

Who Can Win in Truth in Lending Rescission Transactions?

I. INTRODUCTION

The Truth in Lending Act¹ (hereinafter called "the Act") allows a consumer three days in which to rescind a credit transaction in which a second mortgage is taken on the consumer's principal residence.² In many situations consumers can cancel their loan agreements long after the three-day period set up by Congress because the creditor has not given proper Truth in Lending disclosures.

Rescission long after consummation of the transaction creates many problems for creditors. Some courts have construed the statutory language dealing with the consumer's rescission procedure as requiring that the creditor forfeit both the loan and the loan payments, leaving him with nothing.³ A creditor who does not follow strictly the statutory rescission procedure may end up also paying the consumer civil damages.⁴ Compliance with the Truth in Lending Act is so difficult that creditors often do not know that they have violated it.⁵ And creditors are often reluctant to refund the consumer's money upon rescission, as required by the statute, because it may be impossible for them to get the loan proceeds back from the consumer.⁶

Consumers also have problems when the transaction is cancelled long after its consummation. Many times creditors refuse to follow the statutory rescission procedure by failing to cancel the security interest in the consumer's home, thus making it difficult for the consumer to transfer the property.⁷ In addition, some courts, basing their actions on equity principles, have

1. 15 U.S.C. §§ 1601-1667e (1976 & Supp. IV 1980). The Act authorizes the Board of Governors of the Federal Reserve System to issue regulations for its implementation. *Id.* § 1604. In 1969 the Board issued the original version of its Truth in Lending regulations, Regulation Z, 12 C.F.R. §§ 226.1-1503 (1981), which also implements the Fair Credit Billing Act, 15 U.S.C. §§ 1666-1666j (1976 & Supp. IV 1980).

In 1980 Congress enacted the Truth in Lending Simplification and Reform Act (hereinafter called "the Simplification Act"), Pub. L. No. 96-221, 94 Stat. 168 (1980), which amends among other things various rescission provisions of the original Act. *See* text accompanying notes 118-29 *infra*. To implement these amendments, the Board in 1980 issued a revised Regulation Z, 46 Fed. Reg. 20,892 (1981) (to be codified at 12 C.F.R. §§ 226.1-29). Although both the Simplification Act and Revised Regulation Z became effective on April 1, 1981, Congress has given creditors the option of complying with the original Act and Regulation until October 1, 1982. International Banking Facility Deposit Insurance Act, Pub. L. No. 97-110, § 301, 1981 U.S. CODE CONG. & AD. NEWS (95 Stat.) 1513, 1515; Amendments to Regulation Z, 47 Fed. Reg. 755 (1982).

The effects of the Simplification Act and the Revised Regulation Z are discussed in text accompanying notes 118-29, 133, 138 & 143 *infra*. Because many cases will arise concerning transactions consummated under the original law, because the cases discussed in this Note all construe old law, and because many of the problems with the old law have survived the amendments, this Note discusses generally Truth in Lending rescission procedures and draws distinctions between the old and new law only where necessary for clarity.

2. 15 U.S.C. § 1635 (1976); 12 C.F.R. § 226.9 (1981).

3. *See* text accompanying notes 68-90 *infra*.

4. *See* text accompanying note 60 *infra*.

5. *See* text accompanying notes 43-56 *infra*.

6. *See* text accompanying notes 61-63 *infra*.

7. *See* text accompanying notes 64-67 *infra*.

completely set aside the statutory rescission procedure and used a procedure less favorable to the consumer.⁸ These courts require the consumer to pay back the entire loan before he can rescind, while the statutory Truth in Lending procedure allows the consumer to rescind, receive back all the payments he has made to the creditor, and then pay back the loan.⁹

This Note will discuss the Truth in Lending right of rescission and its normal operation,¹⁰ and will illustrate the problems that arise in connection with a transaction that has been rescinded long after consummation.¹¹ The Note will then examine the effect of the Truth in Lending Simplification and Reform Act¹² (hereinafter called "Simplification and Reform Act" or "Simplification Act") upon these problems and will offer some suggestions for further legislative reform.¹³ Finally, it will propose procedures that both creditors and consumers can use to protect themselves.¹⁴

II. THE TRUTH IN LENDING RIGHT OF RESCISSION

A. Scope of Coverage

The Truth in Lending Act¹⁵ and its implementing regulation, Regulation Z,¹⁶ allow consumers to rescind credit transactions¹⁷ under certain circumstances.¹⁸ This right of rescission is intended to provide the consumer with a cooling-off period prior to taking the serious step of pledging his home as security in a credit transaction.¹⁹ The regulation provides:

[I]n the case of any credit transaction in which a security interest is or will be retained or acquired in any real property which is used or expected to be used as

8. See text accompanying notes 94-112 *infra*.

9. 15 U.S.C. § 1635 (b) (1976 & Supp. IV 1980).

10. See text accompanying notes 15-38 *infra*.

11. See text accompanying notes 39-114 *infra*.

12. Pub. L. No. 96-221, 94 Stat. 168 (1980) (amending 15 U.S.C. §§ 1601-1667); see text accompanying notes 118-29 and 142-44 *infra*; see also note 1 *supra*.

13. See text accompanying notes 130-45 *infra*.

14. See text accompanying notes 146-67 *infra*.

15. U.S.C. §§ 1601-1667e (1976 & Supp. IV 1980); see note 1 *supra*.

16. 12 C.F.R. §§ 226.1-.1503 (1981); see note 1 *supra*.

17. In both its original and revised versions, Regulation Z uses its definition of creditor to identify what transactions are covered. In the original version,

[a creditor is] a person who in the ordinary course of business regularly extends or arranges for the extension of consumer credit, or offers to extend or arrange for the extension of such credit, which is payable by agreement in more than four installments or for which the payment of a finance charge is or may be required, whether in connection with loans, sales of property or services, or otherwise.

12 C.F.R. § 226.2(s) (1981). The revised version of the Regulation defines the creditor, and therefore the transaction, more simply as

(1) A person (i) who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than 4 installments (not including a downpayment), and (ii) to whom the obligation is initially payable, either on the face of the note or contract, or by agreement where there is no note or contract.

(2) An arranger of credit.

46 Fed. Reg. 20,893 (1981) (to be codified at 12 C.F.R. § 226.2).

18. 15 U.S.C. § 1635 (1976 & Supp. IV 1980); 12 C.F.R. § 226.9 (1981).

19. See Federal Reserve Board Opinion Letter, Oct. 31, 1969, reprinted in [1969-1974 Transfer Binder] CONSUMER CRED. GUIDE (CCH) ¶ 30,205.

the principal residence of the customer, *the customer shall have the right to rescind that transaction until midnight of the third business day* following the date of consummation of that transaction or the date of delivery of the disclosures required under this section and all other material disclosures required under this part, whichever is later.²⁰

The rescission right does not apply to certain transactions exempted from the Act. They are: (1) purchase money first mortgages on dwellings in which the consumer resides or expects to reside, (2) first mortgages in connection with an initial construction, (3) previously exempt liens that are now subject to subordination, (4) transactions in which the creditor is a state agency, and (5) loans for agricultural purposes.²¹ In short, the rescission right generally applies to transactions by which a security interest, constituting a second mortgage, is taken on a consumer's principal residence by a private creditor.

However, Regulation Z defines a security interest very broadly to include even liens arising as a matter of law. The term encompasses

security interests under the Uniform Commercial Code, real property mortgages, . . . consensual or confessed liens, . . . mechanics, materialman, artisans and similar liens, vendors liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.²²

Therefore, if a contractor puts aluminum siding on a principal residence already subject to a first mortgage and obtains a materialman's lien, the lien, which arises by operation of law, is considered a second mortgage and triggers the pertinent provisions of the Act and Regulation. The consumer then has a three-day period in which to rescind the transaction.

B. *Explanation of Rescission Rights*

The three-day rescission period that arises in connection with a second mortgage on a principal residence does not begin to run until three different events take place. First, two copies of the notice of the right of rescission

20. 12 C.F.R. § 226.9 (1981) (emphasis supplied).

21. *Id.* § 226.9(g). Exempted by the Revised Regulation Z are

(1) [M]ortgages created or retained in the consumer's principal dwelling to finance the acquisition or initial construction of that dwelling; (2) refinancing or consolidation by the same creditor of an extension of credit already secured by the consumer's principal dwelling; (3) transactions in which the creditor is a state agency; (4) an advance, other than an initial advance, in a series of advances under an agreement to extend credit up to a certain amount, which is considered as one transaction; and (5) a renewal of optional insurance premiums not considered a refinancing.

46 Fed. Reg. 20,905 (1981) (to be codified at 12 C.F.R. § 226.23(f)).

22. 12 C.F.R. § 226.2(gg). The Revised Regulation Z defines security interest as an interest in property that secures performance of a . . . credit obligation [of a consumer extended primarily for personal, family, or household purposes] and that is recognized by state or federal law. It does not include incidental interests such as interests in proceeds, accessions, additions, fixtures, insurance proceeds . . . premium rebates, or interests in after acquired property. . . . [For purposes of the right of rescission under §§ 226.15 and 226.23, the term does include interests that arise solely by operation of law.

46 Fed. Reg. 20,894 (1981) (to be codified at 12 C.F.R. § 226.2(a) (25)) (emphasis supplied).

must be delivered to each consumer involved in the transaction.²³ Second, one copy of all the "material" disclosures required by Regulation Z, pertaining to the credit transaction, must be given to each consumer.²⁴ Third, the transaction must be consummated.²⁵ The rescission period begins to run only after the last of these three events occurs.

To exercise these rescission rights, the consumer must notify the creditor by mail, telegram, or other writing of his intention to rescind before midnight of the third business day after the rescission period begins to run.²⁶ This differs from the right of rescission at common law. At common law the rescinding party was required to tender restitution, but under the Act the borrower can rescind by simply giving notice.²⁷ Thus, the consumer can rescind by simply depositing a notice in a mailbox just before midnight of the third business day.²⁸ Furthermore, the creditor is prohibited from performing under the agreement until the rescission period has expired and he is reasonably satisfied that the consumer has not exercised his right of rescission.²⁹

The Act contemplates that a very simple procedure be followed once the consumer exercises his rescission rights. The consumer is not liable for any finance charge, and any security interest taken in the property becomes

23. "Disclosures required under this section," 12 C.F.R. § 226.9(g) (1981), refers to the notice of the right to rescind. Under Regulation Z, 12 C.F.R. § 226.6(e) (1981), when there is more than one consumer, disclosures need be given to only one of them *unless* it is a rescindable transaction. Hence, a husband and a wife will each be considered a consumer, and two copies of the notice of the right of rescission must be given to each of them. R. CLONTZ, TRUTH-IN-LENDING MANUAL ¶ 5.03[7] (4th ed. 1976 & Supp. 1980).

The Revised Regulation Z makes this even clearer. A consumer who is entitled to rescind is defined as a consumer "whose ownership interest is or will be subject to the security interest." 46 Fed. Reg. 20,904 (1981) (to be codified at 12 C.F.R. § 226.23(a)). Two copies of the notice of the right to rescind shall be delivered to each consumer who is entitled to rescind. *Id.* at 20,905. Thus if both a husband and wife have an interest in the property, two copies of the right to rescind notice must be delivered to each.

24. The required disclosures include "all other material disclosures required under this part." 12 C.F.R. § 226.9 (1979). The authority and scope section of Regulation Z, 12 C.F.R. § 226.1 (1981), provides: "This part comprises the regulations issued . . . pursuant to [the Truth in Lending Act]. Therefore, "part" means Regulation Z. The Revised Regulation Z provides an explicit definition of "material." 46 Fed. Reg. 20,905 n.48 (1981); *see also* text accompanying notes 53-56 *infra* and note 13 *supra*.

25. "Consummation" is not defined in the original version of Regulation Z. Under that version a transaction has been considered consummated at the time a contractual relationship is created between a creditor and a consumer according to state laws. R. CLONTZ, *supra* note 23, at ¶ 5.03[11]. According to Clontz, transactions could be consummated in three ways: (1) A bank allows the covered creditor to grant the loan commitment, conditioned upon favorable title search, credit report, and the consumer's agreement to the terms; (2) the institution has the note and deed drafted and executed by all consumers, but holds the loan instrument in abeyance or escrow until the rescission period has expired; or (3) the creditor uses a document such as the one drafted by Clontz himself and termed "Consummation of Loan Secured by Real Property." *Id.* at ¶ 5.03[2].

The Revised Regulation Z defines "consummation" as "the time that a consumer becomes contractually obligated on a credit transaction." 46 Fed. Reg. 20,893 (1981) (to be codified at 12 C.F.R. § 226.2(a)).

26. 12 C.F.R. § 226.9 (1979).

27. Comment, *Consumer Protection: Judicial Approaches to Rescission and Restoration Under the Truth in Lending Act*, 53 WASH. L. REV. 301, 304 (1978); *see also* *Rachbach v. Cogswell*, 547 F.2d 502, 505 (10th Cir. 1976), in which the court held that tender was not a prerequisite to rescission under the Truth in Lending Act.

28. R. CLONTZ, *supra* note 23, at ¶ 5.03[4].

29. 12 C.F.R. § 226.9(c) (1981). The creditor cannot: "(1) Disperse any funds other than in escrow; (2) Make any physical changes in the property of the customer; (3) Perform any work or services for the customer; or (4) Make any deliveries to the customer's residence." *Id.*; *see also* R. CLONTZ, *supra* note 23, at ¶ 5.03[3].

void.³⁰ Within ten days³¹ of receipt of the rescission notice, the creditor is required to return any money or property given by the consumer as a payment on the credit transaction or downpayment or "otherwise" and must take any action necessary to reflect the termination of the security interest.³² The consumer can keep any money or property the creditor has delivered to him pursuant to the credit transaction, until the creditor has performed the above obligations.³³ Once the creditor has performed these obligations, the consumer is required to tender back the property delivered to him by the creditor, or if that would be impracticable or inequitable, to tender its reasonable value.³⁴ Thus, if the consumer wishes to rescind a cash loan, the cash must be tendered back. If aluminum siding has been put on a house, it will be impracticable to tender the siding and therefore its reasonable value should be tendered instead. Once the consumer's tender is made, the creditor has ten days to take possession of the tendered property.³⁵ Failure to do so results in forfeiture, which gives the consumer the right to keep the property with no obligation to pay for it.³⁶

An example of the ordinary operation of the Truth in Lending rescission procedure follows: A consumer, who does not have the first mortgage paid on his home, decides to take out a loan for home improvement. As security for this loan, a second mortgage is taken on the consumer's home, and the consumer is required to make a downpayment. Two days after receiving the loan, the consumer reconsiders and drops a rescission notice in a mailbox. When the bank receives the rescission notice, within ten days³⁷ it must send the consumer's downpayment back to him and terminate on all records the security interest in the consumer's home. The consumer then tenders back all the money he has received under the loan.³⁸ If the bank fails to take possession of the money within ten days, the consumer can keep the money.

30. 12 C.F.R. § 226.9(d) (1981).

31. The Simplification Act and Revised Regulation Z have extended this period to 20 days. Pub. L. No. 96-221, § 612(a) (3), 94 Stat. 168, 175 (1980) (amending 15 U.S.C. § 1635(a)); 46 Fed. Reg. 20,905 (to be codified at 12 C.F.R. § 226.23(d) (2)); *see* text accompanying notes 124-25 *infra*.

32. 12 C.F.R. § 226.9(d) (1981).

33. R. CLONTZ, *supra* note 23, at ¶ 5.03[5].

34. 12 C.F.R. § 226.9(d) (1981).

35. *Id.* The Simplification Act and Revised Regulation Z have extended this period to 20 days. Pub. L. No. 96-221, § 612(a) (3), 94 Stat. 168, 175 (1980) (amending 15 U.S.C. § 1635(a)); 46 Fed. Reg. 20,905 (to be codified at 12 C.F.R. § 226.23(d) (3)); *see* text accompanying notes 124-25 *infra*.

36. 12 C.F.R. § 226.9(d) (1981).

37. *But see* notes 31 & 35 *supra* (effect of Simplification Act).

38. Tender must be made at the location of the property or at the residence of the customer, at the option of the customer. 12 C.F.R. § 226.9(d) (1981). Revised Regulation Z provides: "At the consumer's option, tender of property may be made at the location of the property or at the consumer's residence. Tender of money must be made at the creditor's place of business." 46 Fed. Reg. 20,905 (1981) (to be codified at 12 C.F.R. § 226.23(d) (3)).

III. PROBLEMS ARISING IN CONNECTION WITH TRUTH IN LENDING RESCISSION RIGHTS

A. *Creditor Difficulties*

1. *Dilemma of Complying with Disclosure Procedures*

As mentioned, three different events must take place before the three-day rescission period begins to run.³⁹ Two copies of the notice of the right of rescission must be delivered to each consumer,⁴⁰ one copy of all material disclosures required by Regulation Z must be given to each consumer,⁴¹ and the transaction must be consummated.⁴² If the creditor fails to meet any of these requirements, the three-day rescission period never begins to run and the consumer can rescind at any time within three years following the date of consummation of the transaction or until he sells the property.⁴³ Compliance with the three requirements is not easy; Regulation Z requires such a host of disclosures that it becomes a veritable Gordian knot for the creditor to untie.

The cases are replete with examples of creditor noncompliance with the three requirements. Some examples are: understatement of the amount of finance charge because of a failure to include the premium for dwelling insurance;⁴⁴ omission of the amount financed;⁴⁵ failure to disclose the annual rate of interest;⁴⁶ provision of an improper notice of the right to rescind;⁴⁷ misstatement of the annual percentage rate;⁴⁸ failure to provide two copies of the rescission notice to both the husband and the wife;⁴⁹ omission of the total number of payments to be made;⁵⁰ and use of the term finance charge in a confusing manner.⁵¹ Many creditors are unsure of what disclosures they must make under Regulation Z and are "penalized for technical Regulation Z violations."⁵²

Regulation Z causes part of the confusion about what disclosures are

39. See text accompanying notes 23-25 *supra*.

40. See text accompanying note 23 *supra*.

41. See text accompanying note 24 *supra*.

42. See text accompanying note 25 *supra*.

43. 12 C.F.R. § 226.9(h) (1979).

44. *Harris v. Tower Loan*, 609 F.2d 120 (5th Cir.) *cert. denied*, 449 U.S. 826 (1980). This premium is required to be included in the finance charge under 12 C.F.R. § 226.4(a) (6) (1979).

45. *Palmer v. Wilson*, 359 F. Supp. 1099 (N.D. Cal. 1973), *vacated*, 502 F.2d 860 (9th Cir. 1974). The amount financed is required by 12 C.F.R. § 226.8(d) (1) (1979).

46. *Strader v. Beneficial Fin. Co.*, 191 Colo. 206, 551 P.2d 720 (1976). The annual percentage rate is required by 12 C.F.R. § 226.8(b) (2) (1979).

47. *Powers v. Sims & Levin*, 542 F.2d 1216 (4th Cir. 1976). The creditor inadvertently informed the consumers that they had the right to rescind within two days instead of three. *Id.* at 1219.

48. *Bustamente v. First Fed. Sav. & Loan Ass'n*, 619 F.2d 360 (5th Cir. 1980).

49. *Gerasta v. Hibernia Nat'l Bank*, 411 F. Supp. 176 (E.D. La. 1975), *aff'd in part, rev'd in part*, 575 F.2d 580 (5th Cir. 1978); see note 23 *supra*.

50. *Palmer v. Wilson*, 359 F. Supp. 1099 (N.D. Cal. 1973), *vacated*, 502 F.2d 860 (9th Cir. 1974). The disclosure of the number, amount, and due dates or periods of payments scheduled to repay the indebtedness is required by 12 C.F.R. § 226.8(b) (3) (1979).

51. *Palmer v. Wilson*, 359 F. Supp. 1099 (N.D. Cal. 1973), *vacated*, 502 F.2d 860 (9th Cir. 1974). Regulation Z requires that the disclosures be clear, conspicuous, and in a meaningful sequence. 12 C.F.R. § 226.6(a) (1981).

52. R. CLONTZ, *supra* note 23, at ¶ 5.03 [4a] (c).

required. It requires only that "material" disclosures be made but does not define "material."⁵³ Presently, creditors are forced to rely on case law to determine materiality. Many courts overlook the issue of materiality in their discussion of Truth in Lending, thereby giving creditors little guidance. One court, however, has addressed the issue. In *Ivey v. Hud*⁵⁴ the finance charge was understated by \$11.30, but this was found not to be a material violation of the Truth in Lending Act. The court held that a material disclosure is one "which a reasonable consumer would view as significantly altering the total mix of information made available."⁵⁵ One commentator has argued that to be "material," the omission need not be so important that a reasonable consumer would change creditors, but it must be of some significance to a reasonable consumer in his "comparison shopping for credit."⁵⁶ Thus, creditors attempting to follow *Ivey* must test each disclosure to determine whether it is something a reasonable consumer would view as significant. Such a flexible test is difficult for creditors to use confidently.

In short, creditors have great difficulty in determining what disclosures must be made under Regulation Z. Consequently, many creditors unknowingly fail to meet the three requirements that start the three-day rescission period running, and their consumers therefore can rescind long after the transaction has been consummated.

2. *Creditor Confusion About What Procedure to Follow After Rescission*

When the consumer exercises the right of rescission long after consummation, the creditor is often in a quandary about what course of action he should follow. If the creditor believes he has complied with all requirements of the Truth in Lending Act, he will not be eager to respond to the debtor's claim to rescission.⁵⁷ A creditor who has properly complied with all requirements and who honors the consumer's claim for rescission will be giving up a finance charge that he has rightly earned.⁵⁸

However, because it is difficult to comply with the Truth in Lending Act and Regulation Z in the first instance, it is a Herculean task for the creditor to be certain that he has met all of the disclosure requirements. The majority of cases clearly hold that when a creditor wrongly believes he has made all the proper disclosures, or is uncertain about that fact, his failure to act within ten

53. The original version of Regulation Z called for disclosure of "all other material disclosures required under this part." 12 C.F.R. § 226.9 (1981) (emphasis supplied). The Simplification Act provides a definition of "material disclosure." Pub. L. No. 96-221, § 612, 94 Stat. 168, 175 (1980) (amending 15 U.S.C. § 1602(v)); 46 Fed. Reg. 20,905 (1981); see also text accompanying notes 120-21 *infra*; note 1 *supra*.

54. 428 F. Supp. 1337 (N.D. Ga. 1977), *aff'd mem.*, 607 F.2d 1004 (5th Cir. 1979).

55. *Id.* at 1343.

56. R. CLONTZ, *supra* note 23, at ¶ 5.03[4a].

57. Griffith, *Truth in Lending: Some Aspects*, 26 DE PAUL L. REV. 566, 588-89 (1977).

58. When a consumer exercises his right to rescind, he is not liable for any finance or other charge. 12 C.F.R. § 226.9(d) (1981).

days to perform his required rescission duties will subject him to civil liability.⁵⁹ This liability may consist of the consumer's actual damages, punitive damages of twice the finance charge (but neither less than \$100 nor more than \$1000), and if the consumer is successful, payment of the consumer's attorney fees and court costs.⁶⁰ Additionally, the consumer will still be able to rescind the transaction. Hence, the creditor has merely ten days from receipt of the rescission notice to decide whether to honor the consumer's rescission, a decision that can have grave financial consequences for him.

Another problem is added to this quagmire when the creditor faces a judgment proof consumer who attempts to rescind the transaction. A consumer might be judgment proof when he is bankrupt⁶¹ or owns very little from which a creditor can collect a judgment. This is essentially a no-win situation for the creditor. If he has not complied with all disclosure requirements, he is required to act within ten days to reflect the termination of any security interest and return any payments the consumer has made. Failure to do so within ten days subjects the creditor to civil liabilities.⁶² However, if the creditor does tender the payments back to the judgment proof consumer, he might never see the loan proceeds that the consumer is required to return to him. The creditor's problems are complicated even further in certain jurisdictions by virtue of court interpretations of the rescission procedure.⁶³

B. *Consumer Difficulties*

The rescission procedure outlined by the Act causes consumers difficulties only when creditors do not comply with it. First, if the creditor fails to disclose the consumer's right of rescission, many consumers will never learn of this right.⁶⁴ Oblivious to their prerogative, many consumers will bear harsh financial arrangements that they would have avoided had more details been disclosed to them before the transaction was consummated. This is a burden Congress intended to remove.⁶⁵ Second, consumers face a difficult situation when creditors ignore the rescission notice. If the creditor does not act to terminate the security interest and return the consumer's payments, the rescission has had no effect. Because the security interest is still reflected on the lender's books, the consumer will have great difficulty selling his proper-

59. See *Harris v. Tower Loan*, 609 F.2d 120, 123 (5th Cir.), cert. denied, 449 U.S. 826 (1980); *Eby v. Reb Realty, Inc.*, 495 F.2d 646, 647-48 (9th Cir. 1974).

60. 15 U.S.C. § 1640 (1976 & Supp. IV 1980).

61. See text accompanying note 95 *infra*.

62. See text accompanying notes 59 & 60 *supra*.

63. See text accompanying notes 72-93 *infra*.

64. *Sosa v. Fite*, 498 F.2d 114 (5th Cir. 1974), illustrates the situation in which the consumer does not know about the right to rescind. In that case the consumer rescinded only after the bank had foreclosed the mortgage on her home and she had consulted an attorney. *Id.* at 116-17.

65. The congressional purpose in requiring the creditor to disclose credit terms was "so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." 15 U.S.C. § 1601 (1976 & Supp. IV 1980).

ty.⁶⁶ The consumer must then bring suit to enforce his rights. The delay accompanying such a suit can cause further hardship on the consumer. Some of these problems have been eliminated in certain jurisdictions by virtue of court interpretation of the rescission procedure.⁶⁷

C. Court Interpretation of Rescinded Transactions and Effects Upon Parties

As mentioned,⁶⁸ Regulation Z sets up a simple rescission procedure: (1) the consumer rescinds; (2) the creditor has ten days to terminate the transaction and give back any money or property given by the consumer to the creditor; (3) once the creditor has performed these acts, the consumer must tender back to the creditor the property he has received as part of the transaction; and (4) if the creditor does not accept the tender within ten days the consumer can keep the property without any obligation to pay for it.⁶⁹ However, this procedure has not operated as smoothly as Congress intended. Courts have reached widely varying results when consumers have rescinded transactions several months after their consummation. Variations are especially evident in the federal circuit courts. In handling the rescission procedure, the courts have split into two major factions: pro-consumer courts⁷⁰ and pro-creditor courts.⁷¹

1. Pro-consumer Courts

The leading pro-consumer jurisdiction is the Fifth Circuit. One of its most important cases was *Sosa v. Fite*,⁷² in which a consumer entered a home improvement contract by which aluminum siding was installed on her home and a second mortgage taken as security.⁷³ Proper Truth in Lending disclosures were not given, and the consumer rescinded ten months after entering into the contract.⁷⁴ At the time she rescinded, the consumer also expressly tendered back the property to the creditor. After receiving no response from the creditor, the consumer brought suit to enforce the rescission under the Truth in Lending Act.⁷⁵ The court of appeals concluded that because the

66. Comment, *Consumer Protection: Judicial Approaches to Rescission and Restoration Under the Truth in Lending Act*, 53 WASH. L. REV. 301, 305-07 (1978).

67. See text accompanying notes 72-93 *infra*.

68. See text accompanying notes 30-36 *supra*.

69. 12 C.F.R. § 226.9(d) (1979).

70. Federal pro-consumer jurisdictions appear to be the First Circuit, see *French v. Wilson*, 446 F. Supp. 216 (D.R.I. 1978), the Fifth Circuit, see *Sosa v. Fite*, 498 F.2d 114 (5th Cir. 1974), and the Tenth Circuit, see *Strader v. Beneficial Fin. Co.*, 191 Colo. 206, 551 P.2d 720 (1976). It is unclear whether the Sixth Circuit should be classified as pro-consumer. It indicated its willingness to follow the pro-consumer courts but then in effect followed the pro-creditor courts. See *Rudisell v. Fifth Third Bank*, 662 F.2d 243 (6th Cir. 1980).

71. Federal pro-creditor jurisdictions are the Fourth Circuit, see *Powers v. Sims & Levin*, 542 F.2d 1216 (4th Cir. 1976), and the Ninth Circuit, see *Palmer v. Wilson*, 502 F.2d 860 (9th Cir. 1974). The Sixth Circuit has also shown a willingness to follow the pro-creditor jurisdictions. See *Rudisell v. Fifth Third Bank*, 662 F.2d 243 (6th Cir. 1980); see also note 70 *supra*.

72. 498 F.2d 114 (5th Cir. 1974).

73. *Id.* at 116.

74. *Id.* at 117.

75. *Id.* at 118.

creditor had failed to perform his obligations within ten days after rescission and tender, he had forfeited the loan proceeds.⁷⁶ Thus, the court held that when a consumer rescinds and tenders at the same time, both ten-day periods run simultaneously. The creditor not only must terminate the agreement and return the consumer's money within ten days, but must also accept the consumer's tender of property within the same ten-day period or forfeit it.⁷⁷

Recent cases indicate that the *Sosa* doctrine is alive and well in the Fifth Circuit and jurisdictions that follow it. In *Gerasta v. Hibernia National Bank*⁷⁸ a home improvement loan was cancelled after six months for lack of proper Truth in Lending disclosures. The creditor neither terminated the agreement nor returned the consumer's payments within the first ten-day period. The court distinguished *Sosa*, in which the consumer had made an express tender at the time of rescission; in *Gerasta* the consumers had refused to tender, and therefore, the court held, the second ten-day period had not begun to run as it had in *Sosa* and the bank had not forfeited the loan.⁷⁹ A footnote in the *Gerasta* opinion casts some doubt on whether *Sosa* was still good law: "*Sosa* was decided pursuant to the pre-1974 version of § 1640 [the civil liability damages provision], which limited the applicability of § 1640 to creditors' failures to make required disclosures. We do not consider the question of the continued validity of the *Sosa* decision in light of the 1974 amendment."⁸⁰

Recently, however, the *Sosa* doctrine was clearly revitalized in *Harris v. Tower Loan*.⁸¹ In *Harris* the court stated, "We reaffirm the statutory language and the holding in *Sosa* that the creditor loses any rights in property unaccepted ten days after tender by the obligor."⁸² The court, however, allowed the creditor to offset the value owed to him from the money he returned to the consumer.⁸³

Sosa was also upheld in *Bustamente v. First Federal Savings & Loan Association*⁸⁴ in which the consumer attempted to make a *Sosa* tender to start both ten-day periods running at once.⁸⁵ However, the court distinguished *Sosa* and held that the consumer's tender of property was improper because he tendered only the monthly installment payments as they became due, not

76. *Id.* at 119-20.

77. The court implies, however, that had the creditor performed the duties normally required of him within the first ten-day period, he would have had a second ten days in which to accept the tender. *Id.* at 119 n.6.

78. 575 F.2d 580 (5th Cir. 1978).

79. *Id.* at 582-85. The *Gerasta* opinion is an anomaly. The court ruled that the creditor must perform his obligations of terminating the loan and returning the consumer's money or property. In essence it suspended the first ten-day period since the creditor did not have to tender until the court had rendered judgment. The court further allowed the consumers a reasonable time after the creditor's tender in which to tender the property back to the creditor. *Id.*

80. *Id.* at 584 n.3.

81. 609 F.2d 120 (5th Cir.), cert. denied, 449 U.S. 826 (1980).

82. *Id.* at 123.

83. *Id.*

84. 619 F.2d 360 (5th Cir. 1980).

85. *Id.* at 362.

the proceeds of the loan as the Act requires. Consequently, the second ten-day period leading to forfeiture by the creditor had not begun to run.⁸⁶

Thus, a creditor in the Fifth Circuit or a jurisdiction that follows it⁸⁷ risks the possibility of forfeiting all loan proceeds by a failure to act within ten days if a consumer properly performs a *Sosa* tender. Many of these pro-consumer jurisdictions follow the exact reasoning of *Sosa*. However, an Ohio court took a different approach in *Hank's Auto Sales, Inc. v. Fisher*.⁸⁸ The creditor had accepted a cognovit note as payment, thereby obtaining a security interest in the consumer's residence, but had failed to make any Truth in Lending disclosures. When the consumer rescinded, the creditor took no action. The consumer did not perform a *Sosa* tender, yet the court held that the creditor forfeited the loan principal and was subject to civil liabilities.⁸⁹ The court essentially reached a *Sosa* result without a *Sosa* tender. The court gave no reasoning for this result, one which appears to directly contradict the Act and Regulation.

A recent Sixth Circuit opinion casts doubt on the continued validity of this decision. In *Rudisell v. Fifth Third Bank*⁹⁰ the consumers were not given Truth in Lending disclosures when a mechanic's lien was taken in their home upon the installation of aluminum siding. The lack of disclosure enabled them to rescind nearly three years after consummation of the transaction. The consumers did not perform a *Sosa* tender, but since the creditor did not perform his obligation within ten days, the consumers claimed that the creditor forfeited the loan proceeds and was also required to return their payments. Essentially, the consumers claimed that the court should follow the ruling in *Hank's Auto Sales*, but the *Rudisell* court concluded that such a result cannot be achieved without a *Sosa* tender.⁹¹ Although the court indirectly overruled the decision in *Hank's Auto Sales*, it implied that it would follow *Sosa* in an appropriate case.⁹²

When the results of these pro-consumer cases are added to the many other problems a creditor faces upon rescission,⁹³ it is apparent that the Truth in Lending Act can work a real hardship on creditors.

2. Pro-creditor Courts

Jurisdictions that can be characterized as pro-creditor⁹⁴ have interpreted the rescission procedure in a way that alleviates some of the creditors' problems. However, these decisions greatly burden consumers. In *Palmer v.*

86. *Id.* at 362-65.

87. See note 70 *supra*.

88. 38 Ohio App. 2d 1, 310 N.E.2d 259 (1973).

89. *Id.* at 2-6, 310 N.E.2d at 260-62.

90. 662 F.2d 243 (6th Cir. 1980).

91. *Id.* at 254; see text accompanying notes 107-12 *infra*.

92. 662 F.2d 243, 254 (6th Cir. 1980).

93. See text accompanying notes 39-63 *supra*.

94. See note 71 *supra*.

*Wilson*⁹⁵ the creditor failed to disclose several required credit terms, including the amount financed, the number of payments, and the right to rescind. The failure to disclose enabled the consumer to rescind long after consummation of the loan. Because the consumer was bankrupt and judgment proof, the creditor feared that he would lose all payments and the loan proceeds if he complied with the statutory procedure.⁹⁶ The Ninth Circuit held that it could exercise its equitable powers to condition the granting of rescission on the consumer's first tendering the loan principal back to the creditor.⁹⁷

The *Palmer* court in effect turned the Truth in Lending rescission procedure back into a common-law rescission.⁹⁸ Common-law rescission requires the rescinding party to first tender restitution. When this is done, the contract is void. The rescinding party may then bring an action in replevin or assumpsit to have the consideration he has paid restored to him.⁹⁹ However, when Congress enacted the Truth in Lending Act it sought to facilitate enforcement of the consumer's rights by abrogating the affirmative duty to tender first and instead required only that the consumer give notice.¹⁰⁰

The *Palmer* court's actions have grave consequences for the consumer. To cancel a transaction, the consumer must first procure the entire loan proceeds and tender them. If the statutory rescission procedure were followed, he could utilize the payments tendered back by the creditor to help him raise the loan proceeds, which he would then be required to tender back to the creditor. Furthermore, the statutory rescission procedure outlined by the Truth in Lending Act automatically terminates, upon notice of rescission, any security interest the creditor has in the consumer's property.¹⁰¹ However, under *Palmer* and the common law, the security interest remains intact until the consumer can raise the amount necessary for his tender¹⁰² and makes it difficult, if not impossible, for the consumer to sell his property during this period.

Another case in which a court used its equitable powers to require that the consumer tender prior to rescission was *Powers v. Sims & Levin*.¹⁰³ In that case the consumer pledged his home to obtain a loan and used only half of the loan proceeds to make improvements on his house.¹⁰⁴ The creditor violated the Truth in Lending Act by informing the consumer that he had only two days, instead of the required three, in which to rescind. The consumer

95. 502 F.2d 860 (9th Cir. 1974).

96. *Id.* at 861-62.

97. *Id.* at 861-63. The court felt it inequitable to require the creditor to tender money back when he has had no guarantee that he can obtain the loan proceeds from the consumer. *Id.* at 862.

98. See Note, *Truth-in-Lending: Judicial Modification of the Right of Rescission*, 1974 DUKE L.J. 1227, 1229-31, 1239-42.

99. *Id.* at 1229-31.

100. *Id.* at 1231-34.

101. 12 C.F.R. § 226.9(d) (1979).

102. Note, *Truth-in-Lending: Judicial Modification of the Right of Rescission*, 1974 DUKE L.J. 1227, 1239-42.

103. 542 F.2d 1216 (4th Cir. 1976).

104. *Id.* at 1218.

rescinded several months after consummation but the creditor took no action. The consumer then sent another rescission notice and expressly offered to return the property that constituted the improvements to his home.¹⁰⁵ The court found that since the consumer had used only approximately half of the loan proceeds on his home, the consumer had not tendered the entire loan proceeds back to the creditor. The court held that the consumer's action was an anticipatory breach and that the rescission would not be enforced unless the consumer first tendered the entire loan.¹⁰⁶

The Sixth Circuit has also followed the approach used in the *Palmer* and *Powers* cases.¹⁰⁷ As mentioned,¹⁰⁸ in *Rudisell* an Ohio creditor failed to give Truth in Lending disclosures when he obtained a materialman's lien on the consumer's property by installing aluminum siding.¹⁰⁹ The court held that the consumer could rescind nearly three years after consummation of the transaction but conditioned the rescission on the consumer's first tendering the reasonable value of the aluminum siding.¹¹⁰ The *Rudisell* court reasoned that because rescission is an equitable remedy, a court may condition rescission on the return of money by the consumer.¹¹¹

This is the furthest departure yet from the statutory scheme established in the Truth in Lending Act and is clearly unwarranted. In the *Palmer* case the court invoked principles of equity to avoid forfeiture because the consumer was bankrupt. In *Powers* the consumer's anticipatory breach justified the court's invocation of equity. However, in *Rudisell*, the consumer was not bankrupt and there was no indication that the consumer would not return the loan proceeds. There was no justification for invoking equity principles other than the court's belief that the common-law rescission procedure would "most nearly put the appellants in the position they were in before they entered the transaction."¹¹²

Thus, in the pro-creditor jurisdictions the courts are using their equitable powers to circumvent the statutory rescission procedure and convert it into a common-law rescission which requires tender first by the rescinding party. One commentator¹¹³ has suggested that these courts are utilizing their equitable powers in an incorrect manner. By using equity principles, the courts claim to be discerning the spirit or principle of the statute "to give effect to the intent of the legislature rather than the language chosen to express that intent."¹¹⁴ Generally such modification is appropriate only when:

105. *Id.*

106. *Id.* at 1221-22.

107. *Rudisell v. Fifth Third Bank*, 662 F.2d 243 (6th Cir. 1980).

108. See text accompanying notes 90-92 *supra*.

109. 662 F.2d 243, 245 (6th Cir. 1980).

110. *Id.* at 254.

111. *Id.*

112. *Id.*

113. Note, *Truth-in-Lending: Judicial Modification of the Right of Rescission*, 1974 DUKE L.J. 1227, 1241-42.

114. *Id.* at 1237.

(1) the language of the statute is so narrow that it precludes application of the law to a situation which the court believes the legislature intended to reach; or (2) the statutory language is so ambiguous that its literal interpretation would seem to expand the coverage of the statute beyond that which the legislature intended.¹¹⁵

Even if an argument can be made that one of these two appropriate situations exists, the pro-creditor courts have not properly attempted to carry out the legislative intent. Congress clearly intended to abrogate common-law rescission by eliminating the requirement for an initial tender.¹¹⁶ By requiring such a tender, these pro-creditor courts are not only failing to carry out legislative intent, but are acting in contravention of it. Arguably then, the pro-creditor courts that have resorted to common-law rescission procedures have improperly exercised their equitable powers. However, the Simplification Act has validated the procedures used by these courts by specifically authorizing the courts' discretionary reliance on equity principles.¹¹⁷

IV. EFFECT OF THE TRUTH IN LENDING SIMPLIFICATION AND REFORM ACT ON RESCISSION

Congress in 1980 passed the Truth in Lending Simplification and Reform Act.¹¹⁸ This Act revises many parts of the original Truth in Lending Act, including the rescission provisions. Although both the Simplification Act and the Revised Regulation Z became effective on April 1, 1981, creditors' compliance with the new law is optional until October 1, 1982.¹¹⁹ The amendments relevant to this Note are of two types: (1) those designed to make compliance with the Act easier so that the three-day period will more likely start to run at the time the disclosures are first attempted and (2) those designed to help creditors determine whether rescission is proper when a consumer attempts to rescind long after the consummation of the transaction.

Creditors have had difficulty complying with the original Truth in Lending Act because they are required to make all material Regulation Z disclosures but "material" was never defined.¹²⁰ The Simplification and Reform Act does define "material disclosures:"

The term "material disclosures" means the disclosure, as required by this title, of the annual percentage rate, the method of determining the finance charge and the balance upon which a finance charge will be imposed, the amount of the finance charge, the amount to be financed, the total payments, the number and amount of payments scheduled to repay the indebtedness.¹²¹

115. *Id.*

116. Note, *Judicial Erosion of the Rescission Right Under Truth-in-Lending*, 35 WASH. & LEE L. REV. 979, 985-88 (1978).

117. See text accompanying notes 126-28 *infra*.

118. Pub. L. No. 96-221, 94 Stat. 168 (1980) (amending 15 U.S.C. §§ 1601-1667).

119. *Id.* at § 625, 94 Stat. 185. Originally, compliance was voluntary only until April 1, 1982. Subsequently, however, the period was extended for six months. Pub. L. No. 97-110, 95 Stat. 1515 (1981).

120. See text accompanying notes 53-56 *supra*.

121. Pub. L. No. 96-221, § 612(a) (2), 94 Stat. 168, 175 (1980) (amending 15 U.S.C. § 1602(v) (1976)).

The definition will reduce confusion as to which terms must be disclosed to the consumer, making it easier to comply with the Act. However, a creditor may still be uncertain whether any arithmetic errors are material. Therefore, although the new definition will cut down on litigation and the creditor's problems, it will not eradicate them all.

One excellent change Congress made via the Simplification and Reform Act was the addition of a requirement that the Federal Reserve Board draw up model forms.¹²² Any creditor who uses the forms is deemed to be in compliance with the Act's disclosure requirements in all respects except arithmetic disclosures.¹²³ However, even if a creditor uses these model forms, not only might he disclose incorrect mathematical computations, but he may also make other Truth in Lending violations, such as giving the incorrect number of copies to each consumer. Thus, the rescission period can still extend past its normal three days despite the definition of "material" and the availability of the Federal Reserve forms.

Both the definition and the new forms will help creditors determine whether rescission is proper long after consummation. If the model forms were used, a creditor will need to determine only whether they were completed properly, whether all the material disclosures were correctly made, whether arithmetic computations are correct, and whether proper rescission procedures were followed. This is still quite a lot for the creditor to do, but the new amendments made this task much easier than it is under the original act.

The Simplification and Reform Act also made a change in the rescission procedure itself. It extended the two ten-day periods to twenty-day periods,¹²⁴ so that the creditor will have twenty days from receipt of the rescission notice in which to terminate the loan obligation and return the consumer's money or property. And the creditor does not forfeit the loan proceeds until twenty days after the consumer tenders them. Extension of the periods to twenty days gives the creditor more time in which to determine whether he is in violation of the Act and whether rescission is proper, but it is doubtful that it will alleviate many of the rescission problems discussed above.¹²⁵ The *Sosa* tender is still available to consumers, the judgment proof consumer can still rescind, and many creditors will still be uncertain whether the rescission is valid, even though they have twenty days instead of ten. Perhaps the Simplification Act's requirement that tender of money be made at the creditor's designated place of business will alter the method of performing a *Sosa* tender. Instead of just being able to tender in the notice of rescission that is sent in the mail, a consumer might have to rescind and tender at the creditor's place of business for a valid *Sosa* tender to take place.

122. *Id.* at § 605, 94 Stat. 168, 170 (amending 15 U.S.C. § 1604).

123. *Id.*

124. *Id.* at § 612(a) (3), 94 Stat. 168, 175 (amending 15 U.S.C. § 1635(a) (1976)).

125. See text accompanying notes 39-93 *supra*.

Congress has relegated these remaining problems to the courts. The Simplification and Reform Act specifically authorizes the courts to use their equitable powers to change the rescission procedures: "The procedures prescribed by this subsection shall apply except when otherwise ordered by a Court."¹²⁶ The provision was explained in the Senate Committee Report:

Upon application by the consumer or the creditor, a court is authorized to modify this section's procedures where appropriate. For example, a court might use this discretion in a situation where a consumer in bankruptcy or wage earner proceedings is prohibited from returning the property. The committee expects that the courts, at any time during the rescission process, may impose equitable conditions to insure that the consumer meets his obligations after the creditor has performed his obligations as required under the Act.¹²⁷

This resolves the controversy over whether courts were exceeding their equitable powers by changing the rescission procedure.¹²⁸

In short, the Truth in Lending Simplification and Reform Act takes a step in the direction of clearing up some difficulties with rescission, but it still leaves many of the problems unresolved.¹²⁹

V. PROPOSALS FOR FURTHER CONGRESSIONAL AMENDMENT OF THE TRUTH IN LENDING RESCISSION PROCEDURE

Congress should take further action to alleviate some of the problems that still exist under both the current law and the Simplification Act.¹³⁰ The procedure for rescission within the normal three-day period outlined by Congress has not given rise to serious difficulties and there is no apparent need for any amendment of that procedure. Only when rescission is exercised long after consummation of the loan do problems arise. Therefore, these proposed amendments to the Act and Regulation Z should apply only to rescission long after consummation of the loan.

Currently, a consumer can rescind a transaction by merely sending a notice that says, "I rescind."¹³¹ Some problems could be abated by requiring the consumer to specify his grounds for his rescission in the rescission notice.¹³² This would greatly facilitate the creditor's determination of whether he is in compliance with the Act and whether the consumer truly has the right to rescind. If the creditor uses the model forms permitted by the Simplification and Reform Act,¹³³ this determination will become even easier. The creditor will assume less risk in his determination of the correctness of his disclosures.

126. Pub. L. No. 96-221, § 612(a) (4), 94 Stat. 168, 175 (1980).

127. S. REP. NO. 96-368, 96th Cong., 2d Sess. 29, reprinted in 1980 U.S. CODE CONG. & AD. NEWS 264.

128. See text accompanying notes 113-16 *supra*.

129. See text accompanying notes 39-116 *supra*.

130. *Id.*

131. 12 C.F.R. § 226.9 (1979); see also R. CLONTZ, *supra* note 23, at ¶ 5.03[5].

132. Griffith, *Rescission and Civil Liability: Some Peculiarities of Truth in Lending and Real Estate Transactions*, 6 REAL EST. L.J. 275, 283 (1978).

133. See text accompanying notes 124-28 *supra*.

Furthermore, the statute should be amended to permit expressly the right of setoff by the creditor. In *Harris v. Tower Loan*¹³⁴ the creditor failed to include the premium for fire insurance in the finance charge, an error that enabled the consumer to rescind the transaction after the normal three-day period. The court held:

Nothing in section 1635(b) prevents the creditor from offsetting the value owed to it by the obligor from the sum it initially tenders to the obligor. Such an arrangement prevents a perfunctory exchange of funds and protects the lender from a dissipation of the money while it is in the hands of the obligor. We believe this to be an acceptable course because it is the only means to insure the accomplishment of the congressional purpose of restoring the parties to the status quo ante while affording the statutory remedies to the obligor.¹³⁵

Under this procedure, if the amount already paid by the consumer is greater than the principal of the loan, because of interest and other charges, the creditor would have only to notify the consumer that he is performing an offset and return the difference between the payments made and the principal. If the payments made by the consumer are less than the loan proceeds, the creditor would be relieved from the obligation of returning anything to the consumer and the consumer would have to return only enough money to equal the loan principal. Such a procedure would alleviate many creditors' fears that they will never regain the loan proceeds and will also lose the payments previously made to them.¹³⁶ Including this procedure in the Truth in Lending Act and Regulation Z would extend to all jurisdictions the security creditors now enjoyed only in those that follow *Harris*.

If the Act were amended to include these safeguards, the results of the pro-creditor jurisdictions would no longer be necessary. The creditor would know the reason for rescission, and he could protect himself from the judgmentproof consumer by using the setoff procedure. These courts would have no necessity to require that the consumer tender first.

The final major issue for possible legislative amendment is whether the *Sosa* tender should be expressly abolished in the Act and Regulation Z. The goal of the court in *Sosa* was to prevent a standoff in which the consumer rescinds and the creditor does nothing.¹³⁷ A *Sosa* tender forces a creditor to act quickly in performing his rescission duties: the creditor is subject to civil liability if he does not perform within the required time—ten days under the current Act, twenty under the Simplification Act.¹³⁸ The *Sosa* tender thus threatens a double penalty to creditors—the imposition of not only the civil liabilities, but also a forfeiture of the loan principal.

If Congress did abolish the *Sosa* tender, the consumer would lose a very valuable tool with which to force quick creditor action. Without a *Sosa*

134. 609 F.2d 126 (5th Cir.), cert. denied, 449 U.S. 826 (1980).

135. *Id.* at 123.

136. See text accompanying notes 61–63 *supra*.

137. 498 F.2d 114, 119 (5th Cir. 1974).

138. See text accompanying notes 59–60 *supra*.

tender, the only penalty a creditor faces for not acting within the required time is the civil liability.¹³⁹ Although the threat of liability would be sufficient to spur many creditors into action, it is evident from Congress' initial inclusion of the forfeiture in the Act that it wanted to give the consumer greater leverage than mere civil liability could provide.

However, the imposition of this forfeiture within a single ten-day period is brutal. The ten-day period is such a short time for creditors to take action that instead of hastening creditors in the performance of their rescission duties, it has imposed a very harsh double penalty on creditors who have found it impracticable to comply so quickly.¹⁴⁰ In most cases, the *Sosa* tender has resulted in an automatic forfeiture by the creditor.¹⁴¹ The *Sosa* tender cannot further the goal of forcing creditors to perform quickly when it is practically impossible for creditors to act in that amount of time.

Congress has acted in the Simplification Act to extend the two ten-day periods to twenty-day periods.¹⁴² When creditors are thus given a longer period of time in which to decide whether to honor the consumer's rescission notice and to perform their duties under the rescission procedure, the *Sosa* tender and its attendant forfeiture are not so harsh. Instead of causing automatic forfeiture, as it has in the past,¹⁴³ the *Sosa* tender merely requires the creditor to hasten his performance and not ignore the rescission notice. The *Sosa* rule was originally designed to prevent a standoff in which the creditor refuses to act, not to cause an automatic forfeiture whenever the procedure was invoked. The new provision makes it much more practicable for a creditor to act under the statute or take measures to preserve his rights.¹⁴⁴ Therefore, since the *Sosa* tender provides a consumer with good leverage to force a creditor to act within a short period of time and since Congress has ameliorated the doctrine's harshness by extension of the creditor performance period, the *Sosa* tender should not be expressly abolished by Congress.

VI. PROPOSED SAFEGUARDS FOR CREDITORS AND CONSUMERS

Although the current Truth in Lending rescission procedure causes some difficulties for the parties, actions can be taken to improve one's position until Congress alleviates these problems.

A. Creditor Procedures

When a consumer performs a *Sosa* tender, a creditor's choices are not limited to honoring the rescission within ten days or forfeiting the loan pro-

139. *See id.*

140. *See* text accompanying notes 72-93 *supra*.

141. None of the creditors in the pro-consumer cases complied with the statutory rescission procedure within the required ten days. If the *Sosa* tender had been properly used, there would have been automatic forfeiture in all of these cases. *See* text accompanying notes 72-93 *supra*.

142. *See* text accompanying notes 124-25 *supra*.

143. *See* text accompanying notes 72-93 *supra*.

144. *See* text accompanying notes 145-60 *infra*.

ceeds. There are other actions he might take. A creditor might simply accept the tender by the consumer and therefore not forfeit the loan proceeds. The consumer may have included a recital of tender in his rescission notice only to invoke the effects of the *Sosa* rule and may have had no actual intention of tendering. By attempting to accept the consumer's recited tender, the creditor can ascertain whether the consumer is truly tendering.¹⁴⁵ Many consumers will not have the money necessary to make a true tender. If the creditor tries to accept what turns out to be a consumer's false tender, the second forfeiture period never begins to run.

A creditor should, however, be aware of problems with this procedure. The Truth in Lending Act provides that whoever willfully and knowingly fails to comply with any of its requirements shall be fined up to \$5000 or be imprisoned up to one year or both.¹⁴⁶ If the creditor accepts a tender by the consumer but does not perform his obligations within the required time, the consumer could claim that it is a willful and knowing violation. The consumer could argue that if the creditor has accepted the consumer's tender, he has recognized it as a valid rescission and that therefore his failure to perform his obligations is a willful disregard of the rescission procedure.¹⁴⁷ Thus, the creditor could become subject to both civil and criminal liability.

To avoid criminal liability, a creditor could try depositing the tender in escrow.¹⁴⁸ By so doing, the creditor does not recognize the rescission as valid, but merely states that he is uncertain of its validity and will leave the money in escrow until the determination can be made. The advantages of this procedure are clear. The creditor safeguards himself against forfeiture of the loan proceeds by testing whether the consumer has made a true tender.¹⁴⁹ If the consumer has made not a true tender but merely a recital of tender, the forfeiture provisions of *Sosa* never come into effect. Because the creditor has used an escrow account, the consumer can no longer claim the creditor is willfully and knowingly violating the Act.¹⁵⁰ The only apparent disadvantage of this procedure is that a creditor will still be subject to civil liability for not performing within the required period.

An alternative method for avoiding criminal liability is for the creditor to accept the consumer's tender under protest.¹⁵¹ If the creditor protests the consumer's rescission and tender, he does not recognize it as a valid rescis-

145. See Federal Reserve Board Opinion Letter, Oct. 21, 1969, reprinted in [1969-1974 Transfer Binder] 4 CONSUMER CRED. GUIDE (CCH) ¶ 30,205. A consumer must take some affirmative action to tender property to the creditor. Locking the property in his house and leaving is not a tender.

146. 15 U.S.C. § 1611 (1976).

147. However, in no reported case have the criminal sanctions been imposed.

148. See *Aetna Fin. Co. v. Franklin*, No. 761072 (W.D. La., filed Jan. 10, 1977), holding that it was sufficient under § 1635(b) that a creditor deposit funds paid by a rescinding debtor into escrow.

149. See note 145 *supra*.

150. 15 U.S.C. § 1611 (1976).

151. U.C.C. § 1-207 provides support for performing under protest: "A party who with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as 'without prejudice', 'under protest' or the like are sufficient."

sion and his failure to perform within the required time should not be a willful and knowing violation.¹⁵²

Another way the creditor may avoid forfeiture and both civil and criminal liability is by filing a declaratory judgment action within the forfeiture period, after receipt of the consumer's rescission notice, asking the court to determine whether the transaction is in fact rescindable.¹⁵³ The creditor should also either move the court to require the consumer to pay his tender into court, or accept the tender and pay it into court himself.¹⁵⁴ This action will test whether the consumer is making a true tender that will start the forfeiture period running. To be most effective, the petition should also ask that rescission be conditioned upon full restitution of the principal or net amount of the credit extended to the consumer.¹⁵⁵

In *Aetna Finance Co. v. Franklin*¹⁵⁶ the consumer performed a *Sosa* tender. The creditor accepted the tender and then filed a declaratory judgment action in the federal district court and deposited the accepted tender into escrow with the clerk of courts. The consumer moved to dismiss the action on the ground that the creditor had not acted within ten days to comply with the Truth in Lending rescission procedure.¹⁵⁷ The court denied the motion. Although the case was subsequently settled, it stands for some important propositions. First, the case illustrates that a creditor can avoid civil and criminal liability by filing a declaratory judgment action. If the judge had granted the consumer's motion to dismiss, the creditor would have been subject to both forms of liability. Thus, filing a declaratory judgment action can suspend the time for creditor performance. Second, the case illustrates a method for the creditor to avoid forfeiture in the face of a *Sosa* tender. This creditor deposited the tender in an escrow account when he filed his declaratory judgment action.

The filing of a declaratory judgment action would work best in the pro-creditor jurisdictions, where courts are already predisposed to conditioning rescission upon the consumer's tendering first.¹⁵⁸ These courts would be more likely to condition rescission upon full restitution of the principal or net amount of the credit extended to the consumer, especially if the consumer is unable to pay the tender into court. And a declaratory judgment action could be used to avoid civil liability even when there has been no *Sosa* tender.

One final procedure available to the creditor is to offset the amount the consumer owes him from the amount he tenders back to the consumer. This was expressly permitted in a pro-consumer jurisdiction in *Harris v. Tower*

152. See text accompanying notes 146-47 *supra*.

153. R. CLONTZ, *supra* note 23, at ¶ 5.03[5].

154. See text accompanying notes 156-57 *infra*.

155. R. CLONTZ, *supra* note 23, at ¶ 5.03[5]. The Simplification Act authorizes the courts to vary the rescission procedures by the use of equity principles. See text accompanying notes 127-28 *supra*.

156. No. 761072 (W.D. La., filed Jan. 10, 1977).

157. *Id.*

158. See text accompanying notes 95-112 *supra*.

*Loan.*¹⁵⁹ Furthermore, if the creditor performs this setoff within the required time, he will not be subject to civil liability and can accept any further amounts the consumer might owe him.¹⁶⁰ The disadvantage of this procedure is that the creditor may allow the consumer to rescind a nonrescindable transaction and thus lose a finance charge that is rightfully his.

In sum, a creditor can follow several courses of action when a consumer performs a *Sosa* tender. He can safely deposit the consumer's tender into escrow or under protest, file a declaratory judgment suit, or use the right of setoff to safeguard his position. Additionally, the declaratory judgment suit and the right of setoff can be used by a creditor to safeguard his position when there is merely a rescission and no *Sosa* tender.

B. Consumer Procedures

The rescinding consumer can also take steps to enhance his position against the creditor. In any jurisdiction a consumer should perform a *Sosa* tender. In the pro-consumer jurisdictions, if the creditor is unaware of the *Sosa* rule and does not act within the required time, he will forfeit his loan to the consumer and possibly pay civil damages.¹⁶¹ In the pro-creditor jurisdictions, creditors often do not incur civil liability because the courts hold that there is no valid rescission until the consumer has tendered first.¹⁶² By performing a *Sosa* tender, the consumer will have tendered first, thus leaving the creditor with no excuse for nonperformance. The consumer could then collect the civil remedies from a creditor who fails to act within the required time.

The consumer's only problem arises when the creditor attempts to accept the *Sosa* tender. It was clear in *Sosa* that a mere recital of tender was sufficient.¹⁶³ Only by attempting to accept that tender in some way can a creditor prove that it is not a true tender.¹⁶⁴ If he proves that it is a false tender, then the *Sosa* rule will not apply and the creditor will not forfeit the loan proceeds. If the creditor does attempt to accept a tender that is merely a recital, he might be able to claim that the consumer has committed an anticipatory breach by not returning any of the loan proceeds after having tendered them. To avoid committing such a breach, the consumer should claim that the tender is conditioned upon the creditor's performance of the statutory requirements.¹⁶⁵ The biggest danger of this conditional tender is a showing that a true *Sosa* tender has not been made. Such a showing would weaken the consumer's position by dispelling the threat that a forfeiture will result from the creditor's noncompliance.

159. 609 F.2d 120, 123 (5th Cir.), *cert. denied*, 449 U.S. 826 (1980).

160. See text accompanying notes 59-60 *supra*.

161. See text accompanying notes 68-93 *supra*.

162. See text accompanying notes 94-112 *supra*.

163. 498 F.2d 114, 120 (5th Cir. 1974).

164. See, e.g., *Palmer v. Wilson*, 502 F.2d 860, 862 (9th Cir. 1974).

165. See *Powers v. Sims & Levin*, 542 F.2d 1216, 1220-21 (4th Cir. 1976).

Whether the consumer performs a *Sosa* tender or not, he should wait until the creditor's time for performance has passed and then bring suit. By waiting, the consumer puts the creditor in violation of the statute and can recover civil damages.¹⁶⁶ A consumer can therefore enhance his position in a rescinded transaction by performing a *Sosa* tender and then suing the creditor after the statutory time for the creditor's performance has passed.

VII. CONCLUSION

The case law indicates that the rescission procedure outlined by the Truth in Lending Act, relating to second mortgages taken in principal residences, has not operated as smoothly as Congress intended. The problems are due in part to the difficulty creditors have in making all the proper Truth in Lending disclosures and in part to various court interpretations of the rescission procedure. In pro-consumer jurisdictions courts have used a *Sosa* tender to disadvantage the creditor. In pro-creditor jurisdictions courts have completely set aside the statutory rescission procedure, causing more difficulties for consumers.

By enacting the Truth in Lending Simplification and Reform Act, Congress intended to further its current trend of legislating for more creditor protection. The Simplification and Reform Act is in essence a pro-creditor statute, since many of its provisions safeguard creditor rights. However, this monument of reform does not go far enough in its protection of the creditor. The pro-consumer jurisdictions are still able to penalize the creditor, just as they did before the Simplification and Reform Act was enacted. If Congress continues its pro-creditor trend, it will correct the inadequacies in the Simplification and Reform Act. Until it does, the parties should use the procedures outlined above to safeguard their legal positions.¹⁶⁷

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166. See text accompanying notes 59-60 *supra*.

167. See text accompanying notes 145-166 *supra*.