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COMMENTS

THE FTC HOLDER IN DUE COURSE RULE: NEITHER CREDITOR RUINATION NOR CONSUMER SALVATION

by Sue A. Tanner

The application of the holder in due course doctrine to consumer sales transactions has been under continual attack since the basic principles of the doctrine proclaimed in Miller v. Race were incorporated into the Uniform Commercial Code. Recent developments, including recommendations by the National Commission on Consumer Finance, the redrafted Uniform Consumer Credit Code, the new Model Consumer Credit Act, and the recently enacted Fair Credit Billing Act, foreshadowed the doctrine's in-

1. The essence of the doctrine of holder in due course is that if a holder of a negotiable instrument takes it for value, in good faith, and without notice of the claims or defenses of any other party to the instrument, he has taken in due course and is, therefore, entitled to avoid most claims and personal defenses arising from any irregularities in the underlying transaction. See U.C.C. §§ 3-302, -303, -304, -305.


3. U.C.C. §§ 3-302, -304, -305. See also U.C.C. §§ 1-201(19), 3-201(1). In the early drafts of the UCC the good faith provision required that a bank or finance company observe "the reasonable commercial standards of any business [or trade] in which [it] may be engaged." Braucher, The Legislative History of the UCC, 38 COLUM. L. REV. 798, 812-13 (1958). Financial institutions quickly foresaw the possibility that courts would construe the phrase as requiring the exercise of reasonable discretion with regard to the responsibility of merchants financed, and the phrase was dropped. Good faith now means honesty in fact, a purely subjective test. The financer is under no duty to inquire into the underlying transaction and has notice only if he has actual knowledge or knowledge of such facts that his action in taking the instrument amounts to bad faith. Id. See also Countryman, The Holder in Due Course and Other Anachronisms in Consumer Credit, 52 TEXAS L. REV. 1 (1973); Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 YALE L.J. 1057 (1954). A detailed treatment of the good faith requirement appears in W. BRITTON, HANDBOOK OF LAW OF BILLS AND NOTES §§ 89-124 (2d ed. 1961), and J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UCC §§ 14-1 to -11 (1972). For a broad discussion of the impact of the holder in due course doctrine in consumer financing see W. MAGNUSON & J. CARPER, THE DARK SIDE OF THE MARKETPLACE (1968); Kripke, Gesture and Reality in Consumer Credit Reform, 44 N.Y.U.L. REV. 1 (1969); Murphy, Lawyers for the Poor View the UCC, 44 N.Y.U.L. REV. 298 (1969); Wallace, The Logic of Consumer Credit Reform, 82 YALE L.J. 461 (1973); Comment, The Role of Cut-Off Devices in Consumer Financing, 1968 WIS. L. REV. 505.

4. REPORT OF THE NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES (1973) [hereinafter cited as NCCF REPORT] recommends the abolition of the holder in due course doctrine in consumer credit financing.


6. The Model Consumer Credit Act and its predecessor, the National Consumer Act, were drafted by the National Consumer Law Center. Both acts would retain consumer defenses and allow affirmative claims against interlocking lenders, holders, and assignees of negotiable instruments. See Model Consumer Credit Act §§ 2.601-.603 (1973); National Consumer Act §§ 2.405-407 (1970).

evitable fate in the consumer credit field. Nevertheless, despite its protracted erosion in consumer credit sales, the doctrine has maintained vitality as a device which insulates third party creditors from vicarious liability for seller misconduct. Holder in due course has come to describe the myriad devices by which a creditor seeks to separate himself from the consumer’s product-based claims and defenses arising from the underlying seller-consumer transaction.

Some consumer advocates contend that the doctrine has retained its usefulness because of a process of “buck-passing” from courts to state legislatures, from state legislatures to Congress, and from Congress to the Federal Trade Commission. The Commission, however, has unequivocally stated that “the buck stops here.” On November 14, 1975, the FTC promulgated a Trade Regulation Rule, labeled the Seller Rule, which makes it an unfair or deceptive act or practice within the meaning of section 5 of the Federal Trade Commission Act for a seller, in financing consumer goods and services, to use procedures which separate the consumer’s legal duty to pay from the seller’s legal duty to perform. The rule requires a seller who executes an installment sales agreement or arranges loans for his buyers to ensure that the consumer credit contract used contains a specific provision preserving the consumer’s legal claims and defenses so that they

8. The first director of the National Consumer Law Center has stated that “[c]onsumers, and especially poor consumers, have a right to expect that the law will reflect reality. [They cannot] be made to understand that a rule of law conceived [of] over two centuries ago [to protect commercial trade] should adversely affect them in their dealings in the marketplace today.” Willier, Need for Preservation of Buyer’s Defenses—State Statutes Reviewed, 5 U.C.C. L.J. 132, 145 (1972).

9. See, e.g., Commercial Credit Corp. v. Childs, 199 Ark. 1073, 137 S.W.2d 260 (1940) (watershed case); Vasquez v. Super. Ct., 4 Cal. 3d 800, 484 P.2d 964, 94 Cal. Rptr. 796 (1971); Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967) (departure point for most discussions of holder in due course); MD. ANN. CODE art. 83, § 147 (1975); VT. STAT. ANN. tit. 9, § 2455 (1970).

10. Although the financing patterns which give rise to holder in due course claims may be categorized for analytical purposes, there are no clear delineations between them, and categories often overlap or change form in actual practice. A consumer may be required to execute a promissory note separate or separable from an underlying sales agreement. The note is then negotiated to a bank, finance company, or similar third party. Promissory notes appear most frequently in auto installment sales, home improvement sales, and other “hard goods” financing. Alternate, or at times in addition to the promissory note, the consumer may sign a form contract containing a “waiver of defense” clause by which he agrees to assert any claim or defense only against the seller and not against an assignee of the contract. Despite some early reluctance on the part of courts to uphold these clauses, they have become boilerplate inclusions in most consumer credit contracts which contemplate transfer to a third party financier, and have effectively insulated creditors from most claims and defenses by virtue of the contract terms, as opposed to the application of the law of negotiable instruments. See Gilmore, supra note 3, at 1095-97. The UCC generally supports the validity of these clauses in commercial agreements. U.C.C. § 9-206. A third device used in installment sales is the interlocking loan, sometimes called a purchase-money loan or a specious cash sale. It is increasingly common for a seller to develop an arrangement with a lender whereby the seller refers customers desiring credit to the lender (or lenders if the customer needs to borrow the down payment separately from the balance) for loans which are then paid directly to the seller or to the buyer and seller jointly. The connections between the seller and the lender may involve common ownership, formal or informal agreement, a long course of dealing or the lender’s providing loan applications to the seller who then assists his customers in completing them. See Statement of Basis and Purpose, 40 Fed. Reg. 53,506, 53,508 (1975). Although the lender is, in effect, financing retail sales, if the customer borrows from an “independent lender,” he has no legal ground for refusing to repay the loan even though he may be justifiably dissatisfied with his purchase. In fact and in law, the loan and the purchase are separate agreements.

11. See, e.g., Willier, supra note 8.


may be asserted to defeat or diminish a creditor's right to payment. The proposed amendment to the Seller Rule, dubbed the Creditor Rule, would reach creditors directly.

The rule, which achieved only a partial abrogation of the holder in due course doctrine, also affected transactions to which the doctrine does not apply and sent shock waves through the consumer credit industry that

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14. 16 C.F.R. §§ 433.1-.2 (1976). The Seller Rule reads in full:

1. In connection with any sale or lease of goods or services to consumers, in or affecting commerce as 'commerce' is defined in the Federal Trade Commission Act, it is an unfair or deceptive act or practice within the meaning of Section 5 of that Act for a seller, directly or indirectly to: (a) Take or receive a consumer credit contract which fails to contain the following provision in at least ten point, bold face, type:

   NOTICE
   ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREBUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREBUNDER.

   or (b) Accept, as full or partial payment for such sale or lease, the proceeds of any purchase money loan (as purchase money loan is defined herein), unless any consumer credit contract made in connection with such purchase money loan contains the following provision in at least ten point, bold face, type:

   NOTICE
   ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF. RECOVERY HEREBUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREBUNDER.

15. 40 Fed. Reg. 53,530 (1975). The Creditor Rule adds the following provision:

In connection with any Purchase Money Loan (as that term is defined in § 433.1) or any sale or lease of goods or services, in or affecting commerce as 'commerce' is defined in the Federal Trade Commission Act, it constitutes an unfair or deceptive act or practice within the meaning of Section 5 of that Act, for a seller or a creditor, directly or indirectly, to take or receive a consumer credit contract which fails to contain the following provision in at least ten point, bold face, type:
continue to reverberate.\textsuperscript{16} Consternation reigned, and haphazard FTC implementation procedures did little to alleviate the situation until May 14, 1976, the effective date of the rule, when the Commission issued a set of Guidelines to “facilitate and encourage compliance with the Rule.”\textsuperscript{17} Three months later the Commission issued a Statement of Enforcement Policy\textsuperscript{18} designed to clarify the particularly ambiguous “purchase-money loan” section of the rule.\textsuperscript{19} The two sets of guidelines belatedly answer many of the major questions surrounding the FTC rule but do so without the specificity desired by many.\textsuperscript{20} This Comment sets forth and analyzes the consumer credit industry’s major objections to the Seller Rule and the Creditor Rule.\textsuperscript{21}

\begin{quote}
\textbf{NOTICE}

\begin{verbatim}
ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS AND SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT AFFECT RECUPERATION HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT AFFECT RECUPERATION HEREUNDER.
\end{verbatim}
\end{quote}

\textsuperscript{16} In what one Congressman termed a “Chicken-Little-the-sky-is-falling” reaction, \textit{Oversight Hearings on Federal Trade Commission Rule Concerning Preservation of Consumer’s Claims and Defenses Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 94th Cong., 2d Sess. (1976)} (Statement of Rep. Frank Annunzio at 3) [hereinafter cited as \textit{Oversight Hearings}], creditors raised lending rates, increased dealer reserves, restricted purchasing of long-term contracts such as those in the mobile home and home improvement fields, demanded indemnification agreements from dealers, refused to purchase consumer paper from new dealers, and discontinued the practice of loaning to marginal borrowers. Some banks simply elected to discontinue, for a time, the purchase of any retail paper. Consequently some dealers, particularly those in the used car market, suffered a drastic decline in sales or even went out of business. \textit{See American Bankers Ass’n, Survey on the Effects of FTC Holder in Due Course Rule (1976); Independent Bankers Ass’n of America, Survey on Impact of FTC Holder in Due Course Ruling (1976).} Credit unions were forced by retailers to discontinue discount buying services to members and to include the notice in loan contracts with members in order to assure that purchases would be released to members. Retailers often refused joint proceeds checks and refused to perfect title in credit unions. \textit{See \textit{Oversight Hearings}, supra (Statement of Credit Union Nat’l Ass’n).}

\textsuperscript{17} \textit{Guidelines on Trade Regulation Rule Concerning Preservation of Consumers’ Claims and Defenses, 41 Fed. Reg. 20,022 (1976)} [hereinafter cited as \textit{Staff Guidelines}]. These guidelines, unfortunately, were issued under the disclaimer that their “analysis is informal and advisory in that it has not been formally reviewed or adopted by the Commission.” \textit{Id.} While there has never been a formal adoption of the guidelines, they are now generally regarded by the consumer credit industry as authoritative.

\textsuperscript{18} \textit{Statement of Enforcement Policy, 41 Fed. Reg. 34,594 (1976).}

\textsuperscript{19} 16 C.F.R. § 433.2(b) (1976), quoted at \textsuperscript{16} supra.\textsuperscript{14} Industry spokesmen favored a rule containing rebuttable presumptions or listing all arrangements and procedures which would trigger the rule’s requirements regarding purchase money loans. \textit{See, e.g., Oversight Hearings, supra note 16 (Statement of Walter W. Vaughn for the American Bankers Ass’n) and Statement of Charles O. Maddox, Jr., President, Independent Bankers Ass’n of America).} These two approaches were specifically rejected by the Commission. 40 Fed. Reg. 53,525 (1975). Some consumer spokesmen see the industry’s pressure for specificity as merely a masked desire for guidance as to what loopholes remain in the coverage of the rule. \textit{See, e.g., Oversight Hearings, supra note 16 (Statement of Robert J. Hobbs, Staff Attorney for the Nat’l Consumer Law Center, Inc. at 5, and Statement of George J. Zwibel, Attorney for Neighborhood Legal Services Program, Washington D.C. at 9).}

\textsuperscript{20} In the wake of protest by the consumer credit industry over the Seller Rule, several ultimately unsuccessful bills to neutralize the rule’s effects were introduced in Congress. \textit{H.R. 14685, 94th Cong., 2d Sess. (1976), and S. 3652, 94th Cong., 2d Sess. (1976),} would have amended the Consumer Credit Protection Act, 15 U.S.C. §§ 1601-1681 (Supp. V 1975), by adding a new chapter which would relate to consumer loan contract negotiability and protect creditors from claims and defenses a consumer might assert against a seller in a consumer credit contract purchased by a creditor in good faith. \textit{H.R. 15082, 94th Cong., 2d Sess. (1976),} would have suspended the rule until it could be studied further. A proposed amendment to the 1977 FTC appropriations bill, S. 3619, 94th Cong., 2d Sess. (1976), would have banned the use of any funds for the enforcement of the rule. The amendment would have also suspended the rule until Congress authorized specific expenditures for its enforcement. The proposed bills were generally regarded by the FTC as politically motivated and harmless.
I. THE LEGALITY OF THE TRADE REGULATION RULE

A. Federal Trade Commission Authority

The primary challenge to the Seller Rule disputes the Commission's authority to promulgate such a rule. The FTC Improvement Act specifically granted to the Commission the power to make substantive trade regulation rules designed to protect consumers from unfair or deceptive trade practices. In granting that authority, however, Congress revoked the Commission's previously recognized power to enact such rules pursuant to section 5(g) of the Federal Trade Commission Act. The FTC promulgated the Seller Rule subsequent to the enactment of the Improvement Act. In so doing it relied upon the "saving clause" of the statute which reads in pertinent part: "Any proposed rule under Section 6(g) of such Act with respect to which presentation of data, views and arguments was substantially completed before such date may be promulgated in the same manner and with the same validity as such rule could have been promulgated had this section not been enacted." Certain representatives of the consumer credit industry maintain that the hearings on the Seller Rule had not been substantially completed at the time of the enactment of the Improvement Act. The rule's opponents assert that the Commission's proposing the Creditor Rule as an amendment when promulgating the Seller Rule constituted an admission that it had not yet fully explored the following questions: (1) whether creditors engage in the acts or practices which the Seller Rule was designed to alleviate, (2) whether proper enforcement of the rule mandated the inclusion of creditors and (3) the effect of including creditors within the scope of the rule. These questions, they contend, are simply the rudimentary ramifications of issuing the Seller Rule.

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22. 15 U.S.C. § 57(a) (Supp. V 1975) [hereinafter cited as Improvement Act]. This Act is also referred to as the Magnuson-Moss Warranty Act.


25. 15 U.S.C. § 46(g) (Supp. V 1975). Section 18(a)(2) of the FTC Improvement Act, 15 U.S.C. § 57(a)(2) (Supp. V 1975), reads: "The Commission shall have no authority under this [Act], other than its authority under this section, to prescribe any rule with respect to unfair or deceptive acts or practices in or affecting commerce . . . ."


27. See, e.g., Oversight Hearings, supra note 16 (Statement of Charles O. Maddox, Jr. at 16). The National Savings and Loan League takes a slightly different view of the issue. Citing the complexity of the questions raised by the rule, the League proposes that if there is to be federal rulemaking authority at all, then the Improvement Act should be amended to transfer rulemaking authority relating to unfair and deceptive practices in the savings and loan industry from the FTC to the Federal Home Loan Bank Board, the federal financial regulatory agency responsible for supervising savings and loan institutions. Oversight Hearings, supra note 16 (Statement of Nat'l Savings and Loan League at 2-6).
Industry spokesmen contend further that the Commission failed to observe the spirit of the congressional signal in the Improvement Act that it should operate under procedural protections aimed at assuring that the evidentiary and legal elements upon which it bases substantive statutes are of high quality. The procedural protection most often mentioned is the right of cross-examination of agency witnesses at public hearings. The record indicates, however, that the spirit of the Improvement Act was upheld despite the fact that the FTC was promulgating rules pursuant to the unamended Act. The proceedings were not the simple notice and comment type of rulemaking authorized by National Petroleum Refiners Association v. FTC; indeed, all of the major procedural protections ultimately required by the Improvement Act were provided. The rule was first proposed on January 21, 1971. Following an extensive period of initial written comment, three public hearings were conducted. The rule was then revised and republished on January 5, 1973. Further public hearings were conducted, and on June 11, 1973, the public record was closed. During the course of the public proceedings every individual and organization that expressed a desire to testify was given the opportunity to do so. The rule was promulgated with a lengthy Statement of Basis and Purpose which thoroughly reviewed the information, data, and testimony received during the course of the proceedings, including a statement of purpose for each provision and the reasons underlying any revisions adopted.

Correlatively, the legislative history of the Improvement Act indicates that the right of cross-examination is not unqualified. The parties are allowed to conduct only such cross-examination as is necessary for a "full and true disclosure of all disputed issues of material fact." Cross-examination is permitted only when the Commission determines "1) that there are disputed issues of material fact and 2) that it is necessary to resolve such issues."
issues.\textsuperscript{40} The right is also subject to any of the rulings which the Commission is authorized to make to avoid unnecessary costs or delay. This provision was inserted to preclude the use of oral presentations and cross-examination as devices to interfere with the Commission's use of rulemaking.\textsuperscript{41}

Little could be accomplished by Congress' suspending the rule and requiring that the FTC make a fresh start under the new procedures although such a course is supported by many within the consumer credit industry.\textsuperscript{42} Further hearings could only be dilatory and would not alleviate the real inadequacies uncovered in the rule. Such an approach would also clearly contravene congressional intent, as embodied in the saving clause of the Improvement Act,\textsuperscript{43} that time, resources, and tax dollars should not be wasted by subjecting substantially completed records to new proceedings employing the new procedures. In light of the rulemaking procedures actually used by the Commission, the clause is properly applicable to the Seller Rule.

B. State Law

State legislatures have shown considerable interest in modifying the doctrine of holder in due course in consumer transactions,\textsuperscript{44} and by 1976 only six states had not done so.\textsuperscript{45} State statutes are divisible into two general categories: (1) statutes which render holder in due course principles inapplicable in consumer sales transactions;\textsuperscript{46} and (2) complaint-period statutes which restrict the cutoff of consumer rights for a stated period of time during which the consumer, after receipt of notification of assignment, may communicate sales-related grievances directly to the creditor.\textsuperscript{47} Little uniformity, however, exists among state statutes,\textsuperscript{48} and few jurisdictions have

\begin{itemize}
\item \textsuperscript{41} Id.
\item \textsuperscript{42} See, e.g., Oversight Hearings, supra note 16 (Statement of Charles O. Maddox, Jr. at 29, and Statement of Robert E. Tobey for Consumer Bankers Ass'n at 8).
\item \textsuperscript{43} Pub. L. No. 93-637, § 202(c)(1), 88 Stat. 2198 (1975); see note 26 supra and accompanying text.
\item \textsuperscript{45} As of 1976 Arkansas, Missouri, Montana, Nebraska, Tennessee, and Virginia had not enacted such statutes.
\item \textsuperscript{47} See, e.g., Del. Code tit. 6, § 4312 (1974) (15 days); Ill. Ann. Stat. ch. 121-1/2, § 262D (Smith-Hurd Supp. 1968) (5 days). Any claim or defense raised during the complaint period may be asserted in a later suit to defeat or diminish the creditor's claim to payment.
\end{itemize}
dealt with interlocking or vendor-related loans. Most states continue to treat these loans as indistinguishable from spontaneous transactions solicited by the buyer.

The challenge to FTC authority merges with the erroneous assumption that although it lacks the power to do so, the Commission has preempted state law with the Seller Rule. The claim is that the rule imposes the FTC’s standards on the seller-buyer balance, completely superseding state standards. One creditor states: “The FTC does not have the authority to promulgate a rule which defines as ‘unfair’ a broad sweep of acts and practices, many of which are specifically sanctioned by state statutes.”

There are strong indications that neither house of Congress intended that the Federal Trade Commission take action without careful consideration of state consumer protection policies and statutes. Portions of the legislative history of the Improvement Act lend support to the contention that the Commission utilized a loophole in the Act to promulgate a regulation which contradicts the legislative intent behind the same Act. Other segments, however, support a different conclusion. In any event, proponents of the

49. See note 10 supra. See, e.g., D.C. CODE ENCYCL. § 28-3809 (West Cum. Supp. 1977). This device, so-called “body-dragging,” offers a convenient alternative to discount financing when the latter has been prohibited by law. Information submitted to the FTC indicated substantial increases in vendor-related loans where states had enacted statutes abrogating holder in due course law in consumer transactions. See 40 Fed. Reg. 53,508 (1975).

50. One writer accurately sums up the state statute dilemma this way:

I have no doubt that ultimately the doctrine of holder in due course will die. . . . The question really, is, how effectively and how quickly? Year after year bills are prepared in state legislatures to solve the problem and year after year they go wanting or are compromised to the point that the problem remains more complicated than it was. . . . [T]hose who would employ the doctrine have great strength in terms of money and time, using whatever methods they must . . . to make certain that the doctrine is preserved.

Willier, supra note 8, at 141.


52. Oversight Hearings, supra note 16 (Statement of Walter W. Vaughn at 7).


54. The House Committee Report for the FTC Improvement Act states in part that:

The amendments made by section 201 will permit more effective regulation of the marketplace by the FTC by placing within its reach unfair or deceptive acts or practices which, although local in character, affect interstate commerce. The expansion of the FTC’s jurisdiction . . . is not intended to occupy the field or in any way to preempt State or local agencies from carrying out consumer protection or other activities within their jurisdiction which are also within the expanded jurisdiction of the Commission.


In considering certain arguments against expansion of the Commission’s jurisdiction, the Committee was mindful of the danger of making the Commission alone responsible for eradicating fraud and deceit in every corner of the marketplace. This is not the Committee’s intent . . . . State and local consumer protection efforts are not to be supplanted by this expansion of jurisdiction. In many situations the Commission . . . . would work concurrently with State and local governments . . . . [T]his expansion of jurisdiction . . . will enable the Commission to move against local consumer abuses where state or local consumer protection programs are non-existent or where fly-by-night operators hit one local area and . . . move on to another before local officials can take action.


55. The Act’s purpose, according to the House Report, was to improve the FTC’s consumer protection activities and to provide the Commission with the means of better protecting consumers. H.R. REP. No. 1107, 93d Cong., 2d Sess., reprinted in [1974] U.S. CODE CONG. &
FTC's action maintain that the rule does not overturn state law, but that in the context of variant legislative treatment by the states, "with loopholes aplenty," the FTC has attempted to establish a national standard. Those state laws which provide broader protection for consumers are not greatly affected. Those which provide less are raised to the national standard.

Insofar as it preserves consumer claims and defenses where state law permits them to be destroyed by a holder in due course, the rule clearly preempts state law. Nevertheless, the rule is intended to mesh with existing state consumer protection statutes as well as with current state contract, tort, and procedural law. This aspect of the rule renders it far more complex than if it simply preempted state law. Within the context of local consumer suits, the courts of each state must attempt to fit the rule to the current state consumer law and apply the "new" law which emerges from the meshing process.

This interplay poses a number of potential problems, some of which have already surfaced. Recourse arrangements between sellers and small lenders constitute one area of difficulty. The rationale underlying the Seller Rule assumes that creditors and sellers will enter into some agreement of this type so that creditors will not ultimately be liable for seller misconduct. As the Federal Reserve Board pointed out, however, many states have "small loan" laws which prohibit any person from owing or potentially owing more than the statutory limit to a small lender. If a small lender makes several purchase money loans for consumer purchases from one seller with whom he has a recourse agreement, the seller will be potentially liable to the small lender for an aggregate amount in excess of the small loan limit. These laws may, therefore, prevent small lenders from protecting themselves through the recourse agreements envisioned by the FTC.

The application of state procedural and evidentiary law to disputes involving consumer claims and defenses may render the rule's protection of consumers an empty promise in some states. The Statute of Frauds in effect in most states often provides that no liability is enforceable in the absence of a writing signed by the party to be charged. Therefore, if a creditor fails to sign a credit instrument, as he need not, he may later assert that his liability is barred by the Statute's provision which requires that promises to answer for the default of another be in writing and signed by the party to be charged.

\[\text{AD. NEWS 7702. The Report also stated that "[w]here cases of consumer fraud of a local nature which affect commerce are being effectively dealt with by State or local government agencies, it is the Committee's intent that the [FTC] should not intrude." \textit{Id.} U.S. Code Cong. & Ad. News at 7726 (emphasis added). The Commission could certainly have concluded that such cases were, indeed, not being effectively dealt with in most states since most statutes place few effective restraints on the use of the holder in due course doctrine or other devices which reach an analogous result in consumer transactions. See note 52 supra and accompanying text.} \]

\[\text{56. \textit{See, e.g.,} Oversight Hearings, supra note 16 (Statement of George J. Zwibel).} \]

\[\text{57. \textit{Id.} (Statement of George J. Zwibel at 5).} \]

\[\text{58. \textit{See Staff Guidelines, supra note 17, at 20,0024.}} \]


\[\text{60. U.C.C. \S 3-104.} \]

A third problem concerns primarily savings and loan associations. The Staff Guidelines state that sales of interests in real property are not covered by the rule. "However, the mere fact that a security interest in real property is taken does not mean that a sales transaction does not involve consumer goods or services. . . . [H]ome improvement contracting, which does constitute a sale of goods and services, is often financed by credit secured by real property." Home improvement loans often involve additions to an existing home; a structural addition to a house plus the addition of consumer goods such as new appliances or plumbing fixtures force savings and loan associations to determine which of such appliances are real property under state law and which are personal property subject to the rule.

A similar question arises in the case of a loan to purchase a new mobile home. Although this transaction, if consummated before the mobile home is located on a lot and connected to utilities, would ordinarily be regarded as a sale of personal property, it actually involves the sale of a home. If under state law the unit becomes real property once it is attached to the site, a question arises concerning the rule's continued applicability for the term of the warranty.

Inevitable conflicts arise in any attempt to fit a regulation like the Seller Rule into the broad framework of fifty states' laws. Many more problems will undoubtedly be discovered during the initial years of experience under the rule. Nevertheless, after more than four-and-one-half years of work on the rule, the FTC should have recognized and eliminated the more obvious conflicts discussed above. One would expect the contact maintained between the Commission and the states' attorneys general to have produced at least minimum accord. Ex post facto patching simply lends support to the rule's critics and unnecessarily prolongs the inevitable adjustment period following such a major change in the law.

II. The Extent and Duration of Creditor Liability

Intertwined with the state law imbroglio is confusion regarding the nature and duration of the claims and defenses which may be preserved against a creditor. The Federal Trade Commission has mandated, through the compulsory terms of the sales contract, the consumer's right not only to defend against collection efforts but also to assert claims against the creditor. Moreover, the rule lacks any formula for determining the point at which a creditor's liability ceases and fails to exclude specifically tort claims or

62. Staff Guidelines, supra note 17, at 20,024.
63. See Oversight Hearings, supra note 16 (Statement of National Savings and Loan League at 3).
64. Id. Potential problems also exist in the rule's interplay with federal statutes. For example, 12 U.S.C. § 82 (Supp. V 1975) provides that no banking association should be liable in any way for an amount greater than that of its capital stock undiminished by losses, etc., plus 50% of the unimpaired surplus fund, except in certain enumerated instances not applicable here. Consequently, a bank's consumer lending portfolio partakes, to an indeterminate degree, of a potentially forbidden concentration of liability.
65. The measure of a financer's liability should at least be consistent with the goals of risk allocation. See Section VI infra. There is little justification for increasing the creditor's liability beyond that which is necessary to accomplish those goals, and an overextension of liability would inevitably increase the cost and lower the availability of consumer credit.
down payment recovery by the buyer. These aspects of the rule have caused near panic within the consumer credit industry; much of this panic is baseless.

A majority of jurisdictions preclude an affirmative recovery by a debtor against a creditor. At least eighteen states have provisions directly or indirectly limiting the life of creditor liability. With regard to tort liability, all states but one prohibit the inclusion of consequential damages in a debtor's judgment against a creditor. Again, only one state allows recovery against the creditor for a downpayment or interest paid to the seller by the buyer. On the federal level, section 170 of the Fair Credit Billing Act excludes tort actions from those actions a credit card holder may bring against a card issuer when the card is used to acquire goods and services. That statute also limits creditor liability for flawed goods and services to the outstanding balance owed by the buyer at the time he notifies the bank of his claims or defenses; the lender is not responsible for money already paid on the account.

The industry's conclusion that the Seller Rule imposes liability contrary to that of related state and federal statutes indicates a misreading of the rule. The required contract provision simply preserves against the creditor any legally sufficient tort or contract claims and defenses which applicable state law grants to the consumer against the seller. Where state law affords a consumer a tort claim against a seller which would defeat the seller's right to further payment or enable the consumer to recover affirmatively, that claim

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66. See note 16 supra. One large east coast bank went so far as to refuse to make "related loans" to customers of orthodontists because of fear that the high rate of dissatisfaction with orthodontists would render the note more difficult to collect and subject the bank to malpractice claims which the customers might have against the orthodontist. Many banks have been unable to find an insurer willing to cover all of the perceived risks to the bank. Oversight Hearings, supra note 16 (Statement of Robert E. Tobey of Consumer Bankers Ass'n at 7).


68. For an example of such a statute see ARIZ. REV. STAT. ANN. § 44-145A (West Cum. Supp. 1977).


70. Id.


72. Id. The courts have been silent on the extent of the creditor's liability. The original Uniform Consumer Credit Code not only limited the creditor's liability to the amount owed at the time the consumer asserted his claim or defense, but also insisted that the consumer await the creditor's pleasure in bringing suit for the balance of the debt. UNIFORM CONSUMER CREDIT CODE § 2.404 alts. A & B (1969). The new Uniform Consumer Credit Code, like the Fair Credit Billing Act, limits creditor liability to the amount owed when the creditor first learns of the claim or defense. UNIFORM CONSUMER CREDIT CODE §§ 3.403(3)(d), .404(2), .405(2). The NCCF Report recommends that a holder's liability "not exceed the original amount financed." NCCF REPORT, supra note 4, at 35-36. The Model Consumer Credit Act, however, begins by making the creditor "liable to the full extent of all claims, defenses and equities of the consumer which arise from the transaction." MODEL CONSUMER CREDIT ACT § 2.602(1). This Act apparently intends to authorize affirmative recoveries for all consequential damages because it limits the liability of "good faith" financers to the "total of the original transaction," or "the amount of the proceeds of the loan used in the consumer transaction." Id. §§ 2.602(2), .603(2). The Federal Reserve Board has stated that claims for consequential damages have no relation to the type of unfair practices to which the Seller Rule and Creditor Rule are addressed and has recommended that, in light of a specifically expressed contrary congressional view on the same issue, the FTC amend the rule expressly to exclude tort claims. Comments of the Staff of the Board of Governors of the Federal Reserve System, supra note 59, at 15-16. The Consumer Bankers Association has proposed a substitute rule which would equate creditor liability with that of credit card issuers under the Fair Credit Billing Act. Oversight Hearings, supra note 16 (Statement of Robert E. Tobey, app.).
is preserved against the creditor. Nevertheless, the consumer may never recover consequential damages which exceed the amount of the credit contract; the consumer may sue only to liquidate the unpaid balance and recover amounts already tendered. The rule also prohibits a consumer to assert claims and defenses arising out of separate transactions with the same seller. The rule’s objective was to preserve substantive rights, not to create new ones.

The rule, then, does not create the right to withhold payment. A consumer who refuses to pay does so at the same peril he faced prior to the promulgation of the rule. Similarly, the rule does not extend rights in time. In all cases the consumer is limited to the exact amount of legal damages. Only when a consumer’s legal damages exceed the amount which he still owes a creditor under the contract may he seek a return of all or part of the monies already paid. The notice provision contains its own built in limitation on the liability of the creditor: “Recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder.” This limits affirmative recovery to a refund of the amount paid under the contract; it does not, however, eliminate other rights which a consumer may have as a matter of federal, state, or local law.

The consumer’s rights are also subject to the legal time limits of the jurisdiction. Thus, in addition to contractual time limits, actions such as breach of contract, misrepresentation, or fraud are subject to the statutes of limitations in each state. Further, equitable principles, such as laches and estoppel, also protect sellers, and therefore creditors, from untimely and unreasonable claims.

Creditor protests would be understandable if the rule resulted in their unrestricted and indefinite liability for all consumer claims and defenses. Sophisticated legal and insurance mechanisms exist to compensate consumers for consequential personal injury and property damages when the immediate seller is unreachable or judgment-proof. The risk of such unlimited

73. Staff Guidelines, supra note 17, at 20,024.
74. Id.
76. A three-year warranty terminates after three years whether the loan contract for the item in question extends for three or for fifteen years. See Oversight Hearings, supra note 16 (Statement of Margery Waxman Smith for the Federal Trade Commission at 9-10). This aspect of the rule has been of particular concern to savings and loan associations which finance most long-term home improvement and mobile home loans. See Oversight Hearings, supra note 16 (Statement of National Savings and Loan League and Statement of Burleigh Trimble for United States League of Savings Ass’n).
77. A recent case, however, may be read to infer that an account debtor may recover prior payments on a restitution theory. Farmers Acceptance Corp. v. DeLozier, 178 Colo. 291, 496 P.2d 1016 (1972). See generally RESTATEMENT OF RESTITUTIONS § 14(2) (1936).
78. Staff Guidelines, supra note 17, at 20,023.
79. “Recovery hereunder” refers specifically to recovery under the notice provision. See Oversight Hearings, supra note 16 (Statement of Margery Waxman Smith). See also Staff Guidelines, supra note 17, at 20,023.
80. If the proclaimed evil of the holder in due course doctrine in consumer transactions is merely that it denies the consumer the tactical opportunity to withhold payments, perhaps the proper response is a restoration of that balance and nothing more. This position is advanced by the United States Dept. of Justice. See U.S. Dept. of Justice, Commentaries on the Proposed FTC Rule, FTC RECORD 9124-27 (June 11, 1973). Some have estimated that 98% of holder in due course injustices could be eliminated in this manner. See, e.g., Testimony of Prof. Martin J. Aronstein, FTC TRANSCRIPT 1419 (March 12, 1973).
claims for a creditor dealing with many merchants is probably beyond actuarial calculation and is insurable only at astronomical rates, if at all.\textsuperscript{81} The rule does not, however, impose such unrestricted liability on creditors. Moreover, a rule which completely excluded tort claims would be inappropriate in light of the history of the common law development and the convergence, in some jurisdictions, of actions for tortious strict liability and contractual implied warranty.\textsuperscript{82}

III. Direct Loans

Although every part of the Seller Rule has been attacked as ambiguous, the purchase money loan provision\textsuperscript{83} is most heavily criticized on that point. The provision constitutes the first of two steps taken by the FTC in its attempt to apply the Seller Rule to creditors and thereby avoid circumvention of the rule.\textsuperscript{84} The rule requires that the prescribed notice be included in a loan document when the seller accepts the proceeds of a purchase money loan extended directly to the consumer by the creditor. The rule’s definition of a purchase money loan limits the rule to direct loans in which the seller refers the customer to the creditor or is affiliated with the creditor.\textsuperscript{85}

The FTC has stated that “affiliation” and “referral” are intended to be, to some extent, coextensive in their impact in order to insure that the wide spectrum of relationships involving joint activity is brought within the rule.\textsuperscript{86} The rule requires a seller to insure that the notice is included in a consumer’s loan contract when the seller is affiliated with the creditor “by common control, contract or business arrangements.”\textsuperscript{87} The referral relationship “arises from a pattern of cooperative activity directly relating to the arrang-

\textsuperscript{81} Rohner, \textit{Holder in Due Course in Consumer Transactions: Requiem, Revival, or Reformation?}, 60 CORNELL L. REV. 503, 554 (1975).

\textsuperscript{82} The language in the Fair Credit Billing Act which excludes tort claims is an obvious concession to creditor fears. Nevertheless, creditors are protected to a considerable extent by the Act’s basic rule on maximum liability. 15 U.S.C. § 1666 (Supp. V 1975). It could be argued that the “tort claims” phrase in the statute prevents a consumer from justifying nonpayment on grounds of fraud, misrepresentation, negligence, or strict tort liability. Rohner, \textit{supra} note 81, at 556.

\textsuperscript{83} 16 C.F.R. § 433.1 (1976); see note 14 \textit{supra}.

\textsuperscript{84} The second step is the Commission’s proposal of the Creditor Rule. The FTC has no authority, even under the Improvement Act, to regulate banks, but that Act requires the Board of Governors of the Federal Reserve System to respond to the Commission’s adoption of trade regulation rules by promulgating, within 60 days after the effective date of such rules, substantially similar regulations applicable to banks. The Board may refuse to issue the regulations if it finds that acts or practices of banks similar to those prohibited by the FTC trade regulation rule are not unfair or deceptive to consumers or that implementation of the regulations as to banks would seriously conflict with essential monetary and payment system policies of the Board. Such findings and the reasons supporting them must be published in the Federal Register. 15 U.S.C. § 57(a) (Supp. V 1975). Accordingly, the Federal Reserve Board initiated its statutory rulemaking procedure by publishing for comment the FTC’s proposed Creditor Rule. 41 Fed. Reg. 7110 (1976); see note 14 \textit{supra}. Should the Board adopt the rule, the definition of “creditor” will be revised to include banks specifically.

\textsuperscript{85} See note 14 \textit{supra}.

\textsuperscript{86} Statement of Enforcement Policy, \textit{supra} note 18, at 34,595. The affiliation test applies where the lender and seller are part of the same business entity, or where there is a pre-existing, formal or informal agreement or arrangement between the two to work together in financing consumer sales. \textit{Id}. The referral test applies to relationships in which the lender and seller “cooperate to channel purchases on a continuing basis.” \textit{Id}. This cooperation gives rise to a de facto relationship. \textit{Id}.

\textsuperscript{87} See note 14 \textit{supra}.
The conduct must be on-going, and no formal consideration is necessary. Spokesmen for the consumer credit industry express dismay at the possible scope of the affiliation section of the rule and maintain that the provisions on referrals are such that banks cannot be certain of which loan contracts must include the notice in order to avoid placing the seller who accepts the loan proceeds in violation of the rule. According to the Federal Reserve Board, the notice could conceivably be required in transactions which involve no arrangement between a creditor and a seller regarding the credit extended, and also those in which the creditor cannot know whether or not the proceeds of the loan will be used to purchase goods and services and, if so, from which seller.

A. Referrals

Once a referral relationship is established, all credit contracts between the lender and buyers who use the loan proceeds to purchase from the seller must contain the notice, whether or not the particular transaction involves a referral. Thereafter, seller referrals, even if unknown to the creditor, can theoretically determine whether or not a transaction is a purchase money loan. Merely inquiring of the consumer regarding the possibility of referral is insufficient to relieve the creditor from liability once the relationship has been established. Banks, in particular, commonly make signature loans based on good credit rating. A customer applying for such a loan may not wish to state the purpose of the loan and may consider inquiries regarding it an invasion of privacy. Consequently, many banks have complained that the rule as drafted will disrupt their relationships with preferred customers. Similar problems could conceivably arise from the fact that some consumers will not know, at the time they receive the loan, the seller with whom they will spend the proceeds.

The FTC, and others, have suggested that the creditor’s difficulties are partially resolved by the fact that the Commission interprets the definition of purchase money loan, in the proposed Creditor Rule, to require the inclusion of the notice only when the creditor knows that the consumer will use the loan proceeds to purchase from a seller who regularly refers customers to the creditor. A creditor who, in good faith, does not require the notice would not risk enforcement action. The Commission would take action against a creditor under the Creditor Rule, or against a seller under the Seller Rule, only when the creditor had or should have had knowledge that the

88. Statement of Enforcement Policy, supra note 18, at 34,596.
89. Id.
91. See Comments of the Staff of the Board of Governors of the Federal Reserve System, supra note 59, at 3.
92. Statement of Enforcement Policy, supra note 18, at 34,596.
93. Id.
94. See Comments of the Staff of the Board of Governors of the Federal Reserve System, supra note 59, at 10. Some bank customers have apparently already expressed their irritation with the rule’s requirements. See Oversight Hearings, supra note 16 (Statement of Charles O. Maddox, Jr. at 28).
conditions which invoke the notice had all been met. The infusion of a knowledge requirement into the definition of purchase money loan, however, apparently reflects FTC enforcement policy; such a requirement cannot be inferred from the rule's text.

The referral aspect of the FTC rule occasionally creates more complex problems when the consumer has chosen his seller in advance and both the seller and the creditor know that a referral is involved. If the consumer later decides to purchase from a non-referring seller, the creditor faces liability for the misconduct of the actual seller by virtue of the contract's inclusion of the notice. Similarly, a creditor may unintentionally violate the proposed Creditor Rule if a consumer decides to purchase from a referring seller after obtaining a loan without the notice. The seller's violation of the Seller Rule, however, would probably be regarded as intentional; "objective circumstances" surrounding the transaction would inform him of the source of the proceeds.

Thus, creditors may be forced to require that their borrowers sign a statement indicating the seller from whom they intend to purchase, or they may have to convert all of their loan proceeds checks into payee-designated checks to insure against inadvertent violations. Most bankers feel that the customer relations connotations of such procedures preclude them as realistic choices; instead, they plan to reduce the number of personal signature loans made in order to eliminate the risk of the loan proceeds being received by the wrong category of sellers. They suggest that their only practical alternative is to include the notice in all consumer loan contracts, thereby unreasonably subjecting themselves to consumer claims and defenses against any seller. Should creditors elect not to change to payee-designated checks, the referral aspect of both the Seller Rule and the Creditor Rule may subject them to liability for the misconduct of sellers over whom they have no control; yet control over sellers is one of the basic assumptions underlying the rule. The rule's objective of eliminating seller misconduct from the marketplace would not be served in these instances; sellers who are independent of creditor financing would have no economic incentive to respond to consumer's complaints. Nevertheless, even such uncontrolled creditor liability would advance the rule's cost allocation objectives.

95. See Oversight Hearings, supra note 16 (Statement of Margery Waxman Smith). See also Oversight Hearings, supra note 16 (Statement of Michael C. Harper for Center for Law and Social Policy at 8). Mr. Harper, on behalf of Consumer's Union suggested that creditor's concerns could be allayed without weakening the force of the Creditor Rule by adding the following clause at the end of the rule's definition of purchase money loan: "[U]nless the creditor can show at the time of the loans it did not have knowledge and could not have obtained knowledge by making reasonable inquiry that the proceeds would be so applied." Id.

96. The Statement of Enforcement Policy provides that "[t]he Rule was not intended to subject a seller to liability when he has no reason to believe he is receiving the proceeds of a purchase money loan." Nor does the rule require that the seller interrogate the buyer to determine the source of the proceeds. The objective circumstances surrounding the transaction provide the seller with information concerning the source of the proceeds." Statement of Enforcement Policy, supra note 18, at 34,596. When these circumstances fail to indicate the possibility that the proceeds are from a purchase money loan, the seller is under no obligation to inquire further. The statement lists examples of such circumstances. Id.

97. See Comments of the Staff of the Board of Governors of the Federal Reserve System, supra note 59, at 6.

98. Id.

99. See Section VI infra.
B. Affiliation

Just as the referral aspect of the Seller Rule requires the inclusion of the notice in all loans once the lender and seller establish a referral relationship, so the affiliation aspect of the rule requires the inclusion of the notice in all loans once a contract or business relationship exists between the two. Consequently, many of the difficulties discussed with regard to referral situations also arise in the affiliation context. The purchase money loan definition provides only that those contracts which are made "in connection with the sale of goods and services or the financing thereof" are brought within the scope of the rule. The definition also states that a business arrangement includes "[a]ny understanding, procedure, course of dealing, or arrangement, formal or informal," connected with the sale or financing of consumer goods and services. Materials subsequently issued by the FTC provided further guidance. The definitions include all situations in which a creditor and seller "are party to any agreement, arrangement, understanding, or mutually understood procedure" specifically related to retail sales or sales financing. A business arrangement must be ongoing and clearly related to sales or sales financing and not to ancillary conduct. Thus, the rule is not intended to encompass all of the possible business relationships which have no direct bearing on the financing of consumer sales.

Rather than attempting to list all of the arrangements and procedures which would trigger the requirement of the notice provision, the FTC purposely articulated a general standard because "the practical, everyday possibilities for creditor and seller cooperation are limitless." The FTC concedes that the loan provision does contain some ambiguities but replies that it preferred to articulate in its Statement of Basis and Purpose the general reasoning behind the rule as an aid to specific interpretation.

In the months that have elapsed since promulgation of the rule, the Commission has remained steadfast in its retention of the general standard. Thus, all creditors who make personal loans, and particularly those who make signature loans, must adopt payee-designated checks and thereby provoke a possible disruption in their customer relationships or accept the FTC's amorphous "good faith" test and prepare to meet their burden of proof in that regard should they be called upon to do so. Creditors, therefore, are responsible for their own "good behavior."

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100. See note 14 supra.
101. Id.
102. Statement of Enforcement Policy, supra note 18, at 34,595.
103. Id.
104. Id.
107. See, e.g., Staff Guidelines, supra note 17; Statement of Enforcement Policy, supra note 18.
108. There is a certain amount of logic in the FTC's approach to the purchase money loan situation. Aside from the flexibility which the Commission gains from avoiding constant revision of the rule in response to new credit practices, the shifting of the burden from the Commission to sellers and creditors is consistent with the FTC's chronically inadequate enforcement budget. See Rohner, supra note 81, at 526.
C. Credit Unions

Credit unions have encountered unique problems stemming from the purchase money loan provision in the Seller Rule. No creditor is more consumer-oriented than the credit union. For nearly fifty years credit unions have been in the forefront of consumer advocacy and have supported the elimination of the holder in due course doctrine in consumer transactions. The manner in which the Seller Rule is drafted, however, forces credit unions to oppose it. No relationship exists, and no consideration passes between the seller and the credit union. Because all of their loans are made to members who have voluntarily selected both the seller and the lender, the organizations object to their inclusion within the Seller Rule.

Although the Seller Rule was probably not intended to apply to credit unions, the absence of a specific statement to that effect by the Commission has led to damaging "over-compliance" by retailers with whom the associations deal. The greatest problem has surfaced in the context of automobile purchases. Dealers have inquired about the source of the funds credit union members were using to purchase a car and have refused to accept joint payee checks, to provide title to credit unions and, in some geographic areas, to accept the proceeds of a loan unless the underlying credit contract contained the notice.

The assumptions underlying the Seller Rule, that a lender and a seller can contract for indemnification or that a lender can bring pressure to bear upon a seller, are completely invalid in the credit union context. These institutions are empowered to offer only consumer services and, therefore, enjoy no leverage over sellers. No credit union has yet been able to obtain an indemnification agreement from sellers who have demanded the inclusion of the notice in what they have perceived to be purchase money loan contracts within the meaning of the rule. In some cases dealers have actually blamed the failure to consummate a transaction on a consumer's credit union and then advised him to seek financing from a bank with whom the seller had a relationship. Although some credit unions are discontinuing the practice of passing profits back to members in the form of interest rebates and dividends, they may still be unable to cope financially with the liabilities imposed upon them by the rule.

Credit unions have also been forced to discontinue the popular service of discount buying programs. The continuation of such programs would

109. A credit union is a non-profit cooperative thrift institution formed for the purpose of encouraging savings by offering a good return, using collective monies to make loans to members at competitively low interest rates, and providing other financial services. Members operate the association on a democratic basis under state or federal regulation. See, e.g., 12 U.S.C.A. § 1752 (Supp. 1976); TEX. REV. CIV. STAT. ANN. art. 2461, § 1.02 (Vernon Supp. 1976-77).
110. See Oversight Hearings, supra note 16 (Statement of Credit Union Nat'l Ass'n).
111. Id. (Statement of Credit Union Nat'l Ass'n).
112. Id. (Statement of Credit Union Nat'l Ass'n at 3).
113. Id. (Statement of Credit Union Nat'l Ass'n at 7).
114. Id. (Statement of Credit Union Nat'l Ass'n at 8).
115. Most credit unions provide the service of seeking out merchants willing to sell to credit union members at a discount. The names of these merchants are then published for member reference.
place credit unions squarely within a referral relationship for purposes of the rule\textsuperscript{116} despite the fact that members are under no obligation to borrow from the credit union or to buy from a particular retailer in order to take advantage of the program. Credit unions obtain no consideration from promoting these plans, and in most instances, purchases under the plans generate no new consumer loans.

Although staff attorneys at the FTC have advised credit unions to ignore the rule and to continue to operate as they have in the past,\textsuperscript{117} dealer apprehension has made that approach as impossible as it is precarious. The Commission should either amend the rule to expressly exclude credit unions from its coverage or issue a statement confirming their present exclusion. The inclusion of credit unions cannot promote any of the rule's objectives and yet will severely harm both the institutions and their members.

IV. FRIVOLOUS CLAIMS

The creditor may be vulnerable to frivolous consumer claims and defenses once holder in due course status is stripped away. He has no method of resolving a consumer grievance or judging its validity or speciousness short of investigating the underlying transaction. Many creditors have expressed concern that consumers will realize the cost, and, therefore, the Unlikeliness, of such investigations.\textsuperscript{118} But the probability of wholesale consumer default is slim. The experience of jurisdictions which have previously abolished the doctrine of holder in due course in consumer transactions simply fails to support the threat of deadbeat consumers reveling in their newfound rights.\textsuperscript{119} Consumers, on the whole, can probably be expected to be no less honest than their creditor counterparts. Further, there is no basis for the expectation that the FTC rule will increase litigation in consumer transactions. On the contrary, the holder in due course doctrine is itself law for litigation. The doctrine becomes a factor only after the consumer defaults and the creditor sues. A creditor with a holder in due course defense against a consumer's claim has an incentive to litigate.

The reliability of the holder in due course doctrine may determine the outcome of a lawsuit. In the case of a poorly done job or faulty merchandise, however, the consumer is not primarily concerned with successfully resisting payment; he will probably put more effort into pleading, negotiating, or demanding with the seller. The consumer wants the item fixed.\textsuperscript{120}

\begin{footnotes}
\item[116] See Statement of Enforcement Policy, supra note 18, at 34,596.
\item[117] See, e.g., Letter from J. Arthur Johnson, Director of Governmental Affairs, Connecticut Credit Union League, Inc., to Sharyn Campbell, Counsel, Credit Union Nat'l Ass'n, Inc. (June 16, 1976).
\item[118] See Statement and Renewed Position, American Bankers Ass'n, Consumer Bankers Ass'n, FTC RECORD 6919 (March 5, 1973).
\item[120] Rohner, supra note 81, at 550.
\end{footnotes}
Only when his efforts prove futile or when the seller is insolvent or unreachable is the consumer likely to default. The belief that more complaints will be taken up with the creditor than with the seller is groundless. Moreover, good faith remedial efforts by the seller should reduce the overall flow of claims and defenses. Under the Seller Rule all three parties to the transaction share an incentive to resolve a problem quickly and cheaply. The FTC expects that such resolution should rarely require the services of an attorney; more informal contact is envisioned between, perhaps, a loan officer and the seller.\footnote{121}

Those who contend that a reduction in coercive remedies against the creditor will increase the rate of consumer default apparently find in the legal system elements of moral persuasion, deterrence, and coercion which prompt the debtor to meet his obligations.\footnote{122} It is more likely, however, that the debtor’s own morality and sense of obligation, and those of his community, are equally determinative of whether or not he repays.\footnote{123} The clear consensus among virtually all segments of society, regardless of the efficacy of official sanctions, is that obligations must be fulfilled.\footnote{124}

Should the creditor decide that a consumer’s claims are meritless, he may, of course, proceed as before. Abolishing holder in due course does not create defenses; it merely preserves them. In a case of disputed non-payment there is no requirement that a lender suspend his accumulation of interest, finance charges, and late fees while the account goes unpaid. This economic inducement to consumer honesty is augmented by the probable costs of defending a lawsuit and the possibility of legitimately adverse credit references or the cancellation of a credit account. Thus, the abolition of holder in due course in the indirect loan segment of consumer financing and the subjection of creditors to consumer claims and defenses in the purchase money loan situation does not mean that a consumer can assert claims and defenses freely. It leaves the consumer, although with substantial defenses, as vulnerable as before to all collection efforts short of litigation; only his chances of ultimate vindication are improved.\footnote{125}

It is true that the Seller Rule and proposed Creditor Rule depart from the format of recent statutory proposals in this area. Such proposals generally provide that a consumer maintains his defenses against a creditor only if he “has made a good faith attempt to obtain satisfaction from the seller or lessor with respect to the claims or defenses.”\footnote{126} The Seller Rule assumes

\footnotesize{\textbf{Comments} 1977]}

\footnote{121. Oversight Hearings, supra note 16 (Statement of Margery Waxman Smith at 13).}

\footnote{122. The reasoning seems to be that if a creditor’s remedies are restricted, then the legal system will no longer support the principle that debts must be repaid, deter default through fear, or coerce repayment through direct sanctions. Therefore, the rate of default will theoretically increase.}

\footnote{123. Wallace, The Logic of Consumer Credit Reform, 82 YALE L.J. 461, 463 (1973). For a suggestion that milder punishment will more effectively teach conduct consistent with established norms see Turner & Wright, Effects of Severity of Threat and Perceived Availability on the Attractiveness of Objects, 2 J. PERSONALITY & SOCIAL PSYCH. 128 (1965).}

\footnote{124. See, e.g., H. JACOB, DEBTORS IN COURT 71,110 (1969). One study found a strong willingness among debtors to meet their obligations, even in the face of adversity, despite the absence of effective legal sanctions against non-payment. See D. CAPLOVITZ, CONSUMERS IN TROUBLE: A STUDY OF DEBTORS IN DEFAULT (1974).}

\footnote{125. Rohner, supra note 81, at 550.}

\footnote{126. This language appears in virtually the same form in the 1974 UNIFORM CONSUMER
that in most cases the consumer will attempt to resolve a complaint with the
seller before defaulting. The Commission feared that specification of the
manner in which consumer-seller negotiations must occur would create
problems of proof and unnecessarily formalize procedures which should
remain flexible.\footnote{127} While the FTC's assumptions are undoubtedly valid, the
inclusion in the rule of a broad statement of a requirement similar to those in
related statutes\footnote{128} seems a harmless and positive gesture in light of creditor
apprehensions.

V. MISCELLANEOUS COMPLICATIONS

The Seller Rule has led to several problems which, although less signifi-
cant than those discussed above, are not insubstantial. These are generally
technical difficulties encountered with the rule and appear to require only
minor adjustments by the Commission.\footnote{129}

\textit{Agricultural Credit}. Although the Seller Rule was reportedly not intended
to encompass agricultural credit, this type of credit is expressly brought
within the rule's scope by the definition of "financing a sale" as
"[e]xtending credit to a consumer in connection with a 'Credit Sale' within
the meaning of the Truth in Lending Act and Regulation Z."\footnote{130} "Credit
sales" under the Truth in Lending Act include those for agricultural
purposes,\footnote{131} and the rule's definition appears to be an affirmative expression of
intent to include agricultural credit within its scope. There is no similar
indication with regard to loans, as opposed to credit sales, for agricultural
purposes, but neither is there an affirmative exclusion of such loans. The
Staff Guidelines clarify the Commission's intent by indicating that pur-
chases of equipment for agricultural production are not included within the
rule because agricultural production is a commercial rather than a consumer
activity within the meaning of the rule.\footnote{132} Given the potential for confusion
inherent in its reference to the Truth in Lending Act, however, the explana-
tory statement now contained in the Staff Guidelines should be a part of the
Seller Rule itself.

\textit{Check Credit}. Check credit is credit extended pursuant to check overdraft
plans. The Commission has indicated to the Federal Reserve Board that it

\begin{footnotes}
\footnote{128} See related statutes cited at note 126 supra.
\footnote{129} There has also been nearly unanimous objection to the costs entailed in complying with
the rule. Small retailers and large institutions alike object to the final timing of the rule.
Congress and the Federal Reserve Board have required a number of form changes during the
past two years, and many retailers favor a coordination of procedures by the FTC and the
Board in announcing and implementing new requirements. Further, a survey by the American
Bankers Association of approximately 100 banks throughout the United States revealed an
average initial compliance cost of $7500, with estimates ranging from $35 to $47,728. Included
in the cost estimates were amounts for paper changes, as well as legal and administrative
expenditures.
\footnote{130} See note 14 supra.
\footnote{131} 15 U.S.C. §§ 1602(g), (h) (1970), 1603(5) (Supp. V 1975); 12 C.F.R. §§ 226.2(t), 226.3(e)
\footnote{132} Staff Guidelines, supra note 17, at 20,024.
\end{footnotes}
does not intend that the rule reach check credit. Nevertheless, the rule’s definition of purchase money loan could encompass check credit when the proceeds of a check credit transaction are used to purchase from a referring or from a seller with whom the bank has the requisite affiliation.

Check credit bears no relation to any of the unfair practices to which the rule was addressed. No collusion can possibly exist between the seller and the creditor in a check credit transaction since neither is aware that such a transaction has occurred when the consumer writes a check which will overdraw his account. The consumer himself may not be aware of the nature of the transaction. Because delays are inherent in the check clearing process, checks which are not expected to overdraw an account may do so while those which the consumer expects to overdraw may not.

The rule’s application to check credit obviously discriminates against banks which account for almost all demand deposit accounts in the United States. These institutions exercise no control over the recipient of the proceeds of an overdraft check; under the proposed Creditor Rule, however, factors beyond the bank’s control will effectively compel it to accept liability for the misconduct of that recipient.

Finally, the consumer credit contract in check credit could only be the check itself. Therefore, the rule would require that the notice be printed on all checks used in overdraft accounts since the bank could not ascertain in advance whether a particular check would overdraw an account or whether the check or its proceeds would be used to purchase from a referring or affiliated seller. Thus, the absence of an express exclusion for check credit in the Seller Rule and proposed Creditor Rule obviously leads to unintended and absurd results.

**Leases.** Some uncertainty exists concerning leases to which the Seller Rule applies. The rule declares that any consumer credit contract in connection with a lease of goods or services must contain the notice. The rule’s definitions, however, contain an indirect reference to leases based on a “credit sale” as defined by the Truth in Lending Act. Consequently, leases affected by the rule are only those which constitute “credit sale” agreements under regulation Z; regulation Z applies to leases whereby a consumer contracts to pay a sum substantially equivalent to or greater than the value of the property leased and receives an option to “purchase” the property for no other or for nominal consideration.

**Open-end Credit.** Conflicting statements by the Federal Trade Commission and its representatives produced a great deal of initial confusion regarding the rule’s application to open-end credit arrangements. The rule itself

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133. See Comments of the Staff of the Board of Governors of the Federal Reserve System, supra note 59, at 12.
134. See note 14 supra.
135. See Section III supra.
136. See note 14 supra.
137. Id.
138. See Staff Guidelines, supra note 17, at 20,024.
states that it applies to any instrument evidencing a debt. Nevertheless, statements printed in the FTC's weekly compilation of announcements, dated November 21, 1975, indicated that open-end credit was not affected by the rule. Later, trade associations received a staff letter from the Commission which stated that the rule did apply to open-end credit sales, but the letter was written by a staff attorney with little authority to make such determinations. Not until the effective date of the rule six months later did trade associations know with certainty that the Seller Rule applied to their members' open-end credit sales.

The Commission also required six months to answer other questions from small retailers. A credit account with a small retail establishment usually produces several instruments evidencing a debt: the sales slip, the truth-in-lending disclosure statement, and the monthly statement. The inevitable question, then, was whether each of these written instruments must contain the notice. The Staff Guidelines later explained that the rule does not require such redundant placement of the notice. It must appear only once in any location in which it becomes a clear term or condition of a written credit agreement. Incorporation by reference is appropriate so long as it is clear to both consumer and holder that the obligation is subject to the notice.

Recent meetings between the representatives of various trade associations and the FTC have disclosed that most retailers with open-end credit plans do not sell or assign their credit contracts. Several retail organizations have filed a formal Petition for Exemption with the Commission requesting that the rule's application be suspended in the case of retail credit transactions meeting certain criteria. The FTC indicates that it is giving careful consideration to handling most exceptional cases through the exemption mechanism. While this method is somewhat haphazard, it will eventually relieve those unintentionally affected without endangering the basic simplicity and integrity of the rule which the Commission tenaciously defends.

VI. COST ALLOCATION

The fundamental issue around which criticisms of the FTC's Seller Rule and proposed Creditor Rule revolve is the distribution or allocation of the

140. See note 14 supra.
141. See Letter from FTC staff attorney to Retail Jewelers of America, National Retail Hardware Ass'n, Photo Marketing Ass'n, Western Home Furnishings Ass'n (Dec. 17, 1975).
142. See note 14 supra.
143. Staff Guidelines, supra note 17, at 20,024.
144. See FTC Improvement Act, 15 U.S.C. § 57(a) (Supp. V 1975). The petition, submitted by the National Retail Merchants Association and the American Retail Federation, proposed a permanent exemption from the Seller Rule for all consumer credit contracts which employed neither waivers of claims and defenses nor negotiable instruments, on the condition that sellers agree to elaborate protective measures including formal registration with the FTC. The rule would become a term of the contracts only upon their transfer to a third party. 42 Fed. Reg. 19488 (1977).
146. On April 14, 1977, the Commission issued a permanent exemption from the rule, effective immediately, for two-party open-end consumer credit contracts executed prior to August 1, 1977, provided that the contracts did not involve the use of negotiable instruments or waivers of claims and defenses. In light of the excessive costs involved in modifying pre-
costs of seller misconduct. If consumer claims and defenses are cut off by
the holder in due course doctrine, these costs fall entirely on the individual
buyer; if they are preserved, the costs fall initially on the creditor. Opposi-
tion to the rule ultimately reduces to fundamental differences with the
Commission’s determinations that the costs of seller misconduct should be
internalized and that such internalization can be most efficiently achieved
through the use of the creditor as a conduit.

The legal rules which regulate the rights of the consumer and the creditor
in a credit sales transaction should be directed toward two goals: (1) the
minimization of seller misconduct costs to innocent parties either through
the elimination of the misconduct in the first instance or through returning
the costs of such conduct to the responsible party in the second; and (2) the
reflection in the price of consumer goods of those costs which cannot be
eliminated. 147 "When prices approximate real social costs, consumer
choices lead to a more efficient allocation of society’s resources." 148 The
legal rules, therefore, should allocate the burden of seller misconduct to the
party most able to achieve such goals efficiently.

In cash sales the cost of seller misconduct necessarily falls on the buyer,
who must attempt to shift it back to the seller. To the extent that the buyer is
successful, the seller can be expected to reflect this cost in his prices. The
actual ability of buyers to shift costs to sellers, however, is limited either
because the financial and psychological burdens of litigation are likely to
exceed the amount at stake or because the seller is insolvent or unreach-
able. 149 In either case the entire cost of seller misconduct remains on the
particularly victimized consumer, and no feasible means exist for incor-
porating that cost into the price of the goods sold. 150

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Existing contracts and the pervasive misunderstanding regarding the rule’s applicability to open-
end credit generally, the Commission found it appropriate to exempt, until August 1, those
open-end charge accounts in which credit is extended from time to time pursuant to a single
master agreement. 42 Fed. Reg. 19488 (1977). The exemption was subsequently extended for
an additional 45 days. 42 Fed. Reg. 40426 (1977). On September 16, 1977, the FTC modified the
exemption to make clear that "30 day accounts" which do not allow the consumer the option of
also decided that a permanent exemption was unwarranted, see note 144 supra, but further
extended the limited exemption through October 31, 1977. The denial of a permanent exemption
was based primarily on the fact that some state laws on assignment could operate to cut off
consumer claims and defenses despite non-negotiability and the absence of a waiver in the
contract and that the permanent exemption as proposed had placed the burden of compliance
on retailers at the time of transfer when they were least likely to comply or to be detected if they

147. Note, Direct Loan Financing of Consumer Purchases, 85 Harv. L. Rev. 1409, 1411
(1972). This analysis is analogous to Professor Calabresi’s discussion of primary and secondary
cost reduction in his treatment of the social costs of accidents. See G. CALABRESI, THE COST OF
ACCIDENTS 26-27 (1970). Internalization of the costs of seller misconduct may result in de-
creased demand for products sold on credit thereby reducing the level of seller misconduct. To
this extent, the goal of properly allocating resources is itself a method of Calabresian cost
reduction. Id. at 78-88.

148. Note, supra note 147, at 1412; see C. FERGUSON, MICROECONOMIC THEORY 391-92
(1966).

149. See, e.g., cases collected in Reply Brief for Appellants at 22-23, Payne v. United Cal.
Bank, 23 Cal. App. 3d 850, 100 Cal. Rptr. 672 (1972); Gross v. Applegren, 467 P. 789 (Colo.
(seller disappeared).

150. Consumers would ordinarily act on the basis of the tag price of goods and therefore be
able to accurately evaluate the risk of seller misconduct implicit in cash purchases. It is
possible, of course, to imagine a consumer insurance fund, to which all retailers would
Consumers in a three-party credit sale in which the creditor is insulated from consumer claims and defenses by the holder in due course doctrine occupy a position similar to that of the cash buyer. The presence of the creditor, however, provides an alternative method for allocating seller misconduct costs. By the very nature of his business, the creditor is in a better position than the buyer to return seller misconduct costs to the responsible party and to discourage such misconduct in the first instance. When a direct relationship exists between creditor and seller, cost return presents little or no difficulty. The creditor can offset his losses against a reserve account or insist on a recourse agreement. If the creditor must resort to litigation, his expenses are likely to be less than those the consumer would have to bear. The financer is also in a better position to discourage seller misconduct than the buyer: he enjoys access to commercial information unavailable to consumers and can spread the information costs over many transactions.

Returning seller misconduct costs to the responsible parties will entail administrative costs. But so long as the creditor's cost for minimization is less than that of seller misconduct, in the form of satisfied consumer claims, forgone collections, etc., it will be in the financer's interest to continue policing the market and charging back costs. The cost to creditors of charging back costs, and otherwise discouraging seller misconduct, will probably vary directly with the remoteness of the seller and creditor; the more closely related a creditor and seller are, the more easily the former could ascertain the character of and the probability of misconduct by the latter. As the relationship becomes more distant, the costs of investigation will rise. Distant relationships, some of which may fall within the purchase money loan section of the rule, will preclude the inexpensive and informal methods available in well-established, on-going relationships. At some point the costs of further investigation will exceed the gain from discouraging seller misconduct. At this point, for those cases which do fall within the Seller Rule or the proposed Creditor Rule, it is reasonable for the creditor to absorb the losses; both the losses and the expenses incurred in minimizing and charging back the costs of seller misconduct would be regarded as costs of doing business. The creditor's ability to reflect these costs in the price of credit furthers the second goal of cost allocation: a price structure which more closely approximates real social costs.

Consumers, in particular, underestimate the actual costs of goods and services when they purchase on credit, and nothing in the price system indicates such costs. Cost internalization would provide an adequate basis for consumer choice and spread costs equally throughout the consuming contribute, which would make restitution to victims of seller misconduct when the responsible seller was unavailable. Although such a fund would effectively internalize costs, it would be both clumsy and costly to administer.


152. A creditor's actual financial costs will be lower than those of the consumer. Even if the consumer is able, at some point, to shift the costs back to the seller, the swiftness with which the collection processes of the state serve creditors and the inevitable delay in gaining redress from the seller may result in significant losses to the buyer in the interim. This is especially true
The costs of seller misconduct which can be returned to the seller will be reflected in his prices and spread over all consumers purchasing from him; those costs which cannot be so returned, including the creditor's administrative costs, will be reflected in the price of credit and spread over all credit buyers. The cost of credit to purchase from reliable merchants should then eventually decrease, and the price system would inform all consumers of the relative risks of purchasing from various sellers.

At some point the lack of connection between the creditor and the seller makes risk allocation impractical, and the rule should not, and probably would not, encompass such cases. Subjecting an independent lender to consumer claims and defenses on a "deep pockets" rationale is unreasonable. The great concern over the interlocking or purchase money loan should not be allowed to produce an overreaction which ignores marketplace reality and which would, for that reason, unnecessarily increase the marginal cost and availability of consumer credit. One must realize also that cost internalization is possible only if the creditor is free to adjust his interest rates in response to changing costs. Such freedom may require the elimination of unrealistic interest ceilings.

VII. APPRAISEMENT AND PROGNOSIS

The public policy objectives behind the Seller Rule and the proposed Creditor Rule are unquestionable, and the economic assumptions underlying them are sound. Creditors maintain that they are not well suited to perform the market policing and charging back functions required of them by the rule. While their assertion is valid, it nevertheless indicates a misunderstanding of the entire issue. No one but the seller is well qualified to remedy the evils addressed by the rule. Seller misconduct, obviously, is the problem; the seller is in the best position to remedy the problem, and the seller should bear the entire loss if he fails to do so. But today's complex and credit-oriented marketplace, complete with standardized products and impersonal dealings between seller and buyer, no longer produces such cost internalization on its own. If, as is generally agreed, the individual buyer should not be forced to bear the entire cost of seller misconduct, then the creditor is better situated than the buyer to insure that those costs which can be returned to the seller are so returned, and that those which cannot be returned are reflected in the price of credit so as to provide a realistic basis for consumer purchasing decisions.


153. This would apply only in cases where the financer did not adopt a graduated rate schedule. Since the risk of encountering seller misconduct is not so evenly distributed, more cautious consumers who would rarely enter an unwise transaction would subsidize their less cautious counterparts. This result, however, is not incompatible with general accepted social policies, especially if those subsidized tend to be disadvantaged in terms of wealth or education or both.

154. See Littlefield, The Plight of the Consumer in the Uniform Consumer Credit Code, 48 Denver L.J. 1, 23-25 (1971). This was also recommended by the National Commission on Consumer Finance. See NCCF Report, supra note 4.
Despite its basic soundness, the rule does suffer from a number of technical deficiencies. Some, such as the conflict with widely known state and federal statutes, seem difficult to explain except as the result of carelessness; yet carelessness seems an inappropriate criticism of a rule so long in the making. Most of the problems, however, simply require some detailed adjustments by the Commission. Work is currently being done to resolve these difficulties, but the inordinate time lag between the discovery of a problem and its resolution by the FTC is exasperating to sellers, creditors, and consumers alike. Perhaps the Commission should have provided for a year's rather than six months' lead time. An organized educational effort on behalf of creditors as well as consumers would also have been superior to the "wait and see" attitude which has become the Commission's modus operandi. Many of the questions subsequently raised were anticipated by the FTC at the time it promulgated the rule. Seemingly random implementation procedures have understandably contributed to resentment of and active opposition to the rule on the part of the consumer credit industry and many retailers.

Initial creditor response to the rule, however, has often been hopelessly exaggerated and represents both a misunderstanding of the rule's provisions and a desire to precipitate congressional action to suspend it. Far too many members of the consumer credit industry have been determined to ensure the fulfillment of their own dire predictions concerning the rule's probable effect. Others have displayed encouraging cooperation and remarkable patience with the FTC's implementation efforts. The most likely prognosis, and what is said to have been the ultimate result in jurisdictions which previously severely restricted, or abolished, holder in due course in consumer transactions, is that the initial overreaction of creditors will be followed by a gradual reopening of the coffers at slightly higher interest rates accompanied by more stringent control over participating merchants.

This probable long-term creditor response is superficially disadvantageous to consumers. It is only superficially so because, as is admitted even by consumer advocates, it is probably in the best interests of some consumers to make credit more of a luxury. Significant value judgments are involved in determining whether or not consumers should have access to credit in the future as freely as they have in the past. No one in Washington has seemed anxious to make such judgments or to propose appropriate legislation. Withdrawal of holder in due course protection entails some compromises with current economic policy which assures the consuming public of maximum credit at minimum cost. The proper question, therefore, is not whether the FTC rule is cost-free, but whether the costs are reasonably tolerable in light of the expected benefits. Congress has never seriously considered the question and may, in fact, be unable to do so given the strong and conflicting political pressures to which it is subject. The FTC put a great

155. See note 119 supra and accompanying text. The NCCF study also concluded that the abolition of holder in due course would result in a temporary adjustment of greatly diminished credit availability but expressed doubt as to whether the repercussions would be permanent or even as significant as some had predicted.
deal of time and study into its consideration of the cost-benefit question and ultimately answered it in the affirmative. Initial congressional response to the FTC's solution has generally been positive. The Oversight Hearings produced no changes or recommendations of action to change the rule. Nevertheless, Congress, as well as the Commission and the Federal Reserve Board, should closely monitor the rule's effects during its first years in operation. It is unlikely that the rule can function as anticipated in the absence of a change in the interest rate structure. The Federal Trade Commission having taken the admittedly drastic first step, perhaps Congress can go forward with interest rate changes and the other reforms recommended by the National Commission on Consumer Finance.156

Finally, one must consider whether or not the rule will actually have an impact on the lives of those for whom it was primarily intended. The notice is written in simplified legal terminology; but it is, nonetheless, legal terminology and will very likely be unintelligible to many consumers and meaningless to those who most need to understand its meaning—low income consumers. A promised consumer education effort by the FTC has not yet been forthcoming. Although most merchants and dealers can be expected to comply with the rule, those who deal exclusively with low income consumers, and particularly those in ghetto areas, may be unworthy of such an assumption. Even if such merchants do insert the required notice in their contracts, it is unlikely that they will call it to the attention of consumers. In short, the only groups familiar with the rule are lawyers, merchants, and lenders.

Many consumers who actually stumble across the rule will not thereby benefit from it. One attorney who works extensively with low income consumers157 estimates that only one in four who are injured by a transaction involving holder in due course seeks legal help. Most are ignorant of their legal rights and of the availability of legal aid. The threats and promises of the ghetto merchant or creditor with whom they will, of necessity, continue to deal are far more real than an abstract statement in a contract. For the one in four who does seek help, however, and for the millions of other consumers who will undoubtedly learn of it in time, the rule is a milestone. Twenty years ago Professor Gilmore wrote:

It is hard, and it becomes each year harder, for counsel to explain convincingly why 'the law' requires that a hard-pressed wage-earner who has been bilked by a now-insolvent seller into buying junk masquerading as a television set or a washing machine must pay the full price to a bank or finance company whose own relationship with the fraudulent seller has been intimate, long-continued and profitable.158

At last counsel will no longer be forced to engage in such a futile exercise.

156. All of the questions addressed by the FTC in considering the rule were covered in the NCCF REPORT, supra note 4. Included in the report was a recommendation that at least four years elapse before Congress begin to act on its proposals and then only if the states had not yet moved on the study group's conclusions. Id. at 167. While it is somewhat disturbing that the FTC, an administrative body, acted one full year prior to the expiration of the four-year period after many states had acted to restrict the doctrine and that it acted in the piecemeal fashion specifically condemned by the NCCF Report, coordination and control are still well within Congress' reach if it will act decisively in following the Commission's lead.
158. Gilmore, supra note 3, at 1098.