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Truth in Lending Act - Defendant's Debt Counterclaim - Compulsory or Permissive

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TRUTH IN LENDING ACT—DEFENDANT'S DEBT COUNTERCLAIM—COMPULSORY OR PERMISSIVE?

Courts do not agree whether creditor counterclaims for the balance due on credit contracts are compulsory or permissive counterclaims in consumer suits under the federal Truth in Lending Act. The confusion arises from the apparently conflicting policies of the Act and the Federal Rules of Civil Procedure. However, careful analysis reveals that the policies behind Rule 13 and the Act are better served if the counterclaim is considered permissive and is not afforded the ancillary jurisdiction of the federal courts.

THE FEDERAL TRUTH IN LENDING ACT[1] requires lenders in consumer credit transactions to disclose specific information concerning the terms of the credit extended.[2] As part of the statutory enforcement scheme, the Act provides for private suits in federal or state court against creditors who fail to provide the required information.[3] Under the Act a consumer suing a creditor for disclosure violations is entitled to statutory damages, actual damages,[4] and/or statutory

1. 15 U.S.C. §§ 1601–65 (1970 & Supp. V 1975), *as amended by* Act of Feb. 27, 1976, Pub. L. No. 94–222, § 3(b), 90 Stat. 197; Act of Mar. 23, 1976, Pub. L. No. 94–240, § 4, 90 Stat. 260. The Truth in Lending Act is Title I of the Consumer Credit Protection Act, 15 U.S.C. §§ 1601-8lt (1970 & Supp. V 1975), *as amended by* Act of Feb. 27, 1976, Pub. L. No. 94–222, § 3(b), 90 Stat. 197; Act of Mar. 23, 1976, Pub. L. No. 94–240, § 4, 90 Stat. 260.

2. 15 U.S.C. § 1601 (1970 & Supp. V 1975), *as amended by* Act of Feb. 27, 1976, Pub. L. No. 94–222, § 3(b), 90 Stat. 197; Act of Mar. 23, 1976, Pub. L. No. 94–240, § 4, 90 Stat. 260, provides: "It is the purpose of this subchapter to assure a meaningful disclosure of credit terms 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. . . ." *See* Ratner v. Chemical Bank New York Trust Co., 329 F. Supp. 270, 276-77 (S.D.N.Y. 1971).

3. 15 U.S.C. § 1640 (1970 & Supp. V 1975), *as amended by* Act of Feb. 27, 1976, Pub. L. No. 94–222, § 3(b), 90 Stat. 197; Act of Mar. 23, 1976, Pub. L. No. 94–240, § 4, 90 Stat. 260. In addition to private enforcement, the Act also provides for enforcement by various federal agencies, primarily the Federal Trade Commission. 15 U.S.C. § 1607 (1970 & Supp. V 1975).

4. 15 U.S.C. § 1640(a) (1970 & Supp. V 1975), *as amended by* Act of Feb. 27, 1976, Pub. L. No. 94–222, § 3(b), 90 Stat. 197; Act of Mar. 23, 1976, Pub. L. No. 94–240, § 4, 90 Stat. 260, provides:

> Except as otherwise provided in this section, any creditor who fails to comply with any requirement imposed under this part or part D or E of this subchapter with respect to any person is liable to such person in an amount equal to the sum of —
>
> (1) any actual damage sustained by such person as a result of the failure;
>
> (2)(A)(i) in the case of an individual action twice the amount of any finance charge in connection with the transaction, or (ii) in the case of an individual action relating to a consumer lease under part E of this subchapter, 25 per centum of the total

rescission.[5]

When a debtor, who still owes money under the credit agreement, brings an action in federal court for statutory damages under the Act, it is likely that the creditor will counterclaim for the balance due.[6] It is unlikely that the counterclaim will satisfy the statutory requirements for independent federal jurisdiction.[7] However, if the lender's counterclaim in the Truth in Lending action is compulsory it will be accorded the ancillary jurisdiction of the court.[8] Rule 13(a) of the Federal Rules of Civil Procedure provides that a defendant's counterclaim is compulsory if it arises from the same "transaction or occurrence" as the plaintiff's claim.[9] It is generally agreed that these words should be liberally interpreted in order to allow the disposition of all related claims in a single action.[10] At the first level of inquiry, it appears that this test of compulsoriness is met since both claim and counterclaim arise from the extension of credit to the debtor.

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amount of monthly payments under the lease, except that the liability under this subparagraph shall not be less than $100 nor greater than $1,000; or

(B) in the case of a class action, such amount as the court may allow, except that as to each member of the class no minimum recovery shall be applicable, and the total recovery in such action shall not be more than the lesser of $500,000 or 1 per centum of the net worth of the creditor; and

(3) in the case of any successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court.

5. 15 U.S.C. § 1635 (1970 & Supp. V 1975), *as amended by* Act of Feb. 27, 1976, Pub. L. No. 94-222, § 3(b), 90 Stat. 197; Act of Mar. 23, 1976, Pub. L. No. 94-240, § 4, 90 Stat. 260. Statutory rescission is available only when a security interest is created in "the residence of the person to whom credit is extended." *Id. See* note 45 *infra*, which considers the concurrent availability of § 1640 civil damages and § 1635 statutory rescission.

6. *See* Zeltzer v. Carte Blanche Corp., 414 F. Supp. 1221 (W.D. Pa. 1976); Mims v. Dixie Fin. Corp., 21 F.R. Serv. 2d 1042 (N.D. Ga. 1976); Agostine v. Sidcon Corp., 69 F.R.D. 437 (E.D. Pa. 1975); Ball v. Connecticut Bank & Trust Co., 404 F. Supp. 1 (D. Conn. 1975); Roberts v. National School of Radio & Television Broadcasting, 374 F. Supp. 1266 (N.D. Ga. 1974), *overruled by* Mims v. Dixie Fin. Corp., 21 F.R. Serv. 2d 1042 (N.D. Ga. 1976).

7. Since the creditor's debt collection claim will arise under state law, federal jurisdiction would be based on diversity of citizenship under 28 U.S.C. § 1332 (1970). It is improbable, however, that the claim will satisfy the $10,000 jurisdictional requirement.

8. Lacking independent federal jurisdictional grounds, a permissive counterclaim will not be entertained. *See* note 23 *infra.*

9. Rule 13(a) of the Federal Rules of Civil Procedure, Compulsory Counterclaims, provides: "A pleading shall state as a counterclaim any claim which . . . the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim . . . ."

10. C. WRIGHT & A. MILLER, FEDERAL PRACTICE & PROCEDURE 40 (1971), and cases cited therein. Rule 13 is intended "to dispose of the entire subject matter arising from one set of facts in one action, thus administering complete and even handed justice

The policy underlying the Truth in Lending Act, however, conflicts with this result. The statutory damage provision of the Act has been viewed by the courts as a penalty assessed against violating lenders rather than as a compensatory provision intended to make the borrower whole.[11] In addition, a consumer suing under the Act has also been characterized as a "private attorney general" whose role, by design of the Act, is to prominently participate in the statute's enforcement.[12] Allowing defendants' debt counterclaims would deter consumers from bringing such suits, and thus would be detrimental to the private enforcement provisions of the Act.

As a result of this tension between the Federal Rules and the Truth in Lending Act, judges have been unable to agree whether the debt counterclaim is compulsory or permissive.[13] The purpose of this Note is to examine the court decisions in light of the policies involved, and to study the differing rationales adopted, in an attempt to establish a logical analysis of the problem. This analysis will demonstrate that in the context of a statutory penalty suit, a defendant's debt counterclaim is merely permissive and should not be incorporated into the Truth in Lending action. This result is supported not only by policy considerations under the Truth in Lending Act, but also by a proper application of the Federal Rules.

I. THE BASIS OF THE CONFLICT

A. *Rule 13*

Rule 13 of the Federal Rules of Civil Procedure allows a party to assert counterclaims in response to the opposing party's claims. The present rule derives from, and expands upon, the basic philosophy of the common law doctrines of set-off and recoupment.[14] Rule 13 has been interpreted as providing the courts with broad discretion[15] to join claims in order to facilitate the resolution of all controversies between the parties in a single suit.[16] Judges use the rule to avoid the inefficien-

expeditiously and economically." Blair v. Cleveland Twist Drill Co., 197 F.2d 842, 845 (7th Cir. 1952).

11. Mourning v. Family Publications Serv., Inc., 411 U.S. 356, 376 (1973).

12. Ratner v. Chemical Bank New York Trust Co., 329 F. Supp. 270, 280 (S.D.N.Y. 1971).

13. *See* note 6 *supra*.

14. 6 C. WRIGHT & A. MILLER, *supra* note 10, at 8. *See* 3 T. SEDGWICK, DAMAGES §§ 1033, 1042 (9th ed. 1912); 3 J. STORY, EQUITY JURISPRUDENCE §§ 1870, 1878 (14th ed. 1918).

15. Parmelee v. Chicago Eye Shield Co., 157 F.2d 582 (8th Cir. 1946); Collins v. Metro-Goldwyn Pictures Corp., 106 F.2d 83 (2d Cir. 1939); Waltham Indus. Corp. v. Thompson, 53 F.R.D. 93 (D. Conn. 1971).

16. Montecatini Edison, S.P.A. v. Ziegler, 486 F.2d 1279 (D.C. Cir. 1973); LASA

cies of multiple litigation:[17] "The objective of the Federal Rules with respect to counterclaims is to provide complete relief to the parties, to conserve judicial resources and to avoid the proliferation of lawsuits."[18]

The reasons for the creditor in a Truth in Lending action to counterclaim for the amount owing are largely the same as those prompting any counterclaim. Since the creditor is already in court to defend the action, it is an economically appropriate time, in terms of litigation expenses, for him to assert his claim. Also, the creditor may reasonably fear that if the counterclaim is not presently asserted it may be barred in a subsequent suit.[19] Finally, a creditor forced to pay money damages in a Truth in Lending suit may later find the debtor unable to pay a judgment won by the creditor in a subsequent action on the debt.[20]

If a creditor could establish independent grounds for federal jurisdiction, a determination of the nature of the counterclaim would be unnecessary. Typically, however, a creditor's counterclaim will not satisfy federal jurisdictional requirements.[21] If the counterclaim is held to be merely permissive[22] it will not be entertained as the courts have consistently held that permissive counterclaims must be supported by independent grounds of federal subject matter jurisdiction.[23] Should

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Per L'Industria Del Marmo Societa Per Azioni v. Alexander, 414 F.2d 143 (6th Cir. 1969); Stewart-Warner Corp. v. Westinghouse Elec. Corp., 325 F.2d 822 (2d Cir. 1963), *cert. denied*, 376 U.S. 944 (1964); Blair v. Cleveland Twist Drill Co., 197 F.2d 842 (7th Cir. 1952).

17. Aviation Materials, Inc. v. Pinney, 65 F.R.D. 357 (N.D. Okla. 1975); Tasner v. Billera, 379 F. Supp. 809 (N.D. Ill. 1974); James B. Day & Co. v. Reichhold Chems., Inc., 60 F.R.D. 387 (N.D. Ill. 1973); Avondale Shipyards, Inc. v. Propulsion Sys., Inc., 53 F.R.D. 341 (E.D. La. 1971); Waltham Indus. Corp. v. Thompson, 53 F.R.D. 93 (D. Conn. 1971).

18. Montecatini Edison, S.P.A. v. Ziegler, 486 F.2d 1279, 1282 (D.C. Cir. 1973).

19. If the unasserted counterclaim is held to be compulsory, it will be barred in a later, independent federal action. Pipeliners Local No. 798 v. Ellerd, 503 F.2d 1193 (10th Cir. 1974); Tolson v. Hodge, 411 F.2d 123 (4th Cir. 1969); New Britain Mach. Co. v. Yeo, 358 F.2d 397 (6th Cir. 1966); National Equip. Rental, Ltd. v. Fowler, 287 F.2d 43 (2d Cir. 1961).

When the subsequent suit is brought in state court, the state court may reach the same result. London v. City of Philadelphia, 412 Pa. 496, 194 A.2d 901 (1963); Horne v. Woolever, 170 Ohio St. 178, 163 N.E.2d 378 (1959), *cert. denied*, 362 U.S. 951 (1960); Meacham v. Haley, 38 Tenn. App. 20, 270 S.W.2d 503 (1954). *See* 6 C. WRIGHT & A. MILLER, *supra* note 10, at 94–95.

20. *See* Mims v. Dixie Fin. Corp., 426 F. Supp. 627, 634 (N.D. Ga. 1976).

21. *See* note 7 *supra*.

22. Rule 13(b) of the Federal Rules of Civil Procedure, Permissive Counterclaims, states: "A pleading may state as a counterclaim any claim against an opposing party not arising out of the transaction or occurrence that is the subject matter of the opposing party's claim."

23. *See, e.g.*, Clark v. Universal Builders, Inc., 501 F.2d 324 (7th Cir.), *cert. denied*,

the counterclaim be held compulsory, however, it would be heard despite the absence of independent jurisdictional grounds since it would then fall within the courts' ancillary jurisdiction.[24] In determining whether a counterclaim is compulsory, and therefore comes within the courts' ancillary jurisdiction, the court must apply the deceptively simple "transaction or occurrence" test provided in Rule 13(a).[25]

A literal application of Rule 13 in the context of a Truth in Lending counterclaim appears to present little difficulty. The claims of both parties center around the same consumer credit transaction. This extension of credit, from which both parties' claims derive, is apparently a single transaction or occurrence as required by Rule 13(a).[26] Accordingly, it seems that defendant's counterclaim is compulsory and therefore falls under the ancillary jurisdiction of the court.

In applying Rule 13(a), however, the courts have largely refrained from explicitly defining this test in order to maintain a liberal and flexible standard.[27] Instead, the courts have suggested four subtests to determine whether or not a specific counterclaim is compulsory:

1) Are the issues of fact and law raised by the claim and counterclaim largely the same?
2) Would res judicata bar a subsequent suit on defendant's claim absent the compulsory counterclaim rule?
3) Will substantially the same evidence support or refute plaintiff's claim as well as defendant's counterclaim?
4) Is there any logical relation between the claim and the counterclaim?

In the case of each of these tests, an affirmative answer to the question posed means that the counterclaim is compulsory.[28]

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419 U.S. 1070 (1974); Autographic Register Co. v. Philip Hano Co., 198 F.2d 208 (1st Cir. 1952).

24. Baker v. Gold Seal Liquors, Inc., 417 U.S. 467, 469 n.1 (1974); Mayer Paving & Asphalt Co. v. General Dynamics Corp., 486 F.2d 763 (1973), *cert. denied*, 414 U.S. 1146 (1974); United States *ex rel.* D'Agostino Excavators, Inc. v. Heyward-Robinson Co., 430 F.2d 1077 (1970), *cert. denied*, 400 U.S. 1021 (1971).

This is not to suggest that Rule 13(a) extends federal jurisdiction to compulsory counterclaims, but rather that the tests for ancillary jurisdiction and for compulsory counterclaims are the same. The tests are identical because both Rule 13(a) and the doctrine of ancillary jurisdiction are designed to eliminate the same evil—piecemeal litigation. Great Lakes Rubber Corp. v. Herbert Cooper Co., 286 F.2d 631 (1961).

25. Rule 13(a) provides that a compulsory counterclaim must arise "out of the transaction or occurrence that is the subject matter of the opposing party's claim."

26. *See* Mims v. Dixie Fin. Corp., 21 F.R. Serv. 2d 1042 (N.D. Ga. 1976); Gibson v. Family Fin. Corp., 404 F. Supp. 896 (E.D. La. 1975); Kenney v. Landis Fin. Group, Inc., 376 F. Supp. 852 (N.D. Iowa 1974).

27. 6 C. WRIGHT & A. MILLER, *supra* note 10, at 40–41.

28. *Id.* at 42–43. These subtests have been approved and applied in the context of debt counterclaims in Truth in Lending suits. Mims v. Dixie Fin. Corp., 21 F.R. Serv. 2d 1042 (N.D. Ga. 1976); Roberts v. National School of Radio & Television

Using these guides, the courts require some appreciable gain in judicial economy—the goal of the Federal Rules generally[29] and of Rule 13 in particular—before finding a counterclaim to be compulsory.

Analysis of the cases demonstrates that no such gain is realized by allowing a creditor's counterclaim to be heard in a Truth in Lending proceeding. Use of the judicial subtests for compulsoriness serves to expose the real differences in the claims' transactional origins. Moreover, rejecting a creditor's debt counterclaim and holding it to be merely permissive is more consistent with the policies underlying the Truth in Lending Act.

B. *The Truth in Lending Act*

The Truth in Lending Act was the legislative solution to the problem of the uninformed use of credit by consumers.[30] Congress realized that because of the nonuniform and confusing manner in which credit terms were being presented, consumers were largely unaware of the true cost of credit, particularly the annual rate being charged.[31] The Truth in Lending Act was intended to remedy this situation by requiring creditors to provide consumers with the information necessary to make informed credit decisions.[32]

Section 1601 clearly identifies the two objectives of the Act.[33]

Broadcasting, 374 F. Supp. 1266 (N.D. Ga. 1974), *overruled by* Mims v. Dixie Fin. Corp., 21 F.R. Serv. 2d 1042 (N.D. Ga. 1976).

29. Rule 1 of the Federal Rules of Civil Procedure provides: "[These rules] shall be construed to secure the just, speedy, and inexpensive determination of every action."

30. H.R. REP. NO. 1040, 90th Cong., 2d Sess., *reprinted in* [1968] U.S. CODE CONG. & AD. NEWS 1962, 1964–66.

> Passage of the Truth in Lending Act in 1968 culminated several years of congressional study and debate as to the propriety and usefulness of imposing mandatory disclosure requirements on those who extend credit to consumers in the American market. By the time of passage, it had become abundantly clear that the use of consumer credit was expanding at an extremely rapid rate. From the end of World War II through 1967, the amount of such credit outstanding had increased from $5.6 billion to $95.9 billion, a rate of growth more than 4 1/2 times as great as that of the economy. Yet, as the congressional hearings revealed, consumers remained remarkably ignorant of the nature of their credit obligations and of the costs of deferring payment. Because of the divergent, and at times fraudulent, practices by which consumers were informed of the terms of the credit extended to them, many consumers were prevented from shopping for the best terms available and, at times, were prompted to assume liabilities they could not meet.

Mourning v. Family Publication Serv., Inc., 411 U.S. 356, 363 (1973) (footnotes omitted).

31. *Id.*

32. *See* 114 CONG. REC. 9642 (1968) (remarks of Sen. Daniel B. Brewster).

33. *See* note 2 *supra*. *See also* Comment, *Private Remedies Under the Truth-in-Lending Act: The Relationship Between Rescission and Civil Liability*, 57 IOWA L. REV. 199, 199–200 (1971).

First, the Act seeks to require the disclosure of credit terms in a manner which can be understood by the average consumer. Second, the statute contemplates that by requiring disclosure of credit terms in a specified manner, the consumer will be able to effectively shop for credit through comparison of credit "prices."[34] The Act does not attempt to regulate finance charges[35] and leaves control over credit terms and the manner of debt repayment to state law.[36] Thus, the Truth in Lending Act is solely a disclosure statute designed to ensure that consumers receive specific information in a structured manner.[37]

At the outset, the two houses of Congress differed with respect to the Act's enforcement. The Senate envisioned enforcement solely by private consumer suits for a civil penalty against violating lenders.[38] In contrast, the House believed that enforcement by unsophisticated consumers would be ineffective and therefore thought administrative enforcement was necessary.[39] Ultimately, both consumer and administrative enforcement provisions were incorporated into the resulting conference report.[40]

The civil remedies specified in the Act allow a debtor suing a creditor for disclosure violations to recover statutory damages, actual damages, and, in certain instances, to obtain statutory rescission.[41] It is important to understand the statutory damage remedy because it is in that context that creditors' counterclaims have arisen.[42] In *Bostwick v.*

34. It will be observed that although the Act is intended to achieve both goals, only the first function is directly effected and enforced. The second objective is the indirect and consequential result of implementing the first.

35. *See* Tanner, *Truth in Lending and Regulation Z—A Primer*, 6 GA. ST.B.J. 19 (1969).

36. *See* Boyd, *The Federal Consumer Credit Protection Act—A Consumer Perspective*, 45 NOTRE DAME LAW. 171, 174 (1970).

37. *See* 15 U.S.C. §§ 1637–39 (1970 & Supp. V 1975); Regulation Z, 12 C.F.R. § 226 (1977).

38. S. REP. NO. 392, 90th Cong., 1st Sess. 9 (1967); 113 CONG. REC. 18409 (1967) (remarks of Sen. Bennet); 113 CONG. REC. 18413 (1967) (remarks of Sen. McIntyre); 114 CONG. REC. 1433 (1968) (remarks of Rep. Sullivan).

39. H.R. REP. NO. 1040, 90th Cong., 2d Sess. 18, *reprinted in* [1968] U.S. CODE CONG. & AD.NEWS 1962, 1975–76. Although the House felt administrative action would be the primary means of enforcement, it also provided for the civil liability of lenders in consumer suits. 114 CONG. REC. 1427 (1968) (remarks of Rep. Patman); H.R. 11601, 90th Cong., 1st Sess. § 206(a), 113 CONG. REC. 19615 (1967); *see also* H.R. REP. NO. 1040, 90th Cong., 2d Sess. 19, *reprinted in* [1968] U.S. CODE CONG. & AD. NEWS 1962, 1976.

40. 114 CONG. REC. 14489 (1968) (remarks of Sen. Proxmire); *id.* at 14387 (remarks of Rep. Sullivan).

41. 15 U.S.C. § 1640(a) (1970 & Supp. V 1975), *as amended by* Act of Feb. 27, 1976, Pub. L. No. 94–222, § 3(b), 90 Stat. 197; Act of Mar. 23, 1976, Pub. L. No. 94–240, § 4, 90 Stat. 260; 15 U.S.C. § 1635 (1970 & Supp. V 1975). *See* note 5 *supra*.

42. *See* note 6 *supra*.

Cohen,[43] an early opinion concerning the concurrent allowance of section 1635 rescission and section 1640 damages, the court proceeded on the theory that section 1640 was designed to provide a remedy for aggrieved debtors and was not punitive in nature.[44] The court relied on legislative history indicating that administrative action should be the primary method of enforcement, and that the minimum and double recovery provisions of section 1640(a) were intended solely as an incentive for private suits.[45]

Ratner v. Chemical Bank New York Trust Co.[46] subsequently eroded this position by holding that whether or not the consumer incurs a finance charge is irrelevant to the creditor's liability under section 1640. The court found that the creditor's liability was grounded solely upon his failure to disclose the required information.[47] According to

43. 319 F. Supp. 875 (N.D. Ohio 1970).

44. *Id.* at 877–78.

45. *Id.* In reaching this conclusion, the court relied on an early House report: "While primary enforcement of the bill would be accomplished under the administrative enforcement section . . . , further provision is made for the institution of civil action by an aggrieved debtor." H.R. REP. NO. 1040, 90th Cong., 2d Sess. 19, *reprinted in* [1968] U.S. CODE CONG. & AD. NEWS 1962, 1976. *See* White v. Arlen Realty & Dev. Corp., 374 F. Supp. 151, 157–58 (D. Md. 1974).

The *Bostwick* court also held that since the statutory damage provision in § 1640 was primarily remedial, it was inconsistent with rescission and would thus not be concurrently granted. 319 F. Supp. at 878. The Truth in Lending Act does not specify whether § 1640 civil penalties and § 1635 rescission are mutually exclusive or concurrent remedies. *See* Palmer v. Wilson, 359 F. Supp. 1099, 1103–04 (N.D. Cal. 1973), *vacated and remanded on other grounds*, 502 F.2d 860 (9th Cir. 1974); Bostwick v. Cohen, 319 F. Supp. 875, 877–78 (N.D. Ohio 1970). *Bostwick* was the first judicial resolution of this issue, holding that absent congressional direction to the contrary, the common law doctrine of election of remedies was applicable. This view was later abandoned by decisions interpreting § 1640 as a penalty provision and permitting § 1635 rescission as a concurrent remedy. Eby v. Reb Realty, Inc., 495 F.2d 646 (9th Cir. 1974); Palmer v. Wilson, 359 F. Supp. 1099, 1103–04 (N.D. Cal. 1973), *vacated and remanded on other grounds*, 502 F.2d 860 (9th Cir. 1974). From the beginning commentators have strongly argued for allowing § 1635 rescission and § 1640 damages concurrently. Note, *Truth in Lending Act Litigation: Concurrent Recourse to Rescission and the Civil Penalty*, 43 GEO. WASH. L. REV. 840 (1975); Comment, *supra* note 33.

46. 329 F. Supp. 270 (S.D.N.Y. 1971).

47. *Id.* at 280. The opinion also contains language supporting the *Bostwick* view: "While the contexts differ, this court follows the only previously reported decision in holding the provision for civil recoveries 'remedial' rather than 'penal.' Bostwick v. Cohen, *supra*." *Id.* at 282. It is interesting to note that the court employed this conflicting analysis to the benefit of the consumer. The court first found the provision implicitly penal in nature in order to allow the plaintiff's recovery despite the absence of actual injury. Then, in order to defeat the defendant's argument that his "reasonable" violation should not be subject to a "penalty," the court found that the "'remedial' character of the provision for civil recoveries quite overwhelms its allegedly 'penal' aspect." *Id.* The *Ratner* court appears to be cleverly equivocal in its use of the term "remedial." Since no actual injury was shown, recovery can hardly be described as remedial to this particular plaintiff. If the imposition of damages is considered remedial to consumers as a whole

the court, "[t]he scheme of the statute . . . is to create a species of 'private attorney general' to participate prominently in enforcement. . . . [Congress] invited people like the present plaintiff, whether they were themselves deceived or not, to sue in the public interest."[48] Under this view, a plaintiff's recovery under section 1640 is not recovery for damages suffered on the credit contract, but rather a penalty imposed on the creditor to enforce compliance with the disclosure requirements of the Act.

The position established in *Ratner* is buttressed by the Supreme Court's opinion in *Mourning v. Family Publications Service, Inc.*[49] In *Mourning* the Court held that although no finance charge was assessed, the civil liability under section 1640 could be imposed.[50] The Court characterized the provision as a civil penalty, applicable simply upon a showing of the creditor's failure to disclose.[51] Later cases reiterate this approach, finding no inconsistency in granting both the civil penalty under section 1640 and statutory rescission.[52] Thus, case law supports the characterization of the civil recovery provision as a penalty to violating creditors rather than a remedy for aggrieved debtors.

In addition to judicial support, the statute itself indicates that the provision for civil damages is properly construed as a penalty for violations of the Act.[53] The formula for recovery provided in section

(and to the disclosure problem attacked by the Act), then, from the defendant's point of view, the provision is clearly penal.

48. 329 F. Supp. at 28 (footnotes omitted).

49. 411 U.S. 356 (1973).

50. *Id.* at 376. In *Mourning* the defendant had violated the disclosure requirements of Federal Reserve Board's regulation Z, 12 C.F.R. § 226 (1977).

51. 411 U.S. at 376. The Court stated:

> We are also unable to accept respondent's argument that [§ 1640] does not allow imposition of a civil penalty in cases where no finance charge is involved but where a regulation requiring disclosure has been violated. . . . Since the civil penalty prescribed is modest and the prohibited conduct clearly set out in the regulation, we need not construe this section as narrowly as a criminal statute providing graver penalties, such as prison terms. . . . In light of the emphasis Congress placed on agency rulemaking and on private and administrative enforcement of the Act, we cannot conclude that Congress intended those who failed to comply with regulations to be subject to no penalty or to criminal penalties alone. . . . [I]mposition of the minimum sanction is proper in cases such as this, where the finance charge is nonexistent or undetermined.

Id.

52. Palmer v. Wilson, 502 F.2d 860 (9th Cir. 1974); Eby v. Reb Realty, Inc., 495 F.2d 646 (9th Cir. 1974).

53. Statutory analysis of § 1640 includes the following additional indications that § 1640(a)(2) is a penalty provision:

1) The defense for bona fide clerical errors provided in section 1640(c) is consistent with a penalty construction of the damage provision.
2) The short statute of limitations specified in section 1640(e) is more appropriate for a punitive than a compensatory measure.

1640(a)(2) bears no relation to the consumer's possible injury.[54] Analysis of the 1974 amendments[55] to the Truth in Lending Act also supports this construction. While retaining the prior statutory damage provision, the amended version of section 1640(a) includes an added provision imposing liability for any actual damages sustained by the consumer as a result of the lender's disclosure violations.[56] Allowing both statutory civil damages and actual damages strongly supports the conclusion that the original civil recovery provision should be viewed as a penalty.

The foregoing analysis indicates that Congress viewed the civil recovery provision of section 1640(a)(2) as a civil penalty not calculated to make the borrower whole. Thus, when a borrower sues for the civil penalty provided in section 1640(a)(2), he is acting not as an individual seeking redress for damages suffered in the credit transaction but as a private attorney general to force compliance with the disclosure requirements of the Act. To allow the creditor to assert a counterclaim on the debt owed under the credit contract would seriously diminish consumers' incentive to bring such actions and thus would undermine the private enforcement scheme incorporated into the Act.[57]

II. THE CONFLICT IN THE COURTS: COUNTERCLAIMS IN ACTIONS FOR STATUTORY DAMAGES

In Truth in Lending actions for the statutory penalty, the issue of whether a creditor's counterclaim on the debt is compulsory, and thus given ancillary jurisdiction, has not been treated uniformly by the courts.[58] The first decision to consider the conflicting policies of Rule 13 and the Truth in Lending Act was *Roberts v. National School of Radio & Television Broadcasting*.[59] In *Roberts*, the plaintiff student's suit, filed under the Truth in Lending Act, alleged that the defendant trade school had failed to adequately describe the credit terms of a note

3) The allowed recovery in section 1640(a)(3) for reasonable attorney's fees is indicative of a penalty construction.

Note, *Truth in Lending Act Litigation: Concurrent Recourse to Rescisson and the Civil Penalty*, 43 GEO. WASH. L. REV. 840, 854–61 (1975).

54. The text of § 1640(a)(2) is set forth in note 4 *supra*.

55. Act of Oct. 28, 1974, Pub. L. No. 93–495, 88 Stat. 1500.

56. 15 U.S.C. § 1640(a)(1) (1970 & Supp. V 1975), *as amended by* Act of Feb. 27, 1976, Pub. L. No. 94–222, § 3(b), 90 Stat. 197; Act of Mar. 23, 1976, Pub. L. No. 94–240, § 4, 90 Stat. 260.

57. Zeltzer v. Carte Blanche Corp., 414 F. Supp. 1221 (W.D. Pa. 1976); Roberts v. National School of Radio & Television Broadcasting, 374 F. Supp. 1266 (N.D. Ga. 1974), *overruled by* Mims v. Dixie Fin. Corp., 21 F.R. Serv. 2d 1042 (N.D. Ga. 1976).

58. *See* note 6 *supra*.

59. 374 F. Supp. 1266 (1974), *overruled by* Mims v. Dixie Fin. Corp., 21 F.R. Serv. 2d 1042 (N.D. Ga. 1976).

executed by the plaintiff for the installment payment of his tuition loan. The court held that the defendant's counterclaim for the balance due on the note was permissive, rather than compulsory. Although the court iterated the four generally accepted subtests for determining compulsoriness under Rule 13(a),[60] it did not expressly apply them.[61] Instead, the court seemed to implicitly apply the primary transaction or occurrence test of Rule 13(a). While noting that both the plaintiff and defendant stated claims arising from the same transaction in the sense that each was suing because of the other's obligations on the note, the court hinted at a distinction between the transaction of disclosure and that of credit extension.[62]

The court's vague application of Rule 13 contrasts with its straightforward determination of the result mandated by the Truth in Lending Act. Judge Edenfield adopted both the *Ratner* characterization of a Truth in Lending plaintiff as a "species of private attorneys general" intended to participate prominently in the enforcement of the Act[63] and the *Mourning* position that the creditor's liability under the Truth in Lending Act is to be viewed as a "penalty and a deterrent to activity prohibited by Congress."[64] The court thus viewed the plaintiff's suit more as a Truth in Lending enforcement proceeding than as a private damage action. Consequently, the court refused to accept the "incongruous result" of turning the enforcement suit into a forum for the violator's private claims.[65] Moreover, to permit the defendant's

60. *See* text accompanying note 28 *supra*.

61. 374 F. Supp. at 1270. The court stated, in conclusory fashion: "The counterclaim of the defendant in this case fails to meet any of the tests of compulsoriness under Rule 13(a), Fed. R. Civ. P." *Id.* at 1271.

62. *Id.* The court did not expressly state its reasoning, but instead left it to inference:

> The plaintiff's claim is that the defendant failed to make certain credit disclosures in a financing agreement in accordance with TIL disclosure requirements. The defendant's counterclaim is for the balance due on the note. . . .
>
> . . . While both the plaintiff and the defendant state claims arising from the same transaction in the sense that each party is suing because of the other's obligations on the note, the plaintiff's claim is in furtherance of a stated federal legislative policy. The defendant contends simply that plaintiff is in default on a private duty.

Id.

63. *Id.*

64. *Id.*

65. *Id.* The court stated:

> Given the remedial nature of TIL and the broad public policy which it serves, federal courts should be loath to become immersed in the debt collection suits of the target of the very legislation under which a TIL plaintiff states a cause of action.
>
> . . . To permit the defendant in a TIL action to utilize the proceedings merely as a forum to state grievances against a debtor-plaintiff would be an incongruous result and clearly prejudicial to the plaintiff's claim.

Id.

counterclaim "would unduly complicate the expeditious resolution of TIL litigation"[66]—litigation designed to enforce the provisions of the Act. The careful analysis of the policy behind the Truth in Lending Act, coupled with the terse consideration given to Rule 13,[67] leaves little doubt that the former was the controlling factor in the court's decision. While this sensitivity to the purpose and design of the Truth in Lending Act is a desirable, indeed a necessary factor in reaching a sound resolution of this issue, equal attention should be given to the application of Rule 13 and its underlying policy. Failure to pursue this line of analysis mars the *Roberts* decision. However, later cases recognize the imperatives of the Federal Rules, and deal directly with the impact of Rule 13 on this problem.

The recent case of *Zeltzer v. Carte Blanche Corp.*[68] reached the same result as *Roberts*, but undertook a more thorough analysis. In *Zeltzer* the plaintiff alleged that the creditor failed to make the required Truth in Lending disclosures in connection with a credit card purchase of airline tickets. The defendant counterclaimed to recover the unpaid balance on the plaintiff's credit card account. Judge Teitelbaum reasoned that, while the language of Rule 13(a) indicates that the counterclaim should be held compulsory, allowing defendant's claim would require the resolution of questions controlled solely by state contract law.[69]

The *Zeltzer* court admitted that "both claim and counterclaim arise out of a singular occurrence, plaintiff's purchase of airline tickets through the use of his Carte Blanche card."[70] However, the court was loath to expose the federal courts to a "flood-tide" of debt collection counterclaims involving questions of no federal significance.[71] "[T]he Court is asked by way of a defendant's counterclaim to try a cause of

66. *Id.* This rationale can also be interpreted as negating the possibility that any gain in judicial efficiency would result from the determination that defendant's counterclaim was compulsory.

67. *Id.* at 1270.

68. 414 F. Supp. 1221 (W.D. Pa. 1976).

69. *Id.* at 1222. The judge explained:

> On one hand, the language of Rule 13(a) of the Federal Rules of Civil Procedure indicates that such counterclaims are compulsory and, as such, require no independent basis for the exercise of federal jurisdiction, but must be asserted by a defendant and heard by the court as falling within its ancillary jurisdiction. On the other hand, important policy considerations—stemming from a clear understanding that the federal judicial system rests on a concept of limited jurisdiction, the expansion of which necessarily diminishes the power of the states to adjudicate controversies governed by state law—dictate that federal courts proceed cautiously in permitting the assertion of so-called "debt collection" counterclaims in suits originally brought to recover on an exclusively federal cause of action.

Id. (footnotes omitted).

70. *Id.* at 1223.

71. *Id.* at 1225.

action amounting to *no more* than a state debt collection suit *founded on the same transaction or occurrence* that generated plaintiff's exclusively federal suit. . . ."[72] This judicial reluctance to entertain state law claims, echoing *Roberts*, has little relevance to a proper analysis of this issue. As expressly stated in *Roberts*, "[t]he purpose of ancillary jurisdiction is to enable a court with jurisdiction of the principal action to hear also any ancillary proceedings therein, regardless . . . of any . . . factor that would normally determine jurisdiction."[73] The court should determine whether the defendant's counterclaim is or is not compulsory, rather than look to the nature of the counterclaim.[74]

The *Zeltzer* court apparently realized that its concern for the limited jurisdiction of the federal courts would not justify wholesale neglect of the Federal Rules.[75] In order to reconcile the apparent confrontation between the text of Rule 13 and the underlying policy of the Act, Judge Teitelbaum looked to one of the judicially developed subtests[76] for classifying counterclaims. The court examined whether a "logical relationship" existed between claim and counterclaim such that the purpose of Rule 13(a)—judicial efficiency—would be promoted by the extension of ancillary jurisdiction to the related counterclaim.[77] No such logical relationship was found to exist:

> [T]he factual issues are distinct. Plaintiff's claim entails proof of a limited set of facts relating to the nature of the disclosures made by the defendant. The counterclaim involves proof of a contract, its validity, the record of pay-

72. *Id.* at 1222 (emphasis added).

73. 374 F. Supp. at 1270.

74. It is noteworthy that in analogous situations where the plaintiff asserts a claim under a federal statute and the defendant's counterclaim arises under state law, the courts have not hesitated to hold the counterclaim compulsory if it satisfies the transaction or occurrence test of Rule 13(a). *See* Mayer Paving & Asphalt Co. v. General Dynamics Corp., 486 F.2d 763 (7th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974); United States v. Gerbus Bros. Constr. Co., 57 F.R.D. 206 (E.D. Ky. 1972).

75. 414 F. Supp. at 1225.

76. *See* text accompanying note 28 *supra*.

77. 414 F. Supp. at 1223. The court relied on the test used in Great Lakes Rubber Corp. v. Herbert Cooper Co., 286 F.2d 631 (3d Cir. 1961):

> [A] counterclaim is compulsory if it bears a "logical relationship" to an opposing party's claim. The phrase "logical relationship" is given meaning by the purpose of the rule which it was designed to implement. Thus, a counterclaim is logically related to the opposing party's claim where separate trials on each of their respective claims would involve a substantial duplication of effort and time by the parties and the courts. Where multiple claims involve many of the same factual issues, or the same factual and legal issues, or where they are offshoots of the same basic controversy between the parties, fairness and considerations of convenience and of economy require that the counterclaimant be permitted to maintain his cause of action.

414 F. Supp. at 1223. The logical relation test is discussed in 6 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE 46–48, 54 (1971).

> ments and plaintiff's default. In these circumstances, where claim and counterclaim lack even a close similarity of factual and legal issues, . . . separate trials on each distinct claim will not involve a "substantial duplication of effort and time by the parties and the courts."[78]

Thus, the apparently conflicting policies of the Rules and the Act are convincingly integrated. The court avoids the derogation of the Rules inherent in the *Roberts* approach and fulfills the underlying purpose of the transaction test. This language also seems to recognize the distinction suggested in *Roberts* between the disclosure transaction, upon which the plaintiff's claim is based, and the contract itself, upon which the counterclaim is grounded.[79] This distinction permits a literal application of Rule 13.[80]

In harmony with the *Zeltzer* application of Rule 13 are *Agostine v. Sidcon Corp.*[81] and *Ball v. Connecticut Bank & Trust Co.*,[82] holding defendant debt counterclaims to be permissive. The court in *Agostine* applied the recognized subtests[83] for compulsoriness and found that the issues of fact and law encompassed by the plaintiff's claim and defendant's counterclaim were quite different.[84] In addition, different evidence would be necessary to support the two parties' claims: the plaintiff would only need to show that the credit transaction took place

78. 414 F. Supp. at 1224.

79. The court also incorporates into its opinion the language from *Roberts* suggesting the difference. 414 F. Supp. at 1225. *See* note 62 *supra* and accompanying text.

80. *Zeltzer* was decided in the context of a class action. The court notes that allowing defendant's debt counterclaim may add significantly to the complexity of the suit. 414 F. Supp. at 1223 n.4. *See* Agostine v. Sidcon Corp., 69 F.R.D. 437 (E.D. Pa. 1975). The *Zeltzer* approach of dismissing defendant's counterclaims because they are permissive contrasts with the approach taken in Rodriguez v. Family Publications Serv., 57 F.R.D. 189 (C.D. Cal. 1972), a case factually analogous to *Zeltzer*. The *Rodriguez* court denied plaintiff's motion to maintain the action as a class action because "[c]ounterclaims by defendant for nonpayment of amounts due under the contracts, which would be compulsory counterclaims under Rule 13(a), would raise further difficulties . . . ." *Id.* at 193. Refusing class action treatment, however, is contrary to the statute which specifically contemplates damage awards in class suits. *See* 15 U.S.C. § 1640(a) (1970 & Supp. V 1975), *as amended by* Act of Feb. 27, 1976, Pub. L. No. 94–222, § 3(b), 90 Stat. 197; Act of Mar. 23, 1976, Pub. L. No. 94–240, § 4, 90 Stat. 260. In this regard, *Zeltzer* is preferable to *Rodriguez* in that the plain intent of the statute to allow class actions is maintained. Allowing defendant's counterclaims in a class suit would complicate the proceedings by introducing myriad factual issues not shared by the plaintiff class as a whole. This added complexity would diminish any potential gain in judicial economy and argues against treating such counterclaims as compulsory. It is also possible to separate the class action issue under Rule 23 from the counterclaim question under Rule 13. Under Rule 23(c)(4) the court may deny class treatment on the debt claim, but permit the class action to proceed on the Truth in Lending issues.

81. 69 F.R.D. 437 (E.D. Pa. 1975).

82. 404 F. Supp. 1 (D. Mass. 1975).

83. *See* text accompanying note 28 *supra*.

84. 69 F.R.D. at 441–42.

without the requisite disclosures, while the defendant would have to set forth the underlying debt obligation and proof of default.[85] Thus, the judicial efficiency sought by Rule 13 would not be furthered if defendant's counterclaim was allowed.[86] Moreover, the court reasoned that allowing the counterclaims would effectively frustrate the purpose of the Truth in Lending Act by involving the court "in a myriad of factual and legal questions that are logically unrelated to the alleged Truth in Lending violations."[87] The *Agostine* decision is a logical and proper analysis of the problem. By considering the judicial subtests and the policy of Rule 13, the court avoided being confused or diverted by the transaction or occurrence language.

With similar logic, *Ball* looked directly to the purposes of Rule 13 without directly applying either the primary transaction or occurrence test or any of the several judicial standards. Recognizing that the design of Rule 13(a) is "to prevent multiplicity of actions and to achieve resolution in a single lawsuit of all disputes arising out of common matters,"[88] the court found that permitting the debt counterclaim would not further this goal.[89] Although the court acknowledged that the credit transaction linked the claims, it concluded that the federal claim and state counterclaim stood on such uncommon ground that "wooden application of the common transaction label does not yield real judicial economy. . . ."[90]

In contrast to these decisions are the cases holding a defendant's debt counterclaim to be compulsory in a Truth in Lending action.[91] Few of these decisions, however, provide much insight into their rationale for doing so. An exception is *Mims v. Dixie Finance Corp.*[92] which overruled the court's previous decision in *Roberts*.[93] Recognizing that "the courts have given the compulsory counterclaim a very liberal construction,"[94] the *Mims* court found the defendant's claim to

85. *Id.* at 442.

86. Although the *Agostine* court does not draw this conclusion, it is the implicit rationale behind the accepted tests for compulsoriness. *See* 6 C. WRIGHT & A. MILLER, *supra* note 77, at 43, and text accompanying note 28 *supra*.

87. 69 F.R.D. at 442. *Agostine*, like *Zeltzer*, was a class action suit. *See* note 80 *supra*.

88. 404 F. Supp. at 3 (quoting Southern Constr. Co. v. Pickard, 371 U.S. 57, 60 (1962)).

89. 404 F. Supp. at 4.

90. *Id.*

91. Mims v. Dixie Fin. Corp., 21 F.R. Serv. 2d 1042 (N.D. Ga. 1976); Gibson v. Family Fin. Corp., 404 F. Supp. 896 (E.D. La. 1975); Kennedy v. Russell, Civil No. 17,486 (S.D. Ga. Nov. 18, 1974); Kenney v. Landis Fin. Group, Inc., 376 F. Supp. 852 (N.D. Iowa 1974).

92. 21 F.R. Serv. 2d 1042 (N.D. Ga. 1976).

93. *Id.* at 1048.

94. *Id.* at 1047.

be logically related to that of the plaintiff[95] because the claims of both parties were "offshoots of the same basic transaction; namely, an extension of credit."[96] Although purporting to examine the logical relationship between the claims, the court slid into a direct application of the transaction or occurrence test: "Manifestly, defendants' counterclaims arise out of the same transaction as plaintiffs' Truth-in-Lending claims. Both claims derive their basis from the same credit transaction."[97] This superficial logic exemplifies the "wooden application" of the common transaction test which was unacceptable in *Ball* and *Zeltzer*. The analysis ignores the inherent divergence of the claims and the illusory gain in judicial economy stressed in *Zeltzer, Ball*, and *Agostine*.

In reaching this result the *Mims* court relied heavily on the reasoning in *Spartan Grain & Mill Co. v. Ayers*.[98] In *Spartan*, an action for the unpaid balance of a contract, the court stated that defendant's counterclaim, asserted under the Truth in Lending Act, was compulsory. The *Mims* court reached its result by inferring the inverse: that a counterclaim made in response to a Truth in Lending claim is also compulsory.[99] This reliance on *Spartan* is misplaced for two reasons. First, *Spartan* only tangentially and fleetingly dealt with this issue in the context of allowing a late amendment to the pleadings.[100] Second, the court clearly had jurisdiction of the counterclaim, compulsory or permissive, conferred by the Truth in Lending Act.[101] *Spartan* is thus dicta on this point and is of tenuous precedential value.

The *Spartan* court found that the evidence necessary to prove the

95. *Id.* The logical relation test is one of the four accepted tests used to determine compulsoriness. *See* text accompanying note 28 *supra*. Like the *Zeltzer* court, the *Mims* court looked to Great Lakes Rubber Corp. v. Herbert Cooper Co., 286 F.2d 631 (3d Cir. 1961), for guidance to determine whether such a logical relationship existed. *See* note 77 *supra*.

96. 21 F.R. Serv. 2d at 1048.

97. *Id.* at 1047. The court also noted: "Even the court in *Roberts* found that the plaintiff's Truth-in-Lending claim and the defendant's state claim arose from the same transaction in the sense that each party was suing because of the other's obligation on the note." *Id.* at 1046. The *Mims* court garnered further support for this position from Kennedy v. Russell, Civil No. 17,486 (S.D. Ga. Nov. 18, 1974), which held a defendant's debt counterclaim to be compulsory through direct application of the "transaction or occurrence" test. 21 F.R. Serv. 2d at 1047.

98. 517 F.2d 214 (5th Cir. 1975).

99. 21 F.R. Serv. 2d at 1046: "In arriving at this holding, the Special Master rejects as unpersuasive the argument that Spartan Grain is not entitled to stare decisis treatment because it concerned a TIL counterclaim rather than a lender's counterclaim. To hold otherwise would indeed produce an anomalous result." *Id.*

100. The court remarked: "The argument for allowing amendment is especially compelling when, as here, the omitted counterclaim is compulsory . . . ." 517 F.2d at 220.

101. 15 U.S.C. § 1640(e) (1970 & Supp. V 1975).

plaintiff's contract claim would also show whether the proper disclosures had been made to the borrower.[102] From this the *Mims* court reasoned that those documents necessary to prove a Truth in Lending violation would equally determine the validity of a counterclaim on the underlying obligation.[103] Thus, the court found the "same evidence" test for compulsoriness to be met,[104] reinforcing its belief that judicial economy would be gained by adjudicating both claims in the same proceeding.[105]

The *Mims* court failed to recognize that a Truth in Lending plaintiff must prove a much more limited set of facts than a plaintiff seeking to recover a contractual debt. As indicated in *Agostine*[106] and *Zeltzer*,[107] the Truth in Lending plaintiff need only prove the existence of a credit contract and the failure of the lender to make the proper disclosures in order to prevail in his suit. The terms of the contract and the consumer's payments thereon are irrelevant in determining a lender's liability under the Act. Conversely, these matters must be established by a defendant seeking to recover the balance due on the credit contract.[108] Consequently, if the contract claim has been established the evidence relevant to a Truth in Lending counterclaim will probably be before the court, but the converse does not logically follow. *Mims*, therefore, misplaces its reliance on *Spartan* to determine the result where the defendant is counterclaiming for the balance due on the contract.[109]

As has been seen, the issue of whether to allow a defendant's debt counterclaim in a Truth in Lending action has been problematic for the courts. It has been difficult to determine whether under the transaction or occurrence test of Rule 13(a) such a counterclaim is compulsory. A direct application of the transaction test seemingly indicates that the

102. 517 F.2d at 220.

103. 21 F.R. Serv. 2d at 1046.

104. *Id.* *See* text accompanying note 28 *supra*. The first test was satisfied by the logical relationship found to exist between claim and counterclaim.

105. 21 F.R. Serv. 2d at 1048.

106. 69 F.R.D. at 442.

107. 21 F.R. Serv. 2d at 1051.

108. *Id.*

109. The *Mims* court also argued that dismissing the counterclaim may impose greater hardship on the defendant than the statutory penalties themselves. When ancillary jurisdiction is denied, the defendant must subsequently pursue his claim in state court.

> In addition to incurring this added cost including more attorney fees, the creditor may find itself with a state court judgment that is uncollectible or collectible only after suffering additional costs of execution, although it earlier had possibly been required to pay a judgment rendered in this court for a Truth-in-Lending violation.

counterclaim is compulsory, since both plaintiff's and defendant's claims derive from the transaction of credit extension. This rationale was adopted in *Mims* and expressly acknowledged in *Zeltzer*.[110]

However, a more comprehensive analysis of the issues involved demonstrates the distinction between the Truth in Lending claim and the debt counterclaim. Through application of the judicial subtests under Rule 13 the courts have revealed the distinct transactions upon which the claims are based—a distinction implied by *Roberts* and *Zeltzer* but one which has not been expressly isolated by the courts. The cause of action of the Truth in Lending plaintiff, when he is suing for the statutory penalty, is not based upon the credit contract itself, but rather on the lender's failure to properly disclose the required information. The questions of law and fact appropriate to the parties' claims lack any close identity, and largely different evidence would be required to support the two claims.[111] It is suggested that the act of disclosure and that of credit extension are properly viewed as two separate transactions. As recognized in *Ball* and *Zeltzer*, the combining of such dissimilar claims in a single action produces no real gain in judicial economy and therefore does not further the policy underlying Rule 13. The identity of claim and counterclaim found in *Mims* thus seems to be superficial and invalid. It appears that the courts' struggle with this problem arises from their failure to perceive this transactional separability when directly applying the transaction or occurrence test of Rule 13(a).

The *Roberts* court recognized at the outset the importance of keeping within the purpose and design of the Truth in Lending Act. The established purpose of the Act was "to create a species of private attorneys general to participate prominently in [its] enforcement."[112] Moreover, the civil recovery provision of section 1640(a)(2)[113] has been held to be a civil penalty rather than a damage provision intended to make the borrower whole.[114] Thus, a consumer suing for the

21 F.R. Serv. 2d at 1048. However, when the Truth in Lending cause of action was created, it was obvious that the defendant would be burdened with the litigation cost. If this is viewed as part of the penalty for violation of the statute, it is incongruous to grant jurisdiction to the defendant's counterclaim, for in doing so the court relieves the lender from the expense of a state debt collection suit.

110. 414 F. Supp. at 1225.

111. Zeltzer v. Carte Blanche Corp., 414 F. Supp. 1221, 1225 (W.D. Pa. 1976); Agostine v. Sidcon Corp., 69 F.R.D. 437, 442 (E.D. Pa. 1975). *See* Ball v. Connecticut Bank and Trust Co., 404 F. Supp. 1, 4 (D. Conn. 1975).

112. Ratner v. Chemical Bank New York Trust Co., 329 F. Supp. 270, 280 (S.D.N.Y. 1971).

113. For the text of § 1640(a)(2), see note 4 *supra*.

114. Mourning v. Family Publications Serv., Inc., 411 U.S. 356 (1973).

statutory penalty is acting as a private attorney general to force the lender's compliance with the Act's disclosure requirements rather than as an individual seeking damages for injuries suffered on the credit contract. *Roberts* and *Agostine* recognized that "[t]o permit the defendant to pursue its claim in federal court would unduly complicate the expeditious resolution of TIL litigation."[115] Although sensing the incongruity of allowing the enforcement action to become a forum for the violator's private grievance, *Roberts* did not articulate the true reason for disallowing the defendant's counterclaim. To subject a Truth in Lending plaintiff to the creditor's claim for the balance due on the credit contract would seriously diminish consumers' incentive to initiate enforcement actions.[116] *Roberts* missed the mark in stating that the creditor's counterclaim would be "clearly prejudicial to the plaintiff's claim."[117] Rather, such counterclaims would be prejudicial to the private enforcement scheme on which the Act is based.

These policy arguments, although persuasive in themselves, also reveal another reason for considering the debt counterclaim permissive under Rule 13. When the Truth in Lending action is viewed as an enforcement proceeding rather than a private damage suit, the plaintiff's cause of action is clearly based on the strict disclosure requirements of the Act, not on the credit contract. This emphasizes the separate nature of the disclosures and of the credit contract, facilitating a straightforward application of the transaction or occurrence test. The courts' collective reference to these events as an "extension of credit" serves only to muddle the issue and the analysis.[118]

III. COUNTERCLAIMS IN ACTIONS FOR STATUTORY RESCISSION

The situation of a consumer suing for the statutory penalty can be compared advantageously with actions for statutory rescission under the Truth in Lending Act.[119] Under the Act, rescission is only available

115. Roberts v. National School of Radio & Television Broadcasting, 374 F. Supp. 1266, 1271 (N.D. Ga. 1974), *overruled by* Mims v. Dixie Fin. Corp., 21 F.R. Serv. 2d 1042 (N.D. Ga. 1976). A similar conclusion was expressed by the court in *Agostine*. 69 F.R.D. at 442–43.

116. This disincentive is especially strong in light of the minimal amount ($100) of the statutory penalty. *See* note 4 *supra*.

117. 374 F. Supp. at 1271.

118. This concept contributed to the courts' confusion in *Zeltzer*, *Mims*, and *Roberts*.

119. *See* 15 U.S.C. § 1635 (1970 & Supp. V 1975), which provides, in pertinent part:

> (a) Except as otherwise provided in this section, in the case of any consumer credit transaction in which a security interest, including any such interest arising by operation of law, is or will be retained or acquired in any real property which is used or is expected to be used as the residence of the person

when a security interest has been created in the consumer's residence,[120] as commonly occurs with large credit sales and home improvements. Unlike common law rescission,[121] the statute provides that the consumer can exercise his right to rescind without first tendering the consideration which he received.[122] Moreover, upon rescission by the borrower, the creditor's security interest in the debtor's residence becomes void,[123] reducing the lender's claim to that of an unsecured creditor. Although the courts have disagreed over whether judicially ordered Truth in Lending rescission should be conditioned on the debtor's repayment of the principal of the loan,[124] it is clear that the consumer must ultimately repay the borrowed amount.[125] It has

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to whom credit is extended, the obligor shall have the right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the disclosures required under this section and all other material disclosures required under this part, whichever is later, by notifying the creditor, in accordance with regulations of the Board, of his intention to do so. . . .

(b) When an obligor exercises his right to rescind under subsection (a) of this section, he is not liable for any finance or other charge, and any security interest given by the obligor, including any such interest arising by operation of law, becomes void upon such a rescission. Within ten days after receipt of a notice of rescission, the creditor shall return to the obligor any money or property given as earnest money, downpayment, or otherwise, and shall take any action necessary or appropriate to reflect the termination of any security interest created under the transaction. If the creditor has delivered any property to the obligor, the obligor may retain possession of it. Upon the performance of the creditor's obligations under this section, the obligor shall tender the property to the creditor, except that if return of the property in kind would be impracticable or inequitable, the obligor shall tender its reasonable value . . . .

See generally Note, *Truth-in-Lending: Judicial Modification of the Right of Rescission*, 1974 DUKE L.J. 1227; Note, *Truth in Lending Act Litigation: Concurrent Recourse to Rescission and The Civil Penalty*, 43 GEO. WASH. L. REV. 840 (1975); Comment, *Private Remedies Under the Truth-in-Lending Act: The Relationship Between Rescission and Civil Liability*, 57 IOWA L. REV. 199 (1971).

120. 15 U.S.C. § 1635(a) (1970 & Supp. V 1975).

121. *See* 17 AM. JUR. 2d *Contracts* § 512 (1964).

122. 15 U.S.C. § 1635(b) (1970 & Supp. V 1975).

123. *Id.* Excluded from the coverage of this section, however, are first liens used to finance acquisition of the residence and other specified liens. *Id.* § 1635(e); Regulation Z, 12 C.F.R. § 226.9(g) (1977).

124. *Compare* Palmer v. Wilson, 502 F.2d 860 (9th Cir. 1974), *with* Sosa v. Fite, 498 F.2d 114 (5th Cir. 1974), *and* Hank's Auto Sales, Inc. v. Fisher, 38 Ohio App. 2d 1, 310 N.E.2d 259 (1973). *See* Ljepya v. M.L.S.C. Properties, 353 F. Supp. 866 (N.D. Cal. 1973), *rev'd*, 511 F.2d 935 (9th Cir. 1975). The judicial practice of conditioning rescission on the debtor's tender of the principal has been severely criticized by commentators as being contrary to the plain meaning and purpose of the Truth in Lending Act since the creditor's security interest is thus effectively maintained. *See* Note, *Truth-in-Lending: Judicial Modification of the Right of Rescission*, 1974 DUKE L.J. 1227; Note, *Truth in Lending Act Litigation: Concurrent Recourse to Rescission and the Civil Penalty*, 43 GEO. WASH. L. REV. 840 (1975); Note, *Truth in Lending—Right of Rescission*, 1975 WISC. L. REV. 192.

125. Where the credit sale involves goods or services, the property itself or its

been suggested that the better method of dealing with the debtor's repayment obligation is to incorporate this obligation into the court's judgment of rescission,[126] and this result appears to have met with judicial approval.[127]

With respect to rescission, the specific language of the Act is oriented to the rights and obligations of the debtor.[128] A specific method for enforcing the debtor's repayment obligation is not provided. Although judicial authority is scarce, it has been recognized that a creditor's assertion of his right to repayment is a compulsory counterclaim.[129] Judge Thompson, concurring in *Palmer v. Wilson*,[130] explicitly reached this result:

> If a rescission is demanded and effectuated without litigation, [section 1635(b)] requires the obligor to *return the property or its reasonable value to the creditor*. This, together with the Act's failure to void the principal obligation along with the security, is, for me, clear indication of Congressional intent that a complete windfall to the victim was not intended.
>
> In the present case, defendants did not counterclaim for [the unpaid principal amount]. Under Rule 13(a) of the Federal Rules of Civil Procedure, this is a compulsory counterclaim and the cause of action is lost if not asserted.[131]

It would seem to follow by analogy, that in a Truth in Lending suit for the civil penalty, a defendant's counterclaim should be allowed to offset any recovery awarded to the plaintiff. This logic, however, ignores the basic dichotomy between an action for rescission and one for the statutory penalty. When a plaintiff seeks rescission, he is using

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reasonable value must be tendered back to the creditor. 15 U.S.C. § 1635(b) (1970 & Supp. V 1975). *See* Palmer v. Wilson, 502 F.2d 860 (9th Cir. 1974) (Thompson, J., concurring); Sosa v. Fite, 498 F.2d 114 (5th Cir. 1974).

126. Incorporating [the] debtor's obligation into the court's judgment . . . meets several objectives. First, it conforms with legislative intentions to unburden the debtor of the security interest in his residence. It reflects the termination of the security interest by leaving the parties in the relationship of unsecured creditor and debtor. Yet it also reflects the debtor's obligation to return the consideration received under the contract . . . . In addition, since the loss of the original security interest adversely affects [the] creditor's chance of recovering the principal balance due, this alternative provides incentive for creditors to comply with the Act in making initial contracts.

Note, *Truth in Lending—Right of Rescission*, 1975 WISC. L. REV. 192, 202 (footnotes omitted).

127. *See* Ljepava v. M.L.S.C. Properties, Inc., 511 F.2d 935 (9th Cir. 1975) (plaintiff's name spelled differently than in district court reporter); Eby v. Reb Realty, Inc., 495 F.2d 646 (9th Cir. 1974).

128. *See* pertinent parts of § 1635(b) reprinted in note 119 *supra*.

129. Palmer v. Wilson, 502 F.2d 860, 863 (9th Cir. 1974) (Thompson, J., concurring); Note, *supra* note 126, at 197.

130. 502 F.2d 860 (9th Cir. 1974).

131. *Id.* at 863 (emphasis original).

the statutory cause of action to redress an injury caused by the credit contract itself and should be allowed restitution but not a windfall.[132] Conversely, a plaintiff seeking the statutory penalty is acting in the role of a "private attorney general" and should be afforded greater immunity against the defendant's individual interests.

In a rescission suit, it is consonant with the transaction or occurrence test of Rule 13(a) to recognize the defendant's counterclaim as compulsory. Although the statutory cause of action for rescission or actual damages is triggered by the defendant's disclosure violations, the claim itself, as well as the relevant evidence and remedy, is grounded in the credit contract. Thus, in an action for rescission or actual damages, unlike a suit for the statutory penalty, both claim and counterclaim are based on the same transaction—the parties' credit contract.

IV. CONCLUSION

Civil actions brought under the Truth in Lending Act by borrowers against lenders are an integral and important aspect of the Act's enforcement scheme. Maintaining a defendant's counterclaim for the balance due on the credit contract, in an action for the civil penalty, is not consonant with the purpose of the Act or the criteria for compulsory counterclaims under the Federal Rules. A creditor's debt counterclaim should not be deemed compulsory, and thus accorded the courts' ancillary jurisdiction, since it does not arise out of the same transaction as the plaintiff's Truth in Lending claim. The combination of two such distinct claims in a single suit produces little or no gain in judicial economy and is therefore inconsistent with the purpose of the Rules. Moreover, subjecting a plaintiff who is enforcing the disclosure provisions of the Act to the private claims of the defendant would impair the incentive for consumers to bring such suits. This would significantly vitiate the private enforcement provisions of the Truth in Lending Act and should not be sanctioned.

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132. Similarly, a plaintiff who sues under § 1640(a)(1), *see* note 4 *supra*, for actual damages suffered under the contract, would be exposed to a defendant's counterclaim for the balance due. Presumably, the measure of actual damages would be the difference between the contract cost of credit and the competitive price which the plaintiff could have obtained had full disclosure been made and the plaintiff thus enabled to effectively shop for credit. *See* Note, *Truth in Lending Act Litigation: Concurrent Recourse to Rescission and the Civil Penalty*, 43 GEO. WASH. L. REV. 840, 855 n.105 (1975).