226.9(c) or (g). For example, if on May 1 a card issuer provides a notice pursuant to § 226.9(c) stating that a rate will increase from 15% to 18% on June 15, § 226.55(b)(3)(ii) permits the card issuer to apply the 18% rate to transactions that occur on or after May 16. However, neither § 226.55 nor § 226.9(c) permits the card issuer to begin accruing interest at the 18% rate on those transactions until June 15. See additional examples in comment 55(b)(3)-4.

ii. Mid-cycle increases; application of balance computation methods. Once an increased rate has gone into effect, the card issuer cannot calculate interest charges based on that increased rate for days prior to the effective date. Assume that, in the example in paragraph i. above, the billing cycles for the account begin on the first day of the month and end on the last day of the month. If, for example, the card issuer uses the average daily balance computation method, it cannot apply the 18% rate to the average daily balance for the entire June billing cycle because that rate did not become effective until June 15. However, the card issuer could apply the 15% rate to the average daily balance from June 1 through June 14 and the 18% rate to the average daily balance from June 15 through June 30. Similarly, if the card issuer that uses the daily balance computation method, it could apply the 15% rate to the daily balance for each day from June 1 through June 14 and the 18% rate to the daily balance for each day from June 15 through June 30.

iii. Mid-cycle increases; delayed implementation of increase. If § 226.55(b) and § 226.9(b), (c), or (g) permit a card issuer to apply an increased annual percentage rate, fee, or charge on a date that is not the first day of a billing cycle, the card issuer may delay application of the increased rate, fee, or charge until the first day of the following billing cycle without relinquishing the ability to apply that rate, fee, or charge. Thus, in the example in paragraphs i. and ii. above, the card issuer could delay application of the 18% rate until the start of the next billing cycle (April 1) without relinquishing its ability to apply that rate under § 226.55(b)(3). Similarly, assume that, at account opening on January 1, a card issuer discloses that a non-variable annual percentage rate of 10% will apply to purchases for six months and a non-variable rate of 15% will apply thereafter. The first day of each billing cycle for the account is the fifteenth of the month. If the six-month period expires on July 1, the card issuer may delay application of the 15% rate until the start of the next billing cycle (July 15) without relinquishing its ability to apply that rate under § 226.55(b)(1).

3. Application of a lower rate, fee, or charge. Nothing in § 226.55 prohibits a card issuer from lowering an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii). However, a card issuer that does so cannot subsequently increase the rate, fee, or charge unless permitted by one of the exceptions in § 226.55(b). The following examples illustrate the application of the rule:

i. Application of lower rate during first year. Assume that a card issuer discloses at account opening on January 1 of year one that a non-variable annual percentage rate of 15% will apply to purchases. The card issuer also discloses that, to the extent consistent with § 226.55 and other applicable law, a non-variable penalty rate of 30% may apply if the consumer's required minimum periodic payment is received after the payment due date, which is the tenth of the month. The required minimum periodic payments are applied to accrued interest and fees but do not reduce the purchase balance.

A. Temporary rate returns to standard rate at expiration. On September 30 of year one, the account has a purchase balance of $1,400 at the 15% rate. On October 1, the card issuer provides a notice pursuant to § 226.9(c) informing the consumer that the rate for new purchases will decrease to a non-variable rate of 5% for six months (from October 1 through March 31 of year two) and that, beginning on April 1 of year two, the rate for purchases will increase to the 15% non-variable rate disclosed at account opening. The card issuer does not apply the 5% rate to the $1,400 purchase balance. On October 14 of year one, the consumer makes a $300 purchase at the 5% rate. On January 15 of year two, the consumer makes a $150 purchase at the 5% rate. On April 1 of year two, the card issuer may begin accruing interest on the $300 purchase and the $150 purchase at 15% as disclosed in the § 226.9(c) notice (pursuant to § 226.55(b)(1)).

B. Penalty rate increase. Same facts as above except that the required minimum periodic payment due on November 10 of year one is not received until November 15. Section 226.55 does not permit the card issuer to increase any annual percentage rate on the account at this time. The card issuer may apply the 30% penalty rate to new transactions beginning on April 1 of year two pursuant to § 226.55(b)(3) by providing a § 226.9(g) notice informing the consumer of this increase no later than February 14 of year two. The card issuer may not, however, apply the 30% penalty rate to the $1,400 purchase balance as of September 30 of year one, the $300 purchase on October 15 of year one, or the $150 purchase on January 15 of year two.

ii. Application of lower rate at end of first year. Assume that, at account opening on January 1 of year one, a card issuer discloses that a non-variable annual percentage rate of 15% will apply to purchases for one year and discloses that, after the first year, the card issuer will apply a variable rate that is currently 20% and is determined by adding a margin of 10 percentage points to a publicly-available index not under the card issuer's control. On December 31 of year one, the account has a purchase balance of $3,000.

A. Notice of extension of existing temporary rate provided consistent with § 226.55(b)(1)(i). On December 15 of year one, the card issuer provides a notice pursuant to § 226.9(c) informing the consumer that the existing 15% rate will continue to apply until July 1 of year two. The notice further states that, on July 1 of year two, the variable rate

disclosed at account opening will apply. On July 1 of year two, § 226.55(b)(1) permits the card issuer to apply that variable rate to any remaining portion of the $3,000 balance and to new transactions.

B. Notice of new temporary rate provided consistent with § 226.55(b)(1)(i). On December 15 of year one, the card issuer provides a notice pursuant to § 226.9(c) informing the consumer of a new variable rate that will apply on January 1 of year two that is lower than the variable rate disclosed at account opening. The new variable rate is calculated using the same index and a reduced margin of 8 percentage points. The notice further states that, on July 1 of year two, the margin will increase to the margin disclosed at account opening (10 percentage points). On July 1 of year two, § 226.55(b)(1) permits the card issuer to increase the margin used to determine the variable rate that applies to new purchases to 10 percentage points and to apply that rate to any remaining portion of the $3,000 purchase balance.

C. No notice provided. Same facts as in paragraph ii.B. above except that the card issuer does not send a notice on December 15 of year one. Instead, on January 1 of year two, the card issuer lowers the margin used to determine the variable rate to 8 percentage points and applies that rate to the $3,000 purchase balance and to new purchases. Section 226.9 does not require advance notice in these circumstances. However, unless the account becomes more than 60 days' delinquent, § 226.55 does not permit the card issuer to subsequently increase the rate that applies to the $3,000 purchase balance except due to increases in the index (pursuant to § 226.55(b)(2)).

iii. Application of lower rate after first year. Assume that a card issuer discloses at account opening on January 1 of year one that a non-variable annual percentage rate of 10% will apply to purchases for one year, after which that rate will increase to a non-variable rate of 15%. The card issuer also discloses that, to the extent consistent with § 226.55 and other applicable law, a non-variable penalty rate of 30% may apply if the consumer's required minimum periodic payment is received after the payment due date, which is the tenth of the month. The required minimum periodic payments are applied to accrued interest and fees but do not reduce the purchase balance.

A. Effect of 14-day period. On June 30 of year two, the account has a purchase balance of $1,000 at the 15% rate. On July 1, the card issuer provides a notice pursuant to § 226.9(c) informing the consumer that the rate for new purchases will decrease to a non-variable rate of 5% for six months (from July 1 through December 31 of year two) and that, beginning on January 1 of year three, the rate for purchases will increase to a non-variable rate of 17%. On July 15 of year two, the consumer makes a $200 purchase. On July 16, the consumer makes a $100 purchase. On January 1 of year three, the card issuer may begin accruing interest on the $100 purchase at 17% (pursuant to § 226.55(b)(1)). However, § 226.55(b)(1)(ii)(B) does not permit the card issuer to apply the 17% rate to the $200 purchase because that transaction occurred within 14 days after provision of the § 226.9(c) notice. Instead, the card issuer may apply the 15% rate that applied to purchases prior to provision of the § 226.9(c) notice. In addition, if the card issuer applied the 5% rate to the $1,000 purchase balance, § 226.55(b)(ii)(A) would not permit the card issuer to increase the rate that applies to that balance on January 1 of year three to a rate that is higher than 15% that previously applied to the balance.

B. Penalty rate increase. Same facts as above except that the required minimum periodic payment due on August 25 is received on August 30. At this time, § 226.55 does not permit the card issuer to increase the annual percentage rates that apply to the $1,000 purchase balance, the $200 purchase, or the $100 purchase. Instead, those rates can only be increased as discussed in paragraph iii.A. above. However, if the card issuer provides a notice pursuant to § 226.9(c)

or (g) on September 1, § 226.55(b)(3) permits the card issuer to apply an increased rate (such as the 17% purchase rate or the 30% penalty rate) to transactions that occur on or after September 16 beginning on October 16.

4. Date on which transaction occurred. When a transaction occurred for purposes of § 226.55 is generally determined by the date of the transaction. However, if a transaction that occurred within 14 days after provision of a § 226.9(c) or (g) notice is not charged to the account prior to the effective date of the change or increase, the card issuer may treat the transaction as occurring more than 14 days after provision of the notice for purposes of § 226.55. See example in comment 55(b)(3)-4.iii.B. In addition, when a merchant places a "hold" on the available credit on an account for an estimated transaction amount because the actual transaction amount will not be known until a later date, the date of the transaction for purposes of § 226.55 is the date on which the card issuer receives the actual transaction amount from the merchant. See example in comment 55(b)(3)-4.iii.A.

5. Category of transactions. For purposes of § 226.55, a "category of transactions" is a type or group of transactions to which an annual percentage rate applies that is different than the annual percentage rate that applies to other transactions. Similarly, a type or group of transactions is a "category of transactions" for purposes of § 226.55 if a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) applies to those transactions that is different than the fee or charge that applies to other transactions. For example, purchase transactions, cash advance transactions, and balance transfer transactions are separate categories of transactions for purposes of § 226.55 if a card issuer applies different annual percentage rates to each. Furthermore, if, for example, the card issuer applies different annual percentage rates to different types of purchase transactions (such as one rate for purchases of gasoline or purchases over $100 and a different rate for all other purchases), each type constitutes a separate category of transactions for purposes of § 226.55.

55(b)(1) Temporary rate exception.

1. Relationship to § 226.9(c)(2)(v)(B). A card issuer that has complied with the disclosure requirements in § 226.9(c)(2)(v)(B) has also complied with the disclosure requirements in § 226.55(b)(1)(i).

2. Period of six months or longer. A temporary annual percentage rate must apply to transactions for a specified period of six months or longer before a card issuer can increase that rate pursuant to § 226.55(b)(1). The specified period must expire no less than six months after the date on which the creditor provides the consumer with the disclosures required by § 226.55(b)(1)(i) or, if later, the date on which the account can be used for transactions to which the temporary rate applies. Section 226.55(b)(1) does not prohibit a card issuer from limiting the application of a temporary annual percentage rate to a particular category of transactions (such as balance transfers or purchases over $100). However, in circumstances where the card issuer limits application of the temporary rate to a particular transaction, the specified period must expire no less than six months after the date on which that transaction occurred. The following examples illustrate the application of § 226.55(b)(1):

i. Assume that on January 1 a card issuer offers a consumer a 5% annual percentage rate on purchases made during the months of January through June. A 15% rate will apply thereafter. On February 15, a $500 purchase is charged to the account. On June 15, a $200 purchase is charged to the account. On July 1, the card issuer may begin

accruing interest at the 15% rate on the $500 purchase and the $200 purchase (pursuant to § 226.55(b)(1)).

ii. Same facts as above except that on January 1 the card issuer offered the 5% rate on purchases beginning in the month of February. Section 226.55(b)(1) would not permit the card issuer to begin accruing interest at the 15% rate on the $500 purchase and the $200 purchase until August 1.

iii. Assume that on October 31 of year one the annual percentage rate for purchases is 17%. On November 1, the card issuer offers the consumer a 0% rate for six months on purchases made during the months of November and December. The 17% rate will apply thereafter. On November 15, a $500 purchase is charged to the account. On December 15, a $300 purchase is charged to the account. On January 15 of year two, a $150 purchase is charged to the account. Section 226.55(b)(1) would not permit the card issuer to begin accruing interest at the 17% rate on the $500 purchase and the $300 purchase until May 1 of year two. However, the card issuer may accrue interest at the 17% rate on the $150 purchase beginning on January 15 of year two.

iv. Assume that on June 1 of year one a card issuer offers a consumer a 0% annual percentage rate for six months on the purchase of an appliance. An 18% rate will apply thereafter. On September 1, a $5,000 transaction is charged to the account for the purchase of an appliance. Section 226.55(b)(1) would not permit the card issuer to begin accruing interest at the 18% rate on the $5,000 transaction until March 1 of year two.

v. Assume that on May 31 of year one the annual percentage rate for purchases is 15%. On June 1, the card issuer offers the consumer a 5% rate for six months on a balance transfer of at least $1,000. The 15% rate will apply thereafter. On June 15, a $3,000 balance is transferred to the account. On July 15, a $200 purchase is charged to the account. Section 226.55(b)(1) would not permit the card issuer to begin accruing interest at the 15% rate on the $3,000 transferred balance until December 15. However, the card issuer may accrue interest at the 15% rate on the $200 purchase beginning on July 15.

vi. Same facts as in paragraph v. above except that the card issuer offers the 5% rate for six months on all balance transfers of at least $1,000 during the month of June and a $2,000 balance is transferred to the account on June 30 (in addition to the $3,000 balance transfer on June 15). Because the 5% rate is not limited to a particular transaction, § 226.55(b)(1) permits the card issuer to begin accruing interest on the $3,000 and $2,000 transferred balances on December 1.

3. Deferred interest and similar promotional programs.

i. Application of § 226.55.

The general prohibition in § 226.55(a) applies to the imposition of accrued interest upon the expiration of a

deferred interest or similar promotional program under which the consumer is not obligated to pay interest that accrues on a balance if that balance is paid in full prior to the expiration of a specified period of time. However, the exception in § 226.55(b)(1) also applies to these programs, provided that the specified period is six months or longer and that, prior to the commencement of the period, the card issuer discloses the length of the period and the rate at which interest will accrue on the balance subject to the deferred interest or similar program if that balance is not paid in full prior to expiration of the period. See comment 9(c)(2)(v)-9. For purposes of § 226.55, "deferred interest" has the same meaning as in § 226.16(h)(2) and associated commentary.

ii. Examples.

A. Deferred interest offer at account opening. Assume that, at account opening on January 1 of year one, the card issuer discloses the following with respect to a deferred interest program: "No interest on purchases made in January of year one if paid in full by December 31 of year one. If the balance is not paid in full by that date, interest will be imposed from the transaction date at a rate of 20%." On January 15 of year one, the consumer makes a purchase of $2,000. No other transactions are made on the account. The terms of the deferred interest program require the consumer to make minimum periodic payments with respect to the deferred interest balance, and the payment due on April 1 is not received until April 10. Section 226.55 does not permit the card issuer to charge to the account interest that has accrued on the $2,000 purchase at this time. Furthermore, if the consumer pays the $2,000 purchase in full on or before December 31 of year one, § 226.55 does not permit the card issuer to charge to the account any interest that has accrued on that purchase. If, however, the $2,000 purchase has not been paid in full by January 1 of year two, § 226.55(b)(1) permits the card issuer to charge to the account the interest accrued on that purchase at the 20% rate during year one (to the extent consistent with other applicable law).

B. Deferred interest offer after account opening. Assume that a card issuer discloses at account opening on January 1 of year one that the rate that applies to purchases is a variable annual percentage rate that is currently 18% and will be adjusted quarterly by adding a margin of 8 percentage points to a publicly-available index not under the card issuer's control. The card issuer also discloses that, to the extent consistent with § 226.55 and other applicable law, a non-variable penalty rate of 30% may apply if the consumer's required minimum periodic payment is received after the payment due date, which is the first of the month. On June 30 of year two, the consumer uses the account for a $1,000 purchase in response to an offer of a deferred interest program. Under the terms of this program, interest on the purchase will accrue at the variable rate for purchases but the consumer will not be obligated to pay that interest if the purchase is paid in full by December 31 of year three. The terms of the deferred interest program require the consumer to make minimum periodic payments with respect to the deferred interest balance, and the payment due on September 1 of year two is not received until September 6. Section 226.55 does not permit the card issuer to charge to the account interest that has accrued on the $1,000 purchase at this time. Furthermore, if the consumer pays the $1,000 purchase in full on or before December 31 of year three, § 226.55 does not permit the card issuer to charge to the account any interest that has accrued on that purchase. On December 31 of year three, the $1,000 purchase has been paid in full. Under these circumstances, the card issuer may not charge any interest accrued on the $1,000 purchase.

C. Application of § 226.55(b)(4) to deferred interest programs. Same facts as in paragraph ii.B. above except that, on November 2 of year two, the card issuer has not received the required minimum periodic payments due on September 1, October 1, or November 1 of year two and sends a § 226.9(c) or (g) notice stating that interest accrued on the $1,000 purchase since June 30 of year two will be charged to the account on December 17 of year two and thereafter

interest will be charged on the $1,000 purchase consistent with the variable rate for purchases. On December 17 of year two, § 226.55(b)(4) permits the card issuer to charge to the account interest accrued on the $1,000 purchase since June 30 of year two and § 226.55(b)(3) permits the card issuer to begin charging interest on the $1,000 purchase consistent with the variable rate for purchases. However, if the card issuer receives the required minimum periodic payments due on January 1, February 1, March 1, April 1, May 1, and June 1 of year three, § 226.55(b)(4)(ii) requires the card issuer to cease charging the account for interest on the $1,000 purchase no later than the first day of the next billing cycle. See comment 55(b)(4)-3.iii. However, § 226.55(b)(4)(ii) does not require the card issuer to waive or credit the account for interest accrued on the $1,000 purchase since June 30 of year two. If the $1,000 purchase is paid in full on December 31 of year three, the card issuer is not permitted to charge to the account interest accrued on the $1,000 purchase after June 1 of year three.

4. Contingent or discretionary rate increases. Section § 226.55(b)(1) permits a card issuer to increase a temporary annual percentage rate upon the expiration of a specified period of time. However, § 226.55(b)(1) does not permit a card issuer to apply an increased rate that is contingent on a particular event or occurrence or that may be applied at the card issuer's discretion. The following examples illustrate rate increases that are not permitted by § 226.55:

i. Assume that a card issuer discloses at account opening on January 1 of year one that a non-variable annual percentage rate of 15% applies to purchases but that all rates on an account may be increased to a non-variable penalty rate of 30% if a consumer's required minimum periodic payment is received after the payment due date, which is the fifteenth of the month. On March 1, the account has a $2,000 purchase balance. The payment due on March 15 is not received until March 20. Section 226.55 does not permit the card issuer to apply the 30% penalty rate to the $2,000 purchase balance. However, pursuant to § 226.55(b)(3), the card issuer could provide a § 226.9(c) or (g) notice on or before November 16 informing the consumer that, on January 1 of year two, the 30% rate (or a different rate) will apply to new transactions.

ii. Assume that a card issuer discloses at account opening on January 1 of year one that a non-variable annual percentage rate of 5% applies to transferred balances but that this rate will increase to a non-variable rate of 18% if the consumer does not use the account for at least $200 in purchases each billing cycle. On July 1, the consumer transfers a balance of $4,000 to the account. During the October billing cycle, the consumer uses the account for $150 in purchases. Section 226.55 does not permit the card issuer to apply the 18% rate to the $4,000 transferred balance or the $150 in purchases. However, pursuant to § 226.55(b)(3), the card issuer could provide a § 226.9(c) or (g) notice on or before November 16 informing the consumer that, on January 1 of year two, the 18% rate (or a different rate) will apply to new transactions.

55(b)(2) Variable rate exception.

1. Increases due to increase in index. Section 226.55(b)(2) provides that an annual percentage rate that varies according to an index that is not under the card issuer's control and is available to the general public may be increased due to an increase in the index. This section does not permit a card issuer to increase the rate by changing the method used to determine a rate that varies with an index (such as by increasing the margin), even if that change will not result in an immediate increase. However, from time to time, a card issuer may change the day on which index values are measured to determine changes to the rate. due to an increase in the index. This section does not permit a card issuer to increase the rate by changing the method used to determine a rate that varies with an index (such as by increasing the

margin), even if that change will not result in an immediate increase. However, from time to time, a card issuer may change the day on which index values are measured to determine changes to the rate.

2. Index not under card issuer's control. A card issuer may increase a variable annual percentage rate pursuant to § 226.55(b)(2) only if the increase is based on an index or indices outside the card issuer's control. For purposes of § 226.55(b)(2), an index is under the card issuer's control if:

i. The index is the card issuer's own prime rate or cost of funds. A card issuer is permitted, however, to use a published prime rate, such as that in the Wall Street Journal, even if the card issuer's own prime rate is one of several rates used to establish the published rate.

ii. The variable rate is subject to a fixed minimum rate or similar requirement that does not permit the variable rate to decrease consistent with reductions in the index. A card issuer is permitted, however, to establish a fixed maximum rate that does not permit the variable rate to increase consistent with increases in an index. For example, assume that, under the terms of an account, a variable rate will be adjusted monthly by adding a margin of 5 percentage points to a publicly-available index. When the account is opened, the index is 10% and therefore the variable rate is 15%. If the terms of the account provide that the variable rate will not decrease below 15% even if the index decreases below 10%, the card issuer cannot increase that rate pursuant to § 226.55(b)(2). However, § 226.55(b)(2) does not prohibit the card issuer from providing in the terms of the account that the variable rate will not increase above a certain amount (such as 20%).

iii. The variable rate can be calculated based on any index value during a period of time (such as the 90 days preceding the last day of a billing cycle). A card issuer is permitted, however, to provide in the terms of the account that the variable rate will be calculated based on the average index value during a specified period. In the alternative, the card issuer is permitted to provide in the terms of the account that the variable rate will be calculated based on the index value on a specific day (such as the last day of a billing cycle). For example, assume that the terms of an account provide that a variable rate will be adjusted at the beginning of each quarter by adding a margin of 7 percentage points to a publicly-available index. At account opening at the beginning of the first quarter, the variable rate is 17% (based on an index value of 10%). During the first quarter, the index varies between 9.8% and 10.5% with an average value of 10.1%. On the last day of the first quarter, the index value is 10.2%. At the beginning of the second quarter, § 226.55(b)(2) does not permit the card issuer to increase the variable rate to 17.5% based on the first quarter's maximum index value of 10.5%. However, if the terms of the account provide that the variable rate will be calculated based on the average index value during the prior quarter, § 226.55(b)(2) permits the card issuer to increase the variable rate to 17.1% (based on the average index value of 10.1% during the first quarter). In the alternative, if the terms of the account provide that the variable rate will be calculated based on the index value on the last day of the prior quarter, § 226.55(b)(2) permits the card issuer to increase the variable rate to 17.2% (based on the index value of 10.2% on the last day of the first quarter).

3. Publicly available. The index or indices must be available to the public. A publicly-available index need not be published in a newspaper, but it must be one the consumer can independently obtain (by telephone, for example) and use to verify the annual percentage rate applied to the account.

4. Changing a non-variable rate to a variable rate. Section 226.55 generally prohibits a card issuer from changing a non-variable annual percentage rate to a variable annual percentage rate because such a change can result in an increase. However, a card issuer may change a non-variable rate to a variable rate to the extent permitted by one of the exceptions in § 226.55(b). For example, § 226.55(b)(1) permits a card issuer to change a non-variable rate to a variable rate upon expiration of a specified period of time. Similarly, following the first year after the account is opened, § 226.55(b)(3) permits a card issuer to change a non-variable rate to a variable rate with respect to new transactions (after complying with the notice requirements in § 226.9(b), (c) or (g)).

5. Changing a variable rate to a non-variable rate. Nothing in § 226.55 prohibits a card issuer from changing a variable annual percentage rate to an equal or lower non-variable rate. Whether the non-variable rate is equal to or lower than the variable rate is determined at the time the card issuer provides the notice required by § 226.9(c). For example, assume that on March 1 a variable annual percentage rate that is currently 15% applies to a balance of $2,000 and the card issuer sends a notice pursuant to § 226.9(c) informing the consumer that the variable rate will be converted to a non-variable rate of 14% effective April 15. On April 15, the card issuer may apply the 14% non-variable rate to the $2,000 balance and to new transactions even if the variable rate on March 2 or a later date was less than 14%.

6. Substitution of index. A card issuer may change the index and margin used to determine the annual percentage rate under § 226.55(b)(2) if the original index becomes unavailable, as long as historical fluctuations in the original and replacement indices were substantially similar, and as long as the replacement index and margin will produce a rate similar to the rate that was in effect at the time the original index became unavailable. If the replacement index is newly established and therefore does not have any rate history, it may be used if it produces a rate substantially similar to the rate in effect when the original index became unavailable.

55(b)(3) Advance notice exception.

1. Relationship to § 226.9(h). A card issuer may not increase a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) pursuant to § 226.55(b)(3) if the consumer has rejected the increased fee or charge pursuant to § 226.9(h).

2. Notice provided pursuant to § 226.9(b) and (c). If an increased annual percentage rate, fee, or charge is disclosed pursuant to both § 226.9(b) and (c), that rate, fee, or charge may only be applied to transactions that occur more than 14 days after provision of the § 226.9(c) notice as provided in § 226.55(b)(3)(ii).

3. Account opening.

i. Multiple accounts with same card issuer. When a consumer has a credit card account with a card issuer and the consumer opens a new credit card account with the same card issuer (or its affiliate or subsidiary), the opening of the

new account constitutes the opening of a credit card account for purposes of § 226.55(b)(3)(iii) if, more than 30 days after the new account is opened, the consumer has the option to obtain additional extensions of credit on each account. For example, assume that, on January 1 of year one, a consumer opens a credit card account with a card issuer. On July 1 of year one, the consumer opens a second credit card account with that card issuer. On July 15, a $1,000 balance is transferred from the first account to the second account. The opening of the second account constitutes the opening of a credit card account for purposes of § 226.55(b)(3)(iii) so long as, on August 1, the consumer has the option to engage in transactions using either account. Under these circumstances, the card issuer could not increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) on the second account pursuant to § 226.55(b)(3) until July 1 of year two (which is one year after the second account was opened).

ii. Substitution, replacement or consolidation.

A. Generally. A credit card account has not been opened for purposes of § 226.55(b)(3)(iii) when a credit card account issued by a card issuer is substituted, replaced, or consolidated with another credit card account issued by the same card issuer (or its affiliate or subsidiary). Circumstances in which a credit card account has not been opened for purposes of § 226.55(b)(3)(iii) include when:

(1) A retail credit card account is replaced with a cobranded general purpose credit card account that can be used at a wider number of merchants;

(2) A credit card account is replaced with another credit card account offering different features;

(3) A credit card account is consolidated or combined with one or more other credit card accounts into a single credit card account; or

(4) A credit card account acquired through merger or acquisition is replaced with a credit card account issued by the acquiring card issuer.

B. Limitation. A card issuer that replaces or consolidates a credit card account with another credit card account issued by the card issuer (or its affiliate or subsidiary) may not increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) in a manner otherwise prohibited by § 226.55. For example, assume that, on January 1 of year one, a consumer opens a credit card account with an annual percentage rate of 15% for purchases. On July 1 of year one, the account is replaced with a credit card account that offers different features (such as rewards on purchases). Under these circumstances, § 226.55(b)(3)(iii) prohibits the card issuer from increasing the annual percentage rate for new purchases to a rate that is higher than 15% pursuant to § 226.55(b)(3) until January 1 of year two (which is one year after the first account was opened).

4. Examples.

i. Change-in-terms rate increase; temporary rate increase; 14-day period. Assume that an account is opened on January 1 of year one. On March 14 of year two, the account has a purchase balance of $2,000 at a non-variable annual percentage rate of 15%. On March 15, the card issuer provides a notice pursuant to § 226.9(c) informing the consumer that the rate for new purchases will increase to a non-variable rate of 18% on May 1. The notice further states that the 18% rate will apply for six months (until November 1) and that thereafter the card issuer will apply a variable rate that is currently 22% and is determined by adding a margin of 12 percentage points to a publicly-available index that is not under the card issuer's control. The fourteenth day after provision of the notice is March 29 and, on that date, the consumer makes a $200 purchase. On March 30, the consumer makes a $1,000 purchase. On May 1, the card issuer may begin accruing interest at 18% on the $1,000 purchase made on March 30 (pursuant to § 226.55(b)(3)). Section 226.55(b)(3)(ii) does not permit the card issuer to apply the 18% rate to the $2,200 purchase balance as of March 29 because that balance reflects transactions that occurred prior to or within 14 days after the provision of the § 226.9(c) notice. After six months (November 2), the card issuer may begin accruing interest on any remaining portion of the $1,000 purchase at the previously-disclosed variable rate determined using the 12-point margin (pursuant to § 226.55(b)(1) and (b)(3)).

ii. Checks that access an account. Assume that a card issuer discloses at account opening on January 1 of year one that the annual percentage rate that applies to cash advances is a variable rate that is currently 24% and will be adjusted quarterly by adding a margin of 14 percentage points to a publicly available index not under the card issuer's control. On July 1 of year two, the card issuer provides checks that access the account and, pursuant to § 226.9(b)(3)(i)(A), discloses that a promotional rate of 15% will apply to credit extended by use of the checks until January 1 of year three, after which the cash advance rate determined using the 14-point margin will apply. On July 9 of year two, the consumer uses one of the checks to pay for a $500 transaction. Beginning on January 1 of year three, the card issuer may apply the cash advance rate determined using the 14-point margin to any remaining portion of the $500 transaction (pursuant to § 226.55(b)(1) and (b)(3)).

iii. Hold on available credit; 14-day period. Assume that an account is opened on January 1 of year one. On September 14 of year two, the account has a purchase balance of $2,000 at a non-variable annual percentage rate of 17%. On September 15, the card issuer provides a notice pursuant to § 226.9(c) informing the consumer that the rate for new purchases will increase to a non-variable rate of 20% on October 30. The fourteenth day after provision of the notice is September 29. On September 28, the consumer uses the credit card to check into a hotel and the hotel obtains authorization for a $1,000 hold on the account to ensure there is adequate available credit to cover the anticipated cost of the stay.

A. The consumer checks out of the hotel on October 2. The actual cost of the stay is $1,100 because of additional incidental costs. On October 2, the hotel charges the $1,100 transaction to the account. For purposes of § 226.55(b)(3), the transaction occurred on October 2. Therefore, on October 30, § 226.55(b)(3) permits the card issuer to apply the 20% rate to new purchases and to the $1,100 transaction. However, § 226.55(b)(3)(ii) does not permit the card issuer to apply the 20% rate to any remaining portion of the $2,000 purchase balance.

B. Same facts as above except that the consumer checks out of the hotel on September 29. The actual cost of the stay is $250, but the hotel does not charge this amount to the account until November 1. For purposes of § 226.55(b)(3), the card issuer may treat the transaction as occurring more than 14 days after provision of the § 226.9(c) notice (i.e., after September 29). Accordingly, the card issuer may apply the 20% rate to the $250 transaction.

5. Application of increased fees and charges. See comment 55(c)(1)-3.

55(b)(4) Delinquency exception.

1. Receipt of required minimum periodic payment within 60 days of due date. Section 226.55(b)(4) applies when a card issuer has not received the consumer's required minimum periodic payment within 60 days after the due date for that payment. In order to satisfy this condition, a card issuer that requires monthly minimum payments generally must not have received two consecutive required minimum periodic payments. Whether a required minimum periodic payment has been received for purposes of § 226.55(b)(4) depends on whether the amount received is equal to or more than the first outstanding required minimum periodic payment. For example, assume that the required minimum periodic payments for a credit card account are due on the fifteenth day of the month. On May 13, the card issuer has not received the $50 required minimum periodic payment due on March 15 or the $150 required minimum periodic payment due on April 15. The sixtieth day after the March 15 payment due date is May 14. If the card issuer receives a $50 payment on May 14, § 226.55(b)(4) does not apply because the payment is equal to the required minimum periodic payment due on March 15 and therefore the account is not more than 60 days delinquent. However, if the card issuer instead received a $40 payment on May 14, § 226.55(b)(4) would apply beginning on May 15 because the payment is less than the required minimum periodic payment due on March 15. Furthermore, if the card issuer received the $50 payment on May 15, § 226.55(b)(4) would apply because the card issuer did not receive the required minimum periodic payment due on March 15 within 60 days after the due date for that payment.

2. Relationship to § 226.9(g)(3)(i)(B). A card issuer that has complied with the disclosure requirements in § 226.9(g)(3)(i)(B) has also complied with the disclosure requirements in § 226.55(b)(4)(i).

3. Reduction in rate pursuant to § 226.55(b)(4)(ii). Section 226.55(b)(4)(ii) provides that, if the card issuer receives six consecutive required minimum periodic payments on or before the payment due date beginning with the first payment due following the effective date of the increase, the card issuer must reduce any annual percentage rate, fee, or charge increased pursuant to § 226.55(b)(4) to the annual percentage rate, fee, or charge that applied prior to the increase with respect to transactions that occurred prior to or within 14 days after provision of the § 226.9(c) or (g) notice.

i. Six consecutive payments immediately following effective date of increase. Section 226.55(b)(4)(ii) does not apply if the card issuer does not receive six consecutive required minimum periodic payments on or before the payment due date beginning with the payment due immediately following the effective date of the increase, even if, at some later point in time, the card issuer receives six consecutive required minimum periodic payments on or before the payment

due date.

ii. Rate, fee, or charge that does not exceed rate, fee, or charge that applied before increase. Although § 226.55(b)(4)(ii) requires the card issuer to reduce an annual percentage rate, fee, or charge increased pursuant to § 226.55(b)(4) to the annual percentage rate, fee, or charge that applied prior to the increase, this provision does not prohibit the card issuer from applying an increased annual percentage rate, fee, or charge consistent with any of the other exceptions in § 226.55(b). For example, if a temporary rate applied prior to the § 226.55(b)(4) increase and the temporary rate expired before a reduction in rate pursuant to § 226.55(b)(4)(ii), the card issuer may apply an increased rate to the extent consistent with § 226.55(b)(1). Similarly, if a variable rate applied prior to the § 226.55(b)(4) increase, the card issuer may apply any increase in that variable rate to the extent consistent with § 226.55(b)(2).

iii. Delayed implementation of reduction. If § 226.55(b)(4)(ii) requires a card issuer to reduce an annual percentage rate, fee, or charge on a date that is not the first day of a billing cycle, the card issuer may delay application of the reduced rate, fee, or charge until the first day of the following billing cycle.

iv. Examples. The following examples illustrate the application of § 226.55(b)(4)(ii):

A. Assume that the billing cycles for an account begin on the first day of the month and end on the last day of the month and that the required minimum periodic payments are due on the fifteenth day of the month. Assume also that the account has a $5,000 purchase balance to which a non-variable annual percentage rate of 15% applies. On May 16 of year one, the card issuer has not received the required minimum periodic payments due on the fifteenth day of March, April, or May and sends a § 226.9(c) or (g) notice stating that the annual percentage rate applicable to the $5,000 balance and to new transactions will increase to 28% effective July 1. On July 1, § 226.55(b)(4) permits the card issuer to apply the 28% rate to the $5,000 balance and to new transactions. The card issuer receives the required minimum periodic payments due on the fifteenth day of July, August, September, October, November, and December. On January 1 of year two, § 226.55(b)(4)(ii) requires the card issuer to reduce the rate that applies to any remaining portion of the $5,000 balance to 15%. The card issuer is not required to reduce the rate that applies to any transactions that occurred on or after May 31 (which is the fifteenth day after provision of the § 226.9(c) or (g) notice).

B. Same facts as paragraph iv.A. above except that the 15% rate that applied to the $5,000 balance prior to the § 226.55(b)(4) increase was scheduled to increase to 20% on August 1 of year one (pursuant to § 226.55(b)(1)). On January 1 of year two, § 226.55(b)(4)(ii) requires the card issuer to reduce the rate that applies to any remaining portion of the $5,000 balance to 20%.

C. Same facts as paragraph iv.A. above except that the 15% rate that applied to the $5,000 balance prior to the § 226.55(b)(4) increase was scheduled to increase to 20% on March 1 of year two (pursuant to § 226.55(b)(1)). On January 1 of year two, § 226.55(b)(4)(ii) requires the card issuer to reduce the rate that applies to any remaining portion of the $5,000 balance to 15%.

D. Same facts as paragraph iv.A. above except that the 15% rate that applied to the $5,000 balance prior to the § 226.55(b)(4) increase was a variable rate that was determined by adding a margin of 10 percentage points to a publicly-available index not under the card issuer's control (consistent with § 226.55(b)(2)). On January 1 of year two, § 226.55(b)(4)(ii) requires the card issuer to reduce the rate that applies to any remaining portion of the $5,000 balance to the variable rate determined using the 10-point margin.

E. For an example of the application of § 226.55(b)(4)(ii) to deferred interest or similar programs, see comment 55(b)(1)-3.ii.C.

55(b)(5) Workout and temporary hardship arrangement exception.

1. Scope of exception. Nothing in § 226.55(b)(5) permits a card issuer to alter the requirements of § 226.55 pursuant to a workout or temporary hardship arrangement. For example, a card issuer cannot increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) pursuant to a workout or temporary hardship arrangement unless otherwise permitted by § 226.55. In addition, a card issuer cannot require the consumer to make payments with respect to a protected balance that exceed the payments permitted under § 226.55(c).

2. Relationship to § 226.9(c)(2)(v)(D). A card issuer that has complied with the disclosure requirements in § 226.9(c)(2)(v)(D) has also complied with the disclosure requirements in § 226.55(b)(5)(i). See comment 9(c)(2)(v)-10. Thus, although the disclosures required by § 226.55(b)(5)(i) must generally be provided in writing prior to commencement of the arrangement, a card issuer may comply with § 226.55(b)(5)(i) by complying with § 226.9(c)(2)(v)(D), which states that the disclosure of the terms of the arrangement may be made orally by telephone, provided that the card issuer mails or delivers a written disclosure of the terms of the arrangement to the consumer as soon as reasonably practicable after the oral disclosure is provided.

3. Rate, fee, or charge that does not exceed rate, fee, or charge that applied before workout or temporary hardship arrangement. Upon the completion or failure of a workout or temporary hardship arrangement, § 226.55(b)(5)(ii) prohibits the card issuer from applying to any transactions that occurred prior to commencement of the arrangement an annual percentage rate, fee, or charge that exceeds the annual percentage rate, fee, or charge that applied to those transactions prior to commencement of the arrangement. However, this provision does not prohibit the card issuer from applying an increased annual percentage rate, fee, or charge upon completion or failure of the arrangement, to the extent consistent with any of the other exceptions in § 226.55(b). For example, if a temporary rate applied prior to the arrangement and that rate expired during the arrangement, the card issuer may apply an increased rate upon completion or failure of the arrangement to the extent consistent with § 226.55(b)(1). Similarly, if a variable rate applied prior to the arrangement, the card issuer may apply any increase in that variable rate upon completion or failure of the arrangement to the extent consistent with § 226.55(b)(2).

4. Examples.

i. Assume that an account is subject to a $50 annual fee and that, consistent with § 226.55(b)(4), the margin used to determine a variable annual percentage rate that applies to a $5,000 balance is increased from 5 percentage points to 15 percentage points. Assume also that the card issuer and the consumer subsequently agree to a workout arrangement that reduces the annual fee to $0 and reduces the margin back to 5 points on the condition that the consumer pay a specified amount by the payment due date each month. If the consumer does not pay the agreed-upon amount by the payment due date, § 226.55(b)(5) permits the card issuer to increase the annual fee to $50 and increase the margin for the variable rate that applies to the $5,000 balance up to 15 percentage points.

ii. Assume that a consumer fails to make four consecutive monthly minimum payments totaling $480 on a consumer credit card account with a balance of $6,000 and that, consistent with § 226.55(b)(4), the annual percentage rate that applies to that balance is increased from a non-variable rate of 15% to a non-variable penalty rate of 30%. Assume also that the card issuer and the consumer subsequently agree to a temporary hardship arrangement that reduces all rates on the account to 0% on the condition that the consumer pay an amount by the payment due date each month that is sufficient to cure the $480 delinquency within six months. If the consumer pays the agreed-upon amount by the payment due date during the six-month period and cures the delinquency, § 226.55(b)(5) permits the card issuer to increase the rate that applies to any remaining portion of the $6,000 balance to 15% or any other rate up to the 30% penalty rate.

55(b)(6) Servicemembers Civil Relief Act exception.

1. Rate that does not exceed rate that applied before decrease. Once *50 U.S.C. app. 527* no longer applies, § 226.55(b)(6) prohibits a card issuer from applying an annual percentage rate to any transactions that occurred prior to a decrease in rate pursuant to *50 U.S.C. app. 527* that exceeds the rate that applied to those transactions prior to the decrease. However, this provision does not prohibit the card issuer from applying an increased annual percentage rate once *50 U.S.C. app. 527* no longer applies, to the extent consistent with any of the other exceptions in § 226.55(b). For example, if a temporary rate applied prior to the decrease and that rate expired during the period that *50 U.S.C. app. 527* applied to the account, the card issuer may apply an increased rate once *50 U.S.C. app. 527* no longer applies to the extent consistent with § 226.55(b)(1). Similarly, if a variable rate applied prior to the decrease, the card issuer may apply any increase in that variable rate once *50 U.S.C. app. 527* no longer applies to the extent consistent with § 226.55(b)(2).

2. Example. Assume that on December 31 of year one the annual percentage rate that applies to a $5,000 balance on a credit card account is a variable rate that is determined by adding a margin of 10 percentage points to a publicly-available index that is not under the card issuer's control. On January 1 of year two, the card issuer reduces the rate that applies to the $5,000 balance to a non-variable rate of 6% pursuant to *50 U.S.C. app. 527*. On January 1 of year three, *50 U.S.C. app. 527* ceases to apply and the card issuer provides a notice pursuant to § 226.9(c) informing the consumer that on February 15 of year three the variable rate determined using the 10-point margin will apply to any remaining portion of the $5,000 balance. On February 15 of year three, § 226.55(b)(6) permits the card issuer to begin accruing interest on any remaining portion of the $5,000 balance at the variable rate determined using the 10-point margin.

55(c) Treatment of protected balances.

55(c)(1) Definition of protected balance.

1. Example of protected balance. Assume that, on March 15 of year two, an account has a purchase balance of $1,000 at a non-variable annual percentage rate of 12% and that, on March 16, the card issuer sends a notice pursuant to § 226.9(c) informing the consumer that the annual percentage rate for new purchases will increase to a non-variable rate of 15% on May 1. The fourteenth day after provision of the notice is March 29. On March 29, the consumer makes a $100 purchase. On March 30, the consumer makes a $150 purchase. On May 1, § 226.55(b)(3)(ii) permits the card issuer to begin accruing interest at 15% on the $150 purchase made on March 30 but does not permit the card issuer to apply that 15% rate to the $1,100 purchase balance as of March 29. Accordingly, the protected balance for purposes of § 226.55(c) is the $1,100 purchase balance as of March 29. The $150 purchase made on March 30 is not part of the protected balance.

2. First year after account opening. Section 226.55(c) applies to amounts owed for a category of transactions to which an increased annual percentage rate or an increased fee or charge cannot be applied after the rate, fee, or charge for that category of transactions has been increased pursuant to § 226.55(b)(3). Because § 226.55(b)(3)(iii) does not permit a card issuer to increase an annual percentage rate or a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) during the first year after account opening, § 226.55(c) does not apply to balances during the first year after account opening.

3. Increased fees and charges. Once an account has been open for more than one year, § 226.55(b)(3) permits a card issuer to increase a fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) after complying with the applicable notice requirements in § 226.9(b) or (c), provided that the increased fee or charge is not applied to a protected balance. A card issuer is not prohibited from increasing a fee or charge that applies to the account as a whole or to balances other than the protected balance. For example, after the first year following account opening, a card issuer may add a new annual or a monthly maintenance fee to an account or increase such a fee so long as the fee is not based solely on the protected balance. However, if the consumer rejects an increase in a fee or charge pursuant to § 226.9(h), the card issuer is prohibited from applying the increased fee or charge to the account and from imposing any other fee or charge solely as a result of the rejection. See § 226.9(h)(2)(i) and (ii); comment 9(h)(2)(ii)-2.

55(c)(2) Repayment of protected balance.

1. No less beneficial to the consumer. A card issuer may provide a method of repaying the protected balance that is different from the methods listed in § 226.55(c)(2) so long as the method used is no less beneficial to the consumer than one of the listed methods. A method is no less beneficial to the consumer if the method results in a required minimum periodic payment that is equal to or less than a minimum payment calculated using the method for the account before the effective date of the increase. Similarly, a method is no less beneficial to the consumer if the method amortizes the balance in five years or longer or if the method results in a required minimum periodic payment that is equal to or less than a minimum payment calculated consistent with § 226.55(c)(2)(iii). For example:

i. If at account opening the cardholder agreement stated that the required minimum periodic payment would be either the total of fees and interest charges plus 1% of the total amount owed or $20 (whichever is greater), the card

issuer may require the consumer to make a minimum payment of $20 even if doing so would pay off the balance in less than five years or constitute more than 2% of the balance plus fees and interest charges.

ii. A card issuer could increase the percentage of the balance included in the required minimum periodic payment from 2% to 5% so long as doing so would not result in amortization of the balance in less than five years.

iii. A card issuer could require the consumer to make a required minimum periodic payment that amortizes the balance in four years so long as doing so would not more than double the percentage of the balance included in the minimum payment prior to the date on which the increased annual percentage rate, fee, or charge became effective.

55(c)(2)(ii) Five-year amortization period.

1. Amortization period starting from effective date of increase. Section 226.55(c)(2)(ii) provides for an amortization period for the protected balance of no less than five years, starting from the date on which the increased annual percentage rate or fee or charge required to be disclosed under § 226.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) became effective. A card issuer is not required to recalculate the required minimum periodic payment for the protected balance if, during the amortization period, that balance is reduced as a result of the allocation of payments by the consumer in excess of that minimum payment consistent with § 226.53 or any other practice permitted by these rules and other applicable law.

2. Amortization when applicable rate is variable. If the annual percentage rate that applies to the protected balance varies with an index, the card issuer may adjust the interest charges included in the required minimum periodic payment for that balance accordingly in order to ensure that the balance is amortized in five years. For example, assume that a variable rate that is currently 15% applies to a protected balance and that, in order to amortize that balance in five years, the required minimum periodic payment must include a specific amount of principal plus all accrued interest charges. If the 15% variable rate increases due to an increase in the index, the creditor may increase the required minimum periodic payment to include the additional interest charges.

55(c)(2)(iii) Doubling repayment rate.

1. Portion of required minimum periodic payment on other balances. Section 226.55(c)(2)(iii) addresses the portion of the required minimum periodic payment based on the protected balance. Section 226.55(c)(2)(iii) does not limit or otherwise address the card issuer's ability to determine the portion of the required minimum periodic payment based on other balances on the account or the card issuer's ability to apply that portion of the minimum payment to the balances on the account.

2. Example. Assume that the method used by a card issuer to calculate the required minimum periodic payment for a credit card account requires the consumer to pay either the total of fees and accrued interest charges plus 2% of the total amount owed or $50, whichever is greater. Assume also that the account has a purchase balance of $2,000 at an

annual percentage rate of 15% and a cash advance balance of $500 at an annual percentage rate of 20% and that the card issuer increases the rate for purchases to 18% but does not increase the rate for cash advances. Under § 226.55(c)(2)(iii), the card issuer may require the consumer to pay fees and interest plus 4% of the $2,000 purchase balance. Section 226.55(c)(2)(iii) does not limit the card issuer's ability to increase the portion of the required minimum periodic payment that is based on the cash advance balance.

55(d) Continuing application.

1. Closed accounts. If a credit card account under an open-end (not home-secured) consumer credit plan with a balance is closed, § 226.55 continues to apply to that balance. For example, if a card issuer or a consumer closes a credit card account with a balance, § 226.55(d)(1) prohibits the card issuer from increasing the annual percentage rate that applies to that balance or imposing a periodic fee based solely on that balance that was not charged before the account was closed (such as a closed account fee) unless permitted by one of the exceptions in § 226.55(b).

2. Acquired accounts. If, through merger or acquisition (for example), a card issuer acquires a credit card account under an open-end (not home-secured) consumer credit plan with a balance, § 226.55 continues to apply to that balance. For example, if a credit card account has a $1,000 purchase balance with an annual percentage rate of 15% and the card issuer that acquires that account applies an 18% rate to purchases, § 226.55(d)(1) prohibits the card issuer from applying the 18% rate to the $1,000 balance unless permitted by one of the exceptions in § 226.55(b).

3. Balance transfers.

i. Between accounts issued by the same creditor. if a balance is transferred from a credit card account under an open-end (not home-secured) consumer credit plan issued by a creditor to another credit account issued by the same creditor or its affiliate or subsidiary, § 226.55 continues to apply to that balance. For example, if a credit card account has a $2,000 purchase balance with an annual percentage rate of 15% and that balance is transferred to another credit card account issued by the same creditor that applies an 18% rate to purchases, § 226.55(d)(2) prohibits the creditor from applying the 18% rate to the $2,000 balance unless permitted by one of the exceptions in § 226.55(b). However, the creditor would not generally be prohibited from charging a new periodic fee (such as an annual fee) on the second account so long as the fee is not based solely on the $2,000 balance and the creditor has notified the consumer of the fee either by providing written notice 45 days before imposing the fee pursuant to § 226.9(c) or by providing account-opening disclosures pursuant to § 226.6(b). See also *§ 226.55*(b)(3)(iii); comment 55(b)(3)-3; comment 5(b)(1)(i)-6. Additional circumstances in which a balance is considered transferred for purposes of § 226.55(d)(2) include when:

A. A retail credit card account with a balance is replaced or substituted with a cobranded general purpose credit card account that can be used with a broader merchant base;

B. A credit card account with a balance is replaced or substituted with another credit card account offering

different features;

C. A credit card account with a balance is consolidated or combined with one or more other credit card accounts into a single credit card account; and

D. A credit card account is replaced or substituted with a line of credit that can be accessed solely by an account number.

ii. Between accounts issued by different creditors. If a balance is transferred to a credit card account under an open-end (not home-secured) consumer credit plan issued by a creditor from a credit card account issued by a different creditor or an institution that is not an affiliate or subsidiary of the creditor that issued the account to which the balance is transferred, § 226.55(d)(2) does not prohibit the creditor to which the balance is transferred from applying its account terms to that balance, provided that those terms comply with this part. For example, if a credit card account issued by creditor A has a $1,000 purchase balance at an annual percentage rate of 15% and the consumer transfers that balance to a credit card account with a purchase rate of 17% issued by creditor B, creditor B may apply the 17% rate to the $1,000 balance. However, creditor B may not subsequently increase the rate on that balance unless permitted by one of the exceptions in § 226.55(b).

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1B- Consumer Credit Law Manual Section 226.56

§ **226.56 Requirements for Over-the-Limit Transactions**

56(b) Opt-in requirement.

1. Policy and practice of declining over-the-limit transactions. Section 226.56(b)(1)(i)-(v), including the requirements to provide notice and obtain consumer consent, do not apply to any card issuer that has a policy and practice of declining to pay any over-the-limit transactions for the consumer's credit card account when the card issuer has a reasonable belief that completing a transaction will cause the consumer to exceed the consumer's credit limit for that account. For example, if a card issuer only authorizes those transactions which, at the time of authorization, would not cause the consumer to exceed a credit limit, it is not subject to the requirement to provide consumers notice and an opportunity to affirmatively consent to the card issuer's payment of over-the-limit transactions. However, if an over-the-limit transaction is paid without the consumer providing affirmative consent, the card issuer may not charge a fee for paying the transaction.

2. Over-the-limit transactions not required to be authorized or paid. Section 226.56 does not require a card issuer to authorize or pay an over-the-limit transaction even if the consumer has affirmatively consented to the card issuer's over-the-limit service.

3. Examples of reasonable opportunity to provide affirmative consent. A card issuer provides a reasonable opportunity for the consumer to provide affirmative consent to the card issuer's payment of over-the-limit transactions when, among other things, it provides reasonable methods by which the consumer may affirmatively consent. A card issuer provides such reasonable methods if--

i. On the application. The card issuer provides the notice on the application form that the consumer can fill out to request the service as part of the application;

ii. By mail. The card issuer provides a form with the account-opening disclosures or the periodic statement for the consumer to fill out and mail to affirmatively request the service;

iii. By telephone. The card issuer provides a readily available telephone line that consumers may call to provide affirmative consent.

iv. By electronic means. The card issuer provides an electronic means for the consumer to affirmatively consent. For example, a card issuer could provide a form that can be accessed and processed at its Web site, where the consumer can check a box to opt in and confirm that choice by clicking on a button that affirms the consumer's consent.

4. Separate consent required. A consumer's affirmative consent, or opt-in, to a card issuer's payment of over-the-limit transactions must be obtained separately from other consents or acknowledgments obtained by the card issuer. For example, a consumer's signature on a credit application to request a credit card would not by itself sufficiently evidence the consumer's consent to the card issuer's payment of over-the-limit transactions. However, a card issuer may obtain a consumer's affirmative consent by providing a blank signature line or a check box on the application that the consumer can sign or select to request the over-the-limit service, provided that the signature line or check box is used solely for purposes of evidencing the choice and not for any other purpose, such as to also obtain consumer consents for other account services or features or to receive disclosures electronically.

5. Written confirmation. A card issuer may comply with the requirement in § 226.56(b)(1)(iv) to provide written confirmation of the consumer's decision to affirmatively consent, or opt in, to the card issuer's payment of over-the-limit transactions by providing the consumer a copy of the consumer's completed opt-in form or by sending a letter or notice to the consumer acknowledging that the consumer has elected to opt into the card issuer's service. A card issuer may also satisfy the written confirmation requirement by providing the confirmation on the first periodic statement sent after the consumer has opted in. For example, a card issuer could provide a written notice consistent with § 226.56(e)(2) on the periodic statement. A card issuer may not, however, assess any over-the-limit fees or charges on the consumer's credit card account unless and until the card issuer has sent the written confirmation. Thus, if a card issuer elects to provide written confirmation on the first periodic statement after the consumer has opted in, it would not be permitted to assess any over-the-limit fees or charges until the next statement cycle.

56(b)(2) Completion of over-the-limit transactions without consumer consent.

1. Examples of over-the-limit transactions paid without consumer consent. Section 226.56(b)(2) provides that a card issuer may pay an over-the-limit transaction even if the consumer has not provided affirmative consent, so long as the card issuer does not impose a fee or charge for paying the transaction. The prohibition on imposing fees for paying an over-the-limit transaction applies even in circumstances where the card issuer is unable to avoid paying a transaction that exceeds the consumer's credit limit.

i. Transactions not submitted for authorization. A consumer has not affirmatively consented to a card issuer's payment of over-the-limit transactions. The consumer purchases a $3 cup of coffee using his credit card. Because of the small dollar amount of the transaction, the merchant does not submit the transaction to the card issuer for authorization. The transaction causes the consumer to exceed the credit limit. Under these circumstances, the card issuer is prohibited from imposing a fee or charge on the consumer's credit card account for paying the over-the-limit transaction because the consumer has not opted in to the card issuer's over-the-limit service.

ii. Settlement amount exceeds authorization amount. A consumer has not affirmatively consented to a card issuer's payment of over-the-limit transactions. The consumer uses his credit card at a pay-at-the-pump fuel dispenser to purchase $50 of fuel. Before permitting the consumer to use the fuel pump, the merchant verifies the validity of the card by requesting an authorization hold of $1. The subsequent $50 transaction amount causes the consumer to exceed his credit limit. Under these circumstances, the card issuer is prohibited from imposing a fee or charge on the consumer's credit card account for paying the over-the-limit transaction because the consumer has not opted in to the card issuer's over-the-limit service.

iii. Intervening charges. A consumer has not affirmatively consented to a card issuer's payment of over-the-limit transactions. The consumer makes a $50 purchase using his credit card. However, before the $50 transaction is charged to the consumer's account, a separate recurring charge is posted to the account. The $50 purchase then causes the consumer to exceed his credit limit. Under these circumstances, the card issuer is prohibited from imposing a fee or charge on the consumer's credit card account for paying the over-the-limit transaction because the consumer has not opted in to the card issuer's over-the-limit service.

2. Permissible fees or charges when a consumer has not consented. Section 226.56(b)(2) does not preclude a card issuer from assessing fees or charges other than over-the-limit fees when an over-the-limit transaction is completed. For example, if a consumer has not opted in, the card issuer may assess a balance transfer fee in connection with a balance transfer, provided such a fee is assessed whether or not the transfer exceeds the credit limit. Section 226.56(b)(2) does not limit the card issuer's ability to debit the consumer's account for the amount of the over-the-limit transaction if the card issuer is permitted to do so under applicable law. The card issuer may also assess interest charges in connection with the over-the-limit transaction.

56(c) Method of election.

1. Card issuer-determined methods. A card issuer may determine the means available to consumers to affirmatively consent, or opt in, to the card issuer's payment of over-the-limit transactions. For example, a card issuer may decide to obtain consents in writing, electronically, or orally, or through some combination of these methods. Section 226.56(c) further requires, however, that such methods must be made equally available for consumers to revoke a prior consent. Thus, for example, if a card issuer allows a consumer to consent in writing or electronically, it must also allow the consumer to revoke that consent in writing or electronically.

2. Electronic requests. A consumer consent or revocation request submitted electronically is not considered a

consumer disclosure for purposes of the E-Sign Act.

56(d) Timing and placement of notices.

1. Contemporaneous notice for oral or electronic consent. Under § 226.56(d)(1)(ii), if a card issuer seeks to obtain consent from the consumer orally or by electronic means, the card issuer must provide a notice containing the disclosures in § 226.56(e)(1) prior to and as part of the process of obtaining the consumer's consent.

56(e) Content.

1. Varying fee amounts. If the amount of an over-the-limit fee may vary, such as based on the amount of the over-the-limit transaction, the card issuer may indicate that the consumer may be assessed a fee "up to" the maximum fee.

2. Notice content. In describing the consumer's right to affirmatively consent to a card issuer's payment of over-the-limit transactions, the card issuer may explain that any transactions that exceed the consumer's credit limit will be declined if the consumer does not consent to the service. In addition, the card issuer should explain that even if a consumer consents, the payment of over-the-limit transactions is at the discretion of the card issuer. For example, the card issuer may indicate that it may decline a transaction for any reason, such as if the consumer is past due or significantly over the limit. The card issuer may also disclose the consumer's right to revoke consent.

56(f) Joint relationships.

1. Authorized users. Section 226.56(f) does not permit a card issuer to treat a request to opt in to or to revoke a prior request for the card issuer's payment of over-the-limit transactions from an authorized user that is not jointly liable on a credit card account as a consent or revocation request for that account.

56(g) Continuing right to opt in or revoke opt-in.

1. Fees or charges for over-the-limit transactions incurred prior to revocation. Section 226.56(g) provides that a consumer may revoke his or her prior consent at any time. If a consumer does so, this provision does not require the card issuer to waive or reverse any over-the-limit fees or charges assessed to the consumer's account for transactions that occurred prior to the card issuer's implementation of the consumer's revocation request. Nor does this requirement prevent the card issuer from assessing over-the-limit fees in subsequent cycles if the consumer's account balance continues to exceed the credit limit after the payment due date as a result of an over-the-limit transaction that occurred prior to the consumer's revocation of consent.

56(h) Duration of opt-in.

1. Card issuer ability to stop paying over-the-limit transactions after consumer consent. A card issuer may cease

paying over-the-limit transactions for consumers that have previously opted in at any time and for any reason. For example, a card issuer may stop paying over-the-limit transactions for a consumer to respond to changes in the credit risk presented by the consumer.

56(j) Prohibited practices.

1. Periodic fees or charges. A card issuer may charge an over-the-limit fee or charge only if the consumer has exceeded the credit limit during the billing cycle. Thus, a card issuer may not impose any recurring or periodic fees for paying over-the-limit transactions (for example, a monthly "over-the-limit protection" service fee), even if the consumer has affirmatively consented to or opted in to the service, unless the consumer has in fact exceeded the credit limit during that cycle.

2. Examples of limits on fees or charges imposed per billing cycle. Section 226.56(j)(1) generally prohibits a card issuer from assessing a fee or charge due to the same over-the-limit transaction for more than three billing cycles. The following examples illustrate the prohibition.

i. Assume that a consumer has opted into a card issuer's payment of over-the-limit transactions. The consumer exceeds the credit limit during the December billing cycle and does not make sufficient payment to bring the account balance back under the limit for four consecutive cycles. The consumer does not engage in any additional transactions during this period. In this case, § 226.56(j)(1) would permit the card issuer to charge a maximum of three over-the-limit fees for the December over-the-limit transaction.

ii. Assume the same facts as above except that the consumer makes sufficient payment to reduce his account balance by the payment due date during the February billing cycle. The card issuer may charge over-the-limit fees for the December and January billing cycles. However, because the consumer's account balance was below the credit limit by the payment due date for the February billing cycle, the card issuer may not charge an over-the-limit fee for the February billing cycle.

iii. Assume the same facts as in paragraph i., except that the consumer engages in another over-the-limit transaction during the February billing cycle. Because the consumer has obtained an additional extension of credit which causes the consumer to exceed his credit limit, the card issuer may charge over-the-limit fees for the December transaction on the January, February and March billing statements, and additional over-the-limit fees for the February transaction on the April and May billing statements. The card issuer may not charge an over-the-limit fee for each of the December and the February transactions on the March billing statement because it is prohibited from imposing more than one over-the-limit fee during a billing cycle.

3. Replenishment of credit line. Section 226.56(j)(2) does not prevent a card issuer from delaying replenishment of a consumer's available credit where appropriate, for example, where the card issuer may suspect fraud on the credit card account. However, a card issuer may not assess an over-the-limit fee or charge if the over-the-limit transaction is caused

by the card issuer's decision not to promptly replenish the available credit after the consumer's payment is credited to the consumer's account.

4. Examples of conditioning. Section 226.56(j)(3) prohibits a card issuer from conditioning or otherwise tying the amount of a consumer's credit limit on the consumer affirmatively consenting to the card issuer's payment of over-the-limit transactions where the card issuer assesses an over-the-limit fee for the transaction. The following examples illustrate the prohibition.

i. Amount of credit limit. Assume that a card issuer offers a credit card with a credit limit of $1,000. The consumer is informed that if the consumer opts in to the payment of the card issuer's payment of over-the-limit transactions, the initial credit limit would be increased to $1,300. If the card issuer would have offered the credit card with the $1,300 credit limit but for the fact that the consumer did not consent to the card issuer's payment of over-the-limit transactions, the card issuer would not be in compliance with § 226.56(j)(3). Section 226.56(j)(3) prohibits the card issuer from tying the consumer's opt-in to the card issuer's payment of over-the-limit transactions as a condition of obtaining the credit card with the $1,300 credit limit.

ii. Access to credit. Assume the same facts as above, except that the card issuer declines the consumer's application altogether because the consumer has not affirmatively consented or opted in to the card issuer's payment of over-the-limit transactions. The card issuer is not in compliance with § 226.56(j)(3) because the card issuer has required the consumer's consent as a condition of obtaining credit.

5. Over-the-limit fees caused by accrued fees or interest. Section 226.56(j)(4) prohibits a card issuer from imposing any over-the-limit fees or charges on a consumer's account if the consumer has exceeded the credit limit solely because charges imposed as part of the plan as described in § 226.6(b)(3) were charged to the consumer's account during the billing cycle. For example, a card issuer may not assess an over-the-limit fee or charge even if the credit limit was exceeded due to fees for services requested by the consumer if such fees would constitute charges imposed as part of the plan (such as fees for voluntary debt cancellation or suspension coverage). Section 226.56(j)(4) does not, however, restrict card issuers from assessing over-the-limit fees or charges due to accrued finance charges or fees from prior cycles that have subsequently been added to the account balance. The following examples illustrate the prohibition.

i. Assume that a consumer has opted in to a card issuer's payment of over-the-limit transactions. The consumer's account has a credit limit of $500. The billing cycles for the account begin on the first day of the month and end on the last day of the month. The account is not eligible for a grace period as defined in § 226.5(b)(2)(ii)(B)(3). On December 31, the only balance on the account is a purchase balance of $475. On that same date, $50 in fees charged as part of the plan under § 226.6(b)(3)(i) and interest charges are imposed on the account, increasing the total balance at the end of the December billing cycle to $525. Although the total balance exceeds the $500 credit limit, § 226.56(j)(4) prohibits the card issuer from imposing an over-the-limit fee or charge for the December billing cycle in these circumstances because the consumer's credit limit was exceeded solely because of the imposition of fees and interest charges during that cycle.

ii. Same facts as above except that, on December 31, the only balance on the account is a purchase balance of $400. On that same date, $50 in fees imposed as part of the plan under § 226.6(b)(3)(i), including interest charges, are imposed on the account, increasing the total balance at the end of the December billing cycle to $450. The consumer makes a $25 payment by the January payment due date and the remaining $25 in fees imposed as part of the plan in December is added to the outstanding balance. On January 25, an $80 purchase is charged to the account. At the close of the cycle on January 31, an additional $20 in fees imposed as part of the plan are imposed on the account, increasing the total balance to $525. Because § 226.56(j)(4) does not require the issuer to consider fees imposed as part of the plan for the prior cycle in determining whether an over-the-limit fee may be properly assessed for the current cycle, the issuer need not take into account the remaining $25 in fees and interest charges from the December cycle in determining whether fees imposed as part of the plan caused the consumer to exceed the credit limit during the January cycle. Thus, under these circumstances, § 226.56(j)(4) does not prohibit the card issuer from imposing an over-the-limit fee or charge for the January billing cycle because the $20 in fees imposed as part of the plan for the January billing cycle did not cause the consumer to exceed the credit limit during that cycle.

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1B- Consumer Credit Law Manual Section 226.57

§ 226.57 Reporting and Marketing Rules for College Student Open-End Credit

57(a) Definitions.

57(a)(1) College student credit card.

1. Definition. The definition of college student credit card excludes home-equity lines of credit accessed by credit cards and overdraft lines of credit accessed by debit cards. A college student credit card includes a college affinity card within the meaning of TILA Section 127(r)(1)(A). In addition, a card may fall within the scope of the definition regardless of the fact that it is not intentionally targeted at or marketed to college students. For example, an agreement between a college and a card issuer may provide for marketing of credit cards to alumni, faculty, staff, and other non-student consumers who have a relationship with the college, but also contain provisions that contemplate the issuance of cards to students. A credit card issued to a student at the college in connection with such an agreement qualifies as a college student credit card.

57(a)(5) College credit card agreement.

1. Definition. Section 226.57(a)(5) defines "college credit card agreement" to include any business, marketing or promotional agreement between a card issuer and a college or university (or an affiliated organization, such as an alumni club or a foundation) if the agreement provides for the issuance of credit cards to full-time or part-time students. Business, marketing or promotional agreements may include a broad range of arrangements between a card issuer and an institution of higher education or affiliated organization, including arrangements that do not meet the criteria to be considered college affinity card agreements as discussed in TILA Section 127(r)(1)(A). For example, TILA Section 127(r)(1)(A) specifies that under a college affinity card agreement, the card issuer has agreed to make a donation to the institution or affiliated organization, the card issuer has agreed to offer discounted terms to the consumer, or the credit card will display pictures, symbols, or words identified with the institution or affiliated organization; even if these conditions are not met, an agreement may qualify as a college credit card agreement, if the agreement is a business, marketing or promotional agreement that contemplates the issuance of college student credit cards to college students currently enrolled (either full-time or part-time) at the institution. An agreement may qualify as a college credit card

agreement even if marketing of cards under the agreement is targeted at alumni, faculty, staff, and other non-student consumers, as long as cards may also be issued to students in connection with the agreement.

57(b) Public disclosure of agreements.

1. Public disclosure. Section 226.57(b) requires an institution of higher education to publicly disclose any contract or other agreement made with a card issuer or creditor for the purpose of marketing a credit card. Examples of publicly disclosing such contracts or agreements include, but are not limited to, posting such contracts or agreements on the institution's Web site or making such contracts or agreements available upon request, provided the procedures for requesting the documents are reasonable and free of cost to the requestor, and the requested contracts or agreements are provided within a reasonable time frame.

2. Redaction prohibited. An institution of higher education must publicly disclose any contract or other agreement made with a card issuer for the purpose of marketing a credit card in its entirety and may not redact any portion of such contract or agreement. Any clause existing in such contracts or agreements, providing for the confidentiality of any portion of the contract or agreement, would be invalid to the extent it restricts the ability of the institution of higher education to publicly disclose the contract or agreement in its entirety.

57(c) Prohibited inducements.

1. Tangible item clarified. A tangible item includes any physical item, such as a gift card, a t-shirt, or a magazine subscription, that a card issuer or creditor offers to induce a college student to apply for or open an open-end consumer credit plan offered by such card issuer or creditor. Tangible items do not include non-physical inducements such as discounts, rewards points, or promotional credit terms.

2. Inducement clarified. If a tangible item is offered to a person whether or not that person applies for or opens an open-end consumer credit plan, the tangible item has not been offered to induce the person to apply for or open the plan. For example, refreshments offered to a college student on campus that are not conditioned on whether the student has applied for or agreed to open an open-end consumer credit plan would not violate § 226.57(c).

3. Near campus clarified. A location that is within 1,000 feet of the border of the campus of an institution of higher education, as defined by the institution of higher education, is considered near the campus of an institution of higher education.

4. Mailings included. The prohibition in § 226.57(c) on offering a tangible item to a college student to induce such student to apply for or open an open-end consumer credit plan offered by such card issuer or creditor applies to any solicitation or application mailed to a college student at an address on or near the campus of an institution of higher education.

5. Related event clarified. An event is related to an institution of higher education if the marketing of such event uses the name, emblem, mascot, or logo of an institution of higher education, or other words, pictures, symbols identified with an institution of higher education in a way that implies that the institution of higher education endorses or otherwise sponsors the event.

6. Reasonable procedures for determining if applicant is a student. Section 226.57(c) applies solely to offering a tangible item to a college student. Therefore, a card issuer or creditor may offer any person who is not a college student a tangible item to induce such person to apply for or open an open-end consumer credit plan offered by such card issuer or creditor, on campus, near campus, or at an event sponsored by or related to an institution of higher education. The card issuer or creditor must have reasonable procedures for determining whether an applicant is a college student before giving the applicant the tangible item. For example, a card issuer or creditor may ask whether the applicant is a college student as part of the application process. The card issuer or creditor may rely on the representations made by the applicant.

57(d) Annual report to the Board.

57(d)(2) Contents of report.

1. Memorandum of understanding. Section 226.57(d)(2) requires that the report to the Board include, among other items, a copy of any memorandum of understanding between the card issuer and the institution (or affiliated organization) that "directly or indirectly relates to the college credit card agreement or that controls or directs any obligations or distribution of benefits between any such entities." Such a memorandum of understanding includes any document that amends the college credit card agreement, or that constitutes a further agreement between the parties as to the interpretation or administration of the agreement. For example, a memorandum of understanding required to be included in the report would include a document that provides details on the dollar amounts of payments from the card issuer to the university, to supplement the original agreement which only provided for payments in general terms (e.g., as a percentage). A memorandum of understanding for these purposes would not include email (or other) messages that merely discuss matters such as the addresses to which payments should be sent or the names of contact persons for carrying out the agreement.

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1B- Consumer Credit Law Manual Section 226.58

§ **226.58 Internet Posting of Credit Card Agreements**

58(b) Definitions.

58(b)(1) Agreement.

1. Inclusion of pricing information. For purposes of this section, a credit card agreement is deemed to include certain information, such as annual percentage rates and fees, even if the issuer does not otherwise include this information in the basic credit contract. This information is listed under the defined term "pricing information" in § 226.58(b)(6). For example, the basic credit contract may not specify rates, fees and other information that constitutes pricing information as defined in § 226.58(b)(6); instead, such information may be provided to the cardholder in a separate document sent along with the card. However, this information nevertheless constitutes part of the agreement for purposes of § 226.58.

2. Provisions contained in separate documents included. A credit card agreement is defined as the written document or documents evidencing the terms of the legal obligation, or the prospective legal obligation, between a card issuer and a consumer for a credit card account under an open-end (not home-secured) consumer credit plan. An agreement therefore may consist of several documents that, taken together, define the legal obligation between the issuer and consumer. For example, provisions that mandate arbitration or allow an issuer to unilaterally alter the terms of the card issuer's or consumer's obligation are part of the agreement even if they are provided to the consumer in a document separate from the basic credit contract.

58(b)(2) Amends.

1. Substantive changes. A change to an agreement is substantive, and therefore is deemed an amendment of the agreement, if it alters the rights or obligations of the parties. Section 226.58(b)(2) provides that any change in the pricing information, as defined in § 226.58(b)(6), is deemed to be substantive. Examples of other changes that generally

would be considered substantive include: (i) Addition or deletion of a provision giving the issuer or consumer a right under the agreement, such as a clause that allows an issuer to unilaterally change the terms of an agreement; (ii) addition or deletion of a provision giving the issuer or consumer an obligation under the agreement, such as a clause requiring the consumer to pay an additional fee; (iii) changes that may affect the cost of credit to the consumer, such as changes in a provision describing how the minimum payment will be calculated; (iv) changes that may affect how the terms of the agreement are construed or applied, such as changes in a choice-of-law provision; and (v) changes that may affect the parties to whom the agreement may apply, such as provisions regarding authorized users or assignment of the agreement.

2. Non-substantive changes. Changes that generally would not be considered substantive include, for example: (i) Correction of typographical errors that do not affect the meaning of any terms of the agreement; (ii) changes to the card issuer's corporate name, logo, or tagline; (iii) changes to the format of the agreement, such as conversion to a booklet from a full-sheet format, changes in font, or changes in margins; (iv) changes to the name of the credit card to which the program applies; (v) reordering sections of the agreement without affecting the meaning of any terms of the agreement; (vi) adding, removing, or modifying a table of contents or index; and (vii) changes to titles, headings, section numbers, or captions.

58(b)(4) Offers.

1. Cards offered to limited groups. A card issuer is deemed to offer a credit card agreement to the public even if the issuer solicits, or accepts applications from, only a limited group of persons. For example, a card issuer may market affinity cards to students and alumni of a particular educational institution, or may solicit only high-net-worth individuals for a particular card; in these cases, the agreement would be considered to be offered to the public. Similarly, agreements for credit cards issued by a credit union are considered to be offered to the public even though such cards are available only to credit union members.

2. Individualized agreements. A card issuer is deemed to offer a credit card agreement to the public even if the terms of the agreement are changed immediately upon opening of an account to terms not offered to the public.

58(b)(5) Open account

1. Open account clarified. The definition of open account includes a credit card account under an open-end (not home-secured) consumer credit plan if either: (i) The cardholder can obtain extensions of credit on the account; or (ii) there is an outstanding balance on the account that has not been charged off. Under this definition, an account that meets either of these criteria is considered to be open even if the account is inactive. Similarly, if an account has been closed for new activity (for example, due to default by the cardholder), but the cardholder is still making payments to pay off the outstanding balance, the account is considered open.

58(b)(7) Private label credit card account and private label credit card plan.

1. Private label credit card account. The term private label credit card account means a credit card account under an

open-end (not home-secured) consumer credit plan with a credit card that can be used to make purchases only at a single merchant or an affiliated group of merchants. This term applies to any such credit card account, regardless of whether it is issued by the merchant or its affiliate or by an unaffiliated third party.

2. Co-branded credit cards. The term private label credit card account does not include accounts with so-called co-branded credit cards. Credit cards that display the name, mark, or logo of a merchant or affiliated group of merchants as well as the mark, logo, or brand of payment network are generally referred to as co-branded cards. While these credit cards may display the brand of the merchant or affiliated group of merchants as the dominant brand on the card, such credit cards are usable at any merchant that participates in the payment network. Because these credit cards can be used at multiple unaffiliated merchants, accounts with such credit cards are not considered private label credit card accounts under § 226.58(b)(7).

3. Affiliated group of merchants. The term "affiliated group of merchants" means two or more affiliated merchants or other persons that are related by common ownership or common corporate control. For example, the term would include franchisees that are subject to a common set of corporate policies or practices under the terms of their franchise licenses. The term also applies to two or more merchants or other persons that agree among each other, by contract or otherwise, to accept a credit card bearing the same name, mark, or logo (other than the mark, logo, or brand of a payment network), for the purchase of goods or services solely at such merchants or persons. For example, several local clothing retailers jointly agree to issue credit cards called the "Main Street Fashion Card" that can be used to make purchases only at those retailers. For purposes of this section, these retailers would be considered an affiliated group of merchants.

4. Private label credit card plan. Which credit card accounts issued by a particular issuer constitute a private label credit card plan is determined by where the credit cards can be used. All of the private label credit card accounts issued by a particular card issuer with credit cards usable at the same merchant or affiliated group of merchants constitute a single private label credit card plan, regardless of whether the rates, fees, or other terms applicable to the individual credit card accounts differ. For example, a card issuer has 3,000 open private label credit card accounts with credit cards usable only at Merchant A and 5,000 open private label credit card accounts with credit cards usable only at Merchant B and its affiliates. The card issuer has two separate private label credit card plans, as defined by § 226.58(b)(7)--one plan consisting of 3,000 open accounts with credit cards usable only at Merchant A and another plan consisting of 5,000 open accounts with credit cards usable only at Merchant B and its affiliates.

The example above remains the same regardless of whether (or the extent to which) the terms applicable to the individual open accounts differ. For example, assume that, with respect to the card issuer's 3,000 open accounts with credit cards usable only at Merchant A in the example above, 1,000 of the open accounts have a purchase APR of 12 percent, 1,000 of the open accounts have a purchase APR of 15 percent, and 1,000 of the open accounts have a purchase APR of 18 percent. All of the 5,000 open accounts with credit cards usable only at Merchant B and Merchant B's affiliates have the same 15 percent purchase APR. The card issuer still has only two separate private label credit card plans, as defined by § 226.58(b)(7). The open accounts with credit cards usable only at Merchant A do not constitute three separate private label credit card plans under § 226.58(b)(7), even though the accounts are subject to different terms.

58(c) Submission of agreements to Board.

58(c)(1) Quarterly submissions.

1. Quarterly submission requirement. Section 226.58(c)(1) requires card issuers to send quarterly submissions to the Board no later than the first business day on or after January 31, April 30, July 31, and October 31 of each year. For example, a card issuer has already submitted three credit card agreements to the Board. On October 15, the card issuer stops offering agreement A. On November 20, the card issuer amends agreement B. On December 1, the issuer starts offering a new agreement D. The card issuer must submit to the Board no later than the first business day on or after January 31: (i) Notification that the card issuer is withdrawing agreement A, because it is no longer offered to the public; (ii) the amended version of agreement B; and (iii) agreement D.

2. No quarterly submission required. Under § 226.58(c)(1), a card issuer is not required to make any submission to the Board at a particular quarterly submission deadline if, during the previous calendar quarter, the card issuer did not take any of the following actions: (i) Offering a new credit card agreement that was not submitted to the Board previously; (ii) amending an agreement previously submitted to the Board; and (iii) ceasing to offer an agreement previously submitted to the Board. For example, a card issuer offers five agreements to the public as of September 30 and submits these to the Board by October 31, as required by § 226.58(c)(1). Between September 30 and December 31, the card issuer continues to offer all five of these agreements to the public without amending them and does not begin offering any new agreements. The card issuer is not required to make any submission to the Board by the following January 31.

3. Quarterly submission of complete set of updated agreements. Section 226.58(c)(1) permits a card issuer to submit to the Board on a quarterly basis a complete, updated set of the credit card agreements the card issuer offers to the public. For example, a card issuer offers agreements A, B, and C to the public as of March 31. The card issuer submits each of these agreements to the Board by April 30 as required by § 226.58(c)(1). On May 15, the card issuer amends agreement A, but does not make any changes to agreements B or C. As of June 30, the card issuer continues to offer amended agreement A and agreements B and C to the public. At the next quarterly submission deadline, July 31, the card issuer must submit the entire amended agreement A and is not required to make any submission with respect to agreements B and C. The card issuer may either: (i) Submit the entire amended agreement A and make no submission with respect to agreements B and C; or (ii) submit the entire amended agreement A and also resubmit agreements B and C. A card issuer may choose to resubmit to the Board all of the agreements it offered to the public as of a particular quarterly submission deadline even if the card issuer has not introduced any new agreements or amended any agreements since its last submission and continues to offer all previously submitted agreements.

58(c)(3) Amended agreements.

1. No requirement to resubmit agreements not amended. Under § 226.58(c)(3), if a credit card agreement has been submitted to the Board, the agreement has not been amended, and the card issuer continues to offer the agreement to the public, no additional submission regarding that agreement is required. For example, a credit card issuer begins offering an agreement in October and submits the agreement to the Board the following January 31, as required by § 226.58(c)(1). As of March 31, the card issuer has not amended the agreement and is still offering the agreement to the public. The card issuer is not required to submit anything to the Board regarding that agreement by April 30.

2. Submission of amended agreements. If a card issuer amends a credit card agreement previously submitted to the

Board, § 226.58(c)(3) requires the card issuer to submit the entire amended agreement to the Board by the first quarterly submission deadline after the last day of the calendar quarter in which the change became effective. For example, a card issuer submits an agreement to the Board on October 31. On November 15, the issuer changes the balance computation method used under the agreement. Because an element of the pricing information has changed, the agreement has been amended and the card issuer must submit the entire amended agreement to the Board no later than January 31.

3. Change-in-terms notices not permissible. Section 226.58(c)(3) requires that if an agreement previously submitted to the Board is amended, the card issuer must submit the entire revised agreement to the Board. A card issuer may not fulfill this requirement by submitting a change-in-terms or similar notice covering only the terms that have changed. In addition, amendments must be integrated into the text of the agreement (or the addenda described in § 226.58(c)(8)), not provided as separate riders. For example, a card issuer changes the purchase APR associated with an agreement the issuer has previously submitted to the Board. The purchase APR for that agreement was included in the addendum of pricing information, as required by § 226.58(c)(8). The card issuer may not submit a change-in-terms or similar notice reflecting the change in APR, either alone or accompanied by the original text of the agreement and original pricing information addendum. Instead, the card issuer must revise the pricing information addendum to reflect the change in APR and submit to the Board the entire text of the agreement and the entire revised addendum, even though no changes have been made to the provisions of the agreement and only one item on the pricing information addendum has changed.

58(c)(4) Withdrawal of agreements.

1. Notice of withdrawal of agreement. Section 226.58(c)(4) requires a card issuer to notify the Board if any agreement previously submitted to the Board by that issuer is no longer offered to the public by the first quarterly submission deadline after the last day of the calendar quarter in which the card issuer ceased to offer the agreement. For example, on January 5 a card issuer stops offering to the public an agreement it previously submitted to the Board. The card issuer must notify the Board that the agreement is being withdrawn by April 30, the first quarterly submission deadline after March 31, the last day of the calendar quarter in which the card issuer stopped offering the agreement.

58(c)(5) De minimis exception.

1. Relationship to other exceptions. The de minimis exception is distinct from the private label credit card exception under § 226.58(c)(6) and the product testing exception under § 226.58(c)(7). The de minimis exception provides that a card issuer with fewer than 10,000 open credit card accounts is not required to submit any agreements to the Board, regardless of whether those agreements qualify for the private label credit card exception or the product testing exception. In contrast, the private label credit card exception and the product testing exception provide that a card issuer is not required to submit to the Board agreements offered solely in connection with certain types of credit card plans with fewer than 10,000 open accounts, regardless of the card issuer's total number of open accounts.

2. De minimis exception. Under § 226.58(c)(5), a card issuer is not required to submit any credit card agreements to the Board under § 226.58(c)(1) if the card issuer has fewer than 10,000 open credit card accounts as of the last business day of the calendar quarter. For example, a card issuer offers five credit card agreements to the public as of September 30. However, the card issuer has only 2,000 open credit card accounts as of September 30. The card issuer is not required to submit any agreements to the Board by October 31 because the issuer qualifies for the de minimis exception.

3. Date for determining whether card issuer qualifies clarified. Whether a card issuer qualifies for the de minimis exception is determined as of the last business day of each calendar quarter. For example, as of December 31, a card issuer offers three agreements to the public and has 9,500 open credit card accounts. As of January 30, the card issuer still offers three agreements, but has 10,100 open accounts. As of March 31, the card issuer still offers three agreements, but has only 9,700 open accounts. Even though the card issuer had 10,100 open accounts at one time during the calendar quarter, the card issuer qualifies for the de minimis exception because the number of open accounts was less than 10,000 as of March 31. The card issuer therefore is not required to submit any agreements to the Board under § 226.58(c)(1) by April 30.

4. Date for determining whether card issuer ceases to qualify clarified. Whether a card issuer has ceased to qualify for the de minimis exception under § 226.58(c)(5) is determined as of the last business day of the calendar quarter, For example, as of June 30, a card issuer offers three agreements to the public and has 9,500 open credit card accounts. The card issuer is not required to submit any agreements to the Board under § 226.58(c)(1) because the card issuer qualifies for the de minimis exception. As of July 15, the card issuer still offers the same three agreements, but now has 10,000 open accounts. The card issuer is not required to take any action at this time, because whether a card issuer qualifies for the de minimis exception under § 226.58(c)(5) is determined as of the last business day of the calendar quarter. As of September 30, the card issuer still offers the same three agreements and still has 10,000 open accounts. Because the card issuer had 10,000 open accounts as of September 30, the card issuer ceased to qualify for the de minimis exception and must submit the three agreements it offers to the Board by October 31, the next quarterly submission deadline.

5. Option to withdraw agreements clarified. Section 226.58(c)(5) provides that if a card issuer that did not previously qualify for the de minimis exception qualifies for the de minimis exception, the card issuer must continue to make quarterly submissions to the Board as required by § 226.58(c)(1) until the card issuer notifies the Board that the issuer is withdrawing all agreements it previously submitted to the Board. For example, a card issuer has 10,001 open accounts and offers three agreements to the public as of December 31. The card issuer has submitted each of the three agreements to the Board as required under § 226.58(c)(1). As of March 31, the card issuer has only 9,999 open accounts. The card issuer has two options. First, the card issuer may notify the Board that the card issuer is withdrawing each of the three agreements it previously submitted. Once the card issuer has notified the Board, the card issuer is no longer required to make quarterly submissions to the Board under § 226.58(c)(1). Alternatively, the card issuer may choose not to notify the Board that it is withdrawing its agreements. In this case, the card issuer must continue making quarterly submissions to the Board as required by § 226.58(c)(1). The card issuer might choose not to withdraw its agreements if, for example, the card issuer believes that it likely will cease to qualify for the de minimis exception again in the near future.

58(c)(6) Private label credit card exception.

1. Private label credit card exception. Under § 226.58(c)(6)(i), a card issuer is not required to submit to the Board a credit card agreement if, as of the last business day of the calendar quarter, the agreement: (A) Is offered for accounts under one or more private label credit card plans each of which has fewer than 10,000 open accounts; and (B) is not offered to the public other than for accounts under such a plan. For example, a card issuer offers to the public a credit card agreement offered solely for private label credit card accounts with credit cards that can be used only at Merchant A. The card issuer has 8,000 open accounts with such credit cards usable only at Merchant A. The card issuer is not required to submit this agreement to the Board under § 226.58(c)(1) because the agreement is offered for a private label

credit card plan with fewer than 10,000 open accounts, and the credit card agreement is not offered to the public other than for accounts under that private label credit card plan.

In contrast, assume the same card issuer also offers to the public a different credit card agreement that is offered solely for private label credit card accounts with credit cards usable only at Merchant B. The card issuer has 12,000 open accounts with such credit cards usable only at Merchant B. The private label credit card exception does not apply. Although this agreement is offered for a private label credit card plan (i.e., the 12,000 private label credit card accounts with credit cards usable only at Merchant B), and the agreement is not offered to the public other than for accounts under that private label credit card plan, the private label credit card plan has more than 10,000 open accounts. (The card issuer still is not required to submit to the Board the agreement offered in connection with credit cards usable only at Merchant A, as each agreement is evaluated separately under the private label credit card exception.)

2. Card issuers with small private label and other credit card plans. Whether the private label credit card exception applies is determined on an agreement-by-agreement basis. Therefore, some agreements offered by a card issuer may qualify for the private label credit card exception even though the card issuer also offers other agreements that do not qualify, such as agreements offered for accounts with cards usable at multiple unaffiliated merchants or agreements offered for accounts under private label plans with 10,000 or more open accounts.

3. De minimis exception distinguished. The private label credit card exception under § 226.58(c)(6) is distinct from the de minimis exception under § 226.58(c)(5). The private label credit card exception exempts card issuers from submitting certain agreements to the Board regardless of the card issuer's overall size as measured by total number of open accounts. In contrast, the de minimis exception exempts a particular card issuer from submitting any credit card agreements to the Board if the card issuer has fewer than 10,000 total open accounts. For example, a card issuer offers to the public two credit card agreements. Agreement A is offered solely for private label credit card accounts with credit cards usable only at Merchant A. The card issuer has 5,000 open credit card accounts with such credit cards usable only at Merchant A. Agreement B is offered solely for credit card accounts with cards usable at multiple unaffiliated merchants that participate in a major payment network. The card issuer has 40,000 open credit card accounts with such payment network cards. The card issuer is not required to submit agreement A to the Board under § 226.58(c)(1) because agreement A qualifies for the private label credit card exception under § 226.58(c)(6). Agreement A is offered for accounts under a private label credit card plan with fewer than 10,000 open accounts (i.e., the 5,000 accounts with credit cards usable only at Merchant A) and is not otherwise offered to the public. The card issuer is required to submit agreement B to the Board under § 226.58(c)(1). The card issuer does not qualify for the de minimis exception under § 226.58(c)(5) because it has more than 10,000 open accounts, and agreement B does not qualify for the private label credit card exception under § 226.58(c)(6) because it is not offered solely for accounts under a private label credit card plan with fewer than 10,000 open accounts.

4. Agreement otherwise offered to the public. An agreement qualifies for the private label exception only if it is offered for accounts under one or more private label credit card plans with fewer than 10,000 open accounts and is not offered to the public other than for accounts under such a plan. For example, a card issuer offers a single agreement to the public. The agreement is offered for private label credit card accounts with credit cards usable only at Merchant A. The card issuer has 9,000 such open accounts with credit cards usable only at Merchant A. The agreement also is offered for credit card accounts with credit cards usable at multiple unaffiliated merchants that participate in a major payment network. The agreement does not qualify for the private label credit card exception. The agreement is offered for accounts under a private label credit card plan with fewer than 10,000 open accounts. However, the agreement also is offered to the public for accounts that are not part of a private label credit card plan and therefore does not qualify for

the private label credit card exception.

Similarly, an agreement does not qualify for the private label credit card exception if it is offered in connection with one private label credit card plan with fewer than 10,000 open accounts and one private label credit card plan with 10,000 or more open accounts. For example, a card issuer offers a single credit card agreement to the public. The agreement is offered for two types of accounts. The first type of account is a private label credit card account with a credit card usable only at Merchant A. The second type of account is a private label credit card account with a credit card usable only at Merchant B. The card issuer has 10,000 such open accounts with credit cards usable only at Merchant A and 5,000 such open accounts with credit cards usable only at Merchant B. The agreement does not qualify for the private label credit card exception. While the agreement is offered for accounts under a private label credit card plan with fewer than 10,000 open accounts (i.e., the 5,000 open accounts with credit cards usable only at Merchant B), the agreement is also offered for accounts not under such a plan (i.e., the 10,000 open accounts with credit cards usable only at Merchant A).

5. Agreement used for multiple small private label plans. The private label exception applies even if the same agreement is used for more than one private label credit card plan with fewer than 10,000 open accounts. For example, a card issuer has 15,000 total open private label credit card accounts. Of these, 7,000 accounts have credit cards usable only at Merchant A, 5,000 accounts have credit cards usable only at Merchant B, and 3,000 accounts have credit cards usable only at Merchant C. The card issuer offers to the public a single credit card agreement that is offered for all three types of accounts and is not offered for any other type of account. The card issuer is not required to submit the agreement to the Board under § 226.58(c)(1). The agreement is used for three different private label credit card plans (i.e., the accounts with credit cards usable at Merchant A, the accounts with credit cards usable at Merchant B, and the accounts with credit cards usable at Merchant C), each of which has fewer than 10,000 open accounts, and the card issuer does not offer the agreement for any other type of account. The agreement therefore qualifies for the private label credit card exception under § 226.58(c)(6).

6. Multiple agreements used for one private label credit card plan. The private label credit card exception applies even if a card issuer offers more than one agreement in connection with a particular private label credit card plan. For example, a card issuer has 5,000 open private label credit card accounts with credit cards usable only at Merchant A. The card issuer offers to the public three different agreements each of which may be used in connection with private label credit card accounts with credit cards usable only at Merchant A. The agreements are not offered for any other type of credit card account. The card issuer is not required to submit any of the three agreements to the Board under § 226.58(c)(1) because each of the agreements is used for a private label credit card plan which has fewer than 10,000 open accounts and none of the three is offered to the public other than for accounts under such a plan.

58(c)(8) Form and content of agreements submitted to the Board.

1. "As of" date clarified. Agreements submitted to the Board must contain the provisions of the agreement and pricing information in effect as of the last business day of the preceding calendar quarter. For example, on June 1, a card issuer decides to decrease the purchase APR associated with one of the agreements it offers to the public. The change in the APR will become effective on August 1. If the card issuer submits the agreement to the Board on July 31 (for example, because the agreement has been otherwise amended), the agreement submitted should not include the new lower APR because that APR was not in effect on June 30, the last business day of the preceding calendar quarter.

2. Pricing agreement addendum. Pricing information must be set forth in the separate addendum described in § 226.58(c)(8)(ii)(A) even if it is also stated elsewhere in the agreement.

3. Pricing agreement variations do not constitute separate agreements. Pricing information that may vary from one cardholder to another depending on the cardholder's creditworthiness or state of residence or other factors must be disclosed by setting forth all the possible variations or by providing a range of possible variations. Two agreements that differ only with respect to variations in the pricing information do not constitute separate agreements for purposes of this section. For example, a card issuer offers two types of credit card accounts that differ only with respect to the purchase APR. The purchase APR for one type of account is 15 percent, while the purchase APR for the other type of account is 18 percent. The provisions of the agreement and pricing information for the two types of accounts are otherwise identical. The card issuer should not submit to the Board one agreement with a pricing information addendum listing a 15 percent purchase APR and another agreement with a pricing information addendum listing an 18 percent purchase APR. Instead, the card issuer should submit to the Board one agreement with a pricing information addendum listing possible purchase APRs of 15 or 18 percent.

4. Optional variable terms addendum. Examples of provisions that might be included in the variable terms addendum include a clause that is required by law to be included in credit card agreements in a particular state but not in other states (unless, for example, a clause is included in the agreement used for all cardholders under a heading such as "For State X Residents"), the name of the credit card plan to which the agreement applies (if this information is included in the agreement), or the name of a charitable organization to which donations will be made in connection with a particular card (if this information is included in the agreement).

5. Integrated agreement requirement. Card issuers may not provide provisions of the agreement or pricing information in the form of change-in-terms notices or riders. The only two addenda that may be submitted as part of an agreement are the pricing information addendum and optional variable terms addendum described in § 226.58(c)(8). Changes in provisions or pricing information must be integrated into the body of the agreement, pricing information addendum, or optional variable terms addendum described in § 226.58(c)(8). For example, it would be impermissible for a card issuer to submit to the Board an agreement in the form of a terms and conditions document dated January 1, 2005, four subsequent change in terms notices, and 2 addenda showing variations in pricing information. Instead, the card issuer must submit a document that integrates the changes made by each of the change in terms notices into the body of the original terms and conditions document and a single addendum displaying variations in pricing information.

58(d) Posting of agreements offered to the public.

1. Requirement applies only to agreements submitted to the Board. Card issuers are only required to post and maintain on their publicly available Web site the credit card agreements that the card issuer must submit to the Board under § 226.58(c). If, for example, a card issuer is not required to submit any agreements to the Board because the card issuer qualifies for the de minimis exception under § 226.58(c)(5), the card issuer is not required to post and maintain any agreements on its Web site under § 226.58(d). Similarly, if a card issuer is not required to submit a specific agreement to the Board, such as an agreement that qualifies for the private label exception under § 226.58(c)(6), the card issuer is not required to post and maintain that agreement under § 226.58(d) (either on the card issuer's publicly available Web site or on the publicly available Web sites of merchants at which private label credit cards can be used). (The card issuer

in both of these cases is still required to provide each individual cardholder with access to his or her specific credit card agreement under § 226.58(e) by posting and maintaining the agreement on the card issuer's Web site or by providing a copy of the agreement upon the cardholder's request.)

2. Card issuers that do not otherwise maintain Web sites. Unlike § 226.58(e), § 226.58(d) does not include a special rule for card issuers that do not otherwise maintain a Web site. If a card issuer is required to submit one or more agreements to the Board under § 226.58(c), that card issuer must post those agreements on a publicly available Web site it maintains (or, with respect to an agreement for a private label credit card, on the publicly available Web site of at least one of the merchants at which the card may be used, as provided in § 226.58(d)(1)).

3. Private label credit card plans. Section 226.58(d) provides that, with respect to an agreement offered solely for accounts under one or more private label credit card plans, a card issuer may comply by posting and maintaining the agreement on the Web site of at least one of the merchants at which the cards issued under each private label credit card plan with 10,000 or more open accounts may be used. For example, a card issuer has 100,000 open private label credit card accounts. Of these, 75,000 open accounts have credit cards usable only at Merchant A and 25,000 open accounts have credit cards usable only at Merchant B and Merchant B's affiliates, Merchants C and D. The card issuer offers to the public a single credit card agreement that is offered for both of these types of accounts and is not offered for any other type of account.

The card issuer is required to submit the agreement to the Board under § 226.58(c)(1). (The card issuer has more than 10,000 open accounts, so the § 226.58(c)(5) de minimis exception does not apply. The agreement is offered solely for two different private label credit card plans (i.e., one plan consisting of the accounts with credit cards usable at Merchant A and one plan consisting of the accounts with credit cards usable at Merchant B and its affiliates, Merchants C and D), but both of these plans have more than 10,000 open accounts, so the § 226.58(c)(6) private label credit card exception does not apply. Finally, the agreement is not offered solely in connection with a product test by the card issuer, so the § 226.58(c)(7) product test exception does not apply.)

Because the card issuer is required to submit the agreement to the Board under § 226.58(c)(1), the card issuer is required to post and maintain the agreement on the card issuer's publicly available Web site under § 226.58(d). However, because the agreement is offered solely for accounts under one or more private label credit card plans, the card issuer may comply with § 226.58(d) in either of two ways. First, the card issuer may comply by posting and maintaining the agreement on the card issuer's own publicly available Web site. Alternatively, the card issuer may comply by posting and maintaining the agreement on the publicly available Web site of Merchant A and the publicly available Web site of at least one of Merchants B, C and D. It would not be sufficient for the card issuer to post the agreement on Merchant A's Web site alone because § 226.58(d) requires the card issuer to post the agreement on the publicly available Web site of "at least one of the merchants at which cards issued under each private label credit card plan may be used" (emphasis added).

In contrast, assume that a card issuer has 100,000 open private label credit card accounts. Of these, 5,000 open accounts have credit cards usable only at Merchant A and 95,000 open accounts have credit cards usable only at Merchant B and Merchant B's affiliates, Merchants C and D. The card issuer offers to the public a single credit card agreement that is offered for both of these types of accounts and is not offered for any other type of account.

The card issuer is required to submit the agreement to the Board under § 226.58(c)(1). (The card issuer has more than 10,000 open accounts, so the § 226.58(c)(5) de minimis exception does not apply. The agreement is offered solely for two different private label credit card plans (i.e., one plan consisting of the accounts with credit cards usable at Merchant A and one plan consisting of the accounts with credit cards usable at Merchant B and its affiliates, Merchants

C and D), but one of these plans has more than 10,000 open accounts, so the § 226.58(c)(6) private label credit card exception does not apply. Finally, the agreement is not offered solely in connection with a product test by the card issuer, so the § 226.58(c)(7) product test exception does not apply.)

Because the card issuer is required to submit the agreement to the Board under § 226.58(c)(1), the card issuer is required to post and maintain the agreement on the card issuer's publicly available Web site under § 226.58(d). However, because the agreement is offered solely for accounts under one or more private label credit card plans, the card issuer may comply with § 226.58(d) in either of two ways. First, the card issuer may comply by posting and maintaining the agreement on the card issuer's own publicly available Web site. Alternatively, the card issuer may comply by posting and maintaining the agreement on the publicly available Web site of at least one of Merchants B, C and D. The card issuer is not required to post and maintain the agreement on the publicly available Web site of Merchant A because the card issuer's private label credit card plan consisting of accounts with cards usable only at Merchant A has fewer than 10,000 open accounts.

58(e) Agreements for all open accounts.

1. Requirement applies to all open accounts. The requirement to provide access to credit card agreements under § 226.58(e) applies to all open credit card accounts, regardless of whether such agreements are required to be submitted to the Board pursuant to § 226.58(c) (or posted on the card issuer's Web site pursuant to § 226.58(d)). For example, a card issuer that is not required to submit agreements to the Board because it qualifies for the de minimis exception under § 226.58(c)(5)) would still be required to provide cardholders with access to their specific agreements under § 226.58(e). Similarly, an agreement that is no longer offered to the public would not be required to be submitted to the Board under § 226.58(c), but would still need to be provided to the cardholder to whom it applies under § 226.58(e).

2. Readily available telephone line. Section 226.58(e) provides that card issuers that provide copies of cardholder agreements upon request must provide the cardholder with the ability to request a copy of their agreement by calling a readily available telephone line. To satisfy the readily available standard, the financial institution must provide enough telephone lines so that consumers get a reasonably prompt response. The institution need only provide telephone service during normal business hours. Within its primary service area, an institution must provide a local or toll-free telephone number. It need not provide a toll-free number or accept collect long-distance calls from outside the area where it normally conducts business.

3. Issuers without interactive Web sites. Section 226.58(e)(2) provides that a card issuer that does not maintain a Web site from which cardholders can access specific information about their individual accounts is not required to provide a cardholder with the ability to request a copy of the agreement by using the card issuer's Web site. A card issuer without a Web site of any kind could comply by disclosing the telephone number on each periodic statement; a card issuer with a non-interactive Web site could comply in the same way, or alternatively could comply by displaying the telephone number on the card issuer's Web site.

4. Deadline for providing requested agreements clarified. Sections 226.58(e)(1)(ii) and (e)(2) require that credit card agreements provided upon request must be sent to the cardholder or otherwise made available to the cardholder in electronic or paper form no later than 30 days after the cardholder's request is received. For example, if a card issuer chooses to respond to a cardholder's request by mailing a paper copy of the cardholder's agreement, the card issuer must

mail the agreement no later than 30 days after receipt of the cardholder's request. Alternatively, if a card issuer chooses to respond to a cardholder's request by posting the cardholder's agreement on the card issuer's Web site, the card issuer must post the agreement on its Web site no later than 30 days after receipt of the cardholder's request. Section 226.58(e)(3)(v) provides that a card issuer may provide cardholder agreements in either electronic or paper form regardless of the form of the cardholder's request.

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APPENDIX A EFFECT ON STATE LAWS

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APPENDIX A EFFECT ON STATE LAWS

1. Who may make requests. Appendix A sets forth the procedures for preemption determinations. As discussed in *§ 226.28*, which contains the standards for preemption, a request for a determination of whether a state law is inconsistent with the requirements of chapters 1, 2, or 3 may be made by creditors, states, or any interested party. However, only states may request and receive determinations in connection with the fair credit billing provisions of chapter 4.

References

Statute: Sections 111 and 171(a).

Other sections: Section 226.28.

Previous regulation: Sections 226.6(b) and 226.70 (Supplement V, Section II).

1981 changes: The procedures in appendix A were largely adapted from Supplement V, Section II of the previous regulation (§ 226.70), with changes made to streamline the procedures.

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APPENDIX B STATE EXEMPTIONS

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APPENDIX B STATE EXEMPTIONS

1. General. Appendix B sets forth the procedures for exemption applications. The exemption standards are found in § 226.29 and are discussed in the commentary to that section.

References

Statute: Sections 123 and 171(b).

Other sections: Section 226.29.

Previous regulation: Sections 226.12, 226.50 (Supplement II), 226.60 (Supplement IV), and 226.70 (Supplement V, Section I).

1981 changes: The procedures in appendix B represent a combination and streamlining of the procedures set forth in the supplements to the previous regulation.

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APPENDIX C ISSUANCE OF STAFF INTERPRETATIONS

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APPENDIX C ISSUANCE OF STAFF INTERPRETATIONS

1. General. This commentary is the vehicle for providing official staff interpretations. Individual interpretations generally will not be issued separately from the commentary.

References

Statute: Sections 105 and 130(f).

Other sections: None.

Previous regulation: Section 226.1(d).

1981 changes: Appendix C reflects the Board's intention that this commentary serve as the vehicle for interpreting the regulation, rather than individual interpretive letters.

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APPENDIX D MULTIPLE-ADVANCE CONSTRUCTION LOANS

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APPENDIX D MULTIPLE-ADVANCE CONSTRUCTION LOANS

1. General rule. Appendix D provides a special procedure that creditors may use, at their option, to estimate and disclose the terms of multiple-advance construction loans when the amounts or timing of advances is unknown at consummation of the transaction. This appendix reflects the approach taken in § 226.17(c)(6)(ii), which permits creditors to provide separate or combined disclosures for the construction period and for the permanent financing, if any; i.e., the construction phase and the permanent phase may be treated as one transaction or more than one transaction. Appendix D may also be used in multiple-advance transactions other than construction loans, when the amounts or timing of advances is unknown at consummation.

2. Variable-rate multiple-advance loans. The hypothetical disclosure required in variable-rate transactions by § 226.18(f)(1)(iv) is not required for multiple-advance loans disclosed pursuant to appendix D, part I.

3. Calculation of the total of payments. When disclosures are made pursuant to appendix D, the total of payments may reflect either the sum of the payments or the sum of the amount financed and the finance charge.

4. Annual percentage rate. Appendix D does not require the use of Volume I of the Board's Annual Percentage Rate Tables for calculation of the annual percentage rate. Creditors utilizing appendix D in making calculations and disclosures may use other computation tools to determine the estimated annual percentage rate, based on the finance charge and payment schedule obtained by use of the appendix.

5. Interest reserves. In a multiple-advance construction loan, a creditor may establish an "interest reserve" to ensure that interest is paid as it accrues by designating a portion of the loan to be used for paying the interest that accrues on the loan. An interest reserve is not treated as a prepaid finance charge, whether the interest reserve is the same as or different from the estimated interest figure calculated under appendix D.

- If a creditor permits a consumer to make interest payments as they become due, the interest reserve should be disregarded in the disclosures and calculations under appendix D.

- If a creditor requires the establishment of an interest reserve and automatically deducts interest payments from the reserve amount rather than allow the consumer to make interest payments as they become due, the fact that interest will accrue on those interest payments as well as the other loan proceeds must be reflected in the calculations and disclosures. To reflect the effects of such compounding, a creditor should first calculate interest on the commitment amount (exclusive of the interest reserve) and then add the figure obtained by assuming that one-half of that interest is outstanding at the contract interest rate for the entire construction period. For example, using the example shown under paragraph A, part I of appendix D, the estimated interest would be $1,117.68 ($1093.75 plus an additional $23.93 calculated by assuming half of $1093.75 is outstanding at the contract interest rate for the entire construction period), and the estimated annual percentage rate would be 21.18%.

References

Statute: None.

Other sections: Sections 226.17 and 226.22.

Previous regulation: Interpretation § 226.813.

1981 changes: The use of appendix D is limited to multiple-advance loans for construction purposes or analogous types of transactions.

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APPENDIX E RULES FOR CARD ISSUERS THAT BILL ON A TRANSACTION-BY-TRANSACTION BASIS

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APPENDIX E RULES FOR CARD ISSUERS THAT BILL ON A TRANSACTION-BY-TRANSACTION BASIS

Statute: None.

Previous regulation: Interpretation § 226.709.

Other sections: Sections 226.6 through 226.13, and 226.15.

1981 changes: The rules in this appendix have been streamlined and clarified to indicate how certain card issuers that bill on a transaction basis may comply with the requirements of Subpart B.

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APPENDIX F OPTIONAL ANNUAL PERCENTAGE RATE COMPUTATIONS FOR CREDITORS OFFERING OPEN-END PLANS SUBJECT TO THE REQUIREMENTS OF § 226.5b

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APPENDIX F OPTIONAL ANNUAL PERCENTAGE RATE COMPUTATIONS FOR CREDITORS OFFERING OPEN-END PLANS SUBJECT TO THE REQUIREMENTS OF § 226.5b

1. Daily rate with specific transaction charge. If the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate, see comment 14(c)(3)-2 for guidance on an appropriate calculation method.

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APPENDIX G and H OPEN-END AND CLOSED-END MODEL FORMS AND CLAUSES

1B Consumer Credit Law Manual APPENDIX G and H

APPENDIX G and H OPEN-END AND CLOSED-END MODEL FORMS AND CLAUSES

1. Permissible changes. Although use of the model forms and clauses is not required, creditors using them properly will be deemed to be in compliance with the regulation with regard to those disclosures. Creditors may make certain changes in the format or content of the forms and clauses and may delete any disclosures that are inapplicable to a transaction or a plan without losing the act's protection from liability, except formatting changes may not be made to model forms and samples in G-2(A), G-3(A), G-4(A), G-10(A)-(E), G-17(A)-(D), G-18(A) (except as permitted pursuant to § 226.7(b)(2)), G-18(B)-(C), G-19, G-20, and G-21. The rearrangement of the model forms and clauses may not be so extensive as to affect the substance, clarity, or meaningful sequence of the forms and clauses. Creditors making revisions with that effect will lose their protection from civil liability. Except as otherwise specifically required, acceptable changes include, for example:

i. Using the first person, instead of the second person, in referring to the borrower.

ii. Using "borrower" and "creditor" instead of pronouns.

iii. Rearranging the sequences of the disclosures.

iv. Not using bold type for headings.

v. Incorporating certain state "plain English" requirements.

vi. Deleting inapplicable disclosures by whiting out, blocking out, filling in "N/A" (not applicable) or "0," crossing out, leaving blanks, checking a box for applicable items, or circling applicable items. (This should permit use of multipurpose standard forms.)

vii. Using a vertical, rather than a horizontal, format for the boxes in the closed-end disclosures.

2. Debt-cancellation coverage. This regulation does not authorize creditors to characterize debt-cancellation fees as insurance premiums for purposes of this regulation. Creditors may provide a disclosure that refers to debt cancellation or debt suspension coverage whether or not the coverage is considered insurance. Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law.

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APPENDIX G OPEN-END MODEL FORMS AND CLAUSES

1. Models G-1 and G-1(A). The model disclosures in G-1 and G-1(A) (different balance computation methods) may be used in both the account-opening disclosures under § 226.6 and the periodic disclosures under § 226.7. As is clear from the models given, "shorthand" descriptions of the balance computation methods are not sufficient, except where § 226.7(b)(5) applies. For creditors using model G-1, the phrase "a portion of" the finance charge should be included if the total finance charge includes other amounts, such as transaction charges, that are not due to the application of a periodic rate. If unpaid interest or finance charges are subtracted in calculating the balance, that fact must be stated so that the disclosure of the computation method is accurate. Only model G-1(b) contains a final sentence appearing in brackets, which reflects the total dollar amount of payments and credits received during the billing cycle. The other models do not contain this language because they reflect plans in which payments and credits received during the billing cycle are subtracted. If this is not the case, however, the language relating to payments and credits should be changed, and the creditor should add either the disclosure of the dollar amount as in model G-1(b) or an indication of which credits (disclosed elsewhere on the periodic statement) will not be deducted in determining the balance. (Such an indication may also substitute for the bracketed sentence in model G-1(b).) (See the commentary to § 226.7(a)(5) and (b)(5).) For open-end plans subject to the requirements of § 226.5b, creditors may, at their option, use the clauses in G-1 or G-1(A).

2. Models G-2 and G-2(A). These models contain the notice of liability for unauthorized use of a credit card. For home-equity plans subject to the requirements of § 226.5b, at the creditor's option, a creditor either may use G-2 or G-2(A). For open-end plans not subject to the requirements of § 226.5b, creditors properly use G-2(A).

3. Models G-3, G-3(A), G-4 and G-4(A).

i. These set out models for the long-form billing-error rights statement (for use with the account-opening disclosures and as an annual disclosure or, at the creditor's option, with each periodic statement) and the alternative billing-error rights statement (for use with each periodic statement), respectively. For home-equity plans subject to the requirements of § 226.5b, at the creditor's option, a creditor either may use G-3 or G-3(A), and for creditors that use the short form, G-4 or G-4(A). For open-end (not home-secured) plans that not subject to the requirements of § 226.5b, creditors properly use G-3(A) and G-4(A). Creditors must provide the billing-error rights statements in a form substantially similar to the models in order to comply with the regulation. The model billing-rights statements may be modified in any of the ways set forth in the first paragraph to the commentary on appendices G and H. The models may, furthermore, be modified by deleting inapplicable information, such as:

A. The paragraph concerning stopping a debit in relation to a disputed amount, if the creditor does not have the ability to debit automatically the consumer's savings or checking account for payment.

B. The rights stated in the special rule for credit card purchases and any limitations on those rights.

ii. The model billing rights statements also contain optional language that creditors may use. For example, the creditor may:

A. Include a statement to the effect that notice of a billing error must be submitted on something other than the payment ticket or other material accompanying the periodic disclosures.

B. Insert its address or refer to the address that appears elsewhere on the bill.

C. Include instructions for consumers, at the consumer's option, to communicate with the creditor electronically or in writing.

iii. Additional information may be included on the statements as long as it does not detract from the required disclosures. For instance, information concerning the reporting of errors in connection with a checking account may be included on a combined statement as long as the disclosures required by the regulation remain clear and conspicuous.

4. Models G-5 through G-9. These models set out notices of the right to rescind that would be used at different times in an open-end plan. The last paragraph of each of the rescission model forms contains a blank for the date by which the consumer's notice of cancellation must be sent or delivered. A parenthetical is included to address the situation in which

the consumer's right to rescind the transaction exists beyond 3 business days following the date of the transaction, for example, when the notice or material disclosures are delivered late or when the date of the transaction in paragraph 1 of the notice is an estimate. The language of the parenthetical is not optional. See the commentary to section 226.2(a)(25) regarding the specificity of the security interest disclosure for model form G-7.

5. Model G-10(A), samples G-10(B) and G-10(C), model G-10(D), sample G-10(E), model G-17(A), and samples G-17(B), 17(C) and 17(D).

i. Model G-10(A) and Samples G-10(B) and G-10(C) illustrate, in the tabular format, the disclosures required under § 226.5a for applications and solicitations for credit cards other than charge cards. Model G-10(D) and Sample G-10(E) illustrate the tabular format disclosure for charge card applications and solicitations and reflect the disclosures in the table. Model G-17(A) and Samples G-17(B), G-17(C) and G-17(D) illustrate, in the tabular format, the disclosures required under § 226.6(b)(2) for account-opening disclosures.

ii. Except as otherwise permitted, disclosures must be substantially similar in sequence and format to Models G-10(A), G-10(D) and G-17(A). While proper use of the model forms will be deemed in compliance with the regulation, card issuers and other creditors offering open-end (not home-secured) plans are permitted to disclose the annual percentage rates for purchases, cash advances, or balance transfers in the same row in the table for any transaction types for which the issuer or creditor charges the same annual percentage rate. Similarly, card issuer and other creditors offering open-end (not home-secured) plans are permitted to disclose fees of the same amount in the same row if the fees are in the same category. Fees in different categories may not be disclosed in the same row. For example, a transaction fee and a penalty fee that are of the same amount may not be disclosed in the same row. Card issuers and other creditors offering open-end (not home-secured) plans are also permitted to use headings other than those in the forms if they are clear and concise and are substantially similar to the headings contained in model forms, with the following exceptions. The heading "penalty APR" must be used when describing rates that may increase due to default or delinquency or as a penalty, and in relation to required insurance, or debt cancellation or suspension coverage, the term "required" and the name of the product must be used. (See also §§ 226.5a(b)(5) and 226.6(b)(2)(v) for guidance on headings that must be used to describe the grace period, or lack of grace period, in the disclosures required under § 226.5a for applications and solicitations for credit cards other than charge cards, and the disclosures required under § 226.6(b)(2) for account-opening disclosures, respectively.)

iii. Models G-10(A) and G-17(A) contain two alternative headings ("Minimum Interest Charge" and "Minimum Charge") for disclosing a minimum interest or fixed finance charge under §§ 226.5a(b)(3) and 226.6(b)(2)(iii). If a creditor imposes a minimum charge in lieu of interest in those months where a consumer would otherwise incur an interest charge but that interest charge is less than the minimum charge, the creditor should disclose this charge under the heading "Minimum Interest Charge" or a substantially similar heading. Other minimum or fixed finance charges should be disclosed under the heading "Minimum Charge" or a substantially similar heading.

iv. Models G-10(A), G-10(D) and G-17(A) contain two alternative headings ("Annual Fees" and "Set-up and Maintenance Fees") for disclosing fees for issuance or availability of credit under § 226.5a(b)(2) or § 226.6(b)(2)(ii). If the only fee for issuance or availability of credit disclosed under § 226.5a(b)(2) or § 226.6(b)(2)(ii) is an annual fee, a

creditor should use the heading "Annual Fee" or a substantially similar heading to disclose this fee. If a creditor imposes fees for issuance or availability of credit disclosed under § 226.5a(b)(2) or § 226.6(b)(2)(ii) other than, or in addition to, an annual fee, the creditor should use the heading "Set-up and Maintenance Fees" or a substantially similar heading to disclose fees for issuance or availability of credit, including the annual fee.

v. Although creditors are not required to use a certain paper size in disclosing the §§ 226.5a or 226.6(b)(1) and (2) disclosures, samples G-10(B), G-10(C), G-17(B), G-17(C) and G-17(D) are designed to be printed on an 8 1/2 x 14 inch sheet of paper. A creditor may use a smaller sheet of paper, such as 8 1/2 x 11 inch sheet of paper. If the table is not provided on a single side of a sheet of paper, the creditor must include a reference or references, such as "SEE BACK OF PAGE for more important information about your account." at the bottom of each page indicating that the table continues onto an additional page or pages. A creditor that splits the table onto two or more pages must disclose the table on consecutive pages and may not include any intervening information between portions of the table. In addition, the following formatting techniques were used in presenting the information in the sample tables to ensure that the information is readable:

A. A readable font style and font size (10-point Arial font style, except for the purchase annual percentage rate which is shown in 16-point type).

B. Sufficient spacing between lines of the text.

C. Adequate spacing between paragraphs when several pieces of information were included in the same row of the table, as appropriate. For example, in the samples in the row of the tables with the heading "APR for Balance Transfers," the forms disclose two components: the applicable balance transfer rate and a cross reference to the balance transfer fee. The samples show these two components on separate lines with adequate space between each component. On the other hand, in the samples, in the disclosure of the late payment fee, the forms disclose two components: the late payment fee, and the cross reference to the penalty rate. Because the disclosure of both these components is short, these components are disclosed on the same line in the tables.

D. Standard spacing between words and characters. In other words, the text was not compressed to appear smaller than 10-point type.

E. Sufficient white space around the text of the information in each row, by providing sufficient margins above, below and to the sides of the text.

F. Sufficient contrast between the text and the background. Generally, black text was used on white paper.

vi. While the Board is not requiring issuers to use the above formatting techniques in presenting information in the table (except for the 10-point and 16-point font requirement), the Board encourages issuers to consider these techniques when deciding how to disclose information in the table, to ensure that the information is presented in a readable format.

vii. Creditors are allowed to use color, shading and similar graphic techniques with respect to the table, so long as the table remains substantially similar to the model and sample forms in appendix G.

6. Model G-11. Model G-11 contains clauses that illustrate the general disclosures required under § 226.5a(e) in applications and solicitations made available to the general public.

7. Models G-13(A) and G-13(B). These model forms illustrate the disclosures required under § 226.9(f) when the card issuer changes the entity providing insurance on a credit card account. Model G-13(A) contains the items set forth in § 226.9(f)(3) as examples of significant terms of coverage that may be affected by the change in insurance provider. The card issuer may either list all of these potential changes in coverage and place a check mark by the applicable changes, or list only the actual changes in coverage. Under either approach, the card issuer must either explain the changes or refer to an accompanying copy of the policy or group certificate for details of the new terms of coverage. Model G-13(A) also illustrates the permissible combination of the two notices required by § 226.9(f) -- the notice required for a planned change in provider and the notice required once a change has occurred. This form may be modified for use in providing only the disclosures required before the change if the card issuer chooses to send two separate notices. Thus, for example, the references to the attached policy or certificate would not be required in a separate notice prior to a change in the insurance provider since the policy or certificate need not be provided at that time. Model G-13(B) illustrates the disclosures required under § 226.9(f)(2) when the insurance provider is changed.

8. Samples G-18(A)-(D). For home-equity plans subject to the requirements of § 226.5b, if a creditor chooses to comply with the requirements in § 226.7(b), the creditor may use Samples G-18(A) through G-18(D) to comply with these requirements, as applicable.

9. Samples G-18(D). Sample G-18(D) illustrates how credit card issuers may comply with proximity requirements for payment information on periodic statements. Creditors that offer card accounts with a charge card feature and a revolving feature may change the disclosure to make clear to which feature the disclosures apply.

10. Forms G-18(F)-(G). Forms G-18(F) and G-18(G) are intended as a compliance aid to illustrate front sides of a periodic statement, and how a periodic statement for open-end (not home-secured) plans might be designed to comply with the requirements of § 226.7. The samples contain information that is not required by Regulation Z. The samples also present information in additional formats that are not required by Regulation Z.

i. Creditors are not required to use a certain paper size in disclosing the § 226.7 disclosures. However, Forms G-18(F) and G-18(G) are designed to be printed on an 8 x 14 inch sheet of paper.

ii. The due date for a payment, if a late payment fee or penalty rate may be imposed, must appear on the front of the first page of the statement. See Sample G-18(D) that illustrates how a creditor may comply with proximity requirements for other disclosures. The payment information disclosures appear in the upper right-hand corner on Samples G-18(F) and G-18(G), but may be located elsewhere, as long as they appear on the front of the first page of the periodic statement. The summary of account activity presented on Samples G-18(F) and G-18(G) is not itself a required disclosure, although the previous balance and the new balance, presented in the summary, must be disclosed in a clear and conspicuous manner on periodic statements.

iii. Additional information not required by Regulation Z may be presented on the statement. The information need not be located in any particular place or be segregated from disclosures required by Regulation Z, although the effect of proximity requirements for required disclosures, such as the due date, may cause the additional information to be segregated from those disclosures required to be disclosed in close proximity to one another. Any additional information must be presented consistent with the creditor's obligation to provide required disclosures in a clear and conspicuous manner.

iv. Model Forms G-18(F) and G-18(G) demonstrate two examples of ways in which transactions could be presented on the periodic statement. Model Form G-18(G) presents transactions grouped by type and Model Form G-18(F) presents transactions in a list in chronological order. Neither of these approaches to presenting transactions is required; a creditor may present transactions differently, such as in a list grouped by authorized user or other means.

11. Model Form G-19. See § 226.9(b)(3) regarding the headings required to be disclosed when describing in the tabular disclosure a grace period (or lack of a grace period) offered on check transactions that access a credit card account.

12. Sample G-24. Sample G-24 includes two model clauses for use in complying with § 226.16(h)(4). Model clause (a) is for use in connection with credit card accounts under an open-end (not home-secured) consumer credit plan. Model clause (b) is for use in connection with other open-end credit plans.

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APPENDIX H CLOSED-END MODEL FORMS AND CLAUSES

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APPENDIX H CLOSED-END MODEL FORMS AND CLAUSES

1. Models H-1 and H-2. Creditors may make several types of changes to closed-end model forms H-1 (credit sale) and H-2 (loan) and still be deemed to be in compliance with the regulation, provided that the required disclosures are made clearly and conspicuously. Permissible changes include the addition of the information permitted by footnote 37 to § 226.17 and "directly related" information as set forth in the commentary to § 226.17(a).

The creditor may also delete or, on multipurpose forms, indicate inapplicable disclosures, such as:

- The itemization of the amount financed option. (See Samples H-12 through H-15.)
- The credit life and disability insurance disclosures. (See Samples H-11 and H-12.)
- The property insurance disclosures. (See Samples H-10 through H-12, and H-14.)
- The "filing fees" and "non-filing insurance" disclosures. (See Samples H-11 and H-12.)
- The prepayment penalty or rebate disclosures. (See Samples H-12 and H-14.)
- The total sale price. (See Samples H-11 through H-15.)

Other permissible changes include:

- Adding the creditor's address or telephone number. (See the commentary to § 226.18(a).)
- Combining required terms where several numerical disclosures are the same, for instance, if the "total of payments" equals the "total sale price." (See the commentary to § 226.18.)

- Rearranging the sequence or location of the disclosures -- for instance, by placing the descriptive phrases outside the boxes containing the corresponding disclosures, or by grouping the descriptors together as a glossary of terms in a separate section of the segregated disclosures; by placing the payment schedule at the top of the form; or by changing the order of the disclosures in the boxes, including the annual percentage rate and finance charge boxes.

- Using brackets, instead of checkboxes, to indicate inapplicable disclosures.

- Using a line for the consumer to initial, rather than a checkbox, to indicate an election to receive an itemization of the amount financed.

- Deleting captions for disclosures.

- Using a symbol, such as an asterisk, for estimated disclosures, instead of an "e."

- Adding a signature line to the insurance disclosures to reflect joint policies.

- Separately itemizing the filing fees.

- Revising the late charge disclosure in accordance with the commentary to § 226.18(l).

2. Model H-3. Creditors have considerable flexibility in filling out Model H-3 (itemization of the amount financed). Appropriate revisions, such as those set out in the commentary to § 226.18(c), may be made to this form without loss of protection from civil liability for proper use of the model forms.

3. Models H-4 through H-7. The model clauses are not included in the model forms although they are mandatory for certain transactions. Creditors using the model clauses when applicable to a transaction are deemed to be in compliance with the regulation with regard to that disclosure.

4. Model H-4(A). This model contains the variable rate model clauses applicable to transactions subject to § 226.18(f)(1) and is intended to give creditors considerable flexibility in structuring variable rate disclosures to fit individual plans. The information about circumstances, limitations, and effects of an increase may be given in terms of the contract interest rate or the annual percentage rate. Clauses are shown for hypothetical examples based on the specific amount of the transaction and based on a representative amount. Creditors may preprint the variable rate disclosures based on a representative amount for similar types of transactions, instead of constructing an individualized example for each transaction. In both representative examples and transaction-specific examples, creditors may refer either to the incremental change in rate, payment amount, or number of payments, or to the resulting rate, payment amount, or number of payments. For example, creditors may state that the rate will increase by 2%, with a corresponding $150 increase in the payment, or creditors may state that the rate will increase to 16%, with a corresponding payment of $850.

5. Model H-4(B). This model clause illustrates the variable-rate disclosure required under § 226.18(f)(2), which would alert consumers to the fact that the transaction contains a variable-rate feature and that disclosures were provided earlier.

6. Model H-4(C). This model clause illustrates the early disclosures required generally under § 226.19(b). It includes information on how the consumer's interest rate is determined and how it can change over the term of the loan, and explains changes that may occur in the borrower's monthly payment. It contains an example of how to disclose historical changes in the index or formula values used to compute interest rates for the preceding 15 years. The model clause also illustrates the disclosure of the initial and maximum interest rates and payments based on an initial interest rate (index value plus margin, adjusted by the amount of any discount or premium) in effect as of an identified month and year for the loan program disclosure and illustrates how to provide consumers with a method for calculating the monthly payment for the loan amount to be borrowed.

7. Model H-4(D). This model clause illustrates the adjustment notice required under § 226.20(c), and provides examples of payment change notices and annual notices of interest rate changes.

8. Model H-5. This contains the demand feature clause.

9. Model H-6. This contains the assumption clause.

10. Model H-7. This contains the required deposit clause.

11. Models H-8 and H-9. These models contain the rescission notices for a typical closed-end transaction and a refinancing, respectively. The last paragraph of each model form contains a blank for the date by which the consumer's notice of cancellation must be sent or delivered. A parenthetical is included to address the situation in which the consumer's right to rescind the transaction exists beyond 3 business days following the date of the transaction, for example, where the notice or material disclosures are delivered late or where the date of the transaction in paragraph 1 of the notice is an estimate. The language of the parenthetical is not optional. See the commentary to section 226.2(a)(25) regarding the specificity of the security interest disclosure for model form H-9. The prior version of model form H-9 is substantially similar to the current version and creditors may continue to use it, as appropriate. Creditors are encouraged, however, to use the current version when reordering or reprinting forms.

12. Sample forms. The sample forms (H-10 through H-15) serve a different purpose than the model forms. The samples illustrate various ways of adapting the model forms to the individual transactions described in the commentary to appendix H. The deletions and rearrangments shown relate only to the specific transactions described. As a result, the samples do not provide the general protection from civil liability provided by the model forms and clauses.

13. Sample H-10. This sample illustrates an automobile credit sale. The cash price is $7,500 with a downpayment of $1,500. There is an 8% add-on interest rate and a term of 3 years, with 36 equal monthly payments. The credit life

insurance premium and the filing fees are financed by the creditor. There is a $25 credit report fee paid by the consumer before consummation, which is a prepaid finance charge.

14. Sample H-11. This sample illustrates an installment loan. The amount of the loan is $5,000. There is a 12% simple interest rate and a term of 2 years. The date of the transaction is expected to be April 15, 1981, with the first payment due on June 1, 1981. The first payment amount is labelled as an estimate since the transaction date is uncertain. The odd days' interest ($26.67) is collected with the first payment. The remaining 23 monthly payments are equal.

15. Sample H-12. This sample illustrates a refinancing and consolidation loan. The amount of the loan is $5,000. There is a 15% simple interest rate and a term of 3 years. The date of the transaction is April 1, 1981, with the first payment due on May 1, 1981. The first 35 monthly payments are equal, with an odd final payment. The credit disability insurance premium is financed. In calculating the annual percentage rate, the U.S. Rule has been used. Since an itemization of the amount financed is included with the disclosures, the statement regarding the consumer's option to receive an itemization is deleted.

16. Samples H-13 through H-15. These samples illustrate various mortgage transactions. They assume that the mortgages are subject to the Real Estate Settlement Procedures Act (RESPA). As a result, no option regarding the itemization of the amount financed has been included in the samples, because providing the good faith estimates of settlement costs required by RESPA satisfies Truth in Lending's amount financed itemization requirement. (See footnote 39 to § 226.18(c).)

17. Sample H-13. This sample illustrates a mortgage with a demand feature. The loan amount is $44,900, payable in 360 monthly installments at a simple interest rate of 14.75%. The 15 days of interim interest ($294.34) is collected as a prepaid finance charge at the time of consummation of the loan (April 15, 1981). In calculating the disclosure amounts, the minor irregularities provision in § 226.17(c)(4) has been used. The property insurance premiums are not included in the payment schedule. This disclosure statement could be used for notes with the 7-year call option required by the Federal National Mortgage Association (FNMA) in states where due-on-sale clauses are prohibited.

18. Sample H-14. This sample disclosure form illustrates the disclosures under § 226.19(b) for a variable-rate transaction secured by the consumer's principal dwelling with a term greater than one year. The sample form shows a creditor how to adapt the model clauses in Appendix H-4(C) to the creditor's own particular variable-rate program. The sample disclosure form describes the features of a specific variable-rate mortgage program and alerts the consumer to the fact that information on the creditor's other closed-end variable-rate programs is available upon request. It includes information on how the interest rate is determined and how it can change over time. Section 226.19(b)(2)(viii) permits creditors the option to provide either a historical example or an initial and maximum interest rates and payments disclosure; both are illustrated in the sample disclosure. The historical example explains how the monthly payment can change based on a $10,000 loan amount, payable in 360 monthly installments, based on historical changes in the values for the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year. Index values are measured for 15 years, as of the first week ending in July. This reflects the requirement that the index history be based on values for the same date or period each year in the example. The sample disclosure also illustrates the alternative disclosure under § 226.19(b)(2)(viii)(B) that the initial and the maximum interest rates and payments be shown for a

$10,000 loan originated at an initial interest rate of 12.41 percent (which was in effect July 1996) and to have 2 percentage point annual (and 5 percentage point overall) interest rate limitations or caps. Thus, the maximum amount that the interest rate could rise under this program is 5 percentage points higher than the 12.41 percent initial rate to 17.41 percent, and the monthly payment could rise from $106.03 to a maximum of $145.34. The loan would not reach the maximum interest rate until its fourth year because of the 2 percentage point annual rate limitations, and the maximum payment disclosed reflects the amortization of the loan during that period. The sample form also illustrates how to provide consumers with a method for calculating their actual monthly payment for a loan amount other than $10,000.

19. Sample H-15. This sample illustrates a graduated payment mortgage with a 5-year graduation period and a 7 1/2 percent yearly increase in payments. The loan amount is $44,900, payable in 360 monthly installments at a simple interest rate of 14.75%. Two points ($898), as well as an initial mortgage guarantee insurance premium of $225.00, are included in the prepaid finance charge. The mortgage guarantee insurance premiums are calculated on the basis of 1/4 of 1% of the outstanding principal balance under an annual reduction plan. The abbreviated disclosure permitted under § 226.18(g)(2) is used for the payment schedule for years 6 through 30. The prepayment disclosure refers to both penalties and rebates because information about penalties is required for the simple interest portion of the obligation and information about rebates is required for the mortgage insurance portion of the obligation.

20. Sample H-16. This sample illustrates the disclosures required under § 226.32(c). The sample illustrates the amount borrowed and the disclosures about optional insurance that are required for mortgage refinancings under § 226.32(c)(5). Creditors may, at their option, include these disclosures for all loans subject to § 226.32. The sample also includes disclosures required under § 226.32(c)(3) when the legal obligation includes a balloon payment.

21. HRSA-500-1 9-82. Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA-500-1 9-82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved for use for loans made prior to the mandatory compliance date of the disclosures required under Subpart F. The form was approved for all Health Education Assistance Loans (HEAL) with a variable interest rate that were considered interim student credit extensions as defined in Regulation Z.

22. HRSA-500-2 9-82. Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA-500-2 9-82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved for use for loans made prior to the mandatory compliance date of the disclosures required under Subpart F. The form was approved for all HEAL loans with a fixed interest rate that were considered interim student credit extensions as defined in Regulation Z.

23. HRSA-502-1 9-82. Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA-502-1 9-82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved for use for loans made prior to the mandatory compliance date of the disclosures required under Subpart F. The form was approved for all HEAL loans with a variable interest rate in which the borrower has reached repayment status and is making payments of both interest and principal.

24. HRSA-502-2 9-82. Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA-502-2 9-82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved for use for loans made prior to the mandatory compliance date of the disclosures required under Subpart F. The form was approved for all HEAL loans with a fixed interest rate in which the borrower has reached repayment status and is making payments of both interest and principal.

25. Models H-18, H-19, H-20.

i. These model forms illustrate disclosures required under § 226.47 on or with an application or solicitation, at approval, and after acceptance of a private education loan. Although use of the model forms is not required, creditors using them properly will be deemed to be in compliance with the regulation with regard to private education loan disclosures. Creditors may make certain types of changes to private education loan model forms H-18 (application and solicitation), H-19 (approval), and H-20 (final) and still be deemed to be in compliance with the regulation, provided that the required disclosures are made clearly and conspicuously. The model forms aggregate disclosures into groups under specific headings. Changes may not include rearranging the sequence of disclosures, for instance, by rearranging which disclosures are provided under each heading or by rearranging the sequence of the headings and grouping of disclosures. Changes to the model forms may not be so extensive as to affect the substance or clarity of the forms. Creditors making revisions with that effect will lose their protection from civil liability.

The creditor may delete inapplicable disclosures, such as:

- The Federal student financial assistance alternatives disclosures
- The self-certification disclosure

Other permissible changes include, for example:

- Adding the creditor's address, telephone number, or Web site
- Adding loan identification information, such as a loan identification number
- Adding the date on which the form was printed or produced
- Placing the notice of the right to cancel in the top left or top right of the disclosure to accommodate a window envelope
- Combining required terms where several numerical disclosures are the same. For instance, if the itemization of the amount financed is provided, the amount financed need not be separately disclosed
- Combining the disclosure of loan term and payment deferral options required in § 226.47(a)(3) with the disclosure of cost estimates required in § 226.47(a)(4) in the same chart or table (See comment 47(a)(3)-4.)
- Using the first person, instead of the second person, in referring to the borrower
- Using "borrower" and "creditor" instead of pronouns

- Incorporating certain state "plain English" requirements

- Deleting inapplicable disclosures by whiting out, blocking out, filling in "N/A" (not applicable) or "0," crossing out, leaving blanks, checking a box for applicable items, or circling applicable items

ii. Although creditors are not required to use a certain paper size in disclosing the §§ 226.47(a), (b) and (c) disclosures, samples H-21, H-22, and H-23 are designed to be printed on two 8 1/2 x 11 inch sheets of paper. A creditor may use a larger sheet of paper, such as 8 1/2 x 14 inch sheets of paper, or may use multiple pages. If the disclosures are provided on two sides of a single sheet of paper, the creditor must include a reference or references, such as "SEE BACK OF PAGE" at the bottom of each page indicating that the disclosures continue onto the back of the page. If the disclosures are on two or more pages, a creditor may not include any intervening information between portions of the disclosure. In addition, the following formatting techniques were used in presenting the information in the sample tables to ensure that the information is readable:

A. A readable font style and font size (10-point Helvetica font style for body text).

B. Sufficient spacing between lines of the text.

C. Standard spacing between words and characters. In other words, the body text was not compressed to appear smaller than the 10-point type size.

D. Sufficient white space around the text of the information in each row, by providing sufficient margins above, below and to the sides of the text.

E. Sufficient contrast between the text and the background. Generally, black text was used on white paper.

iii. While the Board is not requiring issuers to use the above formatting techniques in presenting information in the disclosure, the Board encourages issuers to consider these techniques when deciding how to disclose information in the disclosure to ensure that the information is presented in a readable format.

iv. Creditors are allowed to use color, shading and similar graphic techniques in the disclosures, so long as the disclosures remain substantially similar to the model and sample forms in appendix H.

26. Sample H-21. This sample illustrates a disclosure required under § 226.47(a). The sample assumes a range of interest rates between 7.375% and 17.375%. The sample assumes a variable interest rate that will never exceed 25% over the life of the loan. The term of the sample loan is 20 years for an amount up to $20,000 and 30 years for an amount more than $20,000. The repayment options and sample costs have been combined into a single table, as permitted in the commentary to § 226.47(a)(3). It demonstrates the loan amount, interest rate, and total paid when a consumer makes loan payments while in school, pays only interest while in school, and defers all payments while in school.

27. Sample H-22. This sample illustrates a disclosure required under § 226.47(b). The sample assumes the consumer financed $10,000 at an 8.23% annual percentage rate. The sample assumes a variable interest rate that will never exceed 25% over the life of the loan. The payment schedule and terms assumes a 20-year loan term and that the consumer elected to defer payments while enrolled in school. This includes a sample disclosure of a total loan amount of $10,600 and prepaid finance charges totaling $600, for a total amount financed of $10,000.

28. Sample H-22. This sample illustrates a disclosure required under § 226.47(c). The sample assumes the consumer financed $10,000 at an 8.23% annual percentage rate. The sample assumes a variable annual percentage rate in an instance where there is no maximum interest rate. The sample demonstrates disclosure of an assumed maximum rate, and the statement that the consumer's actual maximum rate and payment amount could be higher. The payment schedule and terms assumes a 20-year loan term, the assumed maximum interest rate, and that the consumer elected to defer payments while enrolled in school. This includes a sample disclosure of a total loan amount of $10,600 and prepaid finance charges totaling $600, for a total amount financed of $10,000.

References

Statute: Sections 105 and 130.

Other sections: Sections 226.6, 226.7, 226.9, 226.12, 226.15, 226.18, and 226.23.

Previous regulation: None.

1981 changes: The model forms and clauses have no counterpart in the previous regulation.

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APPENDIX I FEDERAL ENFORCEMENT AGENCIES

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APPENDIX I FEDERAL ENFORCEMENT AGENCIES

Statute: Section 108.

Other sections: None.

Previous regulation: Section 226.1(b).

1981 changes: None.

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APPENDIX J ANNUAL PERCENTAGE RATE COMPUTATIONS FOR CLOSED-END CREDIT TRANSACTIONS

1. Use of appendix J. Appendix J sets forth the actuarial equations and instructions for calculating the annual percentage rate in closed-end credit transactions. While the formulas contained in this appendix may be directly applied to calculate the annual percentage rate for an individual transaction, they may also be utilized to program calculators and computers to perform the calculations.

2. Relation to Board tables. The Board's Annual Percentage Rate Tables also provide creditors with a calculation tool that applies the technical information in appendix J. An annual percentage rate computed in accordance with the instructions in the tables is deemed to comply with the regulation. Volume I of the tables may be used for credit transactions involving equal payment amounts and periods, as well as for transactions involving any of the following irregularities: odd first period, odd first payment and odd last payment. Volume II of the tables may be used for transactions that involve any type of irregularities. These tables may be obtained from any Federal Reserve Bank or from the Board in Washington, D.C. 20551, upon request.

References

Statute: Section 107.

Other sections: Section 226.22.

Previous regulation: Section 226.40 (Supplement I).

1981 changes: Paragraph (b)(2) has been revised to clarify that the term of the transaction never begins earlier than consummation of the transaction. Paragraph (b)(5)(vi) has been revised to permit creditors in single-advance,

single-payment transactions in which the term is less than a year and is equal to a whole number of months, to use either the 12-month method or the 365-day method to compute the number of unit-periods per year.

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APPENDIX K TOTAL ANNUAL LOAN COST RATE COMPUTATIONS FOR REVERSE MORTGAGE TRANSACTIONS

1B Consumer Credit Law Manual APPENDIX K

APPENDIX K TOTAL ANNUAL LOAN COST RATE COMPUTATIONS FOR REVERSE MORTGAGE TRANSACTIONS

1. General. The calculation of total annual loan cost rates under appendix K is based on the principles set forth and the estimation or "iteration" procedure used to compute annual percentage rates under appendix J. Rather than restate this iteration process in full, the regulation cross-references the procedures found in appendix J. In other aspects the appendix reflects the special nature of reverse mortgage transactions. Special definitions and instructions are included where appropriate.

(b) Instructions and equations for the total annual loan cost rate.

(b)(5) Number of unit-periods between two given dates.

1. Assumption as to when transaction begins. The computation of the total annual loan cost rate is based on the assumption that the reverse mortgage transaction begins on the first day of the month in which consummation is estimated to occur. Therefore, fractional unit-periods (used under appendix J for calculating annual percentage rates) are not used.

(b)(9) Assumption for discretionary cash advances.

1. Amount of credit. Creditors should compute the total annual loan cost rates for transactions involving discretionary cash advances by assuming that 50 percent of the initial amount of the credit available under the transaction is advanced at closing or, in an open-end transaction, when the consumer becomes obligated under the plan.

(For the purposes of this assumption, the initial amount of the credit is the principal loan amount less any costs to the consumer under section 226.33(c)(1).)

(b)(10) Assumption for variable-rate reverse mortgage transactions.

1. Initial discount or premium rate. Where a variable-rate reverse mortgage transaction includes an initial discount or premium rate, the creditor should apply the same rules for calculating the total annual loan cost rate as are applied when calculating the annual percentage rate for a loan with an initial discount or premium rate (see the commentary to § 226.17(c)).

(d) Reverse mortgage model form and sample form.

(d)(2) Sample form.

1. General. The "clear and conspicuous" standard for reverse mortgage disclosures does not require disclosures to be printed in any particular type size. Disclosures may be made on more than one page, and use both the front and the reverse sides, as long as the pages constitute an integrated document and the table disclosing the total annual loan cost rates is on a single page.

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APPENDIX L ASSUMED LOAN PERIODS FOR COMPUTATIONS OF TOTAL ANNUAL LOAN COST RATES

1. General. The life expectancy figures used in appendix L are those found in the U.S. Decennial Life Tables for women, as rounded to the nearest whole year and as published by the U. S. Department of Health and Human Services. The figures contained in appendix L must be used by creditors for all consumers (men and women). Appendix L will be revised periodically by the Board to incorporate revisions to the figures made in the Decennial Tables.
[*46 FR 50288* , Oct. 9, 1981; *51 FR 11424, 18876 (1986)* ; *52 FR 10878 (1987)* ; *53 FR 11050, 11058, 13379 (1988)* ; *54 FR 9421, 13455 (1989)* ; *55 FR 13106, 17750 (1990)* ; *56 FR 13754, 22200, 23993 (1991)* ; *57 FR 81, 749 (1992)* ; *58 FR 17084, 17085* , Apr. 1, 1993; *60 FR 16776* , Apr. 3, 1995; *61 FR 14952, 14955, 14956, 14959* , Apr. 4, 1996; *61 FR 49237, 49248* , Sept. 19, 1996; *62 FR 10193, 10196, 10197, 10198* , Mar. 6, 1997; *62 FR 63441, 63445, 63446* , Dec. 1, 1997; *63 FR 16669, 16674, 16675, 16676, 16677, 16678,* Apr. 6, 1998, as corrected at *63 FR 33990,* June 22, 1998; *64 FR 16614, 16616, 16617* , Apr. 6, 1999; Reg. Z, *65 FR 17129, 17131* , Mar. 31, 2000; *65 FR 58903, 58910* , Oct. 3, 2000; *65 FR 70465* , Nov. 24, 2000; Reg. Z, *66 FR 17329, 17339* , Mar. 30, 2001; Reg. Z, *66 FR 41439, 41440* , Aug. 8, 2001; Reg. Z, *66 FR 57849* , Nov. 19, 2001; Reg. Z, *66 FR 65604, 65620* , Dec. 20, 2001; Reg. Z, *67 FR 16980, 16982* , Apr. 9, 2002; *67 FR 61769* , Oct. 2, 2002; *68 FR 16185, 16189* , Apr. 3, 2003; *68 FR 50965* , Aug. 25, 2003; *69 FR 16769, 16773* , Mar. 31, 2004; *69 FR 50298, 50299* , Aug. 16, 2004; *70 FR 46066, 46067* , Aug. 9, 2005; *71 FR 46388* , Aug. 14, 2006; *72 FR 44032, 44033* , Aug. 7, 2007; *72 FR 63462, 63475* , Nov. 9, 2007; *72 FR 71058, 71059* , Dec. 14, 2007; *73 FR 44522, 44604-44613* , July 30, 2008; *73 FR 46190, 46191,* Aug. 8, 2008; *74 FR 5244,* Jan. 29, 2009, withdrawn at *75 FR 7925,* Feb. 22, 2010; *74 FR 23289, 23301, 23002, 23005,* May 19, 2009; *74 FR 36077, 36096* , July 22, 2009; *74 FR 40477, 40478* , Aug. 12, 2009; *74 FR 41194, 41248* , Aug. 14, 2009; *74 FR 60143, 60152* , Nov. 20, 2009; *75 FR 7658,* Feb. 22, 2010]

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16 C.F.R. Part 433 PRESERVATION OF CONSUMERS' CLAIMS AND DEFENSES

Authority: ***38 Stat. 717,*** **as amended (** ***15 U.S.C. 41, et seq.*** **)**

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1B- Consumer Credit Law Manual § 433.1

§ **433.1 Definitions.**

(a) *Person*. An individual, corporation, or any other business organization.

(b) *Consumer*. A natural person who seeks or acquires goods or services for personal, family, or household use.

(c) *Creditor*. A person who, in the ordinary course of business, lends purchase money or finances the sale of goods or services to consumers on a deferred payment basis; *Provided,* such person is not acting, for the purposes of a particular transaction, in the capacity of a credit card issuer.

(d) *Purchase money loan*. A cash advance which is received by a consumer in return for a "Finance Charge" within the meaning of the Truth in Lending Act and Regulation Z, which is applied, in whole or substantial part, to a purchase of goods or services from a seller who (1) refers consumers to the creditor or (2) is affiliated with the creditor by common control, contact, or business arrangement.

(e) *Financing a sale*. Extending credit to a consumer in connection with a "Credit Sale" within the meaning of the Truth in Lending Act and Regulation Z.

(f) *Contract*. Any oral or written agreement, formal or informal, between a creditor and a seller, which contemplates or provides for cooperative or concerted activity in connection with the sale of goods or services to consumers or the financing thereof.

(g) *Business arrangement*. Any understanding, procedure, course of dealing, or arrangement, formal or informal, between a creditor and a seller, in connection with the sale of goods or services to consumers or the financing thereof.

(h) *Credit card issuer*. A person who extends to cardholders the right to use a credit card in connection with purchases of goods or services.

(i) *Consumer credit contract*. Any instrument which evidences or embodies a debt arising from a "Purchase Money Loan" transaction or a "financed sale" as defined in paragraphs (d) and (e) of this section.

(j) *Seller*. A person who, in the ordinary course of business, sells or leases goods or services to consumers.

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1B- Consumer Credit Law Manual § 433.2

§ **433.2 Preservation of consumers' claims and defenses, unfair or deceptive acts or practices.**

In connection with any sale or lease of goods or services to consumers, in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act, it is an unfair or deceptive act or practice within the meaning of Section 5 of that Act for a seller, directly or indirectly, to:

(a) Take or receive a consumer credit contract which fails to contain the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

or, (b) Accept, as full or partial payment for such sale or lease, the proceeds of any purchase money loan (as purchase money loan is defined herein), unless any consumer credit contract made in connection with such purchase money loan contains the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

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1B- Consumer Credit Law Manual § 433.3

§ 433.3 Exemption of sellers taking or receiving open end consumer credit contracts before November 1, 1977 from requirements of § 433.2(a).

(a) Any seller who has taken or received an open end consumer credit contract before November 1, 1977, shall be exempt from the requirements of 16 CFR Part 433 with respect to such contract provided the contract does not cut off consumers' claims and defenses.

(b) *Definitions*. The following definitions apply to this exemption:

(1) All pertinent definitions contained in *16 CFR 433.1*.

(2) Open end consumer credit contract: a consumer credit contract pursuant to which "open end credit" is extended.

(3) "Open end credit": consumer credit extended on an account pursuant to a plan under which a creditor may permit an applicant to make purchases or make loans, from time to time, directly from the creditor or indirectly by use of a credit card, check, or other device, as the plan may provide. The term does not include negotiated advances under an open-end real estate mortgage or a letter of credit.

(4) Contract which does not cut off consumers' claims and defenses: a consumer credit contract which does not constitute or contain a negotiable instrument, or contain any waiver, limitation, term, or condition which has the effect of limiting a consumer's right to assert against any holder of the contract all legally sufficient claims and defenses which

the consumer could assert against the seller of goods or services purchased pursuant to the contract.

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CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT
16 C.F.R. Part 444 CREDIT PRACTICES

1B Consumer Credit Law Manual 16 C.F.R. Part 444

16 C.F.R. Part 444 CREDIT PRACTICES

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1B- Consumer Credit Law Manual § 444.1

§ **444.1 Definitions.**

(a) *Lender*. A person who engages in the business of lending money to consumers within the jurisdiction of the Federal Trade Commission.

(b) *Retail installment seller*. A person who sells goods or services to consumers on a deferred payment basis or pursuant to a lease-purchase arrangement within the jurisdiction of the Federal Trade Commission.

(c) *Person*. An individual, corporation, or other business organization.

(d) *Consumer*. A natural person who seeks or acquires goods, services, or money for personal, family, or household use.

(e) *Obligation*. An agreement between a consumer and a lender or retail installment seller.

(f) *Creditor*. A lender or a retail installment seller.

(g) *Debt*. Money that is due or alleged to be due from one to another.

(h) *Earnings*. Compensation paid or payable to an individual or for his or her account for personal services rendered or to be rendered by him or her, whether denominated as wages, salary, commission, bonus, or otherwise, including periodic payments pursuant to a pension, retirement, or disability program.

(i) *Household goods*. Clothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware, and personal effects (including wedding rings) of the consumer and his or her dependents, provided that the following are not included within the scope of the term "household goods":

(1) Works of art;

(2) Electronic entertainment equipment (except one television and one radio);

(3) Items acquired as antiques; and

(4) Jewelry (except wedding rings).

(j) *Antique*. Any item over one hundred years of age, including such items that have been repaired or renovated without changing their original form or character.

(k) *Cosigner*. A natural person who renders himself or herself liable for the obligation of another person without compensation. The term shall include any person whose signature is requested as a condition to granting credit to another person, or as a condition for forbearance on collection of another person's obligation that is in default. The term shall not include a spouse whose signature is required on a credit obligation to perfect a security interest pursuant to state law. A person who does not receive goods, services, or money in return for a credit obligation does not receive compensation within the meaning of this definition. A person is a cosigner within the meaning of this definition whether or not he or she is designated as such on a credit obligation.

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1B- Consumer Credit Law Manual § 444.2

§ **444.2 Unfair credit practices.**

(a) In connection with the extension of credit to consumers in or affecting commerce, as commerce is defined in the Federal Trade Commission Act, it is an unfair act or practice within the meaning of Section 5 of that Act for a lender or retail installment seller directly or indirectly to take or receive from a consumer an obligation that:

(1) Constitutes or contains a cognovit or confession of judgment (for purposes other than executory process in the State of Louisiana), warrant of attorney, or other waiver of the right to notice and the opportunity to be heard in the event of suit or process thereon.

(2) Constitutes or contains an executory waiver or a limitation of exemption from attachment, execution, or other process on real or personal property held, owned by, or due to the consumer, unless the waiver applies solely to property subject to a security interest executed in connection with the obligation.

(3) Constitutes or contains an assignment of wages or other earnings unless:

(i) The assignment by its terms is revocable at the will of the debtor, or

(ii) The assignment is a payroll deduction plan or preauthorized payment plan, commencing at the time of the transaction, in which the consumer authorizes a series of wage deductions as a method of making each payment, or

(iii) The assignment applies only to wages or other earnings already earned at the time of the assignment.

(4) Constitutes or contains a nonpossessory security interest in household goods other than a purchase money security interest.

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1B- Consumer Credit Law Manual § 444.3

§ **444.3 Unfair or deceptive cosigner practices.**

(a) In connection with the extension of credit to consumers in or affecting commerce, as commerce is defined in the Federal Trade Commission Act, it is:

(1) A deceptive act or practice within the meaning of Section 5 of that Act for a lender or retail installment seller, directly or indirectly, to misrepresent the nature or extent of cosigner liability to any person.

(2) An unfair act or practice within the meaning of Section 5 of that Act for a lender or retail installment seller, directly or indirectly, to obligate a cosigner unless the cosigner is informed prior to becoming obligated, which in the case of open end credit shall mean prior to the time that the agreement creating the cosigner's liability for future charges is executed, of the nature of his or her liability as cosigner.

(b) Any lender or retail installment seller who complies with the preventive requirements in paragraph (c) of this section does not violate paragraph (a) of this section.

(c) To prevent these unfair or deceptive acts or practices, a disclosure, consisting of a separate document that shall contain the following statement and no other, shall be given to the cosigner prior to becoming obligated, which in the case of open end credit shall mean prior to the time that the agreement creating the cosigner's liability for future charges is executed:

Notice to Cosigner

You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay if you have to, and that you want to accept this responsibility.

You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which increase this amount.

The creditor can collect this debt from you without first trying to collect from the borrower. The creditor can use the same collection methods against you that can be used against the borrower, such as suing you, garnishing your wages, etc. If this debt is ever in default, that act may become a part of *your* credit record.

This notice is not the contract that makes you liable for the debt.

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1B- Consumer Credit Law Manual § 444.4

§ **444.4 Late charges.**

(a) In connection with collecting a debt arising out of an extension of credit to a consumer in or affecting commerce, as commerce is defined in the Federal Trade Commission Act, it is an unfair act or practice within the meaning of Section 5 of that Act for a creditor, directly or indirectly, to levy or collect any delinquency charge on a payment, which payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period, when the only delinquency is attributable to late fee(s) or delinquency charge(s) assessed on earlier installment(s).

(b) For purposes of this section, "collecting a debt" means any activity other than the use of judicial process that is intended to bring about or does bring about repayment of all or part of a consumer debt.

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1B- Consumer Credit Law Manual § 444.5

§ **444.5 State exemptions.**

(a) If, upon, application to the Federal Trade Commission by an appropriate state agency, the Federal Trade Commission determines that:

(1) There is a state requirement or prohibition in effect that applies to any transaction to which a provision of this rule applies; and

(2) The state requirement or prohibition affords a level of protection to consumers that is substantially equivalent to, or greater than, the protection afforded by this rule;

Then that provision of the rule will not be in effect in that state to the extent specified by the Federal Trade Commission in its determination, for as long as the state administers and enforces the state requirement or prohibition effectively.

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SUBPART A GENERAL

1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 870.1

§ **870.1 Purpose and scope.**

(a) This part sets forth the procedures and any policies, determinations, and interpretations of general application whereby the Secretary of Labor carries out his duties under section 303 of the CCPA dealing with restrictions on garnishment of earnings, and section 305 permitting exemptions for State-regulated garnishments in certain situations. While the Secretary's duties under section 303 include insuring that certain amounts of earnings are protected, such duties do not include establishing priorities among multiple garnishments, as such priorities are determined by other Federal statutes or by State law.

(b) Functions of the Secretary under the CCPA to be performed as provided in this part are assigned to the Administrator of the Wage and Hour Division (hereinafter referred to as the Administrator), who, under the general direction and control of the Assistant Secretary, Wage and Labor Standards Administration, shall be empowered to take final and binding actions in administering the provisions of this part. The Administrator is empowered to subdelegate any of his duties under this part. Any legal advice and assistance required for administration of this part shall be provided by the Solicitor of Labor.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 870.2

§ **870.2 Amendments to this part.**

The Administrator may, at any time upon his own motion or upon written request of any interested person setting forth reasonable grounds therefor, amend any rules in this part.

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§ 870.10 Maximum part of aggregate disposable earnings subject to garnishment under section 303(a).

(a) *Statutory provision*. Section 303(a) of the CCPA provides that, with some exceptions, the maximum part of the aggregate disposable earnings of an individual for any workweek which is subjected to garnishment may not exceed

(1) 25 per centum of his disposable earnings for that week, or

(2) the amount by which his disposable earnings for that week exceed thirty times the Federal minimum hourly wage prescribed by section 6(a)(1) of the Fair Labor Standards Act of 1938, in effect at the time the earnings are payable,

whichever is less. In the case of earnings for any pay period other than a week, the Secretary of Labor shall by regulation prescribe a multiple of the Federal minimum hourly wage equivalent in effect to that set forth in paragraph (2).

(b) *Weekly pay period*. The statutory exemption formula applies directly to the aggregate disposable earnings paid or payable for a pay period of 1 workweek, or a lesser period. Its intent is to protect from garnishment and save to an individual earner the specified amount of compensation for his personal services rendered in the workweek, or a lesser period. Thus:

(1) The amount of an individual's disposable earnings for a workweek or lesser period which may not be garnished is 30 times the Fair Labor Standards Act minimum wage. If an individual's disposable earnings for such a period are equal to or less than 30 times the minimum wage, the individual's earnings may not be garnished in any amount. (When the

minimum wage increases, the proportionate amount of earnings which may not be garnished also increases.) On April 1, 1991, the minimum wage increased to $4.25. Accordingly, the amount of disposable weekly earnings which may not be garnished is $127.50 effective April 1, 1991. (For the period April 1, 1990 through March 31, 1991, the amount that may not be garnished is $114 (30 x $3.80).)

(2) For earnings payable on or after April 1, 1991, if an individual's disposable earnings for a workweek or lesser period are more than $127.50, but less than $170.00, only the amount above $127.50 is subject to garnishment. (For earnings payable during the period April 1, 1990, through March 31, 1991, when the Fair Labor Standards Act minimum wage was $3.80, this range computes to more than $114.00, but less than $152.00.)

(3) For earnings payable on or after April 1, 1991, if an individual's disposable earnings for a workweek or lesser period are $170.00 or more, 25 percent of his/her disposable earnings is subject to garnishment. (The weekly figure was $152.00 (40 x $3.80) for the period April 1, 1990 through March 31, 1991.)

(c) *Pay for a period longer than 1 week*. In the case of disposable earnings which compensate for personal services rendered in a pay period longer than 1 workweek, the weekly statutory exemption formula must be transformed to a formula applicable to such earnings providing equivalent restrictions on wage garnishment.

(1) The 25 percent part of the formula would apply to the aggregate disposable earnings for all the workweeks or fractions thereof compensated by the pay for such pay period.

(2) The following formula should be used to calculate the dollar amount of disposable earnings which would not be subject to garnishment: The number of workweeks, or fractions thereof, should be multiplied times the applicable Federal minimum wage and that amount should be multiplied by 30. For example, for the period April 1, 1990 through March 31, 1991 when the Federal minimum wage was $3.80 per hour, the formula should be calculated based on a minimum wage of $3.80 ($3.80 multiplied by 30 equals $114; $114 multiplied by the number of workweeks (or fractions thereof) equals the amount that cannot be garnished). As of April 1, 1991, the $4.25 Federal minimum wage replaces $3.80 in the formula (and the amount which cannot be garnished would then be $127.50 multiplied by the number of workweeks (or fractions thereof)). For purposes of this formula, a calendar month is considered to consist of 4 1/3 workweeks. Thus, during the period April 1, 1990 through March 31, 1991 when the Federal minimum hourly wage was $3.80 an hour, the amount of disposable earnings for a 2-week period is $228.00 (2 x 30 x $3.80); for a monthly period, $494.00 (4 1/3x 30 x $3.80). Effective April 1, 1991, such amounts increased as follows: for a two-week period, $255.00 (2 x 30 x $4.25); for a monthly period, $552.50 (4 1/3x 30 x $4.25). The amount of disposable earnings for any other pay period longer than 1 week shall be computed in a manner consistent with section 303(a) of the act and with this paragraph.

(3) Absent any changes to the rate set forth in section 6(a)(1) of the Fair Labor Standards Act, disposable earnings for individuals paid weekly, biweekly, semimonthly, and monthly may not be garnished unless they are in excess of the following amounts:

Date	Minimum amount	Weekly amount	Biweekly amount	Semimonthly amount	Monthly rate
Jan. 1, 1981	$3.35	$100.50	$201.00	$217.75	$435.50
Apr. 1, 1990	$3.80	$114.00	$228.00	$247.00	$494.00
Apr. 1, 1991	$4.25	$127.50	$255.00	$276.25	$552.50

(4) Absent any changes to the rate set forth in section 6(a)(1) of the Fair Labor Standards Act, if the disposable earnings are less than the following figures, only the difference between the appropriate figures set forth in paragraph (c)(3) of this section and the individual's disposable earnings may be garnished.

Date	Minimum amount	Weekly amount	Biweekly amount	Semimonthly amount	Monthly rate
Jan. 1, 1981	$3.35	$134.00	$268.00	$290.33	$580.67
Apr. 1, 1990	$3.80	$152.00	$304.00	$329.33	$658.67
Apr. 1, 1991	$4.25	$170.00	$340.00	$368.33	$736.67

For example, in April of 1990, if an individual's disposable earnings for a biweekly pay period are $274.00, the difference between $228.00 and $274.00 (i.e., $46.00) may be garnished.

(5) If disposable earnings are in excess of the figures stated in paragraph (c)(4) of this section, 25% of the disposable earnings may be garnished.

(d) *Date wages paid or payable controlling*. The date that disposable earnings are paid or payable, and not the date the Court issues the garnishment order, is controlling in determining the amount of disposable earnings that may be garnished. Thus, a garnishment order in November 1990, providing for withholding from wages over a period of time, based on exemptions computed at the $3.80 per hour minimum wage then in effect, would be modified by operation of the change in the law so that wages paid after April 1, 1991, are subject to garnishment to the extent described in paragraphs (b) and (c) of this section on the basis of a minimum rate of $4.25 per hour. This principle is applicable at the time of the enactment of any further increase in the minimum wage.

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§ 870.11 Exceptions to the restrictions provided by section 303(a) of the CCPA and priorities among garnishments.

(a)

(1) Section 303(b) of the Consumer Credit Protection Act provides that the restrictions in section 303(a) do not apply to:

(i) Any debt due for any State or Federal tax, or

(ii) Any order of any court of bankruptcy under Chapter XIII of the Bankruptcy Act.

(2) Accordingly, the Consumer Credit Protection Act does not restrict in any way the amount which may be withheld for State or Federal taxes or in Chapter XIII Bankruptcy Act proceedings.

(b)

(1) Section 303(b) provides the following restrictions on the amount that may be withheld for the support of any person (e.g. alimony or child support):

"(A) Where such individual is supporting his spouse or dependent child (other than a spouse or child with respect to whose support such order is issued), 50 per centum of such individual's disposable earnings for that week; and

"(B) Where such individual is not supporting such a spouse or dependent child described in clause (A), 60 per centum of such individual's disposable earnings for that week; except that, with respect to the disposable earnings of any individual for any workweek, the 50 per centum specified in clause (A) shall be deemed to be 55 per centum and the 60 per centum specified in clause (B) shall be deemed to be 65 per centum, if and to the extent that such earnings are subject to garnishment to enforce a support order with respect to a period which is prior to the twelve week period which ends with the beginning of such workweek."

(2) Compliance with the provisions of section 303(a) and (b) may offer problems when there is more than one garnishment. In that event the priority is determined by State law or other Federal laws as the CCPA contains no provisions controlling the priorities of garnishments. However, in no event may the amount of any individual's disposable earnings which may be garnished exceed the percentages specified in section 303. To illustrate:

(i) If 45% of an individual's disposable earnings were garnished for taxes, and this garnishment has priority, the Consumer Credit Protection Act permits garnishment for the support of any person of only the difference between 45% and the applicable percentage (50 to 65%) in the above quoted section 303(b).

(ii) If 70% of an individual's disposable earnings were garnished for taxes and/or a Title XIII Bankruptcy debt, and these garnishments have priority, the Consumer Credit Protection Act does not permit garnishment either for the support of any person or for other debts.

(iii) If 25% of an individual's disposable earnings were withheld pursuant to an ordinary garnishment which is subject to the restrictions of section 303(a), and the garnishment has priority in accordance with State law, the Consumer Credit Protection Act permits the additional garnishment for the support of any person of only the difference between 25% and the applicable percentage (50-65%) in the above quoted section 303(b).

(iv) If 25% or more of an individual's disposable earnings were withheld pursuant to a garnishment for support, and the support garnishment has priority in accordance with State law, the Consumer Credit Protection Act does not permit the withholding of any additional amounts pursuant to an ordinary garnishment which is subject to the restrictions of section 303(a).

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§ **870.50 General provision.**

Section 305 of the CCPA authorizes that Secretary to "exempt from the provisions of section 303(a) garnishments issued under the laws of any State if he determines that the laws of that State provide restrictions on garnishment which are substantially similar to those provided in section 303(a)."

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§ **870.51 Exemption policy.**

(a) It is the policy of the Secretary of Labor to permit exemption from section 303(a) of the CCPA garnishments issued under the laws of a State if those laws considered together cover every case of garnishment covered by the Act, and if those laws provide the same or greater protection to individuals. Differences in text between the restrictions of State laws and those in section 303(a) of the Act are not material so long as the State laws provide the same or greater restrictions on the garnishment of individuals' earnings.

(b) In determining whether State-regulated garnishments should be exempted from section 303(a) of the CCPA, or whether such an exemption should be terminated, the laws of the State shall be examined with particular regard to the classes of persons and of transactions to which they may apply; the formulas provided for determining the maximum part of an individual's earnings which may be subject to garnishment; restrictions on the application of the formulas; and with regard to procedural burdens placed on the individual whose earnings are subject to garnishment.

(c) Particular attention is directed to the fact that subsection (a) of section 303, when considered with subsection (c) of that section, is read as not requiring the raising of the subsection (a) restrictions as affirmative defenses in garnishment proceedings.

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§ **870.52 Application for exemption of State-regulated garnishments.**

(a) An application for the exemption of garnishments issued under the laws of a State may be made in duplicate by a duly authorized representative of the State. The application shall be filed with the Administrator of the Wage and Hour Division, Department of Labor, Washington, D.C. 20210.

(b) Any application for exemption must be accompanied by two copies of all the provisions of the State laws relating to the garnishment of earnings, certified to be true and complete copies by the Attorney General of the State. In addition, the application must be accompanied by a statement, in duplicate, signed by the Attorney General of the State, showing how the laws of the State satisfy the policy expressed in § 870.51(a) and setting forth any other matters which the Attorney General may wish to state concerning the application.

(c) Notice of the filing of an application for exemption shall be published in the Federal Register. Copies of the application shall be available for public inspection and copying during business hours at the national office of the Wage and Hour Division and in the regional office of the Wage and Hour Division in which the particular State is located. Interested persons shall be afforded an opportunity to submit written comments concerning the application of the State within a period of time to be specified in the notice.

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§ **870.53 Action upon an application for exemption.**

(a) The Administrator shall grant or deny within a reasonable time any application for the exemption of State-regulated garnishments. The State representative shall be notified in writing of the decision. In the event of denial, a statement of the grounds for the denial shall be made. To the extent feasible and appropriate, the Administrator may afford to the State representative and to any other interested persons an opportunity to submit orally or in writing data, views, and arguments on the issue of whether or not an exemption should be granted and on any subsidiary issues.

(b) If an application is denied, the State representative shall have an opportunity to request reconsideration by the Administrator. The request shall be made in writing. The Administrator shall permit argument whenever the opportunity to do so has not been afforded under paragraph (a) of this section, and may permit argument in any other case.

(c) General notice of every exemption of State-regulated garnishments and of its terms and conditions shall be given by publication in the Federal Register.

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§ **870.54 Standards governing the granting of an application for exemption.**

The Administrator may grant any application for the exemption of State-regulated garnishments whenever he finds that the laws of the State satisfy the policy expressed in § 870.51(a).

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§ **870.55 Terms and conditions of every exemption.**

(a) It shall be a condition of every exemption of State-regulated garnishments that the State representative have the powers and duties

(1) To represent, and act on behalf of, the State in relation to the Administrator and his representatives, with regard to any matter relating to, or arising out of, the application, interpretation, and enforcement of State laws regulating garnishment of earnings;

(2) To submit to the Administrator in duplicate and on a current basis, a certified copy of every enactment by the State legislature affecting any of those laws, and a certified copy of any decision in any case involving any of those laws, made by the highest court of the State which has jurisdiction to decide or review cases of its kind, if properly presented to the court; and

(3) To submit to the Administrator any information relating to the enforcement of those laws, which the Administrator may request.

(b) The Administrator may make any exemption subject to additional terms and conditions which he may find appropriate to carry out the purposes of section 303(a) of the Act.

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§ **870.56 Termination of exemption.**

(a) After notice and opportunity to be heard, the Administrator shall terminate any exemption of State-regulated garnishments when he finds that the laws of the State no longer satisfy the purpose of section 303(a) of the Act or the policy expressed in § 870.51(a). Also, after notice and opportunity to be heard, the Administrator may terminate any exemption if he finds that any of its terms or conditions have been violated.

(b) General notice of the termination of every exemption of State-regulated garnishments shall be given by publication in the Federal Register.

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§ **870.57 Exemptions.**

Pursuant to section 305 of the CCPA *(82 Stat. 164)* and in accordance with the provisions of this part, it has been determined that the laws of the following States provide restrictions on garnishment which are substantially similar to those provided in section 303(a) of the CCPA *(82 Stat. 163);* and that, therefore, garnishments issued under those laws should be, and they hereby are, exempted from the provisions of section 303(a) subject to the terms and conditions of §§ 870.55(a) and 870.56:

(a) *State of Virginia.* Effective June 30, 1978, garnishments issued under the laws of the State of Virginia are exempt from the provisions of sections 303(a) and 303(b) of the CCPA under the following additional conditions: (1) Whenever garnishments are ordered in the State of Virginia which are not deemed to be governed by *section 34-29 of the Code* of Virginia, as amended, and the laws of another State are applied, sections 303(a) and 303(b) of the CCPA shall apply to such garnishments according to the provisions thereof; and (2) whenever the earnings of any individual subject to garnishment are withheld and a suspending or supersedeas bond is undertaken in the course of an appeal from a lower court decision, sections 303(a) and 303(b) of the CCPA shall apply to the withholding of such earnings under this procedure according to the provisions thereof.

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[Editor's Note: *15 U.S.C. §§ 1601-1665b* comprise the Truth in Lending Act.]

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§ 1601 Congressional findings and declaration of purpose.

(a) Informed use of credit

The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.

(b) Terms of personal property leases

The Congress also finds that there has been a recent trend toward leasing automobiles and other durable goods for consumer use as an alternative to installment credit sales and that these leases have been offered without adequate cost disclosures. It is the purpose of this subchapter to assure a meaningful disclosure of the terms of leases of personal property for personal, family, or household purposes so as to enable the lessee to compare more readily the various lease terms available to him, limit balloon payments in consumer leasing, enable comparison of lease terms with credit terms where appropriate, and to assure meaningful and accurate disclosures of lease terms in advertisements.

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§ **1602 Definitions and rules of construction.**

(a) The definitions and rules of construction set forth in this section are applicable for the purposes of this subchapter.

(b) The term "Board" refers to the Board of Governors of the Federal Reserve System.

(c) The term "organization" means a corporation, government or governmental subdivision or agency, trust, estate, partnership, cooperative, or association.

(d) The term "person" means a natural person or an organization.

(e) The term "credit" means the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment.

(f) The term "creditor" refers only to a person who both (1) regularly extends, whether in connection with loans, sales of property or services, or otherwise, consumer credit which is payable by agreement in more than four installments or for which the payment of a finance charge is or may be required, and (2) is the person to whom the debt arising from the consumer credit transaction is initially payable on the face of the evidence of indebtedness or, if there is no such evidence of indebtedness, by agreement. Notwithstanding the preceding sentence, in the case of an open-end credit plan

involving a credit card, the card issuer and any person who honors the credit card and offers a discount which is a finance charge are creditors. For the purpose of the requirements imposed under part D of this subchapter and sections 1637(a)(5), 1637(a)(6), 1637(a)(7), 1637(b)(1), 1637(b)(2), 1637(b)(3), 1637(b)(8), and 1637(b)(10) of this title, the term "creditor" shall also include card issuers whether or not the amount due is payable by agreement in more than four installments or the payment of a finance charge is or may be required, and the Board shall, by regulation, apply these requirements to such card issuers, to the extent appropriate, even though the requirements are by their terms applicable only to creditors offering open-end credit plans. Any person who originates 2 or more mortgages referred to in subsection (aa) of this section in any 12-month period or any person who originates 1 or more such mortgages through a mortgage broker shall be considered to be a creditor for purposes of this chapter. The term "creditor" includes a private educational lender (as that term is defined in section 140 [*15 USCS § 1650*]) for purposes of this title [*15 USCS §§ 1601 et seq.*].

(g) The term "credit sale" refers to any sale in which the seller is a creditor. The term includes any contract in the form of a bailment or lease if the bailee or lessee contracts to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the property and services involved and it is agreed that the bailee or lessee will become, or for no other or a nominal consideration has the option to become, the owner of the property upon full compliance with his obligations under the contract.

(h) The adjective "consumer", used with reference to a credit transaction, characterizes the transaction as one in which the party to whom credit is offered or extended is a natural person, and the money, property, or services which are the subject of the transaction are primarily for personal, family, or household purposes.

(i) The terms "open end credit plan" and "open end consumer credit plan" mean a plan under which the creditor reasonably contemplates repeated transactions, which prescribes the terms of such transactions, and which provides for a finance charge which may be computed from time to time on the outstanding unpaid balance. A credit plan or open end consumer credit plan which is an open end credit plan or open end consumer credit plan within the meaning of the preceding sentence is an open end credit plan or open end consumer credit plan even if credit information is verified from time to time.

(j) The term "adequate notice," as used in section 1643 of this title, means a printed notice to a cardholder which sets forth the pertinent facts clearly and conspicuously so that a person against whom it is to operate could reasonably be expected to have noticed it and understood its meaning. Such notice may be given to a cardholder by printing the notice on any credit card, or on each periodic statement of account, issued to the cardholder, or by any other means reasonably assuring the receipt thereof by the cardholder.

(k) The term "credit card" means any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit.

(l) The term "accepted credit card" means any credit card which the cardholder has requested and received or has signed

or has used, or authorized another to use, for the purpose of obtaining money, property, labor, or services on credit.

(m) The term "cardholder" means any person to whom a credit card is issued or any person who has agreed with the card issuer to pay obligations arising from the issuance of a credit card to another person.

(n) The term "card issuer" means any person who issues a credit card, or the agent of such person with respect to such card.

(o) The term "unauthorized use," as used in section 1643 of this title, means a use of a credit card by a person other than the cardholder who does not have actual, implied, or apparent authority for such use and from which the cardholder receives no benefit.

(p) The term "discount" as used in section 1666f of this title means a reduction made from the regular price. The term "discount" as used in section 1666f of this title shall not mean a surcharge.

(q) The term "surcharge" as used in this section and section 1666f of this title means any means of increasing the regular price to a cardholder which is not imposed upon customers paying by cash, check, or similar means.

(r) The term "State" refers to any State, the Commonwealth of Puerto Rico, the District of Columbia, and any territory or possession of the United States.

(s) The term "agricultural purposes" includes the production, harvest, exhibition, marketing, transportation, processing, or manufacture of agricultural products by a natural person who cultivates, plants, propagates, or nurtures those agricultural products, including but not limited to the acquisition of farmland, real property with a farm residence, and personal property and services used primarily in farming.

(t) The term "agricultural products" includes agricultural, horticultural, viticultural, and dairy products, livestock, wildlife, poultry, bees, forest products, fish and shellfish, and any products thereof, including processed and manufactured products, and any and all products raised or produced on farms and any processed or manufactured products thereof.

(u) The term "material disclosures" means the disclosure, as required by this subchapter, of the annual percentage rate, the method of determining the finance charge and the balance upon which a finance charge will be imposed, the amount of the finance charge, the amount to be financed, the total of payments, the number and amount of payments, the due

dates or periods of payments scheduled to repay the indebtedness, and the disclosures required by section 1639(a) of this title.

(v) The term "dwelling" means a residential structure or mobile home which contains one to four family housing units, or individual units of condominiums or cooperatives.

(w) The term "residential mortgage transaction" means a transaction in which a mortgage, deed of trust, purchase money security interest arising under an installment sales contract, or equivalent consensual security interest is created or retained against the consumer's dwelling to finance the acquisition or initial construction of such dwelling.

(x) As used in this section and section 1666f of this title, the term "regular price" means the tag or posted price charged for the property or service if a single price is tagged or posted, or the price charged for the property or service when payment is made by use of an open-end credit plan or a credit card if either (1) no price is tagged or posted, or (2) two prices are tagged or posted, one of which is charged when payment is made by use of an open-end credit plan or a credit card and the other when payment is made by use of cash, check, or similar means. For purposes of this definition, payment by check, draft, or other negotiable instrument which may result in the debiting of an open-end credit plan or a credit cardholder's open-end account shall not be considered payment made by use of the plan or the account.

(y) Any reference to any requirement imposed under this subchapter or any provision thereof includes reference to the regulations of the Board under this subchapter or the provision thereof in question.

(z) The disclosure of an amount or percentage which is greater than the amount or percentage required to be disclosed under this subchapter does not in itself constitute a violation of this subchapter.

(aa)

(1) A mortgage referred to in this subsection means a consumer credit transaction that is secured by the consumer's principal dwelling, other than a residential mortgage transaction, a reverse mortgage transaction, or a transaction under an open end credit plan, if--

(A) the annual percentage rate at consummation of the transaction will exceed by more than 10 percentage points the yield on Treasury securities having comparable periods of maturity on the fifteenth day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor; or

(B) the total points and fees payable by the consumer at or before closing will exceed the greater of--

(i) 8 percent of the total loan amount; or

(ii) $400.

(2)

(A) After the 2-year period beginning 180 days after September 23, 1994, and no more frequently than biennially after the first increase or decrease under this subparagraph, the Board may by regulation increase or decrease the number of percentage points specified in paragraph (1)(A), if the Board determines that the increase or decrease is--

(i) consistent with the consumer protections against abusive lending provided by the amendments made by subtitle B of title I of the Riegle Community Development and Regulatory Improvement Act of 1994; and

(ii) warranted by the need for credit.

(B) An increase or decrease under subparagraph (A) may not result in the number of percentage points referred to in subparagraph (A) being--

(i) less that 8 percentage points; or

(ii) greater than 12 percentage points.

(C) In determining whether to increase or decrease the number of percentage points referred to in subparagraph (A), the Board shall consult with representatives of consumers, including low-income consumers, and lenders.

(3) The amount specified in paragraph (1)(B)(ii) shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index, as reported on June 1 of the year preceding such adjustment.

(4) For purposes of paragraph (1)(B), points and fees shall include--

(A) all items included in the finance charge, except interest or the time-price differential;

(B) all compensation paid to mortgage brokers;

(C) each of the charges listed in section 1605(e) of this title (except an escrow for future payment of taxes), unless--

(i) the charge is reasonable;

(ii) the creditor receives no direct or indirect compensation; and

(iii) the charge is paid to a third party unaffiliated with the creditor; and

(D) such other charges as the Board determines to be appropriate.

(5) This subsection shall not be construed to limit the rate of interest or the finance charge that a person may charge a consumer for any extension of credit.

(bb) The term "reverse mortgage transaction" means a nonrecourse transaction in which a mortgage, deed of trust, or equivalent consensual security interest is created against the consumer's principal dwelling--

(1) securing one or more advances; and

(2) with respect to which the payment of any principal, interest, and shared appreciation or equity is due and payable (other than in the case of default) only after--

(A) the transfer of the dwelling;

(B) the consumer ceases to occupy the dwelling as a principal dwelling; or

(C) the death of the consumer.

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§ **1603 Exempted transactions.**

This subchapter does not apply to the following:

(1) Credit transactions involving extensions of credit primarily for business, commercial, or agricultural purposes, or to government or governmental agencies or instrumentalities, or to organizations.

(2) Transactions in securities or commodities accounts by a broker-dealer registered with the Securities and Exchange Commission.

(3) Credit transactions, other than those in which a security interest is or will be acquired in real property, or in personal property used or expected to be used as the principal dwelling of the consumer and other than private education loans (as that term is defined in section 140(a) [*15 USCS § 1650(a)*]), in which the total amount financed exceeds $25,000.

(4) Transactions under public utility tariffs, if the Board determines that a State regulatory body regulates the charges for the public utility services involved, the charges for delayed payment, and any discount allowed for early payment.

(5) Transactions for which the Board, by rule, determines that coverage under this subchapter is not necessary to carry

out the purposes of this subchapter.

(6) [Repealed.] [Pub. L. 96-221, title VI, § 603(c)(3), Mar. 31, 1980, *94 Stat. 169.]*

(7) Loans made, insured, or guaranteed pursuant to a program authorized by title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*).

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§ 1604 Rules and regulations.

(a) Promulgation, contents, etc., or regulations

The Board shall prescribe regulations to carry out the purposes of this subchapter. Except in the case of a mortgage referred to in section 1602(aa) of this title, these regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.

(b) Model disclosure forms and clauses; publication, criteria, compliance, etc.

The Board shall publish model disclosure forms and clauses for common transactions to facilitate compliance with the disclosure requirements of this subchapter and to aid the borrower or lessee in understanding the transaction by utilizing readily understandable language to simplify the technical nature of the disclosures. In devising such forms, the Board shall consider the use by creditors or lessors of data processing or similar automated equipment. Nothing in this subchapter may be construed to require a creditor or lessor to use any such model form or clause prescribed by the Board under this section. A creditor or lessor shall be deemed to be in compliance with the disclosure provisions of this subchapter with respect to other than numerical disclosures if the creditor or lessor (1) uses any appropriate model form or clause as published by the Board, or (2) uses any such model form or clause and changes it by (A) deleting any information which is not required by this subchapter, or (B) rearranging the format, if in making such deletion or rearranging the format, the creditor or lessor does not affect the substance, clarity, or meaningful sequence of the disclosure.

(c) Procedures applicable for adoption of model forms and clauses

Model disclosure forms and clauses shall be adopted by the Board after notice duly given in the Federal Register and an opportunity for public comment in accordance with section 553 of title 5.

(d) Effective dates of regulations containing new disclosure requirements

Any regulation of the Board, or any amendment or interpretation thereof, requiring any disclosure which differs from the disclosures previously required by this part, part D, or part E of this subchapter or by any regulation of the Board promulgated thereunder shall have an effective date of that October 1 which follows by at least six months the date of promulgation, except that the Board may at its discretion take interim action by regulation, amendment, or interpretation to lengthen the period of time permitted for creditors or lessors to adjust their forms to accommodate new requirements or shorten the length of time for creditors or lessors to make such adjustments when it makes a specific finding that such action is necessary to comply with the findings of a court or to prevent unfair or deceptive disclosure practices. Notwithstanding the previous sentence, any creditor or lessor may comply with any such newly promulgated disclosure requirements prior to the effective date of the requirements.

(f) Exemption authority n*

(1) In general

The Board may exempt, by regulation, from all or part of this subchapter any class of transactions, other than transactions involving any mortgage described in section 1602(aa) of this title, for which, in the determination of the Board, coverage under all or part of this subchapter does not provide a meaningful benefit to consumers in the form of useful information or protection.

(2) Factors for consideration

In determining which classes of transactions to exempt in whole or in part under paragraph (1), the Board shall consider the following factors and publish its rationale at the time a proposed exemption is published for comment:

(A) The amount of the loan and whether the disclosures, right of rescission, and other provisions provide a benefit to the consumers who are parties to such transactions, as determined by the Board.

(B) The extent to which the requirements of this subchapter complicate, hinder, or make more expensive the credit process for the class of transactions.

(C) The status of the borrower, including--

(i) any related financial arrangements of the borrower, as determined by the Board;

(ii) the financial sophistication of the borrower relative to the type of transaction; and

(iii) the importance to the borrower of the credit, related supporting property, and coverage under this subchapter, as determined by the Board;

(D) whether the loan is secured by the principal residence of the consumer; and

(E) whether the goal of consumer protection would be undermined by such an exemption.

(g) Waiver for certain borrowers

(1) In general

The Board, by regulation, may exempt from the requirements of this subchapter certain credit transactions if--

(A) the transaction involves a consumer--

(i) with an annual earned income of more than $200,000; or

(ii) having net assets in excess of $1,000,000 at the time of the transaction; and

(B) a waiver that is handwritten, signed, and dated by the consumer is first obtained from the consumer.

(2) Adjustments by the Board

The Board, at its discretion, may adjust the annual earned income and net asset requirements of paragraph (1) for inflation.

FOOTNOTES:

(n77)Footnote *. So in original. No subsec. (e) has been enacted.

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§ 1605 Determination of finance charge.

(a) "Finance charge" defined

Except as otherwise provided in this section, the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit. The finance charge does not include charges of a type payable in a comparable cash transaction. The finance charge shall not include fees and amounts imposed by third party closing agents (including settlement agents, attorneys, and escrow and title companies) if the creditor does not require the imposition of the charges or the services provided and does not retain the charges. Examples of charges which are included in the finance charge include any of the following types of charges which are applicable:

(1) Interest, time price differential, and any amount payable under a point, discount, or other system or additional charges.

(2) Service or carrying charge.

(3) Loan fee, finder's fee, or similar charge.

(4) Fee for an investigation or credit report.

(5) Premium or other charge for any guarantee or insurance protecting the creditor against the obligor's default or other credit loss.

(6) Borrower-paid mortgage broker fees, including fees paid directly to the broker or the lender (for delivery to the broker) whether such fees are paid in cash or financed.

(b) Life, accident, or health insurance premiums included in finance charge

Charges or premiums for credit life, accident, or health insurance written in connection with any consumer credit transaction shall be included in the finance charges unless

(1) the coverage of the debtor by the insurance is not a factor in the approval by the creditor of the extension of credit, and this fact is clearly disclosed in writing to the person applying for or obtaining the extension of credit; and

(2) in order to obtain the insurance in connection with the extension of credit, the person to whom the credit is extended must give specific affirmative written indication of his desire to do so after written disclosure to him of the cost thereof.

(c) Property damage and liability insurance premiums included in finance charge

Charges or premiums for insurance, written in connection with any consumer credit transaction, against loss of or damage to property or against liability arising out of the ownership or use of property, shall be included in the finance charge unless a clear and specific statement in writing is furnished by the creditor to the person to whom the credit is extended, setting forth the cost of the insurance if obtained from or through the creditor, and stating that the person to whom the credit is extended may choose the person through which the insurance is to be obtained.

(d) Items exempted from computation of finance charge in all credit transactions

If any of the following items is itemized and disclosed in accordance with the regulations of the Board in connection with any transaction, then the creditor need not include that item in the computation of the finance charge with respect to that transaction:

(1) Fees and charges prescribed by law which actually are or will be paid to public officials for determining the existence of or for perfecting or releasing or satisfying any security related to the credit transaction.

(2) The premium payable for any insurance in lieu of perfecting any security interest otherwise required by the creditor in connection with the transaction, if the premium does not exceed the fees and charges described in paragraph (1) which would otherwise be payable.

Any tax levied on security instruments or on documents evidencing indebtedness if the payment of such taxes is a precondition for recording the instrument securing the evidence of indebtedness.

(e) Items exempted from computation of finance charge in extensions of credit secured by an interest in real property

The following items, when charged in connection with any extension of credit secured by an interest in real property, shall not be included in the computation of the finance charge with respect to that transaction:

(1) Fees or premiums for title examination, title insurance, or similar purposes.

(2) Fees for preparation of loan-related documents.

(3) Escrows for future payments of taxes and insurance.

(4) Fees for notarizing deeds and other documents.

(5) Appraisal fees, including fees related to any pest infestation or flood hazard inspections conducted prior to closing.

(6) Credit reports.

(f) Tolerances for accuracy

In connection with credit transactions not under an open end credit plan that are secured by real property or a dwelling, the disclosure of the finance charge and other disclosures affected by any finance charge--

(1) shall be treated as being accurate for purposes of this chapter if the amount disclosed as the finance charge--

(A) does not vary from the actual finance charge by more than $100; or

(B) is greater than the amount required to be disclosed under this chapter; and

(2) shall be treated as being accurate for purposes of section 1635 of this title if--

(A) except as provided in subparagraph (B), the amount disclosed as the finance charge does not vary from the actual finance charge by more than an amount equal to one-half of one percent of the total amount of credit extended; or

(B) in the case of a transaction, other than a mortgage referred to in section 1602(aa) of this title, which--

(i) is a refinancing of the principal balance then due and any accrued and unpaid finance charges of a residential mortgage transaction as defined in section 1602(w) of this title, or is any subsequent refinancing of such a transaction; and

(ii) does not provide any new consolidation or new advance;

if the amount disclosed as the finance charge does not vary from the actual finance charge by more than an amount equal to one percent of the total amount of credit extended.

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§ 1606 Determination of annual percentage rate.

(a) "Annual percentage rate" defined

The annual percentage rate applicable to any extension of consumer credit shall be determined, in accordance with the regulations of the Board,

(1) in the case of any extension of credit other than under an open end credit plan, as

(A) that nominal annual percentage rate which will yield a sum equal to the amount of the finance charge when it is applied to the unpaid balances of the amount financed, calculated according to the actuarial method of allocating payments made on a debt between the amount financed and the amount of the finance charge, pursuant to which a payment is applied first to the accumulated finance charge and the balance is applied to the unpaid amount financed; or

(B) the rate determined by any method prescribed by the Board as a method which materially simplifies computation while retaining reasonable accuracy as compared with the rate determined under subparagraph (A).

(2) in the case of any extension of credit under an open end credit plan, as the quotient (expressed as a percentage) of the total finance charge for the period to which it relates divided by the amount upon which the finance charge for that period is based, multiplied by the number of such periods in a year.

(b) Computation of rate of finance charges for balances within a specified range

Where a creditor imposes the same finance charge for balances within a specified range, the annual percentage rate shall be computed on the median balance within the range, except that if the Board determines that a rate so computed would not be meaningful, or would be materially misleading, the annual percentage rate shall be computed on such other basis as the Board may be regulation require.

(c) Allowable tolerances for purposes of compliance with disclosure requirements

The disclosure of an annual percentage rate is accurate for the purpose of this subchapter if the rate disclosed is within a tolerance not greater than one-eighth of 1 per centum more or less than the actual rate or rounded to the nearest one-fourth of 1 per centum. The Board may allow a greater tolerance to simplify compliance where irregular payments are involved.

(d) Use of rate tables or charts having allowable variance from determined rates

The Board may authorize the use of rate tables or charts which may provide for the disclosure of annual percentage rates which vary from the rate determined in accordance with subsection (a)(1)(A) of this section by not more than such tolerances as the Board may allow. The Board may not allow a tolerance greater than 8 per centum of that rate except to simplify compliance where irregular payments are involved.

(e) Authorization of tolerances in determining annual percentage rates

In the case of creditors determining the annual percentage rate in a manner other than as described in subsection (d) of this section, the Board may authorize other reasonable tolerances.

(f) [Repealed]

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§ **1607 Administrative enforcement.**

(a) Enforcing agencies

Compliance with the requirements imposed under this subchapter shall be enforced under

(1) section 1818 of title 12, in the case of--

(A) national banks, and Federal branches and Federal agencies of foreign banks, by the Office of the Comptroller of the Currency;

(B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) [25A] of the Federal Reserve Act, by the Board; and

(C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System) and insured State branches of foreign banks, by the Board of Directors of the Federal Deposit Insurance Corporation;

(2) section 1818 of title 12, by the Director of the Office of Thrift Supervision, in the case of a savings association the deposits of which are insured by the Federal Deposit Insurance Corporation.

(3) the Federal Credit Union Act [*12 U.S.C. 1751 et seq.*], by the National Credit Union Administration Board with respect to any Federal credit union.

(4) the Federal Aviation Act of 1958 *[49 App. U.S.C. 1301* et seq.], by the Secretary of Transportation with respect to any air carrier or foreign air carrier subject to that Act.

(5) the Packers and Stockyards Act, 1921 [*7 U.S.C. 181 et seq.*] (except as provided in section 406 of that Act [*7 U.S.C. 226, 227*]), by the Secretary of Agriculture with respect to any activities subject to that Act.

(6) the Farm Credit Act of 1971 [*12 U.S.C. 2001 et seq.*] by the Farm Credit Administration with respect to any Federal land bank, Federal land bank association, Federal intermediate credit bank, or production credit association.

The terms used in paragraph (1) that are not defined in this subchapter or otherwise defined in section 1813(s) of title 12) shall have the meaning given to them in section 3101(b) of title 12.

(b) Violations of this subchapter deemed violations of pre-existing statutory requirements; additional agency powers

For the purpose of the exercise by any agency referred to in subsection (a) of this section of its powers under any Act referred to in that subsection, a violation of any requirement imposed under this subchapter shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in subsection (a) of this section, each of the agencies referred to in that subsection may exercise, for the purpose of enforcing compliance with any requirement imposed under this subchapter, any other authority conferred on it by law.

(c) Federal Trade Commission as overall enforcing agency

Except to the extent that enforcement of the requirements imposed under this subchapter is specifically committed to some other Government agency under subsection (a) of this section, the Federal Trade Commission shall enforce such requirements. For the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act [*15 U.S.C. 41 et seq.*], a violation of any requirement imposed under this subchapter shall be deemed a violation of a requirement imposed under that Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Commission to enforce compliance by any person with the requirements imposed under this subchapter, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests in the Federal Trade Commission Act.

(d) Rules and regulations

The authority of the Board to issue regulations under this subchapter does not impair the authority of any other agency designated in this section to make rules respecting its own procedures in enforcing compliance with requirements imposed under this subchapter.

(e) Adjustment of finance charges; procedures applicable, coverage, criteria, etc.

(1) In carrying out its enforcement activities under this section, each agency referred to in subsection (a) or (c) of this section, in cases where an annual percentage rate or finance charge was inaccurately disclosed, shall notify the creditor of such disclosure error and is authorized in accordance with the provisions of this subsection to require the creditor to make an adjustment to the account of the person to whom credit was extended, to assure that such person will not be required to pay a finance charge in excess of the finance charge actually disclosed or the dollar equivalent of the annual percentage rate actually disclosed, whichever is lower. For the purposes of this subsection, except where such disclosure error resulted from a willful violation which was intended to mislead the person to whom credit was extended, in determining whether a disclosure error has occurred and in calculating any adjustment, (A) each agency shall apply (i) with respect to the annual percentage rate, a tolerance of one-quarter of 1 percent more or less than the actual rate, determined without regard to section 1606(c) of this title, and (ii) with respect to the finance charge, a corresponding numerical tolerance as generated by the tolerance provided under this subsection for the annual percentage rate; except that (B) with respect to transactions consummated after two years following March 31, 1980, each agency shall apply (i) for transactions that have a scheduled amortization of ten years or less, with respect to the annual percentage rate, a tolerance not to exceed one-quarter of 1 percent more or less than the actual rate, determined without regard to section 1606(c) of this title, but in no event a tolerance of less than the tolerances allowed under section 1606(c) of this title, (ii) for transactions that have a scheduled amortization of more than ten years, with respect to the annual percentage rate, only such tolerances as are allowed under section 1606(c) of this title, and (iii) for all transactions, with respect to the finance charge, a corresponding numerical tolerance as generated by the tolerances provided under this subsection for the annual percentage rate.

(2) Each agency shall require such an adjustment when it determines that such disclosure error resulted from (A) a clear and consistent pattern or practice of violations, (B) gross negligence, or (C) a willful violation which was intended to mislead the person to whom the credit was extended. Notwithstanding the preceding sentence, except where such disclosure error resulted from a willful violation which was intended to mislead the person to whom credit was extended, an agency need not require such an adjustment if it determines that such disclosure error--

(A) resulted from an error involving the disclosure of a fee or charge that would otherwise be excludable in computing the finance charge, including but not limited to violations involving the disclosures described in sections 1605(b), (c) and (d) of this title, in which event the agency may require such remedial action as it determines to be equitable, except that for transactions consummated after two years after March 31, 1980, such an adjustment shall be ordered for violations of section 1605(b) of this title;

(B) involved a disclosed amount which was 10 per centum or less of the amount that should have been disclosed and (i) in cases where the error involved a disclosed finance charge, the annual percentage rate was disclosed correctly, and (ii) in cases where the error involved a disclosed annual percentage rate, the finance charge was disclosed correctly; in which event the agency may require such adjustment as it determines to be equitable;

(C) involved a total failure to disclose either the annual percentage rate or the finance charge, in which event the agency may require such adjustment as it determines to be equitable; or

(D) resulted from any other unique circumstance involving clearly technical and nonsubstantive disclosure violations that do not adversely affect information provided to the consumer and that have not misled or otherwise deceived the consumer.

In the case of other such disclosure errors, each agency may require such an adjustment.

(3) Notwithstanding paragraph (2), no adjustment shall be ordered--

(A) if it would have a significantly adverse impact upon the safety or soundness of the creditor, but in any such case, the agency may--

(i) require a partial adjustment in an amount which does not have such an impact; or

(ii) require the full adjustment, but permit the creditor to make the required adjustment in partial payments over an extended period of time which the agency considers to be reasonable, if (in the case of an agency referred to in paragraph (1), (2), or (3) of subsection (a) of this section), the agency determines that a partial adjustment or making partial payments over an extended period is necessary to avoid causing the creditor to become undercapitalized pursuant to section 1831o of title 12;

(B) the amount of the adjustment would be less than $1, except that if more than one year has elapsed since the date of the violation, the agency may require that such amount be paid into the Treasury of the United States, or

(C) except where such disclosure error resulted from a willful violation which was intended to mislead the person to whom credit was extended, in the case of an open-end credit plan, more than two years after the violation, or in the case of any other extension of credit, as follows:

(i) with respect to creditors that are subject to examination by the agencies referred to in paragraphs (1) through (3) of subsection (a) of this section, except in connection with violations arising from practices identified in the current examination and only in connection with transactions that are consummated after the date of the immediately preceding examination, except that where practices giving rise to violations identified in earlier examinations have not been corrected, adjustments for those violations shall be required in connection with transactions consummated after the date of examination in which such practices were first identified;

(ii) with respect to creditors that are not subject to examination by such agencies, except in connection with transactions that are consummated after May 10, 1978; and

(iii) in no event after the later of (I) the expiration of the life of the credit extension, or (II) two years after the agreement to extend credit was consummated.

(4)

(A) Notwithstanding any other provision of this section, an adjustment under this subsection may be required by an agency referred to in subsection (a) or (c) of this section only by an order issued in accordance with cease and desist procedures provided by the provision of law referred to in such subsections.

(B) In case of an agency which is not authorized to conduct cease and desist proceedings, such an order may be issued after an agency hearing on the record conducted at least thirty but not more than sixty days after notice of the alleged violation is served on the creditor. Such a hearing shall be deemed to be a hearing which is subject to the provisions of section 1818(h) of title 12 and shall be subject to judicial review as provided therein.

(5) Except as otherwise specifically provided in this subsection and notwithstanding any provision of law referred to in subsection (a) or (c) of this section, no agency referred to in subsection (a) or (c) of this section may require a creditor to make dollar adjustments for errors in any requirements under this subchapter, except with regard to the requirements of section 1666d of this title.

(6) A creditor shall not be subject to an order to make an adjustment, if within sixty days after discovering a disclosure error, whether pursuant to a final written examination report or through the creditor's own procedures, the creditor notifies the person concerned of the error and adjusts the account so as to assure that such person will not be required to pay a finance charge in excess of the finance charge actually disclosed or the dollar equivalent of the annual percentage rate actually disclosed, whichever is lower.

(7) Notwithstanding the second sentence of subsection (e)(1), subsection (e)(3)(C)(i), and subsection (e)(3)(C)(ii) of this section, each agency referred to in subsection (a) or (c) of this section shall require an adjustment for an annual

percentage rate disclosure error that exceeds a tolerance of one quarter of one percent less than the actual rate, determined without regard to section 1606(c) of this title, with respect to any transaction consummated between January 1, 1977, and March 31, 1980.

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§ **1608 Views of other agencies.**

In the exercise of its functions under this subchapter, the Board may obtain upon requests the views of any other Federal agency which, in the judgment of the Board, exercises regulatory or supervisory functions with respect to any class of creditors subject to this subchapter.

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§ **1609**

[Repealed.]

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§ 1610 Effect on other laws.

(a) Inconsistent provisions; procedures applicable for determination

(1) Except as provided in subsection (e) of this section, this part and parts B and C of this subchapter, do not annul, alter, or affect the laws of any State relating to the disclosure of information in connection with credit transactions, except to the extent that those laws are inconsistent with the provisions of this subchapter and then only to the extent of the inconsistency. Upon its own motion or upon the request of any creditor, State or other interested party which is submitted in accordance with procedures prescribed in regulations of the Board, the Board shall determine whether any such inconsistency exists. If the Board determines that a State-required disclosure is inconsistent, creditors located in that State may not make disclosures using the inconsistent term or form, and shall incur no liability under the law of that State for failure to use such term or form, notwithstanding that such determination is subsequently amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

(2) Upon its own motion or upon the request of any creditor, State, or other interested party which is submitted in accordance with procedures prescribed in regulations of the Board, the Board shall determine whether any disclosure required under the law of any State is substantially the same in meaning as a disclosure required under this subchapter. If the Board determines that a State-required disclosure is substantially the same in meaning as a disclosure required by this subchapter, then creditors located in that State may make such disclosure in compliance with such State law in lieu of the disclosure required by this subchapter, except that the annual percentage rate and finance charge shall be disclosed as required by section 1632 of this title, and such State-required disclosure may not be made in lieu of the disclosures applicable to certain mortgages under section 1639 of this title.

(b) State credit charge statutes

Except as provided in section 1639 of this title, this subchapter does not otherwise annul, alter or affect in any manner the meaning, scope or applicability of the laws of any State, including, but not limited to, laws relating to the types, amounts or rates of charges, or any element or elements of charges, permissible under such laws in connection with the extension or use of credit, nor does this subchapter extend the applicability of those laws to any class of persons or transactions to which they would not otherwise apply. The provisions of section 1639 of this title do not annul, alter, or affect the applicability of the laws of any State or exempt any person subject to the provisions of section 1639 of this title from complying with the laws of any State, with respect to the requirements for mortgages referred to in section 1602(aa) of this title, except to the extent that those State laws are inconsistent with any provisions of section 1639 of this title, and ten only to the extent of the inconsistency.

(c) Disclosure as evidence

In any action or proceeding in any court involving a consumer credit sale, the disclosure of the annual percentage rate as required under this subchapter in connection with that sale may not be received as evidence that the sale was a loan or any type of transaction other than a credit sale.

(d) Contract or other obligations under State or Federal law

Except as specified in sections 1635, 1640, and 1666e of this title, this subchapter and the regulations issued thereunder do not affect the validity or enforceability of any contract or obligation under State or Federal law.

(e) Certain credit and charge card application and solicitation disclosure provisions

The provisions of section 1632(c) of this title and section 1637(c), (d), (e), and (f) of this title shall supersede any provision of the law of any State relating to the disclosure of information in any credit or charge card application or solicitation which is subject to the requirements of section 1637(c) of this title or any renewal notice which is subject to the requirements of section 1637(d) of this title, except that any State may employ or establish State laws for the purpose of enforcing the requirements of such sections.

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§ **1611 Criminal liability for willful and knowing violation.**

Whoever willfully and knowingly

(1) gives false or inaccurate information or fails to provide information which he is required to disclose under the provisions of this subchapter or any regulation issued thereunder,

(2) uses any chart or table authorized by the Board under section 1606 of this title in such a manner as to consistently understate the annual percentage rate determined under section 1606(a)(1)(A) of this title, or

(3) otherwise fails to comply with any requirement imposed under this subchapter,

shall be fined not more than $5,000 or imprisoned not more than one year, or both.

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§ 1612 Effect on government agencies.

(a) Consultation requirements respecting compliance of credit instruments issued to participating creditor

Any department or agency of the United States which administers a credit program in which it extends, insures, or guarantees consumer credit and in which it provides instruments to a creditor which contain any disclosures required by this subchapter shall, prior to the issuance or continued use of such instruments, consult with the Board to assure that such instruments comply with this subchapter.

(b) Inapplicability of Federal civil or criminal penalties to Federal, State, and local agencies

No civil or criminal penalty provided under this subchapter for any violation thereof may be imposed upon the United States or any department or agency thereof, or upon any State or political subdivision thereof, or any agency of any State of political subdivision.

(c) Inapplicability of Federal civil or criminal penalties to participating creditor where violating instrument issued by United States

A creditor participating in a credit program administered, insured, or guaranteed by any department or agency or the United States shall not be held liable for a civil or criminal penalty under this subchapter in any case in which the violation results from the use of an instrument required by any such department or agency.

(d) Applicability of State penalties to violations by participating creditor

A creditor participating in a credit program administered, insured, or guaranteed by any department or agency of the United States shall not be held liable for a civil or criminal penalty under the laws of any State (other than laws determined under section 1610 of this title to be inconsistent with this subchapter) for any technical or procedural failure, such as a failure to use a specific form, to make information available at a specific place on an instrument, or to use a specific typeface, as required by State law, which is caused by the use of an instrument required to be used by such department or agency.

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§ 1613 Annual reports to Congress by Board.

Each year the Board shall make a report to the Congress concerning the administration of its functions under this subchapter, including such recommendations as the Board deems necessary or appropriate. In addition, each report of the Board shall include its assessment of the extent to which compliance with the requirements imposed under this subchapter is being achieved.

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§ **1614**

[Repealed.]

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§ 1615 Prohibition on use of "Rule of 78's" in connection with mortgage refinancings and other consumer loans.

(a) Prompt refund of unearned interest required

(1) In general

If a consumer prepays in full the financed amount under any consumer credit transaction, the creditor shall promptly refund any unearned portion of the interest charge to the consumer.

(2) Exception for refund of de minimus amount

No refund shall be required under paragraph (1) with respect to the prepayment of any consumer credit transaction if the total amount of the refund would be less than $1.

(3) Applicability to refinanced transactions and acceleration by the creditor

This subsection shall apply with respect to any prepayment of a consumer credit transaction described in paragraph (1) without regard to the manner or the reason for the prepayment, including--

(A) any prepayment made in connection with the refinancing, consolidation, or restructuring of the transaction; and

(B) any prepayment made as a result of the acceleration of the obligation to repay the amount due with respect to the transaction.

(b) Use of "Rule of 78's" prohibited

For the purpose of calculating any refund of interest required under subsection (a) for any precomputed consumer credit transaction of a term exceeding 61 months which is consummated after September 30, 1993, the creditor shall compute the refund based on a method which is at least as favorable to the consumer as the actuarial method.

(c) Statement of prepayment amount

(1) In general

Before the end of the 5-day period beginning on the date an oral or written request is received by a creditor from a consumer for the disclosure of the amount due on any precomputed consumer credit account, the creditor or assignee shall provide the consumer with a statement of--

(A) the amount necessary to prepay the account in full; and

(B) if the amount disclosed pursuant to subparagraph (A) includes an amount which is required to be refunded under this section with respect to such prepayment, the amount of such refund.

(2) Written statement required if request is in writing

If the customer's request is in writing, the statement under paragraph (1) shall be in writing.

(3) 1 free annual statement

A consumer shall be entitled to obtain 1 statement under paragraph (1) each year without charge.

(4) Additional statements subject to reasonable fees

Any creditor may impose a reasonable fee to cover the cost of providing any statement under paragraph (1) to any consumer in addition to the 1 free annual statement required under paragraph (3) if the amount of the charge for such additional statement is disclosed to the consumer before furnishing such statement.

(d) Definitions

For the purpose of this section--

(1) Actuarial method

The term "actuarial method" means the method of allocating payments made on a debt between the amount financed and the finance charge pursuant to which a payment is applied first to the accumulated finance charge and any remainder is subtracted from, or any deficiency is added to, the unpaid balance of the amount financed.

(2) Consumer, credit

The terms "consumer" and "creditor" have the meanings given to such terms in section 1602 of this title.

(3) Creditor

The term "creditor"--

(A) has the meaning given to such term in section 1602 of this title; and

(B) includes any assignee of any creditor with respect to credit extended in connection with any consumer credit transaction and any subsequent assignee with respect to such credit.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1616

§ 1616 Board review of consumer credit plans and regulations.

[Caution: This section takes effect 9 months after enactment of Act May 22, 2009, P.L. 111-24, as provided by § 3 of such Act.]

(a) Required review. Not later than 2 years after the effective date of this Act and every 2 years thereafter, except as provided in subsection (c)(2), the Board shall conduct a review, within the limits of its existing resources available for reporting purposes, of the consumer credit card market, including--

(1) the terms of credit card agreements and the practices of credit card issuers;

(2) the effectiveness of disclosure of terms, fees, and other expenses of credit card plans;

(3) the adequacy of protections against unfair or deceptive acts or practices relating to credit card plans; and

(4) whether or not, and to what extent, the implementation of this Act and the amendments made by this Act has affected--

(A) cost and availability of credit, particularly with respect to non-prime borrowers;

(B) the safety and soundness of credit card issuers;

(C) the use of risk-based pricing; or

(D) credit card product innovation.

(b) Solicitation of public comment. In connection with conducting the review required by subsection (a), the Board shall solicit comment from consumers, credit card issuers, and other interested parties, such as through hearings or written comments.

(c) Regulations.

(1) Notice. Following the review required by subsection (a), the Board shall publish a notice in the Federal Register that--

(A) summarizes the review, the comments received from the public solicitation, and other evidence gathered by the Board, such as through consumer testing or other research; and

(B) either--

(i) proposes new or revised regulations or interpretations to update or revise disclosures and protections for consumer credit cards, as appropriate; or

(ii) states the reason for the determination of the Board that new or revised regulations are not necessary.

(2) Revision of review period following material revision of regulations. In the event that the Board materially revises regulations on consumer credit card plans, a review need not be conducted until 2 years after the effective date of the

revised regulations, which thereafter shall be treated as the new date for the biennial review required by subsection (a).

(d) Board report to the Congress. The Board shall report to Congress not less frequently than every 2 years, except as provided in subsection (c)(2), on the status of its most recent review, its efforts to address any issues identified from the review, and any recommendations for legislation.

(e) Additional reporting. The Federal banking agencies (as that term is defined in section 3 of the Federal Deposit Insurance Act [*12 USCS § 1813*]) and the Federal Trade Commission shall provide annually to the Board, and the Board shall include in its annual report to Congress under section 10 of the Federal Reserve Act, information about the supervisory and enforcement activities of the agencies with respect to compliance by credit card issuers with applicable Federal consumer protection statutes and regulations, including--

(1) this Act, the amendments made by this Act, and regulations prescribed under this Act and such amendments; and

(2) section 5 of the Federal Trade Commission Act [*15 USCS § 45*], and regulations prescribed under the Federal Trade Commission Act, including part 227 of title 12 of the Code of Federal Regulations, as prescribed by the Board (referred to as "Regulation AA").

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1631

§ 1631 Disclosure requirements.

(a) Duty of creditor or lessor respecting one or more than one obligor

Subject to subsection (b) of this section, a creditor or lessor shall disclose to the person who is obligated on a consumer lease or a consumer credit transaction the information required under this subchapter. In a transaction involving more than one obligor, a creditor or lessor, except in a transaction under section 1635 of this title, need not disclose to more than one of such obligors if the obligor given disclosure is a primary obligor.

(b) Creditor or lessor required to make disclosure

If a transaction involves one creditor as defined in section 1602(f) of this title, or one lessor as defined in section 1667(3) of this title, such creditor or lessor shall make the disclosures. If a transaction involves more than one creditor or lessor, only one creditor or lessor shall by required to make the disclosures. The Board shall by regulation specify which creditor or lessor shall make the disclosures.

(c) Estimates as satisfying statutory requirements

The Board may provide by regulation that any portion of the information required to be disclosed by this subchapter may be given in the form of estimates where the provider of such information is not in a position to know exact information. In the case of any consumer credit transaction a portion of the interest on which is determined on a per diem basis and is to be collected upon the consummation of such transaction, any disclosure with respect to such portion of interest shall be deemed to be accurate for purposes of this chapter if the disclosure is based on information actually known to the creditor at the time that the disclosure documents are being prepared for the consummation of the transaction.

(d) Tolerances for numerical disclosures

The Board shall determine whether tolerances for numerical disclosures other than the annual percentage rate are necessary to facilitate compliance with this subchapter, and if it determines that such tolerances are necessary to facilitate compliance, it shall by regulation permit disclosures within such tolerances. The Board shall exercise its authority to permit tolerances for numerical disclosures other than the annual percentage rate so that such tolerances are narrow enough to prevent such tolerances from resulting in misleading disclosures or disclosures that circumvent the purposes of this subchapter.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1632

§ 1632 Form of disclosure; additional information.

(a) Information clearly and conspicuously disclosed; "annual percentage rate" and "finance charge" order of disclosures and use of different terminology

Information required by this subchapter shall be disclosed clearly and conspicuously, in accordance with regulations of the Board. The terms "annual percentage rate" and "finance charge" shall be disclosed more conspicuously than other terms, data, or information provided in connection with a transaction, except information relating to the identify of the creditor. Except as provided in subsection (c), regulations of the Board need not require that disclosures pursuant to this subchapter be made in the order dot forth in this subchapter and, except as otherwise provided, may permit the use of terminology different from that employed in this subchapter if it conveys substantially the same meaning.

(b) Optional information by creditor or lessor

Any creditor or lessor may supply additional information or explanation with any disclosures required under parts D and E of this subchapter and, except as provided in sections 1637a(b)(3) and 1638(b)(1) of this title, under this part.

(c) Tabular format required for certain disclosures under section 1637(c) of this title

(1) In general

The information described in paragraphs (1)(A), (3)(B)(i)(I), (4)(A), and (4)(C)(i)(I) of section 1637(c) of this title

shall be--

(A) disclosed in the form and manner which the Board shall prescribe by regulations; and

(B) placed in a conspicuous and prominent location on or with any written application, solicitation, or other document or paper with respect to which such disclosure is required.

(2) Tabular format

(A) Form of table to be prescribed

In the regulations prescribed under paragraph (1)(A) of this subsection, the Board shall require that the disclosure of such information shall, to the extent the Board determines to be practicable and appropriate, be in the form of a table which--

(i) contains clear and concise headings for each item of such information; and

(ii) provides a clear and concise form for stating each item of information required to be disclosed under each such heading.

(B) Board discretion in prescribing order and wording of table

In prescribing the form of the table under subparagraph (A), the Board may--

(i) list the items required to be included in the table in a different order than the order in which such items are set forth in paragraph (1)(A) or (4)(A) of section 1637(c) of this title; and

(ii) subject to subparagraph (C), employ terminology which is different than the terminology which is employed in section 1637(c) of this title if such terminology conveys substantially the same meaning.

(C) Grace period

Either the heading or the statement under the heading which relates to the time period referred to in section 1637(c)(1)(A)(iii) of this title shall contain the term "grace period".

(d) Additional electronic disclosures.

(1) Posting agreements. Each creditor shall establish and maintain an Internet site on which the creditor shall post the written agreement between the creditor and the consumer for each credit card account under an open-end consumer credit plan.

(2) Creditor to provide contracts to the board. Each creditor shall provide to the Board, in electronic format, the consumer credit card agreements that it publishes on its Internet site.

(3) Record repository. The Board shall establish and maintain on its publicly available Internet site a central repository of the consumer credit card agreements received from creditors pursuant to this subsection, and such agreements shall be easily accessible and retrievable by the public.

(4) Exception. This subsection shall not apply to individually negotiated changes to contractual terms, such as individually modified workouts or renegotiations of amounts owed by a consumer under an open end consumer credit plan.

(5) Regulations. The Board, in consultation with the other Federal banking agencies (as that term is defined in section 603 [*15 USCS § 1681a*]) and the Federal Trade Commission, may promulgate regulations to implement this subsection, including specifying the format for posting the agreements on the Internet sites of creditors and establishing exceptions to paragraphs (1) and (2), in any case in which the administrative burden outweighs the benefit of increased transparency, such as where a credit card plan has a de minimis number of consumer account holders.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1633

§ **1633 Exemption for State-regulated transactions.**

The Board shall by regulation exempt from the requirements of this part any class of credit transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under this part, and that there is adequate provision for enforcement.

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§ **1634 Effect of subsequent occurrence.**

If information disclosed in accordance with this part is subsequently rendered inaccurate as the result of any act, occurrence, or agreement subsequent to the delivery of the required disclosures, the inaccuracy resulting therefrom does not constitute a violation of this part.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1635

§ 1635 Right of rescission as to certain transactions.

(a) Disclosure of obligor's right to rescind

Except as otherwise provided in this section, in the case of any consumer credit transaction (including opening or increasing the credit limit for an open end credit plan) in which a security interest, including any such interest arising by operation of law, is or will be retained or acquired in any property which is used as the principal dwelling of the person to whom credit is extended, the obligor shall have the right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the information and rescission forms required under this section together with a statement containing the material disclosures required under this subchapter, whichever is later, by notifying the creditor, in accordance with regulations of the Board, of his intention to do so. The creditor shall clearly and conspicuously disclose, in accordance with regulations of the Board, to any obligor in a transaction subject to this section the rights of the obligor under this section. The creditor shall also provide, in accordance with regulations of the Board, appropriate forms for the obligor to exercise his right to rescind any transaction subject to this section.

(b) Return of money or property following rescission

When an obligor exercises his right to rescind under subsection (a) of this section, he is not liable for any finance or other charge, and any security interest given by the obligor, including any such interest arising by operation of law, becomes void upon such a rescission. Within 20 days after receipt of a notice of rescission, the creditor shall return to the obligor any money or property given as earnest money, down payment, or otherwise, and shall take any action necessary or appropriate to reflect the termination of any security interest created under the transaction. If the creditor has delivered any property to the obligor, the obligor may retain possession of it. Upon the performance of the creditor's obligations under this section, the obligor shall tender the property to the creditor, except that if return of the property in kind would be impracticable or inequitable, the obligor shall tender its reasonable value. Tender shall be made at the location of the property or at the residence of the obligor, at the option of the obligor. If the creditor does not take

possession of the property within 20 days after tender by the obligor, ownership of the property vests in the obligor without obligation on his part to pay for it. The procedures prescribed by this subsection shall apply except when otherwise ordered by a court.

(c) Rebuttable presumption of delivery of required disclosures

Notwithstanding any rule of evidence, written acknowledgment of receipt of any disclosures required under this subchapter by a person to whom information, forms, and a statement is required to be given pursuant to this section does no more than create a rebuttable presumption of delivery thereof.

(d) Modification and waiver of rights

The Board may, if it finds that such action is necessary in order to permit homeowners to meet bona fide personal financial emergencies, prescribe regulations authorizing the modification or waiver of any rights created under this section to the extent and under the circumstances set forth in those regulations.

(e) Exempted transactions; reapplication of provisions

This section does not apply to--

(1) a residential mortgage transaction as defined in section 1602(w) of this title;

(2) a transaction which constitutes a refinancing or consolidation (with no new advances) of the principal balance then due and any accrued and unpaid finance charges of an existing extension of credit by the same creditor secured by an interest in the same property;

(3) a transaction in which an agency of a State is the creditor; or

(4) advances under a preexisting open end credit plan if a security interest has already been retained or acquired and such advances are in accordance with a previously established credit limit for such plan.

(f) Time limit for exercise of right

An obligor's right of rescission shall expire three years after the date of consummation of the transaction or upon the sale of the property, whichever occurs first, notwithstanding the fact that the information and forms required under this section or any other disclosures required under this part have not been delivered to the obligor, except that if (1) any

agency empowered to enforce the provisions of this subchapter institutes a proceeding to enforce the provisions of this section within three years after the date of consummation of the transaction, (2) such agency finds a violation of this section, and (3) the obligor's right to rescind is based in whole or in part on any matter involved in such proceeding, then the obligor's right of rescission shall expire three years after the date of consummation of the transaction or upon the earlier sale of the property, or upon the expiration of one year following the conclusion of the proceeding, or any judicial review or period for judicial review thereof, whichever is later.

(g) Additional relief

In any action in which it is determined that a creditor has violated this section, in addition to rescission the court may award relief under section 1640 of this title for violations of this subchapter not relating to the right to rescind.

(h) Limitation on rescission

An obligor shall have no rescission rights arising solely from the form of written notice used by the creditor to inform the obligor of the rights of the obligor under this section, if the creditor provided the obligor the appropriate form of written notice published and adopted by the Board, or a comparable written notice of the rights of the obligor, that was properly completed by the creditor, and otherwise complied with all other requirements of this section regarding notice.

(i) Rescission rights in foreclosure

(1) In general

Notwithstanding section 1649 of this title, and subject to the time period provided in subsection (f) of this title, in addition to any other right of rescission available under this section for a transaction, after the initiation of any judicial or nonjudicial foreclosure process on the primary dwelling of an obligor securing an extension of credit, the obligor shall have a right to rescind the transaction equivalent to other rescission rights provided by this section, if--

(A) a mortgage broker fee is not included in the finance charge in accordance with the laws and regulations in effect at the time the consumer credit transaction was consummated; or

(B) the form of notice of rescission for the transaction is not the appropriate form of written notice published and adopted by the Board or a comparable written notice, and otherwise complied with all the requirements of this section regarding notice.

(2) Tolerance for disclosures

Notwithstanding section 1605(f) of this title, and subject to the time period provided in subsection (f) of this section, for the purposes of exercising any rescission rights after the initiation of any judicial or nonjudicial foreclosure process on the principal dwelling of the obligor securing an extension of credit, the disclosure of the finance charge and other disclosures affected by any finance charge shall be treated as being accurate for purposes of this section if the amount disclosed as the finance charge does not vary from the actual finance charge by more than $35 or is greater than the amount required to be disclosed under this chapter.

(3) Right of recoupment under State law

Nothing in this subsection affects a consumer's right of rescission in recoupment under State law.

(4) Applicability

This subsection shall apply to all consumer credit transactions in existence or consummated on or after September 30, 1995.

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§ **1636**

[Repealed.]

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§ **1637 Open end consumer credit plans.**

(a) Required disclosures by creditor.

Before opening any account under an open end consumer credit plan, the creditor shall disclose to the person to whom credit is to be extended each of the following items, to the extent applicable:

(1) The conditions under which a finance charge may be imposed, including the time period (if any) within which any credit extended may be repaid without incurring a finance charge, except that the creditor may, at his election and without disclosure, impose no such finance charge if payment is received after the termination of such time period. If no such time period is provided, the creditor shall disclose such fact.

(2) The method of determining the balance upon which a finance charge will be imposed.

(3) The method of determining the amount of the finance charge, including any minimum or fixed amount imposed as a finance charge.

(4) Where one or more periodic rates may be used to compute the finance charge, each such rate, the range of balances to which it is applicable, and the corresponding nominal annual percentage rate determined by multiplying the periodic rate by the number of periods in a year.

(5) Identification of other charges which may be imposed as part of the plan, and their method of computation, in accordance with regulations of the Board.

(6) In cases where the credit is or will be secured, a statement that a security interest has been or will be taken in (A) the property purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type.

(7) A statement, in a form prescribed by regulations of the Board of the protection provided by sections 161 and 170 [*15 USCS §§ 1666* and *1666i*] to an obligor and the creditor's responsibilities under sections 162 and 170 [*15 USCS §§ 1666a* and *1666i*]. With respect to one billing cycle per calendar year, at intervals of not less than six months or more than eighteen months, the creditor shall transmit such statement to each obligor to whom the creditor is required to transmit a statement pursuant to section 127(b) [subsec. (b) of this section] for such billing cycle.

(8) In the case of any account under an open end consumer credit plan which provides for any extension of credit which is secured by the consumer's principal dwelling, any information which--

(A) is required to be disclosed under section 127A(a) [*15 USCS § 1637a(a)*]; and

(B) the Board determines is not described in any other paragraph of this subsection.

(b) Statement required with each billing cycle.

The creditor of any account under an open end consumer credit plan shall transmit to the obligor, for each billing cycle at the end of which there is an outstanding balance in that account or with respect to which a finance charge is imposed, a statement setting forth each of the following items to the extent applicable:

(1) The outstanding balance in the account at the beginning of the statement period.

(2) The amount and date of each extension of credit during the period, and a brief identification, on or accompanying the statement of each extension of credit in a form prescribed by the Board sufficient to enable the obligor either to identify the transaction or to relate it to copies of sales vouchers or similar instruments previously furnished, except that a creditor's failure to disclose such information in accordance with this paragraph shall not be deemed a failure to comply with this chapter [*15 USCS §§ 1631 et seq.*] or this title [*15 USCS §§ 1601 et seq.*] if (A) the creditor maintains procedures reasonably adapted to procure and provide such information, and (B) the creditor responds to and treats any

inquiry for clarification or documentation as a billing error and an erroneously billed amount under section 161 [*15 USCS § 1666*]. In lieu of complying with the requirements of the previous sentence, in the case of any transaction in which the creditor and seller are the same person, as defined by the Board, and such person's open end credit plan has fewer than 15,000 accounts, the creditor may elect to provide only the amount and date of each extension of credit during the period and the seller's name and location where the transaction took place if (A) a brief identification of the transaction has been previously furnished, and (B) the creditor responds to and treats any inquiry for clarification or documentation as a billing error and an erroneously billed amount under section 161 [*15 USCS § 1666*].

(3) The total amount credited to the account during the period.

(4) The amount of any finance charge added to the account during the period, itemized to show the amounts, if any, due to the application of percentage rates and the amount, if any, imposed as a minimum or fixed charge.

(5) Where one or more periodic rates may be used to compute the finance charge, each such rate, the range of balances to which it is applicable, and, unless the annual percentage rate (determined under section 107(a)(2) [*15 USCS § 1606(a)(2)*]) is required to be disclosed pursuant to paragraph (6), the corresponding nominal annual percentage rate determined by multiplying the periodic rate by the number of periods in a year.

(6) Where the total finance charge exceeds 50 cents for a monthly or longer billing cycle, or the pro rata part of 50 cents for a billing cycle shorter than monthly, the total finance charge expressed as an annual percentage rate (determined under section 107(a)(2) [*15 USCS § 1606(a)(2)*]), except that if the finance charge is the sum of two or more products of a rate times a portion of the balance, the creditor may, in lieu of disclosing a single rate for the total charge, disclose each such rate expressed as an annual percentage rate, and the part of the balance to which it is applicable.

(7) The balance on which the finance charge was computed and a statement of how the balance was determined. If the balance is determined without first deducting all credits during the period, that fact and the amount of such payments shall also be disclosed.

(8) The outstanding balance in the account at the end of the period.

(9) The date by which or the period (if any) within which, payment must be made to avoid additional finance charges, except that the creditor may, at his election and without disclosure, impose no such additional finance charge if payment is received after such date or the termination of such period.

(10) The address to be used by the creditor for the purpose of receiving billing inquiries from the obligor.

(11)

(A) A written statement in the following form: "Minimum Payment Warning: Making only the minimum payment will increase the amount of interest you pay and the time it takes to repay your balance.", or such similar statement as is established by the Board pursuant to consumer testing.

(B) Repayment information that would apply to the outstanding balance of the consumer under the credit plan, including--

(i) the number of months (rounded to the nearest month) that it would take to pay the entire amount of that balance, if the consumer pays only the required minimum monthly payments and if no further advances are made;

(ii) the number of months (rounded to the nearest month) that it would take to pay the entire amount of that balance, if the consumer pays only the required minimum monthly payments and if no further advances are made;

(iii) the monthly payment amount that would be required for the consumer to eliminate the outstanding balance in 36 months, if no further advances are made, and the total cost to the consumer, including interest and principal payments, of paying that balance in full if the consumer pays the balance over 36 months; and

(iv) a toll-free telephone number at which the consumer may receive information about accessing credit counseling and debt management services.

(C)

(i) Subject to clause (ii), in making the disclosures under subparagraph (B), the creditor shall apply the interest rate or rates in effect on the date on which the disclosure is made until the date on which the balance would be paid in full.

(ii) If the interest rate in effect on the date on which the disclosure is made is a temporary rate that will change under a contractual provision applying an index or formula for subsequent interest rate adjustment, the creditor shall apply the interest rate in effect on the date on which the disclosure is made for as long as that interest rate will apply under that contractual provision, and then apply an interest rate based on the index or formula in effect on the applicable billing date.

(D) All of the information described in subparagraph (B) shall--

(i) be disclosed in the form and manner which the Board shall prescribe, by regulation, and in a manner that avoids duplication; and

(ii) be placed in a conspicuous and prominent location on the billing statement.

(E) In the regulations prescribed under subparagraph (D), the Board shall require that the disclosure of such information shall be in the form of a table that--

(i) contains clear and concise headings for each item of such information; and

(ii) provides a clear and concise form stating each item of information required to be disclosed under each such heading.

(F) In prescribing the form of the table under subparagraph (E), the Board shall require that--

(i) all of the information in the table, and not just a reference to the table, be placed on the billing statement, as required by this paragraph; and

(ii) the items required to be included in the table shall be listed in the order in which such items are set forth in subparagraph (B).

(G) In prescribing the form of the table under subparagraph (D), the Board shall employ terminology which is different than the terminology which is employed in subparagraph (B), if such terminology is more easily understood and conveys substantially the same meaning.

(12) Requirements relating to late payment deadlines and penalties.

(A) Late payment deadline required to be disclosed. In the case of a credit card account under an open end consumer credit plan under which a late fee or charge may be imposed due to the failure of the obligor to make payment on or before the due date for such payment, the periodic statement required under subsection (b) with respect to the account shall include, in a conspicuous location on the billing statement, the date on which the payment is due or, if different, the date on which a late payment fee will be charged, together with the amount of the fee or charge to be imposed if payment is made after that date.

(B) Disclosure of increase in interest rates for late payments. If 1 or more late payments under an open end consumer credit plan may result in an increase in the annual percentage rate applicable to the account, the statement required under subsection (b) with respect to the account shall include conspicuous notice of such fact, together with the applicable penalty annual percentage rate, in close proximity to the disclosure required under subparagraph (A) of the date on which payment is due under the terms of the account.

(C) Payments at local branches. If the creditor, in the case of a credit card account referred to in subparagraph (A), is a financial institution which maintains branches or offices at which payments on any such account are accepted from the obligor in person, the date on which the obligor makes a payment on the account at such branch or office shall be considered to be the date on which the payment is made for purposes of determining whether a late fee or charge may be imposed due to the failure of the obligor to make payment on or before the due date for such payment.

(c) Disclosure in credit and charge card applications and solicitations.

(1) Direct mail applications and solicitations.

(A) Information in tabular format.

Any application to open a credit card account for any person under an open end consumer credit plan, or a solicitation to open such an account without requiring an application, that is mailed to consumers shall disclose the following information, subject to subsection (e) and section 122(c) [*15 USCS § 1632(c)*]:

(i) Annual percentage rates.

(I) Each annual percentage rate applicable to extensions of credit under such credit plan.

(II) Where an extension of credit is subject to a variable rate, the fact that the rate is variable, the annual percentage rate in effect at the time of the mailing, and how the rate is determined.

(III) Where more than one rate applies, the range of balances to which each rate applies.

(ii) Annual and other fees.

(I) Any annual fee, other periodic fee, or membership fee imposed for the issuance or availability of a credit card, including any account maintenance fee or other charge imposed based on activity or inactivity for the account during the billing cycle.

(II) Any minimum finance charge imposed for each period during which any extension of credit which is subject to a finance charge is outstanding.

(III) Any transaction charge imposed in connection with use of the card to purchase goods or services.

(iii) Grace period.

(I) The date by which or the period within which any credit extended under such credit plan for purchases of goods or services must be repaid to avoid incurring a finance charge, and, if no such period is offered, such fact shall be clearly stated.

(II) If the length of such "grace period" varies, the card issuer may disclose the range of days in the grace period, the minimum number of days in the grace period, or the average number of days in the grace period, if the disclosure is identified as such.

(iv) Balance calculation method.

(I) The name of the balance calculation method used in determining the balance on which the finance charge is computed if the method used has been defined by the Board, or a detailed explanation of the balance calculation method used if the method has not been so defined.

(II) In prescribing regulations to carry out this clause, the Board shall define and name not more than the 5

balance calculation methods determined by the Board to be the most commonly used methods.

(B) Other information.

In addition to the information required to be disclosed under subparagraph (A), each application or solicitation to which such subparagraph applies shall disclose clearly and conspicuously the following information, subject to subsections (e) and (f):

(i) Cash advance fee. Any fee imposed for an extension of credit in the form of cash.

(ii) Late fee. Any fee imposed for a late payment.

(iii) Over-the-limit fee. Any fee imposed in connection with an extension of credit in excess of the amount of credit authorized to be extended with respect to such account.

(2) Telephone solicitations.

(A) In general. In any telephone solicitation to open a credit card account for any person under an open end consumer credit plan, the person making the solicitation shall orally disclose the information described in paragraph (1)(A).

(B) Exception. Subparagraph (A) shall not apply to any telephone solicitation if--

(i) the credit card issuer--

(I) does not impose any fee described in paragraph (1)(A)(ii)(I); or

(II) does not impose any fee in connection with telephone solicitations unless the consumer signifies acceptance by using the card;

(ii) the card issuer discloses clearly and conspicuously in writing the information described in paragraph (1) within 30 days after the consumer requests the card, but in no event later than the date of delivery of the card; and

(iii) the card issuer discloses clearly and conspicuously that the consumer is not obligated to accept the card or account and the consumer will not be obligated to pay any of the fees or charges disclosed unless the consumer elects to accept the card or account by using the card.

(3) Applications and solicitations by other means.

(A) In general. Any application to open a credit card account for any person under an open end consumer credit plan, and any solicitation to open such an account without requiring an application, that is made available to the public or contained in catalogs, magazines, or other publications shall meet the disclosure requirements of subparagraph (B), (C), or (D).

(B) Specific information. An application or solicitation described in subparagraph (A) meets the requirement of this subparagraph if such application or solicitation contains--

(i) the information--

(I) described in paragraph (1)(A) in the form required under section 122(c) of this chapter [*15 USCS § 1632(c)*], subject to subsection (e), and

(II) described in paragraph (1)(B) in a clear and conspicuous form, subject to subsections (e) and (f);

(ii) a statement, in a conspicuous and prominent location on the application or solicitation, that--

(I) the information is accurate as of the date the application or solicitation was printed;

(II) the information contained in the application or solicitation is subject to change after such date; and

(III) the applicant should contact the creditor for information on any change in the information contained in the application or solicitation since it was printed;

(iii) a clear and conspicuous disclosure of the date the application or solicitation was printed; and

(iv) a disclosure, in a conspicuous and prominent location on the application or solicitation, of a toll free telephone number or a mailing address at which the applicant may contact the creditor to obtain any change in the information provided in the application or solicitation since it was printed.

(C) General information without any specific term. An application or solicitation described in subparagraph (A) meets the requirement of this subparagraph if such application or solicitation--

(i) contains a statement, in a conspicuous and prominent location on the application or solicitation, that--

(I) there are costs associated with the use of credit cards; and

(II) the applicant may contact the creditor to request disclosure of specific information of such costs by calling a toll free telephone number or by writing to an address, specified in the application;

(ii) contains a disclosure, in a conspicuous and prominent location on the application or solicitation, of a toll free telephone number and a mailing address at which the applicant may contact the creditor to obtain such information; and

(iii) does not contain any of the items described in paragraph (1).

(D) Applications or solicitations containing subsection (a) disclosures. An application or solicitation meets the requirement of this subparagraph if it contains, or is accompanied by--

(i) the disclosures required by paragraphs (1) through (6) of subsection (a);

(ii) the disclosures required by subparagraphs (A) and (B) of paragraph (1) of this subsection included clearly and

conspiciously [conspicuously] (except that the provisions of section 122(c) [*15 USCS § 1632(c)*] shall not apply); and

(iii) a toll free telephone number or a mailing address at which the applicant may contact the creditor to obtain any change in the information provided.

(E) Prompt response to information requests. Upon receipt of a request for any of the information referred to in subparagraph (B), (C), or (D), the card issuer or the agent of such issuer shall promptly disclose all of the information described in paragraph (1).

(4) Charge card applications and solicitations.

(A) In general. Any application or solicitation to open a charge card account shall disclose clearly and conspicuously the following information in the form required by section 122(c) of this chapter [*15 USCS § 1632(c)*], subject to subsection (e):

(i) Any annual fee, other periodic fee, or membership fee imposed for the issuance or availability of the charge card, including any account maintenance fee or other charge imposed based on activity or inactivity for the account during the billing cycle.

(ii) Any transaction charge imposed in connection with use of the card to purchase goods or services.

(iii) A statement that charges incurred by use of the charge card are due and payable upon receipt of a periodic statement rendered for such charge card account.

(B) Other information. In addition to the information required to be disclosed under subparagraph (A), each written application or solicitation to which such subparagraph applies shall disclose clearly and conspicuously the following information, subject to subsections (e) and (f):

(i) Cash advance fee. Any fee imposed for an extension of credit in the form of cash.

(ii) Late fee. Any fee imposed for a late payment.

(iii) Over-the-limit fee. Any fee imposed in connection with an extension of credit in excess of the amount of credit authorized to be extended with respect to such account.

(C) Applications and solicitations by other means. Any application to open a charge card account, and any solicitation to open such an account without requiring an application, that is made available to the public or contained in catalogs, magazines, or other publications shall contain--

(i) the information--

(I) described in subparagraph (A) in the form required under section 122(c) of this chapter [*15 USCS § 1632(c)*], subject to subsection (e), and

(II) described in subparagraph (B) in a clear and conspicuous form, subject to subsections (e) and (f);

(ii) a statement, in a conspicuous and prominent location on the application or solicitation, that--

(I) the information is accurate as of the date the application or solicitation was printed;

(II) the information contained in the application or solicitation is subject to change after such date; and

(III) the applicant should contact the creditor for information on any change in the information contained in the application or solicitation since it was printed;

(iii) a clear and conspicuous disclosure of the date the application or solicitation was printed; an

(iv) a disclosure, in a conspicuous and prominent location on the application or solicitation, of a toll free telephone number or a mailing address at which the applicant may contact the creditor to obtain any change in the information provided in the application or solicitation since it was printed.

(D) Issuers of charge cards which provide access to open end consumer credit plans. If a charge card permits the card holder to receive an extension of credit under an open end consumer credit plan, which is not maintained by the charge card issuer, the charge card issuer may provide the information described in subparagraphs (A) and (B) in the form required by such subparagraphs in lieu of the information required to be provided under paragraph (1), (2), or (3) with respect to any credit extended under such plan, if the charge card issuer discloses clearly and conspicuously to the consumer in the application or solicitation that--

(i) the charge card issuer will make an independent decision as to whether to issue the card;

(ii) the charge card may arrive before the decision is made with respect to an extension of credit under an open end consumer credit plan; and

(iii) approval by the charge card issuer does not constitute approval by the issuer of the extension of credit.

The information required to be disclosed under paragraph (1) shall be provided to the charge card holder by the creditor which maintains such open end consumer credit plan before the first extension of credit under such plan.

(E) Charge card defined. For the purposes of this subsection, the term "charge card" means a card, plate, or other single credit device that may be used from time to time to obtain credit which is not subject to a finance charge.

(5) Regulatory authority of the Board. The Board may, by regulation, require the disclosure of information in addition to that otherwise required by this subsection or subsection (d), and modify any disclosure of information required by this subsection or subsection (d), in any application to open a credit card account for any person under an open end consumer credit plan or any application to open a charge card account for any person, or a solicitation to open any such account without requiring an application, if the Board determines that such action is necessary to carry out the purposes of, or prevent evasions of, any paragraph of this subsection.

(6) Additional notice concerning "introductory rates".

(A) In general. Except as provided in subparagraph (B), an application or solicitation to open a credit card account and all promotional materials accompanying such application or solicitation for which a disclosure is required under paragraph (1), and that offers a temporary annual percentage rate of interest, shall--

(i) use the term "introductory" in immediate proximity to each listing of the temporary annual percentage rate applicable to such account, which term shall appear clearly and conspicuously;

(ii) if the annual percentage rate of interest that will apply after the end of the temporary rate period will be a fixed rate, state in a clear and conspicuous manner in a prominent location closely proximate to the first listing of the temporary annual percentage rate (other than a listing of the temporary annual percentage rate in the tabular format described in section 122(c) [*15 USCS § 1632(c)*]), the time period in which the introductory period will end and the annual percentage rate that will apply after the end of the introductory period; and

(iii) if the annual percentage rate that will apply after the end of the temporary rate period will vary in accordance with an index, state in a clear and conspicuous manner in a prominent location closely proximate to the first listing of the temporary annual percentage rate (other than a listing in the tabular format prescribed by section 122(c) [*15 USCS § 1632(c)*]), the time period in which the introductory period will end and the rate that will apply after that, based on an annual percentage rate that was in effect within 60 days before the date of mailing the application or solicitation.

(B) Exception. Clauses (ii) and (iii) of subparagraph (A) do not apply with respect to any listing of a temporary annual percentage rate on an envelope or other enclosure in which an application or solicitation to open a credit card account is mailed.

(C) Conditions for introductory rates. An application or solicitation to open a credit card account for which a disclosure is required under paragraph (1), and that offers a temporary annual percentage rate of interest shall, if that rate of interest is revocable under any circumstance or upon any event, clearly and conspicuously disclose, in a prominent manner on or with such application or solicitation--

(i) a general description of the circumstances that may result in the revocation of the temporary annual percentage rate; and

(ii) if the annual percentage rate that will apply upon the revocation of the temporary annual percentage rate--

(I) will be a fixed rate, the annual percentage rate that will apply upon the revocation of the temporary annual percentage rate; or

(II) will vary in accordance with an index, the rate that will apply after the temporary rate, based on an annual percentage rate that was in effect within 60 days before the date of mailing the application or solicitation.

(D) Definitions. In this paragraph--

(i) the terms "temporary annual percentage rate of interest" and "temporary annual percentage rate" mean any rate of interest applicable to a credit card account for an introductory period of less than 1 year, if that rate is less than an annual percentage rate that was in effect within 60 days before the date of mailing the application or solicitation; and

(ii) the term "introductory period" means the maximum time period for which the temporary annual percentage rate may be applicable.

(E) Relation to other disclosure requirements. Nothing in this paragraph may be construed to supersede subsection (a) of section 122, or any disclosure required by paragraph (1) or any other provision of this subsection

(7) Internet-based solicitations.

(A) In general. In any solicitation to open a credit card account for any person under an open end consumer credit plan using the Internet or other interactive computer service, the person making the solicitation shall clearly and conspicuously disclose--

(i) the information described in subparagraphs (A) and (B) of paragraph (1); and

(ii) the information described in paragraph (6).

(B) Form of disclosure. The disclosures required by subparagraph (A) shall be--

(i) readily accessible to consumers in close proximity to the solicitation to open a credit card account; and

(ii) updated regularly to reflect the current policies, terms, and fee amounts applicable to the credit card account.

(C) Definitions. For purposes of this paragraph--

(i) the term "Internet" means the international computer network of both Federal and non-Federal interoperable packet switched data networks; and

(ii) the term "interactive computer service" means any information service, system, or access software provider that provides or enables computer access by multiple users to a computer server, including specifically a service or system that provides access to the Internet and such systems operated or services offered by libraries or educational institutions.

(8) Applications from underage consumers.

(A) Prohibition on issuance. No credit card may be issued to, or open end consumer credit plan established by or on behalf of, a consumer who has not attained the age of 21, unless the consumer has submitted a written application to the card issuer that meets the requirements of subparagraph (B).

(B) Application requirements. An application to open a credit card account by a consumer who has not attained the age of 21 as of the date of submission of the application shall require--

(i) the signature of a cosigner, including the parent, legal guardian, spouse, or any other individual who has attained the age of 21 having a means to repay debts incurred by the consumer in connection with the account, indicating joint liability for debts incurred by the consumer in connection with the account before the consumer has attained the age of 21; or

(ii) submission by the consumer of financial information, including through an application, indicating an independent means of repaying any obligation arising from the proposed extension of credit in connection with the account.

(C) Safe harbor. The Board shall promulgate regulations providing standards that, if met, would satisfy the requirements of subparagraph (B)(ii).

(d) Disclosure prior to renewal.

(1) In general. Except as provided in paragraph (2), a card issuer that imposes any fee described in subsection (c)(1)(A)(ii)(I) or (c)(4)(A)(i) shall transmit to a consumer at least 30 days prior to the scheduled renewal date of the consumer's credit or charge card account a clear and conspicuous disclosure of--

(A) the date by which, the month by which, or the billing period at the close of which, the account will expire if not renewed;

(B) the information described in subsection (c)(1)(A) or (c)(4)(A) that would apply if the account were renewed, subject to subsection (e); and

(C) the method by which the consumer may terminate continued credit availability under the account.

(2) Special rule for certain disclosures.

(A) In general. The disclosures required by this subsection may be provided--

(i) prior to posting a fee described in subsection (c)(1)(A)(ii)(I) or (c)(4)(A)(i) to the account, or

(ii) with the periodic billing statement first disclosing that the fee has been posted to the account.

(B) Limitation on use of special rule. Disclosures may be provided under subparagraph (A) only if--

(i) the consumer is given a 30-day period to avoid payment of the fee or to have the fee recredited to the account in any case where the consumer does not wish to continue the availability of the credit; and

(ii) the consumer is permitted to use the card during such period without incurring an obligation to pay such fee.

(3) Short-term renewals. The Board may by regulation provide for fewer disclosures than are required by paragraph (1) in the case of an account which is renewable for a period of less than 6 months.

(e) Other rules for disclosures under subsections (c) and (d).

(1) Fees determined on the basis of a percentage. If the amount of any fee required to be disclosed under subsection (c) or (d) is determined on the basis of a percentage of another amount, the percentage used in making such determination and the identification of the amount against which such percentage is applied shall be disclosed in lieu of the amount of such fee.

(2) Disclosure only of fees actually imposed. If a credit or charge card issuer does not impose any fee required to be disclosed under any provision of subsection (c) or (d), such provision shall not apply with respect to such issuer.

(f) Disclosure of range of certain fees which vary by State allowed.

If the amount of any fee required to be disclosed by a credit or charge card issuer under paragraph (1)(B), (3)(B)(i)(II), (4)(B), or (4)(C)(i)(II) of subsection (c) varies from State to State, the card issuer may disclose the range of such fees for purposes of subsection (c) in lieu of the amount for each applicable State, if such disclosure includes a statement that the amount of such fee varies from State to State.

(g) Insurance in connection with certain open end credit card plans.

(1) Change in insurance carrier. Whenever a card issuer that offers any guarantee or insurance for repayment of all or part of the outstanding balance of an open end credit card plan proposes to change the person providing that guarantee or insurance, the card issuer shall send each insured consumer written notice of the proposed change not less than 30 days prior to the change, including notice of any increase in the rate or substantial decrease in coverage or service which will result from such change. Such notice may be included on or with the monthly statement provided to the consumer prior to the month in which the proposed change would take effect.

(2) Notice of new insurance coverage. In any case in which a proposed change described in paragraph (1) occurs, the insured consumer shall be given the name and address of the new guarantor or insurer and a copy of the policy or group certificate containing the basic terms and conditions, including the premium rate to be charged.

(3) Right to discontinue guarantee or insurance. The notices required under paragraphs (1) and (2) shall each include a statement that the consumer has the option to discontinue the insurance or guarantee.

(4) No preemption of State law. No provision of this subsection shall be construed as superseding any provision of State law which is applicable to the regulation of insurance.

(5) Board definition of substantial decrease in coverage or service. The Board shall define, in regulations, what constitutes a "substantial decrease in coverage or service" for purposes of paragraph (1).

(h) Prohibition on certain actions for failure to incur finance charges.

A creditor of an account under an open end consumer credit plan may not terminate an account prior to its expiration date solely because the consumer has not incurred finance charges on the account. Nothing in this subsection shall prohibit a creditor from terminating an account for inactivity in 3 or more consecutive months.

(i) Advance notice of rate increase and other changes required.

(1) Advance notice of increase in interest rate required. In the case of any credit card account under an open end consumer credit plan, a creditor shall provide a written notice of an increase in an annual percentage rate (except in the case of an increase described in paragraph (1), (2), or (3) of section 171(b) [*15 USCS § 1666i-1(b)*]) not later than 45 days prior to the effective date of the increase.

(2) Advance notice of other significant changes required. In the case of any credit card account under an open end consumer credit plan, a creditor shall provide a written notice of any significant change, as determined by rule of the Board, in the terms (including an increase in any fee or finance charge, other than as provided in paragraph (1)) of the cardholder agreement between the creditor and the obligor, not later than 45 days prior to the effective date of the change.

(3) Notice of right to cancel. Each notice required by paragraph (1) or (2) shall be made in a clear and conspicuous manner, and shall contain a brief statement of the right of the obligor to cancel the account pursuant to rules established by the Board before the effective date of the subject rate increase or other change.

(4) Rule of construction. Closure or cancellation of an account by the obligor shall not constitute a default under an existing cardholder agreement, and shall not trigger an obligation to immediately repay the obligation in full or through a method that is less beneficial to the obligor than one of the methods described in section 171(c)(2) [*15 USCS § 1666i-1(c)(2)*], or the imposition of any other penalty or fee.

(j) Prohibition on penalties for on-time payments.

(1) Prohibition on double-cycle billing and penalties for on-time payments. Except as provided in paragraph (2), a creditor may not impose any finance charge on a credit card account under an open end consumer credit plan as a result of the loss of any time period provided by the creditor within which the obligor may repay any portion of the credit

extended without incurring a finance charge, with respect to--

(A) any balances for days in billing cycles that precede the most recent billing cycle; or

(B) any balances or portions thereof in the current billing cycle that were repaid within such time period.

(2) Exceptions. Paragraph (1) does not apply to--

(A) any adjustment to a finance charge as a result of the resolution of a dispute; or

(B) any adjustment to a finance charge as a result of the return of a payment for insufficient funds.

(k) Opt-in required for over-the-limit transactions if fees are imposed.

(1) In general. In the case of any credit card account under an open end consumer credit plan under which an over-the-limit fee may be imposed by the creditor for any extension of credit in excess of the amount of credit authorized to be extended under such account, no such fee shall be charged, unless the consumer has expressly elected to permit the creditor, with respect to such account, to complete transactions involving the extension of credit under such account in excess of the amount of credit authorized.

(2) Disclosure by creditor. No election by a consumer under paragraph (1) shall take effect unless the consumer, before making such election, received a notice from the creditor of any over-the-limit fee in the form and manner, and at the time, determined by the Board. If the consumer makes the election referred to in paragraph (1), the creditor shall provide notice to the consumer of the right to revoke the election, in the form prescribed by the Board, in any periodic statement that includes notice of the imposition of an over-the-limit fee during the period covered by the statement.

(3) Form of election. A consumer may make or revoke the election referred to in paragraph (1) orally, electronically, or in writing, pursuant to regulations prescribed by the Board. The Board shall prescribe regulations to ensure that the same options are available for both making and revoking such election.

(4) Time of election. A consumer may make the election referred to in paragraph (1) at any time, and such election shall be effective until the election is revoked in the manner prescribed under paragraph (3).

(5) Regulations. The Board shall prescribe regulations--

(A) governing disclosures under this subsection; and

(B) that prevent unfair or deceptive acts or practices in connection with the manipulation of credit limits designed to increase over-the-limit fees or other penalty fees.

(6) Rule of construction. Nothing in this subsection shall be construed to prohibit a creditor from completing an over-the-limit transaction, provided that a consumer who has not made a valid election under paragraph (1) is not charged an over-the-limit fee for such transaction.

(7) Restriction on fees charged for an over-the-limit transaction. With respect to a credit card account under an open end consumer credit plan, an over-the-limit fee may be imposed only once during a billing cycle if the credit limit on the account is exceeded, and an over-the-limit fee, with respect to such excess credit, may be imposed only once in each of the 2 subsequent billing cycles, unless the consumer has obtained an additional extension of credit in excess of such credit limit during any such subsequent cycle or the consumer reduces the outstanding balance below the credit limit as of the end of such billing cycle.

(l) Limit on fees related to method of payment [Caution: This subsection takes effect 9 months after enactment of Act May 22, 2009, P.L. 111-24, as provided by § 3 of such Act, which appears as *15 USCS § 1602* note.]. With respect to a credit card account under an open end consumer credit plan, the creditor may not impose a separate fee to allow the obligor to repay an extension of credit or finance charge, whether such repayment is made by mail, electronic transfer, telephone authorization, or other means, unless such payment involves an expedited service by a service representative of the creditor.

(m) Use of term "fixed rate".

With respect to the terms of any credit card account under an open end consumer credit plan, the term "fixed", when appearing in conjunction with a reference to the annual percentage rate or interest rate applicable with respect to such account, may only be used to refer to an annual percentage rate or interest rate that will not change or vary for any reason over the period specified clearly and conspicuously in the terms of the account.

(n) Standards applicable to initial issuance of subprime or "fee harvester" cards.

(1) In general. If the terms of a credit card account under an open end consumer credit plan require the payment of any fees (other than any late fee, over-the-limit fee, or fee for a payment returned for insufficient funds) by the consumer in the first year during which the account is opened in an aggregate amount in excess of 25 percent of the total amount of credit authorized under the account when the account is opened, no payment of any fees (other than any late fee, over-the-limit fee, or fee for a payment returned for insufficient funds) may be made from the credit made available under the terms of the account.

(2) Rule of construction. No provision of this subsection may be construed as authorizing any imposition or payment of advance fees otherwise prohibited by any provision of law

(o) Due dates for credit card accounts.

(1) In general. The payment due date for a credit card account under an open end consumer credit plan shall be the same day each month.

(2) Weekend or holiday due dates. If the payment due date for a credit card account under an open end consumer credit plan is a day on which the creditor does not receive or accept payments by mail (including weekends and holidays), the creditor may not treat a payment received on the next business day as late for any purpose.

(p) Parental approval required to increase credit lines for accounts for which parent is jointly liable.

No increase may be made in the amount of credit authorized to be extended under a credit card account for which a parent, legal guardian, or spouse of the consumer, or any other individual has assumed joint liability for debts incurred by the consumer in connection with the account before the consumer attains the age of 21, unless that parent, guardian, or spouse approves in writing, and assumes joint liability for, such increase.

(q) [Not enacted]

(r) College card agreements.

[Caution: This subsection takes effect 9 months after enactment of Act May 22, 2009, P.L. 111-24, as provided by § 3 of such Act.]

(1) Definitions. For purposes of this subsection, the following definitions shall apply:

(A) College affinity card. The term "college affinity card" means a credit card issued by a credit card issuer under an open end consumer credit plan in conjunction with an agreement between the issuer and an institution of higher education, or an alumni organization or foundation affiliated with or related to such institution, under which such cards are issued to college students who have an affinity with such institution, organization and--

(i) the creditor has agreed to donate a portion of the proceeds of the credit card to the institution, organization, or foundation (including a lump sum or 1-time payment of money for access);

(ii) the creditor has agreed to offer discounted terms to the consumer; or

(iii) the credit card bears the name, emblem, mascot, or logo of such institution, organization, or foundation, or other words, pictures, or symbols readily identified with such institution, organization, or foundation.

(B) College student credit card account. The term "college student credit card account" means a credit card account under an open end consumer credit plan established or maintained for or on behalf of any college student.

(C) College student. The term "college student" means an individual who is a full-time or a part-time student attending an institution of higher education.

(D) Institution of higher education. The term "institution of higher education" has the same meaning as in section 101 and 102 of the Higher Education Act of 1965 (*20 U.S.C. 1001* and *1002*).

(2) Reports by creditors.

(A) In general. Each creditor shall submit an annual report to the Board containing the terms and conditions of all business, marketing, and promotional agreements and college affinity card agreements with an institution of higher education, or an alumni organization or foundation affiliated with or related to such institution, with respect to any college student credit card issued to a college student at such institution.

(B) Details of report. The information required to be reported under subparagraph (A) includes--

(i) any memorandum of understanding between or among a creditor, an institution of higher education, an alumni association, or foundation that directly or indirectly relates to any aspect of any agreement referred to in such subparagraph or controls or directs any obligations or distribution of benefits between or among any such entities;

(ii) the amount of any payments from the creditor to the institution, organization, or foundation during the period covered by the report, and the precise terms of any agreement under which such amounts are determined; and

(iii) the number of credit card accounts covered by any such agreement that were opened during the period covered by the report, and the total number of credit card accounts covered by the agreement that were outstanding at the end of such period.

(C) Aggregation by institution. The information required to be reported under subparagraph (A) shall be aggregated with respect to each institution of higher education or alumni organization or foundation affiliated with or related to such institution.

(D) Initial report. The initial report required under subparagraph (A) shall be submitted to the Board before the end of the 9-month period beginning on the date of enactment of this subsection [enacted May 22, 2009].

(3) Reports by Board. The Board shall submit to the Congress, and make available to the public, an annual report that lists the information concerning credit card agreements submitted to the Board under paragraph (2) by each institution of higher education, alumni organization, or foundation.

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT 2
15 U.S.C. §§ 1601-1692p CHAPTER 41--CONSUMER CREDIT PROTECTION ACT
SUBCHAPTER I CONSUMER CREDIT COST DISCLOSURE (15 U.S.C. § 1601 et seq.)
Part B Credit Transactions

1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1637a

§ 1637a Disclosure requirements for open end consumer credit plans secured by the consumer's principal dwelling.

(a) Application disclosures

In the case of any open end consumer credit plan which provides for any extension of credit which is secured by the consumer's principal dwelling, the creditor shall make the following disclosures in accordance with subsection (b) of this section:

(1) Fixed annual percentage rate

Each annual percentage rate imposed in connection with extensions of credit under the plan and a statement that such rate does not include costs other than interest.

(2) Variable percentage rate

In the case of a plan which provides for variable rates of interest on credit extended under the plan--

(A) a description of the manner in which such rate will be computed and a statement that such rate does not include costs other than interest;

(B) a description of the manner in which any changes in the annual percentage rate will be made, including--

(i) any negative amortization and interest rate carryover;

(ii) the timing of any such changes;

(iii) any index or margin to which such changes in the rate are related; and

(iv) a source of information about any such index;

(C) if an initial annual percentage rate is offered which is not based on an index--

(i) a statement of such rate and the period of time such initial rate will be in effect; and

(ii) a statement that such rate does not include costs other than interest;

(D) a statement that the consumer should ask about the current index value and interest rate;

(E) a statement of the maximum amount by which the annual percentage rate may change in any 1-year period or a statement that no such limit exists;

(F) a statement of the maximum annual percentage rate that m ay be imposed at any time under the plan;

(G) subject to subsection (b)(3) of this section, a table, based on a $10,000 extension of credit, showing how the annual percentage rate and the minimum periodic payment amount under each repayment option of the plan would have been affected during the preceding 15-year period by changes in any index used to compute such rate;

(H) a statement of--

(i) the maximum annual percentage rate which may be imposed under each repayment option of the plan;

(ii) the minimum amount of any periodic payment which may be required, based on a $10,000 outstanding balance, under each such option when such maximum annual percentage rate is in effect; and

(iii) the earliest date by which such maximum annual interest rate may be imposed; and

(I) a statement that interest rate information will be provided on or with each periodic statement.

(3) Other fees imposed by the creditor

An itemization of any fees imposed by the creditor in connection with the availability or use of credit under such plan, including annual fees, application fees, transaction fees, and closing costs (including costs commonly described as "points", and the time when such fees are payable.

(4) Estimates of fees which may be imposed by third parties

(A) Aggregate amount

An estimate, based on the creditor's experience with such plans and stated as a single amount or as a reasonable range, of the aggregate amount of additional fees that may be imposed by third parties (such as governmental authorities, appraisers, and attorneys) in connection with opening an account under the plan.

(B) Statement of availability

A statement that the consumer may ask the creditor for a good faith estimate by the creditor of the fees that may be imposed by third parties.

(5) Statement of risk of loss of dwelling

A statement that--

(A) any extension of credit under the plan is secured by the consumer's dwelling; and

(B) in the event of any default, the consumer risks the loss of the dwelling.

(6) Conditions to which disclosed terms are subject

(A) Period during which such terms are available

A clear and conspicuous statement--

(i) of the time by which an application must be submitted to obtain the terms disclosed; or

(ii) if applicable, that the terms are subject to change.

(B) Right of refusal if certain terms change.--A statement that--

(i) the consumer may elect not to enter into an agreement to open an account under the plan if any term changes (other than a change contemplated by a variable feature of the plan) before any such agreement is final; and

(ii) if the consumer makes an election described in clause (i), the consumer is entitled to a refund of all fees paid in connection with the application.

(C) Retention of information

A statement that the consumer should make or otherwise retain a copy of information disclosed under this subparagraph.

(7) Rights of creditor with respect to extensions of credit

A statement that--

(A) under certain conditions, the creditor may terminate any account under the plan and require immediate

repayment of any outstanding balance, prohibit any additional extension of credit to the account, or reduce the credit limit applicable to the account; and

(B) the consumer may receive, upon request, more specific information about the conditions under which the creditor may take any action described in subparagraph (A).

(8) Repayment options and minimum periodic payments

The repayment options under the plan, including--

(A) if applicable, any differences in repayment options with regard to--

(i) any period during which additional extensions of credit may be obtained; and

(ii) any period during which repayment is required to be made and no additional extensions of credit may be obtained;

(B) the length of any repayment period, including any differences in the length of any repayment period with regard to the periods described in clauses (i) and (ii) of subparagraph (A); and

(C) an explanation of how the amount of any minimum monthly or periodic payment will be determined under each such option, including any differences in the determination of any such amount with regard to the periods described in clauses (i) and (ii) of subparagraph (A).

(9) Example of minimum payments and maximum repayment period

An example, based on a $10,000 outstanding balance and the interest rate (other than a rate not based on the index under the plan) which is, or was recently, in effect under such plan, showing the minimum monthly or periodic payment, and the time it would take to repay the entire $10,000 if the consumer paid only the minimum periodic payments and obtained no additional extensions of credit.

(10) Statement concerning balloon payments

If, under any repayment option of the plan, the payment of not more than the minimum periodic payments required

under such option over the length of the repayment period--

(A) would not repay any of the principal balance; or

(B) would repay less than the outstanding balance by the end of such period,

as the case may be, a statement of such fact, including an explicit statement that at the end of such repayment period a balloon payment (as defined in section 1665b(f) of this title) would result which would be required to be paid in full at that time.

(11) Negative amortization

If applicable, a statement that--

(A) any limitation in the plan on the amount of any increase in the minimum payments may result in negative amortization;

(B) negative amortization increases the outstanding principal balance of the account; and

(C) negative amortization reduces the consumer's equity in the consumer's dwelling.

(12) Limitations and minimum amount requirements on extensions of credit

(A) Number and dollar amount limitations

Any limitation contained in the plan on the number of extensions of credit and the amount of credit which may be obtained during any month or other defined time period.

(B) Minimum balance and other transaction amount requirements

Any requirement which establishes a minimum amount for--

(i) the initial extension of credit to an account under the plan;

(ii) any subsequent extension of credit to an account under the plan; or

(iii) any outstanding balance of an account under the plan.

(13) Statement regarding tax deductibility

A statement that--

(A) the consumer should consult a tax advisor regarding the deductibility of interest and charges under the plan; and

(B) in any case in which the extension of credit exceeds the fair market value (as defined under the Internal Revenue Code of 1986) of the dwelling, the interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes.

(14) Disclosure requirements established by board

Any other term which the Board requires, in regulations, to be disclosed.

(b) Time and form of disclosures

(1) Time of disclosure

(A) In general

The disclosures required under subsection (a) of this section with respect to any open end consumer credit plan which provides for any extension of credit which is secured by the consumer's principal dwelling and the pamphlet required under subsection (e) of this section shall be provided to any consumer at the time the creditor distributes an application to establish an account under such plan to such consumer.

(B) Telephone, publications, and third party applications

In the case of telephone applications, applications contained in magazines or other publications, or applications

provided by a third party, the disclosures required under subsection (a) of this section and the pamphlet required under subsection (e) of this section shall be provided by the creditor before the end of the 3-day period beginning on the date the creditor receives a completed application from a consumer.

(2) Form

(A) In general

Except as provided in paragraph (1)(B), the disclosures required under subsection (a) of this section shall be provided on or with any application to establish an account under an open end consumer credit plan which provides for any extension of credit which is secured by the consumer's principal dwelling.

(B) Segregation of required disclosures from other information

The disclosures required under subsection (a) of this section shall be conspicuously segregated from all other terms, data, or additional information provided in connection with the application, either by grouping the disclosures separately on the application form or by providing the disclosures on a separate form, in accordance with regulations of the Board.

(C) Precedence of certain information

The disclosures required by paragraphs (5), (6), and (7) of subsection (a) of this section shall precede all of the other required disclosures.

(D) Special provision relating to variable interest rate information

Whether or not the disclosures required under subsection (a) of this section are provided on the application form, the variable rate information described in subsection (a)(2) of this section may be provided separately from the other information required to be disclosed.

(3) Requirement for historical table

In preparing the table required under subsection (a)(2)(G) of this section, the creditor shall consistently select one rate of interest for each year and the manner of selecting the rate from year to year shall be consistent with the plan.

(c) Third party applications

In the case of an application to open an account under any open end consumer credit plan described in subsection

(a) of this section which is provided to a consumer by any person other than the creditor--

(1) such person shall provide such consumer with--

(A) the disclosures required under subsection (a) of this section with respect to such plan, in accordance with subsection (b) of this section; and

(B) the pamphlet required under subsection (e) of this section; or

(2) if such person cannot provide specific terms about the plan because specific information about the plan terms is not available, no nonrefundable fee may be imposed in connection with such application before the end of the 3-day period beginning on the date the consumer receives the disclosures required under subsection (a) of this section with respect to the application.

(d) "Principal dwelling" defined

For purposes of this section and sections 1647 and 1665b of this title, the term "principal dwelling" includes any second or vacation home of the consumer.

(e) Pamphlet

In addition to the disclosures required under subsection (a) of this section with respect to an application to open an account under any open end consumer credit plan described in such subsection, the creditor --

(1) a pamphlet published by the Board pursuant to section 4 of the Home Equity Consumer Protection Act of 1988; or

(2) any pamphlet which provides substantially similar information to the information described in such section, as determined by the Board.

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Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT 2
15 U.S.C. §§ 1601-1692p CHAPTER 41--CONSUMER CREDIT PROTECTION ACT
SUBCHAPTER I CONSUMER CREDIT COST DISCLOSURE (15 U.S.C. § 1601 et seq.)
Part B Credit Transactions

1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1638

§ 1638 Transactions other than under an open end credit plan.

(a) Required disclosures by creditor. For each consumer credit transaction other than under an open end credit plan, the creditor shall disclose each of the following items, to the extent applicable:

(1) The identity of the creditor required to make disclosure.

(2)

(A) The "amount financed", using that term, which shall be the amount of credit of which the consumer has actual use. This amount shall be computed as follows, but the computations need not be disclosed and shall not be disclosed with the disclosures conspicuously segregated in accordance with subsection (b)(1):

(i) take the principal amount of the loan or the cash price less downpayment and trade-in;

(ii) add any charges which are not part of the finance charge or of the principal amount of the loan and which are financed by the consumer, including the cost of any items excluded from the finance charge pursuant to section 106 [*15 USCS § 1605*]; and

(iii) subtract any charges which are part of the finance charge but which will be paid by the consumer before or at the time of the consummation of the transaction, or have been withheld from the proceeds of the credit

(B) In conjunction with the disclosure of the amount financed, a creditor shall provide a statement of the consumer's right to obtain, upon a written request, a written itemization of the amount financed. The statement shall include spaces for a "yes" and "no" indication to be initialed by the consumer to indicate whether the consumer wants a written itemization of the amount financed. Upon receiving an affirmative indication, the creditor shall provide, at the time other disclosures are required to be furnished, a written itemization of the amount financed. For the purposes of this subparagraph, "itemization of the amount financed" means a disclosure of the following items, to the extent applicable:

(i) the amount that is or will be paid directly to the consumer;

(ii) the amount that is or will be credited to the consumer's account to discharge obligations owed to the creditor;

(iii) each amount that is or will be paid to third persons by the creditor on the consumer's behalf, together with an identification of or reference to the third person; and

(iv) the total amount of any charges described in the preceding subparagraph (A)(iii).

(3) The "finance charge", not itemized, using that term.

(4) The finance charge expressed as an "annual percentage rate", using that term. This shall not be required if the amount financed does not exceed $ 75 and the finance charge does not exceed $ 5, or if the amount financed exceeds $ 75 and the finance charge does not exceed $ 7.50

(5) The sum of the amount financed and the finance charge, which shall be termed the "total of payments".

(6) The number, amount, and due dates or period of payments scheduled to repay the total of payments.

(7) In a sale of property or services in which the seller is the creditor required to disclose pursuant to section 121(b) [*15 USCS § 1631(b)*], the "total sale price", using that term, which shall be the total of the cash price of the property or services, additional charges, and the finance charge.

(8) Descriptive explanations of the terms "amount financed", "finance charge", "annual percentage rate", "total of payments", and "total sale price" as specified by the Board. The descriptive explanation of "total sale price" shall include reference to the amount of the downpayment.

(9) Where the credit is secured, a statement that a security interest has been taken in (A) the property which is purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type.

(10) Any dollar charge or percentage amount which may be imposed by a creditor solely on account of a late payment, other than a deferral or extension charge.

(11) A statement indicating whether or not the consumer is entitled to a rebate of any finance charge upon refinancing or prepayment in full pursuant to acceleration or otherwise, if the obligation involves a precomputed finance charge. A statement indicating whether or not a penalty will be imposed in those same circumstances if the obligation involves a finance charge computed from time to time by application of a rate to the unpaid principal balance.

(12) A statement that the consumer should refer to the appropriate contract document for any information such document provides about nonpayment, default, the right to accelerate the maturity of the debt, and prepayment rebates and penalties.

(13) In any residential mortgage transaction, a statement indicating whether a subsequent purchaser or assignee of the consumer may assume the debt obligation on its original terms and conditions.

(14) In the case of any variable interest rate residential mortgage transaction, in disclosures provided at application as prescribed by the Board for a variable rate transaction secured by the consumer's principal dwelling, at the option of the creditor, a statement that the periodic payments may increase or decrease substantially, and the maximum interest rate and payment for a $ 10,000 loan originated at a recent interest rate, as determined by the Board, assuming the maximum periodic increases in rates and payments under the program, or a historical example illustrating the effects of interest rate changes implemented according to the loan program.

(15) In the case of a consumer credit transaction that is secured by the principal dwelling of the consumer, in which the extension of credit may exceed the fair market value of the dwelling, a clear and conspicuous statement that--

(A) the interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes; and

(B) the consumer should consult a tax adviser for further information regarding the deductibility of interest and charges.

(b) Form and timing of disclosures; residential mortgage transaction requirements.

(1) Except as otherwise provided in this chapter [*15 USCS §§ 1631 et seq.*], the disclosures required under subsection (a) shall be made before the credit is extended. Except for the disclosures required by subsection (a)(1) of this section, all disclosures required under subsection (a) and any disclosure provided for in subsection (b), (c), or (d) of section 106 [*15 USCS § 1605*] shall be conspicuously segregated from all other terms, data, or information provided in connection with a transaction, including any computations or itemization.

(2)

(A) Except as provided in subparagraph (G), in the case any extension of credit that is secured by the dwelling of a consumer, which is also subject to the Real Estate Settlement Procedures Act, good faith estimates of the disclosures required under subsection (a) shall be made in accordance with regulations of the Board under section 121(c) [*15 USCS § 1631(c)*] and shall be delivered or placed in the mail not later than three business days after the creditor receives the consumer's written application, which shall be at least 7 business days before consummation of the transaction.

(B) In the case of an extension of credit that is secured by the dwelling of a consumer, the disclosures provided under subparagraph (A), shall be in addition to the other disclosures required by subsection (a), and shall--

(i) state in conspicuous type size and format, the following: "You are not required to complete this agreement merely because you have received these disclosures or signed a loan application."; and

(ii) be provided in the form of final disclosures at the time of consummation of the transaction, in the form and manner prescribed by this section.

(C) **[Caution: For effective date of this subparagraph, see § 2502(c)(2) of Act July 30, 2008, P.L. 110-289.]** In the case of an extension of credit that is secured by the dwelling of a consumer, under which the annual rate of interest is variable, or with respect to which the regular payments may otherwise be variable, in addition to the other disclosures required by subsection (a), the disclosures provided under this subsection shall do the following:

(i) Label the payment schedule as follows: "Payment Schedule: Payments Will Vary Based on Interest Rate Changes".

(ii) State in conspicuous type size and format examples of adjustments to the regular required payment on the extension of credit based on the change in the interest rates specified by the contract for such extension of credit. Among the examples required to be provided under this clause is an example that reflects the maximum payment amount of the regular required payments on the extension of credit, based on the maximum interest rate allowed under the contract, in accordance with the rules of the Board. Prior to issuing any rules pursuant to this clause, the Board shall conduct consumer testing to determine the appropriate format for providing the disclosures required under this subparagraph to consumers so that such disclosures can be easily understood, including the fact that the initial regular payments are for a specific time period that will end on a certain date, that payments will adjust afterwards potentially to a higher amount, and that there is no guarantee that the borrower will be able to refinance to a lower amount.

(D) In any case in which the disclosure statement under subparagraph (A) contains an annual percentage rate of interest that is no longer accurate, as determined under section 107(c) [*15 USCS § 1606(c)*], the creditor shall furnish an additional, corrected statement to the borrower, not later than 3 business days before the date of consummation of the transaction.

(E) The consumer shall receive the disclosures required under this paragraph before paying any fee to the creditor or other person in connection with the consumer's application for an extension of credit that is secured by the dwelling of a consumer. If the disclosures are mailed to the consumer, the consumer is considered to have received them 3 business days after they are mailed. A creditor or other person may impose a fee for obtaining the consumer's credit report before the consumer has received the disclosures under this paragraph, provided the fee is bona fide and reasonable in amount.

(F) Waiver of timeliness of disclosures.To expedite consummation of a transaction, if the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency, the consumer may waive or modify the timing requirements for disclosures under subparagraph (A), provided that--

(i) the term "bona fide personal emergency" may be further defined in regulations issued by the Board;

(ii) the consumer provides to the creditor a dated, written statement describing the emergency and specifically waiving or modifying those timing requirements, which statement shall bear the signature of all consumers entitled to receive the disclosures required by this paragraph; and

(iii) the creditor provides to the consumers at or before the time of such waiver or modification, the final

disclosures required by paragraph (1).

(G)

(i) In the case of an extension of credit relating to a plan described in *section 101(53D) of title 11, United States Code* [*11 USCS § 101(53D)*]--

(I) the requirements of subparagraphs (A) through (E) shall not apply; and

(II) a good faith estimate of the disclosures required under subsection (a) shall be made in accordance with regulations of the Board under section 121(c) *[11 USCS § 121*(c)] before such credit is extended, or shall be delivered or placed in the mail not later than 3 business days after the date on which the creditor receives the written application of the consumer for such credit, whichever is earlier.

(ii) If a disclosure statement furnished within 3 business days of the written application (as provided under clause (i)(II)) contains an annual percentage rate which is subsequently rendered inaccurate, within the meaning of section 107(c) [*11 USCS § 107(c)*], the creditor shall furnish another disclosure statement at the time of settlement or consummation of the transaction.

(3) In the case of a credit transaction described in paragraph (15) of subsection (a), disclosures required by that paragraph shall be made to the consumer at the time of application for such extension of credit.

(c) Timing of disclosures on unsolicited mailed or telephone purchase orders or loan requests.

(1) If a creditor receives a purchase order by mail or telephone without personal solicitation, and the cash price and the total sale price and the terms of financing, including the annual percentage rate, are set forth in the creditor's catalog or other printed material distributed to the public, then the disclosures required under subsection (a) may be made at any time not later than the date the first payment is due.

(2) If a creditor receives a request for a loan by mail or telephone without personal solicitation and the terms of financing, including the annual percentage rate for representative amounts of credit, are set forth in the creditor's printed material distributed to the public, or in the contract of loan or other printed material delivered to the obligor, then the disclosures required under subsection (a) may be made at any time not later than the date the first payment is due.

(d) Timing of disclosure in cases of an addition of a deferred payment price to an existing outstanding balance. If a consumer credit sale is one of a series of consumer credit sales transactions made pursuant to an agreement providing for the addition of the deferred payment price of that sale to an existing outstanding balance, and the person to whom the credit is extended has approved in writing both the annual percentage rate or rates and the method of computing the finance charge or charges, and the creditor retains no security interest in any property as to which he has received payments aggregating the amount of the sales price including any finance charges attributable thereto, then the disclosure required under subsection (a) for the particular sale may be made at any time not later than the date the first payment for that sale is due. For the purposes of this subsection, in the case of items purchased on different dates, the first purchased shall be deemed first paid for, and in the case of items purchased on the same date, the lowest priced shall be deemed first paid for.

(e) Terms and disclosure with respect to private education loans.

(1) Disclosures required in private education loan applications and solicitations. In any application for a private education loan, or a solicitation for a private education loan without requiring an application, the private educational lender shall disclose to the borrower, clearly and conspicuously--

(A) the potential range of rates of interest applicable to the private education loan;

(B) whether the rate of interest applicable to the private education loan is fixed or variable;

(C) limitations on interest rate adjustments, both in terms of frequency and amount, or the lack thereof, if applicable;

(D) requirements for a co-borrower, including any changes in the applicable interest rates without a co-borrower;

(E) potential finance charges, late fees, penalties, and adjustments to principal, based on defaults or late payments of the borrower;

(F) fees or range of fees applicable to the private education loan;

(G) the term of the private education loan;

(H) whether interest will accrue while the student to whom the private education loan relates is enrolled at a covered educational institution;

(I) payment deferral options;

(J) general eligibility criteria for the private education loan;

(K) an example of the total cost of the private education loan over the life of the loan--

(i) which shall be calculated using the principal amount and the maximum rate of interest actually offered by the private educational lender; and

(ii) calculated both with and without capitalization of interest, if an option exists for postponing interest payments;

(L) that a covered educational institution may have school-specific education loan benefits and terms not detailed on the disclosure form;

(M) that the borrower may qualify for Federal student financial assistance through a program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*), in lieu of, or in addition to, a loan from a non-Federal source;

(N) the interest rates available with respect to such Federal student financial assistance through a program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*);

(O) that, as provided in paragraph (6)--

(i) the borrower shall have the right to accept the terms of the loan and consummate the transaction at any time within 30 calendar days (or such longer period as the private educational lender may provide) following the date on which the application for the private education loan is approved and the borrower receives the disclosure documents required under this subsection for the loan; and

(ii) except for changes based on adjustments to the index used for a loan, the rates and terms of the loan may not be changed by the private educational lender during the period described in clause (i);

(P) that, before a private education loan may be consummated, the borrower must obtain from the relevant institution of higher education the form required under paragraph (3), and complete, sign, and return such form to the private educational lender;

(Q) that the consumer may obtain additional information concerning such Federal student financial assistance from their institution of higher education, or at the website of the Department of Education; and

(R) such other information as the Board shall prescribe, by rule, as necessary or appropriate for consumers to make informed borrowing decisions.

(2) Disclosures at the time of private education loan approval. Contemporaneously with the approval of a private education loan application, and before the loan transaction is consummated, the private educational lender shall disclose to the borrower, clearly and conspicuously--

(A) the applicable rate of interest in effect on the date of approval;

(B) whether the rate of interest applicable to the private education loan is fixed or variable;

(C) limitations on interest rate adjustments, both in terms of frequency and amount, or the lack thereof, if applicable;

(D) the initial approved principal amount;

(E) applicable finance charges, late fees, penalties, and adjustments to principal, based on borrower defaults or late payments, including limitations on the discharge of a private education loan in bankruptcy;

(F) fees or range of fees applicable to the private education loan;

(G) the maximum term under the private education loan program;

(H) an estimae of the total amount for repayment, at both the interest rate in effect on the date of approval and at the maximum possible rate of interest offered by the private educational lender and applicable to the borrower, to the extent that such maximum rate may be determined, or if not, a good faith estimate thereof;

(I) any principal and interest payments required while the student for whom the private education loan is intended is enrolled at a covered educational institution and unpaid interest that will accrue during such enrollment;

(J) payment deferral options applicable to the borrower;

(K) whether monthly payments are graduated;

(L) that, as provided in paragraph (6)--

(i) the borrower shall have the right to accept the terms of the loan and consummate the transaction at any time within 30 calendar days (or such longer period as the private educational lender may provide) following the date on which the application for the private education loan is approved and the borrower receives the disclosure documents required under this subsection for the loan; and

(ii) except for changes based on adjustments to the index used for a loan, the rates and terms of the loan may not be changed by the private educational lender during the period described in clause (i);

(M) that the borrower--

(i) may qualify for Federal fnancial assistance through a program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*), in lieu of, or in addition to, a loan from a non-Federal source; and

(ii) may obtain additional information concerning such assistance from their institution of higher education or the website of the Department of Education;

(N) the interest rates available with respect to such Federal financial assistance through a program under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*);

(O) the maximum monthly payment, calculated using the maximum rate of interest actually offered by the private educational lender and applicable to the borrower, to the extent that such maximum rate may be determined, or if not, a good faith estimate thereof; and

(P) such other information as the Board shall prescribe, by rule, as necessary or appropriate for consumers to make informed borrowing decisions.

(3) Self-certification of information.

(A) In general. Before a private educational lender may consummate a private education loan with respect to a student attending an institution of higher education, the lender shall obtain from the applicant for the private education loan the form developed by the Secretary of Education under section 155 of the Higher Education Act of 1965 [*20 USCS § 1019d*], signed by the applicant, in written or electronic form.

(B) Rule of construction. No other provision of this subsection shall be construed to require a private educational lender to perform any additional duty under this paragraph, other than collecting the form required under subparagraph (A).

(4) Disclosures at the time of private education loan consummation. Contemporaneously with the consummation of a private education loan, a private educational lender shall make to the borrower each of the disclosures described in--

(A) paragraph (2)(A) (adjusted, as necessary, for the rate of interest in effect on the date of consummation, based on the index used for the loan);

(B) subparagraphs (B) through (K) and (M) through (P) of paragraph (2); and

(C) paragraph (7).

(5) Format of disclosures.

(A) Model form. Not later than 2 years after the date of enactment of this subsection [enacted Aug. 14, 2008], the Board shall, based on consumer testing, and in consultation with the Secretary of Education, develop and issue model forms that may be used, at the option of the private educational lender, for the provision of disclosures required under this subsection.

(B) Format. Model forms developed under this paragraph shall--

(i) be comprehensible to borrowers, with a clear format and design;

(ii) provide for clear and conspicuous disclosures;

(iii) enable borrowers easily to identify material terms of the loan and to compare such terms among private education loans; and

(C) Safe harbor. Any private educational lender that elects to provide a model form developed under this subsection that accurately reflects the practices of the private educational lender shall be deemed to be in compliance with the disclosures required under this subsection.

(6) Effective period of approved rate of interest and loan terms.

(A) In general. With respect to a private education loan, the borrower shall have the right to accept the terms of the loan and consummate the transaction at any time within 30 calendar days (or such longer period as the private educational lender may provide) following the date on which the application for the private education loan is approved and the borrower receives the disclosure documents required under this subsection for the loan, and the rates and terms of the loan may not be changed by the private educational lender during that period.

(B) Prohibition on changes. Except for changes based on adjustments to the index used for a loan, the rates and terms of the loan may not be changed by the private educational lender prior to the earlier of--

(i) the date of acceptance of the terms of the loan and consummation of the transaction by the borrower, as

described in subparagraph (A); or

(ii) the expiration of the period described in subparagraph (A).

(7) Right to cancel. With respect to a private education loan, the borrower may cancel the loan, without penalty to the borrower, at any time within 3 business days of the date on which the loan is consummated, and the private educational lender shall disclose such right to the borrower in accordance with paragraph (4).

(8) Prohibition on disbursement. No funds may be disbursed with respect to a private education loan until the expiration of the 3-day period described in paragraph (7).

(9) Board regulations. In issuing regulations under this subsection, the Board shall prevent, to the extent possible, duplicative disclosure requirements for private educational lenders that are otherwise required to make disclosures under this title, except that in any case in which the disclosure requirements of this subsection differ or conflict with the disclosure requirements of any other provision of this title, the requirements of this subsection shall be controlling.

(10) Definitions. For purposes of this subsection, the terms "covered educational institution", "private educational lender", and "private education loan" have the same meanings as in section 140 [*15 USCS § 1650*].

(11) Duties of lenders participating in preferred lender arrangements. Each private educational lender that has a preferred lender arrangement with a covered educational institution shall annually, by a date determined by the Board, in consultation with the Secretary of Education, provide to the covered educational institution such information as the Board determines to include in the model form developed under paragraph (5) for each type of private education loan that the lender plans to offer to students attending the covered educational institution, or to the families of such students, for the next award year (as that term is defined in section 481 of the Higher Education Act of 1965 [*20 USCS § 1088*]).

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1639

§ **1639 Requirements for certain mortgages.**

(a) Disclosures

(1) Specific disclosures

In addition to other disclosures required under this chapter, for each mortgage referred to in section 1602(aa) of this title, the creditor shall provide the following disclosures in conspicuous type size:

(A) "You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application.".

(B) "If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.".

(2) Annual percentage rate

In addition to the disclosures required under paragraph (1), the creditor shall disclose--

(A) in the case of a credit transaction with a fixed rate of interest, the annual percentage rate and the amount of the

regular monthly payment; or

(B) in the case of any other credit transaction, the annual percentage rate of the loan, the amount of the regular monthly payment, a statement that the interest rate and monthly payment may increase, and the amount of the maximum monthly payment, based on the maximum interest rate allowed pursuant to section 3806 of Title 12.

(b) Time of disclosures

(1) In general

The disclosures required by this section shall be given not less than 3 business days prior to consummation of the transaction.

(2) New disclosures required

(A) In general

After providing the disclosures required by this section, a creditor may not change the terms of the extension of credit if such changes make the disclosures inaccurate, unless new disclosures are provided that meet the requirements of this section.

(B) Telephone disclosure

A creditor may provide new disclosures pursuant to subparagraph (A) by telephone, if--

(i) the change is initiated by the consumer; and

(ii) at the consummation of the transaction under which the credit is extended--

(I) the creditor provides to the consumer the new disclosures, in writing; and

(II) the creditor and consumer certify in writing that the new disclosures were provided by telephone, by not

later than 3 days prior to the date of consummation of the transaction.

(3) Modifications

The Board may, if it finds that such action is necessary to permit homeowners to meet bona fide personal financial emergencies, prescribe regulations authorizing the modification or waiver of rights created under this subsection, to the extent and under the circumstances set forth in those regulations.

(c) No prepayment penalty

(1) In general

(A) Limitation on terms

A mortgage referred to in section 1602(aa) of this title may not contain terms under which a consumer must pay a prepayment penalty for paying all or part of the principal before the date on which the principal is due.

(B) Construction

For purposes of this subsection, any method of computing a refund of unearned scheduled interest is a prepayment penalty if it is less favorable to the consumer than the actuarial method (as that term is defined in section 1615(d) of this title.

(2) Exception

Notwithstanding paragraph (1), a mortgage referred to in section 1602(aa) of this title may contain a prepayment penalty (including terms calculating a refund by a method that is not prohibited under section 1615(b) of this title for the transaction in question) if--

(A) at the time the mortgage is consummated--

(i) the consumer is not liable for an amount of monthly indebtedness payments (including the amount of credit extended or to be extended under the transaction) that is greater than 50 percent of the monthly gross income of the consumer; and

(ii) the income and expenses of the consumer are verified by a financial statement signed by the consumer, by a credit report, and in the case of employment income, by payment records or by verification from the employer of the consumer (which verification may be in the form of a copy of a pay stub or other payment record supplied by the consumer);

(B) the penalty applies only to a prepayment made with amounts obtained by the consumer by means other than a refinancing by the creditor under the mortgage, or an affiliate of that creditor;

(C) the penalty does not apply after the end of the 5-year period beginning on the date on which the mortgage is consummated; and

(D) the penalty is not prohibited under other applicable law.

(d) Limitations after default

A mortgage referred to in section 1602(aa) of this title may not provide for an interest rate applicable after default that is higher than the interest rate that applies before default. If the date of maturity of a mortgage referred to in subsection n*1602(aa) of this title is accelerated due to default and the consumer is entitled to a rebate of interest, that rebate shall be computed by any method that is not less favorable than the actuarial method (as that term is defined in section 1615(d) of this title).

(e) No balloon payments

A mortgage referred to in section 1602(aa) of this title having a term of less than 5 years may not include terms under which the aggregate amount of the regular periodic payments would not fully amortize the outstanding principal balance.

(f) No negative amortization

A mortgage referred to in section 1602(aa) of this title may not include terms under which the outstanding principal balance will increase at any time over the course of the loan because the regular periodic payments do not cover the full amount of interest due.

(g) No prepaid payments

A mortgage referred to in section 1602(aa) of this title may not include terms under which more than 2 periodic payments required under the loan are consolidated and paid in advance from the loan proceeds provided to the

consumer.

(h) Prohibition on extending credit without regard to payment ability of consumer

A creditor shall not engage in a pattern or practice of extending credit to consumers under mortgages referred to in section 1602(aa) of this title based on the consumers' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, and employment.

(i) Requirements for payments under home improvement contracts

A creditor shall not make a payment to a contractor under a home improvement contract from amounts extended as credit under a mortgage referred to in section 1602(aa) of this title, other than--

(1) in the form of an instrument that is payable to the consumer or jointly to the consumer and the contractor; or

(2) at the election of the consumer, by a third party escrow agent in accordance with terms established in a written agreement signed by the consumer, the creditor, and the contractor before the date of payment.

(j) Consequence of failure to comply

Any mortgage that contains a provision prohibited by this section shall be deemed a failure to deliver the material disclosures required under this chapter, for the purpose of section 1635 of this title.

(k) Definition

For purposes of this section, the term "affiliate" has the same meaning as in section 1841(k) of Title 12.

(l) Discretionary regulatory authority of Board

(1) Exemptions

The Board may, by regulation or order, exempt specific mortgage products or categories of mortgages from any or all of the prohibitions specified in subsections (c) through (i) of this section, if the Board finds that the exemption--

(A) is in the interest of the borrowing public; and

(B) will apply only to products that maintain and strengthen home ownership and equity protection.

(2) Prohibitions

The Board, by regulation or order, shall prohibit acts or practices in connection with--

(A) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and

(B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.

(m) Civil penalties in Federal Trade Commission enforcement actions.

For purposes of enforcement by the Federal Trade Commission, any violation of a regulation issued by the Federal Reserve Board pursuant to subsection (l)(2) of this section shall be treated as a violation of a rule promulgated under section 18 of the Federal Trade Commission Act (*15 U.S.C. 57a*) regarding unfair or deceptive acts or practices.

FOOTNOTES:
(n78)Footnote *. So in original. Should probably read "section".

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§ **1639a Duty of servicers of residential mortgages**

(a) In general. Notwithstanding any other provision of law, whenever a servicer of residential mortgages agrees to enter into a qualified loss mitigation plan with respect to 1 or more residential mortgages originated before the date of enactment of the Helping Families Save Their Homes Act of 2009 [enacted May 20, 2009], including mortgages held in a securitization or other investment vehicle--

(1) to the extent that the servicer owes a duty to investors or other parties to maximize the net present value of such mortgages, the duty shall be construed to apply to all such investors and parties, and not to any individual party or group of parties; and

(2) the servicer shall be deemed to have satisfied the duty set forth in paragraph (1) if, before December 31, 2012, the servicer implements a qualified loss mitigation plan that meets the following criteria:

(A) Default on the payment of such mortgage has occurred, is imminent, or is reasonably foreseeable, as such terms are defined by guidelines issued by the Secretary of the Treasury or his designee under the Emergency Economic Stabilization Act of 2008.

(B) The mortgagor occupies the property securing the mortgage as his or her principal residence.

(C) The servicer reasonably determined, consistent with the guidelines issued by the Secretary of the Treasury or his designee, that the application of such qualified loss mitigation plan to a mortgage or class of mortgages will likely provide an anticipated recovery on the outstanding principal mortgage debt that will exceed the anticipated recovery through foreclosures.

(b) No liability. A servicer that is deemed to be acting in the best interests of all investors or other parties under this section shall not be liable to any party who is owed a duty under subsection (a)(1), and shall not be subject to any injunction, stay, or other equitable relief to such party, based solely upon the implementation by the servicer of a qualified loss mitigation plan.

(c) Standard industry practice. The qualified loss mitigation plan guidelines issued by the Secretary of the Treasury under the Emergency Economic Stabilization Act of 2008 shall constitute standard industry practice for purposes of all Federal and State laws.

(d) Scope of safe harbor. Any person, including a trustee, issuer, and loan originator, shall not be liable for monetary damages or be subject to an injunction, stay, or other equitable relief, based solely upon the cooperation of such person with a servicer when such cooperation is necessary for the servicer to implement a qualified loss mitigation plan that meets the requirements of subsection (a).

(e) Reporting. Each servicer that engages in qualified loss mitigation plans under this section shall regularly report to the Secretary of the Treasury the extent, scope, and results of the servicer's modification activities. The Secretary of the Treasury shall prescribe regulations or guidance specifying the form, content, and timing of such reports.

(f) Definitions. As used in this section--

(1) the term "qualified loss mitigation plan" means--

(A) a residential loan modification, workout, or other loss mitigation plan, including to the extent that the Secretary of the Treasury determines appropriate, a loan sale, real property disposition, trial modification, pre-foreclosure sale, and deed in lieu of foreclosure, that is described or authorized in guidelines issued by the Secretary of the Treasury or his designee under the Emergency Economic Stabilization Act of 2008; and

(B) a refinancing of a mortgage under the Hope for Homeowners program;

(2) the term "servicer" means the person responsible for the servicing for others of residential mortgage loans (including of a pool of residential mortgage loans); and

(3) the term "securitization vehicle" means a trust, special purpose entity, or other legal structure that is used to facilitate the issuing of securities, participation certificates, or similar instruments backed by or referring to a pool of assets that includes residential mortgages (or instruments that are related to residential mortgages such as credit-linked notes).

(g) Rule of construction. No provision of subsection (b) or (d) shall be construed as affecting the liability of any servicer or person as described in subsection (d) for actual fraud in the origination or servicing of a loan or in the implementation of a qualified loss mitigation plan, or for the violation of a State or Federal law, including laws regulating the origination of mortgage loans, commonly referred to as predatory lending laws.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1640

§ **1640 Civil liability.**

(a) Individual or class action for damages; amount of award; factors determining amount of award.

Except as otherwise provided in this section, any creditor who fails to comply with any requirement imposed under this chapter [*15 USCS §§ 1631 et seq.*], including any requirement under section 125 [*15 USCS § 1635*], subsection (f) or (g) of section 131 [*15 USCS § 1641*], or chapter 4 or 5 of this title [*15 USCS §§ 1666 et seq.* or *1667 et seq.*] with respect to any person is liable to such person in an amount equal to the sum of--

(1) any actual damage sustained by such person as a result of the failure;

(2)

(A)

(i) in the case of an individual action twice the amount of any finance charge in connection with the transaction,

(ii) in the case of an individual action relating to a consumer lease under chapter 5 of this title [*15 USCS §§ 1667 et seq.*], 25 per centum of the total amount of monthly payments under the lease, except that the liability under this sub-paragraph shall not be less than $ 100 nor greater than $ 1,000,

(iii) in the case of an individual action relating to an open end consumer credit plan that is not secured by real property or a dwelling, twice the amount of any finance charge in connection with the transaction, with a minimum of $ 500 and a maximum of $ 5,000, or such higher amount as may be appropriate in the case of an established pattern or practice of such failures; or

(iv) in the case of an individual action relating to a credit transaction not under an open end credit plan that is secured by real property or a dwelling, not less than $ 400 or greater than $ 4,000; or

(B) in the case of a class action, such amount as the court may allow, except that as to each member of the class no minimum recovery shall be applicable, and the total recovery under this subparagraph in any class action or series of class actions arising out of the same failure to comply by the same creditor shall not be more than the lesser of $ 500,000 or 1 per centum of the net worth of the creditor;

(3) in the case of any successful action to enforce the foregoing liability or in any action in which a person is deter-mined to have a right of rescission under section 125 [*15 USCS § 1635*] or 128(e)(7), the costs of the action, together with a reasonable attorney's fee as determined by the court; and

(4) in the case of a failure to comply with any requirement under section 129 [*15 USCS § 1639*], an amount equal to the sum of all finance charges and fees paid by the consumer, unless the creditor demonstrates that the failure to comply is not material.

In determining the amount of award in any class action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance by the creditor, the resources of the creditor, the number of persons adversely affected, and the extent to which the creditor's failure of compliance was intentional. In connection with the disclosures referred to in subsections (a) and (b) of section 127 [*15 USCS § 1637*], a creditor shall have a liability determined under paragraph (2) only for failing to comply with the requirements of section 125 [*15 USCS § 1635*], 127(a) [*15 USCS § 1637(a)*], or any of paragraphs (4) through (13) of section 127(b) [*15 USCS § 1637(b)*], or for failing to comply with disclosure requirements under State law for any term or item that the Board has determined to be substantially the same in meaning under section 111(a)(2) [*15 USCS § 1610(a)(2)*] as any of the terms or items referred to in section 127(a), or any of paragraphs (4) through (13) of section 127(b) [*15 USCS § 1637(b)*]. In connection with the disclosures referred to in subsection (c) or (d) of section 127 [*15 USCS § 1637(c)* or *(d)*], a card issuer shall have a liability under this section only to a cardholder who pays a fee de-scribed in section 127(c)(1)(A)(ii)(I) or section 127(c)(4)(A)(i) [*15 USCS § 1637(c)(1)(A)(ii)(I)* or *(c)(4)(A)(i)*] or who uses the credit card or charge card. In connection with the disclosures referred to in section 128 [*15 USCS § 1638*], a creditor shall have a liability determined under paragraph (2) only for failing to comply with the requirements of section 125 [*15 USCS § 1635*] of paragraph (2) (insofar as it requires a disclosure of the "amount financed"), (3), (4), (5), (6), or (9) of section 128(a) [*15 USCS § 1638(a)*], or section 128(b)(2)(C)(ii) [*15 USCS § 1638(b)(2)(C)(ii)*], of subparagraphs (A), (B), (D), (F), or (J) of section 128(e)(2) (for purposes of paragraph (2) or (4) of section 128(e)), or para-graph (4)(C), (6), (7), or (8) of section 128(e), or for failing to comply with disclosure requirements under State law for any term which the Board has determined to be substantially the same in meaning under section 111(a)(2) [*15 USCS § 1610(a)(2)*] as any of the terms referred to in any of those paragraphs of section 128(a) [*15 USCS § 1638(a)*] or section 128(b)(2)(C)(ii) [*15 USCS § 1638(b)(2)(C)(ii)*]. With respect to any failure to make disclosures required under this chapter [*15 USCS §§ 1631 et seq.*] or chapter 4 or 5 of this title [*15 USCS §§ 1666 et seq.* or *1667 et seq.*], liability

shall be imposed only upon the creditor required to make disclosure, except as provided in section 131 [*15 USCS § 1641*].

(b) Correction of errors.

A creditor or assignee has no liability under this section or section 108 or section 112 [*15 USCS § 1607* or *1611*] for any failure to comply with any requirement imposed under this chapter or chapter 5 [*15 USCS §§ 1631 et seq.* or *1667 et seq.*], if within sixty days after discovering an error, whether pursuant to a final written examination report or notice issued under section 108(e)(1) [*15 USCS § 1607(e)(1)*] or through the creditor's or assignee's own procedures, and prior to the institution of an action under this section or the receipt of written notice of the error from the obligor, the creditor or assignee notifies the person concerned of the error and makes whatever adjustments in the appropriate account are necessary to assure that the person will not be required to pay an amount in excess of the charge actually disclosed, or the dollar equivalent of the annual percentage rate actually disclosed, whichever is lower.

(c) Unintentional violations; bona fide errors.

A creditor or assignee may not be held liable in any action brought under this section or section 125 [*15 USCS § 1635*] for a violation of this title [*15 USCS §§ 1601 et seq.*] if the creditor or assignee shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error. Examples of a bona fide error include, but are not limited to, clerical, calculation, computer malfunction and programming, and printing errors, except that an error of legal judgment with respect to a person's obligations under this title [*15 USCS §§ 1601 et seq.*] is not a bona fide error.

(d) Liability in transaction or lease involving multiple obligors.

When there are multiple obligors in a consumer credit transaction or consumer lease, there shall be no more than one recovery of damages under subsection (a)(2) for a violation of this title [*15 USCS §§ 1601 et seq.*].

(e) Jurisdiction of courts; limitations on actions; State attorney general enforcement.

Any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year from the date of the occurrence of the violation or, in the case of a violation involving a private education loan (as that term is defined in section 140(a) [*15 USCS § 1650(a)*]), 1 year from the date on which the first regular payment of principal is due under the loan. This subsection does not bar a person from asserting a violation of this title [*15 USCS §§ 1601 et seq.*] in an action to collect the debt which was brought more than one year from the date of the occurrence of the violation as a matter of defense by recoupment or set-off in such action, except as otherwise provided by State law. An action to enforce a violation of section 129 [*15 USCS § 1639*] may also be brought by the appropriate State attorney general in any appropriate United States district court, or any other court of competent jurisdiction, not later than 3 years after the date on which the violation occurs. The State attorney general shall provide prior written notice of any such civil action to the Federal agency responsible for enforcement under section 108 [*15 USCS § 1607*] and shall provide the agency with a copy of the complaint. If prior notice is not feasible, the State attorney general shall provide notice to such agency immediately upon instituting the action. The Federal agency may--

(1) intervene in the action;

(2) upon intervening--

(A) remove the action to the appropriate United States district court, if it was not originally brought there; and

(B) be heard on all matters arising in the action; and

(3) file a petition for appeal.

(f) Good faith compliance with rule, regulation, or interpretation of Board or with interpretation or approval of duly authorized official or employee of Federal Reserve System.

No provision of this section, section 108(b), section 108(c), section 108(e), or section 112 [*15 USCS § 1607(b), (c), (e)*, or *§ 1611*] imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefor, notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

(g) Recovery for multiple failures to disclose.

The multiple failure to disclose to any person any information required under this chapter [*15 USCS §§ 1631 et seq.*] or chapter 4 or 5 of this title [*15 USCS §§ 1666 et seq.* or *1667 et seq.*] to be disclosed in connection with a single account under an open end consumer credit plan, other single consumer credit sale, consumer loan, and consumer lease, or other extension of consumer credit, shall entitle the person to a single recovery under this section but continued failure to disclose after a recovery has been granted shall give rise to rights to additional recoveries. This subsection does not bar any remedy permitted by section 125 [*15 USCS § 1635*].

(h) Offset from amount owed to creditor or assignee; rights of defaulting consumer.

A person may not take any action to offset any amount for which a creditor or assignee is potentially liable to such person under subsection (a)(2) against any amount owed by such person, unless the amount of the creditor's or assignee's liability under this title [*15 USCS §§ 1601 et seq.*] has been determined by judgment of a court of competent jurisdiction in an action of which such person was a party. This subsection does not bar a consumer then in default on the obligation from asserting a violation of this title [*15 USCS §§ 1601 et seq.*] as an original action, or as a defense or

counterclaim to an action to collect amounts owed by the consumer brought by a person liable under this title [*15 USCS §§ 1601 et seq*.].

(i) Class action moratorium.

(1) In general. During the period beginning on the date of the enactment of the Truth in Lending Class Action Relief Act of 1995 [enacted May 18, 1995] and ending on October 1, 1995, no court may enter any order certifying any class in any action under this title [*15 USCS §§ 1601 et seq*.]--

(A) which is brought in connection with any credit transaction not under an open end credit plan which is secured by a first lien on real property or a dwelling and constitutes a refinancing or consolidation of an existing extension of credit; and

(B) which is based on the alleged failure of a creditor--

(i) to include a charge actually incurred (in connection with the transaction) in the finance charge disclosed pursuant to section 128 [*15 USCS § 1638*];

(ii) to properly make any other disclosure required under section 128 [*15 USCS § 1638*] as a result of the failure described in clause (i); or

(iii) to provide proper notice of rescission rights under section 125(a) [*15 USCS § 1635(a)*] due to the selection by the creditor of the incorrect form from among the model forms prescribed by the Board or from among forms based on such model forms.

(2) Exceptions for certain alleged violations. Paragraph (1) shall not apply with respect to any action--

(A) described in clause (i) or (ii) of paragraph (1)(B), if the amount disclosed as the finance charge results in an annual percentage rate that exceeds the tolerance provided in section 107(c) [*15 USCS § 1606(c)*]; or

(B) described in paragraph (1)(B)(iii), if--

(i) no notice relating to rescission rights under section 125(a) [*15 USCS § 1635(a)*] was provided in any form; or

(ii) proper notice was not provided for any reason other than the reason described in such paragraph.

(j) Private educational lender.

A private educational lender (as that term is defined in section 140(a) [*15 USCS § 1650(a)*]) has no liability under this section for failure to comply with section 128(e)(3) [*15 USCS § 1638(e)(3)*]).

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§ 1641 Liability of assignees.

(a) Prerequisites

Except as otherwise specifically provided in this subchapter, any civil action for a violation of this subchapter or proceeding under section 1607 of this title which may be brought against a creditor may be maintained against any assignee of such creditor only if the violation for which such action or proceeding is brought is apparent on the face of the disclosure statement, except where the assignment was involuntary. For the purpose of this section, a violation apparent on the face of the disclosure statement includes, but is not limited to (1) a disclosure which can be determined to be incomplete or inaccurate from the face of the disclosure statement or other documents assigned, or (2) a disclosure which does not use the terms required to be used by this subchapter.

(b) Proof of compliance with statutory provisions

Except as provided in section 1635(c) of this title, in any action or proceeding by or against any subsequent assignee of the original creditor without knowledge to the contrary by the assignee when he acquires the obligation, written acknowledgement of receipt by a person to whom a statement is required to be given pursuant to this subchapter shall be conclusive proof of the delivery thereof and, except as provided in subsection (a) of this section, of compliance with this part. This section does not affect the rights of the obligor in any action against the original creditor.

(c) Right of rescission

Any consumer who has the right to rescind a transaction under section 1635 of this title may rescind the transaction as against any assignee of the obligation.

(d) Rights upon assignment of certain mortgages

(1) In general

Any person who purchases or is otherwise assigned a mortgage referred to in section 1602(aa) of this title shall be subject to all claims and defenses with respect to that mortgage that the consumer could assert against the creditor of the mortgage, unless the purchaser or assignee demonstrates, by a preponderance of the evidence, that a reasonable person exercising ordinary due diligence, could not determine, based on the documentation required by this title, the itemization of the amount financed, and other disclosure of disbursements that the mortgage was a mortgage referred to in section 1602(aa) of this title. The preceding sentence does not affect rights of a consumer under subsection (a), (b), or (c) of this section or any other provision of this chapter.

(2) Limitation on damages

Notwithstanding any other provision of law, relief provided as a result of any action made permissible by paragraph (1) may not exceed--

(A) with respect to actions based upon a violation of this chapter, the amount specified in section 1640 of this title; and

(B) with respect to all other causes of action, the sum of--

(i) the amount of all remaining indebtedness; and

(ii) the total amount paid by the consumer in connection with the transaction.

(3) Offset

amount of damages that may be awarded under paragraph (2)(B) shall be reduced by the amount of any damages awarded under paragraph (2)(A).

(4) Notice

Any person who sells or otherwise assigns a mortgage referred to in section 1602(aa) of this title shall include a

prominent notice of the potential liability under this subsection as determined by the Board.

(e) Liability of assignee for consumer credit transactions secured by real property

(1) In general

Except as otherwise specifically provided in this chapter, any civil action against a creditor for a violation of this chapter, and any proceeding under section 1607 of this title against a creditor, with respect to a consumer credit transaction secured by real property may be maintained against any assignee of such creditor only if--

(A) the violation for which such action or proceeding is brought is apparent on the face of the disclosure statement provided in connection with such transaction pursuant to this chapter; and

(B) the assignment to the assignee was voluntary.

(2) Violation apparent on the face of the disclosure described

For the purpose of this section, a violation is apparent on the face of the disclosure statement if--

(A) the disclosure can be determined to be incomplete or inaccurate by a comparison among the disclosure statement, any itemization of the amount financed, the note, or any other disclosure of disbursement; or

(B) the disclosure statement does not use the terms or format required to be used by this chapter.

(f) Treatment of servicer

(1) In general

A servicer of a consumer obligation arising from a consumer credit transaction shall not be treated as an assignee of such obligation for purposes of this section unless the servicer is or was the owner of the obligation.

(2) Servicer not treated as owner on basis of assignment for administrative convenience

A servicer of a consumer obligation arising from a consumer credit transaction shall not be treated as the owner of the obligation for purposes of this section on the basis of an assignment of the obligation from the creditor or another assignee to the servicer solely for the administrative convenience of the servicer in servicing the obligation. Upon written request by the obligor, the servicer shall provide the obligor, to the best knowledge of the servicer, with the name, address, and telephone number of the owner of the obligation or the master servicer of the obligation.

(3) Servicer defined

For purposes of this subsection, the term "servicer" has the same meaning as in section 2605(i)(2) of title 12.

(4) Applicability

This subsection shall apply to all consumer credit transactions in existence or consummated on or after September 30, 1995.

(g) Notice of new creditor.

(1) In general. In addition to other disclosures required by this title, not later than 30 days after the date on which a mortgage loan is sold or otherwise transferred or assigned to a third party, the creditor that is the new owner or assignee of the debt shall notify the borrower in writing of such transfer, including--

(A) the identity, address, telephone number of the new creditor;

(B) the date of transfer;

(C) how to reach an agent or party having authority to act on behalf of the new creditor;

(D) the location of the place where transfer of ownership of the debt is recorded; and

(E) any other relevant information regarding the new creditor.

(2) Definition. As used in this subsection, the term "mortgage loan" means any consumer credit transaction that is

secured by the principal dwelling of a consumer.

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§ **1642 Issuance of credit cards.**

No credit card shall be issued except in response to a request or application therefor. This prohibition does not apply to the issuance of a credit card in renewal of, or in substitution for, an accepted credit card.

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§ **1643 Liability of holder of credit card.**

(a) Limits on liability

(1) A cardholder shall be liable for the unauthorized use of a credit card only if--

(A) the card is an accepted credit card;

(B) the liability is not in excess of $50;

(C) the card issuer gives adequate notice to the cardholder of the potential liability;

(D) the card issuer has provided the cardholder with a description of a means by which the card issuer may be notified of loss or theft of the card, which description may be provided on the face or reverse side of the statement required by section 1637(b) of this title or on a separate notice accompanying such statement;

(E) the unauthorized use occurs before the card issuer has been notified that an unauthorized use of the credit card

has occurred or may occur as the result of loss, theft, or otherwise; and

(F) the card issuer has provided a method whereby the user of such card can be identified as the person authorized to use it.

(2) For purposes of this section, a card issuer has been notified when such steps as may be reasonably required in the ordinary course of of business to provide the card issuer with the pertinent information have been taken, whether or not any particular officer, employee, or agent of the card issuer does in fact receive such information.

(b) Burden of proof

In any action by a card issuer to enforce liability for the use of a credit card, the burden of proof is upon the card issuer to show that the use was authorized or, if the use was unauthorized, then the burden of proof is upon the card issuer to show that the conditions of liability for the unauthorized use of a credit card, as set forth in subsection (a) of this section, have been met.

(c) Liability imposed by other laws or by agreement with issuer

Nothing in this section imposes liability upon a cardholder for the unauthorized use of a credit card in excess of his liability for such use under other applicable law or under any agreement with the card issuer.

(d) Exclusiveness of liability

Except as provided in this section, a cardholder incurs no liability from the unauthorized use of a credit card.

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§ **1644 Fraudulent use of credit cards; penalties.**

(a) Use, attempt or conspiracy to use card in transaction affecting interstate or foreign commerce

Whoever knowingly in a transaction affecting interstate or foreign commerce, uses or attempts or conspires to use any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card to obtain money, goods, services, or anything else of value which within any one-year period has a value aggregating $1,000 or more; or

(b) Transporting, attempting or conspiring to transport card in interstate commerce

Whoever, with unlawful or fraudulent intent, transports or attempts or conspires to transport in interstate or foreign commerce a counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card knowing the same to be counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained; or

(c) Use of interstate commerce to sell or transport card

Whoever, with unlawful or fraudulent intent, uses any instrumentality of interstate or foreign commerce to sell or transport a counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card knowing the same to be counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained; or

(d) Receipt, concealment, etc., of goods obtained by use of card

Whoever knowingly receives, conceals, uses, or transports money, goods, services, or anything else of value (except tickets for interstate or foreign transportation) which (1) within any one-year period has a value aggregating

$1,000 or more, (2) has moved in or is part of, or which constitutes interstate or foreign commerce, and (3) has been obtained with a counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card; or

(e) Receipt, concealment, etc., of tickets for interstate or foreign transportation obtained by use of card

Whoever knowingly receives, conceals, uses, sells, or transports in interstate or foreign commerce one or more tickets for interstate or foreign transportation, which (1) within any one-year period have a value aggregating $500 or more, and (2) have been purchased or obtained with one or more counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit cards; or

(f) Furnishing of money, etc., through use of card

Whoever in a transaction affecting interstate or foreign commerce furnishes money, property, services, or anything else of value, which within any one-year period has a value aggregating $1,000 or more, through the use of any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card knowing the same to be counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained--

shall be fined not more than $10,000 or imprisoned not more than ten years, or both.

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§ **1645 Business credit cards; limits on liability of employees.**

The exemption provided by section 1603(1) of this title does not apply to the provisions of sections 1642, 1643, and 1644 of this title, except that a card issuer and a business or other organization which provides credit cards issued by the same card issuer to ten or more of its employees may by contract agree as to liability of the business or other organization with respect to unauthorized use of such credit cards without regard to the provisions of section 1643 of this title, but in no case may such business or other organization or card issuer impose liability upon any employee with respect to unauthorized use of such a credit card except in accordance with and subject to the limitations of section 1643 of this title.

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§ 1646 Dissemination of annual percentage rates; implementation, etc.

(a) Annual percentage rates

The Board shall collect, publish, and disseminate to the public, on a demonstration basis in a number of standard metropolitan statistical areas to be determined by the Board, the annual percentage rates charged for representative types of nonsale credit by creditors in such areas. For the purpose of this section, the Board is authorized to require creditors in such areas to furnish information necessary for the Board to collect, publish, and disseminate such information.

(b) Credit card price and availability information

(1) Collection required

The Board shall collect, on a semiannual basis, credit card price and availability information, including the information required to be disclosed under section 1637(c) of this title, from a broad sample of financial institutions which offer credit card services.

(2) Sample requirements

The broad sample of financial institutions required under paragraph (1) shall include--

(A) the 25 largest issuers of credit cards; and

(B) not less than 125 additional financial institutions selected by the Board in a manner that ensures--

(i) an equitable geographical distribution within the sample; and

(ii) the representation of a wide spectrum of institutions within the sample.

(3) Report of information from sample

Each financial institution in the broad sample established pursuant to paragraph (2) shall report the information to the Board in accordance with such regulations or orders as the Board may prescribe.

(4) Public availability of collected information, report to Congress

The Board shall--

(A) make the information collected pursuant to this subsection available to the public upon request; and

(B) report such information semiannually to Congress.

(c) Implementation

The Board is authorized to enter into contracts or other arrangements with appropriate persons, organizations, or State agencies to carry out its functions under subsections (a) and (b) of this section and to furnish financial assistance in support thereof.

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§ **1647 Home equity plans.**

(a) Index requirement

In the case of extensions of credit under an open end consumer credit plan which are subject to a variable rate and are secured by a consumer's principal dwelling, the index or other rate of interest to which changes in the annual percentage rate are related shall be based on an index or rate of interest which is publicly available and is not under the control of the creditor.

(b) Grounds for acceleration of outstanding balance

A creditor may not unilaterally terminate any account under an open end consumer credit plan under which extensions of credit are secured by a consumer's principal dwelling and require the immediate repayment of any outstanding balance at such time, except in the case of--

(1) fraud or material misrepresentation on the part of the consumer in connection with the account;

(2) failure by the consumer to meet the repayment terms of the agreement for any outstanding balance; or

(3) any other action or failure to act by the consumer which adversely affects the creditor's security for the account or any right of the creditor in such security.

This subsection does not apply to reverse mortgage transactions.

(c) Change in terms

(1) In general

No open end consumer credit plan under which extensions of credit are secured by a consumer's principal dwelling may contain a provision which permits a creditor to change unilaterally any term required to be disclosed under section 1637a(a) of this title or any other term, except a change in insignificant terms such as the address of the creditor for billing purposes.

(2) Certain changes not precluded

Notwithstanding the provisions of subsection n* (1), a creditor may make any of the following changes:

(A) Change the index and margin applicable to extensions of credit under such plan if the index used by the creditor is no longer available and the substitute index and margin would result in a substantially similar interest rate.

(B) Prohibit additional extensions of credit or reduce the credit limit applicable to an account under the plan during any period in which the value of the consumer's principal dwelling which secures any outstanding balance is significantly less than the original appraisal value of the dwelling.

(C) Prohibit additional extensions of credit or reduce the credit limit applicable to the account during any period in which the creditor has reason to believe that the consumer will be unable to comply with the repayment requirements of the account due to a material change in the consumer's financial circumstances.

(D) Prohibit additional extensions of credit or reduce the credit limit applicable to the account during any period in which the consumer is in default with respect to any material obligation of the consumer under the agreement.

(E) Prohibit additional extensions of credit or reduce the credit limit applicable to the account during any period in which--

(i) the creditor is precluded by government action from imposing the annual percentage rate provided for in the account agreement; or

(ii) any government action is in effect which adversely affects the priority of the creditor's security interest in the account to the extent that the value of the creditor's secured interest in the property is less than 120 percent of the amount of the credit limit applicable to the account.

(F) Any change that will benefit the consumer.

(3) Material obligations

Upon the request of the consumer and at the time an agreement is entered into by a consumer to open an account under an open end consumer credit plan under which extensions of credit are secured by the consumer's principal dwelling, the consumer shall be given a list of the categories of contract obligations which are deemed by the creditor to be material obligations of the consumer under the agreement for purposes of paragraph (2)(D).

(4) Consumer benefit

(A) In general

For purposes of paragraph (2)(F), a change shall be deemed to benefit the consumer if the change is unequivocally beneficial to the borrower and the change is beneficial through the entire term of the agreement.

(B) Board categorization

The Board may, by regulation, determine categories of changes that benefit the consumer.

(d) Terms changed after application

If any term or condition described in section 1637a(a) of this title which is disclosed to a consumer in connection with an application to open an account under an open end consumer credit plan described in such section (other than a variable feature of the plan) changes before the account is opened, and if, as a result of such change, the consumer elects not to enter into the plan agreement, the creditor shall refund all fees paid by the consumer in connection with such application.

(e) Additional requirements relating to refunds and imposition of nonrefundable fees

(1) In general

No nonrefundable fee may be imposed by a creditor or any other person in connection with any application by a consumer to establish an account under any open end consumer credit plan which provides for extensions of credit which are secured by a consumer's principal dwelling before the end of the 3-day period beginning on the date such consumer receives the disclosure required under section 1637a(a) of this title and the pamphlet required under section 1637a(e) of this title with respect to such application.

(2) Constructive receipt

For purposes of determining when a nonrefundable fee may be imposed in accordance with this subsection if the disclosures and pamphlet referred to in paragraph (1) are mailed to the consumer, the date of the receipt of the disclosures by such consumer shall be deemed to be 3 business days after the date of mailing by the creditor.

FOOTNOTES:
(n79)Footnote *. So in original. Probably should be "paragraph".

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§ **1648 Reverse mortgages.**

(a) In general

In addition to the disclosures required under this chapter, for each reverse mortgage, the creditor shall, not less than 3 days prior to consummation of the transaction, disclose to the consumer in conspicuous type a good faith estimate of the projected total cost of the mortgage to the consumer expressed as a table of annual interest rates. Each annual interest rate shall be based on a projected total future credit extension balance under a projected appreciation rate for the dwelling and a term for the mortgage. The disclosure shall include--

(1) statements of the annual interest rates for not less than 3 projected appreciation rates and not less than 3 credit transaction periods, as determined by the Board, including--

(A) a short-term reverse mortgage;

(B) a term equaling the actuarial life expectancy of the consumer; and

(C) such longer term as the Board deems appropriate; and

(2) a statement that the consumer is not obligated to complete the reverse mortgage transaction merely because the consumer has received the disclosure required under this section or has signed an application for the reverse mortgage.

(b) Projected total cost

In determining the projected total cost of the mortgage to be disclosed to the consumer under subsection (a) of this section, the creditor shall take into account--

(1) any shared appreciation or equity that the lender will, by contract, be entitled to receive;

(2) all costs and charges to the consumer, including the costs of any associated annuity that the consumer elects or is required to purchase as part of the reverse mortgage transaction;

(3) all payments to and for the benefit of the consumer, including, in the case in which an associated annuity is purchased (whether or not required by the lender as a condition of making the reverse mortgage), the annuity payments received by the consumer and financed from the proceeds of the loan, instead of the proceeds used to finance the annuity; and

(4) any limitation on the liability of the consumer under reverse mortgage transactions (such as nonrecourse limits and equity conservation agreements).

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1649

§ 1649 Certain limitations on liability.

(a) Limitations on liability

For any closed end consumer credit transaction that is secured by real property or a dwelling, that is subject to this subchapter, and that is consummated before September 30, 1995, a creditor or any assignee of a creditor shall have no civil, administrative, or criminal liability under this subchapter for, and a consumer shall have no extended rescission rights under section 1635(f) of this title with respect to--

(1) the creditor's treatment, for disclosure purposes, of--

(A) taxes described in section 1605(d)(3) of this title;

(B) fees described in section 1605(e)(2) and (5) of this title;

(C) fees and amounts referred to in the 3rd sentence of section 1605(a) of this title; or

(D) borrower-paid mortgage broker fees referred to in section 1605(a)(6) of this title;

(2) the form of written notice used by the creditor to inform the obligor of the rights of the obligor under section 1635 of this title if the creditor provided the obligor with a properly dated form of written notice published and adopted by the Board or a comparable written notice, and otherwise complied with all the requirements of this section regarding notice; or

(3) any disclosure relating to the finance charge imposed with respect to the transaction if the amount or percentage actually disclosed--

(A) may be treated as accurate for purposes of this subchapter if the amount disclosed as the finance charge does not vary from the actual finance charge by more than $200;

(B) may, under section 1605(f)(2) of this title, be treated as accurate for purpose of section 1635 of this title; or

(C) is greater than the amount or percentage required to be disclosed under this subchapter.

(b) Exceptions

Subsection (a) of this section shall not apply to--

(1) any individual action or counterclaim brought under this subchapter which was filed before June 1, 1995;

(2) any class action brought under this chapter for which a final order certifying a class was entered before January 1, 1995;

(3) the named individual plaintiffs in any class action brought under this chapter which was filed before June 1, 1995; or

(4) any consumer credit transaction with respect to which a timely notice of rescission was sent to the creditor before June 1, 1995.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1650

§ 1650 Preventing unfair and deceptive private educational lending practices and eliminating conflicts of interest

(a) Definitions. As used in this section--

(1) the term "covered educational institution"--

(A) means any educational institution that offers a postsecondary educational degree, certificate, or program of study (including any institution of higher education); and

(B) includes an agent, officer, or employee of the educational institution;

(2) the term "gift"--

(A)

(i) means any gratuity, favor, discount, entertainment, hospitality, loan, or other item having more than a de minimis monetary value, including services, transportation, lodging, or meals, whether provided in kind, by purchase of a ticket, payment in advance, or reimbursement after the expense has been incurred; and

(ii) includes an item described in clause (i) provided to a family member of an officer, employee, or agent of a covered educational institution, or to any other individual based on that individual's relationship with the officer, employee, or agent, if--

(I) the item is provided with the knowledge and acquiescence of the officer, employee, or agent; and

(II) the officer, employee, or agent has reason to believe the item was provided because of the official position of the officer, employee, or agent; and

(B) does not include--

(i) standard informational material related to a loan, default aversion, default prevention, or financial literacy;

(ii) food, refreshments, training, or informational material furnished to an officer, employee, or agent of a covered educational institution, as an integral part of a training session or through participation in an advisory council that is designed to improve the service of the private educational lender to the covered educational institution, if such training or participation contributes to the professional development of the officer, employee, or agent of the covered educational institution;

(iii) favorable terms, conditions, and borrower benefits on a private education loan provided to a student employed by the covered educational institution, if such terms, conditions, or benefits are not provided because of the student's employment with the covered educational institution;

(iv) the provision of financial literacy counseling or services, including counseling or services provided in coordination with a covered educational institution, to the extent that such counseling or services are not undertaken to secure--

(I) applications for private education loans or private education loan volume;

(II) applications or loan volume for any loan made, insured, or guaranteed under title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*); or

(III) the purchase of a product or service of a specific private educational lender;

(v) philanthropic contributions to a covered educational institution from a private educational lender that are unrelated to private education loans and are not made in exchange for any advantage related to private education loans; or

(vi) State education grants, scholarships, or financial aid funds administered by or on behalf of a State;

(3) the term "institution of higher education" has the same meaning as in section 102 of the Higher Education Act of 1965 (*20 U.S.C. 1002*);

(4) the term "postsecondary educational expenses" means any of the expenses that are included as part of the cost of attendance of a student, as defined under section 472 of the Higher Education Act of 1965 (*20 U.S.C. 1087ll*);

(5) the term "preferred lender arrangement" has the same meaning as in section 151 of the Higher Education Act of 1965 [*20 USCS § 1019*];

(6) the term "private educational lender" means--

(A) a financial institution, as defined in section 3 of the Federal Deposit Insurance Act (*12 U.S.C. 1813*) that solicits, makes, or extends private education loans;

(B) a Federal credit union, as defined in section 101 of the Federal Credit Union Act (*12 U.S.C. 1752*) that solicits, makes, or extends private education loans; and

(C) any other person engaged in the business of soliciting, making, or extending private education loans;

(7) the term "private education loan"--

(A) means a loan provided by a private educational lender that--

(i) is not made, insured, or guaranteed under of title IV of the Higher Education Act of 1965 (*20 U.S.C. 1070 et seq.*); and

(ii) is issued expressly for postsecondary educational expenses to a borrower, regardless of whether the loan is provided through the educational institution that the subject student attends or directly to the borrower from the private educational lender; and

(B) does not include an extension of credit under an open end consumer credit plan, a reverse mortgage transaction, a residential mortgage transaction, or any other loan that is secured by real property or a dwelling; and

(8) the term "revenue sharing" means an arrangement between a covered educational institution and a private educational lender under which--

(A) a private educational lender provides or issues private education loans with respect to students attending the covered educational institution;

(B) the covered educational institution recommends to students or others the private educational lender or the private education loans of the private educational lender; and

(C) the private educational lender pays a fee or provides other material benefits, including profit sharing, to the covered educational institution in connection with the private education loans provided to students attending the covered educational institution or a borrower acting on behalf of a student.

(b) Prohibition on certain gifts and arrangements. A private educational lender may not, directly or indirectly--

(1) offer or provide any gift to a covered educational institution in exchange for any advantage or consideration provided to such private educational lender related to its private education loan activities; or

(2) engage in revenue sharing with a covered educational institution.

(c) Prohibition on co-branding. A private educational lender may not use the name, emblem, mascot, or logo of the covered educational institution, or other words, pictures, or symbols readily identified with the covered educational institution, in the marketing of private education loans in any way that implies that the covered educational institution endorses the private education loans offered by the private educational lender.

(d) Advisory board compensation. Any person who is employed in the financial aid office of a covered educational institution, or who otherwise has responsibilities with respect to private education loans or other financial aid of the institution, and who serves on an advisory board, commission, or group established by a private educational lender or group of such lenders shall be prohibited from receiving anything of value from the private educational lender or group of lenders. Nothing in this subsection prohibits the reimbursement of reasonable expenses incurred by an employee of a covered educational institution as part of their service on an advisory board, commission, or group described in this subsection.

(e) Prohibition on prepayment or repayment fees or penalty. It shall be unlawful for any private educational lender to impose a fee or penalty on a borrower for early repayment or prepayment of any private education loan.

(f) Credit card protections for college students.

(1) Disclosure required. An institution of higher education shall publicly disclose any contract or other agreement made with a card issuer or creditor for the purpose of marketing a credit card.

(2) Inducements prohibited. No card issuer or creditor may offer to a student at an institution of higher education any tangible item to induce such student to apply for or participate in an open end consumer credit plan offered by such card issuer or creditor, if such offer is made--

(A) on the campus of an institution of higher education;

(B) near the campus of an institution of higher education, as determined by rule of the Board; or

(C) at an event sponsored by or related to an institution of higher education.

(3) Sense of the Congress. It is the sense of the Congress that each institution of higher education should consider

adopting the following policies relating to credit cards:

(A) That any card issuer that markets a credit card on the campus of such institution notify the institution of the location at which such marketing will take place.

(B) That the number of locations on the campus of such institution at which the marketing of credit cards takes place be limited.

(C) That credit card and debt education and counseling sessions be offered as a regular part of any orientation program for new students of such institution.

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§ **1651 Procedure for timely settlement of estates of decedent obligors.**

The Board, in consultation with the Federal Trade Commission and each other agency referred to in section 108(a) [*15 USCS § 1607(a)*], shall prescribe regulations to require any creditor, with respect to any credit card account under an open end consumer credit plan, to establish procedures to ensure that any administrator of an estate of any deceased obligor with respect to such account can resolve outstanding credit balances in a timely manner.

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§ **1661 Catalogs and multiple-page advertisements.**

For the purposes of this part, a catalog or other multiple-page advertisement shall be considered a single advertisement if it clearly and conspicuously displays a credit terms table on which the information required to be stated under this part is clearly set forth.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1662

§ **1662 Advertising of downpayments and installments.**

No advertisement to aid, promote, or assist directly or indirectly any extension of consumer credit may state

(1) that a specific periodic consumer credit amount or installment amount can be arranged, unless the creditor usually and customarily arranges credit payments or installments for that period and in that amount.

(2) that a specified downpayment is required in connection with any extension of consumer credit, unless the creditor usually and customarily arranges downpayments in that amount.

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§ **1663 Advertising of open end credit plans.**

No advertisement to aid, promote, or assist directly or indirectly the extension of consumer credit under an open end credit plan may set forth any of the specific terms of that plan unless it also clearly and conspicuously sets forth all of the following items:

(1) Any minimum or fixed amount which could be imposed.

(2) In any case in which periodic rates may be used to compute the finance charge, the periodic rates expressed as annual percentage rates.

(3) Any other term that the Board may by regulation require to be disclosed.

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§ **1664 Advertising of credit other than open end plans.**

(a) Exclusion of open end credit plans

Except as provided in subsection (b) of this section, this section applies to any advertisement to aid, promote, or assist directly or indirectly any consumer credit sale, loan, or other extension of credit subject to the provisions of this subchapter, other than an open end credit plan.

(b) Advertisements of residential real estate

The provisions of this section do not apply to advertisements of residential real estate except to the extent that the Board may by regulation require.

(c) Rate of finance charge expressed as annual percentage rate

If any advertisement to which this section applies states the rate of a finance charge, the advertisement shall state the rate of that charge expressed as an annual percentage rate.

(d) Requisite disclosures in advertisement

If any advertisement to which this section applies states the amount of the downpayment, if any, the amount of any installment payment, the dollar amount of any finance charge, or the number of installments or the period of repayment, then the advertisement shall state all of the following items:

(1) The downpayment, if any.

(2) The terms of repayment.

(3) The rate of the finance charge expressed as an annual percentage rate.

(e) Each advertisement to which this section applies

that relates to a consumer credit transaction that is secured by the principal dwelling of a consumer in which the extension of credit may exceed the fair market value of the dwelling, and which advertisement is disseminated in paper form to the public or through the Internet, as opposed to by radio or television, shall clearly and conspicuously state that--

(1) the interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes; and

(2) the consumer should consult a tax adviser for further information regarding the deductibility of interest and charges.

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§ **1665 Nonliability of advertising media.**

There is no liability under this part on the part of any owner or personnel, as such, of any medium in which an advertisement appears or through which it is disseminated.

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§ **1665a Use of annual percentage rate in oral disclosures; exceptions.**

In responding orally to any inquiry about the cost of credit, a creditor, regardless of the method used to compute finance charges, shall state rates only in terms of the annual percentage rate, except that in the case of an open end credit plan, the periodic rate also may be stated and, in the case of an other than open end credit plan where a major component of the finance charge consists of interest computed at a simple annual rate, the simple annual rate also may be stated. The Board may, by regulation, modify the requirements of this section or provide an exception from this section for a transaction or class of transactions for which the creditor cannot determine in advance the applicable annual percentage rate.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1665b

§ 1665b Advertising of open end consumer credit plans secured by consumer's principal dwelling.

(a) In general

If any advertisement to aid, promote, or assist, directly or indirectly, the extension of consumer credit through an open end consumer credit plan under which extensions of credit are secured by the consumer's principal dwelling states, affirmatively or negatively, any of the specific terms of the plan, including any periodic payment amount required under such plan, such advertisement shall also clearly and conspicuously set forth the following information, in such form and manner as the Board may require:

(1) Loan fees and opening cost estimates

Any loan fee the amount of which is determined as a percentage of the credit limit applicable to an account under the plan and an estimate of the aggregate amount of other fees for opening the account, based on the creditor's experience with the plan and stated as a single amount or as a reasonable range.

(2) Periodic rates

In any case in which periodic rates may be used to compute the finance charge, the periodic rates expressed as an annual percentage rate.

(3) Highest annual percentage rate

The highest annual percentage rate which may be imposed under the plan.

(4) Other information

Any other information the Board may by regulation require.

(b) Tax deductibility

(1) In general

If any advertisement described in subsection (a) of this section contains a statement that any interest expense incurred with respect to the plan is or may be tax deductible, the advertisement shall not be misleading with respect to such deductibility.

(2) Credit in excess of fair market value

Each advertisement described in subsection (a) that relates to an extension of credit that may exceed the fair market value of the dwelling, and which advertisement is disseminated in paper form to the public or through the Internet, as opposed to by radio or television, shall include a clear and conspicuous statement that--

(A) the interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes; and

(B) the consumer should consult a tax adviser for further information regarding the deductibility of interest and charges.

(c) Certain terms prohibited

No advertisement described in subsection (a) of this section with respect to any home equity account may refer to such loan as "free money" or use other terms determined by the Board by regulation to be misleading.

(d) Discounted initial rate

(1) In general

If any advertisement described in subsection (a) of this section includes an initial annual percentage rate that is not

determined by the index or formula used to make later interest rate adjustments, the advertisement shall also state with equal prominence the current annual percentage rate that would have been applied using the index or formula if such initial rate had not been offered.

(2) Quoted rate must be reasonably current

The annual percentage rate required to be disclosed under the paragraph (1) rate must be current as of a reasonable time given the media involved.

(3) Period during which initial rate is in effect

Any advertisement to which paragraph (1) applies shall also state the period of time during which the initial annual percentage rate referred to in such paragraph will be in effect.

(e) Balloon payment

If any advertisement described in subsection (a) of this section contains a statement regarding the minimum monthly payment under the plan, the advertisement shall also disclose, if applicable, the fact that the plan includes a balloon payment.

(f) "Balloon payment" defined

For purposes of this section and section 1637a of this title, the term "balloon payment" means, with respect to any open end consumer credit plan under which extensions of credit are secured by the consumer's principal dwelling, any repayment option under which--

(1) the account holder is required to repay the entire amount of any outstanding balance as of a specified date or at the end of a specified period of time, as determined in accordance with the terms of the agreement pursuant to which such credit is extended; and

(2) the aggregate amount of the minimum periodic payments required would not fully amortize such outstanding balance by such date or at the end of such period.

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§ **1665c Interest rate reduction on open end consumer credit plans.**

[Caution: Subsecs. (a), (b), and (c) become effective 15 months after enactment, as provided by subsec. (d) of this section.]

(a) In general

If a creditor increases the annual percentage rate applicable to a credit card account under an open end consumer credit plan, based on factors including the credit risk of the obligor, market conditions, or other factors, the creditor shall consider changes in such factors in subsequently determining whether to reduce the annual percentage rate for such obligor.

(b) Requirements.

With respect to any credit card account under an open end consumer credit plan, the creditor shall--

(1) maintain reasonable methodologies for assessing the factors described in subsection (a);

(2) not less frequently than once every 6 months, review accounts as to which the annual percentage rate has been increased since January 1, 2009, to assess whether such factors have changed (including whether any risk has declined);

(3) reduce the annual percentage rate previously increased when a reduction is indicated by the review; and

(4) in the event of an increase in the annual percentage rate, provide in the written notice required under section 127(i) [*15 USCS § 1637(i)*] a statement of the reasons for the increase.

(c) Rule of construction.

This section shall not be construed to require a reduction in any specific amount.

(d) Rulemaking.

The Board shall issue final rules not later than 9 months after the date of enactment of this section [enacted May 22, 2009] to implement the requirements of and evaluate compliance with this section, and subsections (a), (b), and (c) shall become effective 15 months after that date of enactment [enacted May 22, 2009].

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§ **1665d Reasonable penalty fees on open end consumer credit plans.**

[Caution: This section takes effect 9 months after enactment of Act May 22, 2009, P.L. 111-24, as provided by § 3 of such Act.]

(a) In general

The amount of any penalty fee or charge that a card issuer may impose with respect to a credit card account under an open end consumer credit plan in connection with any omission with respect to, or violation of, the cardholder agreement, including any late payment fee, over-the-limit fee, or any other penalty fee or charge, shall be reasonable and proportional to such omission or violation.

(b) Rulemaking required.

The Board, in consultation with the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, and the National Credit Union Administration Board, shall issue final rules not later than 9 months after the date of enactment of this section [enacted May 22, 2009], to establish standards for assessing whether the amount of any penalty fee or charge described under subsection (a) is reasonable and proportional to the omission or violation to which the fee or charge relates. Subsection (a) shall become effective 15 months after the date of enactment of this section [enacted May 22, 2009].

(c) Considerations.

In issuing rules required by this section, the Board shall consider--

(1) the cost incurred by the creditor from such omission or violation;

(2) the deterrence of such omission or violation by the cardholder;

(3) the conduct of the cardholder; and

(4) such other factors as the Board may deem necessary or appropriate.

(d) Differentiation permitted.

In issuing rules required by this subsection, the Board may establish different standards for different types of fees and charges, as appropriate.

(e) Safe harbor rule authorized.

The Board, in consultation with the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, and the National Credit Union Administration Board, may issue rules to provide an amount for any penalty fee or charge described under subsection (a) that is presumed to be reasonable and proportional to the omission or violation to which the fee or charge relates.

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§ **1665e Consideration of ability to repay.**

[Caution: This section takes effect 9 months after enactment of Act May 22, 2009, P.L. 111-24, as provided by § 3 of such Act.]

A card issuer may not open any credit card account for any consumer under an open end consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required payments under the terms of such account.

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§ 1666 Correction of billing errors.

(a) Written notice by obligor to creditor; time for and contents of notice; procedure upon receipt of notice by creditor

If a creditor, within sixty days after having transmitted to an obligor a statement of the obligor's account in connection with an extension of consumer credit, receives at the address disclosed under section 1637(b)(10) of this title a written notice (other than notice on a payment stub or other payment medium supplied by the creditor if the creditor so stipulates with the disclosure required under section 1637(a)(7) of this title) from the obligor in which the obligor--

(1) sets forth or otherwise enables the creditor to identify the name and account number (if any) of the obligor,

(2) indicates the obligor's belief that the statement contains a billing error and the amount of such billing error, and

(3) sets forth the reasons for the obligor's belief (to the extent applicable) that the statement contains a billing error,

the creditor shall, unless the obligor has, after giving such written notice and before the expiration of the time limits herein specified, agreed that the statement was correct--

(A) not later than thirty days after the receipt of the notice, send a written acknowledgment thereof to the obligor, unless the action required in subparagraph (B) is taken within such thirty-day period, and

(B) not later than two complete billing cycles of the creditor (in no event later than ninety days) after the receipt of the notice and prior to taking any action to collect the amount, or any part thereof, indicated by the obligor under paragraph (2) either--

(i) make appropriate corrections in the account of the obligor, including the crediting of any finance charges on amounts erroneously billed, and transmit to the obligor a notification of such corrections and the creditor's explanation of any change in the amount indicated by the obligor under paragraph (2) and, if any such change is made and the obligor so requests, copies of documentary evidence of the obligor's indebtedness; or

(ii) send a written explanation or clarification to the obligor, after having conducted an investigation, setting forth to the extent applicable the reasons why the creditor believes the account of the obligor was correctly shown in the statement and, upon request of the obligor, provide copies of documentary evidence of the obligor's indebtedness. In the case of a billing error where the obligor alleges that the creditor's billing statement reflects goods not delivered to the obligor or his designee in accordance with the agreement made at the time of the transaction, a creditor may not construe such amount to be correctly shown unless he determines that such goods were actually delivered, mailed, or otherwise sent to the obligor and provides the obligor with a statement of such determination.

After complying with the provisions of this subsection with respect to an alleged billing error, a creditor has no further responsibility under this section if the obligor continues to make substantially the same allegation with respect to such error.

(b) Billing error

For the purpose of this section, a "billing error" consists of any of the following:

(1) A reflection on a statement of an extension of credit which was not made to the obligor or, if made, was not in the amount reflected on such statement.

(2) A reflection on a statement of an extension of credit for which the obligor requests additional clarification including documentary evidence thereof.

(3) A reflection on a statement of goods or services not accepted by the obligor or his designee or not delivered to the obligor or his designee in accordance with the agreement made at the time of a transaction.

(4) The creditor's failure to reflect properly on a statement a payment made by the obligor or a credit issued to the obligor.

(5) A computation error or similar error of an accounting nature of the creditor on a statement.

(6) Failure to transmit the statement required under section 1637(b) of this title to the last address of the obligor which has been disclosed to the creditor, unless that address was furnished less than twenty days before the end of the billing cycle for which the statement is required.

(7) Any other error described in regulations of the Board.

(c) Action by creditor to collect amount or any part thereof regarded by obligor to be a billing error

For the purposes of this section, "action to collect the amount, or any part thereof, indicated by an obligor under paragraph (2)" does not include the sending of statements of account, which may include finance charges on amounts in dispute, to the obligor following written notice from the obligor as specified under subsection (a) of this section, if--

(1) the obligor's account is not restricted or closed because of the failure of the obligor to pay the amount indicated under paragraph (2) of subsection (a) of this section, and

(2) the creditor indicates the payment of such amount is not required pending the creditor's compliance with this section.

Nothing in this section shall be construed to prohibit any action by a creditor to collect any amount which has not been indicated by the obligor to contain a billing error.

(d) Restricting or closing by creditor of account regarded by obligor to contain a billing error

Pursuant to regulations of the Board, a creditor operating an open end consumer credit plan may not, prior to the sending of the written explanation or clarification required under paragraph (B)(ii), restrict or close an account with respect to which the obligor has indicated pursuant to subsection (a) of this section that he believes such account to contain a billing error solely because of the obligor's failure to pay the amount indicated to be in error. Nothing in this subsection shall be deemed to prohibit a creditor from applying against the credit limit on the obligor's account the amount indicated to be in error.

(e) Effect of noncompliance with requirements by creditor

Any creditor who fails to comply with the requirements of this section or section 1666a of this title forfeits any right to collect from the obligor the amount indicated by the obligor under paragraph (2) of subsection (a) of this

section, and any finance charges thereon, except that the amount required to be forfeited under this subsection may not exceed $50.

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§ **1666a Regulation of credit reports.**

(a) Reports by creditor on obligor's failure to pay amount regarded as billing error

After receiving a notice from an obligor as provided in section 1666(a) of this title, a creditor or his agent may not directly or indirectly threaten to report to any person adversely on the obligor's credit rating or credit standing because of the obligor's failure to pay the amount indicated by the obligor under section 1666(a)(2) of this title, and such amount may not be reported as delinquent to any third party until the creditor has met the requirements of section 1666 of this title and has allowed the obligor the same number of days (not less than ten) thereafter to make payment as is provided under the credit agreement with the obligor for the payment of undisputed amounts.

(b) Reports by creditor on delinquent amounts in dispute; notification of obligor of parties notified of delinquency

If a creditor receives a further written notice from an obligor that an amount is still in dispute within the time allowed for payment under subsection (a) of this section, a creditor may not report to any third party that the amount of the obligor is delinquent because the obligor has failed to pay an amount which he has indicated under section 1666(a)(2) of this title, unless the creditor also reports that the amount is in dispute and, at the same time, notifies the obligor of the name and address of each party to whom the creditor is reporting information concerning the delinquency.

(c) Reports by creditor of subsequent resolution of delinquent amounts

A creditor shall report any subsequent resolution of any delinquencies reported pursuant to subsection (b) of this section to the parties to whom such delinquencies were initially reported.

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§ **1666b Timing of payments.**

(a) Time to make payments. A creditor may not treat a payment on a credit card account under an open end consumer credit plan as late for any purpose, unless the creditor has adopted reasonable procedures designed to ensure that each periodic statement including the information required by section 127(b) [*15 USCS § 1637(b)*] is mailed or delivered to the consumer not later than 21 days before the payment due date.

(b) Grace period. If an open end consumer credit plan provides a time period within which an obligor may repay any portion of the credit extended without incurring an additional finance charge, such additional finance charge may not be imposed with respect to such portion of the credit extended for the billing cycle of which such period is a part, unless a statement which includes the amount upon which the finance charge for the period is based was mailed or delivered to the consumer not later than 21 days before the date specified in the statement by which payment must be made in order to avoid imposition of that finance charge.

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§ **1666c Prompt and fair crediting of payments.**

(a) In general. Payments received from an obligor under an open end consumer credit plan by the creditor shall be posted promptly to the obligor's account as specified in regulations of the Board. Such regulations shall prevent a finance charge from being imposed on any obligor if the creditor has received the obligor's payment in readily identifiable form, by 5:00 p.m. on the date on which such payment is due, in the amount, manner, and location indicated by the creditor to avoid the imposition thereof.

(b) Application of payments.

(1) In general. Upon receipt of a payment from a cardholder, the card issuer shall apply amounts in excess of the minimum payment amount first to the card balance bearing the highest rate of interest, and then to each successive balance bearing the next highest rate of interest, until the payment is exhausted.

(2) Clarification relating to certain deferred interest arrangements. A creditor shall allocate the entire amount paid by the consumer in excess of the minimum payment amount to a balance on which interest is deferred during the last 2 billing cycles immediately preceding the expiration of the period during which interest is deferred.

(c) Changes by card issuer. If a card issuer makes a material change in the mailing address, office, or procedures for handling cardholder payments, and such change causes a material delay in the crediting of a cardholder payment made during the 60-day period following the date on which such change took effect, the card issuer may not impose any late

fee or finance charge for a late payment on the credit card account to which such payment was credited.

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§ **1666d Treatment of credit balances.**

Whenever a credit balance in excess of $1 is created in connection with a consumer credit transaction through (1) transmittal of funds to a creditor in excess of the total balance due on an account, (2) rebates of unearned finance charges or insurance premiums, or (3) amounts otherwise owed to or held for the benefit of an obligor, the creditor shall--

(A) credit the amount of the credit balance to the consumer's account;

(B) refund any part of the amount of the remaining credit balance, upon request of the consumer; and

(C) make a good faith effort to refund to the consumer by cash, check, or money order any part of the amount of the credit balance remaining in the account for more than six months, except that no further action is required in any case in which the consumer's current location is not known by the creditor and cannot be traced through the consumer's last known address or telephone number.

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§ 1666e Notification of credit card issuer by seller of return of goods, etc., by obligor; credit for account of obligor.

With respect to any sales transaction where a credit card has been used to obtain credit, where the seller is a person other than the card issuer, and where the seller accepts or allows a return of the goods or forgiveness of a debit for services which were the subject of such sale, the seller shall promptly transmit to the credit card issuer, a credit statement with respect thereto and the credit card issuer shall credit the account of the obligor for the amount of the transaction.

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§ 1666f Inducements to cardholders by sellers of cash discounts for payments by cash, check or similar means; credit card surcharge prohibition; finance charge for sales transactions involving cash discounts.

(a) Cash discounts

(1) With respect to credit card which may be used for extensions of credit in sales transactions in which the seller is a person other than the card issuer, the card issuer may not, by contract, or otherwise, prohibit any such seller from offering a discount to a cardholder to induce the cardholder to pay by cash, check, or similar means rather than use a credit card.

(b) Finance charge

With respect to any sales transaction, any discount from the regular price offered by the seller for the purpose of inducing payment by cash, checks, or other means not involving the use of an open-end credit plan or a credit card shall not constitute a finance charge as determined under section 1605 of this title if such discount is offered to all prospective buyers and its availability is disclosed clearly and conspicuously.

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§ **1666g Tie-in services prohibited for issuance of credit card.**

Notwithstanding any agreement to the contrary, a card issuer may not require a seller, as a condition to participating in a credit card plan, to open an account with or procure any other service from the card issuer or its subsidiary or agent.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1666h

§ 1666h Offset of cardholder's indebtedness by issuer of credit card with funds deposited with issuer by cardholder; remedies of creditors under State law not affected.

(a) Offset against consumer's funds

A card issuer may not take any action to offset a cardholder's indebtedness arising in connection with a consumer credit transaction under the relevant credit card plan against funds of the cardholder held on deposit with the card issuer unless--

(1) such action was previously authorized in writing by the cardholder in accordance with a credit plan whereby the cardholder agrees periodically to pay debts incurred in his open end credit account by permitting the card issuer periodically to deduct all or a portion of such debt from the cardholder's deposit account, and

(2) such action with respect to any outstanding disputed amount not be taken by the card issuer upon request of the cardholder.

In the case of any credit card account in existence on the effective date of this section, the previous written authorization referred to in clause (1) shall not be required until the date (after such effective date) when such account is renewed, but in no case later than one year after such effective date. Such written authorization shall be deemed to exist if the card issuer has previously notified the cardholder that the use of his credit card account will subject any funds which the card issuer holds in deposit accounts of such cardholder to offset against any amounts due and payable on his credit card account which have not been paid in accordance with the terms of the agreement between the card issuer and the cardholder.

(b) Attachment and levies

This section does not alter or affect the right under State law of a card issuer to attach or otherwise levy upon funds of a cardholder held on deposit with the card issuer if that remedy is constitutionally available to creditors generally.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1666i

§ 1666i Assertion by cardholder against card issuer of claims and defenses arising out of credit card transaction; prerequisites; limitation on amount of claims or defenses.

(a) Claims and defenses assertable

Subject to the limitation contained in subsection (b) of this section, a card issuer who has issued a credit card to a cardholder pursuant to an open end consumer credit plan shall be subject to all claims (other than tort claims) and defenses arising out of any transaction in which the credit card is used as a method of payment or extension of credit if (1) the obligor has made a good faith attempt to obtain satisfactory resolution of a disagreement or problem relative to the transaction from the person honoring the credit card; (2) the amount of the initial transaction exceeds $50; and (3) the place where the initial transaction occurred was in the same State as the mailing address previously provided by the cardholder or was within 100 miles from such address, except that the limitations set forth in clauses (2) and (3) with respect to an obligor's right to assert claims and defenses against a card issuer shall not be applicable to any transaction in which the person honoring the credit card (A) is the same person as the card issuer, (B) is controlled by the card issuer, (C) is under direct or indirect common control with the card issuer, (D) is a franchised dealer in the card issuer's products or services, or (E) has obtained the order for such transaction through a mail solicitation made by or participated in by the card issuer in which the cardholder is solicited to enter into such transaction by using the credit card issued by the card issuer.

(b) Amount of claims and defenses assertable

The amount of claims or defenses asserted by the cardholder may not exceed the amount of credit outstanding with respect to such transaction at the time the cardholder first notifies the card issuer or the person honoring the credit card of such claim or defense. For the purpose of determining the amount of credit outstanding in the preceding sentence, payments and credits to the cardholder's account are deemed to have been applied, in the order indicated, to the payment of: (1) late charges in the order of their entry to the account; (2) finance charges in order of their entry to the account; and (3) debits to the account other than those set forth above, in the order in which each debit entry to the account was

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1666i-1

§ 1666i-1 Limits on interest rate, fee, and finance charge increases applicable to outstanding balances.

(a) In general. In the case of any credit card account under an open end consumer credit plan, no creditor may increase any annual percentage rate, fee, or finance charge applicable to any outstanding balance, except as permitted under subsection (b).

(b) Exceptions. The prohibition under subsection (a) shall not apply to--

(1) an increase in an annual percentage rate upon the expiration of a specified period of time, provided that--

(A) prior to commencement of that period, the creditor disclosed to the consumer, in a clear and conspicuous manner, the length of the period and the annual percentage rate that would apply after expiration of the period;

(B) the increased annual percentage rate does not exceed the rate disclosed pursuant to subparagraph (A); and

(C) the increased annual percentage rate is not applied to transactions that occurred prior to commencement of the period;

(2) an increase in a variable annual percentage rate in accordance with a credit card agreement that provides for changes in the rate according to operation of an index that is not under the control of the creditor and is available to the general public;

(3) an increase due to the completion of a workout or temporary hardship arrangement by the obligor or the failure of the obligor to comply with the terms of a workout or temporary hardship arrangement, provided that--

(A) the annual percentage rate, fee, or finance charge applicable to a category of transactions following any such increase does not exceed the rate, fee, or finance charge that applied to that category of transactions prior to commencement of the arrangement; and

(B) the creditor has provided the obligor, prior to the commencement of such arrangement, with clear and conspicuous disclosure of the terms of the arrangement (including any increases due to such completion or failure); or

(4) an increase due solely to the fact that a minimum payment by the obligor has not been received by the creditor within 60 days after the due date for such payment, provided that the creditor shall--

(A) include, together with the notice of such increase required under section 127(i) [*15 USCS § 1637(i)*], a clear and conspicuous written statement of the reason for the increase and that the increase will terminate not later than 6 months after the date on which it is imposed, if the creditor receives the required minimum payments on time from the obligor during that period; and

(B) terminate such increase not later than 6 months after the date on which it is imposed, if the creditor receives the required minimum payments on time during that period.

(c) Repayment of outstanding balance.

(1) In general. The creditor shall not change the terms governing the repayment of any outstanding balance, except that the creditor may provide the obligor with one of the methods described in paragraph (2) of repaying any outstanding balance, or a method that is no less beneficial to the obligor than one of those methods.

(2) Methods. The methods described in this paragraph are--

(A) an amortization period of not less than 5 years, beginning on the effective date of the increase set forth in the notice required under section 127(i) [*15 USCS § 1637(i)*]; or

(B) a required minimum periodic payment that includes a percentage of the outstanding balance that is equal to not more than twice the percentage required before the effective date of the increase set forth in the notice required under section 127(i) [*15 USCS § 1637(i)*].

(d) Outstanding balance defined. For purposes of this section, the term "outstanding balance" means the amount owed on a credit card account under an open end consumer credit plan as of the end of the 14th day after the date on which the creditor provides notice of an increase in the annual percentage rate, fee, or finance charge in accordance with section 127(i) [*15 USCS § 1637(i)*].

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1666i-2

§ **1666i-2 Additional limits on interest rate increases.**

(a) Limitation on increases within first year. Except in the case of an increase described in paragraph (1), (2), (3), or (4) of section 171(b) [*15 USCS § 1666i-1(b)*], no increase in any annual percentage rate, fee, or finance charge on any credit card account under an open end consumer credit plan shall be effective before the end of the 1-year period beginning on the date on which the account is opened.

(b) Promotional rate minimum term. No increase in any annual percentage rate applicable to a credit card account under an open end consumer credit plan that is a promotional rate (as that term is defined by the Board) shall be effective before the end of the 6-month period beginning on the date on which the promotional rate takes effect, subject to such reasonable exceptions as the Board may establish, by rule.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1666j

§ **1666j Applicability of State laws.**

(a) Consistency of provisions.

This chapter [*15 USCS §§ 1666 et seq.*] does not annul, alter, or affect, or exempt any person subject to the provisions of this chapter [*15 USCS §§ 1666 et seq.*] from complying with, the laws of any State with respect to credit billing practices, except to the extent that those laws are inconsistent with any provision of this chapter [*15 USCS §§ 1666 et seq.*], and then only to the extent of the inconsistency. The Board is authorized to determine whether such inconsistencies exist. The Board may not determine that any State law is inconsistent wit any provision of this chapter [*15 USCS §§ 1666 et seq.*] if the Board determines that such law gives greater protection to the consumer.

(b) Exemptions by Board from credit billing requirements.

The Board shall by regulation exempt from the requirements of this chapter [*15 USCS §§ 1666 et seq.*] any class of credit transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under this chapter [*15 USCS §§ 1666 et seq.*] or that such law gives greater protection to the consumer, and that there is adequate provision for enforcement.

(c) Finance charge or other charge for credit for sales transactions involving cash discounts.

Notwithstanding any other provisions of this title [*15 USCS §§ 1601 et seq.*], any discount offered under section 167(b) of this title [*15 USCS § 1666f(b)*] shall not be considered a finance charge or other charge for credit under the usury laws of any State or under the laws of any State relating to disclosure of information in connection with credit transactions, or relating to the types, amounts or rates of charges, or to any element or elements of charges permissible under such laws in connection with the extension or use of credit.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1667

§ **1667 Definitions.**

For purposes of this part--

(1) The term "consumer lease" means a contract in the form of a lease or bailment for the use of personal property by a natural person for a period of time exceeding four months, and for a total contractual obligation not exceeding $25,000, primarily for personal, family, or household purposes, whether or not the lessee has the option to purchase or otherwise become the owner of the property at the expiration of the lease, except that such term shall not include any credit sale as defined in section 1602(g) of this title. Such term does not include a lease for agricultural, business, or commercial purposes, or to a government or governmental agency or instrumentality, or to an organization.

(2) The term "lessee" means a natural person who leases or is offered a consumer lease.

(3) The term "lessor" means a person who is regularly engaged in leasing, offering to lease, or arranging to lease under a consumer lease.

(4) The term "personal property" means any property which is not real property under the laws of the State where situated at the time offered or otherwise made available for lease.

(5) The terms "security" and "security interest" mean any interest in property which secures payment or performance of an obligation.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1667a

§ **1667a Consumer lease disclosures.**

Each lessor shall give a lessee prior to the consummation of the lease a dated written statement on which the lessor and lessee are identified setting out accurately and in a clear and conspicuous manner the following information with respect to that lease, as applicable:

(1) A brief description or identification of the leased property;

(2) The amount of any payment by the lessee required at the inception of the lease;

(3) The amount paid or payable by the lessee for official fees, registration, certificate of title, or license fees or taxes;

(4) The amount of other charges payable by the lessee not included in the periodic payments, a description of the charges and that the lessee shall be liable for the differential, if any, between the anticipated fair market value of the leased property and its appraised actual value at the termination of the lease, if the lessee has such liability;

(5) A statement of the amount or method of determining the amount of any liabilities the lease imposes upon the lessee at the end of the term and whether or not the lessee has the option to purchase the leased property and at what price and time;

(6) A statement identifying all express warranties and guarantees made by the manufacturer or lessor with respect to the leased property, and identifying the party responsible for maintaining or servicing the leased property together with a description of the responsibility;

(7) A brief description of insurance provided or paid for by the lessor or required of the lessee, including the types and amounts of the coverages and costs;

(8) A description of any security interest held or to be retained by the lessor in connection with the lease and a clear identification of the property to which the security interest relates;

(9) The number, amount, and due dates or periods of payments under the lease and the total amount of such periodic payments;

(10) Where the lease provides that the lessee shall be liable for the anticipated fair market value of the property on expiration of the lease, the fair market value of the property at the inception of the lease, the aggregate cost of the lease on expiration, and the differential between them; and

(11) A statement of the conditions under which the lessee or lessor may terminate the lease prior to the end of the term and the amount or method of determining any penalty or other charge for delinquency, default, late payments, or early termination.

The disclosures required under this section may be made in the lease contract to be signed by the lessee. The Board may provide by regulation that any portion of the information required to be disclosed under this section may be given in the form of estimates where the lessor is not in a position to know exact information.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1667b

§ **1667b Lessee's liability on expiration or termination of lease.**

(a) Estimated residual value of property as basis; presumptions; action by lessor of excess liability; mutually agreeable final adjustment

Where the lessee's liability on expiration of a consumer lease is based on the estimated residual value of the property such estimated residual value shall be a reasonable approximation of the anticipated actual fair market value of the property on lease expiration. There shall be a rebuttable presumption that the estimated residual value is unreasonable to the extent that the estimated residual value exceeds the actual residual value by more than three times the average payment allocable to a monthly period under the lease. In addition, where the lessee has such liability on expiration of a consumer lease there shall be a rebuttable presumption that the lessor's estimated residual value is not in good faith to the extent that the estimated residual value exceeds the actual residual value by more than three times the average payment allocable to a monthly period under the lease and such lessor shall not collect from the lessee the amount of such excess liability on expiration of a consumer lease unless the lessor brings a successful action with respect to such excess liability. In all actions, the lessor shall pay the lessee's reasonable attorney's fees. The presumptions stated in this section shall not apply to the extent the excess of estimated over actual residual value is due to physical damage to the property beyond reasonable wear and use, or to excessive use, and the lease may set standards for such wear and use if such standards are not unreasonable. Nothing in this subsection shall preclude the right of a willing lessee to make any mutually agreeable final adjustment with respect to such excess residual liability, provided such an agreement is reached after termination of the lease.

(b) Penalties and charges for delinquency, default, or early termination

Penalties or other charges for delinquency, default, or early termination may be specified in the lease but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the delinquency, default, or early termination, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.

(c) Independent professional appraisal of residual value of property at termination of lease; finality

If a lease has a residual value provision at the termination of the lease, the lessee may obtain at his expense, a professional appraisal of the leased property by an independent third party agreed to by both parties. Such appraisal shall be final and binding on the parties.

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§ **1667c Consumer lease advertising; liability of advertising media.**

(a) In general

If an advertisement for a consumer lease includes a statement of the amount of any payment or a statement that any or no initial payment is required, the advertisement shall clearly and conspicuously state, as applicable--

(1) the transaction advertised is a lease.

(2) the total amount of any initial payments required on or before consummation of the lease or delivery of the property, whichever is later;

(3) that a security deposit is required;

(4) the number, amount, and timing of scheduled payments; and

(5) with respect to a lease in which the liability of the consumer at the end of the lease term is based on the anticipated residual value of the property, that an extra charge may be imposed at the end of the lease term.

(b) Advertising medium not liable

No owner or employee of any entity that serves as a medium in which an advertisement appears or through which an advertisement is disseminated, shall be liable under this section.

(c) Radio advertisements

(1) In general

An advertisement by radio broadcast to aid, promote, or assist, directly or indirectly, any consumer lease shall be deemed to be in compliance with the requirements of subsection (a) if such advertisement clearly and conspicuously--

(A) states the information required by paragraphs (1) and (2) of subsection (a) of this section;

(B) states the number, amounts, due dates or periods of scheduled payments, and the total of such payments under the lease;

(C) includes--

(i) a referral to--

(I) a toll-free telephone number established in accordance with paragraph (2) that may be used by consumers to obtain the information required under subsection (a) of this section; or

(II) a written advertisement that--

(aa) appears in a publication in general circulation in the community served by the radio station on which such advertisement is broadcast during the period beginning 3 days before any such broadcast and ending 10 days after such broadcast; and

(bb) includes the information required to be disclosed under subsection (a) of this section; and

(ii) the name and dates of any publication referred to in clause (i)(II); and

(D) includes any other information which the Board determines necessary to carry out this chapter.

(2) Establishment of toll-free number

(A) In general

In the case of a radio broadcast advertisement described in paragraph (1) that includes a referral to a toll-free telephone number, the lessor who offers the consumer lease shall--

(i) establish such a toll-free telephone number not later than the date on which the advertisement including the referral is broadcast;

(ii) maintain such telephone number for a period of not less than 10 days, beginning on the date of any such broadcast; and

(iii) provide the information required under subsection (a) of this section with respect to the lease to any person who calls such number.

(B) Form of information

The information required to be provided under subparagraph (A)(iii) shall be provided verbally or, if requested by the consumer, in written form.

(3) No effect on other law

Nothing in this subsection shall affect the requirements of Federal law as such requirements apply to advertisement by any medium other than radio broadcast.

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§ **1667d Civil liability of lessors.**

(a) Grounds for maintenance of action

Any lessor who fails to comply with any requirement imposed under section 1667a or 1667b of this title with respect to any person is liable to such person as provided in section 1640 of this title.

(b) Additional grounds for maintenance of action; "creditor" defined

Any lessor who fails to comply with any requirement imposed under section 1667c of this title with respect to any person who suffers actual damage from the violation is liable to such person as provided in section 1640 of this title. For the purposes of this section, the term "creditor" as used in sections 1640 and 1641 of this title shall include a lessor as defined in this part.

(c) Jurisdiction of courts; time limitation

Notwithstanding section 1640(e) of this title, any action under this section may be brought in any United States district court or in any other court of competent jurisdiction. Such actions alleging a failure to disclose or otherwise comply with the requirements of this part shall be brought within one year of the termination of the lease agreement.

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§ **1667e Applicability of State laws; exemptions by Board from leasing requirements.**

(a) This part does not annul, alter, or affect, or exempt any person subject to the provisions of this part from complying with, the laws of any State with respect to consumer leases, except to the extent that those laws are inconsistent with any provision of this part, and then only to the extent of the inconsistency. The Board is authorized to determine whether such inconsistencies exist. The Board may not determine that any State law is inconsistent with any provision of this part if the Board determines that such law gives greater protection and benefit to the consumer.

(b) The Board shall by regulation exempt from the requirements of this part any class of lease transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under this part or that such law gives greater protection and benefit to the consumer, and that there is adequate provision for enforcement.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1667f

§ **1667f Regulations.**

(a) Regulations authorized

(1) In general

The Board shall prescribe regulations to update and clarify the requirements and definitions applicable to lease disclosures and contracts, and any other issues specifically related to consumer leasing, to the extent that the Board determines such action to be necessary--

(A) to carry out this part;

(B) to prevent any circumvention of this part; or

(C) to facilitate compliance with the requirements of the part.

(2) Classifications, adjustments

Any regulations prescribed under paragraph (1) may contain classifications and differentiations, and may provide for adjustments and exceptions for any class of transactions, as the Board considers appropriate.

(b) Model disclosure

(1) Publication

The Board shall establish and publish model disclosure forms to facilitate compliance with the disclosure requirements of this part and to aid the consumer in understanding the transaction to which the subject disclosure form relates.

(2) Use of automated equipment

In establishing model forms under this subsection, the Board shall consider the use by lessors of data processing or similar automated equipment.

(3) Use optional

A lessor may utilize a model disclosure form established by the Board under this subsection for purposes of compliance with this part, at the discretion of the lessor.

(4) Effect of use

Any lessor who properly uses the material aspects of any model disclosure form established by the Board under this subsection shall be deemed to be in compliance with the disclosure requirements to which the form relates.

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§ 1671 Congressional findings and declaration of purpose.

(a) Disadvantages of garnishment

The Congress finds:

(1) The unrestricted garnishment of compensation due for personal services encourages the making of predatory extensions of credit. Such extensions of credit divert money into excessive credit payments and thereby hinder the production and flow of goods in interstate commerce.

(2) The application of garnishment as a creditors' remedy frequently results in loss of employment by the debtor, and the resulting disruption of employment, production, and consumption constitutes a substantial burden on interstate commerce.

(3) The great disparities among the laws of the several States relating to garnishment have, in effect, destroyed the uniformity of the bankruptcy laws and frustrated the purposes thereof in many areas of the country.

(b) Necessity for regulation

On the basis of the findings stated in subsection (a) of this section, the Congress determines that the provisions of this subchapter are necessary and proper for the purpose of carrying into execution the powers of the Congress to regulate commerce and to establish uniform bankruptcy laws.

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§ **1672 Definitions.**

For the purposes of this subchapter:

(a) The term "earnings" means compensation paid or payable for personal services, whether denominated as wages, salary, commission, bonus, or otherwise, and includes periodic payments pursuant to a pension or retirement program.

(b) The term "disposable earnings" means that part of the earnings of any individual remaining after the deduction from those earnings of any amounts required by law to be withheld.

(c) The term "garnishment" means any legal or equitable procedure through which the earnings of any individual are required to be withheld for payment of any debt.

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§ 1673 Restriction on garnishment.

(a) Maximum allowable garnishment

Except as provided in subsection (b) of this section and in section 1675 of this title, the maximum part of the aggregate disposable earnings of an individual for any workweek which is subjected to garnishment may not exceed

(1) 25 per centum of his disposable earnings for that week, or

(2) the amount by which his disposable earnings for that week exceed thirty times the Federal minimum hourly wage prescribed by section 206(a)(1) of title 29 in effect at the time the earnings are payable,

whichever is less. In the case of earnings for any pay period other than a week, the Secretary of Labor shall by regulation prescribe a multiple of the Federal minimum hourly wage equivalent in effect to that set forth in paragraph (2).

(b) Exceptions

(1) The restrictions of subsection (a) of this section do not apply in the case of

(A) any order for the support of any person issued by a court of competent jurisdiction or in accordance with an

administrative procedure, which is established by State law, which affords substantial due process, and which is subject to judicial review.

(B) any order of any court of the United States having jurisdiction over cases under chapter 13 of title 11.

(C) any debt due for any State or Federal tax.

(2) The maximum part of the aggregate disposable earnings of an individual for any workweek which is subject to garnishment to enforce any order for the support of any person shall not exceed--

(A) where such individual is supporting his spouse or dependent child (other than a spouse or child with respect to whose support such order is used), 50 per centum of such individual's disposable earnings for that week; and

(B) where such individual is not supporting such a spouse or dependent child described in clause (A), 60 per centum of such individual's disposable earnings for that week;

except that, with respect to the disposable earnings of any individual for any workweek, the 50 per centum specified in clause (A) shall be deemed to be 55 per centum and the 60 per centum specified in clause (B) shall be deemed to be 65 per centum, if and to the extent that such earnings are subject to garnishment to enforce a support order with respect to a period which is prior to the twelve-week period which ends with the beginning of such workweek.

(c) Execution or enforcement of garnishment order or process prohibited

No court of the United States or any State, and no State (or officer or agency thereof), may make, execute, or enforce any order or process in violation of this section.

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§ 1674 Restriction on discharge from employment by reason of garnishment.

(a) Termination of employment

No employer may discharge any employee by reason of the fact that his earnings have been subjected to garnishment for any one indebtedness.

(b) Penalties

Whoever willfully violates subsection (a) of this section shall be fined not more than $1,000, or imprisoned not more than one year, or both.

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§ **1675 Exemption for State-regulated garnishments.**

The Secretary of Labor may by regulation exempt from the provisions of section 1673(a) and (b)(2) of this title garnishments issued under the laws of any State if he determines that the laws of that State provide restrictions on garnishment which are substantially similar to those provided in section 1673(a) and (b)(2) of this title.

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§ **1676 Enforcement by Secretary of Labor.**

The Secretary of Labor, acting through the Wage and Hour Division of the Department of Labor, shall enforce the provisions of this subchapter.

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§ **1677 Effect on State laws.**

This subchapter does not annul, alter, or affect, or exempt any person from complying with, the laws of any State

(1) prohibiting garnishments or providing for more limited garnishment than are allowed under this subchapter, or

(2) prohibiting the discharge of any employee by reason of the fact that his earnings have been subjected to garnishment for more than one indebtedness.

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SUBCHAPTER II-A
CREDIT REPAIR ORGANIZATIONS

[Editor's Note: *15 U.S.C. §§ 1679-1679j* comprise the Credit Repair Organizations Act.]

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§ 1679 Findings and purposes

(a) Findings

The Congress makes the following findings:

(1) Consumers have a vital interest in establishing and maintaining their credit worthiness and credit standing in order to obtain and use credit. As a result, consumers who have experienced credit problems may seek assistance from credit repair organizations which offer to improve the credit standing of such consumers.

(2) Certain advertising and business practices of some companies engaged in the business of credit repair services have worked a financial hardship upon consumers, particularly those of limited economic means and who are inexperienced in credit matters.

(b) Purposes

The purposes of this subchapter are--

(1) to ensure that prospective buyers of the services of credit repair organizations are provided with the information necessary to make an informed decision regarding the purchase of such services; and

(2) to protect the public from unfair or deceptive advertising and business practices by credit repair organizations.

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§ **1679a Definitions.**

For purposes of this subchapter, the following definitions apply:

(1) Consumer

The term "consumer" means an individual.

(2) Consumer credit transaction

The term "consumer credit transaction" means any transaction in which credit is offered or extended to an individual for personal, family, or household purposes.

(3) Credit repair organization

The term "credit repair organization"--

(A) means any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of--

(i) improving any consumer's credit record, credit history, or credit rating; or

(ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i); and

(B) does not include--

(i) any nonprofit organization which is exempt from taxation under section 501(c)(3) of title 26;

(ii) any creditor (as defined in section 1602 of this title), with respect to any consumer, to the extent the creditor is assisting the consumer to restructure any debt owed by the consumer to the creditor; or

(iii) any depository institution (as that term is defined in section 1813 of title 12) or any Federal or State credit union (as those terms are defined in section 1752 of title 12), or any affiliate or subsidiary of such a depository institution or credit union.

(4) Credit

The term "credit" has the meaning given to such term in section 1602(e) of this title.

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§ **1679b Prohibited practices.**

(a) In general

No person may--

(1) make any statement, or counsel or advise any consumer to make any statement, which is untrue or misleading (or which, upon the exercise of reasonable care, should be known by the credit repair organization, officer, employee, agent, or other person to be untrue or misleading) with respect to any consumer's credit worthiness, credit standing, or credit capacity to--

(A) any consumer reporting agency (as defined in section 1681a(f) of this title); or

(B) any person--

(i) who has extended credit to the consumer; or

(ii) to whom the consumer has applied or is applying for an extension of credit;

(2) make any statement, or counsel or advise any consumer to make any statement, the intended effect of which is to alter the consumer's identification to prevent the display of the consumer's credit record, history, or rating for the purpose of concealing adverse information that is accurate and not obsolete to--

(A) any consumer reporting agency;

(B) any person--

(i) who has extended credit to the consumer; or

(ii) to whom the consumer has applied or is applying for an extension of credit;

(3) make or use any untrue or misleading representation of the services of the credit repair organization; or

(4) engage, directly or indirectly, in any act, practice, or course of business that constitutes or results in the commission of, or an attempt to commit, a fraud or deception on any person in connection with the offer or sale of the services of the credit repair organization.

(b) Payment in advance

No credit repair organization may charge or receive any money or other valuable consideration for the performance of any service which the credit repair organization has agreed to perform for any consumer before such service is fully performed.

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§ **1679c Disclosures.**

(a) Disclosure required

Any credit repair organization shall provide any consumer with the following written statement before any contract or agreement between the consumer and the credit repair organization is executed:

"Consumer Credit File Rights Under State and Federal Law

"You have a right to dispute inaccurate information in your credit report by contacting the credit bureau directly. However, neither you nor any 'credit repair' company or credit repair organization has the right to have accurate, current, and verifiable information removed from your credit report. The credit bureau must remove accurate, negative information from your report only if it is over 7 years old. Bankruptcy information can be reported for 10 years.

"You have a right to obtain a copy of your credit report from a credit bureau. You may be charged a reasonable fee. There is no fee, however, if you have been turned down for credit, employment, insurance, or a rental dwelling because of information in your credit report within the preceding 60 days. The credit bureau must provide someone to help you interpret the information in your credit file. You are entitled to receive a free copy of your credit report if you are unemployed and intend to apply for employment in the next 60 days, if you are a recipient of public welfare assistance, or if you have reason to believe that there is inaccurate information in your credit report due to fraud.

"You have a right to sue a credit repair organization that violates the Credit Repair Organization Act. This law prohibits deceptive practices by credit repair organizations.

"You have the right to cancel your contract with any credit repair organization for any reason within 3 business days from the date you signed it.

"Credit bureaus are required to follow reasonable procedures to ensure that the information they report is accurate. However, mistakes may occur.

"You may, on your own, notify a credit bureau in writing that you dispute the accuracy of information in your

credit file. The credit bureau must then reinvestigate and modify or remove inaccurate or incomplete information. The credit bureau may not charge any fee for this service. Any pertinent information and copies of all documents you have concerning an error should be given to the credit bureau.

"If the credit bureau's reinvestigation does not resolve the dispute to your satisfaction, you may send a brief statement to the credit bureau, to be kept in your file, explaining why you think the record is inaccurate. The credit bureau must include a summary of your statement about disputed information with any report it issues about you.

"The Federal Trade Commission regulates credit bureaus and credit repair organizations. For more information contact:

"The Public Reference Branch

"Federal Trade Commission

"Washington, D.C. 20580".

(b) Separate statement requirement

The written statement required under this section shall be provided as a document which is separate from any written contract or other agreement between the credit repair organization and the consumer or any other written material provided to the consumer.

(c) Retention of compliance records

(1) In general

The credit repair organization shall maintain a copy of the statement signed by the consumer acknowledging receipt of the statement.

(2) Maintenance for 2 years

The copy of any consumer's statement shall be maintained in the organization's files for 2 years after the date on which the statement is signed by the consumer.

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§ **1679d Credit repair organizations contracts.**

(a) Written contracts required

No services may be provided by any credit repair organization for any consumer--

(1) unless a written and dated contract (for the purchase of such services) which meets the requirements of subsection (b) of this section has been signed by the consumer; or

(2) before the end of the 3-business-day period beginning on the date the contract is signed.

(b) Terms and conditions of contract

No contract referred to in subsection (a) of this section meets the requirements of this subsection unless such contract includes (in writing)--

(1) the terms and conditions of payment, including the total amount of all payments to be made by the consumer to the credit repair organization or to any other person;

(2) a full and detailed description of the services to be performed by the credit repair organization for the consumer, including--

(A) all guarantees of performance; and

(B) an estimate of--

(i) the date by which the performance of the services (to be performed by the credit repair organization or any other person) will be complete; or

(ii) the length of the period necessary to perform such services;

(3) the credit repair organization's name and principal business address; and

(4) a conspicuous statement in bold face type, in immediate proximity to the space reserved for the consumer's signature on the contract, which reads as follows: "You may cancel this contract without penalty or obligation at any time before midnight of the 3rd business day after the date on which you signed the contract. See the attached notice of cancellation form for an explanation of this right."

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§ **1679e Right to cancel contract.**

(a) In general

Any consumer may cancel any contract with any credit repair organization without penalty or obligation by notifying the credit repair organization of the consumer's intention to do so at any time before midnight of the 3rd business day which begins after the date on which the contract or agreement between the consumer and the credit repair organization is executed or would, but for this subsection, become enforceable against the parties.

(b) Cancellation form and other information

Each contract shall be accompanied by a form, in duplicate, which has the heading "Notice of Cancellation" and contains in bold face type the following statement:

"You may cancel this contract, without any penalty or obligation, at any time before midnight of the 3rd day which begins after the date the contract is signed by you.

"To cancel this contract, mail or deliver a signed, dated copy of this cancellation notice, or any other written notice to [name of credit repair organization] at [address of credit repair organization] before midnight on [date]

"I hereby cancel this transaction,

[date]

"[purchaser's signature]."

(c) Consumer copy of contract required

Any consumer who enters into any contract with any credit repair organization shall be given, by the organization--

(1) a copy of the completed contract and the disclosure statement required under section 1679c of this title; and

(2) a copy of any other document the credit repair organization requires the consumer to sign, at the time the contract or the other document is signed.

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§ 1679f Noncompliance with this subchapter.

(a) Consumer waivers invalid

Any waiver by any consumer of any protection provided by or any right of the consumer under this subchapter--

(1) shall be treated as void; and

(2) may not be enforced by any Federal or State court or any other person.

(b) Attempt to obtain waiver

Any attempt by any person to obtain a waiver from any consumer of any protection provided by or any right of the consumer under this subchapter shall be treated as a violation of this subchapter.

(c) Contracts not in compliance

Any contract for services which does not comply with the applicable provisions of this subchapter--

(1) shall be treated as void; and

(2) may not be enforced by any Federal or State court or any other person.

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§ 1679g Civil liability

(a) Liability established

Any person who fails to comply with any provision of this subchapter with respect to any other person shall be liable to such person in an amount equal to the sum of the amounts determined under each of the following paragraphs:

(1) Actual damages

The greater of--

(A) the amount of any actual damage sustained by such person as a result of such failure; or

(B) any amount paid by the person to the credit repair organization.

(2) Punitive damages

(A) Individual actions

In the case of any action by an individual, such additional amount as the court may allow.

(B) Class actions

In the case of a class action, the sum of--

(i) the aggregate of the amount which the court may allow for each named plaintiff; and

(i) the aggregate of the amount which the court may allow for each other class member, without regard to any minimum individual recovery.

(3) Attorneys' fees

In the case of any successful action to enforce any liability under paragraph (1) or (2), the costs of the action, together with reasonable attorneys' fees.

(b) Factors to be considered in awarding punitive damages

In determining the amount of any liability of any credit repair organization under subsection (a)(2) of this section, the court shall consider, among other relevant factors--

(1) the frequency and persistence of noncompliance by the credit repair organization;

(2) the nature of the noncompliance;

(3) the extent to which such noncompliance was intentional; and

(4) in the case of any class action, the number of consumers adversely affected.

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§ 1679h Administrative enforcement.

(a) In general

Compliance with the requirements imposed under this subchapter with respect to credit repair organizations shall be enforced under the Federal Trade Commission Act [*15 U.S.C. § 41 et seq.*] by the Federal Trade Commission.

(b) Violations of this subchapter treated as violations of Federal Trade Commission Act

(1) In general

For the purpose of the exercise by the Federal Trade Commission of the Commission's functions and powers under the Federal Trade Commission Act, any violation of any requirement or prohibition imposed under this subchapter with respect to credit repair organizations shall constitute an unfair or deceptive act or practice in commerce in violation of section 45(a) of this title.

(2) Enforcement authority under other law

All functions and powers of the Federal Trade Commission under the Federal Trade Commission Act shall be available to the Commission to enforce compliance with this subchapter by any person subject to enforcement by the Federal Trade Commission pursuant to this subsection, including the power to enforce the provisions of this subchapter in the same manner as if the violation had been a violation of any Federal Trade Commission trade regulation rule, without regard to whether the credit repair organization--

(A) is engaged in commerce; or

(B) meets any other jurisdictional tests in the Federal Trade Commission Act.

(c) State action for violations

(1) Authority of States

In addition to such other remedies as are provided under State law, whenever the chief law enforcement officer of a State, or an official or agency designated by a State, has reason to believe that any person has violated or is violating this subchapter, the State--

(A) may bring an action to enjoin such violation;

(B) may bring an action on behalf of its residents to recover damages for which the person is liable to such residents under section 1679g of this title as a result of the violation; and

(C) in the case of any successful action under subparagraph (A) or (B), shall be awarded the costs of the action and reasonable attorney fees as determined by the court.

(2) Rights of Commission

(A) Notice to Commission

The State shall serve prior written notice of any civil action under paragraph (1) upon the Federal Trade Commission and provide the Commission with a copy of its complaint, except in any case where such prior notice is not feasible, in which case the State shall serve such notice immediately upon instituting such action.

(B) Intervention

The Commission shall have the right--

(i) to intervene in any action referred to in subparagraph (A);

(ii) upon so intervening, to be heard on all matters arising in the action; and

(iii) to file petitions for appeal.

(3) Investigatory powers

For purposes of bringing any action under this subsection, nothing in this subsection shall prevent the chief law enforcement officer, or an official or agency designated by a State, from exercising the powers conferred on the chief law enforcement officer or such official by the laws of such State to conduct investigations or to administer oaths or affirmations or to compel the attendance of witnesses or the production of documentary and other evidence.

(4) Limitation

Whenever the Federal Trade Commission has instituted a civil action for violation of this subchapter, no State may, during the pendency of such action, bring an action under this section against any defendant named in the complaint of the Commission for any violation of this subchapter that is alleged in that complaint.

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§ **1679i Statute of limitations.**

Any action to enforce any liability under this subchapter may be brought before the later of--

(1) the end of the 5-year period beginning on the date of the occurrence of the violation involved; or

(2) in any case in which any credit repair organization has materially and willfully misrepresented any information which--

(A) the credit repair organization is required, by any provision of this subchapter, to disclose to any consumer; and

(B) is material to the establishment of the credit repair organization's liability to the consumer under this subchapter, the end of the 5-year period beginning on the date of the discovery by the consumer of the misrepresentation.

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§ **1679j Relation to State law.**

This subchapter shall not annul, alter, affect, or exempt any person subject to the provisions of this subchapter from complying with any law of any State except to the extent that such law is inconsistent with any provision of this subchapter, and then only to the extent of the inconsistency.

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[Editor's Note: *15 U.S.C. §§ 1681-1681x* comprise the Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act of 2003 (FACTA), Pub. L. No. 108-159, *117 Stat. 1952* (Dec. 4, 2003).]

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§ 1681 Congressional findings and statement of purpose.

(a) Accuracy and fairness of credit reporting

The Congress makes the following findings:

(1) The banking system is dependent upon fair and accurate credit reporting. Inaccurate credit reports directly impair the efficiency of the banking system, and unfair credit reporting methods undermine the public confidence which is essential to the continued functioning of the banking system.

(2) An elaborate mechanism has been developed for investigating and evaluating the credit worthiness, credit standing, credit capacity, character, and general reputation of consumers.

(3) Consumer reporting agencies have assumed a vital role in assembling and evaluating consumer credit and other information on consumers.

(4) There is a need to insure that consumer reporting agencies exercise their grave responsibilities with fairness, impartiality, and a respect for the consumer's right to privacy.

(b) Reasonable procedures

It is the purpose of this subchapter to require that consumer reporting agencies adopt reasonable procedures for meeting the needs of commerce for consumer credit, personnel, insurance, and other information in a manner which is fair and equitable to the consumer, with regard to the confidentiality, accuracy, relevancy, and proper utilization of such information in accordance with the requirements of this subchapter.

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§ **1681a Definitions; rules of construction.**

(a) Definitions and rules of construction set forth in this section are applicable for the purposes of this subchapter.

(b) The term "person" means any individual, partnership, corporation, trust, estate, cooperative, association, government or governmental subdivision or agency, or other entity.

(c) The term "consumer" means an individual.

(d) Consumer report

(1) In general. The term "consumer report" means any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for--

(A) credit or insurance to be used primarily for personal, family, or household purposes;

(B) employment purposes; or

(C) any other purpose authorized under section 1681b of this title.

(2) Exclusions. Except as provided in paragraph (3), the term "consumer report" does not include--

(A) subject to section 624 [*15 USC § 1681s-3*], any--

(i) report containing information solely as to transactions or experiences between the consumer and the person making the report;

(ii) communication of that information among persons related by common ownership or affiliated by corporate control; or

(iii) communication of other information among persons related by common ownership or affiliated by corporate control, if it is clearly and conspicuously disclosed to the consumer that the information may be communicated among such persons and the consumer is given the opportunity, before the time that the information is initially communicated, to direct that such information not be communicated among such persons;

(B) any authorization or approval of a specific extension of credit directly or indirectly by the issuer of a credit card or similar device;

(C) any report in which a person who has been requested by a third party to make a specific extension of credit directly or indirectly to a consumer conveys his or her decision with respect to such request, if the third party advises the consumer of the name and address of the person to whom the request was made, and such person makes the disclosures to the consumer required under section 615 [*15 USC § 1681m*]; or

(D) a communication described in subsection (o) or (x).

(3) Restriction on sharing of medical information. Except for information or any communication of information disclosed as provided in section 604(g)(3) [*15 USC § 1681b(g)(3)*], the exclusions in paragraph (2) shall not apply with respect to information disclosed to any person related by common ownership or affiliated by corporate control, if the

information is--

(A) medical information;

(B) an individualized list or description based on the payment transactions of the consumer for medical products or services; or

(C) an aggregate list of identified consumers based on payment transactions for medical products or services.

(e) The term "investigative consumer report" means a consumer report or portion thereof in which information on a consumer's character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on or with others with whom he is acquainted or who may have knowledge concerning any such items of information. However, such information shall not include specific factual information on a consumer's credit record obtained directly from a creditor of the consumer or from a consumer reporting agency when such information was obtained directly from a creditor of the consumer or from the consumer.

(f) The term "consumer reporting agency" means any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties, and which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports.

(g) The term "file", when used in connection with information on any consumer, means all of the information on that consumer recorded and retained by a consumer reporting agency regardless of how the information is stored.

(h) The term "employment purposes" when used in connection with a consumer report means a report used for the purpose of evaluating a consumer for employment, promotion, reassignment or retention as an employee.

(i) Medical information

The term "medical information"--

(1) means information or data, whether oral or recorded, in any form or medium, created by or derived from a health care provider or the consumer, that relates to--

(A) the past, present, or future physical, mental, or behavioral health or condition of an individual;

(B) the provision of health care to an individual; or

(C) the payment for the provision of health care to an individual.

(2) does not include the age or gender of a consumer, demographic information about the consumer, including a consumer's residence address or e-mail address, or any other information about a consumer that does not relate to the physical, mental, or behavioral health or condition of a consumer, including the existence or value of any insurance policy.

(j) Definitions relating to child support obligations

(1) Overdue support
The term "overdue support" has the meaning given to such term in section 666(e) of title 42.

(2) State or local child support enforcement agency
The term "State or local child support enforcement agency" means a State or local agency which administers a State or local program for establishing and enforcing child support obligations.

(k) Adverse action

(1) Actions included. The term "adverse action"--

(A) has the same meaning as in section 701(d)(6) of the Equal Credit Opportunity Act [*15 USC § 1691(d)(6)*]; and

(B) means--

(i) a denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any insurance, existing or applied for, in connection with the underwriting of insurance;

(ii) a denial of employment or any other decision for employment purposes that adversely affects any current or prospective employee;

(iii) a denial or cancellation of, an increase in any charge for, or any other adverse or unfavorable change in the terms of, any license or benefit described in section 1681b(a)(3)(D); and

(iv) an action taken or determination that is--

(I) made in connection with an application that was made by, or a transaction that was initiated by, any consumer, or in connection with a review of an account under section 1681b(a)(3)(F)(ii); and

(II) adverse to the interests of the consumer.

(2) Applicable findings, decisions, commentary, and orders. For purposes of any determination of whether an action is an adverse action under paragraph (1)(A), all appropriate final findings, decisions, commentary, and orders issued under section 701(d)(6) of the Equal Credit Opportunity Act [*15 USC § 1691(d)(6)*] by the Board of Governors of the Federal Reserve System or any court shall apply.

(l) Firm offer of credit or insurance

The term "firm offer of credit or insurance" means any offer of credit or insurance to a consumer that will be honored if the consumer is determined, based on information in a consumer report on the consumer, to meet the specific criteria used to select the consumer for the offer, except that the offer may be further conditioned on one or more of the following:

(1) The consumer being determined, based on information in the consumer's application for the credit or insurance, to meet specific criteria bearing on credit worthiness or insurability, as applicable, that are established--

(A) before selection of the consumer for the offer; and

(B) for the purpose of determining whether to extend credit or insurance pursuant to the offer.

(2) Verification--

(A) that the consumer continues to meet the specific criteria used to select the consumer for the offer, by using information in a consumer report on the consumer, information in the consumer's application for the credit or insurance, or other information bearing on the credit worthiness or insurability of the consumer; or

(B) of the information in the consumer's application for the credit or insurance, to determine that the consumer meets the specific criteria bearing on credit worthiness or insurability.

(3) The consumer furnishing any collateral that is a requirement for the extension of the credit or insurance that was--

(A) established before selection of the consumer for the offer of credit or insurance; and

(B) disclosed to the consumer in the offer of credit or insurance.

(m) Credit or insurance transaction that is not initiated by the consumer

The term "credit or insurance transaction that is not initiated by the consumer" does not include the use of a consumer report by a person with which the consumer has an account or insurance policy, for purposes of--

(1) reviewing the account or insurance policy; or

(2) collecting the account.

(n) State

The term "State" means any State, the Commonwealth of Puerto Rico, the District of Columbia, and any territory or possession of the United States.

(o) Excluded communications

A communication is described in this subsection if it is a communication--

(1) that, but for subsection (d)(2)(D), would be an investigative consumer report;

(2) that is made to a prospective employer for the purpose of--

(A) procuring an employee for the employer; or

(B) procuring an opportunity for a natural person to work for the employer;

(3) that is made by a person who regularly performs such procurement;

(4) that is not used by any person for any purpose other than a purpose described in subparagraph (A) or (B) of paragraph (2); and

(5) with respect to which--

(A) the consumer who is the subject of the communication--

(i) consents orally or in writing to the nature and scope of the communication, before the collection of any information for the purpose of making the communication;

(ii) consents orally or in writing to the making of the communication to a prospective employer, before the making of the communication; and

(iii) in the case of consent under clause (i) or (ii) given orally, is provided written confirmation of that consent by

the person making the communication, not later than 3 business days after the receipt of the consent by that person;

(B) the person who makes the communication does not, for the purpose of making the communication, make any inquiry that if made by a prospective employer of the consumer who is the subject of the communication would violate any applicable Federal or State equal employment opportunity law or regulation; and

(C) the person who makes the communication--

(i) discloses in writing to the consumer who is the subject of the communication, not later than 5 business days after receiving any request from the consumer for such disclosure, the nature and substance of all information in the consumer's file at the time of the request, except that the sources of any information that is acquired solely for use in making the communication and is actually used for no other purpose, need not be disclosed other than under appropriate discovery procedures in any court of competent jurisdiction in which an action is brought; and

(ii) notifies the consumer who is the subject of the communication, in writing, of the consumer's right to request the information described in clause (i).

(p) Consumer reporting agency that compiles and maintains files on consumers on a nationwide basis

The term "consumer reporting agency that compiles and maintains files on consumers on a nationwide basis" means a consumer reporting agency that regularly engages in the practice of assembling or evaluating, and maintaining, for the purpose of furnishing consumer reports to third parties bearing on a consumer's credit worthiness, credit standing, or credit capacity, each of the following regarding consumers residing nationwide:

(1) Public record information.

(2) Credit account information from persons who furnish that information regularly and in the ordinary course of business.

(q) Definitions relating to fraud alerts

(1) Active duty military consumer. The term "active duty military consumer" means a consumer in military service who--

(A) is on active duty (as defined in *section 101(d)(1) of title 10, United States Code*) or is a reservist performing duty under a call or order to active duty under a provision of law referred to in *section 101(a)(13) of title 10, United States Code*; and

(B) is assigned to service away from the usual duty station of the consumer.

(2) Fraud alert; active duty alert. The terms "fraud alert" and "active duty alert" mean a statement in the file of a consumer that--

(A) notifies all prospective users of a consumer report relating to the consumer that the consumer may be a victim of fraud, including identity theft, or is an active duty military consumer, as applicable; and

(B) is presented in a manner that facilitates a clear and conspicuous view of the statement described in subparagraph (A) by any person requesting such consumer report.

(3) Identity theft. The term "identity theft" means a fraud committed using the identifying information of another person, subject to such further definition as the Commission may prescribe, by regulation.

(4) Identity theft report. The term "identity theft report" has the meaning given that term by rule of the Commission, and means, at a minimum, a report--

(A) that alleges an identity theft;

(B) that is a copy of an official, valid report filed by a consumer with an appropriate Federal, State, or local law enforcement agency, including the United States Postal Inspection Service, or such other government agency deemed appropriate by the Commission; and

(C) the filing of which subjects the person filing the report to criminal penalties relating to the filing of false information if, in fact, the information in the report is false.

(5) New credit plan. The term "new credit plan" means a new account under an open end credit plan (as defined in section 103(i) of the Truth in Lending Act [*15 USC § 1602(i)*]) or a new credit transaction not under an open end credit plan.

(r) Credit and debit related terms

(1) Card issuer. The term "card issuer" means--

(A) a credit card issuer, in the case of a credit card; and

(B) a debit card issuer, in the case of a debit card.

(2) Credit card. The term "credit card" has the same meaning as in section 103 of the Truth in Lending Act [*15 USC § 1602*].

(3) Debit card. The term "debit card" means any card issued by a financial institution to a consumer for use in initiating an electronic fund transfer from the account of the consumer at such financial institution, for the purpose of transferring money between accounts or obtaining money, property, labor, or services.

(4) Account and electronic fund transfer. The terms "account" and "electronic fund transfer" have the same meanings as in section 903 of the Electronic Fund Transfer Act [*15 USC § 1693a*].

(5) Credit and creditor. The terms "credit" and "creditor" have the same meanings as in section 702 of the Equal Credit Opportunity Act [*15 USC § 1691a*].

(s) Federal banking agency

The term "Federal banking agency" has the same meaning as in section 3 of the Federal Deposit Insurance Act [*12 USC § 1813*].

(t) Financial institution

The term "financial institution" means a State or National bank, a State or Federal savings and loan association, a mutual savings bank, a State or Federal credit union, or any other person that, directly or indirectly, holds a transaction account (as defined in section 19(b) of the Federal Reserve Act [*12 USC § 461*]) belonging to a consumer.

(u) Reseller

The term "reseller" means a consumer reporting agency that--

(1) assembles and merges information contained in the database of another consumer reporting agency or multiple consumer reporting agencies concerning any consumer for purposes of furnishing such information to any third party, to the extent of such activities; and

(2) does not maintain a database of the assembled or merged information from which new consumer reports are produced.

(v) Commission

The term "Commission" means the Federal Trade Commission.

(w) Nationwide specialty consumer reporting agency

The term "nationwide specialty consumer reporting agency" means a consumer reporting agency that compiles and maintains files on consumers on a nationwide basis relating to--

(1) medical records or payments;

(2) residential or tenant history;

(3) check writing history;

(4) employment history; or

(5) insurance claims.

(x) Exclusion of certain communications for employee investigations

(1) Communications described in this subsection. A communication is described in this subsection if--

(A) but for subsection (d)(2)(D), the communication would be a consumer report;

(B) the communication is made to an employer in connection with an investigation of--

(i) suspected misconduct relating to employment; or

(ii) compliance with Federal, State, or local laws and regulations, the rules of a self-regulatory organization, or any preexisting written policies of the employer;

(C) the communication is not made for the purpose of investigating a consumer's credit worthiness, credit standing, or credit capacity; and

(D) the communication is not provided to any person except--

(i) to the employer or an agent of the employer;

(ii) to any Federal or State officer, agency, or department, or any officer, agency, or department of a unit of general local government;

(iii) to any self-regulatory organization with regulatory authority over the activities of the employer or employee;

(iv) as otherwise required by law; or

(v) pursuant to section 608 [*15 USC § 1681f*].

(2) Subsequent disclosure. After taking any adverse action based in whole or in part on a communication described in paragraph (1), the employer shall disclose to the consumer a summary containing the nature and substance of the communication upon which the adverse action is based, except that the sources of information acquired solely for use in preparing what would be but for subsection (d)(2)(D) an investigative consumer report need not be disclosed.

(3) Self-regulatory organization defined. For purposes of this subsection, the term "self-regulatory organization" includes any self-regulatory organization (as defined in section 3(a)(26) of the Securities Exchange Act of 1934 [*15 USC § 78c(a)(26)*]), any entity established under title I of the Sarbanes-Oxley Act of 2002 [*15 USC §§ 7211 et seq.*], any board of trade designated by the Commodity Futures Trading Commission, and any futures association registered with such Commission.

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Consumer Credit Law Manual

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PART I Consumer Credit
CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE SUPPLEMENT 2
15 U.S.C. §§ 1601-1692p CHAPTER 41--CONSUMER CREDIT PROTECTION ACT
SUBCHAPTER III CREDIT REPORTING AGENCIES

1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681b

§ **1681b Permissible purposes of consumer reports.**

(a) In general

Subject to subsection (c), any consumer reporting agency may furnish a consumer report under the following circumstances and no other:

(1) In response to the order of a court having jurisdiction to issue such an order, or a subpoena issued in connection with proceedings before a Federal grand jury.

(2) In accordance with the written instructions of the consumer to whom it relates.

(3) To a person which it has reason to believe--

(A) intends to use the information in connection with a credit transaction involving the consumer on whom the information is to be furnished and involving the extension of credit to, or review or collection of an account of, the consumer; or

(B) intends to use the information for employment purposes; or

(C) intends to use the information in connection with the underwriting of insurance involving the consumer; or

(D) intends to use the information in connection with a determination of the consumer's eligibility for a license or other benefit granted by a governmental instrumentality required by law to consider an applicant's financial responsibility or status; or

(E) intends to use the information, as a potential investor or servicer, or current insurer, in connection with a valuation of, or an assessment of the credit or prepayment risks associated with, an existing credit obligation; or

(F) otherwise has a legitimate business need for the information--

(i) in connection with a business transaction that is initiated by the consumer; or

(ii) to review an account to determine whether the consumer continues to meet the terms of the account.

(G) executive departments and agencies in connection with the issuance of government-sponsored individually-billed travel charge cards.

(4) In response to a request by the head of a State or local child support enforcement agency (or a State or local government official authorized by the head of such an agency), if the person making the request certifies to the consumer reporting agency that--

(A) the consumer report is needed for the purpose of establishing an individual's capacity to make child support payments or determining the appropriate level of such payments;

(B) the paternity of the consumer for the child to which the obligation relates has been established or acknowledged by the consumer in accordance with State laws under which the obligation arises (if required by those laws);

(C) the person has provided at least 10 days' prior notice to the consumer whose report is requested, by certified or registered mail to the last known address of the consumer, that the report will be requested; and

(D) the consumer report will be kept confidential, will be used solely for a purpose described in subparagraph (A), and will not be used in connection with any other civil, administrative, or criminal proceeding, or for any other purpose.

(5) To an agency administering a State plan under section 454 of the Social Security Act (*42 U.S.C. § 654*) for use to set an initial or modified child support award.

(6) To the Federal Deposit Insurance Corporation or the National Credit Union Administration as part of its preparation for its appointment or as part of its exercise of powers, as conservator, receiver, or liquidating agent for an insured depository institution or insured credit union under the Federal Deposit Insurance Act or the Federal Credit Union Act, or other applicable Federal or State law, or in connection with the resolution or liquidation of a failed or failing insured depository institution or insured credit union, as applicable.

(b) Conditions for furnishing and using consumer reports for employment purposes

(1) Certification from user. A consumer reporting agency may furnish a consumer report for employment purposes only if--

(A) the person who obtains such report from the agency certifies to the agency that--

(i) the person has complied with paragraph (2) with respect to the consumer report, and the person will comply with paragraph (3) with respect to the consumer report if paragraph (3) becomes applicable; and

(ii) information from the consumer report will not be used in violation of any applicable Federal or State equal employment opportunity law or regulation; and

(B) the consumer reporting agency provides with the report, or has previously provided, a summary of the consumer's rights under this title, as prescribed by the Federal Trade Commission under section 609(c)(3) [*15 USC § 1681g(c)(3)*].

(2) Disclosure to consumer.

(A) In general. Except as provided in subparagraph (B), a person may not procure a consumer report, or cause a consumer report to be procured, for employment purposes with respect to any consumer, unless--

(i) a clear and conspicuous disclosure has been made in writing to the consumer at any time before the report is procured or caused to be procured, in a document that consists solely of the disclosure, that a consumer report may be obtained for employment purposes; and

(ii) the consumer has authorized in writing (which authorization may be made on the document referred to in clause (i)) the procurement of the report by that person.

(B) Application by mail, telephone, computer, or other similar means. If a consumer described in subparagraph (C) applies for employment by mail, telephone, computer, or other similar means, at any time before a consumer report is procured or caused to be procured in connection with that application--

(i) the person who procures the consumer report on the consumer for employment purposes shall provide to the consumer, by oral, written, or electronic means, notice that a consumer report may be obtained for employment purposes, and a summary of the consumer's rights under section 615(a)(3) [*15 USC § 1681m(a)(3)*]; and

(ii) the consumer shall have consented, orally, in writing, or electronically to the procurement of the report by that person.

(C) Scope. Subparagraph (B) shall apply to a person procuring a consumer report on a consumer in connection with the consumer's application for employment only if--

(i) the consumer is applying for a position over which the Secretary of Transportation has the power to establish qualifications and maximum hours of service pursuant to the provisions of section 31502 of title 49, or a position subject to safety regulation by a State transportation agency; and

(ii) as of the time at which the person procures the report or causes the report to be procured the only interaction between the consumer and the person in connection with that employment application has been by mail, telephone, computer, or other similar means.

(3) Conditions on use for adverse actions.

(A) In general. Except as provided in subparagraph (B), in using a consumer report for employment purposes, before taking any adverse action based in whole or in part on the report, the person intending to take such adverse action shall provide to the consumer to whom the report relates--

(i) a copy of the report; and

(ii) a description in writing of the rights of the consumer under this title, as prescribed by the Federal Trade Commission under section 609(c)(3) [*15 USC § 1681g(c)(3)*].

(B) Application by mail, telephone, computer, or other similar means.

(i) If a consumer described in subparagraph (C) applies for employment by mail, telephone, computer, or other similar means, and if a person who has procured a consumer report on the consumer for employment purposes takes adverse action on the employment application based in whole or in part on the report, then the person must provide to the consumer to whom the report relates, in lieu of the notices required under subparagraph (A) of this section and under section 615(a) [*15 USC § 1681m(a)*], within 3 business days of taking such action, an oral, written or electronic notification--

(I) that adverse action has been taken based in whole or in part on a consumer report received from a consumer reporting agency;

(II) of the name, address and telephone number of the consumer reporting agency that furnished the consumer report (including a toll-free telephone number established by the agency if the agency compiles and maintains files on consumers on a nationwide basis);

(III) that the consumer reporting agency did not make the decision to take the adverse action and is unable to provide to the consumer the specific reasons why the adverse action was taken; and

(IV) that the consumer may, upon providing proper identification, request a free copy of a report and may dispute with the consumer reporting agency the accuracy or completeness of any information in a report.

(ii) If, under clause (B)(i)(IV), the consumer requests a copy of a consumer report from the person who procured

the report, then, within 3 business days of receiving the consumer's request, together with proper identification, the person must send or provide to the consumer a copy of a report and a copy of the consumer's rights as prescribed by the Federal Trade Commission under section 609(c)(3) [*15 USC § 1681g(c)(3)*].

(C) Scope. Subparagraph (B) shall apply to a person procuring a consumer report on a consumer in connection with the consumer's application for employment only if--

(i) the consumer is applying for a position over which the Secretary of Transportation has the power to establish qualifications and maximum hours of service pursuant to the provisions of section 31502 of title 49, or a position subject to safety regulation by a State transportation agency; and

(ii) as of the time at which the person procures the report or causes the report to be procured the only interaction between the consumer and the person in connection with that employment application has been by mail, telephone, computer, or other similar means.

(4) Exception for national security investigations.

(A) In general. In the case of an agency or department of the United States Government which seeks to obtain and use a consumer report for employment purposes, paragraph (3) shall not apply to any adverse action by such agency or department which is based in part on such consumer report, if the head of such agency or department makes a written finding that--

(i) the consumer report is relevant to a national security investigation of such agency or department;

(ii) the investigation is within the jurisdiction of such agency or department;

(iii) there is reason to believe that compliance with paragraph (3) will--

(I) endanger the life or physical safety of any person;

(II) result in flight from prosecution;

(III) result in the destruction of, or tampering with, evidence relevant to the investigation;

(IV) result in the intimidation of a potential witness relevant to the investigation;

(V) result in the compromise of classified information; or

(VI) otherwise seriously jeopardize or unduly delay the investigation or another official proceeding.

(B) Notification of consumer upon conclusion of investigation. Upon the conclusion of a national security investigation described in subparagraph (A), or upon the determination that the exception under subparagraph (A) is no longer required for the reasons set forth in such subparagraph, the official exercising the authority in such subparagraph shall provide to the consumer who is the subject of the consumer report with regard to which such finding was made--

(i) a copy of such consumer report with any classified information redacted as necessary;

(ii) notice of any adverse action which is based, in part, on the consumer report; and

(iii) the identification with reasonable specificity of the nature of the investigation for which the consumer report was sought.

(C) Delegation by head of agency or department. For purposes of subparagraphs (A) and (B), the head of any agency or department of the United States Government may delegate his or her authorities under this paragraph to an official of such agency or department who has personnel security responsibilities and is a member of the Senior Executive Service or equivalent civilian or military rank.

(D) Definitions. For purposes of this paragraph, the following definitions shall apply:

(i) Classified information. The term "classified information" means information that is protected from unauthorized disclosure under Executive Order No. 12958 or successor orders.

(ii) National security investigation. The term "national security investigation" means any official inquiry by an agency or department of the United States Government to determine the eligibility of a consumer to receive access or continued access to classified information or to determine whether classified information has been lost or compromised.

(c) Furnishing reports in connection with credit or insurance transactions that are not initiated by the consumer

(1) In general. A consumer reporting agency may furnish a consumer report relating to any consumer pursuant to subparagraph (A) or (C) of subsection (a)(3) in connection with any credit or insurance transaction that is not initiated by the consumer only if--

(A) the consumer authorizes the agency to provide such report to such person; or

(B)

(i) the transaction consists of a firm offer of credit or insurance;

(ii) the consumer reporting agency has complied with subsection (e);

(iii) there is not in effect an election by the consumer, made in accordance with subsection (e), to have the consumer's name and address excluded from lists of names provided by the agency pursuant to this paragraph; and

(iv) **[Caution: This clause takes effect 9 months after enactment of Act May 22, 2009, P.L. 111-24, as provided by § 3 of such Act.]** the consumer report does not contain a date of birth that shows that the consumer has not attained the age of 21, or, if the date of birth on the consumer report shows that the consumer has not attained the age of 21, such consumer consents to the consumer reporting agency to such furnishing.

(2) Limits on information received under paragraph (1)(b). A person may receive pursuant to paragraph (1)(B) only--

(A) the name and address of a consumer;

(B) an identifier that is not unique to the consumer and that is used by the person solely for the purpose of verifying the identity of the consumer; and

(C) other information pertaining to a consumer that does not identify the relationship or experience of the consumer with respect to a particular creditor or other entity.

(3) Information regarding inquiries. Except as provided in section 609(a)(5) [*15 USC § 1681g(a)(5)*], a consumer reporting agency shall not furnish to any person a record of inquiries in connection with a credit or insurance transaction that is not initiated by a consumer.

(d) [Reserved]

(e) Election of consumer to be excluded from lists

(1) In general. A consumer may elect to have the consumer's name and address excluded from any list provided by a consumer reporting agency under subsection (c)(1)(B) in connection with a credit or insurance transaction that is not initiated by the consumer by notifying the agency in accordance with paragraph (2) that the consumer does not consent to any use of a consumer report relating to the consumer in connection with any credit or insurance transaction that is not initiated by the consumer.

(2) Manner of notification. A consumer shall notify a consumer reporting agency under paragraph (1)--

(A) through the notification system maintained by the agency under paragraph (5); or

(B) by submitting to the agency a signed notice of election form issued by the agency for purposes of this subparagraph.

(3) Response of agency after notification through system. Upon receipt of notification of the election of a consumer under paragraph (1) through the notification system maintained by the agency under paragraph (5), a consumer reporting agency shall--

(A) inform the consumer that the election is effective only for the 5-year period following the election if the

consumer does not submit to the agency a signed notice of election form issued by the agency for purposes of paragraph (2)(B); and

(B) provide to the consumer a notice of election form, if requested by the consumer, not later than 5 business days after receipt of the notification of the election through the system established under paragraph (5), in the case of a request made at the time the consumer provides notification through the system.

(4) Effectiveness of election. An election of a consumer under paragraph (1)--

(A) shall be effective with respect to a consumer reporting agency beginning 5 business days after the date on which the consumer notifies the agency in accordance with paragraph (2);

(B) shall be effective with respect to a consumer reporting agency--

(i) subject to subparagraph (C), during the 5-year period beginning 5 business days after the date on which the consumer notifies the agency of the election, in the case of an election for which a consumer notifies the agency only in accordance with paragraph (2)(A); or

(ii) until the consumer notifies the agency under subparagraph (C), in the case of an election for which a consumer notifies the agency in accordance with paragraph (2)(B);

(C) shall not be effective after the date on which the consumer notifies the agency, through the notification system established by the agency under paragraph (5), that the election is no longer effective; and

(D) shall be effective with respect to each affiliate of the agency.

(5) Notification system.

(A) In general. Each consumer reporting agency that, under subsection (c)(1)(B), furnishes a consumer report in connection with a credit or insurance transaction that is not initiated by a consumer shall--

(i) establish and maintain a notification system, including a toll-free telephone number, which permits any consumer whose consumer report is maintained by the agency to notify the agency, with appropriate identification, of the consumer's election to have the consumer's name and address excluded from any such list of names and addresses provided by the agency for such a transaction; and

(ii) publish by not later than 365 days after the date of enactment of the Consumer Credit Reporting Reform Act of 1996 [enacted Sept. 30, 1996], and not less than annually thereafter, in a publication of general circulation in the area served by the agency--

(I) a notification that information in consumer files maintained by the agency may be used in connection with such transactions; and

(II) the address and toll-free telephone number for consumers to use to notify the agency of the consumer's election under clause (i).

(B) Establishment and maintenance as compliance. Establishment and maintenance of a notification system (including a toll-free telephone number) and publication by a consumer reporting agency on the agency's own behalf and on behalf of any of its affiliates in accordance with this paragraph is deemed to be compliance with this paragraph by each of those affiliates.

(6) Notification system by agencies that operate nationwide. Each consumer reporting agency that compiles and maintains files on consumers on a nationwide basis shall establish and maintain a notification system for purposes of paragraph (5) jointly with other such consumer reporting agencies.

(f) Certain use or obtaining of information prohibited

A person shall not use or obtain a consumer report for any purpose unless--

(1) the consumer report is obtained for a purpose for which the consumer report is authorized to be furnished under this section; and

(2) the purpose is certified in accordance with section 607 [*15 USC § 1681e*] by a prospective user of the report through a general or specific certification.

(g) Protection of medical information

(1) Limitation on consumer reporting agencies. A consumer reporting agency shall not furnish for employment purposes, or in connection with a credit or insurance transaction, a consumer report that contains medical information (other than medical contact information treated in the manner required under section 605(a)(6) [*15 USC § 1681c(a)(6)*]) about a consumer, unless--

(A) if furnished in connection with an insurance transaction, the consumer affirmatively consents to the furnishing of the report;

(B) if furnished for employment purposes or in connection with a credit transaction--

(i) the information to be furnished is relevant to process or effect the employment or credit transaction; and

(ii) the consumer provides specific written consent for the furnishing of the report that describes in clear and conspicuous language the use for which the information will be furnished; or

(C) the information to be furnished pertains solely to transactions, accounts, or balances relating to debts arising from the receipt of medical services, products, or devises, where such information, other than account status or amounts, is restricted or reported using codes that do not identify, or do not provide information sufficient to infer, the specific provider or the nature of such services, products, or devices, as provided in section 605(a)(6) [*15 USC § 1681c(a)(6)*].

(2) Limitation on creditors. Except as permitted pursuant to paragraph (3)(C) or regulations prescribed under paragraph (5)(A), a creditor shall not obtain or use medical information (other than medical information treated in the manner required under section 605(a)(6) [*15 USC § 1681c(a)(6)*]) pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit.

(3) Actions authorized by Federal law, insurance activities and regulatory determinations. Section 603(d)(3) [*15 USC § 1681a(d)(3)*] shall not be construed so as to treat information or any communication of information as a consumer report if the information or communication is disclosed--

(A) in connection with the business of insurance or annuities, including the activities described in section 18B of the model Privacy of Consumer Financial and Health Information Regulation issued by the National Association of

Insurance Commissioners (as in effect on January 1, 2003);

(B) for any purpose permitted without authorization under the Standards for Individually Identifiable Health Information promulgated by the Department of Health and Human Services pursuant to the Health Insurance Portability and Accountability Act of 1996 [Act Aug 21, 1996, P.L. 104-191], or referred to under section 1179 of such Act [probably a reference to section 1179 of the Social Security Act (*42 USC § 1320d-8*)], or described in section 502(e) of Public Law 106-102 [*15 USC § 6802*]; or

(C) as otherwise determined to be necessary and appropriate, by regulation or order and subject to paragraph (6), by the Commission, any Federal banking agency or the National Credit Union Administration (with respect to any financial institution subject to the jurisdiction of such agency or Administration under paragraph (1), (2), or (3) of section 621(b) [*15 USC § 1681s(b)*], or the applicable State insurance authority (with respect to any person engaged in providing insurance or annuities).

(4) Limitation on redisclosure of medical information. Any person that receives medical information pursuant to paragraph (1) or (3) shall not disclose such information to any other person, except as necessary to carry out the purpose for which the information was initially disclosed, or as otherwise permitted by statute, regulation, or order.

(5) Regulations and effective date for paragraph (2).

(A) Regulations required. Each Federal banking agency and the National Credit Union Administration shall, subject to paragraph (6) and after notice and opportunity for comment, prescribe regulations that permit transactions under paragraph (2) that are determined to be necessary and appropriate to protect legitimate operational, transactional, risk, consumer, and other needs (and which shall include permitting actions necessary for administrative verification purposes), consistent with the intent of paragraph (2) to restrict the use of medical information for inappropriate purposes.

(B) Final Regulations Required. The Federal banking agencies and the National Credit Union Administration shall issue the regulations required under subparagraph (A) in final form before the end of the 6-month period [June 4, 2004] beginning on the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003].

(6) Coordination with other laws. No provision of this subsection shall be construed as altering, affecting, or superseding the applicability of any other provision of Federal law relating to medical confidentiality.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681c

§ 1681c Requirements relating to information contained in consumer reports.

(a) Information excluded from consumer reports

Except as authorized under subsection (b) of this section, no consumer reporting agency may make any consumer report containing any of the following items of information:

(1) Cases under title 11 or under the Bankruptcy Act that, from the date of entry of the order for relief or the date of adjudication, as the case may be, antedate the report by more than 10 years.

(2) Civil suits, civil judgments, and records of arrest that, from date of entry, antedate the report by more than seven years or until the governing statute of limitations has expired, whichever is the longer period.

(3) Paid tax liens which, from date of payment, antedate the report by more than seven years.

(4) Accounts placed for collection or charged to profit and loss which antedate the report by more than seven years.

(5) Any other adverse item of information, other than records of convictions of crimes which antedates the report by more than seven years.

(6) The name, address, and telephone number of any medical information furnisher that has notified the agency of its status, unless--

(A) such name, address, and telephone number are restricted or reported using codes that do not identify, or provide information sufficient to infer, the specific provider or the nature of such services, products, or devices to a person other than the consumer; or

(B) the report is being provided to an insurance company for a purpose relating to engaging in the business of insurance other than property and casualty insurance.

(b) Exempted cases

The provisions of paragraphs (1) through (5) of subsection (a) of this section are not applicable in the case of any consumer credit report to be used in connection with--

(1) a credit transaction involving, or which may reasonably be expected to involve, a principal amount of $150,000 or more;

(2) the underwriting of life insurance involving, or which may reasonably be expected to involve, a face amount of $150,000 or more; or

(3) the employment of any individual at an annual salary which equals, or which may reasonably be expected to equal $75,000, or more.

(c) Running of reporting period

(1) In general. The 7-year period referred to in paragraphs (4) and (6) of subsection (a) of this section shall begin, with respect to any delinquent account that is placed for collection (internally or by referral to a third party, whichever is earlier), charged to profit and loss, or subjected to any similar action, upon the expiration of the 180-day period beginning on the date of the commencement of the delinquency which immediately preceded the collection activity, charge to profit and loss, or similar action.

(2) Effective date. Paragraph (1) shall apply only to items of information added to the file of a consumer on or after

the date that is 455 days after the date of enactment of the Consumer Credit Reporting Reform Act of 1996 [enacted Sept. 30, 1996].

(d) Information required to be disclosed

(1) Title 11 information. Any consumer reporting agency that furnishes a consumer report that contains information regarding any case involving the consumer that arises under Title 11, United States Code, shall include in the report an identification of the chapter of such Title 11 under which such case arises if provided by the source of the information. If any case arising or filed under Title 11, United States Code, is withdrawn by the consumer before a final judgment, the consumer reporting agency shall include in the report that such case or filing was withdrawn upon receipt of documentation certifying such withdrawal.

(2) Key factor in credit score information. Any consumer reporting agency that furnishes a consumer report that contains any credit score or any other risk score or predictor on any consumer shall include in the report a clear and conspicuous statement that a key factor (as defined in section 609(f)(2)(B) [*15 USC § 1681g(f)(2)(B)*]) that adversely affected such score or predictor was the number of enquiries, if such a predictor was in fact a key factor that adversely affected such score. This paragraph shall not apply to a check services company, acting as such, which issues authorizations for the purpose of approving or processing negotiable instruments, electronic fund transfers, or similar methods of payments, but only to the extent that such company is engaged in such activities.

(e) Indication of closure of account by consumer

If a consumer reporting agency is notified pursuant to section 1681s-2(a)(4) that a credit account of a consumer was voluntarily closed by the consumer, the agency shall indicate that fact in any consumer report that includes information related to the account.

(f) Indication of dispute by consumer

If a consumer reporting agency is notified pursuant to section 1681s-2(a)(3) that information regarding a consumer who was furnished to the agency is disputed by the consumer, the agency shall indicate that fact in each consumer report that includes the disputed information.

(g) Truncation of credit card and debit card numbers

(1) In general. Except as otherwise provided in this subsection, no person that accepts credit cards or debit cards for the transaction of business shall print more than the last 5 digits of the card number or the expiration date upon any receipt provided to the cardholder at the point of the sale or transaction.

(2) Limitation. This subsection shall apply only to receipts that are electronically printed, and shall not apply to transactions in which the sole means of recording a credit card or debit card account number is by handwriting or by an imprint or copy of the card.

(3) Effective date. This subsection shall become effective--

(A) 3 years after the date of enactment of this subsection, with respect to any cash register or other machine or device that electronically prints receipts for credit card or debit card transactions that is in use before January 1, 2005; and

(B) 1 year after the date of enactment of this subsection, with respect to any cash register or other machine or device that electronically prints receipts for credit card or debit card transactions that is first put into use on or after January 1, 2005.

(h) Notice of discrepancy in address

(1) In general. If a person has requested a consumer report relating to a consumer from a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*], the request includes an address for the consumer that substantially differs from the addresses in the file of the consumer, and the agency provides a consumer report in response to the request, the consumer reporting agency shall notify the requester of the existence of the discrepancy.

(2) Regulations.

(A) Regulations required. The Federal banking agencies, the National Credit Union Administration, and the Commission shall jointly, with respect to the entities that are subject to their respective enforcement authority under section 621 [*15 USC § 1681s*], prescribe regulations providing guidance regarding reasonable policies and procedures that a user of a consumer report should employ when such user has received a notice of discrepancy under paragraph (1).

(B) Policies and procedures to be included. The regulations prescribed under subparagraph (A) shall describe reasonable policies and procedures for use by a user of a consumer report--

(i) to form a reasonable belief that the user knows the identity of the person to whom the consumer report pertains; and

(ii) if the user establishes a continuing relationship with the consumer, and the user regularly and in the ordinary course of business furnishes information to the consumer reporting agency from which the notice of discrepancy pertaining to the consumer was obtained, to reconcile the address of the consumer with the consumer reporting agency by furnishing such address to such consumer reporting agency as part of information regularly furnished by the user for the period in which the relationship is established.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681c-1

§ 1681c-1 Identity theft prevention; fraud alerts and active duty alerts.

(a) One-call fraud alerts

(1) Initial alerts. Upon the direct request of a consumer, or an individual acting on behalf of or as a personal representative of a consumer, who asserts in good faith a suspicion that the consumer has been or is about to become a victim of fraud or related crime, including identity theft, a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] that maintains a file on the consumer and has received appropriate proof of the identity of the requester shall--

(A) include a fraud alert in the file of that consumer, and also provide that alert along with any credit score generated in using that file, for a period of not less than 90 days, beginning on the date of such request, unless the consumer or such representative requests that such fraud alert be removed before the end of such period, and the agency has received appropriate proof of the identity of the requester for such purpose; and

(B) refer the information regarding the fraud alert under this paragraph to each of the other consumer reporting agencies described in section 603(p) [*15 USC § 1681a(p)*], in accordance with procedures developed under section 621(f) [*15 USC § 1681s(f)*].

(2) Access to free reports. In any case in which a consumer reporting agency includes a fraud alert in the file of a consumer pursuant to this subsection, the consumer reporting agency shall--

(A) disclose to the consumer that the consumer may request a free copy of the file of the consumer pursuant to section 612(d) [*15 USC § 1681j(d)*]; and

(B) provide to the consumer all disclosures required to be made under section 609 [*15 USC § 1681g*], without charge to the consumer, not later than 3 business days after any request described in subparagraph (A).

(b) Extended alerts

(1) In general. Upon the direct request of a consumer, or an individual acting on behalf of or as a personal representative of a consumer, who submits an identity theft report to a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] that maintains a file on the consumer, if the agency has received appropriate proof of the identity of the requester, the agency shall--

(A) include a fraud alert in the file of that consumer, and also provide that alert along with any credit score generated in using that file, during the 7-year period beginning on the date of such request, unless the consumer or such representative requests that such fraud alert be removed before the end of such period and the agency has received appropriate proof of the identity of the requester for such purpose;

(B) during the 5-year period beginning on the date of such request, exclude the consumer from any list of consumers prepared by the consumer reporting agency and provided to any third party to offer credit or insurance to the consumer as part of a transaction that was not initiated by the consumer, unless the consumer or such representative requests that such exclusion be rescinded before the end of such period; and

(C) refer the information regarding the extended fraud alert under this paragraph to each of the other consumer reporting agencies described in section 603(p) [*15 USC § 1681a(p)*], in accordance with procedures developed under section 621(f) [*15 USC § 1681s(f)*].

(2) Access to free reports. In any case in which a consumer reporting agency includes a fraud alert in the file of a consumer pursuant to this subsection, the consumer reporting agency shall--

(A) disclose to the consumer that the consumer may request 2 free copies of the file of the consumer pursuant to section 612(d) [*15 USC § 1681j(d)*] during the 12-month period beginning on the date on which the fraud alert was included in the file; and

(B) provide to the consumer all disclosures required to be made under section 609 [*15 USC § 1681g*], without charge to the consumer, not later than 3 business days after any request described in subparagraph (A).

(c) Active duty alerts

Upon the direct request of an active duty military consumer, or an individual acting on behalf of or as a personal representative of an active duty military consumer, a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] that maintains a file on the active duty military consumer and has received appropriate proof of the identity of the requester shall--

(1) include an active duty alert in the file of that active duty military consumer, and also provide that alert along with any credit score generated in using that file, during a period of not less than 12 months, or such longer period as the Commission shall determine, by regulation, beginning on the date of the request, unless the active duty military consumer or such representative requests that such fraud alert be removed before the end of such period, and the agency has received appropriate proof of the identity of the requester for such purpose;

(2) during the 2-year period beginning on the date of such request, exclude the active duty military consumer from any list of consumers prepared by the consumer reporting agency and provided to any third party to offer credit or insurance to the consumer as part of a transaction that was not initiated by the consumer, unless the consumer requests that such exclusion be rescinded before the end of such period; and

(3) refer the information regarding the active duty alert to each of the other consumer reporting agencies described in section 603(p) [*15 USC § 1681a(p)*], in accordance with procedures developed under section 621(f) [*15 USC § 1681s(f)*].

(d) Procedures

Each consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] shall establish policies and procedures to comply with this section, including procedures that inform consumers of the availability of initial, extended, and active duty alerts and procedures that allow consumers and active duty military consumers to request initial, extended, or active duty alerts (as applicable) in a simple and easy manner, including by telephone.

(e) Referrals of alerts

Each consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] that receives a referral of a fraud alert or active duty alert from another consumer reporting agency pursuant to this section shall, as though the agency received the request from the consumer directly, follow the procedures required under--

(1) paragraphs (1)(A) and (2) of subsection (a), in the case of a referral under subsection (a)(1)(B);

(2) paragraphs (1)(A), (1)(B), and (2) of subsection (b), in the case of a referral under subsection (b)(1)(C); and

(3) paragraphs (1) and (2) of subsection (c), in the case of a referral under subsection (c)(3).

(f) Duty of reseller to reconvey alert

A reseller shall include in its report any fraud alert or active duty alert placed in the file of a consumer pursuant to this section by another consumer reporting agency.

(g) Duty of other consumer reporting agencies to provide contact information

If a consumer contacts any consumer reporting agency that is not described in section 603(p) [*15 USC § 1681a(p)*] to communicate a suspicion that the consumer has been or is about to become a victim of fraud or related crime, including identity theft, the agency shall provide information to the consumer on how to contact the Commission and the consumer reporting agencies described in section 603(p) [*15 USC § 1681a(p)*] to obtain more detailed information and request alerts under this section.

(h) Limitations on use of information for credit extensions

(1) Requirements for initial and active duty alerts.

(A) Notification. Each initial fraud alert and active duty alert under this section shall include information that notifies all prospective users of a consumer report on the consumer to which the alert relates that the consumer does not authorize the establishment of any new credit plan or extension of credit, other than under an open-end credit plan (as defined in section 103(i) [*15 USC § 1602(i)*]), in the name of the consumer, or issuance of an additional card on an existing credit account requested by a consumer, or any increase in credit limit on an existing credit account requested by a consumer, except in accordance with subparagraph (B).

(B) Limitation on users.

(i) In general. No prospective user of a consumer report that includes an initial fraud alert or an active duty alert in accordance with this section may establish a new credit plan or extension of credit, other than under an open-end credit plan (as defined in section 103(i) [*15 USC § 1602(i)*]), in the name of the consumer, or issue an additional card on an existing credit account requested by a consumer, or grant any increase in credit limit on an existing credit account requested by a consumer, unless the user utilizes reasonable policies and procedures to form a reasonable belief that the user knows the identity of the person making the request.

(ii) Verification. If a consumer requesting the alert has specified a telephone number to be used for identity verification purposes, before authorizing any new credit plan or extension described in clause (i) in the name of such consumer, a user of such consumer report shall contact the consumer using that telephone number or take reasonable steps to verify the consumer's identity and confirm that the application for a new credit plan is not the result of identity theft.

(2) Requirements for extended alerts.

(A) Notification. Each extended alert under this section shall include information that provides all prospective users of a consumer report relating to a consumer with--

(i) notification that the consumer does not authorize the establishment of any new credit plan or extension of credit described in clause (i), other than under an open-end credit plan (as defined in section 103(i) [*15 USC § 1602(i)*]), in the name of the consumer, or issuance of an additional card on an existing credit account requested by a consumer, or any increase in credit limit on an existing credit account requested by a consumer, except in accordance with subparagraph (B); and

(ii) a telephone number or other reasonable contact method designated by the consumer.

(B) Limitation on users. No prospective user of a consumer report or of a credit score generated using the information in the file of a consumer that includes an extended fraud alert in accordance with this section may establish a new credit plan or extension of credit, other than under an open-end credit plan (as defined in section 103(i) [*15 USC § 1602(i)*]), in the name of the consumer, or issue an additional card on an existing credit account requested by a consumer, or any increase in credit limit on an existing credit account requested by a consumer, unless the user contacts the consumer in person or using the contact method described in subparagraph (A)(ii) to confirm that the application for a new credit plan or increase in credit limit, or request for an additional card is not the result of identity theft.

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§ 1681c-2 Block of information resulting from identity theft.

(a) Block

Except as otherwise provided in this section, a consumer reporting agency shall block the reporting of any information in the file of a consumer that the consumer identifies as information that resulted from an alleged identity theft, not later than 4 business days after the date of receipt by such agency of--

(1) appropriate proof of the identity of the consumer;

(2) a copy of an identity theft report;

(3) the identification of such information by the consumer; and

(4) a statement by the consumer that the information is not information relating to any transaction by the consumer.

(b) Notification

A consumer reporting agency shall promptly notify the furnisher of information identified by the consumer under subsection (a)--

(1) that the information may be a result of identity theft;

(2) that an identity theft report has been filed;

(3) that a block has been requested under this section; and

(4) of the effective dates of the block.

(c) Authority to decline or rescind

(1) In general. A consumer reporting agency may decline to block, or may rescind any block, of information relating to a consumer under this section, if the consumer reporting agency reasonably determines that--

(A) the information was blocked in error or a block was requested by the consumer in error;

(B) the information was blocked, or a block was requested by the consumer, on the basis of a material misrepresentation of fact by the consumer relevant to the request to block; or

(C) the consumer obtained possession of goods, services, or money as a result of the blocked transaction or transactions.

(2) Notification to consumer. If a block of information is declined or rescinded under this subsection, the affected consumer shall be notified promptly, in the same manner as consumers are notified of the reinsertion of information under section 611(a)(5)(B) [*15 USC § 1681i(a)(5)(B)*].

(3) Significance of block. For purposes of this subsection, if a consumer reporting agency rescinds a block, the presence of information in the file of a consumer prior to the blocking of such information is not evidence of whether the consumer knew or should have known that the consumer obtained possession of any goods, services, or money as a result of the block.

(d) Exception for resellers

(1) No reseller file. This section shall not apply to a consumer reporting agency, if the consumer reporting agency--

(A) is a reseller;

(B) is not, at the time of the request of the consumer under subsection (a), otherwise furnishing or reselling a consumer report concerning the information identified by the consumer; and

(C) informs the consumer, by any means, that the consumer may report the identity theft to the Commission to obtain consumer information regarding identity theft.

(2) Reseller with file. The sole obligation of the consumer reporting agency under this section, with regard to any request of a consumer under this section, shall be to block the consumer report maintained by the consumer reporting agency from any subsequent use, if--

(A) the consumer, in accordance with the provisions of subsection (a), identifies, to a consumer reporting agency, information in the file of the consumer that resulted from identity theft; and

(B) the consumer reporting agency is a reseller of the identified information.

(3) Notice. In carrying out its obligation under paragraph (2), the reseller shall promptly provide a notice to the consumer of the decision to block the file. Such notice shall contain the name, address, and telephone number of each consumer reporting agency from which the consumer information was obtained for resale.

(e) Exception for verification companies

The provisions of this section do not apply to a check services company, acting as such, which issues authorizations for the purpose of approving or processing negotiable instruments, electronic fund transfers, or similar methods of payments, except that, beginning 4 business days after receipt of information described in paragraphs (1) through (3) of subsection (a), a check services company shall not report to a national consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*], any information identified in the subject identity theft report as resulting from identity

theft.

(f) Access to blocked information by law enforcement agencies

No provision of this section shall be construed as requiring a consumer reporting agency to prevent a Federal, State, or local law enforcement agency from accessing blocked information in a consumer file to which the agency could otherwise obtain access under this title [*15 USC §§ 1681 et seq*.].

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681d

§ **1681d Disclosure of investigative consumer reports.**

(a) Disclosure of fact of preparation

A person may not procure or cause to be prepared an investigative consumer report on any consumer unless--

(1) it is clearly and accurately disclosed to the consumer that an investigative consumer report including information as to his character, general reputation, personal characteristics, and mode of living, whichever are applicable, may be made, and such disclosure (A) is made in a writing mailed, or otherwise delivered, to the consumer, not later than three days after the date on which the report was first requested, and (B) includes a statement informing the consumer of his right to request the additional disclosures provided for under subsection (b) of this section and the written summary of the rights of the consumer prepared pursuant to section 1681g(c) of this title; and

(2) the person certifies or has certified to the consumer reporting agency that--

(A) the person has made the disclosures to the consumer required by paragraph (1); and

(B) the person will comply with subsection (b) of this section.

(b) Disclosure on request of nature and scope of investigation

Any person who procures or causes to be prepared an investigative consumer report on any consumer shall, upon written request made by the consumer within a reasonable period of time after the receipt by him of the disclosure required by subsection (a)(1) of this section, shall n* make a complete and accurate disclosure of the nature and scope of the investigation requested. This disclosure shall be made in a writing mailed, or otherwise delivered, to the consumer not later than five days after the date on which the request for such disclosure was received from the consumer or such report was first requested, whichever is the later.

(c) Limitation on liability upon showing of reasonable procedures for compliance with provisions

No person may be held liable for any violation of subsection (a) or (b) of this section if he shows by a preponderance of the evidence that at the time of the violation he maintained reasonable procedures to assure compliance with subsection (a) or (b) of this section.

(d) Prohibitions

(1) Certification. A consumer reporting agency shall not prepare or furnish an investigative consumer report unless the agency has received a certification under subsection (a)(2) from the person who requested the report.

(2) Inquiries. A consumer reporting agency shall not make an inquiry for the purpose of preparing an investigative consumer report on a consumer for employment purposes if the making of the inquiry by an employer or prospective employer of the consumer would violate any applicable Federal or State equal employment opportunity law or regulation.

(3) Certain public record information. Except as otherwise provided in section 1681k of this title, a consumer reporting agency shall not furnish an investigative consumer report that includes information that is a matter of public record and that relates to an arrest, indictment, conviction, civil judicial action, tax lien, or outstanding judgment, unless the agency has verified the accuracy of the information during the 30-day period ending on the date on which the report is furnished.

(4) Certain adverse information. A consumer reporting agency shall not prepare or furnish an investigative consumer report on a consumer that contains information that is adverse to the interest of the consumer and that is obtained through a personal interview with a neighbor, friend, or associate of the consumer or with another person with whom the consumer is acquainted or who has knowledge of such item of information, unless--

(A) the agency has followed reasonable procedures to obtain confirmation of the information, from an additional source that has independent and direct knowledge of the information; or

(B) the person interviewed is the best possible source of the information.

FOOTNOTES:
(n80)Footnote *. So in original. Probably should be omitted.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681e

§ **1681e Compliance procedures.**

(a) Identity and purposes of credit users

Every consumer reporting agency shall maintain reasonable procedures designed to avoid violations of section 1681c of this title and to limit the furnishing of consumer reports to the purposes listed under section 1681b of this title. These procedures shall require that prospective users of the information identify themselves, certify the purposes for which the information is sought, and certify that the information will be used for no other purpose. Every consumer reporting agency shall make a reasonable effort to verify the identity of a new prospective user and the uses certified by such prospective user prior to furnishing such user a consumer report. No consumer reporting agency may furnish a consumer report to any person if it has reasonable grounds for believing that the consumer report will not be used for a purpose listed in section 1681b of this title.

(b) Accuracy of report

Whenever a consumer reporting agency prepares a consumer report it shall follow reasonable procedures to assure maximum possible accuracy of the information concerning the individual about whom the report relates.

(c) Disclosure of consumer reports by users allowed

A consumer reporting agency may not prohibit a user of a consumer report furnished by the agency on a consumer from disclosing the contents of the report to the consumer, if adverse action against the consumer has been taken by the user based in whole or in part on the report.

(d) Notice to users and furnishers of information

(1) Notice requirement. A consumer reporting agency shall provide to any person--

(A) who regularly and in the ordinary course of business furnishes information to the agency with respect to any consumer; or

(B) to whom a consumer report is provided by the agency;

a notice of such person's responsibilities under this title.

(2) Content of notice. The Federal Trade Commission shall prescribe the content of notices under paragraph (1), and a consumer reporting agency shall be in compliance with this subsection if it provides a notice under paragraph (1) that is substantially similar to the Federal Trade Commission prescription under this paragraph.

(e) Procurement of consumer report for resale

(1) Disclosure. A person may not procure a consumer report for purposes of reselling the report (or any information in the report) unless the person discloses to the consumer reporting agency that originally furnishes the report--

(A) the identity of the end-user of the report (or information); and

(B) each permissible purpose under section 1681b for which the report is furnished to the end-user of the report (or information).

(2) Responsibilities of procurers for resale. A person who procures a consumer report for purposes of reselling the report (or any information in the report) shall--

(A) establish and comply with reasonable procedures designed to ensure that the report (or information) is resold by the person only for a purpose for which the report may be furnished under section 1681b, including by requiring that each person to which the report (or information) is resold and that resells or provides the report (or information) to any other person--

(i) identifies each end user of the resold report (or information);

(ii) certifies each purpose for which the report (or information) will be used; and

(iii) certifies that the report (or information) will be used for no other purpose; and

(B) before reselling the report, make reasonable efforts to verify the identifications and certifications made under subparagraph (A).

(3) Resale of consumer report to a Federal agency or department. Notwithstanding paragraph (1) or (2), a person who procures a consumer report for purposes of reselling the report (or any information in the report) shall not disclose the identity of the end-user of the report under paragraph (1) or (2) if--

(A) the end user is an agency or department of the United States Government which procures the report from the person for purposes of determining the eligibility of the consumer concerned to receive access or continued access to classified information (as defined in section 1681b(b)(4)(E)(i)); and

(B) the agency or department certifies in writing to the person reselling the report that nondisclosure is necessary to protect classified information or the safety of persons employed by or contracting with, or undergoing investigation for work or contracting with the agency or department.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681f

§ **1681f Disclosures to governmental agencies.**

Notwithstanding the provisions of section 1681b of this title, a consumer reporting agency may furnish identifying information respecting any consumer, limited to his name, address, former addresses, places of employment, or former places of employment, to a governmental agency.

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§ **1681g Disclosures to consumers.**

(a) Information on file; sources; report recipients

Every consumer reporting agency shall, upon request, and subject to section 1681h(a)(1) of this title, clearly and accurately disclose to the consumer:

(1) All information in the consumer's file at the time of the request, except that--

(A) if the consumer to whom the file relates requests that the first 5 digits of the social security number (or similar identification number) of the consumer not be included in the disclosure and the consumer reporting agency has received appropriate proof of the identity of the requester, the consumer reporting agency shall so truncate such number in such disclosure; and

(B) nothing in this paragraph shall be construed to require a consumer reporting agency to disclose to a consumer any information concerning credit scores or any other risk scores or predictors relating to the consumer.

(2) The sources of the information; except that the sources of information acquired solely for use in preparing an investigative consumer report and actually used for no other purpose need not be disclosed: Provided, That in the event an action is brought under this subchapter, such sources shall be available to the plaintiff under appropriate discovery procedures in the court in which the action is brought.

(3)

(A) Identification of each person (including each end-user identified under section 1681e(e)(1)) that procured a consumer report--

(i) for employment purposes, during the 2-year period preceding the date on which the request is made; or

(ii) for any other purpose, during the 1-year period preceding the date on which the request is made.

(B) An identification of a person under subparagraph (A) shall include--

(i) the name of the person or, if applicable, the trade name (written in full) under which such person conducts business; and

(ii) upon request of the consumer, the address and telephone number of the person.

(C) Subparagraph (A) does not apply if--

(i) the end user is an agency or department of the United States Government that procures the report from the person for purposes of determining the eligibility of the consumer to whom the report relates to receive access or continued access to classified information (as defined in section 1681b(b)(4)(E)(i)]); and

(ii) the head of the agency or department makes a written finding as prescribed under section 1681b(b)(4)(A).

(4) The dates, original payees, and amounts of any checks upon which is based any adverse characterization of the consumer, included in the file at the time of the disclosure.

(5) A record of all inquiries received by the agency during the 1-year period preceding the request that identified the consumer in connection with a credit or insurance transaction that was not initiated by the consumer.

(6) If the consumer requests the credit file and not the credit score, a statement that the consumer may request and obtain a credit score.

(b) Accuracy of report

The requirements of subsection (a) of this section respecting the disclosure of sources of information and the recipients of consumer reports do not apply to information received or consumer reports furnished prior to the effective date of this subchapter except to the extent that the matter involved is contained in the files of the consumer reporting agency on that date.

(c) Summary of rights to obtain and dispute information in consumer reports and to obtain credit scores

(1) Commission summary of rights required.

(A) In general. The Commission shall prepare a model summary of the rights of consumers under this title.

(B) Content of summary. The summary of rights prepared under subparagraph (A) shall include a description of--

(i) the right of a consumer to obtain a copy of a consumer report under subsection (a) from each consumer reporting agency;

(ii) the frequency and circumstances under which a consumer is entitled to receive a consumer report without charge under section 612 [*15 USC § 1681j*];

(iii) the right of a consumer to dispute information in the file of the consumer under section 611 [*15 USC § 1681i*];

(iv) the right of a consumer to obtain a credit score from a consumer reporting agency, and a description of how to obtain a credit score;

(v) the method by which a consumer can contact, and obtain a consumer report from, a consumer reporting agency

without charge, as provided in the regulations of the Commission prescribed under section 211(c) of the Fair and Accurate Credit Transactions Act of 2003; and

(vi) the method by which a consumer can contact, and obtain a consumer report from, a consumer reporting agency described in section 603(w) [*15 USC § 1681a(w)*], as provided in the regulations of the Commission prescribed under section 612(a)(1)(C) [*15 USC § 1681j(a)(1)(C)*].

(C) Availability of summary of rights. The Commission shall--

(i) actively publicize the availability of the summary of rights prepared under this paragraph;

(ii) conspicuously post on its Internet website the availability of such summary of rights; and

(iii) promptly make such summary of rights available to consumers, on request.

(2) Summary of rights required to be included with agency disclosures. A consumer reporting agency shall provide to a consumer, with each written disclosure by the agency to the consumer under this section--

(A) the summary of rights prepared by the Commission under paragraph (1);

(B) in the case of a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*], a toll-free telephone number established by the agency, at which personnel are accessible to consumers during normal business hours;

(C) a list of all Federal agencies responsible for enforcing any provision of this title, and the address and any appropriate phone number of each such agency, in a form that will assist the consumer in selecting the appropriate agency;

(D) a statement that the consumer may have additional rights under State law, and that the consumer may wish to contact a State or local consumer protection agency or a State attorney general (or the equivalent thereof) to learn of those rights; and

(E) a statement that a consumer reporting agency is not required to remove accurate derogatory information from the file of a consumer, unless the information is outdated under section 605 [*15 USC § 1681c*] or cannot be verified.

(d) Summary of rights of identity theft victims

(1) In general. The Commission, in consultation with the Federal banking agencies and the National Credit Union Administration, shall prepare a model summary of the rights of consumers under this title with respect to the procedures for remedying the effects of fraud or identity theft involving credit, an electronic fund transfer, or an account or transaction at or with a financial institution or other creditor.

(2) Summary of rights and contact information. Beginning 60 days after the date on which the model summary of rights is prescribed in final form by the Commission pursuant to paragraph (1), if any consumer contacts a consumer reporting agency and expresses a belief that the consumer is a victim of fraud or identity theft involving credit, an electronic fund transfer, or an account or transaction at or with a financial institution or other creditor, the consumer reporting agency shall, in addition to any other action that the agency may take, provide the consumer with a summary of rights that contains all of the information required by the Commission under paragraph (1), and information on how to contact the Commission to obtain more detailed information.

(e) Information available to victims

(1) In general. For the purpose of documenting fraudulent transactions resulting from identity theft, not later than 30 days after the date of receipt of a request from a victim in accordance with paragraph (3), and subject to verification of the identity of the victim and the claim of identity theft in accordance with paragraph (2), a business entity that has provided credit to, provided for consideration products, goods, or services to, accepted payment from, or otherwise entered into a commercial transaction for consideration with, a person who has allegedly made unauthorized use of the means of identification of the victim, shall provide a copy of application and business transaction records in the control of the business entity, whether maintained by the business entity or by another person on behalf of the business entity, evidencing any transaction alleged to be a result of identity theft to--

(A) the victim;

(B) any Federal, State, or local government law enforcement agency or officer specified by the victim in such a request; or

(C) any law enforcement agency investigating the identity theft and authorized by the victim to take receipt of records provided under this subsection.

(2) Verification of identity and claim. Before a business entity provides any information under paragraph (1), unless the business entity, at its discretion, otherwise has a high degree of confidence that it knows the identity of the victim making a request under paragraph (1), the victim shall provide to the business entity--

(A) as proof of positive identification of the victim, at the election of the business entity--

(i) the presentation of a government-issued identification card;

(ii) personally identifying information of the same type as was provided to the business entity by the unauthorized person; or

(iii) personally identifying information that the business entity typically requests from new applicants or for new transactions, at the time of the victim's request for information, including any documentation described in clauses (i) and (ii); and

(B) as proof of a claim of identity theft, at the election of the business entity--

(i) a copy of a police report evidencing the claim of the victim of identity theft; and

(ii) a properly completed--

(I) copy of a standardized affidavit of identity theft developed and made available by the Commission; or

(II) an affidavit of fact that is acceptable to the business entity for that purpose.

(3) Procedures. The request of a victim under paragraph (1) shall--

(A) be in writing;

(B) be mailed to an address specified by the business entity, if any; and

(C) if asked by the business entity, include relevant information about any transaction alleged to be a result of identity theft to facilitate compliance with this section including--

(i) if known by the victim (or if readily obtainable by the victim), the date of the application or transaction; and

(ii) if known by the victim (or if readily obtainable by the victim), any other identifying information such as an account or transaction number.

(4) No charge to victim. Information required to be provided under paragraph (1) shall be so provided without charge.

(5) Authority to decline to provide information. A business entity may decline to provide information under paragraph (1) if, in the exercise of good faith, the business entity determines that--

(A) this subsection does not require disclosure of the information;

(B) after reviewing the information provided pursuant to paragraph (2), the business entity does not have a high degree of confidence in knowing the true identity of the individual requesting the information;

(C) the request for the information is based on a misrepresentation of fact by the individual requesting the information relevant to the request for information; or

(D) the information requested is Internet navigational data or similar information about a person's visit to a website or online service.

(6) Limitation on liability. Except as provided in section 621 [*15 USC § 1681s*], sections 616 and 617 [*15 USC §§ 1681n* and *1681o*] do not apply to any violation of this subsection.

(7) Limitation on civil liability. No business entity may be held civilly liable under any provision of Federal, State, or other law for disclosure, made in good faith pursuant to this subsection.

(8) No new recordkeeping obligation. Nothing in this subsection creates an obligation on the part of a business entity to obtain, retain, or maintain information or records that are not otherwise required to be obtained, retained, or maintained in the ordinary course of its business or under other applicable law.

(9) Rule of construction

(A) In general. No provision of subtitle A of title V of Public Law 106-102, prohibiting the disclosure of financial information by a business entity to third parties shall be used to deny disclosure of information to the victim under this subsection.

(B) Limitation. Except as provided in subparagraph (A), nothing in this subsection permits a business entity to disclose information, including information to law enforcement under subparagraphs (B) and (C) of paragraph (1), that the business entity is otherwise prohibited from disclosing under any other applicable provision of Federal or State law.

(10) Affirmative defense. In any civil action brought to enforce this subsection, it is an affirmative defense (which the defendant must establish by a preponderance of the evidence) for a business entity to file an affidavit or answer stating that--

(A) the business entity has made a reasonably diligent search of its available business records; and

(B) the records requested under this subsection do not exist or are not reasonably available.

(11) Definition of victim. For purposes of this subsection, the term "victim" means a consumer whose means of identification or financial information has been used or transferred (or has been alleged to have been used or transferred) without the authority of that consumer, with the intent to commit, or to aid or abet, an identity theft or a similar crime.

(12) Effective date. This subsection shall become effective 180 days after the date of enactment of this subsection.

(13) Effectiveness study. Not later than 18 months after the date of enactment of this subsection, the Comptroller General of the United States shall submit a report to Congress assessing the effectiveness of this provision.

(f) Disclosure of credit scores

(1) In general. Upon the request of a consumer for a credit score, a consumer reporting agency shall supply to the consumer a statement indicating that the information and credit scoring model may be different than the credit score that may be used by the lender, and a notice which shall include--

(A) the current credit score of the consumer or the most recent credit score of the consumer that was previously calculated by the credit reporting agency for a purpose related to the extension of credit;

(B) the range of possible credit scores under the model used;

(C) all of the key factors that adversely affected the credit score of the consumer in the model used, the total number of which shall not exceed 4, subject to paragraph (9);

(D) the date on which the credit score was created; and

(E) the name of the person or entity that provided the credit score or credit file upon which the credit score was created.

(2) Definitions. For purposes of this subsection, the following definitions shall apply:

(A) Credit score. The term "credit score"--

(i) means a numerical value or a categorization derived from a statistical tool or modeling system used by a person

who makes or arranges a loan to predict the likelihood of certain credit behaviors, including default (and the numerical value or the categorization derived from such analysis may also be referred to as a "risk predictor" or "risk score"); and

(ii) does not include--

(I) any mortgage score or rating of an automated underwriting system that considers one or more factors in addition to credit information, including the loan to value ratio, the amount of down payment, or the financial assets of a consumer; or

(II) any other elements of the underwriting process or underwriting decision.

(B) Key factors. The term "key factors" means all relevant elements or reasons adversely affecting the credit score for the particular individual, listed in the order of their importance based on their effect on the credit score.

(3) Timeframe and manner of disclosure. The information required by this subsection shall be provided in the same timeframe and manner as the information described in subsection (a).

(4) Applicability to certain uses. This subsection shall not be construed so as to compel a consumer reporting agency to develop or disclose a score if the agency does not--

(A) distribute scores that are used in connection with residential real property loans; or

(B) develop scores that assist credit providers in understanding the general credit behavior of a consumer and predicting the future credit behavior of the consumer.

(5) Applicability to credit scores developed by another person.

(A) In general. This subsection shall not be construed to require a consumer reporting agency that distributes credit scores developed by another person or entity to provide a further explanation of them, or to process a dispute arising pursuant to section 611 [*15 USC § 1681i*], except that the consumer reporting agency shall provide the consumer with the name and address and website for contacting the person or entity who developed the score or developed the methodology of the score.

(B) Exception. This paragraph shall not apply to a consumer reporting agency that develops or modifies scores that are developed by another person or entity.

(6) Maintenance of credit scores not required. This subsection shall not be construed to require a consumer reporting agency to maintain credit scores in its files.

(7) Compliance in certain cases. In complying with this subsection, a consumer reporting agency shall--

(A) supply the consumer with a credit score that is derived from a credit scoring model that is widely distributed to users by that consumer reporting agency in connection with residential real property loans or with a credit score that assists the consumer in understanding the credit scoring assessment of the credit behavior of the consumer and predictions about the future credit behavior of the consumer; and

(B) a statement indicating that the information and credit scoring model may be different than that used by the lender.

(8) Fair and reasonable fee. A consumer reporting agency may charge a fair and reasonable fee, as determined by the Commission, for providing the information required under this subsection.

(9) Use of enquiries as a key factor. If a key factor that adversely affects the credit score of a consumer consists of the number of enquiries made with respect to a consumer report, that factor shall be included in the disclosure pursuant to paragraph (1)(C) without regard to the numerical limitation in such paragraph.

(g) Disclosure of credit scores by certain mortgage lenders

(1) In general. Any person who makes or arranges loans and who uses a consumer credit score, as defined in subsection (f), in connection with an application initiated or sought by a consumer for a closed end loan or the establishment of an open end loan for a consumer purpose that is secured by 1 to 4 units of residential real property (hereafter in this subsection referred to as the "lender") shall provide the following to the consumer as soon as reasonably practicable:

(A) Information required under subsection (f).

(i) In general. A copy of the information identified in subsection (f) that was obtained from a consumer reporting agency or was developed and used by the user of the information.

(ii) Notice under subparagraph (d). In addition to the information provided to it by a third party that provided the credit score or scores, a lender is only required to provide the notice contained in subparagraph (D).

(B) Disclosures in case of automated underwriting system.

(i) In general. If a person that is subject to this subsection uses an automated underwriting system to underwrite a loan, that person may satisfy the obligation to provide a credit score by disclosing a credit score and associated key factors supplied by a consumer reporting agency.

(ii) Numerical credit score. However, if a numerical credit score is generated by an automated underwriting system used by an enterprise, and that score is disclosed to the person, the score shall be disclosed to the consumer consistent with subparagraph (C).

(iii) Enterprise defined. For purposes of this subparagraph, the term "enterprise" has the same meaning as in paragraph (6) of section 1303 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 [*12 USC § 4502*].

(C) Disclosures of credit scores not obtained from a consumer reporting agency. A person that is subject to the provisions of this subsection and that uses a credit score, other than a credit score provided by a consumer reporting agency, may satisfy the obligation to provide a credit score by disclosing a credit score and associated key factors supplied by a consumer reporting agency.

(D) Notice to home loan applicants. A copy of the following notice, which shall include the name, address, and telephone number of each consumer reporting agency providing a credit score that was used:

"*NOTICE TO THE HOME LOAN APPLICANT*

"*In connection with your application for a home loan, the lender must disclose to you the score that a consumer reporting agency distributed to users and the lender used in connection with your home loan, and the key factors affecting your credit scores.*

"*The credit score is a computer generated summary calculated at the time of the request and based on information that a consumer reporting agency or lender has on file. The scores are based on data*

about your credit history and payment patterns. Credit scores are important because they are used to assist the lender in determining whether you will obtain a loan. They may also be used to determine what interest rate you may be offered on the mortgage. Credit scores can change over time, depending on your conduct, how your credit history and payment patterns change, and how credit scoring technologies change.

"*Because the score is based on information in your credit history, it is very important that you review the credit-related information that is being furnished to make sure it is accurate. Credit records may vary from one company to another.*

"*If you have questions about your credit score or the credit information that is furnished to you, contact the consumer reporting agency at the address and telephone number provided with this notice, or contact the lender, if the lender developed or generated the credit score. The consumer reporting agency plays no part in the decision to take any action on the loan application and is unable to provide you with specific reasons for the decision on a loan application.*

"*If you have questions concerning the terms of the loan, contact the lender.*".

(E) Actions not required under this subsection. This subsection shall not require any person to--

(i) explain the information provided pursuant to subsection (f);

(ii) disclose any information other than a credit score or key factors, as defined in subsection (f);

(iii) disclose any credit score or related information obtained by the user after a loan has closed;

(iv) provide more than 1 disclosure per loan transaction; or

(v) provide the disclosure required by this subsection when another person has made the disclosure to the consumer for that loan transaction.

(F) No obligation for content.

(i) In general. The obligation of any person pursuant to this subsection shall be limited solely to providing a copy of the information that was received from the consumer reporting agency.

(ii) Limit on liability. No person has liability under this subsection for the content of that information or for the omission of any information within the report provided by the consumer reporting agency.

(G) Person defined as excluding enterprise. As used in this subsection, the term "person" does not include an enterprise (as defined in paragraph (6) of section 1303 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 [*12 USC § 4502*]).

(2) Prohibition on disclosure clauses null and void.

(A) In general. Any provision in a contract that prohibits the disclosure of a credit score by a person who makes or arranges loans or a consumer reporting agency is void.

(B) No liability for disclosure under this subsection. A lender shall not have liability under any contractual provision for disclosure of a credit score pursuant to this subsection.

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§ **1681h Conditions and form of disclosure to consumers.**

(a) In general

(1) Proper identification. A consumer reporting agency shall require, as a condition of making the disclosures required under section 1681g of this title, that the consumer furnish proper identification.

(2) Disclosure in writing. Except as provided in subsection (b), the disclosures required to be made under section 1681g of this title shall be provided under that section in writing.

(b) Other forms of disclosure

(1) In general. If authorized by a consumer, a consumer reporting agency may make the disclosures required under 1681g of this title--

(A) other than in writing; and

(B) in such form as may be--

(i) specified by the consumer in accordance with paragraph (2); and

(ii) available from the agency.

(2) Form. A consumer may specify pursuant to paragraph (1) that disclosures under section 1681g of this title shall be made--

(A) in person, upon the appearance of the consumer at the place of business of the consumer reporting agency where disclosures are regularly provided, during normal business hours, and on reasonable notice;

(B) by telephone, if the consumer has made a written request for disclosure by telephone;

(C) by electronic means, if available from the agency; or

(D) by any other reasonable means that is available from the agency.

(c) Trained personnel

Any consumer reporting agency shall provide trained personnel to explain to the consumer any information furnished to him pursuant to section 1681g of this title.

(d) Persons accompanying consumer

The consumer shall be permitted to be accompanied by one other person of his choosing, who shall furnish reasonable identification. A consumer reporting agency may require the consumer to furnish a written statement granting permission to the consumer reporting agency to discuss the consumer's file in such person's presence.

(e) Limitation of liability

Except as provided in sections 1681n and 1681o of this title, no consumer may bring any action or proceeding in the nature of defamation, invasion of privacy, or negligence with respect to the reporting of information against any consumer reporting agency, any user of information, or any person who furnishes information to a consumer reporting

agency, based on information disclosed pursuant to section 1681g, 1681h, or 1681m of this title, or based on information disclosed by a user of a consumer report to or for a consumer against whom the user has taken adverse action, based in whole or in part on the report except as to false information furnished with malice or willful intent to injure such consumer.

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§ 1681i Procedure in case of disputed accuracy.

(a) Reinvestigations of disputed information

(1) Reinvestigation required.

(A) In general. Subject to subsection (f), if the completeness or accuracy of any item of information contained in a consumer's file at a consumer reporting agency is disputed by the consumer and the consumer notifies the agency directly, or indirectly through a reseller, of such dispute, the agency shall, free of charge, conduct a reasonable reinvestigation to determine whether the disputed information is inaccurate and record the current status of the disputed information, or delete the item from the file in accordance with paragraph (5), before the end of the 30-day period beginning on the date on which the agency receives the notice of the dispute from the consumer or reseller.

(B) Extension of period to reinvestigate. Except as provided in subparagraph (C), the 30-day period described in subparagraph (A) may be extended for not more than 15 additional days if the consumer reporting agency receives information from the consumer during that 30-day period that is relevant to the reinvestigation.

(C) Limitations on extension of period to reinvestigate. Subparagraph (B) shall not apply to any reinvestigation in which, during the 30-day period described in subparagraph (A), the information that is the subject of the reinvestigation is found to be inaccurate or incomplete or the consumer reporting agency determines that the information cannot be verified.

(2) Prompt notice of dispute to furnisher of information.

(A) In general. Before the expiration of the 5-business-day period beginning on the date on which a consumer reporting agency receives notice of a dispute from any consumer or a reseller in accordance with paragraph (1), the agency shall provide notification of the dispute to any person who provided any item of information in dispute, at the address and in the manner established with the person. The notice shall include all relevant information regarding the dispute that the agency has received from the consumer or reseller.

(B) Provision of other information. The consumer reporting agency shall promptly provide to the person who provided the information in dispute all relevant information regarding the dispute that is received by the agency from the consumer or the reseller after the period referred to in subparagraph (A) and before the end of the period referred to in paragraph (1)(A).

(3) Determination that dispute is frivolous or irrelevant.

(A) In general. Notwithstanding paragraph (1), a consumer reporting agency may terminate a reinvestigation of information disputed by a consumer under that paragraph if the agency reasonably determines that the dispute by the consumer is frivolous or irrelevant, including by reason of a failure by a consumer to provide sufficient information to investigate the disputed information.

(B) Notice of determination. Upon making any determination in accordance with subparagraph (A) that a dispute is frivolous or irrelevant, a consumer reporting agency shall notify the consumer of such determination not later than 5 business days after making such determination, by mail or, if authorized by the consumer for that purpose, by any other means available to the agency.

(C) Contents of notice. A notice under subparagraph (B) shall include--

(i) the reasons for the determination under subparagraph (A); and

(ii) identification of any information required to investigate the disputed information, which may consist of a standardized form describing the general nature of such information.

(4) Consideration of consumer information. In conducting any reinvestigation under paragraph (1) with respect to disputed information in the file of any consumer, the consumer reporting agency shall review and consider all relevant information submitted by the consumer in the period described in paragraph (1)(A) with respect to such disputed information.

(5) Treatment of inaccurate or unverifiable information.

(A) In general. If, after any reinvestigation under paragraph (1) of any information disputed by a consumer, an item of the information is found to be inaccurate or incomplete or cannot be verified, the consumer reporting agency shall--

(i) promptly delete that item of information from the file of the consumer, or modify that item of information, as appropriate, based on the results of the reinvestigation; and

(ii) promptly notify the furnisher of that information that the information has been modified or deleted from the file of the consumer.

(B) Requirements relating to reinsertion of previously deleted material.

(i) Certification of accuracy of information. If any information is deleted from a consumer's file pursuant to subparagraph (A), the information may not be reinserted in the file by the consumer reporting agency unless the person who furnishes the information certifies that the information is complete and accurate.

(ii) Notice to consumer. If any information that has been deleted from a consumer's file pursuant to subparagraph (A) is reinserted in the file, the consumer reporting agency shall notify the consumer of the reinsertion in writing not later than 5 business days after the reinsertion or, if authorized by the consumer for that purpose, by any other means available to the agency.

(iii) Additional information. As part of, or in addition to, the notice under clause (ii), a consumer reporting agency shall provide to a consumer in writing not later than 5 business days after the date of the reinsertion--

(I) a statement that the disputed information has been reinserted;

(II) the business name and address of any furnisher of information contacted and the telephone number of such furnisher, if reasonably available, or of any furnisher of information that contacted the consumer reporting agency, in connection with the reinsertion of such information; and

(III) a notice that the consumer has the right to add a statement to the consumer's file disputing the accuracy or completeness of the disputed information.

(C) Procedures to prevent reappearance. A consumer reporting agency shall maintain reasonable procedures designed to prevent the reappearance in a consumer's file, and in consumer reports on the consumer, of information that is deleted pursuant to this paragraph (other than information that is reinserted in accordance with subparagraph (B)(i)).

(D) Automated reinvestigation system. Any consumer reporting agency that compiles and maintains files on consumers on a nationwide basis shall implement an automated system through which furnishers of information to that consumer reporting agency may report the results of a reinvestigation that finds incomplete or inaccurate information in a consumer's file to other such consumer reporting agencies.

(6) Notice of results of reinvestigation.

(A) In general. A consumer reporting agency shall provide written notice to a consumer of the results of a reinvestigation under this subsection not later than 5 business days after the completion of the reinvestigation, by mail or, if authorized by the consumer for that purpose, by other means available to the agency.

(B) Contents. As part of, or in addition to, the notice under subparagraph (A), a consumer reporting agency shall provide to a consumer in writing before the expiration of the 5-day period referred to in subparagraph (A)--

(i) a statement that the reinvestigation is completed;

(ii) a consumer report that is based upon the consumer's file as that file is revised as a result of the reinvestigation;

(iii) a notice that, if requested by the consumer, a description of the procedure used to determine the accuracy and completeness of the information shall be provided to the consumer by the agency, including the business name and address of any furnisher of information contacted in connection with such information and the telephone number of such furnisher, if reasonably available;

(iv) a notice that the consumer has the right to add a statement to the consumer's file disputing the accuracy or completeness of the information; and

(v) a notice that the consumer has the right to request under subsection (d) that the consumer reporting agency furnish notifications under that subsection.

(7) Description of reinvestigation procedure. A consumer reporting agency shall provide to a consumer a description referred to in paragraph (6)(B)(iii) by not later than 15 days after receiving a request from the consumer for that description.

(8) Expedited dispute resolution. If a dispute regarding an item of information in a consumer's file at a consumer reporting agency is resolved in accordance with paragraph (5)(A) by the deletion of the disputed information by not later than 3 business days after the date on which the agency receives notice of the dispute from the consumer in accordance with paragraph (1)(A), then the agency shall not be required to comply with paragraphs (2), (6), and (7) with respect to that dispute if the agency--

(A) provides prompt notice of the deletion to the consumer by telephone;

(B) includes in that notice, or in a written notice that accompanies a confirmation and consumer report provided in accordance with subparagraph (C), a statement of the consumer's right to request under subsection (d) that the agency furnish notifications under that subsection; and

(C) provides written confirmation of the deletion and a copy of a consumer report on the consumer that is based on the consumer's file after the deletion, not later than 5 business days after making the deletion.

(b) Statement of dispute

If the reinvestigation does not resolve the dispute, the consumer may file a brief statement setting forth the nature of the dispute. The consumer reporting agency may limit such statements to not more than one hundred words if it provides the consumer with assistance in writing a clear summary of the dispute.

(c) Notification of consumer dispute in subsequent consumer reports

Whenever a statement of a dispute is filed, unless there is reasonable grounds to believe that it is frivolous or

irrelevant, the consumer reporting agency shall, in any subsequent consumer report containing the information in question, clearly note that it is disputed by the consumer and provide either the consumer's statement or a clear and accurate codification or summary thereof.

(d) Notification of deletion of disputed information

Following any deletion of information which is found to be inaccurate or whose accuracy can no longer be verified or any notation as to disputed information, the consumer reporting agency shall, at the request of the consumer, furnish notification that the item has been deleted or the statement, codification or summary pursuant to subsection (b) or (c) of this section to any person specifically designated by the consumer who has within two years prior thereto received a consumer report for employment purposes, or within six months prior thereto received a consumer report for any other purpose, which contained the deleted or disputed information.

(e) Treatment of complaints and report to Congress

(1) In general. The Commission shall--

(A) compile all complaints that it receives that a file of a consumer that is maintained by a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] contains incomplete or inaccurate information, with respect to which, the consumer appears to have disputed the completeness or accuracy with the consumer reporting agency or otherwise utilized the procedures provided by subsection (a); and

(B) transmit each such complaint to each consumer reporting agency involved.

(2) Exclusion. Complaints received or obtained by the Commission pursuant to its investigative authority under the Federal Trade Commission Act [*15 USC §§ 41 et seq*.] shall not be subject to paragraph (1).

(3) Agency responsibilities. Each consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] that receives a complaint transmitted by the Commission pursuant to paragraph (1) shall--

(A) review each such complaint to determine whether all legal obligations imposed on the consumer reporting agency under this title [*15 USC §§ 1681 et seq*.] (including any obligation imposed by an applicable court or administrative order) have been met with respect to the subject matter of the complaint;

(B) provide reports on a regular basis to the Commission regarding the determinations of and actions taken by the consumer reporting agency, if any, in connection with its review of such complaints; and

(C) maintain, for a reasonable time period, records regarding the disposition of each such complaint that is sufficient to demonstrate compliance with this subsection.

(4) Rulemaking authority. The Commission may prescribe regulations, as appropriate to implement this subsection.

(5) The Commission shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives an annual report regarding information gathered by the Commission under this subsection.

(f) Reinvestigation requirement applicable to resellers

(1) Exemption from general reinvestigation requirement. Except as provided in paragraph (2), a reseller shall be exempt from the requirements of this section.

(2) Action required upon receiving notice of a dispute. If a reseller receives a notice from a consumer of a dispute concerning the completeness or accuracy of any item of information contained in a consumer report on such consumer produced by the reseller, the reseller shall, within 5 business days of receiving the notice, and free of charge--

(A) determine whether the item of information is incomplete or inaccurate as a result of an act or omission of the reseller; and

(B) if--

(i) the reseller determines that the item of information is incomplete or inaccurate as a result of an act or omission of the reseller, not later than 20 days after receiving the notice, correct the information in the consumer report or delete it; or

(ii) if the reseller determines that the item of information is not incomplete or inaccurate as a result of an act or omission of the reseller, convey the notice of the dispute, together with all relevant information provided by the

consumer, to each consumer reporting agency that provided the reseller with the information that is the subject of the dispute, using an address or a notification mechanism specified by the consumer reporting agency for such notices.

(3) Responsibility of consumer reporting agency to notify consumer through reseller. Upon the completion of a reinvestigation under this section of a dispute concerning the completeness or accuracy of any information in the file of a consumer by a consumer reporting agency that received notice of the dispute from a reseller under paragraph (2)--

(A) the notice by the consumer reporting agency under paragraph (6), (7), or (8) of subsection (a) shall be provided to the reseller in lieu of the consumer; and

(B) the reseller shall immediately reconvey such notice to the consumer, including any notice of a deletion by telephone in the manner required under paragraph (8)(A).

(4) Reseller reinvestigations. No provision of this subsection shall be construed as prohibiting a reseller from conducting a reinvestigation of a consumer dispute directly.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681j

§ **1681j Charges for certain disclosures.**

(a) Free annual disclosure

(1) Nationwide consumer reporting agencies.

(A) In general. All consumer reporting agencies described in subsections (p) and (w) of section 603 [*15 USC § 1681a*] shall make all disclosures pursuant to section 609 [*15 USC § 1681g*] once during any 12-month period upon request of the consumer and without charge to the consumer.

(B) Centralized source. Subparagraph (A) shall apply with respect to a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] only if the request from the consumer is made using the centralized source established for such purpose in accordance with section 211(c) of the Fair and Accurate Credit Transactions Act of 2003.

(C) Nationwide specialty consumer reporting agency.

(i) In general. The Commission shall prescribe regulations applicable to each consumer reporting agency described in section 603(w) [*15 USC § 1681a(w)*] to require the establishment of a streamlined process for consumers to request consumer reports under subparagraph (A), which shall include, at a minimum, the establishment by each such

agency of a toll-free telephone number for such requests.

(ii) Considerations. In prescribing regulations under clause (i), the Commission shall consider--

(I) the significant demands that may be placed on consumer reporting agencies in providing such consumer reports;

(II) appropriate means to ensure that consumer reporting agencies can satisfactorily meet those demands, including the efficacy of a system of staggering the availability to consumers of such consumer reports; and

(III) the ease by which consumers should be able to contact consumer reporting agencies with respect to access to such consumer reports.

(iii) Date of issuance. The Commission shall issue the regulations required by this subparagraph in final form not later than 6 months after the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003].

(iv) Consideration of ability to comply. The regulations of the Commission under this subparagraph shall establish an effective date by which each nationwide specialty consumer reporting agency (as defined in section 603(w) [*15 USC § 1681a(w)*]) shall be required to comply with subsection (a), which effective date--

(I) shall be established after consideration of the ability of each nationwide specialty consumer reporting agency to comply with subsection (a); and

(II) shall be not later than 6 months after the date on which such regulations are issued in final form (or such additional period not to exceed 3 months, as the Commission determines appropriate).

(2) Timing. A consumer reporting agency shall provide a consumer report under paragraph (1) not later than 15 days after the date on which the request is received under paragraph (1).

(3) Reinvestigations. Notwithstanding the time periods specified in section 611(a)(1) [*15 USC § 1681i(a)(1)*], a reinvestigation under that section by a consumer reporting agency upon a request of a consumer that is made after

receiving a consumer report under this subsection shall be completed not later than 45 days after the date on which the request is received.

(4) Exception for first 12 months of operation. This subsection shall not apply to a consumer reporting agency that has not been furnishing consumer reports to third parties on a continuing basis during the 12-month period preceding a request under paragraph (1), with respect to consumers residing nationwide.

(b) Free disclosure after adverse notice to consumer

Each consumer reporting agency that maintains a file on a consumer shall make all disclosures pursuant to section 1681g of this title without charge to the consumer if, not later than 60 days after receipt by such consumer of a notification pursuant to section 1681m of this title, or of a notification from a debt collection agency affiliated with that consumer reporting agency stating that the consumer's credit rating may be or has been adversely affected, the consumer makes a request under section 1681g of this title.

(c) Free disclosure under certain other circumstances

Upon the request of the consumer, a consumer reporting agency shall make all disclosures pursuant to section 1681g of this title once during any 12-month period without charge to that consumer if the consumer certifies in writing that the consumer--

(1) is unemployed and intends to apply for employment in the 60-day period beginning on the date on which the certification is made;

(2) is a recipient of public welfare assistance; or

(3) has reason to believe that the file on the consumer at the agency contains inaccurate information due to fraud.

(d) Free disclosures in connection with fraud alerts

Upon the request of a consumer, a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] shall make all disclosures pursuant to section 609 [*15 USC § 1681g*] without charge to the consumer, as provided in subsections (a)(2) and (b)(2) of section 605A [*15 USC § 1681c-1*], as applicable.

(e) Other charges prohibited

A consumer reporting agency shall not impose any charge on a consumer for providing any notification required by this chapter or making any disclosure required by this chapter, except as authorized by subsection (f) of this section.

(f) Reasonable charges allowed for certain disclosures

(1) In general. In the case of a request from a consumer other than a request that is covered by any of subsections (a) through (d), a consumer reporting agency may impose a reasonable charge on a consumer--

(A) for making a disclosure to the consumer pursuant to section 1681g of this title, which charge--

(i) shall not exceed $8; and

(ii) shall be indicated to the consumer before making the disclosure; and

(B) for furnishing, pursuant to section 1681i(d) of this title, following a reinvestigation under section 1681i(a) of this title, a statement, codification, or summary to a person designated by the consumer under that section after the 30-day period beginning on the date of notification of the consumer under paragraph (6) or (8) of section 1681i(a) of this title with respect to the reinvestigation, which charge--

(i) shall not exceed the charge that the agency would impose on each designated recipient for a consumer report; and

(ii) shall be indicated to the consumer before furnishing such information.

(2) Modification of amount. The Federal Trade Commission shall increase the amount referred to in paragraph (1)(A)(i) on January 1 of each year, based proportionally on changes in the Consumer Price Index, with fractional changes rounded to the nearest fifty cents.

(g) Prevention of deceptive marketing of credit reports.

(1) In general. Subject to rulemaking pursuant to section 205(b) of the Credit CARD Act of 2009 [note to this section], any advertisement for a free credit report in any medium shall prominently disclose in such advertisement that free credit reports are available under Federal law at: "AnnualCreditReport.com" (or such other source as may be authorized under Federal law).

(2) Television and radio advertisement. In the case of an advertisement broadcast by television, the disclosures required under paragraph (1) shall be included in the audio and visual part of such advertisement. In the case of an advertisement broadcast by televison [television] or radio, the disclosure required under paragraph (1) shall consist only of the following: "This is not the free credit report provided for by Federal law".

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681k

§ 1681k Public record information for employment purposes.

(a) In general

A consumer reporting agency which furnishes a consumer report for employment purposes and which for that purpose compiles and reports items of information on consumers which are matters of public record and are likely to have an adverse effect upon a consumer's ability to obtain employment shall--

(1) at the time such public record information is reported to the user of such consumer report, notify the consumer of the fact that public record information is being reported by the consumer reporting agency, together with the name and address of the person to whom such information is being reported; or

(2) maintain strict procedures designed to insure that whenever public record information which is likely to have an adverse effect on a consumer's ability to obtain employment is reported it is complete and up to date. For purposes of this paragraph, items of public record relating to arrests, indictments, convictions, suits, tax liens, and outstanding judgments shall be considered up to date if the current public record status of the item at the time of the report is reported.

(b) Exemption for national security investigations

Subsection (a) does not apply in the case of an agency or department of the United States Government that seeks to obtain and use a consumer report for employment purposes, if the head of the agency or department makes a written finding as prescribed under section 1681b(b)(4)(A).

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681l

§ **1681l Restrictions on investigative consumer reports.**

Whenever a consumer reporting agency prepares an investigative consumer report, no adverse information in the consumer report (other than information which is a matter of public record) may be included in a subsequent consumer report unless such adverse information has been verified in the process of making such subsequent consumer report, or the adverse information was received within the three-month period preceding the date the subsequent report is furnished.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681m

§ 1681m Requirements on users of consumer reports.

(a) Duties of users taking adverse actions on the basis of information contained in consumer reports

If any person takes any adverse action with respect to any consumer that is based in whole or in part on any information contained in a consumer report, the person shall--

(1) provide oral, written, or electronic notice of the adverse action to the consumer;

(2) provide to the consumer orally, in writing, or electronically--

(A) the name, address, and telephone number of the consumer reporting agency (including a toll-free telephone number established by the agency if the agency compiles and maintains files on consumers on a nationwide basis) that furnished the report to the person; and

(B) a statement that the consumer reporting agency did not make the decision to take the adverse action and is unable to provide the consumer the specific reasons why the adverse action was taken; and

(3) provide to the consumer an oral, written, or electronic notice of the consumer's right--

(A) to obtain, under section 1681j of this title, a free copy of a consumer report on the consumer from the consumer reporting agency referred to in paragraph (2), which notice shall include an indication of the 60-day period under that section for obtaining such a copy; and

(B) to dispute, under section 1681i of this title, with a consumer reporting agency the accuracy or completeness of any information in a consumer report furnished by the agency.

(b) Adverse action based on information obtained from third parties other than consumer reporting agencies

(1) In general. Whenever credit for personal, family, or household purposes involving a consumer is denied or the charge for such credit is increased either wholly or partly because of information obtained from a person other than a consumer reporting agency bearing upon the consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living, the user of such information shall, within a reasonable period of time, upon the consumer's written request for the reasons for such adverse action received within sixty days after learning of such adverse action, disclose the nature of the information to the consumer. The user of such information shall clearly and accurately disclose to the consumer his right to make such written request at the time such adverse action is communicated to the consumer.

(2) Duties of person taking certain actions based on information provided by affiliate.

(A) Duties, generally. If a person takes an action described in subparagraph (B) with respect to a consumer, based in whole or in part on information described in subparagraph (C), the person shall--

(i) notify the consumer of the action, including a statement that the consumer may obtain the information in accordance with clause (ii); and

(ii) upon a written request from the consumer received within 60 days after transmittal of the notice required by clause (i), disclose to the consumer the nature of the information upon which the action is based by not later than 30 days after receipt of the request.

(B) Action described. An action referred to in subparagraph (A) is an adverse action described in section 1681a(k)(1)(A), taken in connection with a transaction initiated by the consumer, or any adverse action described in clause (i) or (ii) of section 1681a(k)(1)(B).

(C) Information described. Information referred to in subparagraph (A)--

(i) except as provided in clause (ii), is information that--

(I) is furnished to the person taking the action by a person related by common ownership or affiliated by common corporate control to the person taking the action; and

(II) bears on the credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living of the consumer; and

(ii) does not include--

(I) information solely as to transactions or experiences between the consumer and the person furnishing the information; or

(II) information in a consumer report.

(c) Reasonable procedures to assure compliance

No person shall be held liable for any violation of this section if he shows by a preponderance of the evidence that at the time of the alleged violation he maintained reasonable procedures to assure compliance with the provisions of this section.

(d) Duties of users making written credit or insurance solicitations on the basis of information contained in consumer files

(1) In general. Any person who uses a consumer report on any consumer in connection with any credit or insurance transaction that is not initiated by the consumer, that is provided to that person under section 1681b(c)(1)(B), shall provide with each written solicitation made to the consumer regarding the transaction a clear and conspicuous statement that--

(A) information contained in the consumer's consumer report was used in connection with the transaction;

(B) the consumer received the offer of credit or insurance because the consumer satisfied the criteria for credit worthiness or insurability under which the consumer was selected for the offer;

(C) if applicable, the credit or insurance may not be extended if, after the consumer responds to the offer, the consumer does not meet the criteria used to select the consumer for the offer or any applicable criteria bearing on credit worthiness or insurability or does not furnish any required collateral;

(D) the consumer has a right to prohibit information contained in the consumer's file with any consumer reporting agency from being used in connection with any credit or insurance transaction that is not initiated by the consumer; and

(E) the consumer may exercise the right referred to in subparagraph (D) by notifying a notification system established under section 1681b(e).

(2) Disclosure of address and telephone number; format. A statement under paragraph (1) shall--

(A) include the address and toll-free telephone number of the appropriate notification system established under section 604(e) [*15 USC § 1681b(e)*]; and

(B) be presented in such format and in such type size and manner as to be simple and easy to understand, as established by the Commission, by rule, in consultation with the Federal banking agencies and the National Credit Union Administration.

(3) Maintaining criteria on file. A person who makes an offer of credit or insurance to a consumer under a credit or insurance transaction described in paragraph (1) shall maintain on file the criteria used to select the consumer to receive the offer, all criteria bearing on credit worthiness or insurability, as applicable, that are the basis for determining whether or not to extend credit or insurance pursuant to the offer, and any requirement for the furnishing of collateral as a condition of the extension of credit or insurance, until the expiration of the 3-year period beginning on the date on which the offer is made to the consumer.

(4) Authority of federal agencies regarding unfair or deceptive acts or practices not affected. This section is not intended to affect the authority of any Federal or State agency to enforce a prohibition against unfair or deceptive acts or practices, including the making of false or misleading statements in connection with a credit or insurance transaction

that is not initiated by the consumer.

(e) Red flag guidelines and regulations required

(1) Guidelines. The Federal banking agencies, the National Credit Union Administration, and the Commission shall jointly, with respect to the entities that are subject to their respective enforcement authority under section 621 [*15 USC § 1681s*]--

(A) establish and maintain guidelines for use by each financial institution and each creditor regarding identity theft with respect to account holders at, or customers of, such entities, and update such guidelines as often as necessary;

(B) prescribe regulations requiring each financial institution and each creditor to establish reasonable policies and procedures for implementing the guidelines established pursuant to subparagraph (A), to identify possible risks to account holders or customers or to the safety and soundness of the institution or customers; and

(C) prescribe regulations applicable to card issuers to ensure that, if a card issuer receives notification of a change of address for an existing account, and within a short period of time (during at least the first 30 days after such notification is received) receives a request for an additional or replacement card for the same account, the card issuer may not issue the additional or replacement card, unless the card issuer, in accordance with reasonable policies and procedures--

(i) notifies the cardholder of the request at the former address of the cardholder and provides to the cardholder a means of promptly reporting incorrect address changes;

(ii) notifies the cardholder of the request by such other means of communication as the cardholder and the card issuer previously agreed to; or

(iii) uses other means of assessing the validity of the change of address, in accordance with reasonable policies and procedures established by the card issuer in accordance with the regulations prescribed under subparagraph (B).

(2) Criteria.

(A) In general. In developing the guidelines required by paragraph (1)(A), the agencies described in paragraph (1)

shall identify patterns, practices, and specific forms of activity that indicate the possible existence of identity theft.

(B) Inactive accounts. In developing the guidelines required by paragraph (1)(A), the agencies described in paragraph (1) shall consider including reasonable guidelines providing that when a transaction occurs with respect to a credit or deposit account that has been inactive for more than 2 years, the creditor or financial institution shall follow reasonable policies and procedures that provide for notice to be given to a consumer in a manner reasonably designed to reduce the likelihood of identity theft with respect to such account.

(3) Consistency with verification requirements. Guidelines established pursuant to paragraph (1) shall not be inconsistent with the policies and procedures required under *section 5318(l) of title 31, United States Code*.

(f) Prohibition on sale or transfer of debt caused by identity theft

(1) In general. No person shall sell, transfer for consideration, or place for collection a debt that such person has been notified under section 605B [*15 USC § 1681c-2*] has resulted from identity theft.

(2) Applicability. The prohibitions of this subsection shall apply to all persons collecting a debt described in paragraph (1) after the date of a notification under paragraph (1).

(3) Rule of construction. Nothing in this subsection shall be construed to prohibit--

(A) the repurchase of a debt in any case in which the assignee of the debt requires such repurchase because the debt has resulted from identity theft;

(B) the securitization of a debt or the pledging of a portfolio of debt as collateral in connection with a borrowing; or

(C) the transfer of debt as a result of a merger, acquisition, purchase and assumption transaction, or transfer of substantially all of the assets of an entity.

(g) Debt collector communications concerning identity theft

If a person acting as a debt collector (as that term is defined in title VIII [*15 USC §§ 1692 et seq.*]) on behalf of a

third party that is a creditor or other user of a consumer report is notified that any information relating to a debt that the person is attempting to collect may be fraudulent or may be the result of identity theft, that person shall--

(1) notify the third party that the information may be fraudulent or may be the result of identity theft; and

(2) upon request of the consumer to whom the debt purportedly relates, provide to the consumer all information to which the consumer would otherwise be entitled if the consumer were not a victim of identity theft, but wished to dispute the debt under provisions of law applicable to that person.

(h) Duties of users in certain credit transactions

(1) In general. Subject to rules prescribed as provided in paragraph (6), if any person uses a consumer report in connection with an application for, or a grant, extension, or other provision of, credit on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through that person, based in whole or in part on a consumer report, the person shall provide an oral, written, or electronic notice to the consumer in the form and manner required by regulations prescribed in accordance with this subsection.

(2) Timing. The notice required under paragraph (1) may be provided at the time of an application for, or a grant, extension, or other provision of, credit or the time of communication of an approval of an application for, or grant, extension, or other provision of, credit, except as provided in the regulations prescribed under paragraph (6).

(3) Exceptions. No notice shall be required from a person under this subsection if--

(A) the consumer applied for specific material terms and was granted those terms, unless those terms were initially specified by the person after the transaction was initiated by the consumer and after the person obtained a consumer report; or

(B) the person has provided or will provide a notice to the consumer under subsection (a) in connection with the transaction.

(4) Other notice not sufficient. A person that is required to provide a notice under subsection (a) cannot meet that requirement by providing a notice under this subsection.

(5) Content and delivery of notice. A notice under this subsection shall, at a minimum--

(A) include a statement informing the consumer that the terms offered to the consumer are set based on information from a consumer report;

(B) identify the consumer reporting agency furnishing the report;

(C) include a statement informing the consumer that the consumer may obtain a copy of a consumer report from that consumer reporting agency without charge; and

(D) include the contact information specified by that consumer reporting agency for obtaining such consumer reports (including a toll-free telephone number established by the agency in the case of a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*]).

(6) Rulemaking.

(A) Rules required. The Commission and the Board shall jointly prescribe rules.

(B) Content. Rules required by subparagraph (A) shall address, but are not limited to--

(i) the form, content, time, and manner of delivery of any notice under this subsection;

(ii) clarification of the meaning of terms used in this subsection, including what credit terms are material, and when credit terms are materially less favorable;

(iii) exceptions to the notice requirement under this subsection for classes of persons or transactions regarding which the agencies determine that notice would not significantly benefit consumers;

(iv) a model notice that may be used to comply with this subsection; and

(v) the timing of the notice required under paragraph (1), including the circumstances under which the notice must be provided after the terms offered to the consumer were set based on information from a consumer report.

(7) Compliance. A person shall not be liable for failure to perform the duties required by this section if, at the time of the failure, the person maintained reasonable policies and procedures to comply with this section.

(8) Enforcement.

(A) No civil actions. Sections 616 and 617 [*15 USC §§ 1681n* and *1681o*] shall not apply to any failure by any person to comply with this section.

(B) Administrative enforcement. This section shall be enforced exclusively under section 621 [*15 USC § 1681s*] by the Federal agencies and officials identified in that section.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681n

§ **1681n Civil liability for willful noncompliance.**

(a) In general

Any person who willfully fails to comply with any requirement imposed under this subchapter with respect to any consumer is liable to that consumer in an amount equal to the sum of--

(1)

(A) any actual damages sustained by the consumer as a result of the failure or damages of not less than $100 and not more than $1,000; or

(B) in the case of liability of a natural person for obtaining a consumer report under false pretenses or knowingly without a permissible purpose, actual damages sustained by the consumer as a result of the failure or $1,000, whichever is greater; and

(2) such amount of punitive damages as the court may allow; and

(3) in the case of any successful action to enforce any liability under this section, the costs of the action together with reasonable attorney's fees as determined by the court.

(b) Civil liability for knowing noncompliance

Any person who obtains a consumer report from a consumer reporting agency under false pretenses or knowingly without a permissible purpose shall be liable to the consumer reporting agency for actual damages sustained by the consumer reporting agency or $1,000, whichever is greater.

(c) Attorney's fees

Upon a finding by the court that an unsuccessful pleading, motion, or other paper filed in connection with an action under this section was filed in bad faith or for purposes of harassment, the court shall award to the prevailing party attorney's fees reasonable in relation to the work expended in responding to the pleading, motion, or other paper.

(d) Clarification of willful noncompliance. For the purposes of this section, any person who printed an expiration date on any receipt provided to a consumer cardholder at a point of sale or transaction between December 4, 2004, and the date of the enactment of this subsection [enacted June 3, 2008] but otherwise complied with the requirements of section 605(g) [*15 USCS § 1681c(g)*] for such receipt shall not be in willful noncompliance with section 605(g) [*15 USCS § 1681c(g)*] by reason of printing such expiration date on the receipt.

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§ **1681o Civil liability for negligent noncompliance.**

(a) In general

Any person who is negligent in failing to comply with any requirement imposed under this subchapter with respect to any consumer is liable to that consumer in an amount equal to the sum of--

(1) any actual damages sustained by the consumer as a result of the failure; and

(2) in the case of any successful action to enforce any liability under this section, the costs of the action together with reasonable attorney's fees as determined by the court.

(b) Attorney's fees

On a finding by the court that an unsuccessful pleading, motion, or other paper filed in connection with an action under this section was filed in bad faith or for purposes of harassment, the court shall award to the prevailing party attorney's fees reasonable in relation to the work expended in responding to the pleading, motion, or other paper.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681p

§ **1681p Jurisdiction of courts; limitation of actions.**

An action to enforce any liability created under this title may be brought in any appropriate United States district court, without regard to the amount in controversy, or in any other court of competent jurisdiction, not later than the earlier of--

(1) 2 years after the date of discovery by the plaintiff of the violation that is the basis for such liability; or

(2) 5 years after the date on which the violation that is the basis for such liability occurs.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681q

§ **1681q Obtaining information under false pretenses.**

Any person who knowingly and willfully obtains information on a consumer from a consumer reporting agency under false pretenses shall be fined under title 18, imprisoned for not more than 2 years, or both.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681r

§ **1681r Unauthorized disclosures by officers or employees.**

Any officer or employee of a consumer reporting agency who knowingly and willfully provides information concerning an individual from the agency's files to a person not authorized to receive that information shall be fined under title 18, imprisoned for not more than 2 years, or both.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681s

§ **1681s Administrative enforcement.**

(a) Enforcement by Federal Trade Commission

(1) Compliance with the requirements imposed under this title shall be enforced under the Federal Trade Commission Act by the Federal Trade Commission with respect to consumer reporting agencies and all other persons subject thereto, except to the extent that enforcement of the requirements imposed under this is specifically committed to some other government agency under subsection (b) hereof. For the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act, a violation of any requirement or prohibition imposed under this title shall constitute an unfair or deceptive act or practice in commerce in violation of section 5(a) of the Federal Trade Commission Act and shall be subject to enforcement by the Federal Trade Commission under section 5(b) thereof with respect to any consumer reporting agency or person subject to enforcement by the Federal Trade Commission pursuant to this subsection, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests in the Federal Trade Commission Act. The Federal Trade Commission shall have such procedural, investigative, and enforcement powers, including the power to issue procedural rules in enforcing compliance with the requirements imposed under this title and to require the filing of reports, the production of documents, and the appearance of witnesses as though the applicable terms and conditions of the Federal Trade Commission Act were part of this title. Any person violating any of the provisions of this title shall be subject to the penalties and entitled to the privileges and immunities provided in the Federal Trade Commission Act as though the applicable terms and provisions thereof were part of this title.

(2)

(A) In the event of a knowing violation, which constitutes a pattern or practice of violations of this title, the Commission may commence a civil action to recover a civil penalty in a district court of the United States against any person that violates this title. In such action, such person shall be liable for a civil penalty of not more than $2,500 per

violation.

(B) In determining the amount of a civil penalty under subparagraph (A), the court shall take into account the degree of culpability, any history of prior such conduct, ability to pay, effect on ability to continue to do business, and such other matters as justice may require.

(3) Notwithstanding paragraph (2), a court may not impose any civil penalty on a person for a violation of section 1681s-2(a)(1) unless the person has been enjoined from committing the violation, or ordered not to commit the violation, in an action or proceeding brought by or on behalf of the Federal Trade Commission, and has violated the injunction or order, and the court may not impose any civil penalty for any violation occurring before the date of the violation of the injunction or order.

(4) [Deleted]

(b) Enforcement by other agencies

Compliance with the requirements imposed under this title with respect to consumer reporting agencies, persons who use consumer reports from such agencies, persons who furnish information to such agencies, and users of information that are subject to subsection (d) of section 1681m(d) shall be enforced under--

(1) section 1818 of title 12, in the case of--

(A) national banks, and Federal branches and Federal agencies of foreign banks, by the Office of the Comptroller of the Currency;

(B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act, by the Board of Governors of the Federal Reserve System; and

(C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System) and insured State branches of foreign banks, by the Board of Directors of the Federal Deposit Insurance Corporation;

(2) section 1818 of title 12, by the Director of the Office of Thrift Supervision, in the case of a savings association the deposits of which are insured by the Federal Deposit Insurance Corporation;

(3) the Federal Credit Union Act [*12 U.S.C. 1751 et seq.*], by the Administrator of the National Credit Union Administration [National Credit Union Administration Board] with respect to any Federal credit union;

(4) subtitle IV of title 49, by the Secretary of Transportation, with respect to all carriers subject to the jurisdiction of the Surface Transportation Board.

(5) part A of subtitle VII of title 49, by the Secretary of Transportation with respect to any air carrier or foreign air carrier subject to that Act; and

(6) the Packers and Stockyards Act, 1921 [*7 U.S.C. 181 et seq.*] (except as provided in section 406 of that Act [*7 U.S.C. 226, 227*]), by the Secretary of Agriculture with respect to any activities subject to that Act.

The terms used in paragraph (1) that are not defined in this subchapter or otherwise defined in section 1813(s) of title 12) shall have the meaning given to them in section 3101(b) of title 12.

(c) State action for violations

(1) Authority of States. In addition to such other remedies as are provided under State law, if the chief law enforcement officer of a State, or an official or agency designated by a State, has reason to believe that any person has violated or is violating this subchapter, the State--

(A) may bring an action to enjoin such violation in any appropriate United States district court or in any other court of competent jurisdiction;

(B) subject to paragraph (5), may bring an action on behalf of the residents of the State to recover--

(i) damages for which the person is liable to such residents under sections 1681n and 1681o of this title as a result of the violation;

(ii) in the case of a violation described in any of paragraphs (1) through (3) of section 1681s-2(c) of this title, damages for which the person would, but for section 1681s-2(c) of this title, be liable to such residents as a result of the violation; or

(iii) damages of not more than $1,000 for each willful or negligent violation; and

(C) in the case of any successful action under subparagraph (A) or (B), shall be awarded the costs of the action and reasonable attorney fees as determined by the court.

(2) Rights of Federal regulators. The State shall serve prior written notice of any action under paragraph (1) upon the Federal Trade Commission or the appropriate Federal regulator determined under subsection (b) of this section and provide the Commission or appropriate Federal regulator with a copy of its complaint, except in any case in which such prior notice is not feasible, in which case the State shall serve such notice immediately upon instituting such action. The Federal Trade Commission or appropriate Federal regulator shall have the right--

(A) to intervene in the action;

(B) upon so intervening, to be heard on all matters arising therein;

(C) to remove the action to the appropriate United States district court; and

(D) to file petitions for appeal.

(3) Investigatory powers. For purposes of bringing any action under this subsection, nothing in this subsection shall prevent the chief law enforcement officer, or an official or agency designated by a State, from exercising the powers conferred on the chief law enforcement officer or such official by the laws of such State to conduct investigations or to administer oaths or affirmations or to compel the attendance of witnesses or the production of documentary and other evidence.

(4) Limitation on State action while Federal action pending. If the Federal Trade Commission or the appropriate Federal regulator has instituted a civil action or an administrative action under section 8 of the Federal Deposit Insurance Act for a violation of this subchapter, no State may, during the pendency of such action, bring an action under this section against any defendant named in the complaint of the Commission or the appropriate Federal regulator for any violation of this subchapter that is alleged in that complaint.

(5) Limitations on state actions for certain violations

(A) Violation of injunction required. A State may not bring an action against a person under paragraph (1)(B) for a violation described in any of paragraphs (1) through (3) of section 1681s-2(c), unless--

(i) the person has been enjoined from committing the violation, in an action brought by the State under paragraph (1)(A); and

(ii) the person has violated the injunction.

(B) Limitation on damages recoverable. In an action against a person under paragraph (1)(B) for a violation described in any of paragraphs (1) through (3) of section 1681s-2(c) of this title, a State may not recover any damages incurred before the date of the violation of an injunction on which the action is based.

(d) Enforcement by other agencies

For the purpose of the exercise by any agency referred to in subsection (b) of its powers under any Act referred to in that subsection, a violation of any requirement imposed under this subchapter shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in subsection (b), each of the agencies referred to in that subsection may exercise, for the purpose of enforcing compliance with any requirement imposed under this subchapter any other authority conferred on it by law.

(e) Regulatory authority

(1) The Federal banking agencies referred to in paragraphs (1) and (2) of subsection (b) shall jointly prescribe such regulations as necessary to carry out the purposes of this Act with respect to any persons identified under paragraphs (1) and (2) of subsection (b), and the Board of Governors of the Federal Reserve System shall have authority to prescribe regulations consistent with such joint regulations with respect to bank holding companies and affiliates (other than depository institutions and consumer reporting agencies) of such holding companies.

(2) The Board of the National Credit Union Administration shall prescribe such regulations as necessary to carry out the purposes of this Act with respect to any persons identified under paragraph (3) of subsection (b).

(f) Coordination of consumer complaint investigations

(1) In general. Each consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] shall develop and maintain procedures for the referral to each other such agency of any consumer complaint received by the agency alleging identity theft, or requesting a fraud alert under section 605A [*15 USC § 1681c-1*] or a block under section 605B [*15 USC § 1681c-2*].

(2) Model form and procedure for reporting identity theft. The Commission, in consultation with the Federal banking agencies and the National Credit Union Administration, shall develop a model form and model procedures to be used by consumers who are victims of identity theft for contacting and informing creditors and consumer reporting agencies of the fraud.

(3) Annual summary reports. Each consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] shall submit an annual summary report to the Commission on consumer complaints received by the agency on identity theft or fraud alerts.

(g) FTC regulation of coding of trade names

If the Commission determines that a person described in paragraph (9) of section 1681s-2(a) has not met the requirements of such paragraph, the Commission shall take action to ensure the person's compliance with such paragraph, which may include issuing model guidance or prescribing reasonable policies and procedures, as necessary to ensure that such person complies with such paragraph.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681s-1

§ 1681s-1 Information on overdue child support obligations.

Notwithstanding any other provision of this subchapter, a consumer reporting agency shall include in any consumer report furnished by the agency in accordance with section 1681b of this title, any information on the failure of the consumer to pay overdue support which--

(1) is provided--

(A) to the consumer reporting agency by a State or local child support enforcement agency; or

(B) to the consumer reporting agency and verified by any local, State, or Federal Government agency; and

(2) antedates the report by 7 years or less.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681s-2

§ 1681s-2 Responsibilities of furnishers of information to consumer reporting agencies.

(a) Duty of furnishers of information to provide accurate information

(1) Prohibition

(A) Reporting information with actual knowledge of errors

A person shall not furnish any information relating to a consumer to any consumer reporting agency if the person knows or has reasonable cause to believe that the information is inaccurate.

(B) Reporting information after notice and confirmation of errors

A person shall not furnish information relating to a consumer to any consumer reporting agency if--

(i) the person has been notified by the consumer, at the address specified by the person for such notices, that specific information is inaccurate; and

(ii) the information is, in fact, inaccurate.

(C) No address requirement

A person who clearly and conspicuously specifies to the consumer an address for notices referred to in subparagraph (B) shall not be subject to subparagraph (A); however, nothing in subparagraph (B) shall require a person to specify such an address.

(D) Definition

For purposes of subparagraph (A), the term "reasonable cause to believe that the information is inaccurate" means having specific knowledge, other than solely allegations by the consumer, that would cause a reasonable person to have substantial doubts about the accuracy of the information.

(2) Duty to correct and update information

A person who--

(A) regularly and in the ordinary course of business furnishes information to one or more consumer reporting agencies about the person's transactions or experiences with any consumer; and

(B) has furnished to a consumer reporting agency information that the person determines is not complete or accurate,

shall promptly notify the consumer reporting agency of that determination and provide to the agency any corrections to that information, or any additional information, that is necessary to make the information provided by the person to the agency complete and accurate, and shall not thereafter furnish to the agency any of the information that remains not complete or accurate.

(3) Duty to provide notice of dispute

If the completeness or accuracy of any information furnished by any person to any consumer reporting agency is disputed to such person by a consumer, the person may not furnish the information to any consumer reporting agency without notice that such information is disputed by the consumer.

(4) Duty to provide notice of closed accounts

A person who regularly and in the ordinary course of business furnishes information to a consumer reporting agency regarding a consumer who has a credit account with that person shall notify the agency of the voluntary closure of the account by the consumer, in information regularly furnished for the period in which the account is closed.

(5) Duty to provide notice of delinquency of accounts

(A) In general. A person who furnishes information to a consumer reporting agency regarding a delinquent account being placed for collection, charged to profit or loss, or subjected to any similar action shall, not later than 90 days after furnishing the information, notify the agency of the date of delinquency on the account, which shall be the month and year of the commencement of the delinquency on the account that immediately preceded the action.

(B) Rule of construction. For purposes of this paragraph only, and provided that the consumer does not dispute the information, a person that furnishes information on a delinquent account that is placed for collection, charged for profit or loss, or subjected to any similar action, complies with this paragraph, if--

(i) the person reports the same date of delinquency as that provided by the creditor to which the account was owed at the time at which the commencement of the delinquency occurred, if the creditor previously reported that date of delinquency to a consumer reporting agency;

(ii) the creditor did not previously report the date of delinquency to a consumer reporting agency, and the person establishes and follows reasonable procedures to obtain the date of delinquency from the creditor or another reliable source and reports that date to a consumer reporting agency as the date of delinquency; or

(iii) the creditor did not previously report the date of delinquency to a consumer reporting agency and the date of delinquency cannot be reasonably obtained as provided in clause (ii), the person establishes and follows reasonable procedures to ensure the date reported as the date of delinquency precedes the date on which the account is placed for collection, charged to profit or loss, or subjected to any similar action, and reports such date to the credit reporting agency.

(6) Duties of furnishers upon notice of identity theft-related information

(A) Reasonable procedures. A person that furnishes information to any consumer reporting agency shall have in place reasonable procedures to respond to any notification that it receives from a consumer reporting agency under section 605B [*15 USC § 1681c-2*] relating to information resulting from identity theft, to prevent that person from refurnishing such blocked information.

(B) Information alleged to result from identity theft. If a consumer submits an identity theft report to a person who

furnishes information to a consumer reporting agency at the address specified by that person for receiving such reports stating that information maintained by such person that purports to relate to the consumer resulted from identity theft, the person may not furnish such information that purports to relate to the consumer to any consumer reporting agency, unless the person subsequently knows or is informed by the consumer that the information is correct.

(7) Negative information

(A) Notice to consumer required.

(i) In general. If any financial institution that extends credit and regularly and in the ordinary course of business furnishes information to a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] furnishes negative information to such an agency regarding credit extended to a customer, the financial institution shall provide a notice of such furnishing of negative information, in writing, to the customer.

(ii) Notice effective for subsequent submissions. After providing such notice, the financial institution may submit additional negative information to a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] with respect to the same transaction, extension of credit, account, or customer without providing additional notice to the customer.

(B) Time of notice.

(i) In general. The notice required under subparagraph (A) shall be provided to the customer prior to, or no later than 30 days after, furnishing the negative information to a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*].

(ii) Coordination with new account disclosures. If the notice is provided to the customer prior to furnishing the negative information to a consumer reporting agency, the notice may not be included in the initial disclosures provided under section 127(a) of the Truth in Lending Act [*15 USC § 1637(a)*].

(C) Coordination with other disclosures. The notice required under subparagraph (A)--

(i) may be included on or with any notice of default, any billing statement, or any other materials provided to the customer; and

(ii) must be clear and conspicuous.

(D) Model disclosure.

(i) Duty of Board to prepare. The Board shall prescribe a brief model disclosure a financial institution may use to comply with subparagraph (A), which shall not exceed 30 words.

(ii) Use of model not required. No provision of this paragraph shall be construed as requiring a financial institution to use any such model form prescribed by the Board.

(iii) Compliance using model. A financial institution shall be deemed to be in compliance with subparagraph (A) if the financial institution uses any such model form prescribed by the Board, or the financial institution uses any such model form and rearranges its format.

(E) Use of notice without submitting negative information. No provision of this paragraph shall be construed as requiring a financial institution that has provided a customer with a notice described in subparagraph (A) to furnish negative information about the customer to a consumer reporting agency.

(F) Safe harbor. A financial institution shall not be liable for failure to perform the duties required by this paragraph if, at the time of the failure, the financial institution maintained reasonable policies and procedures to comply with this paragraph or the financial institution reasonably believed that the institution is prohibited, by law, from contacting the consumer.

(G) Definitions. For purposes of this paragraph, the following definitions shall apply:

(i) Negative information. The term "negative information" means information concerning a customer's delinquencies, late payments, insolvency, or any form of default.

(ii) Customer; financial institution. The terms "customer" and "financial institution" have the same meanings as in section *509 Public Law 106-102* [*15 USC § 6809*].

(8) Ability of consumer to dispute information directly with furnisher

(A) In general. The Federal banking agencies, the National Credit Union Administration, and the Commission shall jointly prescribe regulations that shall identify the circumstances under which a furnisher shall be required to reinvestigate a dispute concerning the accuracy of information contained in a consumer report on the consumer, based on a direct request of a consumer.

(B) Considerations. In prescribing regulations under subparagraph (A), the agencies shall weigh--

(i) the benefits to consumers with the costs on furnishers and the credit reporting system;

(ii) the impact on the overall accuracy and integrity of consumer reports of any such requirements;

(iii) whether direct contact by the consumer with the furnisher would likely result in the most expeditious resolution of any such dispute; and

(iv) the potential impact on the credit reporting process if credit repair organizations, as defined in section 403(3) [*15 USC § 1679a(3)*], including entities that would be a credit repair organization, but for section 403(3)(B)(i) [*15 USC § 1679a(3)(B)(i)*], are able to circumvent the prohibition in subparagraph (G).

(C) Applicability. Subparagraphs (D) through (G) shall apply in any circumstance identified under the regulations promulgated under subparagraph (A).

(D) Submitting a notice of dispute. A consumer who seeks to dispute the accuracy of information shall provide a dispute notice directly to such person at the address specified by the person for such notices that--

(i) identifies the specific information that is being disputed;

(ii) explains the basis for the dispute; and

(iii) includes all supporting documentation required by the furnisher to substantiate the basis of the dispute.

(E) Duty of person after receiving notice of dispute. After receiving a notice of dispute from a consumer pursuant to subparagraph (D), the person that provided the information in dispute to a consumer reporting agency shall--

(i) conduct an investigation with respect to the disputed information;

(ii) review all relevant information provided by the consumer with the notice;

(iii) complete such person's investigation of the dispute and report the results of the investigation to the consumer before the expiration of the period under section 611(a)(1) [*15 USC § 1681i(a)(1)*] within which a consumer reporting agency would be required to complete its action if the consumer had elected to dispute the information under that section; and

(iv) if the investigation finds that the information reported was inaccurate, promptly notify each consumer reporting agency to which the person furnished the inaccurate information of that determination and provide to the agency any correction to that information that is necessary to make the information provided by the person accurate.

(F) Frivolous or irrelevant dispute.

(i) In general. This paragraph shall not apply if the person receiving a notice of a dispute from a consumer reasonably determines that the dispute is frivolous or irrelevant, including--

(I) by reason of the failure of a consumer to provide sufficient information to investigate the disputed information; or

(II) the submission by a consumer of a dispute that is substantially the same as a dispute previously submitted by or for the consumer, either directly to the person or through a consumer reporting agency under subsection (b), with respect to which the person has already performed the person's duties under this paragraph or subsection (b), as applicable.

(ii) Notice of determination. Upon making any determination under clause (i) that a dispute is frivolous or irrelevant, the person shall notify the consumer of such determination not later than 5 business days after making such determination, by mail or, if authorized by the consumer for that purpose, by any other means available to the person.

(iii) Contents of notice. A notice under clause (ii) shall include--

(I) the reasons for the determination under clause (i); and

(II) identification of any information required to investigate the disputed information, which may consist of a standardized form describing the general nature of such information.

(G) Exclusion of credit repair organizations. This paragraph shall not apply if the notice of the dispute is submitted by, is prepared on behalf of the consumer by, or is submitted on a form supplied to the consumer by, a credit repair organization, as defined in section 403(3) [*15 USC § 1679a(3)*], or an entity that would be a credit repair organization, but for section 403(3)(B)(i) [*15 USC § 1679a(3)(B)(i)*].

(9) Duty to provide notice of status as medical information furnisher A person whose primary business is providing medical services, products, or devices, or the person's agent or assignee, who furnishes information to a consumer reporting agency on a consumer shall be considered a medical information furnisher for purposes of this title, and shall notify the agency of such status.

(b) Duties of furnishers of information upon notice of dispute

(1) In general

After receiving notice pursuant to section 1681i(a)(2) of this title of a dispute with regard to the completeness or accuracy of any information provided by a person to a consumer reporting agency, the person shall--

(A) conduct an investigation with respect to the disputed information;

(B) review all relevant information provided by the consumer reporting agency pursuant to section 1681i(a)(2) of this title;

(C) report the results of the investigation to the consumer reporting agency;

(D) if the investigation finds that the information is incomplete or inaccurate, report those results to all other consumer reporting agencies to which the person furnished the information and that compile and maintain files on consumers on a nationwide basis; and

(E) if an item of information disputed by a consumer is found to be inaccurate or incomplete or cannot be verified after any reinvestigation under paragraph (1), for purposes of reporting to a consumer reporting agency only, as appropriate, based on the results of the reinvestigation promptly--

(i) modify that item of information;

(ii) delete that item of information; or

(iii) permanently block the reporting of that item of information.

(2) Deadline

A person shall complete all investigations, reviews, and reports required under paragraph (1) regarding information provided by the person to a consumer reporting agency, before the expiration of the period under section 1681i(a)(1) of this title within which the consumer reporting agency is required to complete actions required by that section regarding that information.

(c) Limitation on liability

Except as provided in section 621(c)(1)(B) [*15 USC § 1681s(c)(1)(B)*], sections 616 and 617 [*15 USC §§ 1681n*, *1681o*] do not apply to any violation of--

(1) subsection (a) of this section, including any regulations issued thereunder;

(2) subsection (e) of this section, except that nothing in this paragraph shall limit, expand, or otherwise affect liability under section 616 or 617 [*15 USC § 1681n* or *1681o*], as applicable, for violations of subsection (b) of this section; or

(3) subsection (e) of section 615 [*15 USC § 1681m*].

(d) Limitation on enforcement

The provisions of law described in paragraphs (1) through (3) of subsection (c) (other than with respect to the exception described in paragraph (2) of subsection (c)) shall be enforced exclusively as provided under section 621 [*15 USC § 1681s*] by the Federal agencies and officials and the State officials identified in section 621 [*15 USC § 1681s*].

(e) Accuracy guidelines and regulations required

(1) Guidelines. The Federal banking agencies, the National Credit Union Administration, and the Commission shall, with respect to the entities that are subject to their respective enforcement authority under section 621 [*15 USC § 1681s*], and in coordination as described in paragraph (2)--

(A) establish and maintain guidelines for use by each person that furnishes information to a consumer reporting agency regarding the accuracy and integrity of the information relating to consumers that such entities furnish to consumer reporting agencies, and update such guidelines as often as necessary; and

(B) prescribe regulations requiring each person that furnishes information to a consumer reporting agency to establish reasonable policies and procedures for implementing the guidelines established pursuant to subparagraph (A).

(2) Coordination. Each agency required to prescribe regulations under paragraph (1) shall consult and coordinate with each other such agency so that, to the extent possible, the regulations prescribed by each such entity are consistent and comparable with the regulations prescribed by each other such agency.

(3) Criteria. In developing the guidelines required by paragraph (1)(A), the agencies described in paragraph (1) shall--

(A) identify patterns, practices, and specific forms of activity that can compromise the accuracy and integrity of information furnished to consumer reporting agencies;

(B) review the methods (including technological means) used to furnish information relating to consumers to consumer reporting agencies;

(C) determine whether persons that furnish information to consumer reporting agencies maintain and enforce policies to assure the accuracy and integrity of information furnished to consumer reporting agencies; and

(D) examine the policies and processes that persons that furnish information to consumer reporting agencies employ to conduct reinvestigations and correct inaccurate information relating to consumers that has been furnished to consumer reporting agencies.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1681s-3

§ **1681s-3 Affiliate sharing.**

(a) Special rule for solicitation for purposes of marketing

(1) Notice. Any person that receives from another person related to it by common ownership or affiliated by corporate control a communication of information that would be a consumer report, but for clauses (i), (ii), and (iii) of section 603(d)(2)(A) [*15 USC § 1681a(d)(2)(A)*], may not use the information to make a solicitation for marketing purposes to a consumer about its products or services, unless--

(A) it is clearly and conspicuously disclosed to the consumer that the information may be communicated among such persons for purposes of making such solicitations to the consumer; and

(B) the consumer is provided an opportunity and a simple method to prohibit the making of such solicitations to the consumer by such person.

(2) Consumer choice

(A) In general. The notice required under paragraph (1) shall allow the consumer the opportunity to prohibit all solicitations referred to in such paragraph, and may allow the consumer to choose from different options when electing to prohibit the sending of such solicitations, including options regarding the types of entities and information covered,

and which methods of delivering solicitations the consumer elects to prohibit.

(B) Format. Notwithstanding subparagraph (A), the notice required under paragraph (1) shall be clear, conspicuous, and concise, and any method provided under paragraph (1)(B) shall be simple. The regulations prescribed to implement this section shall provide specific guidance regarding how to comply with such standards.

(3) Duration

(A) In general. The election of a consumer pursuant to paragraph (1)(B) to prohibit the making of solicitations shall be effective for at least 5 years, beginning on the date on which the person receives the election of the consumer, unless the consumer requests that such election be revoked.

(B) Notice upon expiration of effective period. At such time as the election of a consumer pursuant to paragraph (1)(B) is no longer effective, a person may not use information that the person receives in the manner described in paragraph (1) to make any solicitation for marketing purposes to the consumer, unless the consumer receives a notice and an opportunity, using a simple method, to extend the opt-out for another period of at least 5 years, pursuant to the procedures described in paragraph (1).

(4) Scope. This section shall not apply to a person--

(A) using information to make a solicitation for marketing purposes to a consumer with whom the person has a pre-existing business relationship;

(B) using information to facilitate communications to an individual for whose benefit the person provides employee benefit or other services pursuant to a contract with an employer related to and arising out of the current employment relationship or status of the individual as a participant or beneficiary of an employee benefit plan;

(C) using information to perform services on behalf of another person related by common ownership or affiliated by corporate control, except that this subparagraph shall not be construed as permitting a person to send solicitations on behalf of another person, if such other person would not be permitted to send the solicitation on its own behalf as a result of the election of the consumer to prohibit solicitations under paragraph (1)(B);

(D) using information in response to a communication initiated by the consumer;

(E) using information in response to solicitations authorized or requested by the consumer; or

(F) if compliance with this section by that person would prevent compliance by that person with any provision of State insurance laws pertaining to unfair discrimination in any State in which the person is lawfully doing business.

(5) No retroactivity. This subsection shall not prohibit the use of information to send a solicitation to a consumer if such information was received prior to the date on which persons are required to comply with regulations implementing this subsection.

(b) Notice for other purposes permissible

A notice or other disclosure under this section may be coordinated and consolidated with any other notice required to be issued under any other provision of law by a person that is subject to this section, and a notice or other disclosure that is equivalent to the notice required by subsection (a), and that is provided by a person described in subsection (a) to a consumer together with disclosures required by any other provision of law, shall satisfy the requirements of subsection (a).

(c) User requirements

Requirements with respect to the use by a person of information received from another person related to it by common ownership or affiliated by corporate control, such as the requirements of this section, constitute requirements with respect to the exchange of information among persons affiliated by common ownership or common corporate control, within the meaning of section 625(b)(2) [*15 USC § 1681t(b)(2)*].

(d) Definitions

For purposes of this section, the following definitions shall apply:

(1) Pre-existing business relationship. The term "pre-existing business relationship" means a relationship between a person, or a person's licensed agent, and a consumer, based on--

(A) a financial contract between a person and a consumer which is in force;

(B) the purchase, rental, or lease by the consumer of that person's goods or services, or a financial transaction

(including holding an active account or a policy in force or having another continuing relationship) between the consumer and that person during the 18-month period immediately preceding the date on which the consumer is sent a solicitation covered by this section;

(C) an inquiry or application by the consumer regarding a product or service offered by that person, during the 3-month period immediately preceding the date on which the consumer is sent a solicitation covered by this section; or

(D) any other pre-existing customer relationship defined in the regulations implementing this section.

(2) Solicitation. The term "solicitation" means the marketing of a product or service initiated by a person to a particular consumer that is based on an exchange of information described in subsection (a), and is intended to encourage the consumer to purchase such product or service, but does not include communications that are directed at the general public or determined not to be a solicitation by the regulations prescribed under this section.

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§ **1681t Relation to State laws.**

(a) In general

Except as provided in subsections (b) and (c) of this section, this subchapter does not annul, alter, affect, or exempt any person subject to the provisions of this subchapter from complying with the laws of any State with respect to the collection, distribution, or use of any information on consumers, or for the prevention or mitigation of identity theft, except to the extent that those laws are inconsistent with any provision of this subchapter, and then only to the extent of the inconsistency.

(b) General exceptions

No requirement or prohibition may be imposed under the laws of any State--

(1) with respect to any subject matter regulated under--

(A) subsection (c) or (e) of section 1681b of this title, relating to the prescreening of consumer reports;

(B) section 1681i of this title, relating to the time by which a consumer reporting agency must take any action, including the provision of notification to a consumer or other person, in any procedure related to the disputed accuracy of information in a consumer's file, except that this subparagraph shall not apply to any State law in effect on September 30, 1996;

(C) subsections (a) and (b) of section 1681m of this title, relating to the duties of a person who takes any adverse action with respect to a consumer;

(D) section 1681m(d) of this title, relating to the duties of persons who use a consumer report of a consumer in connection with any credit or insurance transaction that is not initiated by the consumer and that consists of a firm offer of credit or insurance;

(E) section 1681c of this title, relating to information contained in consumer reports, except that this subparagraph shall not apply to any State law in effect on the date of enactment of the Consumer Credit Reporting Reform Act of 1996 [September 30, 1996];

(F) section 1681s-2 of this title, relating to the responsibilities of persons who furnish information to consumer reporting agencies, except that this paragraph shall not apply--

(i) with respect to section 54A(a) of chapter 93 of the Massachusetts Annotated Laws (as in effect on the date of enactment of the Consumer Credit Reporting Reform Act of 1996 [September 30, 1996]); or

(ii) with respect to *section 1785.25(a) of the California Civil Code* (as in effect on the date of enactment of the Consumer Credit Reporting Reform Act of 1996 [September 30, 1996]);

(G) section 609(e) [*15 USC § 1681g(e)*], relating to information available to victims under section 609(e) [*15 USC § 1681g(e)*];

(H) section 624 [*15 USC § 1681s-3*], relating to the exchange and use of information to make a solicitation for marketing purposes; or

(I) section 615(h) [*15 USC § 1681m(h)*], relating to the duties of users of consumer reports to provide notice with respect to terms in certain credit transactions;

(2) with respect to the exchange of information among persons affiliated by common ownership or common corporate control, except that this paragraph shall not apply with respect to subsection (a) or (c)(1) of section 2480e of title 9, Vermont Statutes Annotated (as in effect on September 30, 1996);

(3) with respect to the disclosures required to be made under subsection (c), (d), (e), or (g) of section 609 [*15 USC § 1681g*], or subsection (f) of section 609 [*15 USC § 1681g*] relating to the disclosure of credit scores for credit granting purposes, except that this paragraph--

(A) shall not apply with respect to sections 1785.10, 1785.16, and 1785.20.2 of the California Civil Code (as in effect on the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003]) and section 1785.15 through section 1785.15.2 of such Code (as in effect on such date);

(B) shall not apply with respect to sections 5-3-106(2) and 212-14.3-104.3 of the Colorado Revised Statutes (as in effect on the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003]); and

(C) shall not be construed as limiting, annulling, affecting, or superseding any provision of the laws of any State regulating the use in an insurance activity, or regulating disclosures concerning such use, of a credit-based insurance score of a consumer by any person engaged in the business of insurance;

(4) with respect to the frequency of any disclosure under section 612(a) [*15 USC § 1681j(a)*], except that this paragraph shall not apply--

(A) with respect to *section 12-14.3-105(1)(d) of the Colorado Revised Statutes* (as in effect on the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003]);

(B) with respect to *section 10-1-393(29)(C) of the Georgia Code* (as in effect on the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003]);

(C) with respect to section 1316.2 of title 10 of the Maine Revised Statutes (as in effect on the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003]);

(D) with respect to sections 14-1209(a)(1) and 14-1209(b)(1)(i) of the Commercial Law Article of the Code of Maryland (as in effect on the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003]);

(E) with respect to section 59(d) and section 59(e) of chapter 93 of the General Laws of Massachusetts (as in effect

on the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003]);

(F) with respect to section 56:11-37.10(a)(1) of the New Jersey Revised Statutes (as in effect on the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003]); or

(G) with respect to section 2480c(a)(1) of title 9 of the Vermont Statutes Annotated (as in effect on the date of enactment of the Fair and Accurate Credit Transactions Act of 2003 [enacted Dec. 4, 2003]); or

(5) with respect to the conduct required by the specific provisions of--

(A) section 605(g) [*15 USC § 1681c(g)*];

(B) section 605A [*15 USC § 1681c-1*];

(C) section 605B [*15 USC § 1681c-2*];

(D) section 609(a)(1)(A) [*15 USC § 1681g(a)(1)(A)*];

(E) section 612(a) [*15 USC § 1681j(a)*];

(F) subsections (e), (f), and (g) of section 615 [*15 USC § 1681m*];

(G) section 621(f) [*15 USC § 1681s(f)*];

(H) section 623(a)(6) [*15 USC § 1681s-2(a)(6)*]; or

(I) section 628 [*15 USC § 1681w*].

(c) Definition of firm offer of credit or insurance

Notwithstanding any definition of the term "firm offer of credit or insurance" (or any equivalent term) under the laws of any State, the definition of that term contained in section 1681a(l) of this title shall be construed to apply in the enforcement and interpretation of the laws of any State governing consumer reports.

(d) Limitations

Subsections (b) and (c) do not affect any settlement, agreement, or consent judgment between any State Attorney General and any consumer reporting agency in effect on the date of enactment of the Consumer Credit Reporting Reform Act of 1996 [September 30, 1996].

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§ 1681u Disclosures to FBI for counterintelligence purposes.

(a) Identity of financial institutions

Notwithstanding section 604 [*15 USC § 1681b*] or any other provision of this title, a consumer reporting agency shall furnish to the Federal Bureau of Investigation the names and addresses of all financial institutions (as that term is defined in section 1101 of the Right to Financial Privacy Act of 1978) at which a consumer maintains or has maintained an account, to the extent that information is in the files of the agency, when presented with a written request for that information, signed by the Director of the Federal Bureau of Investigation, or the Director's designee in a position not lower than Deputy Assistant Director at Bureau headquarters or a Special Agent in Charge of a Bureau field office designated by the Director, which certifies compliance with this section. The Director or the Director's designee may make such a certification only if the Director or the Director's designee has determined in writing, that such information is sought for the conduct of an authorized investigation to protect against international terrorism or clandestine intelligence activities, provided that such an investigation of a United States person is not conducted solely upon the basis of activities protected by the first amendment to the Constitution of the United States.

(b) Identifying information

Notwithstanding the provisions of section 604 [*15 USC § 1681b*] or any other provision of this title, a consumer reporting agency shall furnish identifying information respecting a consumer, limited to name, address, former addresses, places of employment, or former places of employment, to the Federal Bureau of Investigation when presented with a written request, signed by the Director or the Director's designee in a position not lower than Deputy Assistant Director at Bureau headquarters or a Special Agent in Charge of a Bureau field office designated by the Director, which certifies compliance with this subsection. The Director or the Director's designee may make such a certification only if the Director or the Director's designee has determined in writing that such information is sought for the conduct of an authorized investigation to protect against international terrorism or clandestine intelligence activities, provided that such an investigation of a United States person is not conducted solely upon the basis of activities protected by the first amendment to the Constitution of the United States.

(c) Court order for disclosure of consumer reports

Notwithstanding section 604 [*15 USC § 1681b*] or any other provision of this title, if requested in writing by the Director of the Federal Bureau of Investigation, or a designee of the Director in a position not lower than Deputy Assistant Director at Bureau headquarters or a Special Agent in Charge in a Bureau field office designated by the Director, a court may issue an order ex parte directing a consumer reporting agency to furnish a consumer report to the Federal Bureau of Investigation, upon a showing in camera that the consumer report is sought for the conduct of an authorized investigation to protect against international terrorism or clandestine intelligence activities, provided that such an investigation of a United States person is not conducted solely upon the basis of activities protected by the first amendment to the Constitution of the United States. The terms of an order issued under this subsection shall not disclose that the order is issued for purposes of a counterintelligence investigation.

(d) Confidentiality

(1) If the Director of the Federal Bureau of Investigation, or his designee in a position not lower than Deputy Assistant Director at Bureau headquarters or a Special Agent in Charge in a Bureau field office designated by the Director, certifies that otherwise there may result a danger to the national security of the United States, interference with a criminal, counterterrorism, or counterintelligence investigation, interference with diplomatic relations, or danger to the life or physical safety of any person, no consumer reporting agency or officer, employee, or agent of a consumer reporting agency shall disclose to any person (other than those to whom such disclosure is necessary to comply with the request or an attorney to obtain legal advice or legal assistance with respect to the request) that the Federal Bureau of Investigation has sought or obtained the identity of financial institutions or a consumer report respecting any consumer under subsection (a), (b), or (c), and no consumer reporting agency or officer, employee, or agent of a consumer reporting agency shall include in any consumer report any information that would indicate that the Federal Bureau of Investigation has sought or obtained such information on a consumer report.

(2) The request shall notify the person or entity to whom the request is directed of the nondisclosure requirement under paragraph (1).

(3) Any recipient disclosing to those persons necessary to comply with the request or to an attorney to obtain legal advice or legal assistance with respect to the request shall inform such persons of any applicable nondisclosure requirement. Any person who receives a disclosure under this subsection shall be subject to the same prohibitions on disclosure under paragraph (1).

(4) At the request of the Director of the Federal Bureau of Investigation or the designee of the Director, any person making or intending to make a disclosure under this section shall identify to the Director or such designee the person to whom such disclosure will be made or to whom such disclosure was made prior to the request, except that nothing in this section shall require a person to inform the Director or such designee of the identity of an attorney to whom disclosure was made or will be made to obtain legal advice or legal assistance with respect to the request for the identity

of financial institutions or a consumer report respecting any consumer under this section.

(e) Payment of fees

The Federal Bureau of Investigation shall, subject to the availability of appropriations, pay to the consumer reporting agency assembling or providing report or information in accordance with procedures established under this section a fee for reimbursement for such costs as are reasonably necessary and which have been directly incurred in searching, reproducing, or transporting books, papers, records, or other data required or requested to be produced under this section.

(f) Limit on dissemination

The Federal Bureau of Investigation may not disseminate information obtained pursuant to this section outside of the Federal Bureau of Investigation, except to other Federal agencies as may be necessary for the approval or conduct of a foreign counterintelligence investigation, or, where the information concerns a person subject to the Uniform Code of Military Justice, to appropriate investigative authorities within the military department concerned as may be necessary for the conduct of a joint foreign counterintelligence investigation.

(g) Rules of construction

Nothing in this section shall be construed to prohibit information from being furnished by the Federal Bureau of Investigation pursuant to a subpoena or court order, in connection with a judicial or administrative proceeding to enforce the provisions of this Act. Nothing in this section shall be construed to authorize or permit the withholding of information from the Congress.

(h) Reports to Congress

(1) On a semiannual basis, the Attorney General shall fully inform the Permanent Select Committee on Intelligence and the Committee on Banking, Finance and Urban Affairs of the House of Representatives, and the Select Committee on Intelligence and the Committee on Banking, Housing, and Urban Affairs of the Senate concerning all requests made pursuant to subsections (a), (b), and (c).

(2) In the case of the semiannual reports required to be submitted under paragraph (1) to the Permanent Select Committee on Intelligence of the House of Representatives and the Select Committee on Intelligence of the Senate, the submittal dates for such reports shall be as provided in section 507 of the National Security Act of 1947.

(i) Damages

Any agency or department of the United States obtaining or disclosing any consumer reports, records, or information contained therein in violation of this section is liable to the consumer to whom such consumer reports, records, or information relate in an amount equal to the sum of--

(1) $100, without regard to the volume of consumer reports, records, or information involved;

(2) any actual damages sustained by the consumer as a result of the disclosure;

(3) if the violation is found to have been willful or intentional, such punitive damages as a court may allow; and

(4) in the case of any successful action to enforce liability under this subsection, the costs of the action, together with reasonable attorney fees, as determined by the court.

(j) Disciplinary actions for violations

If a court determines that any agency or department of the United States has violated any provision of this section and the court finds that the circumstances surrounding the violation raise questions of whether or not an officer or employee of the agency or department acted willfully or intentionally with respect to the violation, the agency or department shall promptly initiate a proceeding to determine whether or not disciplinary action is warranted against the officer or employee who was responsible for the violation.

(k) Good-faith exception

Notwithstanding any other provision of this title, any consumer reporting agency or agent or employee thereof making disclosure of consumer reports or identifying information pursuant to this subsection in good-faith reliance upon a certification of the Federal Bureau of Investigation pursuant to provisions of this section shall not be liable to any person for such disclosure under this title, the constitution of any State, or any law or regulation of any State or any political subdivision of any State.

(l) Limitation of remedies

Notwithstanding any other provision of this title, the remedies and sanctions set forth in this section shall be the only judicial remedies and sanctions for violation of this section.

(m) Injunctive relief

In addition to any other remedy contained in this section, injunctive relief shall be available to require compliance with the procedures of this section. In the event of any successful action under this subsection, costs together with reasonable attorney fees, as determined by the court, may be recovered.

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§ 1681v Disclosures to governmental agencies for counterterrorism purposes.

(a) Disclosure

Notwithstanding section 1681b of this title or any other provision of this chapter, a consumer reporting agency shall furnish a consumer report of a consumer and all other information in a consumer's file to a government agency authorized to conduct investigations of, or intelligence or counterintelligence activities or analysis related to, international terrorism when presented with a written certification by such government agency that such information is necessary for the agency's conduct or such investigation, activity or analysis.

(b) Form of certification

The certification described in subsection (a) of this section shall be signed by a supervisory official designated by the head of a Federal agency or an officer of a Federal agency whose appointment to office is required to be made by the President, by and with the advice and consent of the Senate.

(c) Confidentiality

(1) If the head of a government agency authorized to conduct investigations of intelligence or counterintelligence activities or analysis related to international terrorism, or his designee, certifies that otherwise there may result a danger to the national security of the United States, interference with a criminal, counterterrorism, or counterintelligence investigation, interference with diplomatic relations, or danger to the life or physical safety of any person, no consumer reporting agency or officer, employee, or agent of such consumer reporting agency, shall disclose to any person (other than those to whom such disclosure is necessary to comply with the request or an attorney to obtain legal advice or legal

assistance with respect to the request), or specify in any consumer report, that a government agency has sought or obtained access to information under subsection (a).

(2) The request shall notify the person or entity to whom the request is directed of the nondisclosure requirement under paragraph (1).

(3) Any recipient disclosing to those persons necessary to comply with the request or to any attorney to obtain legal advice or legal assistance with respect to the request shall inform such persons of any applicable nondisclosure requirement. Any person who receives a disclosure under this subsection shall be subject to the same prohibitions on disclosure under paragraph (1).

(4) At the request of the authorized government agency, any person making or intending to make a disclosure under this section shall identify to the requesting official of the authorized government agency the person to whom such disclosure will be made or to whom such disclosure was made prior to the request, except that nothing in this section shall require a person to inform the requesting official of the identity of an attorney to whom disclosure was made or will be made to obtain legal advice or legal assistance with respect to the request for information under subsection (a).

(d) Rule of construction

Nothing in section 626 [*15 USC § 1681u*] of this title shall be construed to limit the authority of the Director of the Federal Bureau of Investigation under this section.

(e) Safe harbor

Notwithstanding any other provision of this title, any consumer reporting agency or agent or employee thereof making disclosure of consumer reports or other information pursuant to this section in good-faith reliance upon a certification of a government agency pursuant to the provisions of this section shall not be liable to any person for such disclosure under this subchapter, the constitution of any State, or any law or regulation of any State or any political subdivision of any State.

(f) Reports to Congress

(1) On a semi-annual basis, the Attorney General shall fully inform the Committee on the Judiciary, the Committee on Financial Services, and the Permanent Select Committee on Intelligence of the House of Representatives and the Committee on the Judiciary, the Committee on Banking, Housing, and Urban Affairs, and the Select Committee on Intelligence of the Senate concerning all requests made pursuant to subsection (a).

(2) In the case of the semiannual reports required to be submitted under paragraph (1) to the Permanent Select Committee on Intelligence of the House of Representatives and the Select Committee on Intelligence of the Senate, the submittal dates for such reports shall be as provided in section 507 of the National Security Act of 1947 (*50 U.S.C. 415b*).

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§ **1681w Disposal of records.**

(a) Regulations.

(1) In general. Not later than 1 year after the date of enactment of this section [enacted Dec. 4, 2003], the Federal banking agencies, the National Credit Union Administration, and the Commission with respect to the entities that are subject to their respective enforcement authority under section 621 [*15 USC § 1681s*], and the Securities and Exchange Commission, and in coordination as described in paragraph (2), shall issue final regulations requiring any person that maintains or otherwise possesses consumer information, or any compilation of consumer information, derived from consumer reports for a business purpose to properly dispose of any such information or compilation.

(2) Coordination. Each agency required to prescribe regulations under paragraph (1) shall--

(A) consult and coordinate with each other such agency so that, to the extent possible, the regulations prescribed by each such agency are consistent and comparable with the regulations by each such other agency; and

(B) ensure that such regulations are consistent with the requirements and regulations issued pursuant to Public Law 106-102 and other provisions of Federal law.

(3) Exemption authority. In issuing regulations under this section, the Federal banking agencies, the National Credit

Union Administration, the Commission, and the Securities and Exchange Commission may exempt any person or class of persons from application of those regulations, as such agency deems appropriate to carry out the purpose of this section.

(b) Rule of construction.

Nothing in this section shall be construed--

(1) to require a person to maintain or destroy any record pertaining to a consumer that is not imposed under other law; or

(2) to alter or affect any requirement imposed under any other provision of law to maintain or destroy such a record.

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§ **1681x Corporate and technological circumvention prohibited.**

The Commission shall prescribe regulations, to become effective not later than 90 days after the date of enactment of this section [enacted Dec. 4, 2003], to prevent a consumer reporting agency from circumventing or evading treatment as a consumer reporting agency described in section 603(p) [*15 USC § 1681a(p)*] for purposes of this title [*15 USC § 1681 et seq.*], including--

(1) by means of a corporate reorganization or restructuring, including a merger, acquisition, dissolution, divestiture, or asset sale of a consumer reporting agency; or

(2) by maintaining or merging public record and credit account information in a manner that is substantially equivalent to that described in paragraphs (1) and (2) of section 603(p) [*15 USC § 1681a(p)*], in the manner described in section 603(p) [*15 USC § 1681a(p)*].

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SUBCHAPTER IV EQUAL CREDIT OPPORTUNITY

[Editor's Note: *15 U.S.C. §§ 1691-1691f* comprise the Equal Credit Opportunity Act.]

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§ **1691 Scope of prohibition.**

(a) Activities constituting discrimination

It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction--

(1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract);

(2) because all or part of the applicant's income derives from any public assistance program; or

(3) because the applicant has in good faith exercised any right under this chapter.

(b) Activities not constituting discrimination

It shall not constitute discrimination for purposes of this subchapter for a creditor--

(1) to make an inquiry of marital status if such inquiry is for the purpose of ascertaining the creditor's rights and remedies applicable to the particular extension of credit and not to discriminate in a determination of credit-worthiness;

(2) to make an inquiry of the applicant's age or of whether the applicant's income derives from any public assistance program if such inquiry is for the purpose of determining the amount and probable continuance of income levels, credit history, or other pertinent element of credit-worthiness as provided in regulations of the Board;

(3) to use any empirically derived credit system which considers age if such system is demonstrably and statistically sound in accordance with regulations of the Board, except that in the operation of such system the age of an elderly applicant may not be assigned a negative factor or value; or

(4) to make an inquiry or to consider the age of an elderly applicant when the age of such applicant is to be used by the creditor in the extension of credit in favor of such applicant.

(c) Additional activities not constituting discrimination

It is not a violation of this section for a creditor to refuse to extend credit offered pursuant to--

(1) any credit assistance program expressly authorized by law for an economically disadvantaged class of persons;

(2) any credit assistance program administered by a nonprofit organization for its members or an economically disadvantaged class of persons; or

(3) any special purpose credit program offered by a profit-making organization to meet special social needs which meets standards prescribed in regulations by the Board;

if such refusal is required by or made pursuant to such program.

(d) Reason for adverse action; procedure applicable; "adverse action" defined

(1) Within thirty days (or such longer reasonable time as specified in regulations of the Board for any class of credit transaction) after receipt of a completed application for credit, a creditor shall notify the applicant of its action on the application.

(2) Each applicant against whom adverse action is taken shall be entitled to a statement of reasons for such action

from the creditor. A creditor satisfies this obligation by--

(A) providing statements of reasons in writing as a matter of course to applicants against whom adverse action is taken; or

(B) giving written notification of adverse action which discloses (i) the applicant's right to a statement of reasons within thirty days after receipt by the creditor of a request made within sixty days after such notification, and (ii) the identity of the person or office from which such statement may be obtained. Such statement may be given orally if the written notification advises the applicant of his right to have the statement of reasons confirmed in writing on written request.

(3) A statement of reasons meets the requirements of this section only if it contains the specific reasons for the adverse action taken.

(4) Where a creditor has been requested by a third party to make a specific extension of credit directly or indirectly to an applicant, the notification and statement of reasons required by this subsection may be made directly by such creditor, or indirectly through the third party, provided in either case that the identity of the creditor is disclosed.

(5) The requirements of paragraph (2), (3), or (4) may be satisfied by verbal statements or notifications in the case of any creditor who did not act on more than one hundred and fifty applications during the calendar year preceding the calendar year in which the adverse action is taken, as determined under regulations of the Board.

(6) For purposes of this subsection, the term "adverse action" means a denial or revocation of credit, a change in the terms of an existing credit arrangement, or a refusal to grant credit in substantially the amount or on substantially the terms requested. Such term does not include a refusal to extend additional credit under an existing credit arrangement where the applicant is delinquent or otherwise in default, or where such additional credit would exceed a previously established credit limit.

(e) Appraisals; copies of reports to applicants; costs

Each creditor shall promptly furnish an applicant, upon written request by the applicant made within a reasonable period of time of the application, a copy of the appraisal report used in connection with the applicant's application for a loan that is or would have been secured by a lien on residential real property. The creditor may require the applicant to reimburse the creditor for the cost of the appraisal.

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§ **1691a Definitions; rules of construction.**

(a) The definitions and rules of construction set forth in this section are applicable for the purposes of this subchapter.

(b) The term "applicant" means any person who applies to a creditor directly for an extension, renewal, or continuation of credit, or applies to a creditor indirectly by use of an existing credit plan for an amount exceeding a previously established credit limit.

(c) The term "Board" refers to the Board of Governors of the Federal Reserve System.

(d) The term "credit" means the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment therefor.

(e) The term "creditor" means any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal, or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew, or continue credit.

(f) The term "person" means a natural person, a corporation, government or governmental subdivision or agency, trust, estate, partnership, cooperative, or association.

(g) Any reference to any requirement imposed under this subchapter or any provision thereof includes reference to the regulations of the Board under this subchapter or the provision thereof in question.

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§ 1691b Promulgation of regulations by Board; establishment of Consumer Advisory Council by Board; duties, membership, etc., of Council.

(a) Regulations

(1) The Board shall prescribe regulations to carry out the purposes of this subchapter. These regulations may contain but are not limited to such classifications, differentiation, or other provision, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate or substantiate compliance therewith.

(2) Such regulations may exempt from the provisions of this subchapter any class of transactions that are not primarily for personal, family, or household purposes, or business or commercial loans made available by a financial institution, except that a particular type within a class of such transactions may be exempted if the Board determines, after making an express finding that the application of this subchapter or of any provision of this subchapter of such transaction would not contribute substantially to effecting the purposes of this subchapter.

(3) An exemption granted pursuant to paragraph (2) shall be for no longer than five years and shall be extended only if the Board makes a subsequent determination, in the manner described by such paragraph, that such exemption remains appropriate.

(4) Pursuant to Board regulations, entities making business or commercial loans shall maintain such records or other data relating to such loans as may be necessary to evidence compliance with this subsection or enforce any action

pursuant to the authority of this Act. In no event shall such records or data be maintained for a period of less than one year. The Board shall promulgate regulations to implement this paragraph in the manner prescribed by chapter 5 of title 5, United States Code.

(5) The Board shall provide in regulations that an applicant for a business or commercial loan shall be provided a written notice of such applicant's right to receive a written statement of the reasons for the denial of such loan.

(b) Consumer Advisory Council

The Board shall establish a Consumer Advisory Council to advise and consult with it in the exercise of its functions under this chapter and to advise and consult with it concerning other consumer related matters it may place before the Council. In appointing the members of the Council, the Board shall seek to achieve a fair representation of the interests of creditors and consumers. The Council shall meet from time to time at the call of the Board. Members of the Council who are not regular full-time employees of the United States shall, while attending meetings of such Council, be entitled to receive compensation at a rate fixed by the Board, but not exceeding $100 per day, including travel time. Such members may be allowed travel expenses, including transportation and subsistence, while away from their homes or regular place of business.

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§ 1691c Administrative enforcement.

(a) Enforcing agencies

Compliance with the requirements imposed under this subchapter shall be enforced under:

(1) section 8 of the Federal Deposit Insurance Act [*12 U.S.C. 1818*], in the case of--

(A) national banks, and Federal branches and Federal agencies of foreign banks, by the Office of the Comptroller of the Currency;

(B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) [25A] of the Federal Reserve Act, by the Board; and

(C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System) and insured State branches of foreign banks, by the Board of Directors of the Federal Deposit Insurance Corporation;

(2) Section 8 of the Federal Deposit Insurance Act [*12 U.S.C. 1818*], by the Director of the Office of Thrift Supervision, in the case of a savings association the deposits of which are insured by the Federal Deposit Insurance Corporation.

(3) The Federal Credit Union Act [*12 U.S.C. 1751 et seq.*], by the Administrator of the National Credit Union Administration with respect to any Federal Credit Union.

(4) Subtitle IV of title 49, by the Secretary of Transportation, with respect to all carriers subject to the jurisdiction of the Surface Transportation, Board.

(5) Part A of subtitle VII of title 49, by the Secretary of Transportation with respect to any air carrier or foreign air carrier subject to that Act.

(6) The Packers and Stockyards Act, 1921 [*7 U.S.C. 181 et seq.*] (except as provided in section 406 of that Act [*7 U.S.C. 226, 227*]), by the Secretary of Agriculture with respect to any activities subject to that Act.

(7) The Farm Credit Act of 1971 [*12 U.S.C. 2001 et seq.*], by the Farm Credit Administration with respect to any Federal land bank, Federal land bank association, Federal intermediate credit bank, and production credit association;

(8) The Securities Exchange Act of 1934 [*15 U.S.C. 78a et seq.*], by the Securities and Exchange Commission with respect to brokers and dealers; and

(9) The Small Business Investment Act of 1958 [*15 U.S.C. 661 et seq.*], by the Small Business Administration, with respect to small business investment companies.

The terms used in paragraph (1) that are not defined in this subchapter or otherwise defined in section 3(s) of the Federal Deposit Insurance Act (*12 U.S.C. 1813(s)*) shall have the meaning given to them in section 1(b) of the International Banking Act of 1978 (*12 U.S.C. 3101*).

(b) Violations of subchapter deemed violations of preexisting statutory requirements; additional agency powers

For the purpose of the exercise by any agency referred to in subsection (a) of this section of its powers under any Act referred to in that subsection, a violation of any requirement imposed under this subchapter shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in subsection (a) of this section, each of the agencies referred to in that subsection may exercise for the purpose of enforcing compliance with any requirement imposed under this subchapter, any other authority conferred on

it by law. The exercise of the authorities of any of the agencies referred to in subsection (a) of this section for the purpose of enforcing compliance with any requirement imposed under this subchapter shall in no way preclude the exercise of such authorities for the purpose of enforcing compliance with any other provision of law not relating to the prohibition of discrimination on the basis of sex or marital status with respect to any aspect of a credit transaction.

(c) Overall enforcement authority of Federal Trade Commission

Except to the extent that enforcement of the requirements imposed under this subchapter is specifically committed to some other Government agency under subsection (a) of this section, the Federal Trade Commission shall enforce such requirements. For the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act [*15 U.S.C. 41 et seq.*], a violation of any requirement imposed under this subchapter shall be deemed a violation of a requirement imposed under that Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Commission to enforce compliance by any person with the requirements imposed under this subchapter, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests in the Federal Trade Commission Act, including the power to enforce any Federal Reserve Board regulation promulgated under this subchapter in the same manner as if the violation had been a violation of a Federal Trade Commission trade regulation rule.

(d) Rules and regulations by enforcing agencies

The authority of the Board to issue regulations under this subchapter does not impair the authority of any other agency designated in this section to make rules respecting its own procedures in enforcing compliance with requirements imposed under this subchapter.

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§ 1691c-1 Incentives for self-testing and self-correction.

(a) Privileged information

(1) Conditions for privilege

A report or result of a self-test (as that term is defined by regulations of the Board) shall be considered to be privileged under paragraph (2) if a creditor--

(A) conducts, or authorizes an independent third party to conduct, a self-test of any aspect of a credit transaction by a creditor, in order to determine the level or effectiveness of compliance with this subchapter by the creditor; and

(B) has identified any possible violation of this subchapter by the creditor and has taken, or is taking, appropriate corrective action to address any such possible violation.

(2) Privileged self-test

If a creditor meets the condition's specified in subparagraphs (A) and (B) of paragraph (1) with respect to a self-test described in that paragraph, any report or results of that self-test--

(A) shall be privileged; and

(B) may not be obtained or used by any applicant, department, or agency in any--

(i) proceeding or civil action in which one or more violations of this subchapter are alleged; or

(ii) examination or investigation relating to compliance with this subchapter.

(b) Results of self-testing

(1) In general

No provision of this section may be construed to prevent an applicant, department, or agency from obtaining or using a report or results of any self-test in any proceeding or civil action in which a violation of this subchapter is alleged, or in any examination or investigation of compliance with this subchapter if--

(A) the creditor or any person with lawful access to the report or results--

(i) voluntarily releases or discloses all, or any part of, the report or results to the applicant, department, or agency, or to the general public; or

(ii) refers to or describes the report or results as a defense to charges of violations of this subchapter against the creditor to whom the self-test relates; or

(B) the report or results are sought in conjunction with an adjudication or admission of a violation of this title for the sole purpose of determining an appropriate penalty or remedy.

(2) Disclosure for determination of penalty or remedy

Any report or results of a self-test that are disclosed for the purpose specified in paragraph (1)(B)--

(A) shall be used only for the particular proceeding in which the adjudication or admission referred to in paragraph

(1)(B) is made; and

(B) may not be used in any other action or proceeding.

(c) Adjudication

An applicant, department, or agency that challenges a privilege asserted under this section may seek a determination of the existence and application of that privilege in--

(1) a court of competent jurisdiction; or

(2) an administrative law proceeding with appropriate jurisdiction.

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§ 1691d Applicability of other laws.

(a) Requests for signature of husband and wife for creation of valid lien, etc.

A request for the signature of both parties to a marriage for the purpose of creating a valid lien, passing clear title, waiving inchoate rights to property, or assigning earnings, shall not constitute discrimination under this subchapter: Provided, however, That this provision shall not be construed to permit a creditor to take sex or marital status into account in connection with the evaluation of creditworthiness of any applicant.

(b) State property laws affecting creditworthiness

Consideration or application of State property laws directly or indirectly affecting creditworthiness shall not constitute discrimination for purposes of this subchapter.

(c) State laws prohibiting separate extension of consumer credit to husband and wife

Any provision of State law which prohibits the separate extension of consumer credit to each party to a marriage shall not apply in any case where each party to a marriage voluntarily applies for separate credit from the same creditor: Provided, That in any case where such a State law is so preempted, each party to the marriage shall be solely responsible for the debt so contracted.

(d) Combining credit accounts of husband and wife with same creditor to determine permissible finance charges or loan ceilings under Federal or State laws

When each party to a marriage separately and voluntarily applies for and obtains separate credit accounts with the

same creditor, those accounts shall not be aggregated or otherwise combined for purposes of determining permissible finance charges or permissible loan ceilings under the laws of any State or of the United States.

(e) Election of remedies under subchapter or State law; nature of relief determining applicability

Where the same act or omission constitutes a violation of this subchapter and of applicable State law, a person aggrieved by such conduct may bring a legal action to recover monetary damages either under this subchapter or under such State law, but not both. This election of remedies shall not apply to court actions in which the relief sought does not include monetary damages or to administrative actions.

(f) Compliance with inconsistent State laws; determination of inconsistency

This subchapter does not annul, alter, or affect, or exempt any person subject to the provisions of this subchapter from complying with, the laws of any State with respect to credit discrimination, except to the extent that those laws are inconsistent with any provision of this subchapter, and then only to the extent of the inconsistency. The Board is authorized to determine whether such inconsistencies exist. The Board may not determine that any State law is inconsistent with any provision of this subchapter if the Board determines that such law gives greater protection to the applicant.

(g) Exemption by regulation of credit transactions covered by State law; failure to comply with State law

The Board shall by regulation exempt from the requirements of sections 1691 and 1691a of this title any class of credit transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under this subchapter or that such law gives greater protection to the applicant, and that there is adequate provision for enforcement. Failure to comply with any requirement of such State law in any transaction so exempted shall constitute a violation of this subchapter for the purposes of section 1691e of this title.

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§ **1691e Civil liability.**

(a) Individual or class action for actual damages

Any creditor who fails to comply with any requirement imposed under this subchapter shall be liable to the aggrieved applicant for any actual damages sustained by such applicant acting either in an individual capacity or as a member of a class.

(b) Recovery of punitive damages in individual and class action for actual damages; exemptions; maximum amount of punitive damages in individual actions; limitation on total recovery in class actions; factors determining amount of award

Any creditor, other than a government or governmental subdivision or agency, who fails to comply with any requirement imposed under this subchapter shall be liable to the aggrieved applicant for punitive damages in an amount not greater than $10,000, in addition to any actual damages provided in subsection (a) of this section, except that in the case of a class action the total recovery under this subsection shall not exceed the lesser of $500,000 or 1 per centum of the net worth of the creditor. In determining the amount of such damages in any action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance by the creditor, the resources of the creditor, the number of persons adversely affected, and the extent to which the creditor's failure of compliance was intentional.

(c) Action for equitable and declaratory relief

Upon application by an aggrieved applicant, the appropriate United States district court or any other court of competent jurisdiction may grant such equitable and declaratory relief as is necessary to enforce the requirements imposed under this subchapter.

(d) Recovery of costs and attorney fees

In the case of any successful action under subsection (a), (b), or (c) of this section, the costs of the action, together with a reasonable attorney's fee as determined by the court, shall be added to any damages awarded by the court under such subsection.

(e) Good faith compliance with rule, regulation, or interpretation of Board or interpretation or approval by an official or employee of Federal Reserve System duly authorized by Board

No provision of this subchapter imposing liability shall apply to any act done or omitted in good faith in conformity with any official rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefor, notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

(f) Jurisdiction of courts; time for maintenance of action; exceptions

Any action under this section may be brought in the appropriate United States district court without regard to the amount in controversy, or in any other court of competent jurisdiction. No such action shall be brought later than two years from the date of the occurrence of the violation, except that--

(1) whenever any agency having responsibility for administrative enforcement under section 1691c of this title commences an enforcement proceeding within two years from the date of the occurrence of the violation,

(2) whenever the Attorney General commences a civil action under this section within two years from the date of the occurrence of the violation,

then any applicant who has been a victim of the discrimination which is the subject of such proceeding or civil action may bring an action under this section not later than one year after the commencement of that proceeding or action.

(g) Request by responsible enforcement agency to Attorney General for civil action

The agencies having responsibility for administrative enforcement under section 1691c of this title, if unable to obtain compliance with section 1691 of this title, are authorized to refer the matter to the Attorney General with a recommendation that an appropriate civil action be instituted. Each agency referred to in paragraphs (1), (2), and (3) of section 1691c(a) of this title shall refer the matter to the Attorney General whenever the agency has reason to believe that 1 or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit in violation of section 1691(a) of this title. Each such agency may refer the matter to the Attorney General whenever the

agency has reason to believe that 1 or more creditors has violated section 1691(a) of this title.

(h) Authority for Attorney General to bring civil action; jurisdiction

When a matter is referred to the Attorney General pursuant to subsection (g) of this section, or whenever he has reason to believe that one or more creditors are engaged in a pattern or practice in violation of this subchapter, the Attorney General may bring a civil action in any appropriate United States district court for such relief as may be appropriate, including actual and punitive damages and injunctive relief.

(i) Recovery under both subchapter and fair housing enforcement provisions prohibited for violation based on same transaction

No person aggrieved by a violation of this subchapter and by a violation of section 3605 of title 42 shall recover under this subchapter and section 3612 of title 42, if such violation is based on the same transaction.

(j) Discovery of creditor's granting standards

Nothing in this subchapter shall be construed to prohibit the discovery of a creditor's credit granting standards under appropriate discovery procedures in the court or agency in which an action or proceeding is brought.

(k) Notice to HUD of violations

Whenever an agency referred to in paragraph (1), (2), or (3) of section 1691c(a) of this title--

(1) has reason to believe, as a result of receiving a consumer complaint, conducting a consumer compliance examination, or otherwise, that a violation of this subchapter has occurred;

(2) has reason to believe that the alleged violation would be a violation of the Fair Housing Act; and

(3) does not refer the matter to the Attorney General pursuant to subsection (g) of this section,

the agency shall notify the Secretary of Housing and Urban Development of the violation, and shall notify the applicant that the Secretary of Housing and Urban Development has been notified of the alleged violation and that remedies for the violation may be available under the Fair Housing Act.

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§ **1691f Annual reports to Congress.**

Each year, the Board and the Attorney General shall, respectively, make reports to the Congress concerning the administration of their functions under this subchapter, including such recommendations as the Board and the Attorney General, respectively, deem necessary or appropriate. In addition, each report of the Board shall include its assessment of the extent to which compliance with the requirements of this subchapter is being achieved, and a summary of the enforcement actions taken by each of the agencies assigned administrative enforcement responsibilities under section 1691c of this title.

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SUBCHAPTER V DEBT COLLECTION PRACTICES

[Editor's Note: *15 U.S.C. §§ 1692-1692p* comprise the Fair Debt Collection Practices Act.]

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§ 1692 Congressional findings and declaration of purpose.

(a) Abusive practices

There is abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors. Abusive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy.

(b) Inadequacy of laws

Existing laws and procedures for redressing these injuries are inadequate to protect consumers.

(c) Available non-abusive collection methods

Means other than misrepresentation or other abusive debt collection practices are available for the effective collection of debts.

(d) Interstate commerce

Abusive debt collection practices are carried on to a substantial extent in interstate commerce and through means and instrumentalities of such commerce. Even where abusive debt collection practices are purely intrastate in character, they nevertheless directly affect interstate commerce.

(e) Purposes

It is the purpose of this subchapter to eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses.

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§ **1692a Definitions.**

As used in this subchapter

(1) The term "Commission" means the Federal Trade Commission.

(2) The term "communication" means the conveying of information regarding a debt directly or indirectly to any person through any medium.

(3) The term "consumer" means any natural person obligated or allegedly obligated to pay any debt.

(4) The term "creditor" means any person who offers or extends credit creating a debt or to whom a debt is owed, but such term does not include any person to the extent that he receives an assignment or transfer of a debt in default solely for the purpose of facilitating collection of such debt for another.

(5) The term "debt" means any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment.

(6) The term "debt collector" means any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another. Notwithstanding the exclusion provided by clause (F) of the last sentence of this paragraph, the term includes any creditor who, in the process of collecting his own debts, uses any name other than his own which would indicate that a third person is collecting or attempting to collect such debts. For the purpose of section 1692f(6) of this title, such term also includes any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the enforcement of security interests. The term does not include--

(A) any officer or employee of a creditor while, in the name of the creditor, collecting debts for such creditor;

(B) any person while acting as a debt collector for another person, both of whom are related by common ownership or affiliated by corporate control, if the person acting as a debt collector does so only for persons to whom it is so related or affiliated and if the principal business of such person is not the collection of debts;

(C) any officer or employee of the United States or any State to the extent that collecting or attempting to collect any debt is in the performance of his official duties;

(D) any person while serving or attempting to serve legal process on any other person in connection with the judicial enforcement of any debt;

(E) any nonprofit organization which, at the request of consumers, performs bona fide consumer credit counseling and assists consumers in the liquidation of their debts by receiving payments from such consumers and distributing such amounts to creditors; and

(F) any person collecting or attempting to collect any debt owed or due or asserted to be owed or due another to the extent such activity (i) is incidental to a bona fide fiduciary obligation or a bona fide escrow arrangement; (ii) concerns a debt which was originated by such person; (iii) concerns a debt which was not in default at the time it was obtained by such person; or (iv) concerns a debt obtained by such person as a secured party in a commercial credit transaction involving the creditor.

(G) [Redesignated]

(7) The term "location information" means a consumer's place of abode and his telephone number at such place, or his

place of employment.

(8) The term "State" means any State, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any political subdivision of any of the foregoing.

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§ **1692b Acquisition of location information.**

Any debt collector communicating with any person other than the consumer for the purpose of acquiring location information about the consumer shall--

(1) identify himself, state that he is confirming or correcting location information concerning the consumer, and, only if expressly requested, identify his employer;

(2) not state that such consumer owes any debt;

(3) not communicate with any such person more than once unless requested to do so by such person or unless the debt collector reasonably believes that the earlier response of such person is erroneous or incomplete and that such person now has correct or complete location information;

(4) not communicate by post card;

(5) not use any language or symbol on any envelope or in the contents of any communication effected by the mails or telegram that indicates that the debt collector is in the debt collection business or that the communication relates to the collection of a debt; and

(6) after the debt collector knows the consumer is represented by an attorney with regard to the subject debt and has knowledge of, or can readily ascertain, such attorney's name and address, not communicate with any person other than that attorney, unless the attorney fails to respond within a reasonable period of time to communication from the debt collector.

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§ **1692c Communication in connection with debt collection.**

(a) Communication with the consumer generally

Without the prior consent of the consumer given directly to the debt collector or the express permission of a court of competent jurisdiction, a debt collector may not communicate with a consumer in connection with the collection of any debt--

(1) at any unusual time or place or a time or place known or which should be known to be inconvenient to the consumer. In the absence of knowledge of circumstances to the contrary, a debt collector shall assume that the convenient time for communicating with a consumer is after 8 o'clock antimeridian and before 9 o'clock postmeridian, local time at the consumer's location;

(2) if the debt collector knows the consumer is represented by an attorney with respect to such debt and has knowledge of, or can readily ascertain, such attorney's name and address, unless the attorney fails to respond within a reasonable period of time to a communication from the debt collector or unless the attorney consents to direct communication with the consumer; or

(3) at the consumer's place of employment if the debt collector knows or has reason to know that the consumer's employer prohibits the consumer from receiving such communication.

(b) Communication with third parties

Except as provided in section 1692b of this title, without the prior consent of the consumer given directly to the debt collector, or the express permission of a court of competent jurisdiction, or as reasonably necessary to effectuate a postjudgment judicial remedy, a debt collector may not communicate, in connection with the collection of any debt, with any person other than the consumer, his attorney, a consumer reporting agency if otherwise permitted by law, the creditor, the attorney of the creditor, or the attorney of the debt collector.

(c) Ceasing communication

If a consumer notifies a debt collector in writing that the consumer refuses to pay a debt or that the consumer wishes the debt collector to cease further communication with the consumer, the debt collector shall not communicate further with the consumer with respect to such debt, except--

(1) to advise the consumer that the debt collector's further efforts are being terminated;

(2) to notify the consumer that the debt collector or creditor may invoke specified remedies which are ordinarily invoked by such debt collector or creditor; or

(3) where applicable, to notify the consumer that the debt collector or creditor intends to invoke a specified remedy.

If such notice from the consumer is made by mail, notification shall be complete upon receipt.

(d) "Consumer" defined

For the purpose of this section, the term "consumer" includes the consumer's spouse, parent (if the consumer is a minor), guardian, executor, or administrator.

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§ **1692d Harassment or abuse.**

A debt collector may not engage in any conduct the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:

(1) The use or threat of use of violence or other criminal means to harm the physical person, reputation, or property of any person.

(2) The use of obscene or profane language or language the natural consequence of which is to abuse the hearer or reader.

(3) The publication of a list of consumers who allegedly refuse to pay debts, except to a consumer reporting agency or to persons meeting the requirements of section 1681a(f) or 1681b(3) of this title.

(4) The advertisement for sale of any debt to coerce payment of the debt.

(5) Causing a telephone to ring or engaging any person in telephone conversation repeatedly or continuously with intent to annoy, abuse, or harass any person at the called number.

(6) Except as provided in section 1692b of this title, the placement of telephone calls without meaningful disclosure of the caller's identity.

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§ 1692e False or misleading representations.

A debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of any debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:

(1) The false representation or implication that the debt collector is vouched for, bonded by, or affiliated with the United States or any State, including the use of any badge, uniform, or facsimile thereof.

(2) The false representation of--

(A) the character, amount, or legal status of any debt; or

(B) any services rendered or compensation which may be lawfully received by any debt collector for the collection of a debt.

(3) The false representation or implication that any individual is an attorney or that any communication is from an attorney.

(4) The representation or implication that nonpayment of any debt will result in the arrest or imprisonment of any person or the seizure, garnishment, attachment, or sale of any property or wages of any person unless such action is lawful and the debt collector or creditor intends to take such action.

(5) The threat to take any action that cannot legally be taken or that is not intended to be taken.

(6) The false representation or implication that a sale, referral, or other transfer of any interest in a debt shall cause the consumer to--

(A) lose any claim or defense to payment of the debt; or

(B) become subject to any practice prohibited by this subchapter.

(7) The false representation or implication that the consumer committed any crime or other conduct in order to disgrace the consumer.

(8) Communicating or threatening to communicate to any person credit information which is known or which should be known to be false, including the failure to communicate that a disputed debt is disputed.

(9) The use or distribution of any written communication which simulates or is falsely represented to be a document authorized, issued, or approved by any court, official, or agency of the United States or any State, or which creates a false impression as to its source, authorization, or approval.

(10) The use of any false representation or deceptive means to collect or attempt to collect any debt or to obtain information concerning a consumer.

(11) The failure to disclose in the initial written communication with the consumer and, in addition, if the initial communication with the consumer is oral, in that initial oral communication, that the debt collector is attempting to collect a debt and that any information obtained will be used for that purpose, and the failure to disclose in subsequent communications that the communication is from a debt collector, except that this paragraph shall not apply to a formal pleading made in connection with a legal action.

(12) The false representation or implication that accounts have been turned over to innocent purchasers for value.

(13) The false representation or implication that documents are legal process.

(14) The use of any business, company, or organization name other than the true name of the debt collector's business, company, or organization.

(15) The false representation or implication that documents are not legal process forms or do not require action by the consumer.

(16) The false representation or implication that a debt collector operates or is employed by a consumer reporting agency as defined by section 1681a(f) of this title.

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§ **1692f Unfair practices.**

A debt collector may not use unfair or unconscionable means to collect or attempt to collect any debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:

(1) The collection of any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law.

(2) The acceptance by a debt collector from any person of a check or other payment instrument postdated by more than five days unless such person is notified in writing of the debt collector's intent to deposit such check or instrument not more than ten nor less than three business days prior to such deposit.

(3) The solicitation by a debt collector of any postdated check or other postdated payment instrument for the purpose of threatening or instituting criminal prosecution.

(4) Depositing or threatening to deposit any postdated check or other postdated payment instrument prior to the date on such check or instrument.

(5) Causing charges to be made to any person for communications by concealment of the true purpose of the communication. Such charges include, but are not limited to, collect telephone calls and telegram fees.

(6) Taking or threatening to take any nonjudicial action to effect dispossession or disablement of property if--

(A) there is no present right to possession of the property claimed as collateral through an enforceable security interest;

(B) there is no present intention to take possession of the property; or

(C) the property is exempt by law from such dispossession or disablement.

(7) Communicating with a consumer regarding a debt by post card.

(8) Using any language or symbol, other than the debt collector's address, on any envelope when communicating with a consumer by use of the mails or by telegram, except that a debt collector may use his business name if such name does not indicate that he is in the debt collection business.

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§ **1692g Validation of debts.**

(a) Notice of debt; contents

Within five days after the initial communication with a consumer in connection with the collection of any debt, a debt collector shall, unless the following information is contained in the initial communication or the consumer has paid the debt, send the consumer a written notice containing--

(1) the amount of the debt;

(2) the name of the creditor to whom the debt is owed;

(3) a statement that unless the consumer, within thirty days after receipt of the notice, disputes the validity of the debt, or any portion thereof, the debt will be assumed to be valid by the debt collector;

(4) a statement that if the consumer notifies the debt collector in writing within the thirty-day period that the debt, or any portion thereof, is disputed, the debt collector will obtain verification of the debt or a copy of a judgment against the consumer and a copy of such verification or judgment will be mailed to the consumer by the debt collector; and

(5) a statement that, upon the consumer's written request within the thirty-day period, the debt collector will provide

the consumer with the name and address of the original creditor, if different from the current creditor.

(b) Disputed debts

If the consumer notifies the debt collector in writing within the thirty-day period described in subsection (a) that the debt, or any portion thereof, is disputed, or that the consumer requests the name and address of the original creditor, the debt collector shall cease collection of the debt, or any disputed portion thereof, until the debt collector obtains verification of the debt or a copy of a judgment, or the name and address of the original creditor, and a copy of such verification or judgment, or name and address of the original creditor, is mailed to the consumer by the debt collector. Collection activities and communications that do not otherwise violate this title may continue during the 30-day period referred to in subsection (a) unless the consumer has notified the debt collector in writing that the debt, or any portion of the debt, is disputed or that the consumer requests the name and address of the original creditor. Any collection activities and communication during the 30-day period may not overshadow or be inconsistent with the disclosure of the consumer's right to dispute the debt or request the name and address of the original creditor.

(c) Admission of liability

The failure of a consumer to dispute the validity of a debt under this section may not be construed by any court as an admission of liability by the consumer.

(d) Legal Pleadings

A communication in the form of a formal pleading in a civil action shall not be treated as an initial communication for purposes of subsection (a).

(e) Notice Provisions

The sending or delivery of any form or notice which does not relate to the collection of a debt and is expressly required by the Internal Revenue Code of 1986, title V of Gramm-Leach-Bliley Act, or any provision of Federal or State law relating to notice of data security breach or privacy, or any regulation prescribed under any such provision of law, shall not be treated as an initial communication in connection with debt collection for purposes of this section.

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§ **1692h Multiple debts.**

If any consumer owes multiple debts and makes any single payment to any debt collector with respect to such debts, such debt collector may not apply such payment to any debt which is disputed by the consumer and, where applicable, shall apply such payment in accordance with the consumer's directions.

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§ 1692i Legal actions by debt collectors.

(a) Venue

Any debt collector who brings any legal action on a debt against any consumer shall--

(1) in the case of an action to enforce an interest in real property securing the consumer's obligation, bring such action only in a judicial district or similar legal entity in which such real property is located; or

(2) in the case of an action not described in paragraph (1), bring such action only in the judicial district or similar legal entity--

(A) in which such consumer signed the contract sued upon; or

(B) in which such consumer resides at the commencement of the action.

(b) Authorization of actions

Nothing in this subchapter shall be construed to authorize the bringing of legal actions by debt collectors.

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§ **1692j Furnishing certain deceptive forms.**

(a) It is unlawful to design, compile, and furnish any form knowing that such form would be used to create the false belief in a consumer that a person other than the creditor of such consumer is participating in the collection of or in an attempt to collect a debt such consumer allegedly owes such creditor, when in fact such person is not so participating.

(b) Any person who violates this section shall be liable to the same extent and in the same manner as a debt collector is liable under section 1692k of this title for failure to comply with a provision of this subchapter.

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§ **1692k Civil liability.**

(a) Amount of damages

Except as otherwise provided by this section, any debt collector who fails to comply with any provision of this subchapter with respect to any person is liable to such person in an amount equal to the sum of--

(1) any actual damage sustained by such person as a result of such failure;

(2)

(A) in the case of any action by an individual, such additional damages as the court may allow, but not exceeding $1,000; or

(B) in the case of a class action, (i) such amount for each named plaintiff as could be recovered under subparagraph (A), and (ii) such amount as the court may allow for all other class members, without regard to a minimum individual recovery, not to exceed the lesser of $500,000 or 1 per centum of the net worth of the debt collector; and

(3) in the case of any successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court. On a finding by the court that an action under this section was brought in bad faith and for the purpose of harassment, the court may award to the defendant attorney's fees reasonable in relation to the work expended and costs.

(b) Factors considered by court

In determining the amount of liability in any action under subsection (a) of this section, the court shall consider, among other relevant factors--

(1) in any individual action under subsection (a)(2)(A) of this section, the frequency and persistence of noncompliance by the debt collector, the nature of such noncompliance, and the extent to which such noncompliance was intentional; or

(2) in any class action under subsection (a)(2)(B) of this section, the frequency and persistence of noncompliance by the debt collector, the nature of such noncompliance, the resources of the debt collector, the number of persons adversely affected, and the extent to which the debt collector's noncompliance was intentional.

(c) Intent

A debt collector may not be held liable in any action brought under this subchapter if the debt collector shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.

(d) Jurisdiction

An action to enforce any liability created by this subchapter may be brought in any appropriate United States district court without regard to the amount in controversy, or in any other court of competent jurisdiction, within one year from the date on which the violation occurs.

(e) Advisory opinions of Commission

No provision of this section imposing any liability shall apply to any act done or omitted in good faith in conformity with any advisory opinion of the Commission, notwithstanding that after such act or omission has occurred, such opinion is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

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§ 1692l Administrative enforcement.

(a) Federal Trade Commission

Compliance with this subchapter shall be enforced by the Commission, except to the extent that enforcement of the requirements imposed under this subchapter is specifically committed to another agency under subsection (b) of this section. For purpose of the exercise by the Commission of its functions and powers under the Federal Trade Commission Act [*15 U.S.C. 41 et seq.*], a violation of this subchapter shall be deemed an unfair or deceptive act or practice in violation of that Act. All of the functions and powers of the Commission under the Federal Trade Commission Act are available to the Commission to enforce compliance by any person with this subchapter, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests in the Federal Trade Commission Act, including the power to enforce the provisions of this subchapter in the same manner as if the violation had been a violation of a Federal Trade Commission trade regulation rule.

(b) Applicable provisions of law

Compliance with any requirements imposed under this subchapter shall be enforced under--

(1) section 1818 of title 12, in the case of--

(A) national banks, and Federal branches and Federal agencies of foreign banks, by the Office of the Comptroller of the Currency;

(B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) [25A] of the Federal Reserve Act, by the Board of Governors of the Federal Reserve System; and

(C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System) and insured State branches of foreign banks, by the Board of Directors of the Federal Deposit Insurance Corporation;

(2) section 1818 of title 12, by the Director of the Office of Thrift Supervision, in the case of a savings association the deposits of which are insured by the Federal Deposit Insurance Corporation;

(3) the Federal Credit Union Act [*12 U.S.C. 1751 et seq.*], by the National Credit Union Administration Board with respect to any Federal credit union;

(4) subtitle IV of title 49, by the Secretary of Transportation, with respect to all carriers subject to the jurisdiction of the Surface Transportation Board;

(5) part A of subtitle VII of title 49, by the Secretary of Transportation with respect to any air carrier or any foreign air carrier subject to that Act; and

(6) the Packers and Stockyards Act, 1921 [*7 U.S.C. 181 et seq.*] (except as provided in section 406 of that Act [*7 U.S.C. 226, 227*]), by the Secretary of Agriculture with respect to any activities subject to that Act.

The terms used in paragraph (1) that are not defined in this subchapter or otherwise defined in section 1813(s) of title 12) shall have the meaning given to them in section 3101 of title 12.

(c) Agency powers

For the purpose of the exercise by any agency referred to in subsection (b) of this section of its powers under any Act referred to in that subsection, a violation of any requirement imposed under this subchapter shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in subsection (b) of this section, each of the agencies referred to in that subsection may exercise, for the purpose of enforcing compliance with any requirement imposed under this subchapter any other authority conferred on it by law, except as provided in subsection (d) of this section.

(d) Rules and regulations

Neither the Commission nor any other agency referred to in subsection (b) of this section may promulgate trade regulation rules or other regulations with respect to the collection of debts by debt collectors as defined in this subchapter.

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§ **1692m Reports to Congress by the Commission; views of other Federal agencies.**

(a) Not later than one year after the effective date of this subchapter and at one-year intervals thereafter, the Commission shall make reports to the Congress concerning the administration of its functions under this subchapter, including such recommendations as the Commission deems necessary or appropriate. In addition, each report of the Commission shall include its assessment of the extent to which compliance with this subchapter is being achieved and a summary of the enforcement actions taken by the Commission under section 1692l of this title.

(b) In the exercise of its functions under this subchapter, the Commission may obtain upon request the views of any other Federal agency which exercises enforcement functions under section 1692l of this title.

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§ **1692n Relation to State laws.**

This title does not annul, alter, or affect, or exempt any person subject to the provisions of this title from complying with the laws of any State with respect to debt collection practices, except to the extent that those laws are inconsistent with any provision of this title, and then only to the extent of the inconsistency. For purposes of this section, a State law is not inconsistent with this title if the protection such law affords any consumer is greater than the protection provided by this title.

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§ **1692n Exemption for State regulation.**

The Commission shall by regulation exempt from the requirements of this title any class of debt collection practices within any State if the Commission determines that under the law of that State that class of debt collection practices is subject to requirements substantially similar to those imposed by this title, and that there is adequate provision for enforcement.

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§ **1692n Exception for certain bad check enforcement programs operated by private entities.**

(a) In general

(1) Treatment of certain private entities. Subject to paragraph (2), a private entity shall be excluded from the definition of a debt collector, pursuant to the exception provided in section 803(6) [*15 USC § 1692a(6)*], with respect to the operation by the entity of a program described in paragraph (2)(A) under a contract described in paragraph (2)(B).

(2) Conditions of applicability. Paragraph (1) shall apply if--

(A) a State or district attorney establishes, within the jurisdiction of such State or district attorney and with respect to alleged bad check violations that do not involve a check described in subsection (b), a pretrial diversion program for alleged bad check offenders who agree to participate voluntarily in such program to avoid criminal prosecution;

(B) a private entity, that is subject to an administrative support services contract with a State or district attorney and operates under the direction, supervision, and control of such State or district attorney, operates the pretrial diversion program described in subparagraph (A); and

(C) in the course of performing duties delegated to it by a State or district attorney under the contract, the private entity referred to in subparagraph (B)--

(i) complies with the penal laws of the State;

(ii) conforms with the terms of the contract and directives of the State or district attorney;

(iii) does not exercise independent prosecutorial discretion;

(iv) contacts any alleged offender referred to in subparagraph (A) for purposes of participating in a program referred to in such paragraph--

(I) only as a result of any determination by the State or district attorney that probable cause of a bad check violation under State penal law exists, and that contact with the alleged offender for purposes of participation in the program is appropriate; and

(II) the alleged offender has failed to pay the bad check after demand for payment, pursuant to State law, is made for payment of the check amount;

(v) includes as part of an initial written communication with an alleged offender a clear and conspicuous statement that--

(I) the alleged offender may dispute the validity of any alleged bad check violation;

(II) where the alleged offender knows, or has reasonable cause to believe, that the alleged bad check violation is the result of theft or forgery of the check, identity theft, or other fraud that is not the result of the conduct of the alleged offender, the alleged offender may file a crime report with the appropriate law enforcement agency; and

(III) if the alleged offender notifies the private entity or the district attorney in writing, not later than 30 days after being contacted for the first time pursuant to clause (iv), that there is a dispute pursuant to this subsection, before further restitution efforts are pursued, the district attorney or an employee of the district attorney authorized to make such a determination makes a determination that there is probable cause to believe that a crime has been committed; and

(vi) charges only fees in connection with services under the contract that have been authorized by the contract with the State or district attorney.

(b) Certain checks excluded

A check is described in this subsection if the check involves, or is subsequently found to involve--

(1) a postdated check presented in connection with a payday loan, or other similar transaction, where the payee of the check knew that the issuer had insufficient funds at the time the check was made, drawn, or delivered;

(2) a stop payment order where the issuer acted in good faith and with reasonable cause in stopping payment on the check;

(3) a check dishonored because of an adjustment to the issuer's account by the financial institution holding such account without providing notice to the person at the time the check was made, drawn, or delivered;

(4) a check for partial payment of a debt where the payee had previously accepted partial payment for such debt;

(5) a check issued by a person who was not competent, or was not of legal age, to enter into a legal contractual obligation at the time the check was made, drawn, or delivered; or

(6) a check issued to pay an obligation arising from a transaction that was illegal in the jurisdiction of the State or district attorney at the time the check was made, drawn, or delivered.

(c) Definitions

For purposes of this section, the following definitions shall apply:

(1) State or district attorney. The term "State or district attorney" means the chief elected or appointed prosecuting attorney in a district, county (as defined in *section 2 of title 1, United States Code*), municipality, or comparable jurisdiction, including State attorneys general who act as chief elected or appointed prosecuting attorneys in a district, county (as so defined), municipality or comparable jurisdiction, who may be referred to by a variety of titles such as district attorneys, prosecuting attorneys, commonwealth's attorneys, solicitors, county attorneys, and state's attorneys, and who are responsible for the prosecution of State crimes and violations of jurisdiction-specific local ordinances.

(2) Check. The term "check" has the same meaning as in section 3(6) of the Check Clearing for the 21st Century Act.

(3) Bad check violation. The term "bad check violation" means a violation of the applicable State criminal law relating to the writing of dishonored checks.

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PART I Consumer Credit
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18 U.S.C. §§ 1961-1968 CHAPTER 96--RACKETEER INFUENCED AND CORRUPT ORGANIZATIONS ACT (RICO)

1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1961

§ **1961 Definitions.**

As used in this chapter--

(1) "racketeering activity" means (A) any act or threat involving murder, kidnapping, gambling, arson, robbery, bribery, extortion, dealing in obscene matter, or dealing in a controlled substance or listed chemical (as defined in section 102 of the Controlled Substances Act), which is chargeable under State law and punishable by imprisonment for more than one year; (B) any act which is indictable under any of the following provisions of title *18, United States Code: Section 201* (relating to bribery), section 224 (relating to sports bribery), sections 471, 472, and 473 (relating to counterfeiting), section 659 (relating to theft from interstate shipment) if the act indictable under section 659 is felonious, section 664 (relating to embezzlement from pension and welfare funds), sections 891-894 (relating to extortionate credit transactions), section 1028 (relating to fraud and related activity in connection with identification documents), section 1029 (relating to fraud and related activity in connection with access devices), section 1084 (relating to the transmission of gambling information), section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), section 1344 (relating to financial institution fraud), section 1425 (relating to the procurement of citizenship or nationalization unlawfully), section 1426 (relating to the reproduction of naturalization or citizenship papers), section 1427 (relating to the sale of naturalization or citizenship papers), sections 1461-1465 (relating to obscene matter), section 1503 (relating to obstruction of justice [influencing or injuring officer or juror generally]), section 1510 (relating to obstruction of criminal investigations), section 1511 (relating to the obstruction of State or local law enforcement), section 1512 (relating to tampering with a witness, victim, or an informant), section 1513 (relating to retaliating against a witness, victim, or an informant), section 1542 (relating to false statement in application and use of passport), section 1543 (relating to forgery or false use of passport), section 1544 (relating to misuse of passport), section 1546 (relating to fraud and misuse of visas, permits, and other documents), sections 1581-1592 (relating to peonage, slavery, and trafficking in persons), section 1951 (relating to interference with commerce, robbery, or extortion), section 1952 (relating to racketeering), section 1953 (relating to interstate transportation of wagering paraphernalia), section 1954 (relating to unlawful welfare fund payments), section 1955 (relating to the prohibition of illegal gambling businesses), section 1956 (relating to the laundering of monetary instruments), section 1957 (relating to engaging in monetary

transactions in property derived from specified unlawful activity), section 1958 (relating to use of interstate commerce facilities in the commission of murder-for-hire), section 1960 (relating to illegal money transmitters), 2251, 2251A, 2252, and 2260 (relating to sexual exploitation of children), sections 2312 and 2313 (relating to interstate transportation of stolen motor vehicles), sections 2314 and 2315 (relating to interstate transportation of stolen property), section 2318 (relating to trafficking in counterfeit labels for phonorecords, computer programs or computer program documentation or packaging and copies of motion pictures or other audiovisual works), section 2319 (relating to criminal infringement of a copyright), section 2319A (relating to unauthorized fixation of and trafficking in sound recordings and music videos of live musical performances), section 2320 (relating to trafficking in goods or services bearing counterfeit marks), section 2321 (relating to trafficking in certain motor vehicles or motor vehicle parts), sections 2341-2346 (relating to trafficking in contraband cigarettes), sections 2421-24 (relating to white slave traffic), sections 175-178 (relating to biological weapons), sections 229-229F (relating to chemical weapons), section 831 (relating to nuclear materials), (C) an act which is indictable under title *29, United States Code, section 186* (dealing with restrictions on payments and loans to labor organizations) or section 501(c) (relating to embezzlement from union funds), (D) any offense involving fraud connected with a case under title 11 (except a case under section 157 of this title), fraud in the sale of securities, or the felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in a controlled substance or listed chemical (as defined in section 102 of the Controlled Substances Act), punishable under any law of the United States, (E) any act which is indictable under the Currency and Foreign Transactions Reporting Act, (F) any act which is indictable under the Immigration and Nationality Act, section 274 (relating to bringing in and harboring certain aliens), section 277 (relating to aiding or assisting certain aliens to enter the United States), or section 278 (relating to importation of alien for immoral purpose) if the act indictable under such section of such Act was committed for the purpose of financial gain, or (G) any act that is indictable under any provision listed in section 2332b(g)(5)(B);

(2) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, any political subdivision, or any department, agency, or instrumentality thereof;

(3) "person" includes any individual or entity capable of holding a legal or beneficial interest in property;

(4) "enterprise" includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity;

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity;

(6) "unlawful debt" means a debt (A) incurred or contracted in gambling activity which was in violation of the law of the United States, a State or political subdivision thereof, or which is unenforceable under State or Federal law in whole or in part as to principal or interest because of the laws relating to usury, and (B) which was incurred in connection with the business of gambling in violation of the law of the United States, a State or political subdivision thereof, or the business of lending money or a thing of value at a rate usurious under State or Federal law, where the usurious rate is at

least twice the enforceable rate;

(7) "racketeering investigator" means any attorney or investigator so designated by the Attorney General and charged with the duty of enforcing or carrying into effect this chapter;

(8) "racketeering investigation" means any inquiry conducted by any racketeering investigator for the purpose of ascertaining whether any person has been involved in any violation of this chapter or of any final order, judgment, or decree of any court of the United States, duly entered in any case or proceeding arising under this chapter;

(9) "documentary material" includes any book, paper, document, record, recording, or other material; and

(10) "Attorney General" includes the Attorney General of the United States, the Deputy Attorney General of the United States, the Associate Attorney General of the United States, any Assistant Attorney General of the United States, or any employee of the Department of Justice or any employee of any department or agency of the United States so designated by the Attorney General to carry out the powers conferred on the Attorney General by this chapter. Any department or agency so designated may use in investigations authorized by this chapter either the investigative provisions of this chapter or the investigative power of such department or agency otherwise conferred by law.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1962

§ **1962 Prohibited activities.**

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of *section 2, title 18, United States Code*, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1963

§ **1963 Criminal penalties.**

(a) Whoever violates any provision of section 1962 of this chapter shall be fined under this title or imprisoned not more than 20 years (or for life if the violation is based on a racketeering activity for which the maximum penalty includes life imprisonment), or both, and shall forfeit to the United States, irrespective of any provision of State law--

(1) any interest the person has acquired or maintained in violation of section 1962;

(2) any--

(A) interest in;

(B) security of;

(C) claim against; or

(D) property or contractual right of any kind affording a source of influence over;

any enterprise which the person has established, operated, controlled, conducted, or participated in the conduct of,

in violation of section 1962; and

(3) any property constituting, or derived from, any proceeds which the person obtained, directly or indirectly, from racketeering activity or unlawful debt collection in violation of section 1962.

The court, in imposing sentence on such person shall order, in addition to any other sentence imposed pursuant to this section, that the person forfeit to the United States all property described in this subsection. In lieu of a fine otherwise authorized by this section, a defendant who derives profits or other proceeds from an offense may be fined not more than twice the gross profits or other proceeds.

(b) Property subject to criminal forfeiture under this section includes--

(1) real property, including things growing on, affixed to, and found in land; and

(2) tangible and intangible personal property, including rights, privileges, interests, claims, and securities.

(c) All right, title, and interest in property described in subsection (a) vests in the United States upon the commission of the act giving rise to forfeiture under this section. Any such property that is subsequently transferred to a person other than the defendant may be the subject of a special verdict of forfeiture and thereafter shall be ordered forfeited to the United States, unless the transferee establishes in a hearing pursuant to subsection (*l*) that he is a bona fide purchaser for value of such property who at the time of purchase was reasonably without cause to believe that the property was subject to forfeiture under this section.

(d)

(1) Upon application of the United States, the court may enter a restraining order or injunction, require the execution of a satisfactory performance bond, or take any other action to preserve the availability of property described in subsection (a) for forfeiture under this section--

(A) upon the filing of an indictment or information charging a violation of section 1962 of this chapter and alleging that the property with respect to which the order is sought would, in the event of conviction, be subject to forfeiture under this section; or

(B) prior to the filing of such an indictment or information, if, after notice to persons appearing to have an interest in the property and opportunity for a hearing, the court determines that--

(i) there is a substantial probability that the United States will prevail on the issue of forfeiture and that failure to enter the order will result in the property being destroyed, removed from the jurisdiction of the court, or otherwise made unavailable for forfeiture; and

(ii) the need to preserve the availability of the property through the entry of the requested order outweighs the hardship on any party against whom the order is to be entered:

Provided, however, That an order entered pursuant to subparagraph (B) shall be effective for not more than ninety days, unless extended by the court for good cause shown or unless an indictment or information described in subparagraph (A) has been filed.

(2) A temporary restraining order under this subsection may be entered upon application of the United States without notice or opportunity for a hearing when an information or indictment has not yet been filed with respect to the property, if the United States demonstrates that there is probable cause to believe that the property with respect to which the order is sought would, in the event of conviction, be subject to forfeiture under this section and that provision of notice will jeopardize the availability of the property for forfeiture. Such a temporary order shall expire not more than fourteen days after the date on which it is entered, unless extended for good cause shown or unless the party against whom it is entered consents to an extension for a longer period. A hearing requested concerning an order entered under this paragraph shall be held at the earliest possible time, and prior to the expiration of the temporary order.

(3) The court may receive and consider, at a hearing held pursuant to this subsection, evidence and information that would be inadmissible under the Federal Rules of Evidence.

(e) Upon conviction of a person under this section, the court shall enter a judgment of forfeiture of the property to the United States and shall also authorize the Attorney General to seize all property ordered forfeited upon such terms and conditions as the court shall deem proper. Following the entry of an order declaring the property forfeited, the court may, upon application of the United States, enter such appropriate restraining orders or injunctions, require the execution of satisfactory performance bonds, appoint receivers, conservators, appraisers, accountants, or trustees, or take any other action to protect the interest of the United States in the property ordered forfeited. Any income accruing to, or derived from, an enterprise or an interest in an enterprise which has been ordered forfeited under this section may be used to offset ordinary and necessary expenses to the enterprise which are required by law, or which are necessary to protect the interests of the United States or third parties.

(f) Following the seizure of property ordered forfeited under this section, the Attorney General shall direct the disposition of the property by sale or any other commercially feasible means, making due provision for the rights of any innocent persons. Any property right or interest not exercisable by, or transferable for value to, the United States shall expire and shall not revert to the defendant, nor shall the defendant or any person acting in concert with or on behalf of the defendant be eligible to purchase forfeited property at any sale held by the United States. Upon application of a person, other than the defendant or a person acting in concert with or on behalf of the defendant, the court may restrain

or stay the sale or disposition of the property pending the conclusion of any appeal of the criminal case giving rise to the forfeiture, if the applicant demonstrates that proceeding with the sale or disposition of the property will result in irreparable injury, harm or loss to him. Notwithstanding *31 U.S.C. 3302(b)*, the proceeds of any sale or other disposition of property forfeited under this section and any moneys forfeited shall be used to pay all proper expenses for the forfeiture and the sale, including expenses of seizure, maintenance and custody of the property pending its disposition, advertising and court costs. The Attorney General shall deposit in the Treasury any amounts of such proceeds or moneys remaining after the payment of such expenses.

(g) With respect to property ordered forfeited under this section, the Attorney General is authorized to--

(1) grant petitions for mitigation or remission of forfeiture, restore forfeited property to victims of a violation of this chapter, or take any other action to protect the rights of innocent persons which is in the interest of justice and which is not inconsistent with the provisions of this chapter;

(2) compromise claims arising under this section;

(3) award compensation to persons providing information resulting in a forfeiture under this section;

(4) direct the disposition by the United States of all property ordered forfeited under this section by public sale or any other commercially feasible means, making due provision for the rights of innocent persons; and

(5) take appropriate measures necessary to safeguard and maintain property ordered forfeited under this section pending its disposition.

(h) The Attorney General may promulgate regulations with respect to--

(1) making reasonable efforts to provide notice to persons who may have an interest in property ordered forfeited under this section;

(2) granting petitions for remission or mitigation of forfeiture;

(3) the restitution of property to victims of an offense petitioning for remission or mitigation of forfeiture under this

chapter;

(4) the disposition by the United States of forfeited property by public sale or other commercially feasible means;

(5) the maintenance and safekeeping of any property forfeited under this section pending its disposition; and

(6) the compromise of claims arising under this chapter.

Pending the promulgation of such regulations, all provisions of law relating to the disposition of property, or the proceeds from the sale thereof, or the remission or mitigation of forfeitures for violation of the customs laws, and the compromise of claims and the award of compensation to informers in respect of such forfeitures shall apply to forfeitures incurred, or alleged to have been incurred, under the provisions of this section, insofar as applicable and not inconsistent with the provisions hereof. Such duties as are imposed upon the Customs Service or any person with respect to the disposition of property under the customs law shall be performed under this chapter by the Attorney General.

(i) Except as provided in subsection (*l*), no party claiming an interest in property subject to forfeiture under this section may--

(1) intervene in a trial or appeal of a criminal case involving the forfeiture of such property under this section; or

(2) commence an action at law or equity against the United States concerning the validity of his alleged interest in the property subsequent to the filing of an indictment or information alleging that the property is subject to forfeiture under this section.

(j) The district courts of the United States shall have jurisdiction to enter orders as provided in this section without regard to the location of any property which may be subject to forfeiture under this section or which has been ordered forfeited under this section.

(k) In order to facilitate the identification or location of property declared forfeited and to facilitate the disposition of petitions for remission or mitigation of forfeiture, after the entry of an order declaring property forfeited to the United States the court may, upon application of the United States, order that the testimony of any witness relating to the property forfeited be taken by deposition and that any designated book, paper, document, record, recording, or other material not privileged be produced at the same time and place, in the same manner as provided for the taking of depositions under *Rule 15 of the Federal Rules of Criminal Procedure*.

(*l*)

(1) Following the entry of an order of forfeiture under this section, the United States shall publish notice of the order and of its intent to dispose of the property in such manner as the Attorney General may direct. The Government may also, to the extent practicable, provide direct written notice to any person known to have alleged an interest in the property that is the subject of the order of forfeiture as a substitute for published notice as to those persons so notified.

(2) Any person, other than the defendant, asserting a legal interest in property which has been ordered forfeited to the United States pursuant to this section may, within thirty days of the final publication of notice or his receipt of notice under paragraph (1), whichever is earlier, petition the court for a hearing to adjudicate the validity of his alleged interest in the property. The hearing shall be held before the court alone, without a jury.

(3) The petition shall be signed by the petitioner under penalty of perjury and shall set forth the nature and extent of the petitioner's right, title, or interest in the property, the time and circumstances of the petitioner's acquisition of the right, title, or interest in the property, any additional facts supporting the petitioner's claim, and the relief sought.

(4) The hearing on the petition shall, to the extent practicable and consistent with the interests of justice, be held within thirty days of the filing of the petition. The court may consolidate the hearing on the petition with a hearing on any other petition filed by a person other than the defendant under this subsection.

(5) At the hearing, the petitioner may testify and present evidence and witnesses on his own behalf, and cross-examine witnesses who appear at the hearing. The United States may present evidence and witnesses in rebuttal and in defense of its claim to the property and cross-examine witnesses who appear at the hearing. In addition to testimony and evidence presented at the hearing, the court shall consider the relevant portions of the record of the criminal case which resulted in the order of forfeiture.

(6) If, after the hearing, the court determines that the petitioner has established by a preponderance of the evidence that--

(A) the petitioner has a legal right, title, or interest in the property, and such right, title, or interest renders the order of forfeiture invalid in whole or in part because the right, title, or interest was vested in the petitioner rather than the defendant or was superior to any right, title, or interest of the defendant at the time of the commission of the acts which gave rise to the forfeiture of the property under this section; or

(B) the petitioner is a bona fide purchaser for value of the right, title, or interest in the property and was at the time

of purchase reasonably without cause to believe that the property was subject to forfeiture under this section;

the court shall amend the order of forfeiture in accordance with its determination.

(7) Following the court's disposition of all petitions filed under this subsection, or if no such petitions are filed following the expiration of the period provided in paragraph (2) for the filing of such petitions, the United States shall have clear title to property that is the subject of the order of forfeiture and may warrant good title to any subsequent purchaser or transferee.

(m) If any of the property described in subsection (a), as a result of any act or omission of the defendant--

(1) cannot be located upon the exercise of due diligence;

(2) has been transferred or sold to, or deposited with, a third party;

(3) has been placed beyond the jurisdiction of the court;

(4) has been substantially diminished in value; or

(5) has been commingled with other property which cannot be divided without difficulty;

the court shall order the forfeiture of any other property of the defendant up to the value of any property described in paragraphs (1) through (5).

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1964

§ **1964 Civil remedies.**

(a) The district courts of the United States shall have jurisdiction to prevent and restrain violations of section 1962 of this chapter by issuing appropriate orders, including, but not limited to: ordering any person to divest himself of any interest, direct or indirect, in any enterprise; imposing reasonable restrictions on the future activities or investments of any person, including, but not limited to, prohibiting any person from engaging in the same type of endeavor as the enterprise engaged in, the activities of which affect interstate or foreign commerce; or ordering dissolution or reorganization of any enterprise, making due provision for the rights of innocent persons.

(b) The Attorney General may institute proceedings under this section. Pending final determination thereof, the court may at any time enter such restraining orders or prohibitions, or take such other actions, including the acceptance of satisfactory performance bonds, as it shall deem proper.

(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee, except that no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962. The exception contained in the preceding sentence does not apply to an action against any person that is criminally convicted in connection with the fraud, in which case the statute of limitations shall start to run on the date on which the conviction becomes final.

(d) A final judgment or decree rendered in favor of the United States in any criminal proceeding brought by the United States under this chapter shall estop the defendant from denying the essential allegations of the criminal offense in any subsequent civil proceeding brought by the United States.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1965

§ **1965 Venue and process.**

(a) Any civil action or proceeding under this chapter against any person may be instituted in the district court of the United States for any district in which such person resides, is found, has an agent, or transacts his affairs.

(b) In any action under section 1964 of this chapter in any district court of the United States in which it is shown that the ends of justice require that other parties residing in any other district be brought before the court, the court may cause such parties to be summoned, and process for that purpose may be served in any judicial district of the United States by the marshal thereof.

(c) In any civil or criminal action or proceeding instituted by the United States under this chapter in the district court of the United States for any judicial district, subpenas issued by such court to compel the attendance of witnesses may be served in any other judicial district, except that in any civil action or proceeding no such subpena shall be issued for service upon any individual who resides in another district at a place more than one hundred miles from the place at which such court is held without approval given by a judge of such court upon a showing of good cause.

(d) All other process in any action or proceeding under this chapter may be served on any person in any judicial district in which such person resides, is found, has an agent, or transacts his affairs.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1966

§ **1966 Expedition of actions.**

In any civil action instituted under this chapter by the United States in any district court of the United States, the Attorney General may file with the clerk of such court a certificate stating that in his opinion the case is of general public importance. A copy of that certificate shall be furnished immediately by such clerk to the chief judge or in his absence to the presiding district judge of the district in which such action is pending. Upon receipt of such copy, such judge shall designate immediately a judge of that district to hear and determine action.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1967

§ **1967 Evidence.**

In any proceeding ancillary to or in any civil action instituted by the United States under this chapter the proceedings may be open or closed to the public at the discretion of the court after consideration of the rights of affected persons.

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§ **1968 Civil investigative demand.**

(a) Whenever the Attorney General has reason to believe that any person or enterprise may be in possession, custody, or control of any documentary materials relevant to a racketeering investigation, he may, prior to the institution of a civil or criminal proceeding thereon, issue in writing, and cause to be served upon such person, a civil investigative demand requiring such person to produce such material for examination.

(b) Each such demand shall--

(1) state the nature of the conduct constituting the alleged racketeering violation which is under investigation and the provision of law applicable thereto;

(2) describe the class or classes of documentary material produced thereunder with such definiteness and certainty as to permit such material to be fairly identified;

(3) state that the demand is returnable forthwith or prescribe a return date which will provide a reasonable period of time within which the material so demanded may be assembled and made available for inspection and copying or reproduction; and

(4) identify the custodian to whom such material shall be made available.

(c) No such demand shall--

(1) contain any requirement which would be held to be unreasonable if contained in a subpena duces tecum issued by a court of the United States in aid of a grand jury investigation of such alleged racketeering violation; or

(2) require the production of any documentary evidence which would be privileged from disclosure if demanded by a subpena duces tecum issued by a court of the United States in aid of a grand jury investigation of such alleged racketeering violation.

(d) Service of any such demand or any petition filed under this section may be made upon a person by--

(1) delivering a duly executed copy thereof to any partner, executive officer, managing agent, or general agent thereof, or to any agent thereof authorized by appointment or by law to receive service of process on behalf of such person, or upon any individual person;

(2) delivering a duly executed copy thereof to the principal office or place of business of the person to be served; or

(3) depositing such copy in the United States mail, by registered or certified mail duly addressed to such person at its principal office or place of business.

(e) A verified return by the individual serving any such demand or petition setting forth the manner of such service shall be prima facie proof of such service. In the case of service by registered or certified mail, such return shall be accompanied by the return post office receipt of delivery of such demand.

(f)

(1) The Attorney General shall designate a racketeering investigator to serve as racketeer document custodian, and such additional racketeering investigators as he shall determine from time to time to be necessary to serve as deputies to such officer.

(2) Any person upon whom any demand issued under this section has been duly served shall make such material available for inspection and copying or reproduction to the custodian designated therein at the principal place of

business of such person, or at such other place as such custodian and such person thereafter may agree and prescribe in writing or as the court may direct, pursuant to this section on the return date specified in such demand, or on such later date as such custodian may prescribe in writing. Such person may upon written agreement between such person and the custodian substitute for copies of all or any part of such material originals thereof.

(3) The custodian to whom any documentary material is so delivered shall take physical possession thereof, and shall be responsible for the use made thereof and for the return thereof pursuant to this chapter. The custodian may cause the preparation of such copies of such documentary material as may be required for official use under regulations which shall be promulgated by the Attorney General. While in the possession of the custodian, no material so produced shall be available for examination, without the consent of the person who produced such material, by any individual other than the Attorney General. Under such reasonable terms and conditions as the Attorney General shall prescribe, documentary material while in the possession of the custodian shall be available for examination by the person who produced such material or any duly authorized representatives of such person.

(4) Whenever any attorney has been designated to appear on behalf of the United States before any court or grand jury in any case or proceeding involving any alleged violation of this chapter, the custodian may deliver to such attorney such documentary material in the possession of the custodian as such attorney determines to be required for use in the presentation of such case or proceeding on behalf of the United States. Upon the conclusion of any such case or proceeding, such attorney shall return to the custodian any documentary material so withdrawn which has not passed into the control of such court or grand jury through the introduction thereof into the record of such case or proceeding.

(5) Upon the completion of--

(i) the racketeering investigation for which any documentary material was produced under this chapter, and

(ii) any case or proceeding arising from such investigation,

the custodian shall return to the person who produced such material all such material other than copies thereof made by the Attorney General pursuant to this subsection which has not passed into the control of any court or grand jury through the introduction thereof into the record of such case or proceeding.

(6) When any documentary material has been produced by any person under this section for use in any racketeering investigation, and no such case or proceeding arising therefrom has been instituted within a reasonable time after completion of the examination and analysis of all evidence assembled in the course of such investigation, such person shall be entitled, upon written demand made upon the Attorney General, to the return of all documentary material other than copies thereof made pursuant to this subsection so produced by such person.

(7) In the event of the death, disability, or separation from service of the custodian of any documentary material produced under any demand issued under this section or the official relief of such custodian from responsibility for the custody and control of such material, the Attorney General shall promptly--

(i) designate another racketeering investigator to serve as custodian thereof, and

(ii) transmit notice in writing to the person who produced such material as to the identity and address of the successor so designated.

Any successor so designated shall have with regard to such materials all duties and responsibilities imposed by this section upon his predecessor in office with regard thereto, except that he shall not be held responsible for any default or dereliction which occurred before his designation as custodian.

(g) Whenever any person fails to comply with any civil investigative demand duly served upon him under this section or whenever satisfactory copying or reproduction of any such material cannot be done and such person refuses to surrender such material, the Attorney General may file, in the district court of the United States for any judicial district in which such person resides, is found, or transacts business, and serve upon such person a petition for an order of such court for the enforcement of this section, except that if such person transacts business in more than one such district such petition shall be filed in the district in which such person maintains his principal place of business, or in such other district in which such person transacts business as may be agreed upon by the parties to such petition.

(h) Within twenty days after the service of any such demand upon any person, or at any time before the return date specified in the demand, whichever period is shorter, such person may file, in the district court of the United States for the judicial district within which such person resides, is found, or transacts business, and serve upon such custodian a petition for an order of such court modifying or setting aside such demand. The time allowed for compliance with the demand in whole or in part as deemed proper and ordered by the court shall not run during the pendency of such petition in the court. Such petition shall specify each ground upon which the petitioner relies in seeking such relief, and may be based upon any failure of such demand to comply with the provisions of this section or upon any constitutional or other legal right or privilege of such person.

(i) At any time during which any custodian is in custody or control of any documentary material delivered by any person in compliance with any such demand, such person may file, in the district court of the United States for the judicial district within which the office of such custodian is situated, and serve upon such custodian a petition for an order of such court requiring the performance by such custodian of any duty imposed upon him by this section.

(j) Whenever any petition is filed in any district court of the United States under this section, such court shall have jurisdiction to hear and determine the matter so presented, and to enter such order or orders as may be required to carry into effect the provisions of this section.

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§ **3601 Declaration of policy.**

It is the policy of the United States to provide, within constitutional limitations, for fair housing throughout the United States.

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§ **3602 Definitions.**

As used in this subchapter--

(a) "Secretary" means the Secretary of Housing and Urban Development.

(b) "Dwelling" means any building, structure, or portion thereof which is occupied as, or designed or intended for occupancy as, a residence by one or more families, and any vacant land which is offered for sale or lease for the construction or location thereon of any such building, structure, or portion thereof.

(c) "Family" includes a single individual.

(d) "Person" includes one or more individuals, corporations, partnerships, associations, labor organizations, legal representatives, mutual companies, joint-stock companies, trusts, unincorporated organizations, trustees, trustees in cases under title 11, receivers, and fiduciaries.

(e) "To rent" includes to lease, to sublease, to let and otherwise to grant for a consideration the right to occupy premises not owned by the occupant.

(f) "Discriminatory housing practice" means an act that is unlawful under section 3604, 3605, 3606 or 3618 of this title.

(g) "State" means any of the several States, the District of Columbia, the Commonwealth of Puerto Rico, or any of the territories and possessions of the United States.

(h) "Handicap" means, with respect to a person--

(1) a physical or mental impairment which substantially limits one or more of such person's major life activities,

(2) a record of having such an impairment, or

(3) being regarded as having such an impairment,

but such term does not include current, illegal use of or addiction to a controlled substance (as defined in section 102 of the Controlled Substances Act (*21 U.S.C. 802*)).

(i) "Aggrieved person" includes any person who--

(1) claims to have been injured by a discriminatory housing practice; or

(2) believes that such person will be injured by a discriminatory housing practice that is about to occur.

(j) "Complainant" means the person (including the Secretary) who files a complaint under section 3610 of this title.

(k) "Familial status" means one or more individuals' (who have not attained the age of 18 years) being domiciled with--

(1) a parent or another person having legal custody of such individual or individuals; or

(2) the designee of such parent or other person having such custody, with the written permission of such parent or other person.

The protections afforded against discrimination on the basis of familial status shall apply to any person who is pregnant or is in the process of securing legal custody of any individual who has not attained the age of 18 years.

(l) "Conciliation" means the attempted resolution of issues raised by a complaint, or by the investigation of such complaint, through informal negotiations involving the aggrieved person, the respondent, and the Secretary.

(m) "Conciliation agreement" means a written agreement setting forth the resolution of the issues in conciliation.

(n) "Respondent" means--

(1) the person or other entity accused in a complaint of an unfair housing practice; and

(2) any other person or entity identified in the course of investigation and notified as required with respect to respondents so identified under section 3610(a) of this title.

(o) "Prevailing party" has the same meaning as such term has in section 722 of the Revised Statutes of the United States (*42 U.S.C. 1988*).

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§ **3603 Effective dates of certain prohibitions.**

(a) Application to certain described dwellings

Subject to the provisions of subsection (b) of this section and section 3607 of this title, the prohibitions against discrimination in the sale or rental of housing set forth in section 3604 of this title shall apply:

(1) Upon enactment of this subchapter, to--

(A) dwellings owned or operated by the Federal Government;

(B) dwellings provided in whole or in part with the aid of loans, advances, grants, or contributions made by the Federal Government, under agreements entered into after November 20, 1962, unless payment due thereon has been made in full prior to April 11, 1968;

(C) dwellings provided in whole or in part by loans insured, guaranteed, or otherwise secured by the credit of the Federal Government, under agreements entered into after November 20, 1962, unless payment thereon has been made in full prior to April 11, 1968: *Provided*, That nothing contained in subparagraphs (B) and (C) of this subsection shall be applicable to dwellings solely by virtue of the fact that they are subject to mortgages held by an FDIC or FSLIC institution; and

(D) dwellings provided by the development or the redevelopment of real property purchased, rented, or otherwise obtained from a State or local public agency receiving Federal financial assistance for slum clearance or urban renewal with respect to such real property under loan or grant contracts entered into after November 20, 1962.

(2) After December 31, 1968, to all dwellings covered by paragraph (1) and to all other dwellings except as exempted by subsection (b) of this section.

(b) Exemptions

Nothing in section 3604 of this title (other than subsection (c)) shall apply to--

(1) any single-family house sold or rented by an owner: *Provided*, That such private individual owner does not own more than three such single-family houses at any one time: *Provided further*, That in the case of the sale of any such single-family house by a private individual owner not residing in such house at the time of such sale or who was not the most recent resident of such house prior to such sale, the exemption granted by this subsection shall apply only with respect to one such sale within any twenty-four month period: *Provided further*, That such bona fide private individual owner does not own any interest in, nor is there owned or reserved on his behalf, under any express or voluntary agreement, title to or any right to all or a portion of the proceeds from the sale or rental of, more than three such single-family houses at any one time: *Provided further*, That after December 31, 1969, the sale or rental of any such single-family house shall be excepted from the application of this subchapter only if such house is sold or rented (A) without the use in any manner of the sales or rental facilities or the sales or rental services of any real estate broker, agent, or salesman, or of such facilities or services of any person in the business of selling or renting dwellings, or of any employee or agent of any such broker, agent, salesman, or person and (B) without the publication, posting or mailing, after notice, of any advertisement or written notice in violation of section 3604(c) of this title; but nothing in this proviso shall prohibit the use of attorneys, escrow agents, abstractors, title companies, and other such professional assistance as necessary to perfect or transfer the title, or

(2) rooms or units in dwellings containing living quarters occupied or intended to be occupied by no more than four families living independently of each other, if the owner actually maintains and occupies one of such living quarters as his residence.

(c) Business of selling or renting dwellings defined

For the purposes of subsection (b) of this section, a person shall be deemed to be in the business of selling or renting dwellings if--

(1) he has, within the preceding twelve months, participated as principal in three or more transactions involving the sale or rental of any dwelling or any interest therein, or

(2) he has, within the preceding twelve months, participated as agent, other than in the sale of his own personal residence in providing sales or rental facilities or sales or rental services in two or more transactions involving the sale or rental of any dwelling or any interest therein, or

(3) he is the owner of any dwelling designed or intended for occupancy by, or occupied by, five or more families.

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§ **3604 Discrimination in the sale or rental of housing and other prohibited practices.**

As made applicable by section 3603 of this title and except as exempted by sections 3603(b) and 3607 of this title, it shall be unlawful--

(a) To refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin.

(b) To discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith, because of race, color, religion, sex, familial status, or national origin.

(c) To make, print, or publish, or cause to be made, printed, or published any notice, statement, or advertisement, with respect to the sale or rental of a dwelling that indicates any preference, limitation, or discrimination based on race, color, religion, sex, handicap, familial status, or national origin, or an intention to make any such preference, limitation, or discrimination.

(d) To represent to any person because of race, color, religion, sex, handicap, familial status, or national origin that any dwelling is not available for inspection, sale, or rental when such dwelling is in fact so available.

(e) For profit, to induce or attempt to induce any person to sell or rent any dwelling by representations regarding the entry or prospective entry into the neighborhood of a person or persons of a particular race, color, religion, sex, handicap, familial status, or national origin.

(f)

(1) To discriminate in the sale or rental, or to otherwise make unavailable or deny, a dwelling to any buyer or renter because of a handicap of--

(A) that buyer or renter,

(B) a person residing in or intending to reside in that dwelling after it is so sold, rented, or made available; or

(C) any person associated with that buyer or renter.

(2) To discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection with such dwelling, because of a handicap of--

(A) that person; or

(B) a person residing in or intending to reside in that dwelling after it is so sold, rented, or made available; or

(C) any person associated with that person.

(3) For purposes of this subsection, discrimination includes--

(A) a refusal to permit, at the expense of the handicapped person, reasonable modifications of existing premises occupied or to be occupied by such person if such modifications may be necessary to afford such person full enjoyment of the premises except that, in the case of a rental, the landlord may where it is reasonable to do so condition permission for a modification on the renter agreeing to restore the interior of the premises to the condition that existed before the modification, reasonable wear and tear excepted.

(B) a refusal to make reasonable accommodations in rules, policies, practices, or services, when such accommodations may be necessary to afford such person equal opportunity to use and enjoy a dwelling; or

(C) in connection with the design and construction of covered multifamily dwellings for first occupancy after the date that is 30 months after the date of enactment of the Fair Housing Amendments Act of 1988, a failure to design and construct those dwellings in such a manner that--

(i) the public use and common use portions of such dwellings are readily accessible to and usable by handicapped persons;

(ii) all the doors designed to allow passage into and within all premises within such dwellings are sufficiently wide to allow passage by handicapped persons in wheelchairs; and

(iii) all premises within such dwellings contain the following features of adaptive design:

(I) an accessible route into and through the dwelling;

(II) light switches, electrical outlets, thermostats, and other environmental controls in accessible locations;

(III) reinforcements in bathroom walls to allow later installation of grab bars; and

(IV) usable kitchens and bathrooms such that an individual in a wheelchair can maneuver about the space.

(4) Compliance with the appropriate requirements of the American National Standard for buildings and facilities providing accessibility and usability for physically handicapped people (commonly cited as "ANSI A117.1") suffices to satisfy the requirements of paragraph (3)(C)(iii).

(5)

(A) If a State or unit of general local government has incorporated into its laws the requirements set forth in

paragraph (3)(C), compliance with such laws shall be deemed to satisfy the requirements of that paragraph.

(B) A State or unit of general local government may review and approve newly constructed covered multifamily dwellings for the purpose of making determinations as to whether the design and construction requirements of paragraph (3)(C) are met.

(C) The Secretary shall encourage, but may not require, States and units of local government to include in their existing procedures for the review and approval of newly constructed covered multifamily dwellings, determinations as to whether the design and construction of such dwellings are consistent with paragraph (3)(C), and shall provide technical assistance to States and units of local government and other persons to implement the requirements of paragraph (3)(C).

(D) Nothing in this subchapter shall be construed to require the Secretary to review or approve the plans, designs or construction of all covered multifamily dwellings, to determine whether the design and construction of such dwellings are consistent with the requirements of paragraph 3(C).

(6)

(A) Nothing in paragraph (5) shall be construed to affect the authority and responsibility of the Secretary or a State or local public agency certified pursuant to section 3610(f)(3) of this title to receive and process complaints or otherwise engage in enforcement activities under this subchapter.

(B) Determinations by a State or a unit of general local government under paragraphs (5) (A) and (B) shall not be conclusive in enforcement proceedings under this subchapter.

(7) As used in this subsection, the term "covered multifamily dwellings" means--

(A) buildings consisting of 4 or more units if such buildings have one or more elevators; and

(B) ground floor units in other buildings consisting of 4 or more units.

(8) Nothing in this subchapter shall be construed to invalidate or limit any law of a State or political subdivision of a State, or other jurisdiction in which this subchapter shall be effective, that requires dwellings to be designed and constructed in a manner that affords handicapped persons greater access than is required by this subchapter.

(9) Nothing in this subsection requires that a dwelling be made available to an individual whose tenancy would constitute a direct threat to the health or safety of other individuals or whose tenancy would result in substantial physical damage to the property of others.

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§ **3605 Discrimination in residential real estate-related transactions.**

(a) In general

It shall be unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin.

(b) "Residential real estate-related transaction" defined

As used in this section, the term "residential real estate-related transaction" means any of the following:

(1) The making or purchasing of loans or providing other financial assistance--

(A) for purchasing, constructing, improving, repairing, or maintaining a dwelling; or

(B) secured by residential real estate.

(2) The selling, brokering, or appraising of residential real property.

(c) Appraisal exemption

Nothing in this subchapter prohibits a person engaged in the business of furnishing appraisals of real property to take into consideration factors other than race, color, religion, national origin, sex, handicap, or familial status.

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§ **3606 Discrimination in the provision of brokerage services.**

After December 31, 1968, it shall be unlawful to deny any person access to or membership or participation in any multiple-listing service, real estate brokers' organization or other service, organization, or facility relating to the business of selling or renting dwellings, or to discriminate against him in the terms or conditions of such access, membership, or participation, on account of race, color, religion, sex, handicap, familial status, or national origin.

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§ **3607 Exemption.**

(a) Religious organizations and private clubs

Nothing in this subchapter shall prohibit a religious organization, association, or society, or any nonprofit institution or organization operated, supervised or controlled by or in conjunction with a religious organization, association, or society, from limiting the sale, rental or occupancy of dwellings which it owns or operates for other than a commercial purpose to persons of the same religion, or from giving preference to such persons, unless membership in such religion is restricted on account of race, color, or national origin. Nor shall anything in this subchapter prohibit a private club not in fact open to the public, which as an incident to its primary purpose or purposes provides lodgings which it owns or operates for other than a commercial purpose, from limiting the rental or occupancy of such lodgings to its members or from giving preference to its members.

(b) Numbers of occupants; housing for older persons; persons convicted of making or distributing controlled substances; good faith defense

(1) Nothing in this subchapter limits the applicability of any reasonable local, State, or Federal restrictions regarding the maximum number of occupants permitted to occupy a dwelling. Nor does any provision in this subchapter regarding familial status apply with respect to housing for older persons.

(2) As used in this section, "housing for older persons" means housing--

(A) provided under any State or Federal program that the Secretary determines is specifically designed and operated

to assist elderly persons (as defined in the State or Federal program); or

(B) intended for, and solely occupied by, persons 62 years of age or older; or

(C) intended and operated for occupancy by persons 55 years of age or older, and--

(i) at least 80 percent of the occupied units are occupied by at least one person who is 55 years of age or older;

(ii) the housing facility or community publishes and adheres to policies and procedures that demonstrate the intent required under this subparagraph; and

(iii) the housing facility or community complies with rules issued by the Secretary for verification of occupancy, which shall--

(I) provide for verification by reliable surveys and affidavits; and

(II) include examples of the types of policies and procedures relevant to a determination of compliance with the requirement of clause (ii). Such surveys and affidavits shall be admissible in administrative and judicial proceedings for the purposes of such verification.

(3) Housing shall not fail to meet the requirements for housing for older persons by reason of:

(A) persons residing in such housing as of Sept. 13, 1988, who do not meet the age requirements of subsections (2)(B) or (C): Provided, That new occupants of such housing meet the age requirements of subsections (2)(B) or (C); or

(B) unoccupied units: Provided, That such units are reserved for occupancy by persons who meet the age requirements of subsections (2) (B) or (C).

(4) Nothing in this subchapter prohibits conduct against a person because such person has been convicted by any court of competent jurisdiction of the illegal manufacture or distribution of a controlled substance as defined in section 102 of

the Controlled Substances Act (*21 U.S.C. 802*).

(5)

(A) A person shall not be held personally liable for monetary damages for a violation of this chapter if such person reasonably relied, in good faith, on the application of the exemption under this subsection relating to housing for older persons.

(B) For the purposes of this paragraph, a person may only show good faith reliance on the application of the exemption by showing that--

(i) such person has no actual knowledge that the facility or community is not, or will not be, eligible for such exemption; and

(ii) the facility or community has stated formally, in writing, that the facility or community complies with the requirements for such exemption.

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§ **3608 Administration.**

(a) Authority and responsibility

The authority and responsibility for administering this Act shall be in the Secretary of Housing and Urban Development.

(b) Assistant Secretary

The Department of Housing and Urban Development shall be provided an additional Assistant Secretary.

(c) Delegation of authority; appointment of administrative law judges; location of conciliation meetings; administrative review

The Secretary may delegate any of his functions, duties, and powers to employees of the Department of Housing and Urban Development or to boards of such employees, including functions, duties, and powers with respect to investigating, conciliating, hearing, determining, ordering, certifying, reporting, or otherwise acting as to any work, business, or matter under this subchapter. The person to whom such delegations are made with respect to hearing functions, duties, and powers shall be appointed and shall serve in the Department of Housing and Urban Development in compliance with sections 3105, 3344, 5372, and 7521 of title 5. Insofar as possible, conciliation meetings shall be held in the cities or other localities where the discriminatory housing practices allegedly occurred. The Secretary shall by rule prescribe such rights of appeal from the decisions of his administrative law judges to other administrative law judges or to other officers in the Department, to boards of officers or to himself, as shall be appropriate and in accordance with law.

(d) Cooperation of Secretary and executive departments and agencies in administration of housing and urban development programs and activities to further fair housing purposes

All executive departments and agencies shall administer their programs and activities relating to housing and urban development (including any Federal agency having regulatory or supervisory authority over financial institutions) in a manner affirmatively to further the purposes of this subchapter and shall cooperate with the Secretary to further such purposes.

(e) Functions of Secretary

The Secretary of Housing and Urban Development shall--

(1) make studies with respect to the nature and extent of discriminatory housing practices in representative communities, urban, suburban, and rural, throughout the United States;

(2) publish and disseminate reports, recommendations, and information derived from such studies, including an annual report to the Congress--

(A) specifying the nature and extent of progress made nationally in eliminating discriminatory housing practices and furthering the purposes of this subchapter, obstacles remaining to achieving equal housing opportunity, and recommendations for further legislative or executive action; and

(B) containing tabulations of the number of instances (and the reasons therefor) in the preceding year in which--

(i) investigations are not completed as required by section 3610(a)(1)(B) of this title;

(ii) determinations are not made within the time specified in section 3610(g) of this title; and

(iii) hearings are not commenced or findings and conclusions are not made as required by section 3612(g) of this title.

(3) cooperate with and render technical assistance to Federal, State, local, and other public or private agencies, organizations, and institutions which are formulating or carrying on programs to prevent or eliminate discriminatory housing practices;

(4) cooperate with and render such technical and other assistance to the Community Relations Service as may be appropriate to further its activities in preventing or eliminating discriminatory housing practices

(5) administer the programs and activities relating to housing and urban development in a manner affirmatively to further the policies of this subchapter; and

(6) annually report to the Congress, and make available to the public, data on the race, color, religion, sex, national origin, age, handicap, and family characteristics of persons and households who are applicants for, participants in, or beneficiaries or potential beneficiaries of, programs administered by the Department to the extent such characteristics are within the coverage of the provisions of law and Executive orders referred to in subsection (f) of this section which apply to such programs (and in order to develop the data to be included and made available to the public under this subsection, the Secretary shall, without regard to any other provision of law, collect such information relating to those characteristics as the Secretary determines to be necessary or appropriate).

(f) Provisions of law applicable to Department programs

The provisions of law and Executive orders to which subsection (e)(6) of this section applies are--

(1) title VI of the Civil Rights Act of 1964 [*42 U.S.C.A. § 2000d et seq.*];

(2) title VIII of the Civil Rights Act of 1968;

(3) section 504 of the Rehabilitation Act of 1973 [*29 U.S.C. 794*];

(4) the Age Discrimination Act of 1975 [*42 U.S.C.A. § 6101 et seq.*];

(5) the Equal Credit Opportunity Act [*15 U.S.C.A. § 1691 et seq.*];

(6) section 1982 of title 42;

(7) section 8(a) of the Small Business Act [*15 U.S.C. 637(a)*];

(8) section 527 of the National Housing Act [*12 U.S.C. 1735f-5*];

(9) section 109 of the Housing and Community Development Act of 1974 [*42 U.S.C. 5309*];

(10) section 3 of the Housing and Urban Development Act of 1968 [*12 U.S.C. 1701u*];

(11) Executive orders 11063 [*42 U.S.C.A. § 1982* note], 11246 [*42 U.S.C.A. § 2000e* note], 11625 [*15 U.S.C.A. § 631* note], 12250 [*42 U.S.C.A. § 2000d-1* note], 12259 [*42 U.S.C.A. § 3608* note; now revoked by Ex. Ord. No. 12892, Jan. 17, 1994, *59 F.R. 2939* , also set out under this section], and 12432 [*15 U.S.C.A. § 637* note]; and

(12) any other provision of law which the Secretary specifies by publication in the Federal Register for the purpose of this subsection.

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§ **3608a Collection of certain data.**

(a) In general

To assess the extent of compliance with Federal fair housing requirements (including the requirements established under title VI of Public Law 88-352 [*42 U.S.C. 2000d et seq.*] and title VIII of Public Law 90-284 [*42 U.S.C. 3601 et seq.*]), the Secretary of Agriculture shall collect, not less than annually, data on the racial and ethnic characteristics of persons eligible for, assisted, or otherwise benefiting under each community development, housing assistance, and mortgage and loan insurance and guarantee program administered by such Secretary. Such data shall be collected on a building basis if the Secretary determines such collection to be appropriate.

(b) Reports to Congress

The Secretary of Agriculture shall include in the annual report of such Secretary to the Congress a summary and evaluation of the data collected by such Secretary under subsection (a) of this section during the preceding year.

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§ **3609 Education and conciliation; conferences and consultations; reports.**

Immediately after the enactment of this title [enacted April 11, 1968] the Secretary shall commence such educational and conciliatory activities as in his judgment will further the purposes of this subchapter. He shall call conferences of persons in the housing industry and other interested parties to acquaint them with the provisions of this subchapter and his suggested means of implementing it, and shall endeavor with their advice to work out programs of voluntary compliance and of enforcement. He may pay per diem, travel, and transportation expenses for persons attending such conferences as provided in section 5703 of title 5. He shall consult with State and local officials and other interested parties to learn the extent, if any, to which housing discrimination exists in their State or locality, and whether and how State or local enforcement programs might be utilized to combat such discrimination in connection with or in place of, the Secretary's enforcement of this subchapter. The Secretary shall issue reports on such conferences and consultations as he deems appropriate.

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§ **3610 Administrative enforcement; preliminary matters.**

(a) Complaints and answers

(1)

(A)

(i) An aggrieved person may, not later than one year after an alleged discriminatory housing practice has occurred or terminated, file a complaint with the Secretary alleging such discriminatory housing practice. The Secretary, on the Secretary's own initiative, may also file such a complaint.

(ii) Such complaints shall be in writing and shall contain such information and be in such form as the Secretary requires.

(iii) The Secretary may also investigate housing practices to determine whether a complaint should be brought under this section.

(B) Upon the filing of such a complaint--

(i) the Secretary shall serve notice upon the aggrieved person acknowledging such filing and advising the

aggrieved person of the time limits and choice of forums provided under this subchapter;

(ii) the Secretary shall, not later than 10 days after such filing or the identification of an additional respondent under paragraph (2), serve on the respondent a notice identifying the alleged discriminatory housing practice and advising such respondent of the procedural rights and obligations of respondents under this subchapter, together with a copy of the original complaint;

(iii) each respondent may file, not later than 10 days after receipt of notice from the Secretary, an answer to such complaint; and

(iv) the Secretary shall make an investigation of the alleged discriminatory housing practice and complete such investigation within 100 days after the filing of the complaint (or, when the Secretary takes further action under subsection (f)(2) of this section with respect to a complaint, within 100 days after the commencement of such further action), unless it is impracticable to do so.

(C) If the Secretary is unable to complete the investigation within 100 days after the filing of the complaint (or, when the Secretary takes further action under subsection (f)(2) of this section with respect to a complaint, within 100 days after the commencement of such further action), the Secretary shall notify the complainant and respondent in writing of the reasons for not doing so.

(D) Complaints and answers shall be under oath or affirmation, and may be reasonably and fairly amended at any time.

(2)

(A) A person who is not named as a respondent in a complaint, but who is identified as a respondent in the course of investigation, may be joined as an additional or substitute respondent upon written notice, under paragraph (1), to such person, from the Secretary.

(B) Such notice, in addition to meeting the requirements of paragraph (1), shall explain the basis for the Secretary's belief that the person to whom the notice is addressed is properly joined as a respondent.

(b) Investigative report and conciliation

(1) During the period beginning with the filing of such complaint and ending with the filing of a charge or a dismissal by the Secretary, the Secretary shall, to the extent feasible, engage in conciliation with respect to such complaint.

(2) A conciliation agreement arising out of such conciliation shall be an agreement between the respondent and the complainant, and shall be subject to approval by the Secretary.

(3) A conciliation agreement may provide for binding arbitration of the dispute arising from the complaint. Any such arbitration that results from a conciliation agreement may award appropriate relief, including monetary relief.

(4) Each conciliation agreement shall be made public unless the complainant and respondent otherwise agree and the Secretary determines that disclosure is not required to further the purposes of this subchapter.

(5)

(A) At the end of each investigation under this section, the Secretary shall prepare a final investigative report containing--

(i) the names and dates of contacts with witnesses;

(ii) a summary and the dates of correspondence and other contacts with the aggrieved person and the respondent;

(iii) a summary description of other pertinent records;

(iv) a summary of witness statements; and

(v) answers to interrogatories.

(B) A final report under this paragraph may be amended if additional evidence is later discovered.

(c) Failure to comply with conciliation agreement

Whenever the Secretary has reasonable cause to believe that a respondent has breached a conciliation agreement, the Secretary shall refer the matter to the Attorney General with a recommendation that a civil action be filed under section 3614 of this title for the enforcement of such agreement.

(d) Prohibitions and requirements with respect to disclosure of information

(1) Nothing said or done in the course of conciliation under this subchapter may be made public or used as evidence in a subsequent proceeding under this subchapter without the written consent of the persons concerned.

(2) Notwithstanding paragraph (1), the Secretary shall make available to the aggrieved person and the respondent, at any time, upon request following completion of the Secretary's investigation, information derived from an investigation and any final investigative report relating to that investigation.

(e) Prompt judicial action

(1) If the Secretary concludes at any time following the filing of a complaint that prompt judicial action is necessary to carry out the purposes of this subchapter, the Secretary may authorize a civil action for appropriate temporary or preliminary relief pending final disposition of the complaint under this section. Upon receipt of such an authorization, the Attorney General shall promptly commence and maintain such an action. Any temporary restraining order or other order granting preliminary or temporary relief shall be issued in accordance with the Federal Rules of Civil Procedure. The commencement of a civil action under this subsection does not affect the initiation or continuation of administrative proceedings under this section and section 3612 of this title.

(2) Whenever the Secretary has reason to believe that a basis may exist for the commencement of proceedings against any respondent under sections 3614(a) and 3614(c) of this title or for proceedings by any governmental licensing or supervisory authorities, the Secretary shall transmit the information upon which such belief is based to the Attorney General, or to such authorities, as the case may be.

(f) Referral for State or local proceedings

(1) Whenever a complaint alleges a discriminatory housing practice--

(A) within the jurisdiction of a State or local public agency; and

(B) as to which such agency has been certified by the Secretary under this subsection;

the Secretary shall refer such complaint to that certified agency before taking any action with respect to such complaint.

(2) Except with the consent of such certified agency, the Secretary, after that referral is made, shall take no further action with respect to such complaint unless--

(A) the certified agency has failed to commence proceedings with respect to the complaint before the end of the 30th day after the date of such referral;

(B) the certified agency, having so commenced such proceedings, fails to carry forward such proceedings with reasonable promptness; or

(C) the Secretary determines that the certified agency no longer qualifies for certification under this subsection with respect to the relevant jurisdiction.

(3)

(A) The Secretary may certify an agency under this subsection only if the Secretary determines that--

(i) the substantive rights protected by such agency in the jurisdiction with respect to which certification is to be made;

(ii) the procedures followed by such agency;

(iii) the remedies available to such agency; and

(iv) the availability of judicial review of such agency's action;

are substantially equivalent to those created by and under this subchapter.

(B) Before making such certification, the Secretary shall take into account the current practices and past performance, if any, of such agency.

(4) During the period which begins on the date of the enactment of the Fair Housing Amendments Act of 1988 [enacted Sept. 13, 1988] and ends 40 months after such date, each agency certified (including an agency certified for interim referrals pursuant to 24 CFR 115.11, unless such agency is subsequently denied recognition under 24 CFR 115.7) for the purposes of this subchapter on the day before such date shall for the purposes of this subsection be considered certified under this subsection with respect to those matters for which such agency was certified on that date. If the Secretary determines in an individual case that an agency has not been able to meet the certification requirements within this 40-month period due to exceptional circumstances, such as the infrequency of legislative sessions in that jurisdiction, the Secretary may extend such period by not more than 8 months.

(5) Not less frequently than every 5 years, the Secretary shall determine whether each agency certified under this subsection continues to qualify for certification. The Secretary shall take appropriate action with respect to any agency not so qualifying.

(g) Reasonable cause determination and effect

(1) The Secretary shall, within 100 days after the filing of the complaint (or, when the Secretary takes further action under subsection (f)(2) of this section with respect to a complaint, within 100 days after the commencement of such further action), determine based on the facts whether reasonable cause exists to believe that a discriminatory housing practice has occurred or is about to occur, unless it is impracticable to do so, or unless the Secretary has approved a conciliation agreement with respect to the complaint. If the Secretary is unable to make the determination within 100 days after the filing of the complaint (or, when the Secretary takes further action under subsection (f)(2) of this section with respect to a complaint, within 100 days after the commencement of such further action), the Secretary shall notify the complainant and respondent in writing of the reasons for not doing so.

(2)

(A) If the Secretary determines that reasonable cause exists to believe that a discriminatory housing practice has occurred or is about to occur, the Secretary shall, except as provided in subparagraph (C), immediately issue a charge on behalf of the aggrieved person, for further proceedings under section 3612 of this title.

(B) Such charge--

(i) shall consist of a short and plain statement of the facts upon which the Secretary has found reasonable cause to believe that a discriminatory housing practice has occurred or is about to occur;

(ii) shall be based on the final investigative report; and

(iii) need not be limited to the facts or grounds alleged in the complaint filed under subsection (a) of this section.

(C) If the Secretary determines that the matter involves the legality of any State or local zoning or other land use law or ordinance, the Secretary shall immediately refer the matter to the Attorney General for appropriate action under section 3614 of this title, instead of issuing such charge.

(3) If the Secretary determines that no reasonable cause exists to believe that a discriminatory housing practice has occurred or is about to occur, the Secretary shall promptly dismiss the complaint. The Secretary shall make public disclosure of each such dismissal.

(4) The Secretary may not issue a charge under this section regarding an alleged discriminatory housing practice after the beginning of the trial of a civil action commenced by the aggrieved party under an Act of Congress or a State law, seeking relief with respect to that discriminatory housing practice.

(h) Service of copies of charge

After the Secretary issues a charge under this section, the Secretary shall cause a copy thereof, together with information as to how to make an election under section 3612(a) of this title and the effect of such an election, to be served--

(1) on each respondent named in such charge, together with a notice of opportunity for a hearing at a time and place specified in the notice, unless that election is made; and

(2) on each aggrieved person on whose behalf the complaint was filed.

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§ **3611 Subpoenas; giving of evidence.**

(a) In general

The Secretary may, in accordance with this subsection, issue subpoenas and order discovery in aid of investigations and hearings under this subchapter. Such subpoenas and discovery may be ordered to the same extent and subject to the same limitations as would apply if the subpoenas or discovery were ordered or served in aid of a civil action in the United States district court for the district in which the investigation is taking place.

(b) Witness fees

Witnesses summoned by a subpoena under this chapter shall be entitled to the same witness and mileage fees as witnesses in proceedings in United States district courts. Fees payable to a witness summoned by a subpoena issued at the request of a party shall be paid by that party or, where a party is unable to pay the fees, by the Secretary.

(c) Criminal penalties

(1) Any person who willfully fails or neglects to attend and testify or to answer any lawful inquiry or to produce records, documents, or other evidence, if it is in such person's power to do so, in obedience to the subpoena or other lawful order under subsection (a) of this section, shall be fined not more than $100,000 or imprisoned not more than one year, or both.

(2) Any person who, with intent thereby to mislead another person in any proceeding under this subchapter--

(A) makes or causes to be made any false entry or statement of fact in any report, account, record, or other document produced pursuant to subpoena or other lawful order under subsection (a) of this section;

(B) willfully neglects or fails to make or to cause to be made full, true, and correct entries in such reports, accounts, records, or other documents; or

(C) willfully mutilates, alters, or by any other means falsifies any documentary evidence;

shall be fined not more than $100,000 or imprisoned not more than one year, or both.

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§ **3612 Enforcement by Secretary.**

(a) Election of judicial determination

When a charge is filed under section 3610 of this title, a complainant, a respondent, or an aggrieved person on whose behalf the complaint was filed, may elect to have the claims asserted in that charge decided in a civil action under subsection (o) of this section in lieu of a hearing under subsection (b) of this section. The election must be made not later than 20 days after the receipt by the electing person of service under section 3610(h) of this title or, in the case of the Secretary, not later than 20 days after such service. The person making such election shall give notice of doing so to the Secretary and to all other complainants and respondents to whom the charge relates.

(b) Administrative law judge hearing in absence of election

If an election is not made under subsection (a) of this section with respect to a charge filed under section 3610 of this title, the Secretary shall provide an opportunity for a hearing on the record with respect to a charge issued under section 3610 of this title. The Secretary shall delegate the conduct of a hearing under this section to an administrative law judge appointed under *section 3105 of title 5, United States Code*. The administrative law judge shall conduct the hearing at a place in the vicinity in which the discriminatory housing practice is alleged to have occurred or to be about to occur.

(c) Rights of parties

At a hearing under this section, each party may appear in person, be represented by counsel, present evidence, cross-examine witnesses, and obtain the issuance of subpoenas under section 3611 of this title. Any aggrieved person may intervene as a party in the proceeding. The Federal Rules of Evidence apply to the presentation of evidence in such hearing as they would in a civil action in a United States district court.

(d) Expedited discovery and hearing

(1) Discovery in administrative proceedings under this section shall be conducted as expeditiously and inexpensively as possible, consistent with the need of all parties to obtain relevant evidence.

(2) A hearing under this section shall be conducted as expeditiously and inexpensively as possible, consistent with the needs and rights of the parties to obtain a fair hearing and a complete record.

(3) The Secretary shall, not later than 180 days after the date of enactment of this subsection [enacted Sept. 13, 1988], issue rules to implement this subsection.

(e) Resolution of charge

Any resolution of a charge before a final order under this section shall require the consent of the aggrieved person on whose behalf the charge is issued.

(f) Effect of trial of civil action on administrative proceedings

An administrative law judge may not continue administrative proceedings under this section regarding any alleged discriminatory housing practice after the beginning of the trial of a civil action commenced by the aggrieved party under an Act of Congress or a State law, seeking relief with respect to that discriminatory housing practice.

(g) Hearings, findings and conclusions, and order

(1) The administrative law judge shall commence the hearing under this section no later than 120 days following the issuance of the charge, unless it is impracticable to do so. If the administrative law judge is unable to commence the hearing within 120 days after the issuance of the charge, the administrative law judge shall notify the Secretary, the aggrieved person on whose behalf the charge was filed, and the respondent, in writing of the reasons for not doing so.

(2) The administrative law judge shall make findings of fact and conclusions of law within 60 days after the end of the hearing under this section, unless it is impracticable to do so. If the administrative law judge is unable to make findings of fact and conclusions of law within such period, or any succeeding 60-day period thereafter, the administrative law judge shall notify the Secretary, the aggrieved person on whose behalf the charge was filed, and the respondent, in writing of the reasons for not doing so.

(3) If the administrative law judge finds that a respondent has engaged or is about to engage in a discriminatory housing practice, such administrative law judge shall promptly issue an order for such relief as may be appropriate, which may include actual damages suffered by the aggrieved person and injunctive or other equitable relief. Such order may, to vindicate the public interest, assess a civil penalty against the respondent--

(A) in an amount not exceeding $10,000 if the respondent has not been adjudged to have committed any prior discriminatory housing practice;

(B) in an amount not exceeding $25,000 if the respondent has been adjudged to have committed one other discriminatory housing practice during the 5-year period ending on the date of the filing of this charge; and

(C) in an amount not exceeding $50,000 if the respondent has been adjudged to have committed 2 or more discriminatory housing practices during the 7-year period ending on the date of the filing of this charge;

except that if the acts constituting the discriminatory housing practice that is the object of the charge are committed by the same natural person who has been previously adjudged to have committed acts constituting a discriminatory housing practice, then the civil penalties set forth in subparagraphs (B) and (C) may be imposed without regard to the period of time within which any subsequent discriminatory housing practice occurred.

(4) No such order shall affect any contract, sale, encumbrance, or lease consummated before the issuance of such order and involving a bona fide purchaser, encumbrancer, or tenant without actual notice of the charge filed under this subchapter.

(5) In the case of an order with respect to a discriminatory housing practice that occurred in the course of a business subject to a licensing or regulation by a governmental agency, the Secretary shall, not later than 30 days after the date of the issuance of such order (or, if such order is judicially reviewed, 30 days after such order is in substance affirmed upon such review)--

(A) send copies of the findings of fact, conclusions of law, and the order, to that governmental agency; and

(B) recommend to that governmental agency appropriate disciplinary action (including, where appropriate, the suspension or revocation of the license of the respondent).

(6) In the case of an order against a respondent against whom another order was issued within the preceding 5 years

under this section, the Secretary shall send a copy of each such order to the Attorney General.

(7) If the administrative law judge finds that the respondent has not engaged or is not about to engage in a discriminatory housing practice, as the case may be, such administrative law judge shall enter an order dismissing the charge. The Secretary shall make public disclosure of each such dismissal.

(h) Review by Secretary; service of final order

(1) The Secretary may review any finding, conclusion, or order issued under subsection (g) of this section. Such review shall be completed not later than 30 days after the finding, conclusion, or order is so issued; otherwise the finding, conclusion, or order becomes final.

(2) The Secretary shall cause the findings of fact and conclusions of law made with respect to any final order for relief under this section, together with a copy of such order, to be served on each aggrieved person and each respondent in the proceeding.

(i) Judicial review

(1) Any party aggrieved by a final order for relief under this section granting or denying in whole or in part the relief sought may obtain a review of such order under chapter 158 of title 28, United States Code.

(2) Notwithstanding such chapter, venue of the proceeding shall be in the judicial circuit in which the discriminatory housing practice is alleged to have occurred, and filing of the petition for review shall be not later than 30 days after the order is entered.

(j) Court enforcement of administrative order upon petition by Secretary

(1) The Secretary may petition any United States court of appeals for the circuit in which the discriminatory housing practice is alleged to have occurred or in which any respondent resides or transacts business for the enforcement of the order of the administrative law judge and for appropriate temporary relief or restraining order, by filing in such court a written petition praying that such order be enforced and for appropriate temporary relief or restraining order.

(2) The Secretary shall file in court with the petition the record in the proceeding. A copy of such petition shall be forthwith transmitted by the clerk of the court to the parties to the proceeding before the administrative law judge.

(k) Relief which may be granted

(1) Upon the filing of a petition under subsection (i) or (j) of this section, the court may--

(A) grant to the petitioner, or any other party, such temporary relief, restraining order, or other order as the court deems just and proper;

(B) affirm, modify, or set aside, in whole or in part, the order, or remand the order for further proceedings; and

(C) enforce such order to the extent that such order is affirmed or modified.

(2) Any party to the proceeding before the administrative law judge may intervene in the court of appeals.

(3) No objection not made before the administrative law judge shall be considered by the court, unless the failure or neglect to urge such objection is excused because of extraordinary circumstances.

(l) Enforcement decree in absence of petition for review

If no petition for review is filed under subsection (i) of this section before the expiration of 45 days after the date the administrative law judge's order is entered, the administrative law judge's findings of fact and order shall be conclusive in connection with any petition for enforcement--

(1) which is filed by the Secretary under subsection (j) of this section after the end of such day; or

(2) under subsection (m) of this section.

(m) Court enforcement of administrative order upon petition of any person entitled to relief

If before the expiration of 60 days after the date the administrative law judge's order is entered, no petition for review has been filed under subsection (i) of this section, and the Secretary has not sought enforcement of the order under subsection (j) of this section, any person entitled to relief under the order may petition for a decree enforcing the order in the United States court of appeals for the circuit in which the discriminatory housing practice is alleged to have occurred.

(n) Entry of decree

The clerk of the court of appeals in which a petition for enforcement is filed under subsection *(l)* or (m) of this section shall forthwith enter a decree enforcing the order and shall transmit a copy of such decree to the Secretary, the respondent named in the petition, and to any other parties to the proceeding before the administrative law judge.

(o) Civil action for enforcement when election is made for such civil action

(1) If an election is made under subsection (a) of this section, the Secretary shall authorize, and not later than 30 days after the election is made the Attorney General shall commence and maintain, a civil action on behalf of the aggrieved person in a United States district court seeking relief under this subsection. Venue for such civil action shall be determined under chapter 87 of title 28, United States Code.

(2) Any aggrieved person with respect to the issues to be determined in a civil action under this subsection may intervene as of right in that civil action.

(3) In a civil action under this subsection, if the court finds that a discriminatory housing practice has occurred or is about to occur, the court may grant as relief any relief which a court could grant with respect to such discriminatory housing practice in a civil action under section 3613 of this title. Any relief so granted that would accrue to an aggrieved person in a civil action commenced by that aggrieved person under section 3613 of this title shall also accrue to that aggrieved person in a civil action under this subsection. If monetary relief is sought for the benefit of an aggrieved person who does not intervene in the civil action, the court shall not award such relief if that aggrieved person has not complied with discovery orders entered by the court.

(p) Attorney's fees

In any administrative proceeding brought under this section, or any court proceeding arising therefrom, or any civil action under section 3612 of this title, the administrative law judge or the court, as the case may be, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee and costs. The United States shall be liable for such fees and costs to the extent provided by *section 504 of title 5, United States Code*, or by *section 2412 of title 28, United States Code*.

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§ **3613 Enforcement by private persons.**

(a) Civil action

(1)

(A) An aggrieved person may commence a civil action in an appropriate United States district court or State court not later than 2 years after the occurrence or the termination of an alleged discriminatory housing practice, or the breach of a conciliation agreement entered into under this subchapter, whichever occurs last, to obtain appropriate relief with respect to such discriminatory housing practice or breach.

(B) The computation of such 2-year period shall not include any time during which an administrative proceeding under this subchapter, was pending with respect to a complaint or charge under this subchapter based upon such discriminatory housing practice. This subparagraph does not apply to actions arising from a breach of a conciliation agreement.

(2) An aggrieved person may commence a civil action under this subsection whether or not a complaint has been filed under section 3610(a) of this section and without regard to the status of any such complaint, but if the Secretary or a State or local agency has obtained a conciliation agreement with the consent of an aggrieved person, no action may be filed under this subsection by such aggrieved person with respect to the alleged discriminatory housing practice which forms the basis for such complaint except for the purpose of enforcing the terms of such an agreement.

(3) An aggrieved person may not commence a civil action under this subsection with respect to an alleged

discriminatory housing practice which forms the basis of a charge issued by the Secretary if an administrative law judge has commenced a hearing on the record under this subchapter with respect to such charge.

(b) Appointment of attorney by court

Upon application by a person alleging a discriminatory housing practice or a person against whom such a practice is alleged, the court may--

(1) appoint an attorney for such person; or

(2) authorize the commencement or continuation of a civil action under under subsection (a) of this section without the payment of fees, costs, or security, if in the opinion of the court such person is financially unable to bear the costs of such action.

(c) Relief which may be granted

(1) In a civil action under subsection (a) of this section, if the court finds that a discriminatory housing practice has occurred or is about to occur, the court may award to the plaintiff actual and punitive damages, and subject to subsection (d) of this section, may grant as relief, as the court deems appropriate, any permanent or temporary injunction, temporary restraining order, or other order (including an order enjoining the defendant from engaging in such practice or ordering such affirmative action as may be appropriate).

(2) In a civil action under subsection (a) of this section, the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee and costs. The United States shall be liable for such fees and costs to the same extent as a private person.

(d) Effect on certain sales, encumbrances, and rentals

Relief granted under this section shall not affect any contract, sale, encumbrance, or lease consummated before the granting of such relief and involving a bona fide purchaser, encumbrancer, or tenant, without actual notice of the filing of a complaint with the Secretary or civil action under this subchapter.

(e) Intervention by Attorney General

Upon timely application, the Attorney General may intervene in such civil action, if the Attorney General certifies that the case is of general public importance. Upon such intervention the Attorney General may obtain such relief as

would be available to the Attorney General under section 3614(e) of this section in a civil action to which such section applies.

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§ 3614 Enforcement by the Attorney General.

(a) Pattern or practice cases

Whenever the Attorney General has reasonable cause to believe that any person or group of persons is engaged in a pattern or practice of resistance to the full enjoyment of any of the rights granted by this subchapter, or that any group of persons has been denied any of the rights granted by this subchapter and such denial raises an issue of general public importance, the Attorney General may commence a civil action in any appropriate United States district court.

(b) On referral of discriminatory housing practice or conciliation agreement for enforcement

(1)

(A) The Attorney General may commence a civil action in any appropriate United States district court for appropriate relief with respect to a discriminatory housing practice referred to the Attorney General by the Secretary under section 3610(g) of this title.

(B) A civil action under this paragraph may be commenced not later than the expiration of 18 months after the date of the occurrence or the termination of the alleged discriminatory housing practice.

(2)

(A) The Attorney General may commence a civil action in any appropriate United States district court for

appropriate relief with respect to breach of a conciliation agreement referred to the Attorney General by the Secretary under section 3610(c) of this title.

(B) A civil action may be commenced under this paragraph not later than the expiration of 90 days after the referral of the alleged breach under section 3610(c) of this title.

(c) Enforcement of subpoenas

The Attorney General, on behalf of the Secretary, or other party at whose request a subpoena is issued, under this subchapter, may enforce such subpoena in appropriate proceedings in the United States district court for the district in which the person to whom the subpoena was addressed resides, was served, or transacts business.

(d) Relief which may be granted in civil actions under subsections (a) and (b)

(1) In a civil action under subsection (a) or (b) of this section, the court--

(A) may award such preventive relief, including a permanent or temporary injunction, restraining order, or other order against the person responsible for a violation of this subchapter as is necessary to assure the full enjoyment of the rights granted by this subchapter;

(B) may award such other relief as the court deems appropriate, including monetary damages to persons aggrieved; and

(C) may, to vindicate the public interest, assess a civil penalty against the respondent--

(i) in an amount not exceeding $50,000, for a first violation; and

(ii) in an amount not exceeding $100,000, for any subsequent violation.

(2) In a civil action under this section, the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee and costs. The United States shall be liable for such fees and costs to the extent provided by *section 2412 of title 28, United States Code*.

(e) Intervention in civil actions

Upon timely application, any person may intervene in a civil action commenced by the Attorney General under subsection (a) or (b) of this section which involves an alleged discriminatory housing practice with respect to which such person is an aggrieved person or a conciliation agreement to which such person is a party. The court may grant such appropriate relief to any such intervening party as is authorized to be granted to a plaintiff in a civil action under section 3613 of this title.

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§ **3614-1 Incentives for self-testing and self-correction.**

(a) Privileged information

(1) Conditions for privilege

A report or result of a self-test (as that term is defined by regulation of the Secretary) shall be considered to be privileged under paragraph (2) if any person--

(A) conducts, or authorizes an independent third party to conduct, a self-test of any aspect of a residential real estate related lending transaction of that person, or any part of that transaction, in order to determine the level or effectiveness of compliance with this subchapter by that person; and

(B) has identified any possible violation of this subchapter by that person and has taken, or is taking, appropriate corrective action to address any such possible violation.

(2) Privileged self-test

If a person meets the conditions specified in subparagraphs (A) and (B) of paragraph (1) with respect to a self-test described in that paragraph, any report or results of that self-test--

(A) shall be privileged; and

(B) may not be obtained or used by any applicant, department, or agency in any--

(i) proceeding or civil action in which one or more violations of this subchapter are alleged; or

(ii) examination or investigation relating to compliance with this subchapter.

(b) Results of self-testing

(1) In general

No provision of this section may be construed to prevent an aggrieved person, complainant, department, or agency from obtaining or using a report or results of any self-test in any proceeding or civil action in which a violation of this subchapter is alleged, or in any examination or investigation of compliance with this subchapter if--

(A) the person to whom the self-test relates or any person with lawful access to the report or the results--

(i) voluntarily releases or discloses all, or any part of, the report or results to the aggrieved person, complainant, department, or agency, or to the general public; or

(ii) refers to or describes the report or results as a defense to charges of violations of this subchapter against the person to whom the self-test relates; or

(B) the report or results are sought in conjunction with an adjudication or admission of a violation of this subchapter for the sole purpose of determining an appropriate penalty or remedy.

(2) Disclosure for determination of penalty or remedy

Any report or results of a self-test that are disclosed for the purpose specified in paragraph (1)(B)--

(A) shall be used only for the particular proceeding in which the adjudication or admission referred to in paragraph

(1)(B) is made; and

(B) may not be used in any other action or proceeding.

(c) Adjudication

An aggrieved person, complainant, department, or agency that challenges a privilege asserted under this section may seek a determination of the existence and application of that privilege in--

(1) a court of competent jurisdiction; or

(2) an administrative law proceeding with appropriate jurisdiction.

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§ **3614a Rules to implement subchapter.**

The Secretary may make rules (including rules for the collection, maintenance, and analysis of appropriate data) to carry out this subchapter. The Secretary shall give public notice and opportunity for comment with respect to all rules made under this section.

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§ **3615 Effect on State laws.**

Nothing in this subchapter shall be construed to invalidate or limit any law of a State or political subdivision of a State, or of any other jurisdiction in which this subchapter shall be effective, that grants, guarantees, or protects the same rights as are granted by this subchapter; but any law of a State, a political subdivision, or other such jurisdiction that purports to require or permit any action that would be a discriminatory housing practice under this subchapter shall to that extent be invalid.

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§ 3616 Cooperation with State and local agencies administering fair housing laws; utilization of services and personnel; reimbursement; written agreements; publication in Federal Register.

The Secretary may cooperate with State and local agencies charged with the administration of State and local fair housing laws and, with the consent of such agencies, utilize the services of such agencies and their employees and, notwithstanding any other provision of law, may reimburse such agencies and their employees for services rendered to assist him in carrying out this subchapter. In furtherance of such cooperative efforts, the Secretary may enter into written agreements with such State or local agencies. All agreements and terminations thereof shall be published in the Federal Register.

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§ **3616a Fair housing initiatives program.**

(a) In general

The Secretary of Housing and Urban Development (in this section referred to as the "Secretary") may make grants to, or (to the extent of amounts provided in appropriation Acts) enter into contracts or cooperative agreements with, State or local governments or their agencies, public or private nonprofit organizations or institutions, or other public or private entities that are formulating or carrying out programs to prevent or eliminate discriminatory housing practices, to develop, implement, carry out, or coordinate--

(1) programs or activities designed to obtain enforcement of the rights granted by title VIII of the Act of April 11, 1968 [*42 U.S.C. 3601 et seq.*] (commonly referred to as the Civil Rights Act of 1968), or by State or local laws that provide rights and remedies for alleged discriminatory housing practices that are substantially equivalent to the rights and remedies provided in such title VIII, through such appropriate judicial or administrative proceedings (including informal methods of conference, conciliation, and persuasion) as are available therefor; and

(2) education and outreach programs designed to inform the public concerning rights and obligations under the laws referred to in paragraph (1).

(b) Private enforcement initiatives

(1) In general

The Secretary shall use funds made available under this subsection to conduct, through contracts with private nonprofit fair housing enforcement organizations, investigations of violations of the rights granted under title VIII of the Civil Rights Act of 1968, and such enforcement activities as appropriate to remedy such violations. The Secretary may enter into multiyear contracts and take such other action as is appropriate to enhance the effectiveness of such investigations and enforcement activities.

(2) Activities

The Secretary shall use funds made available under this subsection to conduct, through contracts with private nonprofit fair housing enforcement organizations, a range of investigative and enforcement activities designed to--

(A) carry out testing and other investigative activities in accordance with subsection (b)(1) of this section, including building the capacity for housing investigative activities in unserved or underserved areas;

(B) discover and remedy discrimination in the public and private real estate markets and real estate-related transactions, including, but not limited to, the making or purchasing of loans or the provision of other financial assistance sales and rentals of housing and housing advertising;

(C) carry out special projects, including the development of prototypes to respond to new or sophisticated forms of discrimination against persons protected under title VIII of the Civil Rights Act of 1968;

(D) provide technical assistance to local fair housing organizations, and assist in the formation and development of new fair housing organizations; and

(E) provide funds for the costs and expenses of litigation, including expert witness fees.

(c) Funding of fair housing organizations

(1) In general

The Secretary shall use funds made available under this section to enter into contracts or cooperative agreements with qualified fair housing enforcement organizations, other private nonprofit fair housing enforcement organizations, and nonprofit groups organizing to build their capacity to provide fair housing enforcement, for the purpose of supporting the continued development or implementation of initiatives which enforce the rights granted under title VIII of the Civil Rights Act of 1968, as amended. Contracts or cooperative agreements may not provide more than 50 percent of the operating budget of the recipient organization for any one year.

(2) Capacity enhancement

The Secretary shall use funds made available under this section to help establish, organize, and build the capacity of fair housing enforcement organizations, particularly in those areas of the country which are currently underserved by fair housing enforcement organizations as well as those areas where large concentrations of protected classes exist. For purposes of meeting the objectives of this paragraph, the Secretary may enter into contracts or cooperative agreements with qualified fair housing enforcement organizations. The Secretary shall establish annual goals which reflect the national need for private fair housing enforcement organizations.

(d) Education and outreach

(1) In general

The Secretary, through contracts with one or more qualified fair housing enforcement organizations, other fair housing enforcement organizations, and other nonprofit organizations representing groups of persons protected under title VIII of the Civil Rights Act of 1968, shall establish a national education and outreach program. The national program shall be designed to provide a centralized, coordinated effort for the development and dissemination of fair housing media products, including--

(A) public service announcements, both audio and video;

(B) television, radio and print advertisements;

(C) posters; and

(D) pamphlets and brochures.

The Secretary shall designate a portion of the amounts provided in subsection (g)(4) of this section for a national program specifically for activities related to the annual national fair housing month. The Secretary shall encourage cooperation with real estate industry organizations in the national education and outreach program. The Secretary shall also encourage the dissemination of educational information and technical assistance to support compliance with the housing adaptability and accessibility guidelines contained in the Fair Housing Act Amendments of 1988.

(2) Regional and local programs

The Secretary, through contracts with fair housing enforcement organizations, other nonprofit organizations

representing groups of persons protected under title VIII of the Civil Rights Act of 1968, State and local agencies certified by the Secretary under section 3610(f) of this title, or other public or private entities that are formulating or carrying out programs to prevent or eliminate discriminatory housing practices, shall establish or support education and outreach programs at the regional and local levels.

(3) Community-based programs

The Secretary shall provide funding to fair housing organizations and other nonprofit organizations representing groups of persons protected under title VIII of the Civil Rights Act of 1968, or other public or private entities that are formulating or carrying out programs to prevent or eliminate discriminatory housing practices, to support community-based education and outreach activities, including school, church, and community presentations, conferences, and other educational activities.

(e) Program administration

(1) Not less than 30 days before providing a grant or entering into any contract or cooperative agreement to carry out activities authorized by this section, the Secretary shall submit notification of such proposed grant, contract, or cooperative agreement (including a description of the geographical distribution of such contracts) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking, Finance and Urban Affairs of the House of Representatives.

(2) [Repealed. Pub. L. 104-66, title I, § 1071(d), Dec. 21, 1995, *109 Stat. 720]*

(f) Regulations

(1) The Secretary shall issue such regulations as may be necessary to carry out the provisions of this section.

(2) The Secretary shall, for use during the demonstration authorized in this section, establish guidelines for testing activities funded under the private enforcement initiative of the fair housing initiatives program. The purpose of such guidelines shall be to ensure that investigations in support of fair housing enforcement efforts described in subsection (a)(1) of this section shall develop credible and objective evidence of discriminatory housing practices. Such guidelines shall apply only to activities funded under this section, shall not be construed to limit or otherwise restrict the use of facts secured through testing not funded under this section in any legal proceeding under Federal fair housing laws, and shall not be used to restrict individuals or entities, including those participating in the fair housing initiatives program, from pursuing any right or remedy guaranteed by Federal law. Not later than 6 months after the end of the demonstration period authorized in this section, the Secretary shall submit to Congress the evaluation of the Secretary of the effectiveness of such guidelines in achieving the purposes of this section.

(3) Such regulations shall include provisions governing applications for assistance under this section, and shall require each such application to contain--

(A) a description of the assisted activities proposed to be undertaken by the applicant, together with the estimated costs and schedule for completion of such activities;

(B) a description of the experience of the applicant in formulating or carrying out programs to prevent or eliminate discriminatory housing practices;

(C) available information, including studies made by or available to the applicant, indicating the nature and extent of discriminatory housing practices occurring in the general location where the applicant proposes to conduct its assisted activities, and the relationship of such activities to such practices;

(D) an estimate of such other public or private resources as may be available to assist the proposed activities;

(E) a description of proposed procedures to be used by the applicant for monitoring conduct and evaluating results of the proposed activities; and

(F) any additional information required by the Secretary.

(4) Regulations issued under this subsection shall not become effective prior to the expiration of 90 days after the Secretary transmits such regulations, in the form such regulations are intended to be published, to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking, Finance and Urban Affairs of the House of Representatives.

(5) The Secretary shall not obligate or expend any amount under this section before the effective date of the regulations required under this subsection.

(g) Authorization of appropriations

There are authorized to be appropriated to carry out the provisions of this section[,] $21,000,000 for fiscal year 1993 and $26,000,000 for fiscal year 1994, of which--

(1) not less than $3,820,000 for fiscal year 1993 and $8,500,000 for fiscal year 1994 shall be for private enforcement initiatives authorized under subsection (b) of this section, divided equally between activities specified under subsection (b)(1) and those specified under subsection (b)(2) of this section;

(2) not less than $2,230,000 for fiscal year 1993 and $8,500,000 for fiscal year 1994 shall be for qualified fair housing enforcement organizations authorized under subsection (c)(1) of this section;

(3) not less than $2,010,000 for fiscal year 1993 and $4,000,000 for fiscal year 1994 shall be for the creation of new fair housing enforcement organizations authorized under subsection (c)(2) of this section; and

(4) not less than $2,540,000 for fiscal year 1993 and $5,000,000 for fiscal year 1994 shall be for education and outreach programs authorized under subsection (d) of this section, to be divided equally between activities specified under subsection (d)(1) and those specified under subsections (d)(2) and (d)(3) of this section.

Any amount appropriated under this section shall remain available until expended.

(h) Qualified fair housing enforcement organization

(1) The term "qualified fair housing enforcement organization" means any organization that--

(A) is organized as a private, tax-exempt, nonprofit, charitable organization;

(B) has at least 2 years experience in complaint intake, complaint investigation, testing for fair housing violations and enforcement of meritorious claims; and

(C) is engaged in all the activities listed in paragraph (1)(B) at the time of application for assistance under this section.

An organization which is not solely engaged in fair housing enforcement activities may qualify as a qualified fair housing enforcement organization, provided that the organization is actively engaged in each of the activities listed in subparagraph (B).

(2) The term "fair housing enforcement organization" means any organization that--

(A) meets the requirements specified in paragraph (1)(A);

(B) is currently engaged in the activities specified in paragraph (1)(B);

(C) upon the receipt of funds under this section will become engaged in all of the activities specified in paragraph (1)(B); and

(D) for purposes of funding under subsection (b) of this section, has at least 1 year of experience in the activities specified in paragraph (1)(B).

(i) Prohibition on use of funds

None of the funds authorized under this section may be used by the Secretary for purposes of settling claims, satisfying judgments or fulfilling court orders in any litigation action involving either the Department or housing providers funded by the Department. None of the funds authorized under this section may be used by the Department for administrative costs.

(j) Reporting requirements

Not later than 180 days after the close of each fiscal year in which assistance under this section is furnished, the Secretary shall prepare and submit to the Congress a comprehensive report which shall contain--

(1) a description of the progress made in accomplishing the objectives of this section;

(2) a summary of all the private enforcement activities carried out under this section and the use of such funds during the preceding fiscal year;

(3) a list of all fair housing enforcement organizations funded under this section during the preceding fiscal year, identified on a State-by-State basis;

(4) a summary of all education and outreach activities funded under this section and the use of such funds during the preceding fiscal year; and

(5) any findings, conclusions, or recommendations of the Secretary as a result of the funded activities.

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§ 3617 Interference, coercion, or intimidation; enforcement by civil action.

It shall be unlawful to coerce, intimidate, threaten, or interfere with any person in the exercise or enjoyment of, or on account of his having exercised or enjoyed, or on account of his having aided or encouraged any other person in the exercise or enjoyment of, any right granted or protected by section 3603, 3604, 3605, or 3606 of this title.

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§ **3618 Authorization of appropriations.**

There are hereby authorized to be appropriated such sums as are necessary to carry out the purposes of this subchapter.

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§ **3619 Separability of provisions.**

If any provision of this subchapter or the application thereof to any person or circumstances is held invalid, the remainder of the subchapter and the application of the provision to other persons not similarly situated or to other circumstances shall not be affected thereby.

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§ **3631 Violations; penalties.**

Whoever, whether or not acting under color of law, by force or threat of force willfully injuries, intimidates or interferes with, or attempts to injure, intimidate or interfere with--

(a) any person because of his race, color, religion, sex, handicap (as such term is defined in section 3602 of this title), familial status (as such term is defined in section 3602 of this title), or national origin and because he is or has been selling, purchasing, renting, financing, occupying, or contracting or negotiating for the sale, purchase, rental, financing or occupation of any dwelling, or applying for or participating in any service, organization, or facility relating to the business of selling or renting dwellings; or

(b) any person because he is or has been, or in order to intimidate such person or any other person or any class of persons from--

(1) participating, without discrimination on account of race, color, religion, sex, handicap (as such term is defined in section 3602 of this title), familial status (as such term is defined in section 3602 of this title), or national origin, in any of the activities, services, organizations or facilities described in subsection (a) of this section; or

(2) affording another person or class of persons opportunity or protection so to participate; or

(c) any citizen because he is or has been, or in order to discourage such citizen or any other citizen from lawfully

aiding or encouraging other persons to participate, without discrimination on account of race, color, religion, sex, handicap (as such term is defined in section 3602 of this title), familial status (as such term is defined in section 3602 of this title), or national origin, in any of the activities, services, organizations or facilities described in subsection (a) of this section, or participating lawfully in speech or peaceful assembly opposing any denial of the opportunity to so participate--

shall be fined under title 18, or imprisoned not more than one year, or both; and if bodily injury from the acts committed in violation of this section or if such acts include the use, attempted use, or threatened use of a dangerous weapon, explosives, or fire results shall be fined under title 18, or imprisoned not more than ten years, or both; and if death results from the acts committed in violation of this section or if such acts include kidnapping or an attempt to kidnap, aggravated sexual abuse or an attempt to commit aggravated sexual abuse, or an attempt to kill, shall be fined under title 18 or imprisoned for any term of years or for life, or both.

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§ **9-201 General Validity of Security Agreement.**

Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. Nothing in this Article validates any charge or practice illegal under any statute or regulation thereunder governing usury, small loans, retail installment sales, or the like, or extends the application of any such statute or regulation to any transaction not otherwise subject thereto.

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§ **9-202 Title to Collateral Immaterial.**

Each provision of this Article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor.

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§ **9-203 Attachment and Enforceability of Security Interest; Proceeds; Formal Requisites.**

(1) Subject to the provisions of Section 4-210 on the security interest of a collecting bank, Sections 9-115 and 9-116 on security interests in investment property, and Section 9-113 on a security interest arising under the Articles on Sales and Leases, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:

> (a) the collateral is in the possession of the secured party pursuant to agreement, the collateral is investment property and the secured party has control pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned;
>
> (b) value has been given; and
>
> (c) the debtor has rights in the collateral.

(2) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in subsection (1) have taken place unless explicit agreement postpones the time of attaching.

(3) Unless otherwise agreed a security agreement gives the secured party the rights to proceeds provided by Section 9-306.

(4) A transaction, although subject to this Article, is also subject to _____ [*], and in the case of conflict between the provisions of this Article and any such statute, the provisions of such statute control. Failure to

comply with any applicable statute has only the effect which is specified therein.

Note:

At [*] in subsection (4) insert reference to any local statute regulating small loans, retail installment sales and the like.

The foregoing subsection (4) is designed to make it clear that certain transactions, although subject to this Article, must also comply with other applicable legislation.

This Article is designed to regulate all the "security" aspects of transactions within its scope. There is, however, much regulatory legislation, particularly in the consumer field, which supplements this Article and should not be repealed by its enactment. Examples are small loan acts, retail installment selling acts and the like. Such acts may provide for licensing and rate regulation and may prescribe particular forms of contract. Such provisions should remain in force despite the enactment of this Article. On the other hand if a retail installment selling act contains provisions on filing, rights on default, etc., such provisions should be repealed as inconsistent with this Article except that inconsistent provisions as to deficiencies, penalties, etc., in the Uniform Consumer Credit Code and other recent related legislation should remain because those statutes were drafted after the substantial enactment of the Article and with the intention of modifying certain provisions of this Article as to consumer credit.

As amended in 1972, 1977 and 1994.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-204

§ **9-204 After-Acquired Property; Future Advances.**

(1) Except as provided in subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral.

(2) No security interest attaches under an after-acquired *property clause* to consumer goods other than accessions (Section 9-314) when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value.

(3) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment (subsection (1) of Section 9-105).

As amended in 1972.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-501

§ **9-501 Default; Procedure When Security Agreement Covers Both Real and Personal Property.**

(1) When a debtor is in default under a security agreement, a secured party has the rights and remedies provided in this Part and except as limited by subsection (3) those provided in the security agreement. He may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure. If the collateral is documents the secured party may proceed either as to the documents or as to the goods covered thereby. A secured party in possession has the rights, remedies and duties provided in Section 9-207. The rights and remedies referred to in this subsection are cumulative.

(2) After default, the debtor has the rights and remedies provided in this Part, those provided in the security agreement and those provided in Section 9-207.

(3) To the extent that they give rights to the debtor and impose duties on the secured party, the rules stated in the subsections referred to below may not be waived or varied except as provided with respect to compulsory disposition of collateral (subsection (3) of Section 9-504 and Section 9-505) and with respect to redemption of collateral (Section 9-506) but the parties may by agreement determine the standards by which the fulfillment of these rights and duties is to be measured if such standards are not manifestly unreasonable:

(a) subsection (2) of Section 9-502 and subsection (2) of Section 9-504 insofar as they require accounting for surplus proceeds of collateral;

(b) subsection (3) of Section 9-504 and subsection (1) of Section 9-505 which deal with disposition of collateral;

(c) subsection (2) of Section 9-505 which deals with acceptance of collateral as discharge of obligation;

(d) Section 9-506 which deals with redemption of collateral; and

(e) subsection (1) of Section 9-507 which deals with the secured party's liability for failure to comply with this Part.

(4) If the security agreement covers both real and personal property, the secured party may proceed under this Part as to the personal property or he may proceed as to both the real and the personal property in accordance with his rights and remedies in respect of the real property in which case the provisions of this Part do not apply.

(5) When a secured party has reduced his claim to judgment the lien of any levy which may be made upon his collateral by virtue of any execution based upon the judgment shall relate back to the date of the perfection of the security interest in such collateral. A judicial sale, pursuant to such execution, is a foreclosure of the security interest by judicial procedure within the meaning of this section, and the secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this Article.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-503

§ **9-503 Secured Party's Right to Take Possession After Default.**

Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides the secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal a secured party may render equipment unusable, and may dispose of collateral on the debtor's premises under Section 9-504.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-504

§ **9-504 Secured Party's Right to Dispose of Collateral After Default; Effect of Disposition.**

(1) A secured party after default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing. Any sale of goods is subject to the Article on Sales (Article 2). The proceeds of disposition shall be applied in the order following to

> (a) the reasonable expenses of retaking, holding, preparing for sale or lease, selling, leasing and the like and, to the extent provided for in the agreement and not prohibited by law, the reasonable attorneys' fees and legal expenses incurred by the secured party;
>
> (b) the satisfaction of indebtedness secured by the security interest under which the disposition is made;
>
> (c) the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification of demand therefor is received before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.

(2) If the security interest secures an indebtedness, the secured party must account to the debtor for any surplus, and, unless otherwise agreed, the debtor is liable for any deficiency. But if the underlying transaction was a sale of accounts or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.

(3) Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any

private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of sale. In the case of consumer goods no other notification need be sent. In other cases notification shall be sent to any other secured party from whom the secured party has received (before sending his notification to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. The secured party may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale.

(4) When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto. The purchaser takes free of all such rights and interests even though the secured party fails to comply with the requirements of this Part or of any judicial proceedings

(a) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale; or

(b) in any other case, if the purchaser acts in good faith.

(5) A person who is liable to a secured party under a guaranty, indorsement, repurchase agreement or the like and who receives a transfer of collateral from the secured party or is subrogated to his rights has thereafter the rights and duties of the secured party. Such a transfer of collateral is not a sale or disposition of the collateral under this Article.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-505

§ **9-505 Compulsory Disposition of Collateral; Acceptance of the Collateral as Discharge of Obligation.**

(1) If the debtor has paid sixty per cent of the cash price in the case of a purchase money security interest in consumer goods or sixty per cent of the loan in the case of another security interest in consumer goods, and has not signed after default a statement renouncing or modifying his rights under this Part a secured party who has taken possession of collateral must dispose of it under Section 9-504 and if he fails to do so within ninety days after he takes possession the debtor at his option may recover in conversion or under Section 9-507(1) on secured party's liability.

(2) In any other case involving consumer goods or any other collateral a secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor if he has not signed after default a statement renouncing or modifying his rights under this subsection. In the case of consumer goods no other notice need be given. In other cases notice shall be sent to any other secured party from whom the secured party has received (before sending his notice to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. If the secured party receives objection in writing from a person entitled to receive notification within twenty-one days after the notice was sent, the secured party must dispose of the collateral under Section 9-504. In the absence of such written objection the secured party may retain the collateral in satisfaction of the debtor's obligation.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-506

§ **9-506 Debtor's Right to Redeem Collateral.**

At any time before the secured party has disposed of collateral or entered into a contract for its disposition under Section 9-504 or before the obligation has been discharged under Section 9-505(2) the debtor or any other secured party may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party in retaking, holding and preparing the collateral for disposition, in arranging for the sale, and to the extent provided in the agreement and not prohibited by law, his reasonable attorneys' fees and legal expenses.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-507

§ **9-507 Secured Party's Liability for Failure to Comply With This Part.**

(1) If it is established that the secured party is not proceeding in accordance with the provisions of this Part disposition may be ordered or restrained on appropriate terms and conditions. If the disposition has occurred the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this Part. If the collateral is consumer goods, the debtor has a right to recover in any event an amount not less than the credit service charge plus ten per cent of the principal amount of the debt or the time price differential plus 10 per cent of the cash price.

(2) The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner. The principles stated in the two preceding sentences with respect to sales also apply as may be appropriate to other types of disposition. A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors shall conclusively be deemed to be commercially reasonable, but this sentence does not indicate that any such approval must be obtained in any case nor does it indicate that any disposition not so approved is not commercially reasonable.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-101

§ **9-101 Short Title.**

This article may be cited as Uniform Commercial Code-Secured Transactions.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-102

§ **9-102 Definitions and Index of Definitions.**

(a) [Article 9 definitions.] In this article:

(1) "Accession" means goods that are physically united with other goods in such a manner that the identity of the original goods is not lost.

(2) "Account", except as used in "account for", means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a State, governmental unit of a State, or person licensed or authorized to operate the game by a State or governmental unit of a State. The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.

(3) "Account debtor" means a person obligated on an account, chattel paper, or general intangible. The term does not include persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper.

(4) "Accounting", except as used in "accounting for", means a record:

(A) authenticated by a secured party;

(B) indicating the aggregate unpaid secured obligations as of a date not more than 35 days earlier or 35 days later than the date of the record; and

(C) identifying the components of the obligations in reasonable detail.

(5) "Agricultural lien" means an interest in farm products:

(A) which secures payment or performance of an obligation for:

(i) goods or services furnished in connection with a debtor's farming operation; or

(ii) rent on real property leased by a debtor in connection with its farming operation;

(B) which is created by statute in favor of a person that:

(i) in the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; or

(ii) leased real property to a debtor in connection with the debtor's farming operation; and

(C) whose effectiveness does not depend on the person's possession of the personal property.

(6) "As-extracted collateral" means:

(A) oil, gas, or other minerals that are subject to a security interest that:

(i) is created by a debtor having an interest in the minerals before extraction; and

(ii) attaches to the minerals as extracted; or

(B) accounts arising out of the sale at the wellhead or minehead of oil, gas, or other minerals in which the debtor had an interest before extraction.

(7) "Authenticate" means:

(A) to sign; or

(B) to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record.

(8) "Bank" means an organization that is engaged in the business of banking. The term includes savings banks, savings and loan associations, credit unions, and trust companies.

(9) "Cash proceeds" means proceeds that are money, checks, deposit accounts, or the like.

(10) "Certificate of title" means a certificate of title with respect to which a statute provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral.

(11) "Chattel paper" means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this paragraph, "monetary obligation" means a monetary obligation secured by the goods or owned under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does

not include (i) charters or other contracts involving the use or hire of a vessel or (ii) records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper.

(12) "Collateral" means the property subject to a security interest or agricultural lien. The term includes:

(A) proceeds to which a security interest attaches;

(B) accounts, chattel paper, payment intangibles, and promissory notes that have been sold; and

(C) goods that are the subject of a consignment.

(13) "Commercial tort claim" means a claim arising in tort with respect to which:

(A) the claimant is an organization; or

(B) the claimant is an individual and the claim:

(i) arose in the course of the claimant's business or profession; and

(ii) does not include damages arising out of personal injury to or the death of an individual.

(14) "Commodity account" means an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer.

(15) "Commodity contract" means a commodity futures contract, an option on a commodity futures contract, a commodity option, or another contract if the contract or option is:

(A) traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to federal commodities laws; or

(B) traded on a foreign commodity board of trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer.

(16) "Commodity customer" means a person for which a commodity intermediary carries a commodity contract on its books.

(17) "Commodity intermediary" means a person that:

(A) is registered as a futures commission merchant under federal commodities law; or

(B) in the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to federal commodities law.

(18) "Communicate" means:

(A) to send a written or other tangible record;

(B) to transmit a record by any means agreed upon by the persons sending and receiving the record; or

(C) in the case of transmission of a record to or by a filing office, to transmit a record by any means prescribed by filing-office rule.

(19) "Consignee" means a merchant to which goods are delivered in a consignment.

(20) "Consignment" means a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and:

(A) the merchant:

(i) deals in goods of that kind under a name other than the name of the person making delivery;

(ii) is not an auctioneer; and

(iii) is not generally known by its creditors to be substantially engaged in selling the goods of others;

(B) with respect to each delivery, the aggregate value of the goods is $1,000 or more at the time of delivery;

(C) the goods are not consumer goods immediately before delivery; and

(D) the transaction does not create a security interest that secures an obligation.

(21) "Consignor" means a person that delivers goods to a consignee in a consignment.

(22) "Consumer debtor" means a debtor in a consumer transaction.

(23) "Consumer goods" means goods that are used or bought for use primarily for personal, family, or household purposes.

(24) "Consumer-goods transaction" means a consumer transaction in which:

(A) an individual incurs an obligation primarily for personal, family, or household purposes; and

(B) a security interest in consumer goods secures the obligation.

(25) "Consumer obligor" means an obligor who is an individual and who incurred the obligation as part of a transaction entered into primarily for personal, family, or household purposes.

(26) "Consumer transaction" means a transaction in which (i) an individual incurs an obligation primarily for personal, family, or household purposes, (ii) a security interest secures the obligation, and (iii) the collateral is held or acquired primarily for personal, family, or household purposes. The term includes consumer-goods transactions.

(27) "Continuation statement" means an amendment of a financing statement which:

(A) identifies, by its file number, the initial financing statement to which it relates; and

(B) indicates that it is a continuation statement for, or that it is filed to continue the effectiveness of, the identified financing statement.

(28) "Debtor" means:

(A) a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor;

(B) a seller of accounts, chattel paper, payment intangibles, or promissory notes; or

(C) a consignee.

(29) "Deposit account" means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.

(30) "Document" means a document of title or a receipt of the type described in Section 7-201(2).

(31) "Electronic chattel paper" means chattel paper evidenced by a record or records consisting of information stored in an electronic medium.

(32) "Encumbrance" means a right, other than an ownership interest, in real property. The term includes mortgages and other liens on real property.

(33) "Equipment" means goods other than inventory, farm products, or consumer goods.

(34) "Farm products" means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:

(A) crops grown, growing, or to be grown, including:

(i) crops produced on trees, vines, and bushes; and

(ii) aquatic goods produced in aquacultural operations;

(B) livestock, born or unborn, including aquatic goods produced in aquacultural operations;

(C) supplies used or produced in a farming operation; or

(D) products of crops or livestock in their unmanufactured states.

(35) "Farming operation" means raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation.

(36) "File number" means the number assigned to an initial financing statement pursuant to Section 9-519(a).

(37) "Filing office" means an office designated in Section 9-501 as the place to file a financing statement.

(38) "Filing-office rule" means a rule adopted pursuant to Section 9-526.

(39) "Financing statement" means a record or records composed of an initial financing statement and any filed record relating to the initial financing statement.

(40) "Fixture filing" means the filing of a financing statement covering goods that are or are to become fixtures and satisfying Section 9-502(a) and (b). The term includes the filing of a financing statement covering goods of a transmitting utility which are or are to become fixtures.

(41) "Fixtures" means goods that have become so related to particular real property that an interest in them arises under real property law.

(42) "General intangible" means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.

(43) [reserved]

(44) "Goods" means all things that are movable when a security interest attaches. The term includes (i) fixtures, (ii) standing timber that is to be cut and removed under a conveyance or contract for sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes, and (v) manufactured homes. The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if (i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods. The term does not include a computer program embedded in goods that consist solely of the medium in which the program is embedded. The term also does not include accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money, or oil, gas, or other minerals before extraction.

(45) "Governmental unit" means a subdivision, agency, department, county, parish, municipality, or other unit of the government of the United States, a State, or a foreign country. The term includes an organization having a separate corporate existence if the organization is eligible to issue debt on which interest is exempt from income taxation under

the laws of the United States.

(46) "Health-care-insurance receivable" means an interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided or to be provided.

(47) "Instrument" means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

(48) "Inventory" means goods, other than farm products, which:

(A) are leased by a person as lessor;

(B) are held by a person for sale or lease or to be furnished under a contract of service;

(C) are furnished by a person under a contract of service; or

(D) consist of raw materials, work in process, or materials used or consumed in a business.

(49) "Investment property" means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account.

(50) "Jurisdiction of organization", with respect to a registered organization, means the jurisdiction under whose law the organization is organized.

(51) "Letter-of-credit right" means a right to payment or performance under a letter of credit, whether or not the beneficiary has demanded or is at the time entitled to demand payment or performance. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit.

(52) "Lien creditor" means:

(A) a creditor that has acquired a lien on the property involved by attachment, levy, or the like;

(B) an assignee for benefit of creditors from the time of assignment;

(C) a trustee in bankruptcy from the date of the filing of the petition; or

(D) a receiver in equity from the time of appointment.

(53) "Manufactured home" means a structure, transportable in one or more sections, which, in the traveling mode, is eight body feet or more in width or 40 body feet or more in length, or, when erected on site, is 320 or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air-conditioning, and electrical systems contained therein. The term includes any structure that meets all of the requirements of this paragraph except the size requirements and with respect to which the manufacturer voluntarily files a certification required by the United States Secretary of Housing and Urban Development and complies with the standards established under Title 42 of the United States Code.

(54) "Manufactured-home transaction" means a secured transaction:

(A) that creates a purchase-money security interest in a manufactured home, other than a manufactured home held as inventory; or

(B) in which a manufactured home, other than a manufactured home held as inventory, is the primary collateral.

(55) "Mortgage" means a consensual interest in real property, including fixtures, which secures payment or performance of an obligation.

(56) "New debtor" means a person that becomes bound as debtor under Section 9-203(d) by a security agreement previously entered into by another person.

(57) "New value" means (i) money, (ii) money's worth in property, services, or new credit, or (iii) release by a transferee of an interest in property previously transferred to the transferee. The term does not include an obligation substituted for another obligation.

(58) "Noncash proceeds" means proceeds other than cash proceeds.

(59) "Obligor" means a person that, with respect to an obligation secured by a security interest in or an agricultural lien on the collateral, (i) owes payment or other performance of the obligation, (ii) has provided property other than the collateral to secure payment or other performance of the obligation, or (iii) is otherwise accountable in whole or in part for payment or other performance of the obligation. The term does not include issuers or nominated persons under a letter of credit.

(60) "Original debtor", except as used in Section 9-310(c), means a person that, as debtor, entered into a security agreement to which a new debtor has become bound under Section 9-203(d).

(61) "Payment intangible" means a general intangible under which the account debtor's principal obligation is a monetary obligation.

(62) "Person related to", with respect to an individual, means:

(A) the spouse of the individual;

(B) a brother, brother-in-law, sister, or sister-in-law of the individual;

(C) an ancestor or lineal descendant of the individual or the individual's spouse; or

(D) any other relative, by blood or marriage, of the individual or the individual's spouse who shares the same home with the individual.

(63) "Person related to", with respect to an organization, means:

(A) a person directly or indirectly controlling, controlled by, or under common control with the organization;

(B) an officer or director of, or a person performing similar functions with respect to, the organization;

(C) an officer or director of, or a person performing similar functions with respect to, a person described in subparagraph (A);

(D) the spouse of an individual described in subparagraph (A), (B), or (C); or

(E) an individual who is related by blood or marriage to an individual described in subparagraph (A), (B), (C), or (D) and shares the same home with the individual.

(64) "Proceeds", except as used in Section 9-609(b), means the following property:

(A) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;

(B) whatever is collected on, or distributed on account of, collateral;

(C) rights arising out of collateral;

(D) to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or

(E) to the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

(65) "Promissory note" means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of

money or funds.

(66) "Proposal" means a record authenticated by a secured party which includes the terms on which the secured party is willing to accept collateral in full or partial satisfaction of the obligation it secures pursuant to Sections 9-620, 9-621, and 9-622.

(67) "Public-finance transaction" means a secured transaction in connection with which:

(A) debt securities are issued;

(B) all or a portion of the securities issued have an initial stated maturity of at least 20 years; and

(C) the debtor, obligor, secured party, account debtor or other person obligated on collateral, assignor or assignee of a secured obligation, or assignor or assignee of a security interest is a State or a governmental unit of a State.

(68) "Pursuant to commitment", with respect to an advance made or other value given by a secured party, means pursuant to the secured party's obligation, whether or not a subsequent event of default or other event not within the secured party's control has relieved or may relieve the secured party from its obligation.

(69) "Record", except as used in "for record", "of record", "record or legal title", and "record owner", means information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form.

(70) "Registered organization" means an organization organized solely under the law of a single State or the United States and as to which the State or the United States must maintain a public record showing the organization to have been organized.

(71) "Secondary obligor" means an obligor to the extent that:

(A) the obligor's obligation is secondary; or

(B) the obligor has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor, or property of either.

(72) "Secured party" means:

(A) a person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding;

(B) a person that holds an agricultural lien;

(C) a consignor;

(D) a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold;

(E) a trustee, indenture trustee, agent, collateral agent, or other representative in whose favor a security interest or agricultural lien is created or provided for; or

(F) a person that holds a security interest arising under Section 2-401, 2-505, 2-711(3), 2A-508(5), 4-210, or 5-118.

(73) "Security agreement" means an agreement that creates or provides for a security interest.

(74) "Send", in connection with a record or notification, means:

(A) to deposit in the mail, deliver for transmission, or transmit by any other usual means of communication, with postage or cost of transmission provided for, addressed to any address reasonable under the circumstances; or

(B) to cause the record or notification to be received within the time that it would have been received if properly sent under subparagraph (A).

(75) "Software" means a computer program and any supporting information provided in connection with a transaction relating to the program. The term does not include a computer program that is included in the definition of goods.

(76) "State" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(77) "Supporting obligation" means a letter-of-credit right or secondary obligation that supports the payment or performance of an account, chattel paper, a document, a general intangible, an instrument, or investment property.

(78) "Tangible chattel paper" means chattel paper evidenced by a record or records consisting of information that is inscribed on a tangible medium.

(79) "Termination statement" means an amendment of a financing statement which:

(A) identifies, by its file number, the initial financing statement to which it relates; and

(B) indicates either that it is a termination statement or that the identified financing statement is no longer effective.

(80) "Transmitting utility" means a person primarily engaged in the business of:

(A) operating a railroad, subway, street railway, or trolley bus;

(B) transmitting communications electrically, electromagnetically, or by light;

(C) transmitting goods by pipeline or sewer; or

(D) transmitting or producing and transmitting electricity, steam, gas, or water.

(b) [Definitions in other articles.] The following definitions in other articles apply to this article:

"Applicant"	Section 5-102.
"Beneficiary"	Section 5-102.
"Broker"	Section 8-102.
"Certificated security"	Section 8-102.
"Check"	Section 3-104.
"Clearing corporation"	Section 8-102.
"Contract for sale"	Section 2-106.
"Customer"	Section 4-104.
"Entitlement holder"	Section 8-102.
"Financial asset"	Section 8-102.
"Holder in due course"	Section 3-302.
"Issuer" (with respect to a letter of credit or letter-of-credit right)	Section 5-102.
"Issuer" (with respect to a security)	Section 8-201.
"Lease"	Section 2A-103.
"Lease agreement"	Section 2A-103.
"Lease contract"	Section 2A-103.
"Leasehold interest"	Section 2A-103.
"Lessee"	Section 2A-103.
"Lessee in ordinary course of business"	Section 2A-103.
"Lessor"	Section 2A-103.
"Lessor's residual interest"	Section 2A-103.
"Letter of credit"	Section 5-102.
"Merchant"	Section 2-104.
"Negotiable instrument"	Section 3-104.
"Nominated person"	Section 5-102.
"Note"	Section 3-104.
"Proceeds of a letter of credit"	Section 5-114.
"Prove"	Section 3-103.
"Sale"	Section 2-106.
"Securities account"	Section 8-501.
"Securities intermediary"	Section 8-102.
"Security"	Section 8-102.
"Security certificate"	Section 8-102.
"Security entitlement"	Section 8-102.
"Uncertificated security"	Section 8-102.

(c) [Article 1 definitions and principles.] Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-103

§ 9-103 Purchase-Money Security Interest; Application of Payments; Burden of Establishing.

(a) [Definitions.] In this section:

(1) "purchase-money collateral" means goods or software that secures a purchase-money obligation incurred with respect to that collateral; and

(2) "purchase-money obligation" means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

(b) [Purchase-money security interest in goods.] A security interest in goods is a purchase-money security interest:

(1) to the extent that the goods are purchase-money collateral with respect to that security interest;

(2) if the security interest is in inventory that is or was purchase-money collateral, also to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase-money security interest; and

(3) also to the extent that the security interest secures a purchase-money obligation incurred with respect to software in which the secured party holds or held a purchase-money security interest.

(c) [Purchase-money security interest in software.] A security interest in software is a purchase-money security interest to the extent that the security interest also secures a purchase-money obligation incurred with respect to goods in which the secured party holds or held a purchase-money security interest if:

(1) the debtor acquired its interest in the software in an integrated transaction in which it acquired an interest in the goods; and

(2) the debtor acquired its interest in the software for the principal purpose of using the software in the goods.

(d) [Consignor's inventory purchase-money security interest.] The security interest of a consignor in goods that are the subject of a consignment is a purchase-money security interest in inventory.

(e) [Application of payment in non-consumer-goods transaction.] In a transaction other than a consumer-goods transaction, if the extent to which a security interest is a purchase-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

(1) in accordance with any reasonable method of application to which the parties agree;

(2) in the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or

(3) in the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:

(A) to obligations that are not secured; and

(B) if more than one obligation is secured, to obligations secured by purchase-money security interests in the order in which those obligations were incurred.

(f) [No loss of status of purchase-money security interest in non-consumer-goods transaction.] In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if:

(1) the purchase-money collateral also secures an obligation that is not a purchase-money obligation;

(2) collateral that is not purchase-money collateral also secures the purchase-money obligation; or

(3) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

(g) [Burden of proof in non-consumer-goods transaction.] In a transaction other than a consumer-goods transaction, a secured party claiming a purchase-money security interest has the burden of establishing the extent to which the security interest is a purchase-money security interest.

(h) [Non-consumer-goods transactions; no inference.] The limitation of the rules in subsections (e), (f), and (g) to transactions other than consumer-goods transactions is intended to leave to the court the determination of the proper rules in consumer-goods transactions. The court may not infer from that limitation the nature of the proper rule in consumer-goods transactions and may continue to apply established approaches.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-108

§ **9-108 Sufficiency of Description.**

(a) [Sufficiency of description.] Except as otherwise provided in subsections (c), (d), and (e), a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.

(b) [Examples of reasonable identification.] Except as otherwise provided in subsection (d), a description of collateral reasonably identifies the collateral if it identifies the collateral by:

(1) specific listing;

(2) category;

(3) except as otherwise provided in subsection (e), a type of collateral defined in [the Uniform Commercial Code];

(4) quantity;

(5) computational or allocational formula or procedure; or

(6) except as otherwise provided in subsection (c), any other method, if the identity of the collateral is objectively determinable.

(c) [Supergeneric description not sufficient.] A description of collateral as "all the debtor's assets" or "all the debtor's personal property" or using words of similar import does not reasonably identify the collateral.

(d) [Investment property.] Except as otherwise provided in subsection (e), a description of a security entitlement, securities account, or commodity account is sufficient if it describes:

(1) the collateral by those terms or as investment property; or

(2) the underlying financial asset or commodity contract.

(e) [When description by type insufficient.] A description only by type of collateral defined in [the Uniform Commercial Code] is an insufficient description of:

(1) a commercial tort claim; or

(2) in a consumer transaction, consumer goods, a security entitlement, a securities account, or a commodity account.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-109

§ **9-109 Scope.**

(a) [General scope of article.] Except as otherwise provided in subsections (c) and (d), this article applies to:

(1) a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;

(2) an agricultural lien;

(3) a sale of accounts, chattel paper, payment intangibles, or promissory notes;

(4) a consignment;

(5) a security interest arising under Section 2-401, 2-505, 2-711(3), or 2A-508(5), as provided in Section 9-110; and

(6) a security interest arising under Section 4-210 or 5-118.

(b) [Security interest in secured obligation.] The application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.

(c) [Extent to which article does not apply.] This article does not apply to the extent that:

(1) a statute, regulation, or treaty of the United States preempts this article;

(2) another statute of this State expressly governs the creation, perfection, priority, or enforcement of a security interest created by this State or a governmental unit of this State;

(3) a statute of another State, a foreign country, or a governmental unit of another State or a foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority, or enforcement of a security interest created by the State, country, or governmental unit; or

(4) the rights of a transferee beneficiary or nominated person under a letter of credit are independent and superior under Section 5-114.

(d) [Inapplicability of article.] This article does not apply to:

(1) a landlord's lien, other than an agricultural lien;

(2) a lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but Section 9-333 applies with respect to priority of the lien;

(3) an assignment of a claim for wages, salary, or other compensation of an employee;

(4) a sale of accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose;

(5) an assignment of accounts, chattel paper, payment intangibles, or promissory notes which is for the purpose of collection only;

(6) an assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract;

(7) an assignment of a single account, payment intangible, or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness;

(8) a transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds;

(9) an assignment of a right represented by a judgment, other than a judgment taken on a right to payment that was collateral;

(10) a right of recoupment or set-off, but:

(A) Section 9-340 applies with respect to the effectiveness of rights of recoupment or set-off against deposit accounts; and

(B) Section 9-404 applies with respect to defenses or claims of an account debtor;

(11) the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for:

(A) liens on real property in Sections 9-203 and 9-308;

(B) fixtures in Section 9-334;

(C) fixture filings in Sections 9-501, 9-502, 9-512, 9-516, and 9-519; and

(D) security agreements covering personal and real property in Section 9-604;

(12) an assignment of a claim arising in tort, other than a commercial tort claim, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds; or

(13) an assignment of a deposit account in a consumer transaction, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-110

§ **9-110 Security Interests Arising Under Article 2 or 2A.**

A security interest arising under Section 2-401, 2-505, 2-711(3), or 2A-508(5) is subject to this article. However, until the debtor obtains possession of the goods:

(1) the security interest is enforceable, even if Section 9-203(b)(3) has not been satisfied;

(2) filing is not required to perfect the security interest;

(3) the rights of the secured party after default by the debtor are governed by Article 2 or 2A; and

(4) the security interest has priority over a conflicting security interest created by the debtor.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-201

§ **9-201 General Effectiveness of Security Agreement.**

(a) [General effectiveness.] Except as otherwise provided in [the Uniform Commercial Code], a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.

(b) [Applicable consumer laws and other law.] A transaction subject to this article is subject to any applicable rule of law which establishes a different rule for consumers and [insert reference to (i) any other statute or regulation that regulates the rates, charges, agreements, and practices for loans, credit sales, or other extensions of credit and (ii) any consumer-protection statute or regulation].

(c) [Other applicable law controls.] In case of conflict between this article and a rule of law, statute, or regulation described in subsection (b), the rule of law, statute, or regulation controls. Failure to comply with a statute or regulation described in subsection (b) has only the effect the statute or regulation specifies.

(d) [Further deference to other applicable law.] This article does not:

(1) validate any rate, charge, agreement, or practice that violates a rule of law, statute, or regulation described in subsection (b); or

(2) extend the application of the rule of law, statute, or regulation to a transaction not otherwise subject to it.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-202

§ **9-202 Title to Collateral Immaterial.**

Except as otherwise provided with respect to consignments or sales of accounts, chattel paper, payment intangibles, or promissory notes, the provisions of this article with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-203

§ 9-203 Attachment and Enforceability of Security Interest; Proceeds; Supporting Obligations; Formal Requisites.

(a) [Attachment.] A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment.

(b) [Enforceability.] Except as otherwise provided in subsections (c) through (i), a security interest is enforceable against the debtor and third parties with respect to the collateral only if:

(1) value has been given;

(2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and

(3) one of the following conditions is met:

(A) the debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;

(B) the collateral is not a certificated security and is in the possession of the secured party under Section 9-313 pursuant to the debtor's security agreement;

(C) the collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under Section 8-301 pursuant to the debtor's security agreement; or

(D) the collateral is deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights, and the secured party has control under Section 9-104, 9-105, 9-106, or 9-107 pursuant to the debtor's security agreement.

(c) [Other UCC provisions.] Subsection (b) is subject to Section 4-210 on the security interest of a collecting bank, Section 5-118 on the security interest of a letter-of-credit issuer or nominated person, Section 9-110 on a security interest arising under Article 2 or 2A, and Section 9-206 on security interests in investment property.

(d) [When person becomes bound by another person's security agreement.] A person becomes bound as debtor by a security agreement entered into by another person if, by operation of law other than this article or by contract:

(1) the security agreement becomes effective to create a security interest in the person's property; or

(2) the person becomes generally obligated for the obligations of the other person, including the obligation secured under the security agreement, and acquires or succeeds to all or substantially all of the assets of the other person.

(e) [Effect of new debtor becoming bound.] If a new debtor becomes bound as debtor by a security agreement entered into by another person:

(1) the agreement satisfies subsection (b)(3) with respect to existing or after-acquired property of the new debtor to the extent the property is described in the agreement; and

(2) another agreement is not necessary to make a security interest in the property enforceable.

(f) [Proceeds and supporting obligations.] The attachment of a security interest in collateral gives the secured party the

rights to proceeds provided by Section 9-315 and is also attachment of a security interest in a supporting obligation for the collateral.

(g) [Lien securing right to payment.] The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien.

(h) [Security entitlement carried in securities account.] The attachment of a security interest in a securities account is also attachment of a security interest in the security entitlements carried in the securities account.

(i) [Commodity contracts carried in commodity account.] The attachment of a security interest in a commodity account is also attachment of a security interest in the commodity contracts carried in the commodity account.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-204

§ **9-204 After-Acquired Property; Future Advances.**

(a) [After-acquired collateral.] Except as otherwise provided in subsection (b), a security agreement may create or provide for a security interest in after-acquired collateral.

(b) [When after-acquired property clause not effective.] A security interest does not attach under a term constituting an after-acquired *property clause* to:

(1) consumer goods, other than an accession when given as additional security, unless the debtor acquires rights in them within 10 days after the secured party gives value; or

(2) a commercial tort claim.

(c) [Future advances and other value.] A security agreement may provide that collateral secures, or that accounts, chattel paper, payment intangibles, or promissory notes are sold in connection with, future advances or other value, whether or not the advances or value are given pursuant to commitment.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-205

§ **9-205 Use or Disposition of Collateral Permissible.**

(a) [When security interest not invalid or fraudulent.] A security interest is not invalid or fraudulent against creditors solely because:

(1) the debtor has the right or ability to:

(A) use, commingle, or dispose of all or part of the collateral, including returned or repossessed goods;

(B) collect, compromise, enforce, or otherwise deal with collateral;

(C) accept the return of collateral or make repossessions; or

(D) use, commingle, or dispose of proceeds; or

(2) the secured party fails to require the debtor to account for proceeds or replace collateral.

(b) [Requirements of possession not relaxed.] This section does not relax the requirements of possession if attachment, perfection, or enforcement of a security interest depends upon possession of the collateral by the secured party.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-207

§ 9-207 Rights and Duties of Secured Party Having Possession or Control of Collateral.

(a) [Duty of care when secured party in possession.] Except as otherwise provided in subsection (d), a secured party shall use reasonable care in the custody and preservation of collateral in the secured party's possession. In the case of chattel paper or an instrument, reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(b) [Expenses, risks, duties, and rights when secured party in possession.] Except as otherwise provided in subsection (d), if a secured party has possession of collateral:

(1) reasonable expenses, including the cost of insurance and payment of taxes or other charges, incurred in the custody, preservation, use, or operation of the collateral are chargeable to the debtor and are secured by the collateral;

(2) the risk of accidental loss or damage is on the debtor to the extent of a deficiency in any effective insurance coverage;

(3) the secured party shall keep the collateral identifiable, but fungible collateral may be commingled; and

(4) the secured party may use or operate the collateral:

(A) for the purpose of preserving the collateral or its value;

(B) as permitted by an order of a court having competent jurisdiction; or

(C) except in the case of consumer goods, in the manner and to the extent agreed by the debtor.

(c) [Duties and rights when secured party in possession or control.] Except as otherwise provided in subsection (d), a secured party having possession of collateral or control of collateral under Section 9-104, 9-105, 9-106, or 9-107:

(1) may hold as additional security any proceeds, except money or funds, received from the collateral;

(2) shall apply money or funds received from the collateral to reduce the secured obligation, unless remitted to the debtor; and

(3) may create a security interest in the collateral.

(d) [Buyer of certain rights to payment.] If the secured party is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor:

(1) subsection (a) does not apply unless the secured party is entitled under an agreement:

(A) to charge back uncollected collateral; or

(B) otherwise to full or limited recourse against the debtor or a secondary obligor based on the nonpayment or other default of an account debtor or other obligor on the collateral; and

(2) subsections (b) and (c) do not apply.

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REVISED ARTICLE 9 SELECTED PROVISIONS *
PART 2 EFFECTIVENESS OF SECURITY AGREEMENT; ATTACHMENT OF SECURITY INTEREST; RIGHTS OF PARTIES TO SECURITY AGREEMENT
[SUBPART 2 RIGHTS AND DUTIES]

1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-208

§ 9-208 Additional Duties of Secured Party Having Control of Collateral.

(a) [Applicability of section.] This section applies to cases in which there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations, or otherwise give value.

(b) [Duties of secured party after receiving demand from debtor.] Within 10 days after receiving an authenticated demand by the debtor:

(1) a secured party having control of a deposit account under Section 9-104(a)(2) shall send to the bank with which the deposit account is maintained an authenticated statement that releases the bank from any further obligation to comply with instructions originated by the secured party;

(2) a secured party having control of a deposit account under Section 9-104(a)(3) shall:

(A) pay the debtor the balance on deposit in the deposit account; or

(B) transfer the balance on deposit into a deposit account in the debtor's name;

(3) a secured party, other than a buyer, having control of electronic chattel paper under Section 9-105 shall:

(A) communicate the authoritative copy of the electronic chattel paper to the debtor or its designated custodian;

(B) if the debtor designates a custodian that is the designated custodian with which the authoritative copy of the electronic chattel paper is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and

(C) take appropriate action to enable the debtor or its designated custodian to make copies of or revisions to the authoritative copy which add or change an identified assignee of the authoritative copy without the consent of the secured party;

(4) a secured party having control of investment property under Section 8-106(d)(2) or 9-106(b) shall send to the securities intermediary or commodity intermediary with which the security entitlement or commodity contract is maintained an authenticated record that releases the securities intermediary or commodity intermediary from any further obligation to comply with entitlement orders or directions originated by the secured party; and

(5) a secured party having control of a letter-of-credit right under Section 9-107 shall send to each person having an unfulfilled obligation to pay or deliver proceeds of the letter of credit to the secured party an authenticated release from any further obligation to pay or deliver proceeds of the letter of credit to the secured party.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-209

§ 9-209 Duties of Secured Party if Account Debtor Has Been Notified of Assignment.

(a) [Applicability of section.] Except as otherwise provided in subsection (c), this section applies if:

(1) there is no outstanding secured obligation; and

(2) the secured party is not committed to make advances, incur obligations, or otherwise give value.

(b) [Duties of secured party after receiving demand from debtor.] Within 10 days after receiving an authenticated demand by the debtor, a secured party shall send to an account debtor that has received notification of an assignment to the secured party as assignee under Section 9-406(a) an authenticated record that releases the account debtor from any further obligation to the secured party.

(c) [Inapplicability to sales.] This section does not apply to an assignment constituting the sale of an account, chattel paper, or payment intangible.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-210

§ 9-210 Request for Accounting; Request Regarding List of Collateral or Statement of Account.

(a) [Definitions.] In this section:

(1) "Request" means a record of a type described in paragraph (2), (3), or (4).

(2) "Request for an accounting" means a record authenticated by a debtor requesting that the recipient provide an accounting of the unpaid obligations secured by collateral and reasonably identifying the transaction or relationship that is the subject of the request.

(3) "Request regarding a list of collateral" means a record authenticated by a debtor requesting that the recipient approve or correct a list of what the debtor believes to be the collateral securing an obligation and reasonably identifying the transaction or relationship that is the subject of the request.

(4) "Request regarding a statement of account" means a record authenticated by a debtor requesting that the recipient approve or correct a statement indicating what the debtor believes to be the aggregate amount of unpaid obligations secured by collateral as of a specified date and reasonably identifying the transaction or relationship that is the subject of the request.

(b) [Duty to respond to requests.] Subject to subsections (c), (d), (e), and (f), a secured party, other than a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor, shall comply with a request within 14 days after receipt:

(1) in the case of a request for an accounting, by authenticating and sending to the debtor an accounting; and

(2) in the case of a request regarding a list of collateral or a request regarding a statement of account, by authenticating and sending to the debtor an approval or correction.

(c) [Request regarding list of collateral; statement concerning type of collateral.] A secured party that claims a security interest in all of a particular type of collateral owned by the debtor may comply with a request regarding a list of collateral by sending to the debtor an authenticated record including a statement to that effect within 14 days after receipt.

(d) [Request regarding list of collateral; no interest claimed.] A person that receives a request regarding a list of collateral, claims no interest in the collateral when it receives the request, and claimed an interest in the collateral at an earlier time shall comply with the request within 14 days after receipt by sending to the debtor an authenticated record:

(1) disclaiming any interest in the collateral; and

(2) if known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's interest in the collateral.

(e) [Request for accounting or regarding statement of account; no interest in obligation claimed.] A person that receives a request for an accounting or a request regarding a statement of account, claims no interest in the obligations when it receives the request, and claimed an interest in the obligations at an earlier time shall comply with the request within 14 days after receipt by sending to the debtor an authenticated record:

(1) disclaiming any interest in the obligations; and

(2) if known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's interest in the obligations.

(f) [Charges for responses.] A debtor is entitled without charge to one response to a request under this section during any six-month period. The secured party may require payment of a charge not exceeding $25 for each additional response.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-301

§ 9-301 Law Governing Perfection and Priority of Security Interests.

Except as otherwise provided in Sections 9-303 through 9-306, the following rules determine the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral:

(1) Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.

(2) While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest in that collateral.

(3) Except as otherwise provided in paragraph (4), while negotiable documents, goods, instruments, money, or tangible chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:

(A) perfection of a security interest in the goods by filing a fixture filing;

(B) perfection of a security interest in timber to be cut; and

(C) the effect of perfection or nonperfection and the priority of a nonpossessory security interest in the collateral.

(4) The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-315

§ **9-315 Secured Party's Rights on Disposition of Collateral and in Proceeds.**

(a) [Disposition of collateral: continuation of security interest or agricultural lien; proceeds.] Except as otherwise provided in this article and in Section 2-403(2):

(1) a security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien; and

(2) a security interest attaches to any identifiable proceeds of collateral.

(b) [When commingled proceeds identifiable.] Proceeds that are commingled with other property are identifiable proceeds:

(1) if the proceeds are goods, to the extent provided by Section 9-336; and

(2) if the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved.

(c) [Perfection of security interest in proceeds.] A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.

(d) [Continuation of perfection.] A perfected security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds unless:

(1) the following conditions are satisfied:

(A) a filed financing statement covers the original collateral;

(B) the proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and

(C) the proceeds are not acquired with cash proceeds;

(2) the proceeds are identifiable cash proceeds; or

(3) the security interest in the proceeds is perfected other than under subsection (c) when the security interest attaches to the proceeds or within 20 days thereafter.

(e) [When perfected security interest in proceeds becomes unperfected.] If a filed financing statement covers the original collateral, a security interest in proceeds which remains perfected under subsection (d)(1) becomes unperfected at the later of:

(1) when the effectiveness of the filed financing statement lapses under Section 9-515 or is terminated under Section 9-513; or

(2) the 21st day after the security interest attaches to the proceeds.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-319

§ 9-319 Rights and Title of Consignee With Respect to Creditors and Purchasers.

(a) [Consignee has consignor's rights.] Except as otherwise provided in subsection (b), for purposes of determining the rights of creditors of, and purchasers for value of goods from, a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to transfer.

(b) [Applicability of other law.] For purposes of determining the rights of a creditor of a consignee, law other than this article determines the rights and title of a consignee while goods are in the consignee's possession if, under this part, a perfected security interest held by the consignor would have priority over the rights of the creditor.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-320

§ **9-320 Buyer of Goods.**

(a) [Buyer in ordinary course of business.] Except as otherwise provided in subsection (e), a buyer in ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.

(b) [Buyer of consumer goods.] Except as otherwise provided in subsection (e), a buyer of goods from a person who used or bought the goods for use primarily for personal, family, or household purposes takes free of a security interest, even if perfected, if the buyer buys:

(1) without knowledge of the security interest;

(2) for value;

(3) primarily for the buyer's personal, family, or household purposes; and

(4) before the filing of a financing statement covering the goods.

(c) [Effectiveness of filing for subsection (b).] To the extent that it affects the priority of a security interest over a buyer of goods under subsection (b), the period of effectiveness of a filing made in the jurisdiction in which the seller is located is governed by Section 9-316(a) and (b).

(d) [Buyer in ordinary course of business at wellhead or minehead.] A buyer in ordinary course of business buying oil, gas, or other minerals at the wellhead or minehead or after extraction takes free of an interest arising out of an encumbrance.

(e) [Possessory security interest not affected.] Subsections (a) and (b) do not affect a security interest in goods in the possession of the secured party under Section 9-313.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-323

§ 9-323 Future Advances.

(a) [When priority based on time of advance.] Except as otherwise provided in subsection (c), for purposes of determining the priority of a perfected security interest under Section 9-322(a)(1), perfection of the security interest dates from the time an advance is made to the extent that the security interest secures an advance that:

(1) is made while the security interest is perfected only:

(A) under Section 9-309 when it attaches; or

(B) temporarily under Section 9-312(e), (f), or (g); and

(2) is not made pursuant to a commitment entered into before or while the security interest is perfected by a method other than under Section 9-309 or 9-312(e), (f), or (g).

(b) [Lien creditor.] Except as otherwise provided in subsection (c), a security interest is subordinate to the rights of a person that becomes a lien creditor to the extent that the security interest secures an advance made more than 45 days after the person becomes a lien creditor unless the advance is made:

(1) without knowledge of the lien; or

(2) pursuant to a commitment entered into without knowledge of the lien.

(c) [Buyer of receivables.] Subsections (a) and (b) do not apply to a security interest held by a secured party that is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor.

(d) [Buyer of goods.] Except as otherwise provided in subsection (e), a buyer of goods other than a buyer in ordinary course of business takes free of a security interest to the extent that it secures advances made after the earlier of:

(1) the time the secured party acquires knowledge of the buyer's purchase; or

(2) 45 days after the purchase.

(e) [Advances made pursuant to commitment: priority of buyer of goods.] Subsection (d) does not apply if the advance is made pursuant to a commitment entered into without knowledge of the buyer's purchase and before the expiration of the 45-day period.

(f) [Lessee of goods.] Except as otherwise provided in subsection (g), a lessee of goods, other than a lessee in ordinary course of business, takes the leasehold interest free of a security interest to the extent that it secures advances made after the earlier of:

(1) the time the secured party acquires knowledge of the lease; or

(2) 45 days after the lease contract becomes enforceable.

(g) [Advances made pursuant to commitment: priority of lessee of goods.] Subsection (f) does not apply if the advance is made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the 45-day period.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-401

§ **9-401 Alienability of Debtor's Rights.**

(a) [Other law governs alienability; exceptions.] Except as otherwise provided in subsection (b) and Sections 9-406, 9-407, 9-408, and 9-409, whether a debtor's rights in collateral may be voluntarily or involuntarily transferred is governed by law other than this article.

(b) [Agreement does not prevent transfer.] An agreement between the debtor and secured party which prohibits a transfer of the debtor's rights in collateral or makes the transfer a default does not prevent the transfer from taking effect.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-404

§ **9-404 Rights Acquired by Assignee; Claims and Defenses Against Assignee.**

(a) [Assignee's rights subject to terms, claims, and defenses; exceptions.] Unless an account debtor has made an enforceable agreement not to assert defenses or claims, and subject to subsections (b) through (e), the rights of an assignee are subject to:

(1) all terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract; and

(2) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.

(b) [Account debtor's claim reduces amount owed to assignee.] Subject to subsection (c) and except as otherwise provided in subsection (d), the claim of an account debtor against an assignor may be asserted against an assignee under subsection (a) only to reduce the amount the account debtor owes.

(c) [Rule for individual under other law.] This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(d) [Omission of required statement in consumer transaction.] In a consumer transaction, if a record evidences the account debtor's obligation, law other than this article requires that the record include a statement to the effect that the account debtor's recovery against an assignee with respect to claims and defenses against the assignor may not exceed amounts paid by the account debtor under the record, and the record does not include such a statement, the extent to which a claim of an account debtor against the assignor may be asserted against an assignee is determined as if the record included such a statement.

(e) [Inapplicability to health-care-insurance receivable.] This section does not apply to an assignment of a health-care-insurance receivable.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-405

§ **9-405 Modification of Assigned Contract.**

(a) [Effect of modification on assignee.] A modification of or substitution for an assigned contract is effective against an assignee if made in good faith. The assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that the modification or substitution is a breach of contract by the assignor. This subsection is subject to subsections (b) through (d).

(b) [Applicability of subsection (a).] Subsection (a) applies to the extent that:

(1) the right to payment or a part thereof under an assigned contract has not been fully earned by performance; or

(2) the right to payment or a part thereof has been fully earned by performance and the account debtor has not received notification of the assignment under Section 9-406(a).

(c) [Rule for individual under other law.] This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(d) [Inapplicability to health-care-insurance receivable.] This section does not apply to an assignment of a health-care-insurance receivable.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-406

§ 9-406 Discharge of Account Debtor; Notification of Assignment; Identification and Proof of Assignment; Restrictions on Assignment of Accounts, Chattel Paper, Payment Intangibles, and Promissory Notes Ineffective.

(a) [Discharge of account debtor; effect of notification.] Subject to subsections (b) through (i), an account debtor on an account, chattel paper, or a payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.

(b) [When notification ineffective.] Subject to subsection (h), notification is ineffective under subsection (a):

(1) if it does not reasonably identify the rights assigned;

(2) to the extent that an agreement between an account debtor and a seller of a payment intangible limits the account debtor's duty to pay a person other than the seller and the limitation is effective under law other than this article; or

(3) at the option of an account debtor, if the notification notifies the account debtor to make less than the full amount of any installment or other periodic payment to the assignee, even if:

(A) only a portion of the account, chattel paper, or payment intangible has been assigned to that assignee;

(B) a portion has been assigned to another assignee; or

(C) the account debtor knows that the assignment to that assignee is limited.

(c) [Proof of assignment.] Subject to subsection (h), if requested by the account debtor, an assignee shall seasonably furnish reasonable proof that the assignment has been made. Unless the assignee complies, the account debtor may discharge its obligation by paying the assignor, even if the account debtor has received a notification under subsection (a).

(d) [Term restricting assignment generally ineffective.] Except as otherwise provided in subsection (e) and Sections 2A-303 and 9-407, and subject to subsection (h), a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:

(1) prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note; or

(2) provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account, chattel paper, payment intangible, or promissory note.

(e) [Inapplicability of subsection (d) to certain sales.] Subsection (d) does not apply to the sale of a payment intangible or promissory note.

(f) [Legal restrictions on assignment generally ineffective.] Except as otherwise provided in Sections 2A-303 and 9-407 and subject to subsections (h) and (i), a rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, or account debtor to the assignment or transfer of, or creation of a security interest in, an account or chattel paper is ineffective to the extent that the rule of law, statute, or regulation:

(1) prohibits, restricts, or requires the consent of the government, governmental body or official, or account debtor to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in the account or chattel paper; or

(2) provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account or chattel paper.

(g) [Subsection (b)(3) not waivable.] Subject to subsection (h), an account debtor may not waive or vary its option under subsection (b)(3).

(h) [Rule for individual under other law.] This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(i) [Inapplicability to health-care-insurance receivable.] This section does not apply to an assignment of a health-care-insurance receivable.

(j) [Section prevails over specified inconsistent law.] This section prevails over any inconsistent provisions of the following statutes, rules, and regulations:

[List here any statutes, rules, and regulations containing provisions inconsistent with this section.]

Legislative Note:
States that amend statutes, rules, and regulations to remove provisions inconsistent with this section need not enact subsection (j)

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-513

§ **9-513 Termination Statement.**

(a) [Consumer goods.] A secured party shall cause the secured party of record for a financing statement to file a termination statement for the financing statement if the financing statement covers consumer goods and:

(1) there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value; or

(2) the debtor did not authorize the filing of the initial financing statement.

(b) [Time for compliance with subsection (a).] To comply with subsection (a), a secured party shall cause the secured party of record to file the termination statement:

(1) within one month after there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value; or

(2) if earlier, within 20 days after the secured party receives an authenticated demand from a debtor.

(c) [Other collateral.] In cases not governed by subsection (a), within 20 days after a secured party receives an authenticated demand from a debtor, the secured party shall cause the secured party of record for a financing statement to send to the debtor a termination statement for the financing statement or file the termination statement in the filing office if:

(1) except in the case of a financing statement covering accounts or chattel paper that has been sold or goods that are the subject of a consignment, there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value;

(2) the financing statement covers accounts or chattel paper that has been sold but as to which the account debtor or other person obligated has discharged its obligation;

(3) the financing statement covers goods that were the subject of a consignment to the debtor but are not in the debtor's possession; or

(4) the debtor did not authorize the filing of the initial financing statement.

(d) [Effect of filing termination statement.] Except as otherwise provided in Section 9-510, upon the filing of a termination statement with the filing office, the financing statement to which the termination statement relates ceases to be effective. Except as otherwise provided in Section 9-510, for purposes of Sections 9-519(g), 9-522(a), and 9-523(c), the filing with the filing office of a termination statement relating to a financing statement that indicates that the debtor is a transmitting utility also causes the effectiveness of the financing statement to lapse.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-601

§ 9-601 Rights After Default; Judicial Enforcement; Consignor or Buyer of Accounts, Chattel Paper, Payment Intangibles, or Promissory Notes.

(a) [Rights of secured party after default.] After default, a secured party has the rights provided in this part and, except as otherwise provided in Section 9-602, those provided by agreement of the parties. A secured party:

(1) may reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure; and

(2) if the collateral is documents, may proceed either as to the documents or as to the goods they cover.

(b) [Rights and duties of secured party in possession or control.] A secured party in possession of collateral or control of collateral under Section 9-104, 9-105, 9-106, or 9-107 has the rights and duties provided in Section 9-207.

(c) [Rights cumulative; simultaneous exercise.] The rights under subsections (a) and (b) are cumulative and may be exercised simultaneously.

(d) [Rights of debtor and obligor.] Except as otherwise provided in subsection (g) and Section 9-605, after default, a debtor and an obligor have the rights provided in this part and by agreement of the parties.

(e) [Lien of levy after judgment.] If a secured party has reduced its claim to judgment, the lien of any levy that may be made upon the collateral by virtue of an execution based upon the judgment relates back to the earliest of:

(1) the date of perfection of the security interest or agricultural lien in the collateral;

(2) the date of filing a financing statement covering the collateral; or

(3) any date specified in a statute under which the agricultural lien was created.

(f) [Execution sale.] A sale pursuant to an execution is a foreclosure of the security interest or agricultural lien by judicial procedure within the meaning of this section. A secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this article.

(g) [Consignor or buyer of certain rights to payment.] Except as otherwise provided in Section 9-607(c), this part imposes no duties upon a secured party that is a consignor or is a buyer of accounts, chattel paper, payment intangibles, or promissory notes.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-602

§ **9-602 Waiver and Variance of Rights and Duties.**

Except as otherwise provided in Section 9-624, to the extent that they give rights to a debtor or obligor and impose duties on a secured party, the debtor or obligor may not waive or vary the rules stated in the following listed sections:

(1) Section 9-207(b)(4)(C), which deals with use and operation of the collateral by the secured party;

(2) Section 9-210, which deals with requests for an accounting and requests concerning a list of collateral and statement of account;

(3) Section 9-607(c), which deals with collection and enforcement of collateral;

(4) Sections 9-608(a) and 9-615(c) to the extent that they deal with application or payment of noncash proceeds of collection, enforcement, or disposition;

(5) Sections 9-608(a) and 9-615(d) to the extent that they require accounting for or payment of surplus proceeds of collateral;

(6) Section 9-609 to the extent that it imposes upon a secured party that takes possession of collateral without judicial process the duty to do so without breach of the peace;

(7) Sections 9-610(b), 9-611, 9-613, and 9-614, which deal with disposition of collateral;

(8) Section 9-615(f), which deals with calculation of a deficiency or surplus when a disposition is made to the secured party, a person related to the secured party, or a secondary obligor;

(9) Section 9-616, which deals with explanation of the calculation of a surplus or deficiency;

(10) Sections 9-620, 9-621, and 9-622, which deal with acceptance of collateral in satisfaction of obligation;

(11) Section 9-623, which deals with redemption of collateral;

(12) Section 9-624, which deals with permissible waivers; and

(13) Sections 9-625 and 9-626, which deal with the secured party's liability for failure to comply with this article.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-603

§ 9-603 Agreement on Standards Concerning Rights and Duties.

(a) [Agreed standards.] The parties may determine by agreement the standards measuring the fulfillment of the rights of a debtor or obligor and the duties of a secured party under a rule stated in Section 9-602 if the standards are not manifestly unreasonable.

(b) [Agreed standards inapplicable to breach of peace.] Subsection (a) does not apply to the duty under Section 9-609 to refrain from breaching the peace.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-608

§ 9-608 Application of Proceeds of Collection or Enforcement; Liability for Deficiency and Right to Surplus.

(a) [Application of proceeds, surplus, and deficiency if obligation secured.] If a security interest or agricultural lien secures payment or performance of an obligation, the following rules apply:

(1) A secured party shall apply or pay over for application the cash proceeds of collection or enforcement under Section 9-607 in the following order to:

(A) the reasonable expenses of collection and enforcement and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

(B) the satisfaction of obligations secured by the security interest or agricultural lien under which the collection or enforcement is made; and

(C) the satisfaction of obligations secured by any subordinate security interest in or other lien on the collateral subject to the security interest or agricultural lien under which the collection or enforcement is made if the secured party receives an authenticated demand for proceeds before distribution of the proceeds is completed.

(2) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable

proof of the interest or lien within a reasonable time. Unless the holder complies, the secured party need not comply with the holder's demand under paragraph (1)(C).

(3) A secured party need not apply or pay over for application noncash proceeds of collection and enforcement under Section 9-607 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(4) A secured party shall account to and pay a debtor for any surplus, and the obligor is liable for any deficiency.

(b) [No surplus or deficiency in sales of certain rights to payment.] If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes, the debtor is not entitled to any surplus, and the obligor is not liable for any deficiency.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-609

§ **9-609 Secured Party's Right to Take Possession After Default.**

(a) [Possession; rendering equipment unusable; disposition on debtor's premises.] After default, a secured party:

(1) may take possession of the collateral; and

(2) without removal, may render equipment unusable and dispose of collateral on a debtor's premises under Section 9-610.

(b) [Judicial and nonjudicial process.] A secured party may proceed under subsection (a):

(1) pursuant to judicial process; or

(2) without judicial process, if it proceeds without breach of the peace.

(c) [Assembly of collateral.] If so agreed, and in any event after default, a secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which

is reasonably convenient to both parties.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-610

§ 9-610 Disposition of Collateral After Default.

(a) [Disposition after default.] After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.

(b) [Commercially reasonable disposition.] Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms.

(c) [Purchase by secured party.] A secured party may purchase collateral:

(1) at a public disposition; or

(2) at a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

(d) [Warranties on disposition.] A contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property

of the kind subject to the contract.

(e) [Disclaimer of warranties.] A secured party may disclaim or modify warranties under subsection (d):

(1) in a manner that would be effective to disclaim or modify the warranties in a voluntary disposition of property of the kind subject to the contract of disposition; or

(2) by communicating to the purchaser a record evidencing the contract for disposition and including an express disclaimer or modification of the warranties.

(f) [Record sufficient to disclaim warranties.] A record is sufficient to disclaim warranties under subsection (e) if it indicates "There is no warranty relating to title, possession, quiet enjoyment, or the like in this disposition" or uses words of similar import.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-611

§ 9-611 Notification Before Disposition of Collateral.

(a) ["Notification date."] In this section, "notification date" means the earlier of the date on which:

(1) a secured party sends to the debtor and any secondary obligor an authenticated notification of disposition; or

(2) the debtor and any secondary obligor waive the right to notification.

(b) [Notification of disposition required.] Except as otherwise provided in subsection (d), a secured party that disposes of collateral under Section 9-610 shall send to the persons specified in subsection (c) a reasonable authenticated notification of disposition.

(c) [Persons to be notified.] To comply with subsection (b), the secured party shall send an authenticated notification of disposition to:

(1) the debtor;

(2) any secondary obligor; and

(3) if the collateral is other than consumer goods:

(A) any other person from which the secured party has received, before the notification date, an authenticated notification of a claim of an interest in the collateral;

(B) any other secured party or lienholder that, 10 days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

(i) identified the collateral;

(ii) was indexed under the debtor's name as of that date; and

(iii) was filed in the office in which to file a financing statement against the debtor covering the collateral as of that date; and

(C) any other secured party that, 10 days before the notification date, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in Section 9-311(a).

(d) [Subsection (b) inapplicable: perishable collateral; recognized market.] Subsection (b) does not apply if the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.

(e) [Compliance with subsection (c)(3)(B).] A secured party complies with the requirement for notification prescribed by subsection (c)(3)(B) if:

(1) not later than 20 days or earlier than 30 days before the notification date, the secured party requests, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the office indicated in subsection (c)(3)(B); and

(2) before the notification date, the secured party:

(A) did not receive a response to the request for information; or

(B) received a response to the request for information and sent an authenticated notification of disposition to each secured party or other lienholder named in that response whose financing statement covered the collateral.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-612

§ **9-612 Timeliness of Notification Before Disposition of Collateral.**

(a) [Reasonable time is question of fact.] Except as otherwise provided in subsection (b), whether a notification is sent within a reasonable time is a question of fact.

(b) [10-day period sufficient in non-consumer transaction.] In a transaction other than a consumer transaction, a notification of disposition sent after default and 10 days or more before the earliest time of disposition set forth in the notification is sent within a reasonable time before the disposition.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-613

§ 9-613 Contents and Form of Notification Before Disposition of Collateral: General.

Except in a consumer-goods transaction, the following rules apply:

(1) The contents of a notification of disposition are sufficient if the notification:

(A) describes the debtor and the secured party;

(B) describes the collateral that is the subject of the intended disposition;

(C) states the method of intended disposition;

(D) states that the debtor is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for an accounting; and

(E) states the time and place of a public disposition or the time after which any other disposition is to be made.

(2) Whether the contents of a notification that lacks any of the information specified in paragraph (1) are nevertheless sufficient is a question of fact.

(3) The contents of a notification providing substantially the information specified in paragraph (1) are sufficient, even if the notification includes:

(A) information not specified by that paragraph; or

(B) minor errors that are not seriously misleading.

(4) A particular phrasing of the notification is not required.

(5) The following form of notification and the form appearing in Section 9-614(3), when completed, each provides sufficient information:Form C-1A NOTIFICATION OF DISPOSITION OF COLLATERAL

NOTIFICATION OF DISPOSITION OF COLLATERAL

To:	[*Name of debtor, obligor, or other person to which the notification is sent*]
From:	[*Name, address, and telephone number of secured party*]
Name of Debtor(s):	[*Include only if debtor(s) are not an addressee*]

[*For a public disposition:*]

We will sell [or lease or license, *as applicable*] the [*describe collateral*] [to the highest qualified bidder] in public as follows:

Day and Date:	.....
Time:	.....
Place:	.....

[*For a private disposition:*]

We will sell [or lease or license, *as applicable*] the [*describe collateral*] privately sometime after [*day and date*].

You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell [or lease or license, *as applicable*] [for a charge of $_____]. You may request an accounting by calling us at [*telephone number*]

[End of Form]

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-614

§ 9-614 Contents and Form of Notification Before Disposition of Collateral: Consumer-Goods Transaction.

In a consumer-goods transaction, the following rules apply:

(1) A notification of disposition must provide the following information:

(A) the information specified in Section 9-613(1);

(B) a description of any liability for a deficiency of the person to which the notification is sent;

(C) a telephone number from which the amount that must be paid to the secured party to redeem the collateral under Section 9-623 is available; and

(D) a telephone number or mailing address from which additional information concerning the disposition and the obligation secured is available.

(2) A particular phrasing of the notification is not required.

(3) The following form of notification, when completed, provides sufficient information:

[*Name and address of secured party*]

[*Date*] Form C-2A NOTICE OF OUR PLAN TO SELL PROPERTY

NOTICE OF OUR PLAN TO SELL PROPERTY

[*Name and address of any obligor who is also a debtor*]

Subject: [*Identification of Transaction*]

We have your [*describe collateral*], because you broke promises in our agreement.

[*For a public disposition:*]

We will sell [*describe collateral*] at public sale. A sale could include a lease or license. The sale will be held as follows:

Day and Date: .....

Time: .....

Place: .....

You may attend the sale and bring bidders if you want.

[*For a private disposition:*]

We will sell [*describe collateral*] at private sale sometime after [*date*]. A sale could include a lease or license.

The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you [*will or will not, as applicable*] still owe us the difference. If we get more money than you owe, you will get the extra money, unless we must pay it to someone else.

You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at [*telephone number*].

If you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at [*telephone number*] [or write us at [*secured party's address*] and request a written explanation. [We will charge you $_____ for the explanation if we sent you another written explanation of the amount you owe us within the last six months.]

If you need more information about the sale call us at [*telephone number*] [or write us at [*secured party's address*].

We are sending this notice to the following other people who have an interest in [*describe collateral*] or who owe

money under your agreement:

[*Names of all other debtors and obligors, if any*]

[End of Form]

(4) A notification in the form of paragraph (3) is sufficient, even if additional information appears at the end of the form.

(5) A notification in the form of paragraph (3) is sufficient, even if it includes errors in information not required by paragraph (1), unless the error is misleading with respect to rights arising under this article.

(6) If a notification under this section is not in the form of paragraph (3), law other than this article determines the effect of including information not required by paragraph (1).

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-615

§ 9-615 Application of Proceeds of Disposition; Liability for Deficiency and Right to Surplus.

(a) [Application of proceeds.] A secured party shall apply or pay over for application the cash proceeds of disposition under Section 9-610 in the following order to:

(1) the reasonable expenses of retaking, holding, preparing for disposition, processing, and disposing, and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

(2) the satisfaction of obligations secured by the security interest or agricultural lien under which the disposition is made;

(3) the satisfaction of obligations secured by any subordinate security interest in or other subordinate lien on the collateral if:

(A) the secured party receives from the holder of the subordinate security interest or other lien an authenticated demand for proceeds before distribution of the proceeds is completed; and

(B) in a case in which a consignor has an interest in the collateral, the subordinate security interest or other lien is

senior to the interest of the consignor; and

(4) a secured party that is a consignor of the collateral if the secured party receives from the consignor an authenticated demand for proceeds before distribution of the proceeds is completed.

(b) [Proof of subordinate interest.] If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder does so, the secured party need not comply with the holder's demand under subsection (a)(3).

(c) [Application of noncash proceeds.] A secured party need not apply or pay over for application noncash proceeds of disposition under Section 9-610 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(d) [Surplus or deficiency if obligation secured.] If the security interest under which a disposition is made secures payment or performance of an obligation, after making the payments and applications required by subsection (a) and permitted by subsection (c):

(1) unless subsection (a)(4) requires the secured party to apply or pay over cash proceeds to a consignor, the secured party shall account to and pay a debtor for any surplus; and

(2) the obligor is liable for any deficiency.

(e) [No surplus or deficiency in sales of certain rights to payment.] If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes:

(1) the debtor is not entitled to any surplus; and

(2) the obligor is not liable for any deficiency.

(f) [Calculation of surplus or deficiency in disposition to person related to secured party.] The surplus or deficiency following a disposition is calculated based on the amount of proceeds that would have been realized in a disposition complying with this part to a transferee other than the secured party, a person related to the secured party, or a

secondary obligor if:

(1) the transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor; and

(2) the amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(g) [Cash proceeds received by junior secured party.] A secured party that receives cash proceeds of a disposition in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or other lien that is not subordinate to the security interest or agricultural lien under which the disposition is made:

(1) takes the cash proceeds free of the security interest or other lien;

(2) is not obligated to apply the proceeds of the disposition to the satisfaction of obligations secured by the security interest or other lien; and

(3) is not obligated to account to or pay the holder of the security interest or other lien for any surplus.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-616

§ 9-616 Explanation of Calculation of Surplus or Deficiency.

(a) [Definitions.] In this section:

(1) "Explanation" means a writing that:

(A) states the amount of the surplus or deficiency;

(B) provides an explanation in accordance with subsection (c) of how the secured party calculated the surplus or deficiency;

(C) states, if applicable, that future debits, credits, charges, including additional credit service charges or interest, rebates, and expenses may affect the amount of the surplus or deficiency; and

(D) provides a telephone number or mailing address from which additional information concerning the transaction is available.

(2) "Request" means a record:

(A) authenticated by a debtor or consumer obligor;

(B) requesting that the recipient provide an explanation; and

(C) sent after disposition of the collateral under Section 9-610.

(b) [Explanation of calculation.] In a consumer-goods transaction in which the debtor is entitled to a surplus or a consumer obligor is liable for a deficiency under Section 9-615, the secured party shall:

(1) send an explanation to the debtor or consumer obligor, as applicable, after the disposition and:

(A) before or when the secured party accounts to the debtor and pays any surplus or first makes written demand on the consumer obligor after the disposition for payment of the deficiency; and

(B) within 14 days after receipt of a request; or

(2) in the case of a consumer obligor who is liable for a deficiency, within 14 days after receipt of a request, send to the consumer obligor a record waiving the secured party's right to a deficiency.

(c) [Required information.] To comply with subsection (a)(1)(B), a writing must provide the following information in the following order:

(1) the aggregate amount of obligations secured by the security interest under which the disposition was made, and, if the amount reflects a rebate of unearned interest or credit service charge, an indication of that fact, calculated as of a specified date:

(A) if the secured party takes or receives possession of the collateral after default, not more than 35 days before the secured party takes or receives possession; or

(B) if the secured party takes or receives possession of the collateral before default or does not take possession of the collateral, not more than 35 days before the disposition;

(2) the amount of proceeds of the disposition;

(3) the aggregate amount of the obligations after deducting the amount of proceeds;

(4) the amount, in the aggregate or by type, and types of expenses, including expenses of retaking, holding, preparing for disposition, processing, and disposing of the collateral, and attorney's fees secured by the collateral which are known to the secured party and relate to the current disposition;

(5) the amount, in the aggregate or by type, and types of credits, including rebates of interest or credit service charges, to which the obligor is known to be entitled and which are not reflected in the amount in paragraph (1); and

(6) the amount of the surplus or deficiency.

(d) [Substantial compliance.] A particular phrasing of the explanation is not required. An explanation complying substantially with the requirements of subsection (a) is sufficient, even if it includes minor errors that are not seriously misleading.

(e) [Charges for responses.] A debtor or consumer obligor is entitled without charge to one response to a request under this section during any six-month period in which the secured party did not send to the debtor or consumer obligor an explanation pursuant to subsection (b)(1). The secured party may require payment of a charge not exceeding $25 for each additional response.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-617

§ **9-617 Rights of Transferee of Collateral.**

(a) [Effects of disposition.] A secured party's disposition of collateral after default:

(1) transfers to a transferee for value all of the debtor's rights in the collateral;

(2) discharges the security interest under which the disposition is made; and

(3) discharges any subordinate security interest or other subordinate lien [other than liens created under [cite acts or statutes providing for liens, if any, that are not to be discharged].

(b) [Rights of good-faith transferee.] A transferee that acts in good faith takes free of the rights and interests described in subsection (a), even if the secured party fails to comply with this article or the requirements of any judicial proceeding.

(c) [Rights of other transferee.] If a transferee does not take free of the rights and interests described in subsection (a), the transferee takes the collateral subject to:

(1) the debtor's rights in the collateral;

(2) the security interest or agricultural lien under which the disposition is made; and

(3) any other security interest or other lien.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-618

§ 9-618 Rights and Duties of Certain Secondary Obligors.

(a) [Rights and duties of secondary obligor.] A secondary obligor acquires the rights and becomes obligated to perform the duties of the secured party after the secondary obligor:

(1) receives an assignment of a secured obligation from the secured party;

(2) receives a transfer of collateral from the secured party and agrees to accept the rights and assume the duties of the secured party; or

(3) is subrogated to the rights of a secured party with respect to collateral.

(b) [Effect of assignment, transfer, or subrogation.] An assignment, transfer, or subrogation described in subsection (a):

(1) is not a disposition of collateral under Section 9-610; and

(2) relieves the secured party of further duties under this article.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-619

§ **9-619 Transfer of Record or Legal Title.**

(a) ["Transfer statement."] In this section, "transfer statement" means a record authenticated by a secured party stating:

(1) that the debtor has defaulted in connection with an obligation secured by specified collateral;

(2) that the secured party has exercised its post-default remedies with respect to the collateral;

(3) that, by reason of the exercise, a transferee has acquired the rights of the debtor in the collateral; and

(4) the name and mailing address of the secured party, debtor, and transferee.

(b) [Effect of transfer statement.] A transfer statement entitles the transferee to the transfer of record of all rights of the debtor in the collateral specified in the statement in any official filing, recording, registration, or certificate-of-title system covering the collateral. If a transfer statement is presented with the applicable fee and request form to the official or office responsible for maintaining the system, the official or office shall:

(1) accept the transfer statement;

(2) promptly amend its records to reflect the transfer; and

(3) if applicable, issue a new appropriate certificate of title in the name of the transferee.

(c) [Transfer not a disposition; no relief of secured party's duties.] A transfer of the record or legal title to collateral to a secured party under subsection (b) or otherwise is not of itself a disposition of collateral under this article and does not of itself relieve the secured party of its duties under this article.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-620

§ 9-620 Acceptance of Collateral in Full or Partial Satisfaction of Obligation; Compulsory Disposition of Collateral.

(a) [Conditions to acceptance in satisfaction.] Except as otherwise provided in subsection (g), a secured party may accept collateral in full or partial satisfaction of the obligation it secures only if:

(1) the debtor consents to the acceptance under subsection (c);

(2) the secured party does not receive, within the time set forth in subsection (d), a notification of objection to the proposal authenticated by:

(A) a person to which the secured party was required to send a proposal under Section 9-621; or

(B) any other person, other than the debtor, holding an interest in the collateral subordinate to the security interest that is the subject of the proposal;

(3) if the collateral is consumer goods, the collateral is not in the possession of the debtor when the debtor consents to the acceptance; and

(4) subsection (e) does not require the secured party to dispose of the collateral or the debtor waives the requirement pursuant to Section 9-624.

(b) [Purported acceptance ineffective.] A purported or apparent acceptance of collateral under this section is ineffective unless:

(1) the secured party consents to the acceptance in an authenticated record or sends a proposal to the debtor; and

(2) the conditions of subsection (a) are met.

(c) [Debtor's consent.] For purposes of this section:

(1) a debtor consents to an acceptance of collateral in partial satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default; and

(2) a debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default or the secured party:

(A) sends to the debtor after default a proposal that is unconditional or subject only to a condition that collateral not in the possession of the secured party be preserved or maintained;

(B) in the proposal, proposes to accept collateral in full satisfaction of the obligation it secures; and

(C) does not receive a notification of objection authenticated by the debtor within 20 days after the proposal is sent.

(d) [Effectiveness of notification.] To be effective under subsection (a)(2), a notification of objection must be received by the secured party:

(1) in the case of a person to which the proposal was sent pursuant to Section 9-621, within 20 days after notification was sent to that person; and

(2) in other cases:

(A) within 20 days after the last notification was sent pursuant to Section 9-621; or

(B) if a notification was not sent, before the debtor consents to the acceptance under subsection (c).

(e) [Mandatory disposition of consumer goods.] A secured party that has taken possession of collateral shall dispose of the collateral pursuant to Section 9-610 within the time specified in subsection (f) if:

(1) 60 percent of the cash price has been paid in the case of a purchase-money security interest in consumer goods; or

(2) 60 percent of the principal amount of the obligation secured has been paid in the case of a non-purchase-money security interest in consumer goods.

(f) [Compliance with mandatory disposition requirement.] To comply with subsection (e), the secured party shall dispose of the collateral:

(1) within 90 days after taking possession; or

(2) within any longer period to which the debtor and all secondary obligors have agreed in an agreement to that effect entered into and authenticated after default.

(g) [No partial satisfaction in consumer transaction.] In a consumer transaction, a secured party may not accept collateral in partial satisfaction of the obligation it secures.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-621

§ 9-621 Notification of Proposal to Accept Collateral.

(a) [Persons to which proposal to be sent.] A secured party that desires to accept collateral in full or partial satisfaction of the obligation it secures shall send its proposal to:

(1) any person from which the secured party has received, before the debtor consented to the acceptance, an authenticated notification of a claim of an interest in the collateral;

(2) any other secured party or lienholder that, 10 days before the debtor consented to the acceptance, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

(A) identified the collateral;

(B) was indexed under the debtor's name as of that date; and

(C) was filed in the office or offices in which to file a financing statement against the debtor covering the collateral as of that date; and

(3) any other secured party that, 10 days before the debtor consented to the acceptance, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in Section 9-311(a).

(b) [Proposal to be sent to secondary obligor in partial satisfaction.] A secured party that desires to accept collateral in partial satisfaction of the obligation it secures shall send its proposal to any secondary obligor in addition to the persons described in subsection (a).

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-622

§ **9-622 Effect of Acceptance of Collateral.**

(a) [Effect of acceptance.] A secured party's acceptance of collateral in full or partial satisfaction of the obligation it secures:

(1) discharges the obligation to the extent consented to by the debtor;

(2) transfers to the secured party all of a debtor's rights in the collateral;

(3) discharges the security interest or agricultural lien that is the subject of the debtor's consent and any subordinate security interest or other subordinate lien; and

(4) terminates any other subordinate interest.

(b) [Discharge of subordinate interest notwithstanding noncompliance.] A subordinate interest is discharged or terminated under subsection (a), even if the secured party fails to comply with this article.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-623

§ **9-623 Right to Redeem Collateral.**

(a) [Persons that may redeem.] A debtor, any secondary obligor, or any other secured party or lienholder may redeem collateral.

(b) [Requirements for redemption.] To redeem collateral, a person shall tender:

(1) fulfillment of all obligations secured by the collateral; and

(2) the reasonable expenses and attorney's fees described in Section 9-615(a)(1).

(c) [When redemption may occur.] A redemption may occur at any time before a secured party:

(1) has collected collateral under Section 9-607;

(2) has disposed of collateral or entered into a contract for its disposition under Section 9-610; or

(3) has accepted collateral in full or partial satisfaction of the obligation it secures under Section 9-622.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-624

§ **9-624 Waiver.**

(a) [Waiver of disposition notification.] A debtor or secondary obligor may waive the right to notification of disposition of collateral under Section 9-611 only by an agreement to that effect entered into and authenticated after default.

(b) [Waiver of mandatory disposition.] A debtor may waive the right to require disposition of collateral under Section 9-620(e) only by an agreement to that effect entered into and authenticated after default.

(c) [Waiver of redemption right.] Except in a consumer-goods transaction, a debtor or secondary obligor may waive the right to redeem collateral under Section 9-623 only by an agreement to that effect entered into and authenticated after default.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-625

§ 9-625 Remedies for Secured Party's Failure to Comply With Article.

(a) [Judicial orders concerning noncompliance.] If it is established that a secured party is not proceeding in accordance with this article, a court may order or restrain collection, enforcement, or disposition of collateral on appropriate terms and conditions.

(b) [Damages for noncompliance.] Subject to subsections (c), (d), and (f), a person is liable for damages in the amount of any loss caused by a failure to comply with this article. Loss caused by a failure to comply may include loss resulting from the debtor's inability to obtain, or increased costs of, alternative financing.

(c) [Persons entitled to recover damages; statutory damages in consumer-goods transaction.] Except as otherwise provided in Section 9-628:

(1) a person that, at the time of the failure, was a debtor, was an obligor, or held a security interest in or other lien on the collateral may recover damages under subsection (b) for its loss; and

(2) if the collateral is consumer goods, a person that was a debtor or a secondary obligor at the time a secured party failed to comply with this part may recover for that failure in any event an amount not less than the credit service charge plus 10 percent of the principal amount of the obligation or the time-price differential plus 10 percent of the cash price.

(d) [Recovery when deficiency eliminated or reduced.] A debtor whose deficiency is eliminated under Section 9-626 may recover damages for the loss of any surplus. However, a debtor or secondary obligor whose deficiency is eliminated or reduced under Section 9-626 may not otherwise recover under subsection (b) for noncompliance with the provisions of this part relating to collection, enforcement, disposition, or acceptance.

(e) [Statutory damages: noncompliance with specified provisions.] In addition to any damages recoverable under subsection (b), the debtor, consumer obligor, or person named as a debtor in a filed record, as applicable, may recover $500 in each case from a person that:

(1) fails to comply with Section 9-208;

(2) fails to comply with Section 9-209;

(3) files a record that the person is not entitled to file under Section 9-509(a);

(4) fails to cause the secured party of record to file or send a termination statement as required by Section 9-513(a) or (c);

(5) fails to comply with Section 9-616(b)(1) and whose failure is part of a pattern, or consistent with a practice, of noncompliance; or

(6) fails to comply with Section 9-616(b)(2).

(f) [Statutory damages: noncompliance with Section 9-210.] A debtor or consumer obligor may recover damages under subsection (b) and, in addition, $500 in each case from a person that, without reasonable cause, fails to comply with a request under Section 9-210. A recipient of a request under Section 9-210 which never claimed an interest in the collateral or obligations that are the subject of a request under that section has a reasonable excuse for failure to comply with the request within the meaning of this subsection.

(g) [Limitation of security interest: noncompliance with Section 9-210.] If a secured party fails to comply with a request regarding a list of collateral or a statement of account under Section 9-210, the secured party may claim a security interest only as shown in the list or statement included in the request as against a person that is reasonably misled by the failure.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-627

§ **9-627 Determination of Whether Conduct Was Commercially Reasonable.**

(a) [Greater amount obtainable under other circumstances; no preclusion of commercial reasonableness.] The fact that a greater amount could have been obtained by a collection, enforcement, disposition, or acceptance at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition, or acceptance was made in a commercially reasonable manner.

(b) [Dispositions that are commercially reasonable.] A disposition of collateral is made in a commercially reasonable manner if the disposition is made:

(1) in the usual manner on any recognized market;

(2) at the price current in any recognized market at the time of the disposition; or

(3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

(c) [Approval by court or on behalf of creditors.] A collection, enforcement, disposition, or acceptance is commercially

reasonable if it has been approved:

(1) in a judicial proceeding;

(2) by a bona fide creditors' committee;

(3) by a representative of creditors; or

(4) by an assignee for the benefit of creditors.

(d) [Approval under subsection (c) not necessary; absence of approval has no effect.] Approval under subsection (c) need not be obtained, and lack of approval does not mean that the collection, enforcement, disposition, or acceptance is not commercially reasonable.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-628

§ 9-628 Nonliability and Limitation on Liability of Secured Party; Liability of Secondary Obligor.

(a) [Limitation of liability of secured party for noncompliance with article.] Unless a secured party knows that a person is a debtor or obligor, knows the identity of the person, and knows how to communicate with the person:

(1) the secured party is not liable to the person, or to a secured party or lienholder that has filed a financing statement against the person, for failure to comply with this article; and

(2) the secured party's failure to comply with this article does not affect the liability of the person for a deficiency.

(b) [Limitation of liability based on status as secured party.] A secured party is not liable because of its status as secured party:

(1) to a person that is a debtor or obligor, unless the secured party knows:

(A) that the person is a debtor or obligor;

(B) the identity of the person; and

(C) how to communicate with the person; or

(2) to a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:

(A) that the person is a debtor; and

(B) the identity of the person.

(c) [Limitation of liability if reasonable belief that transaction not a consumer-goods transaction or consumer transaction.] A secured party is not liable to any person, and a person's liability for a deficiency is not affected, because of any act or omission arising out of the secured party's reasonable belief that a transaction is not a consumer-goods transaction or a consumer transaction or that goods are not consumer goods, if the secured party's belief is based on its reasonable reliance on:

(1) a debtor's representation concerning the purpose for which collateral was to be used, acquired, or held; or

(2) an obligor's representation concerning the purpose for which a secured obligation was incurred.

(d) [Limitation of liability for statutory damages.] A secured party is not liable to any person under Section 9-625(c)(2) for its failure to comply with Section 9-616.

(e) [Limitation of multiple liability for statutory damages.] A secured party is not liable under Section 9-625(c)(2) more than once with respect to any one secured obligation.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-703

§ **9-703 Security Interest Perfected Before Effective Date.**

(a) [Continuing priority over lien creditor: perfection requirements satisfied.] A security interest that is enforceable immediately before this [Act] takes effect and would have priority over the rights of a person that becomes a lien creditor at that time is a perfected security interest under this [Act] if, when this [Act] takes effect, the applicable requirements for enforceability and perfection under this [Act] are satisfied without further action.

(b) [Continuing priority over lien creditor: perfection requirements not satisfied.] Except as otherwise provided in Section 9-705, if, immediately before this [Act] takes effect, a security interest is enforceable and would have priority over the rights of a person that becomes a lien creditor at that time, but the applicable requirements for enforceability or perfection under this [Act] are not satisfied when this [Act] takes effect, the security interest:

(1) is a perfected security interest for one year after this [Act] takes effect;

(2) remains enforceable thereafter only if the security interest becomes enforceable under Section 9-203 before the year expires; and

(3) remains perfected thereafter only if the applicable requirements for perfection under this [Act] are satisfied before the year expires.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-704

§ **9-704 Security Interest Unperfected Before Effective Date.**

A security interest that is enforceable immediately before this [Act] takes effect but which would be subordinate to the rights of a person that becomes a lien creditor at that time:

(1) remains an enforceable security interest for one year after this [Act] takes effect;

(2) remains enforceable thereafter if the security interest becomes enforceable under Section 9-203 when this [Act] takes effect or within one year thereafter; and

(3) becomes perfected:

(A) without further action, when this [Act] takes effect if the applicable requirements for perfection under this [Act] are satisfied before or at that time; or

(B) when the applicable requirements for perfection are satisfied if the requirements are satisfied after that time.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 9-705

§ **9-705 Effectiveness of Action Taken Before Effective Date.**

(a) [Pre-effective-date action; one-year perfection period unless reperfected.] If action, other than the filing of a financing statement, is taken before this [Act] takes effect and the action would have resulted in priority of a security interest over the rights of a person that becomes a lien creditor had the security interest become enforceable before this [Act] takes effect, the action is effective to perfect a security interest that attaches under this [Act] within one year after this [Act] takes effect. An attached security interest becomes unperfected one year after this [Act] takes effect unless the security interest becomes a perfected security interest under this [Act] before the expiration of that period.

(b) [Pre-effective-date filing.] The filing of a financing statement before this [Act] takes effect is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under this [Act].

(c) [Pre-effective-date filing in jurisdiction formerly governing perfection.] This [Act] does not render ineffective an effective financing statement that, before this [Act] takes effect, is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in [former Section 9-103]. However, except as otherwise provided in subsections (d) and (e) and Section 9-706, the financing statement ceases to be effective at the earlier of:

(1) the time the financing statement would have ceased to be effective under the law of the jurisdiction in which it is filed; or

(2) June 30, 2006.

(d) [Continuation statement.] The filing of a continuation statement after this [Act] takes effect does not continue the effectiveness of the financing statement filed before this [Act] takes effect. However, upon the timely filing of a continuation statement after this [Act] takes effect and in accordance with the law of the jurisdiction governing perfection as provided in Part 3, the effectiveness of a financing statement filed in the same office in that jurisdiction before this [Act] takes effect continues for the period provided by the law of that jurisdiction.

(e) [Application of subsection (c)(2) to transmitting utility financing statement.] Subsection (c)(2) applies to a financing statement that, before this [Act] takes effect, is filed against a transmitting utility and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in [former Section 9-103] only to the extent that Part 3 provides that the law of a jurisdiction other than the jurisdiction in which the financing statement is filed governs perfection of a security interest in collateral covered by the financing statement.

(f) [Application of Part 5.] A financing statement that includes a financing statement filed before this [Act] takes effect and a continuation statement filed after this [Act] takes effect is effective only to the extent that it satisfies the requirements of Part 5 for an initial financing statement.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1-105

§ **1-105 Territorial Application of the Act; Parties' Power to Choose Applicable Law.**

(2) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods.	Section 2-402.
Applicability of the Article on Leases.	Sections 2A-105 and 2A-106.
Applicability of the Article on Bank Deposits and Collections.	Section 4-102.
Governing law in the Article on Funds Transfers.	Section 4A-507.
Letters of Credit.	Section 5-116.
Bulk sales subject to the Article on Bulk Sales.	Section 6-103.
[*If a State adopts the repealer of Article 6, then this item should be deleted*.]	
Applicability of the Article on Investment Securities.	Section 8-110.
The material within the following brackets is overstruck in the original. [Perfection provisions of the Article on Secured Transactions.]	The material within the following brackets is overstruck in the original. [Section 9-103.]
Law governing perfection, the effect of perfection or nonperfection, and the priority of security interests and agricultural liens.	Sections 9-301 through 9-307.

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1B-CONSUMER CREDIT LAW MANUAL PRIMARY SOURCE PAMPHLET Consumer Credit Law Manual § 1-201

§ **1-201 General Definitions.**

Subject to additional definitions contained in the subsequent Articles of this Act which are applicable to specific Articles or Parts thereof, and unless the context otherwise requires, in this Act:

* * *

(9) "Buyer in ordinary course of business" means a person The material within the following brackets is overstruck in the original. [who] that buys goods in good faith, The material within the following brackets is overstruck in the original. [and] without knowledge that the sale The material within the following brackets is overstruck in the original. [to him is in violation of] violates the The material within the following brackets is overstruck in the original. [ownership] rights The material within the following brackets is overstruck in the original. [or security interest] of The material within the following brackets is overstruck in the original. [a third party] another person in the goods, and The material within the following brackets is overstruck in the original. [buys] in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind The material within the following brackets is overstruck in the original. [but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons] A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices. A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. The material within the following brackets is overstruck in the original. ["Buying"] A buyer in ordinary course of business may The material within the following brackets is overstruck in the original. [be] buy for cash, The material within the following brackets is overstruck in the original. [or] by exchange of other property, or on secured or unsecured credit, and The material within the following brackets is overstruck in the original. [includes receiving] may acquire goods or documents of title under a pre-existing contract for sale The material within the following brackets is overstruck in the original. [but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.] Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Article 2 may be a buyer in ordinary course of business. A person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt is not a buyer in

ordinary course of business.

* * *

(32) "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, security interest, issue or re-issue, gift, or any other voluntary transaction creating an interest in property.

* * *

(37) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The material within the following brackets is overstruck in the original. [The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2-401) is limited in effect to a reservation of a "security interest".] The term also includes any interest of a consignor and a buyer of accounts, The material within the following brackets is overstruck in the original. [or] chattel paper, The material within the following brackets is overstruck in the original. [which] a payment intangible, or a promissory note in a transaction that is subject to Article 9. The special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 2-401 is not a "security interest", but a buyer may also acquire a "security interest" by complying with Article 9. The material within the following brackets is overstruck in the original. [Unless a consignment is intended as security, reservation of title thereunder is not a "security interest", but a consignment in any event is subject to the provisions on consignment sales (Section 2-326).] Except as otherwise provided in Section 2-505, the right of a seller or lessor of goods under Article 2 or 2A to retain or acquire possession of the goods is not a "security interest", but a seller or lessor may also acquire a "security interest" by complying with Article 9. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2-401) is limited in effect to a reservation of a "security interest".

* * *